ADB

Report and Recommendation of the President to the Board of Directors

INTERNAL

Project Number: 55103-001
October 2022

Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1
Armenia: Fiscal Sustainability and Financial Markets Development Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 18 October 2022)

Currency unit	–	dram (AMD)
AMD1.00	=	$0.0025
$1.00	=	AMD403.2700

ABBREVIATIONS

ADB	–	Asian Development Bank
AFD	–	Agence Française de Développement
CBA	–	Central Bank of Armenia
COVID-19	–	coronavirus disease
DRR	–	disaster risk reduction
FRMD	–	Fiscal Risk Management Department
GDP	–	gross domestic product
GMRA	–	Global Market Repurchase Agreement
IMF	–	International Monetary Fund
MOE	–	Ministry of Economy
MOF	–	Ministry of Finance
MTDS	–	Medium-Term Development Strategy
MTEF	–	Medium-Term Expenditure Framework
OP	–	operational priority
PA	–	policy action
PDMD	–	Public Debt Management Department
PIM	–	public investment management
POB	–	Public Oversight Board
PPA	–	power purchase agreement
PPEF	–	Post-Program Engagement Framework
PPP	–	public–private partnership
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTE

In this report, "$" refers to United States dollars.

Vice-President	Shixin Chen, Operations 1
Director General	Eugenue Zhukov, Central and West Asia Department (CWRD)
Deputy Director General	Nianshan Zhang, CWRD
Senior Advisor	Cindy Malvicini, CWRD
Directors	Tariq H. Niazi; Public Management, Financial Sector, and Trade Division (CWPF); CWRD Paolo Spantigati, Country Director, Armenia Resident Mission (ARRM), CWRD
Team leaders	João Pedro Farinha-Fernandes, Principal Financial Sector Economist, CWPF, CWRD Grigor Gyurjyan, Senior Economics Officer, ARRM, CWRD
Team members	Maria Pia Ancora, Senior Urban Development Specialist, Urban Development and Water Division, CWRD Rafael Aquino, Associate Project Officer, CWPF, CWRD Ethyl Bulao-Lorena, Senior Operations Assistant, CWPF, CWRD Vardan Karapetyan, Senior Project Officer, ARRM, CWRD Nanki Kaur, Senior Climate Change Specialist (Climate Change Adaptation), Climate Change and Disaster Risk Management Division (SDCD), Sustainable Development and Climate Change Department (SDCC) Baurzhan Konysbayev, Principal Counsel, Office of the General Counsel Malte Maass, Climate Change Specialist, SDCD, SDCC Yuji Miyaki, Public Management Specialist (Taxation), CWPF, CWRD Akmal Nartayev; Senior Financial Management Specialist; Public Financial Management Division; Procurement, Portfolio, and Financial Management Department Irfan Qureshi, Economist, Macroeconomics Research Division, Economic Research and Regional Cooperation Department Hanif Rahemtulla, Principal Public Management Specialist, Governance Thematic Group, SDCC Mary Alice Rosero; Senior Social Development Specialist (Gender and Development); Portfolio, Results, Safeguards, and Gender Unit (CWOD-PSG); CWRD Aida Satylganova, Social Development Specialist (Resettlement), CWOD-PSG, CWRD Armine Yedigaryan, Environment Specialist (Safeguards), CWOD-PSG, CWRD
Peer reviewers	Yoonhee Kim, Financial Sector Specialist, Finance Sector Group, SDCC Ashish Narain, Principal Economist, Social Sectors and Public Sector Management Division, Pacific Department

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PROGRAM AT A GLANCE

1. Basic Data — **Project Number:** 55103-001

Project Name	Fiscal Sustainability and Financial Markets Development Program (Subprogram 1)	**Department/Division**	CWRD/CWPF
Country	Armenia, Republic of	**Executing Agency**	Ministry of Finance (MOF)
Borrower	Armenia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=55103-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=55103-001-PortAtaGlance		

2. Sector

Sector	Subsector(s)	ADB Financing ($ million)
✓ **Finance**	Money and capital markets	50.000
Public sector management	Public expenditure and fiscal management	50.000
	Total	**100.000**

3. Operational Priorities

- ✓ OP1: Addressing remaining poverty and reducing inequalities
- ✓ OP2: Accelerating progress in gender equality
- ✓ OP3: Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability
- ✓ OP6: Strengthening governance and institutional capacity

Climate Change Information

GHG reductions (tons per annum)	0
Climate Change impact on the Project	Low
ADB Financing	
Adaptation ($ million)	22.200
Mitigation ($ million)	10.000
Cofinancing	
Adaptation ($ million)	0.000
Mitigation ($ million)	0.000

Sustainable Development Goals

SDG 5.a
SDG 9.1
SDG 12.1, 12.2, 12.6
SDG 13.a
SDG 17.1, 17.17, 17.3, 17.4, 17.5

Gender Equity and Mainstreaming

Some gender elements (SGE) ✓

Poverty Targeting

General Intervention on Poverty ✓

4. Risk Categorization: Complex

5. Safeguard Categorization — **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

6. Financing

Modality and Sources	Amount ($ million)
ADB	**100.000**
Sovereign Programmatic Approach Policy-Based Lending (Regular Loan): Ordinary capital resources	100.000
Cofinancing	**100.000**
Agence Francaise de Developpement - Programmatic Approach Policy-Based Lending (Loan) (Not ADB Administered)	100.000
Counterpart	**0.000**
None	0.000
Total	**200.000**

Currency of ADB Financing: US Dollar

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Fiscal Sustainability and Financial Markets Development Program, and (ii) a proposed policy-based loan to Armenia for subprogram 1 of the Fiscal Sustainability and Financial Markets Development Program. The proposed program builds on previous Asian Development Bank (ADB) reform engagement in Armenia, specifically on its Post-Program Engagement Framework (PPEF),[1] and aims to help the government further strengthen its fiscal management policies and practices, improve the infrastructure of money markets and the government securities market, and promote capital markets. The proposed programmatic assistance is aligned with the Programme of the Government of the Republic of Armenia, 2021–2026;[2] with ADB's country partnership strategy, 2019–2023 for Armenia;[3] and with ADB's Strategy 2030 by (i) prioritizing the development of financial and capital markets to support private sector development and enhance financial stability;[4] and (ii) helping Armenia's planning, fiscal, and financial policies address climate change challenges.[5]

2. The programmatic approach with parallel cofinancing and forthcoming technical assistance (TA) from the Agence Française de Développement (AFD)[6] enables the capturing of reform efforts supported by ADB TA during the PPEF in subprogram 1 (footnote 49); and allows the structuring of subprogram 2 with ambitious reform targets with enough flexibility to cope with current uncertainties about the specific legal and institutional formats that might ultimately be needed. The strong alignment with the corresponding reform pillars of past programs[7] (i) recognizes the benefits of continuity in medium-term, interconnected reform agendas; and (ii) allows a gradual transition into new and deeper reform activities in the fiscal management area, as requested by the government.[8] The program is closely coordinated with the policy reform work of the World Bank and the International Monetary Fund (IMF).

