



ARTICLES COVERING IMF PRESS CONFERENCE GIVEN ON JUNE 17, 2008 IN YEREVAN, ARMENIA

PRIME MINISTER TIGRAN SARKISIAN RECEIVES IMF MISSION

June 17, ARMENPRESS

Prime Minister Tigran Sarkisian received today Marta Castello-Branco, head of a visiting IMF mission, IMF resident representative Nienke Oomes and other officials of the IMF Armenia Office.

The IMF mission has arrived in Armenia to discuss the government's macro-economic policies and structural reforms. The delegation presented to the prime minister the IMF's report on Armenian tax reforms.

These discussions with IMF will serve as a basis for fresh negotiations between the government and IMF on new cooperation programs. Today's meeting was also attended by a presidential aide on economic issues, finance and economy ministers, chief of the state taxation service, chairman of the Central Bank and chairman of the parliament committee on economic affairs.

According to the government's public relations department, the IMF mission head said IMF is encouraged by the reforms which the government wants to enforce in the taxation sector, saying they are in compliance with IMF principles.

According to IMF officials, the Armenian government tax reform program is comprehensive aimed to reduce poverty, maintain growth rates and reduce corruption level. The only remaining thing is to take into account some proposals and suggestions present in the IMF report.

By thanking the IMF for preparing the report Prime Minister Tigran Sarkisian described it as very interesting saying that it creates a basis for further IMF-Armenia cooperation.

IMF: 12-MONTH RATE OF INFLATION IN ARMENIA IS EXPECTED TO FALL TO AROUND 7 PERCENT IN DECEMBER

June 17, ArmlInfo

According to the International Monetary Fund, the 12-month rate of inflation in Armenia is expected to fall to around 7 percent in December instead of 4% +/- 1.5% budgeted, Chief of the IMF Middle East and Central Asia Division Marta Castello-Branco said at a press-conference in Yerevan, Tuesday. Rising energy and food import prices, recent and planned pension and wage increases, and rapid credit growth will likely keep inflationary pressures high in Armenia, she said. Against this background, the challenge for monetary policy is to limit the second-round effects of higher food and energy prices, and thus contain inflationary expectations. Fiscal policy should also play a role in containing inflation by prioritizing government expenditures and saving, rather than spending, any higher-than-expected revenues in 2008. Finally, reducing monopolistic practices in the import sector will also contribute to lower prices, she noted.



IMF RECOMMENDS ARMENIAN GOVERNMENT TO CHANGE ITS TAX POLICY

June 17, ArmlInfo

IMF and the Armenian Government have certain contradictions concerning the current tax policy in Armenia, the chief of the IMF Middle East and Central Asia Division Marta Castello-Branco said during a press-conference in Yerevan today. She said that Armenia's tax system was much too complicated as there were several tax regimes some of which were privileged.

IMF opposes the regime of presumptive taxes for fuel and tobacco. If this business paid VAT and profit tax, the budget would receive more tax revenues. IMF Resident Representative in Armenia Nienke Oomes said that the Armenian Government was considering the possibility of introducing tax incentives for listing on the stock exchange. IMF opposes this idea as, even though it supports the idea to develop the capital market, it believes that privileged tax regimes may hinder the tax reforms. The key goal of the reforms is to create equal and clear conditions for all tax-payers.

IMF AND ARMENIAN GOVERNMENT INTERESTED IN CONTINUING THEIR COOPERATION

June 17, ArmlInfo

IMF and the Armenian Government have expressed wish to continue their cooperation, the chief of the IMF Middle East and Central Asia Division Marta Castello-Branco said during a press-conference in Yerevan today.

She said that it was the initiative of the Armenian Government as the PRGF was already near completion. The first steps towards a new program have already been made. In Sept the parties will start relevant negotiations. The new program will be aimed at deepening tax and customs reforms. IMF welcomes the new package of tax and customs reforms and the growth in tax revenues in 2007.

However, the reforms have so far been fragmentary and need more consistency. Even though in 2007 the share of tax revenues in GDP significantly grew, Armenia still has room for improvement. Castello-Branco expressed displeasure with the fact that the import of fuel and tobacco in Armenia is subject to fixed duty, which means that the big business does not pay VAT and profit tax.

To remind, in May 2008 IMF approved disbursement of the last \$5.4mln tranche of \$37.3mln PRGF program.

IMF EXCITED ABOUT PRECONDITIONS OF TAX REFORMS IN ARMENIA

June 17, ARKA

International Monetary Fund (IMF) is excited about the preconditions of tax reforms set in the program of Armenian Government.



The preconditions are in harmony with the IMF-suggested principles, said the Head of IMF mission in Armenia Marta Castello-Branco at her meeting with Armenian Premier Tigran Sargsian. Among participants at the meeting were Resident Representative of IMF in Armenia Nienke Oomes and representatives of IMF office in Yerevan.

The sides discussed macroeconomic policy of Armenia and the structural reforms in the country, the Press Service of Armenian Government reported. The IMF report on tax reforms in the country was presented at the meeting.

According to the representatives of the IMF mission, the program on tax reforms is quite complete and aims at reducing poverty, maintaining economic growth rates and reducing corruption. According to them, now it is the time to implement all the above in an interconnected manner taking into account the comments and recommendations mentioned in the report.

The participants stressed the importance of informing the public on the logics of the reforms on time and in an accessible manner. Armenian Premier thanked the IMF representatives for the report and appreciated the comments that provide a basis for further Armenia-IMF cooperation.

Among participants at the meeting were Advisor to President on economic issues Vahram Nersisians, Ministers of Economy and Finance Nerses Yeritsian and Tigran Davtian, the Chief of the State Taxation Service Vahram Barseghian, the Chairman of the Central Bank of Armenia Artur Javadian and the Head of Standing Parliament Commission on Economic Issues Vardan Ayvazian.

THE IMF PROPOSES “TO TIGHTEN THE BELT”

June 18, Business Newspaper “Capital”

The International Monetary Fund says that to curb inflation Armenia must “tighten the belt” – tighten monetary and fiscal policies. This proposal was made by the IMF staff team visiting Yerevan during June 11-17, 2008. The IMF team visited Armenia with a view to reviewing recent economic developments, and discussing the macroeconomic policies and structural reform priorities of the new government.

Yesterday, during the meeting with journalists, head of the IMF Armenian mission, Marta Castello- Branco said that the team was pleased with the government’s strong commitment to economic reform, in particular with the focus on strengthening tax policy and tax administration.

7 Percent Inflation

The IMF representative stated that while strong growth continued, inflationary pressures remained high, mainly due to higher food and fuel international prices. Inflationary pressures pose a problem not only in Armenia, but throughout the world. Given the high share of imported food within the Armenian consumption basket, food inflation had a devastating impact on overall inflation, thus shifting it from the target (4%+/-1.5%).



Mrs. Castello-Branco noted that other negative international development, financial market turbulence, did not affect Armenia, since cash transfers in Armenia are of a different nature. To contain inflationary expectations the challenge for monetary policy is to tighten monetary and fiscal policies to a certain extent.

The head of the Armenian mission stated that tax revenues were higher than expected, and here fiscal policy should also play a role in containing inflation by saving government expenditures, rather than spending. The government should prioritize expenditures. Moreover, reducing monopolistic practices in the import sector will also contribute to lower prices. To the IMF viewpoint, barring further external supply shocks, the 12-month rate of inflation is expected to fall later in the year, to around 7 percent in December.

Opposing Tax Privileges

The IMF fully supports the priorities reflected in the comprehensive plan to modernize tax administration developed by the STS, including restructuring the STS, addressing corruption, speeding up VAT refunds, strengthening large taxpayer administration, and enhancing taxpayer services. The IMF also supports the government's plans to address tax policy deficiencies.

To sustain the reform effort and increase its credibility, the government should make sure that all the measures should be fully implemented; otherwise the results would be incomplete. While the IMF supports the reforms implemented in the tax sector, it has an agreement with the government in particular concerning the tax privileges. Mrs. Nienke Oomes, IMF Resident representative in Armenia, said that the IMF opposes the government approach of granting tax incentives for listing on the stock exchange. "Of course, we support capital market development; however tax privileges may harm tax reforms which are aimed at creating equal tax conditions", said the IMF representative and then continued, "The tax field should be further simplified, because presently it is rather complex, and different tax regimes are operated, such as presumptive tax on fuel and tobacco". Taxation of these goods with VAT and profit tax would result in a higher level of tax collection, and enhance the tax revenue/GDP ratio. She also considered that simplified tax mechanisms should be applied for the taxation of small and medium enterprises.

The New Program

According to Marta Castello-Branco, the program implemented by the IMF in Armenia has ended in May of this year, and Armenia has asked the Fund to implement a new program. An IMF mission will visit Armenia in September in order to negotiate the terms of the new program, but the IMF has already outlined the main priorities of the new program, in particular, improvement of business environment and reforms in the tax administration. The IMF would also support the government by performing fiscal analysis. New economic developments in Armenia could lead to new regimes under which the country may be more vulnerable to cyclic recurrences and fiscal analysis are crucial for their adequate handling.

RA PRIME MINISTER MET WITH IMF MISSION

June 18, RIA Oreanda



RA Prime Minister Tigran Sargsyan met with head of the IMF mission Martha Castello-Branco, IMF Permanent Representative in Armenia Nienke Oomes and the IMF Armenia Office representatives. In our country to discuss a macroeconomic policy- and structural reform-related agenda, the mission presented to the Prime Minister the IMF report on Armenia's tax reform by noting that the current discussions may provide a basis for the upcoming talks on a new IMF-GOA cooperation program. The meeting was attended by the chief economic adviser to RA President, the ministers of finance and economy, the head of the State tax service by the government, the CBA chairman and the head of the RA National Assembly standing committee on economic affairs.

The mission head said those at the IMF are encouraged by the Government's undertakings in the area of tax reform as reflected in the government program which she said to be in conformity with the principles issued by the Fund. In the opinion of mission representatives, aimed at curbing poverty and keeping up the pace of growth whilst combating corruption, Armenia's tax reform program is sufficiently comprehensive and all it needs is implementing in a coherent manner, account taken of the observations and recommendations raised in the Report. During the discussion, the interlocutors underscored the logic behind these reforms, namely the need for informing the public at large in a timely and easy-to-reach manner.

Expressing his appreciation for the preparation of the report, Prime Minister Tigran Sargsyan valued the comments available in the paper which is supposed to provide a framework for the development and implementation of the new bilateral cooperation program.

TAX REFORMS ARE WELL-THOUGHT, SOUND AND COMPREHENSIVE

June 18, Newspaper "Azg"

Marta Castello-Branco, head of the IMF Armenian mission, and Nienke Oomes, IMF Resident Representative in Armenia met yesterday with the journalists. Marta Castello-Branco informed journalists that the reason for the mission visiting Yerevan was that the previous IMF program with Armenia ended in May and presently discussions with the government on a new program are underway. In the meanwhile, she described the results achieved during implementation of the previous program.

The IMF representative stated that while strong growth continued, inflationary pressures remained high. The latter should be viewed as a new challenge that spread throughout the world due to higher food and fuel prices. In Armenia food inflation has a dramatic effect since food has a huge share within consumption basket. Inflation in Armenia was higher than expected. In order to curb inflation the CBA raised interest rates. The IMF representative thinks that in addition to that measure the government should rather save than spend any higher-than-expected revenues in 2008. In a response to the Azg question – wouldn't it be more feasible to spend these revenues in other areas, such as pension reform, rather than saving them, Mrs. Castello-Branco replied that there are several sectors, such as health, education and pension reforms, where spending of these funds will not lead to additional inflation pressures.