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Macroeconomic management performance.** The twin shocks of the coronavirus disease (COVID-19) pandemic and military conflict caused real gross domestic product (GDP) to

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1 The Second Public Efficiency and Financial Markets Program was completed in November 2019. Its PPEF—originally to be implemented from late 2019 to September 2021—guided most ADB technical assistance (TA) efforts to reform activities in Armenia until now. ADB. Armenia: Second Public Efficiency and Financial Markets Program.

2 Government of Armenia. 2021. *Programme of the Government of the Republic of Armenia, 2021–2026.*

3 The program supports two of the country partnership strategy's three strategic pillars. Under pillar 1 (priority infrastructure investments), it will help strengthen the integration of public–private partnership (PPP) promotion into the frameworks for public investment and fiscal risk management, and ensure that private participation in infrastructure is fiscally responsible and well managed. Under pillar 2 (targeted financial services delivery improvements), the program supports the development of financial and capital markets. ADB. 2019. *Country Partnership Strategy: Armenia, 2019–2023—Fostering Inclusive, Diversified, and Transformative Growth*. Manila.

4 ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

5 The program's main alignment is with Operational priority (OP) 6: strengthening governance and institutional capacity. The program also makes contributions to OP1: addressing remaining poverty and reducing inequalities; to OP2: accelerating progress in gender equality; and to OP3: tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability.

6 AFD started to coordinate with ADB since the formal request in November 2020. Discussions on joint programmatic assistance gained momentum in October 2021, with field missions duly reflected in joint aides-mémoires.

7 Also refer to ADB. Armenia: Public Efficiency and Financial Markets Program, Subprogram 1; and ADB. Armenia: Public Efficiency and Financial Markets, Subprogram 2.

8 Subprogram 2 will also help bring to fruition key reform efforts initiated in subprogram 1 (footnote 32).

fall by 7.4% in 2020, interrupting the sustained growth momentum and the fiscal consolidation that Armenia had initiated in 2017.[9] However, a sound fiscal track record enabled Armenia to counter multiple shocks.[10] A credible inflation-targeting framework allowed the Central Bank of Armenia (CBA) to keep its policy rate at accommodative levels for most of 2020, until exchange rate pressures in the fourth quarter justified the ensuing increases in interest rates. With the lagged effects of the 2020 fiscal response, and despite two additional waves of COVID-19 and heightened political uncertainties that resulted in snap elections in June 2021, the economy grew by 5.7% in 2021, driven by activity in services and strong remittances from abroad.[11] The 2022 budget projects a deficit equal to 3.1% of GDP. With a gradual shift in spending away from current expenditure, capital outlays are planned to reach 4.4% of projected GDP in 2022, about one percentage point above their share in 2021. In line with the government's revised debt reduction program for 2022–2026, government debt is expected to decline gradually to 53.5% by 2026. Sustainable debt levels and the macroeconomic management credibility that Armenia attained in recent years were crucial enablers of the efficacy of these policy responses.[12] The general direction of macroeconomic conditions and macroeconomic policies is satisfactory.

4. **Drive for reforms—staying on track.** Despite the challenges to reform implementation in 2020 and 2021—e.g., lack of TA field work, COVID-19 response emergencies, social and regional tensions, political (and high) turnover of senior staff at key line ministries—Armenia's key reform directions did not change. For example, the 2020 recession brought about record-high gross financing needs for the government that needed to be met within the same Medium-Term Debt Strategy (MTDS) orientation that had been followed and communicated to markets, and supported by ADB programs, since 2017. In line with reform commitments, Armenia coped with this challenge by aggressively expanding its (potentially more costly) issuance of market-development-friendly (benchmark) securities in local currency through the new regular auction program.[13] And despite difficulties faced in late 2020, it continued this debt management strategy and succeeded in further reducing its public debt vulnerabilities to currency risk[14] and to promote the benchmark securities program. This sent a strong signal and confirmed expectations—reflected in ADB's previous policy-based lending in 2019 (footnote 1)—about Armenia's new public debt management confidence and was in line with the agreement for ADB to stand ready to explore further policy-based lending on the basis of the PPEF should fiscal needs arise.

5. The government's fiscal strategy envisages medium-term consolidation and a gradual increase in capital expenditure to support economic growth while still reducing public debt to less than 60% of GDP (Armenia's fiscal rule). This strategy can only remain growth-friendly if the government: (i) improves the efficiency and impact of public expenditure, and strengthens control and monitoring of state-owned enterprises (SOEs), public–private partnerships (PPPs), and overall fiscal risks so as to minimize disruptions to fiscal consolidation; and (ii) continues to promote banks' and firms' access to more local currency finance, by improving money market

[9] The fiscal deficit was 1% of GDP in 2019, down from 5.5% in 2016. Government spending was 24.8% of GDP in 2019, down from 28.6% in 2016. Public debt was 49.9% of GDP in 2019, down from 53.7% in 2017.

[10] The government implemented a stimulus package equivalent to 3.5% of GDP, with employee subsidies for small and medium-sized enterprises, direct support to vulnerable households, and state-guaranteed loans to selected firms.

[11] Following stimulus implemented in 2020, the government narrowed the budget deficit from the equivalent of 5.4% of GDP in 2020 to 4.6% in 2021. Economic growth, revenue collection above target, and prudent spending helped reduce public debt from the equivalent of 67.4% of GDP in 2020 to 63.4% in 2021.

[12] The IMF recently commented, "Armenia's economy continued to recover in 2021 and early 2022, largely thanks to the authorities' economic management efforts. They persevered with strong policy implementation and remained proactive to adjust policies appropriately to unforeseen developments (…)"

[13] The share of net domestic securities issuance in total debt issued was 26% in 2018 but reached 85% in 2020.

[14] External public debt declined to 45.7% of GDP at the end of 2021. Domestic public debt increased to 17.7% of GDP in 2021, in line with the government's strategy to gradually increase the share of domestic debt.

infrastructure, deepening the government securities market, and fostering capital markets. Recent financial reform results are therefore encouraging.[15]

6. **Structure of the Armenian economy and binding constraints.** Armenia is a small, open economy, with about 3 million people and per capita annual income of $13,000 (in purchasing power parity). With the deindustrialization process that accompanied the credit- and construction-led boom of the early 21st century, the country is now highly import dependent and with little integration in international capital markets. Inflows of remittances help finance large trade deficits.[16] International trade is challenging, as (i) Armenia is landlocked; (ii) most of its transport infrastructure is past its life cycle, hindering trade within the country and with its trading partners; and (iii) for geopolitical reasons, the borders with neighboring Azerbaijan and Türkiye are closed. In 2018, the government initiated a set of major reforms with the medium-term aim of moving Armenia into an export-led economy model in which activities producing traded goods and services would play a key role, a recognition that the traded sector must become an engine of growth. This strategic priority places crucial concern on real exchange rate competitiveness, key public investments to boost private sector productivity, and affordable access to finance.[17] The lack of the latter in particular has been identified consistently as the main challenge to doing business in Armenia,[18] especially for small and medium-sized enterprises.[19] Also, chronic difficulties in planning and executing public infrastructure investments in the last few decades have left the economy operating in significantly deteriorated transport infrastructure, for instance. So investing in a more knowledge-based, export-oriented economic model while ensuring urgent fiscal consolidation is very challenging. Success hinges on whether (i) fiscal management can be strengthened (not only to ensure urgently needed efficiency and impact upgrades in public infrastructure and public spending, but also to lower country premiums and support the development of financial markets); and (ii) financial markets can be developed to lower the costs (and raise the tenor) of local currency finance to the private sector.

7. **Core development problem: weak fiscal management and low financial markets development.** This core development problem is a binding constraint to the sustainability of Armenia's future growth process,[20] and has been a target of ADB reform assistance in Armenia since 2017. Local financial markets remain nascent, limiting Armenia's private sector and banking industry,[21] constraining fiscal management and monetary policy, and threatening financial stability. The root causes of this core development problem can be found in three policy areas:

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[15] The turnover ratio in government securities increased from 7% in 2018 to 34% in 2021, and the term premium between policy rate and average lending rates in local currency (over 1 year) decreased from 625 basis points in December 2018 to 439 basis points by the end of April 2022.

[16] Armenia ran trade deficits well above 15% of GDP during 2005–2014. Remittances helped fund (and boost) these trade deficits (average of 18% of GDP during that period). However, after the implosion in construction activities (because of international sanctions) in the Russian Federation during 2015–2019, remittances fell to 11% of GDP and the trade deficit to 12.6% of GDP in 2019. The current account deficit dropped from 16.5% of GDP in 2009 to 7.3% of GDP in 2019, and even further to 4% in 2021 because of the COVID-19 crisis.

[17] Armenia's ratio of private sector credit to GDP is about half the average ratio of upper middle-income countries.

[18] The 17 banks of the banking system in Armenia represent 85% of the financial system's assets and 110% of GDP, and there is little concentration of both assets and liabilities. As regards access, for instance, when it comes to account ownership at a financial institution (population aged 25+), Armenia (with 57%) lags not only its comparable upper middle income peers (85% on average) but also the average in lower middle income countries (65%).

[19] IMF. 2021. *Republic of Armenia: Selected Issues.* Washington, DC.

[20] World Bank. 2017. *Future Armenia: Connect, Compete, Prosper. A Systematic Country Diagnostic.* Washington, DC.

[21] Key constraints to banks' capacity to generate medium-term lending must be eliminated, e.g., pricing benchmarks for finance in local currency are nonexistent for medium-term tenors and are very high for short-term tenors. With credit risk, maximum tenors by banks in local currency are now at 24 months and at average rates of about 17%. Foreign currency lending remains common practice in the banking system, benefiting from commercial wholesale, medium-term facilities available from abroad. Hence, the economy remains dollarized, vulnerable to external shocks.

(i) **Fiscal management.** Gaps still hold back fiscal credibility in Armenia, pose risks to fiscal consolidation, and lower the efficiency and economic impact of public expenditure. This is factored into the country risk, and consequently into all financial contracts across the economy.[22] Second, it is crucial that public expenditure and investment decisions embedded in medium-term budget planning reflect national priorities and strategies, and that economic and social impacts become the guiding principle for public expenditure prioritization and approvals.[23] Fundamentally, current budget programs are not leveraged in support of politically prioritized and actionable strategies, and their current structure hinders the performance of multiyear budget planning.[24] Evaluation and monitoring practices (of budget execution) are absent, and the internal audit function needs a general overhaul. Third, these structural difficulties were especially identified in the capital budget since 2017, e.g., fundamental weaknesses in national and sector planning, and budget planning itself; in project appraisal; and project selection.[25] Fourth, in the context of reform efforts to establish stop-gap and legal mechanisms to govern PPP decision-making in fiscally responsible ways, completing an effective legal and regulatory framework for private participation in infrastructure in integration with new formalized public investment management (PIM) processes is still a priority. This is the only way to ensure the development of efficiency-enhancing and fiscally sustainable infrastructure in the future. Armenia's difficult experience with PPPs, having created an issue of "legacy PPPs" of close to 10% of GDP (i.e., PPPs approved before any legislation was put in place), calls for such a framework. Fifth, to ensure fiscal sustainability and reduce risk premiums, public liability management functions must become more effective and credible in meeting their core objectives, especially in controlling fiscal risks (e.g., of PPPs and SOEs). In this regard, fiscal risk management needs continued strengthening and expansion as a core function, not only to upgrade fiscal transparency but also in benefit of risk mitigation action and policies.