Mrs. Castello-Branco informed journalists that the IMF team discussed with the government the planned program of pension reforms, and to their viewpoint, the reforms should be implemented in a consistent manner, without undue haste. Still the major issue of discussions between the



IMF team and the authorities were the changes in tax administration and tax policy. The main proposal made by the IMF was that both tax administration and tax policy reforms in Armenia should be carried out simultaneously as a single whole. "The changes proposed by the government are encouraging, well-thought and comprehensive; the government has also established the deadlines for their fulfillment. The problem now is to ensure their full implementation", stressed the IMF representative. She has also indicated the IMF urged the authorities to extend the tax base while treating equally all the taxpayers. For this reason, taxation of fuel and tobacco should be moved from the presumptive to regular tax regime, which will increase tax revenues.

Mrs. Nienke Oomes stated that in a number of cases the IMF opposed the government initiatives. In particular, the IMF opposes the government's proposal to grant tax incentives for listing on the stock exchange.

Another important issue addressed by Marta Castello-Branco is the inflationary pressure. The IMF proposes to tighten fiscal and monetary policies, as well as encourage competition in the area of imports. She said that the end-of-period inflation forecast for this year is 7 percent, which is still higher than the programmed target of 4+-1.5 percent. She stressed again that inflation in Armenia is mainly conditioned by the external factors.

MACROECONOMIC GROWTH IN ARMENIA REMAINS SUSTAINABLE

June 18, Newspaper "Republic of Armenia"

The recent economic developments in Armenia are again in the centre of attention of the international experts. An IMF staff team headed by Marta Castello-Branco visited Yerevan during June 11-17, 2008 to review recent economic developments, and discuss the macroeconomic policies.

During the meeting with journalists, Mrs. Castello-Branco mentioned that the discussions were rather successful and they prepared the ground for negotiations of a new IMF-supported program in September. The head of the mission was pleased with the government's strong commitment to economic reform, in particular with the focus on strengthening tax policy and tax administration.

According to the assessment of the IMF team, the agenda of tax reforms raises hopes. The program developed by the STS with a view to addressing tax administration deficiencies gained the full support of the IMF and other donors. The IMF strongly supports the priorities reflected in the program, including STS restructuring, addressing corruption, speeding up VAT refunds, strengthening large taxpayer administration, and enhancing taxpayer services.

"We have spent sufficient time for discussing the tax reforms, and the issues of improving tax administration. We support the idea that both tax administration and tax policy reforms in Armenia should be carried out simultaneously as a single whole. The programs implemented by the government in this area are rather encouraging. To our viewpoint these steps are sound, well-thought and comprehensive. Now the problem is to implement them in full," observed Mrs. Castello-Branco. Then she elaborated on fiscal developments. She noted that fiscal developments have been positive, mainly on account of strong revenue performance. If the higher-than-expected tax revenue is saved, the fiscal deficit for 2008 can be significantly lower



than budgeted, allowing fiscal policy to support monetary policy in its efforts to reduce inflationary pressures. "If the higher-than-expected tax revenue is saved, the authorities would be able to channel the funds for investing into the priority sectors of health and education. The government should prioritize the spending", mentioned Mrs. Castello-Branco. She expressed the view that to sustain the reform effort and increase its credibility, the government should make sure that appropriate funding is allocated for the tax reform program. Given the government's goal to create equal conditions for all businesses, the IMF opposes privileged tax regimes.

The IMF mission reviewed with the authorities the existing inflation pressures and the measures to curb them. According to Mrs. Castello-Branco, monetary and fiscal policies should be tightened for this purpose. In case of any higher-than-expected revenues in 2008, government expenditures should be prioritized and saved, rather than spend.

"Tightening fiscal and monetary policies would increase competition in domestic consumer markets, and lead to reduced prices reflected by appreciation of dram. Concerning inflation, given all the external developments and expectations, our forecast for end-of-period inflation is 7 percent. Of course this indicator is higher than the programmed target of 4+-1.5 percent, however it reflects high international oil prices and strong domestic demand", said Mrs. Castello-Branco.

The IMF supports the new government's plans to modernize Armenia's pension system, and expresses the view that it should be implemented without undue haste in order to perform all the necessary preparatory work. Given that investment in new systems and procedures will be required, and adequate time needs to be given for effective planning and implementation.

Concerning macroeconomic performance and outlook, Armenia appears to be set for another year of double-digit real GDP growth. GDP grew at 9.3 percent in the first four months of 2008, and will continue to be driven by the ongoing boom in the construction sector. Strong growth has translated into rising import demand, leading to a marked deterioration in the current account deficit, and a reduction of appreciation pressures. The dram/dollar exchange rate has remained broadly stable since December 2007.

CPI inflation in Armenia has risen sharply in recent months. But it is still lower than in neighboring countries. However, the surge in inflation to around 10 percent was mainly due to higher food import prices.

The head of the IMF delegation commented on the new program, saying that it will address the unsolved issues, prioritizing the tax reforms. "To our viewpoint, the program of tax reforms is an ongoing process, although much has been done in this direction during the recent years. The reforms would serve as a lever for improving the business climate, and the new program should focus on this issue. Our program will be aimed at modernizing the existing policy instruments. The program should also emphasize the role of poverty reduction in Armenia", stated Mrs. Castello-Branco.



IMF CALLS FOR TIGHTER MONETARY AND FISCAL POLICIES IN ARMENIA

June 18, ARKA News (Armenia) / "Capital"

International Monetary Fund recommends Armenia to tighten the fiscal, as well as the monetary and credit policies, the IMF task group members stated during their one-week visit to Yerevan. IMF has forecasted a 7% inflation by the end of the year if no shocks from outside occur. Head of the delegation Marta Castello Branco said foreign inflation pressures are intensifying in the country which is caused by the crisis in the global financial market, high prices of wheat and fuel. "These factors could not but cause price growth in Armenia given the fact that Armenia is importing a substantial part of its food products," the IMF representative said. Inflation growth is also accounted for by large volumes of money transfers from abroad.

THE PRIME MINISTER MET WITH THE IMF OFFICIALS

June 18, Newspaper "Republic of Armenia", Government Department of Information and Public Relations

Yesterday Prime Minister Tigran Sargsyan met with Marta Castello-Branco, head of the IMF Armenian mission, and Nienke Oomes, IMF Resident Representative in Armenia.

During the meeting, the IMF team which visited Yerevan to review recent economic developments, and discuss the macroeconomic policies and structural reform priorities presented the report on tax reforms in Armenia.

The discussions with the IMF team will prepare the ground for negotiations of a new IMF-supported program in September. Present at the meeting were the chief economic adviser to the President, the ministers of finance and economy, the head of the state tax services, the CBA chairman, and the chairman of the NA standing committee on economic issues.

The head of the IMF mission indicated that the IMF team was pleased with the government's strong commitment to economic reform, in particular with the focus on strengthening tax policy and tax administration. The reform agenda is sufficiently integrative, aimed at reducing poverty, sustaining the strong growth rates, and addressing corruption. To ensure the credibility of the reform effort, it will be crucial to implement the various reform initiatives fully and without delay. It would be also crucial to ensure the adequate public outreach.

The Prime Minister expressed his gratitude for the presentation of the report, and considered it extremely useful, since it established grounds for close cooperation between Armenia and the Fund, as well as preparation and execution of the new program.



ARMENIA PREPARES FOR NEW PROGRAMME WITH THE IMF

June 19, Global Insight Daily Analysis

The Armenian government and the International Monetary Fund (IMF) have both expressed willingness to continue their cooperation even after the expiry of the current Poverty Reduction and Growth Facility (PRGF) arrangement, which is nearing completion. According to ARMINFO quoting the head of the IMF's Middle East and Central Asia Division Marta Castello-Branco, the first steps towards a new programme had already been taken, and negotiations will commence in September.

The new assistance programme will focus on achieving further progress with tax and customs reforms. The IMF welcomes the government's new reform package in these areas, as well as the growth of tax revenues witnessed over last year. However, the international lender adds that these reforms have so far remained fragmentary and too inconsistent. For example, the share of tax revenues of GDP increased over 2007, but still remains low.

In addition, Castello-Branco criticized the fact that fuel and tobacco imports are subject to a fixed duty, implying that large businesses pay disproportionately low value-added tax (VAT) and profit tax. In addition, the Armenian tax system in general remains too complicated and discriminatory. The Armenian government is considering introduction of tax incentives for companies to list on the stock exchange. The IMF does not recommend this; it sees that, while support for development of capital markets would be desirable, a new privileged tax regime risks progress with tax reforms, the main goal of which is to create an equal and transparent tax system.

Significance: The IMF in May completed its final review of Armenia's performance under the current PRGF facility, approving a disbursement of 3.3 billion Special Drawing Rights (SDR, some US\$5.4 billion), bringing the total amount paid under the programme to 23 million SDR (see Armenia: 22 May 2008). Given Armenia's good reform progress, the announcement of a further assistance programme being planned was expected.

However, so is the stress put by IMF on the urgent need to make further progress with tax reforms. Fiscal revenue collection in Armenia is still suppressed by the widespread shadow economy, and reducing this remains a key task. Increasing the general competitiveness of the industrial sector also has a connection to the tax policy in that reforms in the system of tax rebates and fixed payments would be needed in order to create a level playing field for producers, and to support efficient allocation of resources.

IMF PLEASSED WITH ECONOMIC REFORM, PREDICTS RISE IN INFLATION

June 21, www.reporter.am

Marta Castello-Branco, Middle East and Central Asia head of mission for the International Monetary Fund (IMF), was in Yerevan June 11–17. In a press briefing on June 17, Ms. Castello-Branco told journalists that the Fund was pleased with the “government’s strong commitment to economic reform, in particular with the focus on strengthening tax policy and tax administration.”



She said that to ensure the credibility of the reform effort, all initiatives must be implemented fully and immediately. While Armenia seems to be heading toward another year of double-digit gap growth, there has been a rise in import demand and a reduction of appreciation measures. While inflation has risen in Armenia in recent months and inflationary pressures continue to be high in Armenia, the rates have been lower than in the region thanks to a tightening of monetary policy and a prudent fiscal policy by Armenia's Central Bank, Ms. Castello-Branco said.

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Asked by the *Armenian Reporter* about the effect of the planned addition of value-added tax (VAT) to agricultural products next year, Ms. Castello-Branco said, "The VAT on agriculture is in connection with [Armenia's] membership in the WTO, which is a positive thing. In our view, . . . below a certain level [of production], there would have to be in place a very simple way of paying taxes. If you are a larger organization, then you would operate within the VAT profit tax regime." This statement falls in line with the IMF's position that to address tax policy deficiencies, it is imperative to introduce a VAT threshold to provide small businesses with simpler procedures to assess and pay their taxes.

IMF FORECASTS TWO-DIGIT GDP GROWTH IN ARMENIA

June 23, ARKA

The two-digit GDP growth recorded in Armenia over the recent years is likely to be maintained, said Marta Castello-Branco, IMF Department for Middle East and Central Asia.

She pointed out that 9.3% GDP growth was recorded in Armenia in January-April 2008. Further GDP growth is being recorded due to the construction sector.

High growth caused an increase in the demand for imported products. This, in turn, increased the current account deficit and reduced inflationary pressures, while the AMD/USD exchange rate has mainly remained stable since last December, said Marta Castello-Branco.

She pointed out that all the countries have to oppose the rise in the prices for both oil and other products, which affects Armenia, which mainly imports products.

On the other hand, Marta Castello-Branco said, a financial panic can be observed on the international markets, which, however, has not affected Armenia. Specifically, Armenia continues receiving transfers, especially from Russia, where numerous labor migrants are working. It is natural that, as oil prices rise, transfers will continue.