(ii) **Government securities and money markets**. Several factors hold back efficiency and liquidity in Armenia's government securities and money markets, such as the still-small stock of market-development-friendly securities outstanding; weak cash/liquidity management and forecasting between the Ministry of Finance (MOF) and the CBA, and the money markets volatility these difficulties create; and the need to fully implement legal and regulatory changes to increase liquidity in secured interbank markets, improve price discovery, and develop the standardized and safe instruments for interbank trading that are missing. Formalized processes of consultation with markets on market development options are nascent, and public debt management implementation must become consistently in line with the announced strategic orientation.

(iii) **Capital markets.** Gaps and deficiencies in the legal frameworks for corporate transparency and governance, for financial instruments (and vehicles), and for the

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[22] As highlighted in recent research at the IMF, improvements in fiscal transparency are favorable to emerging economies' borrowing costs and help increase foreign investors' demand for their sovereign debt beyond the benefits of availability of information on the debt servicing capabilities of sovereign borrowers. See also A. Afonso, J. Jalles, and A. Veñancio. 2022. Do financial markets reward government spending efficiency? *Journal of International Financial Markets, Institutions and Money*. Vol. 77.

[23] This is not currently the case: not only does a systematic misalignment exist between strategic and budget planning, but the strategic framework itself is fragmented and mostly lacks links between strategies and programs.

[24] As a result, for instance in the practical context of the climate change action agenda, there are no planning and budgeting mechanisms to systematically translate the agenda into investment projects at any level of government.

[25] IMF. 2018. *Republic of Armenia: Technical Assistance Report–Public Investment Management Assessment.* Washington, DC. Also see IMF. 2019. *Republic of Armenia: Fiscal Transparency Evaluation.* Washington, DC.

protection of investors have held back the development of corporate equity and debt markets in Armenia. Without fundamental upgrades to corporate transparency and governance, the pool of potential issuers is too narrow, and the confidence of investors is too low and too dependent on expensive due diligence. There has been no stability or clarity in tax treatment of capital market instruments, and this has affected potential issuers and investors alike. Market design efforts must be deployed to improve price discovery in (and international financial integration of) Armenia's financial and capital markets. Also, completion of reforms in areas (i) and (ii) above is imperative for reform accomplishments in this area (iii) to have an ultimate impact on corporate debt and equity markets activity in Armenia. This is because only after a liquid yield curve is established in Armenia (as the risk-free reference for all financial contracts, including those used in conventional banking) can corporate debt and equity instruments be systematically priced, become liquid, and attractive to both sides of the capital market.

8. The discussion in para. 7 and the sector assessment[26] summarize the key channels through which the absence of financial markets affects the growth potential of Armenia, and the root causes of the core development problem. The assessment's problem tree explicitly identifies the weaknesses in fiscal credibility and management as being both (i) a root cause of this core development problem (e.g., through the way specific handicaps in debt management hold back the development of debt markets); and (ii) a part of the stated core development problem itself in view of the reasoning presented in para. 5 on the new macro-fiscal context. The urgent fiscal consolidation that Armenia needs again can only be growth-friendly if reforms create fiscal space[27] and lift the economic and social impact of public expenditure,[28] not least because of the effect that country risk premiums have on financial contracts across the private sector.[29]

B. Policy Reform, ADB's Value Addition, and Sustainability

9. **Proposed reforms in the policy design and monitoring framework.** On the basis of the PPEF reform plan approved in 2019 and ADB's continued TA engagement (footnote 49), the program is structured along the same three pillars of previous assistance.[30] In specifically addressing gaps identified in para. 7, the proposed reforms support the government's Programme, 2021–2026 (footnote 2 and para. 29), and build on recent and ongoing ADB TA for the implementation of its Strategy and Action Plan for Public Finance Management Reforms for 2019–2023. All 15 actions under subprogram 1 have been completed.

10. **Reform area 1: Strengthening fiscal management, public debt and fiscal risk management policies and practices, and infrastructure investment sustainability.** Reforms

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[26] Sector Assessment (Summary): Finance (Money and Capital Markets) and Public Sector Management (Public Expenditure and Fiscal Management) (accessible from the list of linked documents in Appendix 2).

[27] Antonio Afonso and José Alves. 2022. Does Government Spending Efficiency Improve Fiscal Sustainability? *CESifo Working Paper.* No. 9738.

[28] Inefficiencies in PIM processes, as estimated by the IMF, can on average lead to a 30% loss of return on investment.

[29] Many of the issues discussed in para. 7 and summarized as root causes in the problem tree of the sector assessment can also have effects that are external to the implicit theory of change of the program. For example, the lack of corporate transparency in Armenia is not only a significant constraint to capital markets development. It is also a significant source of information asymmetries that makes it harder for banks to do due diligence, i.e., it (i) gets reflected in high premiums and rationing of small borrowers, and (ii) explains high collateral requirements in Armenian banks (270% of loan amount). IMF. 2018. *Armenia Financial Sector Assessment Program* Washington, DC. Given some of the clear by-product benefits, e.g., of corporate transparency and corporate governance across the private sector, ADB programs have pressed ahead on these reforms since the first program intervention in 2017.

[30] Both subprograms have the same three policy areas and, in a sequenced manner, include actions to implement each of the complementing reform efforts that are needed to achieve the outcome indicators (Appendix 1).

have been set in motion to enhance fiscal credibility in Armenia, by upgrading fiscal planning, management, and transparency, and to raise the economic and social impact of public expenditure. In view of capacity constraints, the program prioritized a steady sequence of gradual improvements to the fiscal policy framework and to MOF's institutional functions.