However, the problem is that higher than forecast inflation rates will be recorded, and one of the key issues is an increasing deficit of current account, which affects the increasing imports.

Marta Castello-Branco said that, with the current account deficit and inflationary pressures increasing, the IMF recommends a tougher policy.

The IMF made a relevant proposal to the RA Government, and the sides are in agreement over this, all the more so that the CBA has made several steps to raise the interest rates in order to toughen its monetary policy, Castello-Branco said.



She also pointed out positive fiscal changes, which have mostly been recorded due to tax revenues.

If the extra revenues are not spent, inflationary pressures may be reduced, Marta Castello-Branco said.

In January-April 2008, 9.3% economic growth was recorded in Armenia as compared with the corresponding period last year.

IMF SUPPORTS ARMENIAN GOVERNMENT'S TAX POLICY IMPROVEMENT PROGRAM

June 23, ARKA

The International Monetary Fund (IMF) supports the RA Government's program of improving the tax policy.

Marta Castello-Branco, IMF Department for Middle East and Central Asia, reported that the RA Government's program sets the rates of value-added tax (VAT), simplified orders of calculating and paying taxes, by small and medium-sized enterprises.

Marta Castello-Branco also pointed out the IMF's disagreements with the RA Government's approaches. Specifically, the IMF considered Armenia's tax system to be rather complicated - several taxation regimes are in effect, particularly fixed payments for fuel and cigarettes.

She believes it to run counter to the spirit of reforms as means preferred treatment. If the importers of fuel and cigarettes are made liable to VAT and profit tax, tax revenues can be increased.

Speaking of tax administration reforms in Armenia, Marta Castello-Branco pointed out that it is a hope-inspiring and comprehensive program.

One of the principal issues is that tax administration and policy reforms must be simultaneous, as the reason for failure of reforms is frequently their improper implementation, said the IMF official.

She also pointed out that, to improve tax administration, the RA State Taxation Service elaborated a comprehensive program of modernizing tax administration. The proposals made by the IMF and other donor organizations are incorporated in the program.

The IMF is fully supportive of the proposals incorporated in the program, including the ones concerning the restructuring of the taxation service, corruption control, facilitation of VAT reimbursement, improvement of tax administration involving tax-payers, and provision of higher-quality services to tax-payers, Marta Castello-Branco said.

She pointed out that, to ensure steady reforms and win public confidence, Armenia's Government must procure necessary funds.



IMF PUBLISHED CONCLUDING STATEMENT OF ITS MISSION IN ARMENIA

June 23, RIA Oreanda

On 23 June 2008 was announced, that an IMF staff team visited Yerevan during June 11-17, 2008, to review recent economic developments and discuss macroeconomic policies and structural reform priorities for the remainder of 2008 and the medium term. The team met with the newly-appointed government, Central Bank of Armenia (CBA) staff, parliamentarians, and representatives from the business and international donor communities. The discussions pave the ground for negotiations of a new IMF-supported program during the 2008 Article IV consultations in September.

The team was pleased with the new government's strong impetus for reform. The emphasis on tax administration/policy reform is particularly encouraging, and should contribute to improving the business environment and promoting broad-based growth. The new government's efforts to improve fiscal analysis and strengthen the fiscal framework are also welcome, as this will make fiscal policy a more effective demand management tool and improve coordination between the monetary and fiscal authorities.

I. Macroeconomic Performance and Outlook

Armenia appears to be set for another year of double-digit real GDP growth. Economic performance in the first five months of 2008 remained robust, and growth during the rest of the year will continue to be driven by the ongoing boom in the construction sector. Risks are mainly on the upside, as agricultural production may well turn out to be better than currently projected, and some investment projects not yet included in the forecast may materialize in 2008.

CPI inflation has risen sharply in recent months, despite a gradual tightening of monetary policy and a moderate fiscal stance. While the surge in inflation to around 10 percent was mainly due to higher food import prices, non-food inflation has picked up as well, amid high international oil prices and strong domestic demand. End-year CPI inflation is expected to be close to 7 percent, exceeding the announced inflation target (4 ± 1.5 percent), but still lower than in neighboring countries.

Fiscal developments have been positive, creating space for fiscal tightening. Tax revenues gained strength, driven by strong VAT performance. Based on the assumption that higher-than-expected tax revenues will be saved, the fiscal deficit is projected to be around 1.2 percent of GDP, significantly lower than budgeted (2.6 percent of GDP). This will limit the fiscal impulse and help contain real exchange rate appreciation.

The trade deficit widened further in the first four months of 2008 on the heels of surging imports. Although private transfer inflows are expected to grow at a robust pace, the external current account deficit is projected to widen to around 8.6 percent in 2008. With appreciation pressures diminished by rising import demand, the dram/dollar exchange rate has remained broadly stable since December 2007.

II. Policy Discussions

Discussions focused on key policy challenges relevant for the upcoming program negotiations: (i) controlling inflation in the face of supply shocks and rising demand pressures; (ii) the urgent need



to tackle the unfinished tax policy and administration reform agenda; (iii) the effectiveness of foreign exchange intervention by the CBA; and (iv) the increased vulnerability to medium-term fiscal risks.

Controlling inflation in the face of supply shocks and rising demand pressures

Given the magnitude of potential supply shocks and growing inflationary pressures from the demand side, further monetary and fiscal tightening will be needed. Rising energy and food import prices, recent and planned pension and wage increases, and rapid credit growth will likely keep inflationary pressures high, worsen the terms of trade, and widen the current account deficit. Against this background, the challenge for monetary policy is to limit the second-round effects of higher food and energy prices, and thus contain inflationary expectations. This is no easy task, given the weak monetary transmission mechanism, calling for supportive fiscal policy and efforts to enhance domestic competition.

In the current economic environment, fiscal policy will play a key role in containing inflationary pressures while sustaining long-term growth. After an initial phase of significant adjustment (until 2002), fiscal policy has become moderately pro-cyclical in recent years. The more challenging international economic environment, together with the persistence of double-digit domestic growth and a widening current account deficit call for a counter-cyclical fiscal stance. To create fiscal space for dealing with medium-term risks, it will be important to save any revenue over performance in 2008, as well as to better prioritize competing expenditure projects. Dampening inflationary pressures through expenditure restraint will help sustain real increases in pensioners' income over the medium-term, as well as free up funds for targeted temporary assistance to those vulnerable groups who are disproportionately affected by higher food prices.

Finally, discontinuing monopolistic practices in the import sector would allow consumers to benefit from potential further dram appreciation in the form of lower import prices. Our estimates indicate a significantly lower pass-through for exchange rate appreciation (10 percent) than for depreciation (31 percent), supporting the anecdotal evidence of limited competition between importers.

The unfinished tax policy and administration reform agenda

There is broad consensus on the need to complete the tax reform agenda. Despite a notable improvement in 2007, the tax-to-GDP ratio in Armenia is still lower than in most transition countries, and well below potential. The momentum for reform has gathered pace since the new government took office, with priority given to a number of key tax policy and administration initiatives. To address tax policy deficiencies, steps are underway to introduce a VAT threshold and provide small businesses (those below the VAT threshold) with simpler procedures to assess and pay their taxes. To address tax administration weaknesses, the State Tax Service (STS) has developed a comprehensive plan to modernize tax administration, in line with previous advice from the IMF and other donors. We fully support the immediate priorities reflected in the plan, including restructuring the STS organization, addressing corruption, strengthening large taxpayer administration, and enhancing taxpayer services, particularly for small businesses. Adding to these initiatives, we would also encourage the authorities to take early steps to introduce risk-based VAT refund processing. This will improve exporters' competitiveness.

The government's ambitious tax reform agenda is encouraging, but it requires firm political commitment to be successful, including appropriate funding for the STS reform program. It also



requires simultaneous efforts to reshape the tax policy framework to ensure a level playing field for businesses. Privileged tax regimes (such as the introduction of new tax holidays and the current presumptive taxes for fuel and tobacco) are inconsistent with this aim, and risk undermining the reform effort.

Effectiveness of foreign exchange intervention

As in other countries, controlling inflation in the face of appreciation pressures has become a policy challenge. While the authorities remain committed to a flexible exchange rate regime, significant dram appreciation between 2003 and 2007 has raised concerns about external competitiveness, and the CBA has increasingly engaged in foreign exchange interventions. International experience has shown that intervention is likely to be ineffective when there is a conflict between exchange rate and inflation objectives. While acknowledging that a significant part of interventions were conducted to accommodate dedollarization, this may have been the case in Armenia in 2006 and 2007. As the extent of cash dedollarization is inherently difficult to quantify, large-scale unsterilized foreign exchange purchases may have contributed to inflationary pressures. Foreign exchange sales in 2008 so far have been more in line with the tightening of monetary policy needed to curb inflation.

Preliminary empirical evidence suggests that CBA foreign exchange market intervention has had only a limited impact on the level of the exchange rate. While this is in line with the stated CBA objective of maintaining a flexible exchange rate, foreign exchange market interventions also seem not to have significantly reduced exchange rate volatility. It may well be, however, that interventions have contributed to reducing intraday exchange rate volatility, thereby allowing the dram to appreciate in an orderly manner.

Increased vulnerability to fiscal risks

We support the plans to modernize Armenia's pension system, and recognize that raising the replacement ratio will necessarily entail fiscal costs. However, all costs involved should be realistically estimated and weighed against competing priorities by including them in the medium-term expenditure framework and budget discussions. Finally, since investment in new systems and procedures will be required, adequate time needs to be given for effective planning and implementation before the new pension system can be in place.

Additional macro-fiscal risks are associated with the conversion of budgetary institutions (particularly schools) into noncommercial organizations (NCOs) outside the treasury system. While the authorities' efforts to address these risks are welcome, further measures and resources for the NCO unit will be needed for the implementation of effective reporting and control systems.

III. Toward a New IMF-Supported Program

The IMF team will negotiate terms of a new IMF-supported program with the government in September 2008. The focus of the prospective program should be on strengthening the fiscal and monetary policy frameworks, while deepening productivity-enhancing structural reforms, notably by making tax administration and tax policy more fair and transparent, increasing domestic competition, and diversifying the economy. An up-to-date Poverty Reduction Strategy Paper is required before a new PRGF arrangement can be considered by the IMF Executive Board.



In terms of program design, the measurement of the fiscal stance and the monetary policy targets may need to be modified compared to previous programs:

- The increasing importance of macro-fiscal controls in overall economic management requires a better measure of the fiscal stance. Such a measure should capture the impact of fiscal actions on relevant policy variables (growth, inflation, debt sustainability, etc.) more accurately than the overall balance of the central government.
- The adoption of inflation targeting (IT) by the CBA calls for a modified approach to monetary conditionality, as monetary targets are not compatible with the IT strategy. IMF-supported programs in IT countries have aimed at complementing traditional monetary conditionality with a "reviews-based" approach, including a periodic assessment of monetary policy in the context of the IT framework, and an agreement on a defined set of indicators on which reviews are primarily based. This approach would require at least broad agreement between IMF staff and the CBA on the appropriate monetary policy reaction to a range of possible eventualities.

In case a new program will not be agreed upon soon, Armenia would be expected to engage in Post Program Monitoring (PPM) with the IMF, as long as its outstanding credit exceeds 100 percent of quota. PPM would entail frequent consultations with IMF staff, with a particular focus on macroeconomic and structural policies that have a bearing on external liability, including a quantified macroeconomic framework. There are normally two Board discussions in a twelve-month period.

IMF PLEASED WITH NEW ARMENIAN GOVERNMENT'S REFORM DRIVE

23 June, Global Insight Daily Analysis

Global Insight Perspective

Significance The newest discussions between the IMF and Armenian officials pave the way for negotiations of a new assistance programme to be planned during the coming Article IV Consultation in September this year.