11. Under subprogram 1, the government started linking medium-term fiscal planning and budget allocation decisions to national strategic planning directions and priorities. For example: a results framework was established from current national strategies and high-level targets, and line ministries were instructed to bring their new budget request submissions and Medium-Term Expenditure Framework (MTEF) budgeting proposals in line with it; a pilot on gender-responsive budgeting was implemented in two key ministries, and evaluated for future steps; and the institutional framework for budget planning, control, and monitoring was enhanced (see policy action [PA] 1.1). For subprogram 2, to complete linking medium-term fiscal planning and budget allocation decisions to national strategic directions and policy targets, and to raise the quality and impact of public expenditure overall, the government will (i) set up and operationalize a new institutional mechanism for linking national strategic planning to medium-term resource allocation, underpinned by a new ledger of high-level key performance indicators to explicitly anchor the results-focus of program budgeting and sustainable development goal budget tagging (with a climate change mitigation and adaptation module); (ii) continue rolling out formal evaluations to program budgeting as a basis for a new regulatory mechanism to score budget programs and reappraise budget allocations; (iii) undertake reforms to improve MTEF reliability for medium-term fiscal planning and accuracy against ultimate annual budget allocations; and (iv) through MOF, mainstream gender-responsive budgeting across ministries from fiscal year 2024 onward.

12. To enable climate change adaptation action, the government approved by decree a national climate adaptation plan and the key principles to guide its integration into budget policy and programming, including the principle of climate-aligned financial decision-making and management (PA1.2). For subprogram 2, the government will (i) approve the financing strategy and investment plan to facilitate the broad engagement of interministerial stakeholders toward the coordinated mobilization and targeting of global sources of climate change finance into public and private efforts of adaptation and mitigation; (ii) develop a financing framework for climate adaptation; (iii) modify its national strategy for disaster risk reduction (DRR) to bring it in line with the Sendai framework and ensure coherence with the Paris Agreement); and (iv) introduce budget programs for DRR and for climate change adaptation and mitigation.

13. To raise the economic and social impact of public investment decisions and the fiscal sustainability of their implementation, the government introduced and operationalized a high-level, comprehensive PIM framework[31] to include, among other aspects, (i) disaster and climate change risk adaptation and mitigation objectives embedded in the key identification and prioritization criteria; (ii) integration with the new, fiscally responsible PPP operational framework;[32] and (iii) linkages to medium-term fiscal planning (PA1.3). For subprogram 2, a monitoring system and institutional function will be established to allow better identification of cost overruns (and causes) and under-execution of projects. The government will also approve (i) a

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[31] Approved through a Prime Minister's decree in May 2021, the PIM framework defines the main features of project prioritization, the institutional framework, the stages of project selection (identification, pre-assessment, preselection, evaluation) and implementation, and the role of the investment committee, chaired by Prime Minister.

[32] The approval, in June 2021, of the PPP contingent liability ceiling decree operationalized MOF's function of vetting new PPPs. Another government decree in November 2020 set the methodology for the assessment of contingent liabilities deriving from PPPs. The amendment to the PPP Law in July 2021 refined the concept of fiscal affordability by introducing a ceiling on the annual flow of the direct liabilities arising from PPP projects. These legal amendments also brought PPP-related procurement legislation.

new PIM (Government) decree to raise the legal standing of its mandatory requirements, (ii) a comprehensive PIM manual or handbook (through the Ministry of Economy [MOE]), to include an integration of methodologies to valuate climate change adaptation and mitigation benefits, and (iii) comprehensive technical guidelines (through the MOE) for mainstreaming climate change mitigation and adaptation (and DRR) into public investment.

14. To establish a full-fledged risk vetting and monitoring framework for PPPs, and to complete the operational framework for PPPs, the government approved (i) the PPP Contingent Liabilities decree (with methodologies and tools for the identification, assessment, and calculation of risks, and their reporting in State Budget documentation, as well as requirements for benchmarking them against PPPs' fiscal affordability ceilings); (ii) more detailed methodological guidelines and tools—consistent with the new PPP Contingent Liabilities decree; and (iii) decrees to establish ceilings for both contingent liabilities and direct liabilities (PA1.4). For subprogram 2, to ensure fiscal sustainability and reduce possible biases toward off-budget solutions, the government will standardize the (reporting and accounting) treatment of all fiscal liabilities by linking up the risk vetting and monitoring framework for PPPs with the MTEF and the fiscal rule. This ambitious objective will likely require government approval of new legal amendment proposals to align budgetary system laws with the Public Debt Law, and explicitly link (stock) PPPs' fiscal affordability ceilings to the debt concept of the fiscal rule.

15. To improve financial transparency and start strengthening the centralized fiscal monitoring of SOEs, (i) Parliament enacted changes to the laws on accounting and auditing to ensure that all SOEs above a specific size (and other large companies) are obliged to have their financial reports audited; and (ii) MOF's Fiscal Risk Management Department (FRMD) established and operationalized the collection of financial information on all SOEs into a new database, including financial SOEs (PA1.5).[33] For subprogram 2, to strengthen centralized fiscal monitoring and control and the operational performance of SOEs, the government will (i) through MOF, upgrade the compliance monitoring functions for SOEs' publication of audited financial statements; and (ii) rationalize the institutional oversight of SOEs—that is now fragmented between the State Property Management Committee and MOF's dual roles (fiscal risk management and dividend collection)—to streamline MOF's access to financial information and to align performance appraisal to efficiency gains. Also in subprogram 2, to reduce fiscal inefficiencies and promote impact in direct forms of investment promotion, the government will bring state-owned equity funds and other financial SOEs under a new ownership policy.[34]

16. To upgrade fiscal transparency and public disclosure and continue sustaining the institutional strengthening of the fiscal risk management function at MOF, MOF (through the FRMD) upgraded the comprehensiveness of its fiscal risks statements, now also disclosing (i) a calculation of headline contingent liability exposures to major SOEs and selected PPPs, including power purchase agreements (PPAs); and (ii) an explicit acknowledgment and quantification of fiscal risks deriving from disaster risk and climate change.[35] MOF also established internal comprehensive periodic reporting on PPP Contingent Liabilities (including the operationalization of a database for PPP-related fiscal commitments and risk assessment matrixes for each PPP), with increasingly detailed calculation of contingent liability exposures per risk category and selected PPPs [including PPAs]), to serve as the basis for annual budget submissions and annual

[33] The reporting functions of the FRMD were also continuously improved by deepening the content of the fiscal risk assessments that are now included in the MTEF and annual budget document. MOF's control and coverage of the wide array of SOE operations and activities that produce fiscal risks have become considerably more robust.
[34] The new ownership policy orientation will include binding strategic mandates that eliminate crowing-out of the private sector and require a value-for-money rationale for the existence of this type of SOEs, etc.
[35] MOF also produced the first two MTEF updates reporting on fiscal risks from disaster risk and climate change.