Implications The discussions concentrated on issues relevant to the approaching negotiations over a new Armenia-IMF programme. In particular, the international lender calls for measures to control inflation, determined completion of tax reforms, careful evaluation of the effectiveness of currency market interventions and medium-term fiscal risks, especially in the face of the planned pension reforms.

Outlook The IMF and the Armenian authorities plan to negotiate terms of a new assistance programme in September. Given the remaining reform needs in the Armenian economy, agreement is important.

A team of the International Monetary Fund (IMF) visited the Armenian capital Yerevan over 11-17 June, to review the country's recent economic developments and discuss macroeconomic policies and reform priorities in the future with the new government, the parliament, the Central Bank of Armenia (CBA), and representatives of the business community and of international donors.



The IMF commended the new Armenian government's strong impetus for reform. In particular, the Fund welcomed the emphasis put on reform of tax administration and tax policy, noting that this will help in improving the business environment and in promoting broad-based growth. In addition, the IMF is pleased with the government's efforts to improve fiscal analysis and framework, as this will enable more efficient use of fiscal policy in demand management and allow for better coordination with monetary policy.

Policy discussions concentrated on four main issues, relevant for the approaching negotiations over a new IMF-assisted development programme, as outlined below.

Inflation Control

The IMF sees that, given the current continued and growing inflation pressure from the demand side, combined with the potential for supply shocks, both monetary and fiscal policy should be further tightened. Monetary policy should be designed to curb second-round inflationary effects from higher food and energy prices. This will be challenging given the recent and planned pension and wage increases. Moreover, the effect of monetary policy will be limited due to the weakness of the monetary transmission mechanism. Thus, monetary policy needs to be supported by fiscal measures and efforts to develop competition in the Armenian economy.

Indeed, fiscal policy will be crucial in containing inflationary pressures at present. In addition, looking forward, it will play an important role in supporting long-term economic growth.

The IMF notes that Armenian fiscal policy has in recent years become moderately pro-cyclical. However, given the persistence of very high growth, the widening current account deficit and the challenges posed by the international economic environment at present, a counter-cyclical fiscal stance would be advisable. In addition, fiscal restraint should be exercised this year, in order to generate fiscal room to deal with medium term risks affecting the public finances. Responsible fiscal spending will also dampen inflationary pressures, sustaining the real value of pension increases in the medium term, while also allowing to direct funds for temporary assistance for groups that are particularly affected by the currently very high food prices. The Fund also recommends abolishing monopolistic practices in the import sector, as this would allow consumers to benefit from potential further appreciation of the dram exchange rate.

Tax Policy and Administration Reform

The Fund observes that Armenian tax reform momentum has intensified since the new government took office. However, more remains to be done on this front as, although the tax-to-GDP ratio in Armenia improved last year, it still remains considerably below potential and also lower than in most transition economies. The Armenian government is going to introduce a value added tax (VAT) threshold in order to address tax policy deficiencies, and the State Tax Service (STS) has developed a plan for modernizing the tax administration, in accordance with previous advice from the IMF and other donors. The IMF gives its full support to priorities reflected in the plan.

However, the Fund also notes that while the ambitious tax reform plans are encouraging, successful implementation of the measures calls for strong political commitment. In addition, the tax policy framework should be simultaneously reformed, in order to ensure a level playing field



for all businesses. The prevalence of some privileged tax regimes is undermining the efforts to reform the tax system.

Currency Market Interventions

Controlling inflation at the same time as the domestic currency is subject to strong appreciation pressures has become challenging. The Armenian monetary authorities remain committed to a flexible exchange rate regime, but in the wake of considerable dram strengthening, concerns over external competitiveness have arisen, and the Central Bank of Armenia (CBA) has to an increasing extent intervened in the currency markets to curb appreciation in the face of strong foreign exchange inflows. However, when monetary authorities are attempting to target both the inflation rate and the exchange rate, a conflict between these objectives arises, and currency market interventions are likely to prove ineffective. Indeed, the IMF adds that according to preliminary empirical evidence, the CBA's currency interventions are likely to have only had a limited effect on the exchange rate.

Medium-Term Fiscal Risks

The IMF argues that Armenia has become increasingly vulnerable to medium-term fiscal risks. The international lender supports the authorities' plans to modernize the pension system, recognizing that increasing the replacement ratio will involve fiscal costs. However, the Fund urges policy makers to realistically estimate all of these costs, while also carefully weighing the benefits and costs against those involved in alternative policies, by including them in the medium-term expenditure framework and budget discussions. Risks are also involved in the conversion of budgetary institutions into non-commercial organizations outside the treasury system.

Outlook and Implications

The IMF and Armenia are going to negotiate terms of the new assistance programme in September 2008. The Fund concludes that the focus of the new programme should be strengthening of the monetary and fiscal policy frameworks and deepening of structural reforms, in order to enhance productivity of the economy. Above all, fulfilling the latter goal calls for making the tax policy more fair and transparent, increasing domestic competition and diversifying the economy.

The IMF requires the Armenian authorities to submit an up-to-date Poverty Reduction Strategy Paper before approval of a new Poverty Reduction and Growth Facility (PRGF) arrangement can be considered by the IMF's Executive Board. The Fund adds that the measurement of the fiscal stance and the monetary policy targets may need to be modified in the new arrangement compared to the previous PRGF programme.

If the Armenian authorities and the IMF will not be able to agree on the terms of a new programme soon, Armenia would be expected to start Post-Programme Monitoring (PPM) with the international lender, for as long as the country's outstanding credit exceeds 100% of quota.

The IMF in May completed its final review of Armenia's performance under the current PRGF facility, approving a disbursement of 3.3 billion Special Drawing Rights (SDR, some US\$5.4 billion), bringing the total amount paid under the programme to 23 million SDR (see Armenia: 22 May 2008:).