MTEF updates to Parliament. Finally, MOF approved the updated Fiscal Risk Management Roadmap for 2022–2023, charting objectives to, by the end of 2023, achieve e.g. full operationalization of the vetting and mitigation functions (PA1.6).[36] For subprogram 2, MOF will produce a financial protection recommendation for line ministries' action against disasters (on geological and hydrometeorological hazards and taking into account climate change). Parliament will also approve legal amendments to establish (i) a governing framework for PPP renegotiations, (ii) a higher legal anchoring of MOF's fiscal risk management functions and staffing certification, and (iii) a high-level fiscal risks management council. The government will formalize a cross-institutional mechanism of information flow protocols to ensure that all concerned state bodies and MOF departments contribute timely to an integrated fiscal risk management framework, and MOF will also activate the risk vetting and mitigation functions.

17. To promote more effective, efficient, and transparent procurement practices while embedding key climate change action objectives, a Prime Minister's decree approved a procurement development and reform concept (and action plan) that covers, among other aspects, an analysis of the feasibility of introducing green procurement (as a procurement tool that favors products, services and works that respect the environment), and proposals for the standardization of procurement packages in the recurrent budget (PA1.7). For subprogram 2, the government will approve any necessary procurement legislation reform changes and implement the action plan, including (i) the feasibility assessment for green procurement, and (ii) the introduction of standardized procurement packages in the recurrent budget.

18. To effectively formulate green economy policy and align economic policy tools with climate change mitigation and adaptation targets, MOE (i) issued, for review by the co-implementing ministries, a draft "green economy transition" concept; and (ii) created an operational unit dedicated to the green economy transition and operationalized it (PA1.8). For subprogram 2, the government will approve (i) the national strategy on Green and Sustainable Economic Development, and (ii) the legal decree approving an implementation road map for establishing preconditions for "circular economy" activities.[37]

19. Under subprogram 1, public debt management and strategic communication to the markets were further aligned to continue reducing public debt exposure to exchange rate risk and to develop the domestic government securities market. In addition, new institutional mechanisms were proposed for parliamentary approval to gradually insulate the government securities issuance program against short-term macroeconomic risks. These were achieved through several reform and institutional upgrade efforts, e.g., submission by the government to Parliament of draft legal amendments to the Law of the Treasury System and the Law on Budget System to ensure that the Stabilization Account acts strictly as a support mechanism for managing government debt refinancing risk and countercyclical stabilization with good governance (PA1.9). For subprogram 2, MOF will execute the MTDS, 2022–2024 within its benchmark targets for refinancing risk, interest rate risk, and exchange rate risk, with minimal deviations. MOF will also approve the MTDS for 2023–2025 with (i) higher objectives in terms of reducing exchange rate risk; and (ii) more stringent exchange rate risk benchmark indicators (i.e., the share of public domestic debt in total debt and the share of dram denominated debt in total debt to be at least 30%). Lastly, MOF will prepare—subsequent to parliamentary approval of the legal amendments to the Law of the

[36] A key objective for end-2023 is also to more systematically cover of all material sources of risk including disasters caused by natural and artificial hazards (biological and technological) and by climate change, and potential environmental liabilities of the state.

[37] Economic production processes focused on maintaining natural resources longer in the economic cycle.

Treasury System and the Law on Budget System—any necessary secondary legislation to govern the replenishment and utilization of the Stabilization Account.

20. **Reform area 2: Improving government securities market and money market infrastructure**. Under subprogram 1, to strengthen joint action toward developing and reforming the financial and capital markets, the government approved the Capital Markets Development Program (jointly prepared by the CBA, MOE, and MOF). In addition, MOE established the Capital Markets Development Division to coordinate the program's implementation, while MOF, through its Public Debt Management Department (PDMD), took several steps to enable money market development and systemic liquidity management. First, it initiated a new issuance program of 6-month securities (as a benchmark) and ramped it up (as the main security issued) to increase its benchmarking value for other segments of the capital market and increase liquidity in repo (interbank) markets. Second, MOF and the Armenia Stock Exchange finalized the technical specifications to enable the implementation of bond switch auctions. Finally, the PDMD widened its role in the coordinated systemic liquidity forecasting framework (with regard to foreign exchange flows) to more effectively support the CBA's operational objective of reducing interbank rate volatility. For subprogram 2, the implementation of the Capital Markets Development Strategy will remain on track, MOE will publicly disclose its status, and submit for interministerial review legal and regulatory proposals to promote the private equity and venture capital industries. To smooth the public debt redemption profile further and decrease spikes in refinancing needs, MOF will continue all necessary issuance and active liability management practices (buybacks or exchanges) and ensure that bond switch auction options become fully operational.[38]

21. To establish truly secured interbank markets in Armenia and significantly improve price discovery and liquidity in its money markets, several reform steps were taken. First, Parliament approved amendments to the civil code to resolve re-characterization risks in repo transactions (and other key issues in obtaining the International Capital Market Association-certified Global Market Repurchase Agreement [GMRA] Legal Opinion). Second, the CBA approved the necessary amendments to its regulations to ensure GMRA applicability in Armenia to all counterparties. Finally, the CBA obtained the aforementioned International Capital Market Association-certified GMRA Legal Opinion (PA1.11). This completed a long legal reform effort to meet the key prerequisites for the GMRA's wider application in the local market.[39] For subprogram 2, the CBA will (i) implement regulatory initiatives to promote the transition in the finance sector towards the GMRA, including taking a formal decision (and implementing it) to use the GMRA in its open-market operations; (ii) approve legal and regulatory solutions to enable interbank interest rate benchmarking; and (iii) establish of a new money market trading platform.[40]

22. **Reform area 3: Broadening the base of financial instruments and investors, and enhancing corporate transparency.** Under subprogram 1, to promote investor interest[41] and price discovery in trading: (i) Parliament approved legal amendments to the Law on Currency Regulation and Currency Control to encourage corporate debt issuances and enable flexibility in the currency denomination of repo contracts' settlement; (ii) the CBA amended its regulations to introduce clearer rules for market-making in corporate bonds; (iii) the CBA implemented a new

[38] The PDMD (MOF) will also continue to widen its role in the coordinated liquidity forecasting framework with the CBA, by channeling the necessary tax revenue forecasts within its support for the CBA's systemic liquidity management.

[39] The Legal Opinion on the enforceability of the GMRA in Armenia was published on 22 June 2022.

[40] A new overnight repo platform is expected to be launched by the Armenia Stock Exchange by the end of 2022. Active trading on the platform can allow calculation of real, transaction-based money market reference rates.

[41] Tax Code amendments to encourage access to capital markets entered into effect in 2020. With this, the government sought to improve the attractiveness of Armenian-listed securities by exempting interest and dividend income from income and corporation taxes for resident and nonresident investors.

regulatory framework to (a) fill regulatory gaps and eliminate uncertainties over derivative instruments, and (b) promote the participation of foreign institutional investors in the local corporate debt market;[42] and (iv) Parliament approved amendments to the Law on Joint-Stock Companies to enable the issuance of common shares of various classes, for instance (PA1.12). To achieve key reform targets under subprogram 2, (i) MOF and the CBA will develop and approve solutions to give nonresidents easier (and direct) access to the government securities market in Armenia (onshore or offshore); and (ii) Parliament will approve amendments to the Law on Joint-Stock Companies, such as to (a) clarify the separation between ordinary and preferred shares, in support of the development of private equity; (b) align the rules governing negative equity balances with the insolvency legislation, in support of project finance; and (c) give government the authority to set corporate governance requirements. Subsequent to the latter, a new corporate governance code (which prescribes, for instance, a minimum 30% presence of women on management boards) will be approved by government decree.

23. To ensure market integrity and sustainability in the potential proliferation of green finance instruments, the CBA formally launched a working group to study options for the development of green finance and assess if climate change risks to banking stability justify specific adjustments to regulatory approaches (PA1.13). For subprogram 2, the CBA will (i) adopt a time-bound road map for sustainable finance in Armenia; and (ii) introduce an integrated framework of corporate reporting standards on environmental, social, and governance aspects to its supervisees, and issue proposals on a new framework for certifying banks' green finance-related internal tagging and classification system (to address risks of greenwashing).

24. To fundamentally enhance corporate transparency in Armenia and establish proper governance and effectiveness in the professions that underpin it, (i) Parliament approved proposals to amend the laws on accounting and audit, and a proposed new law on regulation and public oversight of audit and accounting to (a) delegate key regulatory functions to the (now established) Public Oversight Board (POB; led by MOF with members from MOE, the CBA, and the State Revenue Committee; and giving private sector stakeholders consultative voting rights) and the Chamber of Expert Accountants and Auditors of Armenia, and (b) set mandatory audit requirements; (ii) the POB approved secondary legislation to define the procedure for the registration of auditors, expert accountants, and audit organizations; and (iii) MOF established an electronic register.[43] The POB also approved a simplified manual of financial reporting for microenterprises in Armenia (PA1.14). In subprogram 2, the authorities will establish the monitoring guidelines on quality assessments of audit companies, auditors, and expert accountants, and approve operational procedures for the oversight of professional accountancy organizations. A gender-targeted training program will be explored.

25. To keep strengthening the protection of creditors' rights, Parliament adopted amendments to the Bankruptcy Law to provide additional and effective mechanisms for maximum satisfaction of creditors' claims. Procedures for realizing the object of a secured right were also clarified and made more cost efficient (e.g., by reducing the amount of the administrators' remuneration).[44] To improve transparency, efficiency, and credibility, the Ministry of Justice procured an e-bankruptcy system (e.g., for selecting candidates of bankruptcy administrators) (PA1.15). In subprogram 2,

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[42] The CBA also allowed foreign investors to open accounts in local currency to purchase local securities.

[43] The register for the certified service providers in the field of audit was created and published on the MOF website. The work on this reform continues, particularly the improvement of audit quality by establishing monitoring and oversight mechanisms under the Chamber of Accountants and Auditors of Armenia.

[44] The amendments addressed the following issues: (i) procedure for declaration and inventory of the debtor's property, (ii) procedures for realizing the object of a secured right, (iii) administrators' remuneration, and (iv) standardization of administrators' annual statistical reports.

the Ministry of Justice will (i) operationalize the e-bankruptcy system; (ii) formalize, together with the CBA, a joint effort to diagnose issues in the Armenian bankruptcy regime to chart future reform efforts (e.g., financial rehabilitation and sale of assets); and (iii) draft proposals for a new insolvency code for interministerial review.

26. **ADB's value addition.** ADB has gained experience in helping governments deepen their countries' financial markets and strengthen fiscal management. Lessons from it, and from the work in Armenia in these areas since 2017, allowed ADB to support the Government of Armenia's steady progress with specific reform efforts, and in the required sequence despite the country's several recent political transitions. Policy dialogue also often emphasized the need for more context-specific solutions that only TA work and reform analysis could uncover. For this step-by-step approach, the continuity of ADB's reform assistance is an advantage. Country-specific TA, staff consultancy resources, and several regional TA windows from ADB contributed to the effectiveness of the past and current policy dialogue in Armenia.[45] ADB's institutional memory of specific reform challenges makes its assistance increasingly more efficient in helping the government chart multiyear efforts to develop the different underpinnings of financial markets, and strengthen key public functions that can best promote and benefit from it. ADB's TA and policy dialogue have also often helped convene stakeholders and mobilize AFD cofinancing.

27. **Lessons.** Recent program completion reports confirm that the programmatic approach is best suited for the multiyear reform agendas that ADB aims to support, and for ADB programs to serve as organizing frameworks, both for maintaining coordination between development partners and for adequately addressing reform sequencing challenges.[46] ADB's sustained reform support creates continuity and promotes the effectiveness of the policy dialogue—e.g. lessons from each reform assistance effort have seamlessly benefited subsequent reform assistance. In Armenia, this ensured traction in policy dialogue during the difficulties of 2020–2021 and helped sustain agreements on the new 2023–2024 reform targets. Even though the PPEF was an effective platform for the wide array of TA dialogue and reform efforts, a key lesson of past experience still points to the advantages of the programmatic approach in this regard.[47] Setting realistic policy actions is also critical to ensure that implementing agencies' staff remain fully connected to the process. This often requires a more pragmatic and sequenced approach that emphasizes issues of form on how to approach reform challenges. As often observed in other "post-transition" contexts, catalyzing interagency institutional collaboration is also a challenge in Armenia at working levels. Promoting analytical cooperation between agencies often requires setting formal requirements for it to support policy dialogue continuity and frame the progress that is needed.