Given Armenia's relatively good progress with structural reforms so far and the new government's apparent willingness to continue on this path, a new assistance programme with the IMF seems likely. However, the task of improving tax administration continues to present significant challenges, and given its importance in strengthening the Armenian business environment, the stress given to issues related to tax policy and fiscal administration is no surprise. While recognizing Armenia's progress in these areas, the IMF has also repeatedly noted that a lot still remains to be achieved. Most recently, the Fund noted the inconsistent and fragmentary nature of these reforms (see Armenia: 19 June 2008:).

Moreover, the need to increase competitiveness also is connected to exchange rate developments, as although the strong lari appreciation is not yet a substantial threat to competitiveness, it may become one going forward. The risk of contradictory macroeconomic policies in the presence of substantial inflation pressures further underlines the need to enhance competitiveness by additional reforms, so that competitiveness does not need to be supported by exchange rate policy measures.

Fiscal revenue collection in Armenia is still suppressed by the widespread shadow economy, and reducing this remains a key task. Increasing the general competitiveness of the industrial sector also has a connection to the tax policy in that reforms in the system of tax rebates and fixed payments would be needed in order to create a level playing field for producers, and to support efficient allocation of resources.

The rising energy and food prices, together with planned further increases in fiscal spending, and rapid credit growth are likely to maintain a strong inflation push and to further widen the current account deficit. Given the challenges in macroeconomic policy design, in enhancing competitiveness and in diversifying the economy, it is important that agreement on terms of a new programme between the IMF and the new Armenian government will be found. At present, this also seems likely.

IMF: INFLATION TO BE AROUND 7% IN ARMENIA BY END OF 2008

June 23, ARKA

Inflation is to be around 7% in Armenia by the end of 2008, Head of IMF Middle East and Central Asia Department Marta Castello-Branco told journalists. This exceeds the level planned by the Central Bank of Armenia - 4% (+1.5%) - as offer shocks had impact not only on Armenia, but also in all over the world, she said.

She also said that inflation is caused mainly by external factors, the continuous rise in prices in the world in particular, as foodstuffs are mainly imported to Armenia. Among internal factors contributing to inflation she pointed out the growing demand and stressed the necessity to toughen monetary-credit and fiscal policies.

International developments caused substantial increase in inflation of consumer prices in Armenia in the last months, she said. Yet, she stressed, inflation level is lower in Armenia than in neighboring countries due to the gradual toughening of the monetary and credit policy, and increase in interest rates in particular, and prudent fiscal policy.



The main reason for almost 10% rise in inflation is high prices for import of foodstuffs and increase in foodstuff prices in the country due to rise in oil prices in the world and growing local demand, Castello-Branco said. If no external shocks occur in terms of offer, inflation is expected to reduce down to about 7% by the end of the year, she said.

In May foodstuff price index was 109.9% in Armenia against May 2007; compared with April foodstuff prices grew by 1% in the country.

IMF SUPPORTS NEW GOVERNMENT PROGRAMS ON PENSION SYSTEM MODERNIZATION IN ARMENIA

June 24, ARKA

International Monetary Fund (IMF) supports the new programs of Armenian Government on modernization of the pension system in the country, the Head of IMF Department for Middle East and Central Asia Marta Castello-Branco told journalists.

The IMF is expecting a final version of the government programs on pension reforms, she said.

The IM supports implementation of pension reforms in Armenia, but attaches importance to consistency and deliberation to ensure all the required preparatory work is done, Castello-Branco said.

She also pointed out the necessity to realistically estimate the required on-budget expenditures in terms of competitive advantages.

Since investments are required for introduction of new systems and procedures, effective planning and sufficient time should be made available to make investments before the new pension system is introduced, she said.

IMF AGAINST GIVING ARMENIA PREFERENTIAL TAX REGIMES

June 26, ARKA

International Monetary Fund (IMF) is against giving Armenia preferential tax regimes bearing in mind the government's objective to provide equal competitive conditions for businessmen, IMF Resident Representative in Armenia Nienke Oomes told journalists.

Some tax preferences that the IMF disagrees with are still under discussion, she said. Among them are tax preferences for listing companies on securities' market and the current system of fixed payments on fuel and cigarettes.

The IMF is supporting development of capital market, but not through tax preferences or exemption from tax as it can destroy the tax reforms implemented in the country, Oomes said.



NEW IMF-ARMENIA COOPERATION PROGRAM TO BE DISCUSSED IN SEPTEMBER

June 26, ARKA

A new program of cooperation between Armenia and International Monetary Fund is to be discussed in September, Marta Castello-Branco, the head of the Fund's unit on the Middle East and Central Asia, said last week in Yerevan.

She said that the new program will be focused on the problems, haven't been considered before.

As an example, she singled out tax reforms.

Castello-Branco said that the new program puts emphasis also on improvement of business environment in Armenia.

She said that the IMF will provide assistance to Armenia for improvement monetary and tax policy.

As another important component of the program, the IMF representative pointed out poverty reduction.

ARMENIA NEEDS EXPANDED TAX BASE, IMF STATES

June 26, ARKA

Armenia has to expand its tax base, Marta Castello-Branco of the Department for Middle East and Central Asia, International Monetary Fund (IMF), told reporters.

She pointed out a low level of the tax-GDP ratio not only as compared with the neighboring countries, but also in the context of the potential available, which has repeatedly been indicated, she said.

On the other hand, Marta Castello-Branco pointed out a rise in the tax-GDP ratio last year.

The IMF believes that Armenia has to make numerous steps to realize this potential, which requires a comprehensive program of expanding the tax base, which is supposed to involve more taxpayers.

Armenia is so far from its real potential that the present situation is more complicated due to several taxation regimes, including preferential tax regimes. As long as this system remains in effect, Armenia can hardly reach a potentially high level of the tax-GDP ratio, Marta Castello-Branco said. She pointed out the need for fair conditions for all the tax-payers.