28. **Development partner coordination.** The program was developed in partnership with the AFD as ADB's parallel cofinancing partner. TA was coordinated for reform areas 1 and 3, and this will intensify for subprogram 2. The objectives of the program were regularly discussed with the IMF and the World Bank. Concerted efforts were also deployed to leverage positions in areas where direct operational coordination was required, especially with the IMF on various fiscal management reforms (e.g., fiscal risk management, PIM, and PPP reforms). Other development

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[45] ADB. Armenia: Supporting Diagnostic Assessment of Public Financial Management; ADB. Armenia: Preparing the Second Public Efficiency and Financial Markets Program; ADB. Supporting the Enabling Environment for Public Financial Management Reforms; ADB. Armenia: Tax Policy Review (TA DRMTF/DC 0020); ADB. Strengthening Fiscal Governance and Sustainability in Public–Private Partnerships; ADB. Improving Infrastructure and State-Owned Enterprise Governance for Sustainable Investment and Debt Management; and ADB. Strengthening Financial Management in Asia and the Pacific, Phase 2.

[46] ADB. 2021. *Completion Report: Public Efficiency and Financial Markets Program (Subprograms 1 and 2) in Armenia*. Manila.

[47] ADB. 2022. *Completion Report: Second Public Efficiency and Financial Markets Program in Armenia*. Manila.

partners' TA efforts also contribute to the program's implementation, and this is coordinated by the respective implementing agencies. Through MOF and MOE, key reform activities were coordinated with German development cooperation (Deutsche Gesellschaft für Internationale Zusammenarbeit - GIZ) and the United Nations Development Programme (UNDP) on budget planning reforms (and on green economy and green transition). Coordination with the European Bank for Reconstruction and Development was led by the CBA.

C. Expected Outcome of the Reforms

29. The program helps implement the national strategy of Armenia, i.e., pillar 6 (institutional development) directly and pillar 3 (infrastructure development) indirectly.[48] The outcome of the program is deepened financial markets in Armenia and strengthened fiscal management and sustainability. The effects expected from each reform area are as follows:[49]

(i) Reform area 1 aims to (a) raise the economic and social impact of public investment and policies, (b) significantly increase fiscal credibility, (c) complete an effective framework to ensure that only fiscally responsible and planning-relevant PPPs are entertained, and (d) establish strong capacity to manage and assess the risks in current and future PPPs. Risk premiums and rating outlooks are expected to gradually reflect these developments and the ensuing fiscal credibility upgrades, and translate into lower financial costs across the economy (footnote 22).

(ii) Reform area 2 aims to (a) help establish a liquid yield curve along key tenors, promoting liquid money markets (in terms of trading turnover) and formal pricing benchmarks in local currency for the entire economy; and (b) sustain a debt issuance program that is conducive to market development and dominates debt policy and borrowing practices.[50] Lowering liquidity risk premiums in money and government securities markets will also help the financial system lower the term premium in the pricing of local currency loans to firms.

(iii) In reform area 3, the expectation is that capital markets can become more accessible to Armenia's firms once liquid pricing benchmarks are a reality (i.e., upon completion of reform areas 1–2). As liquidity premiums get reduced, access to issuers (banks and nonfinancial entities) and investors will be feasible on the back of enhanced corporate transparency and effective insolvency legislation.

D. Development Financing Needs and Budget Support

30. In November 2021, MOF sent a formal request for a policy-based loan to support the government's ongoing reforms under the PPEF and to finance the 2022–2024 budget financing needs. Regional conflicts and geopolitical developments since February 2022 left the Armenian economic outlook under serious uncertainty. Armenia's economic exposure to the Russian Federation is significant (33% of its trade, 50% of its remittances, and 40% of foreign direct investment), and its banking system has significant counterparty links to Russian banks. On the

[48] The alignment with pillar 6 is noteworthy. The section on financial policy (which calls for working with ADB and the IMF, among others) discusses tax policy efficiency reforms (e.g., eliminating bad-tax benefit practices), fiscal sustainability, debt management reforms to reduce the debt burden and its foreign currency share (by continuously expanding the regular treasury/bonds issuance program), together with further developing capital markets, and fixing problems in capital expenditure execution. The section on state expenses prioritizes reforms to medium-term budget planning and implementation, and better public investment integration with the PPP option and strategic planning.

[49] Program Economic and Impact Assessment (accessible from the list of linked documents in Appendix 2).

[50] This will continue to require bold market-based public debt issuance efforts, which, in local currency, are tantamount to taking on more refinancing risk in the short-term in exchange for a prospective reduction in liquidity premiums.

other hand, the sudden inflow of new residents with export activities has been a very positive macroeconomic development, adding to higher than expected tourism and remittance flows in early 2022. Growth prospects for 2022–2024 are very uncertain, but the outlook remains positive.

31. The government's gross financing needs in 2022–2024 are estimated to total $6.6 billion.[51] Net of planned domestic debt issuance, financing needs are estimated at $3.9 billion. The Government of Armenia has requested a regular loan of $100 million from ADB's ordinary capital resources to help finance the program. The loan will have a 15-year term, including a grace period of 3 years; an interest rate determined in accordance with ADB's Flexible Loan Product; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average maturity is 9.25 years, and the maturity premium payable to ADB is 0.10% per year.

Table 1: Summary of the Medium-Term Expenditure Framework ($ million)

Item	2022	2023	2024
A. Revenue and grants	4,132.7	4,609.0	5,189.4
B. Expenditure	4,483.0	5,206.5	5,748.3
C. Overall fiscal balance (= A. minus B.)	(350.3)	(597.5)	(558.9)
D. Debt repayment	1,282.6	2,090.0	1,719.8
E. Gross financing needs (= C. plus D.)	1,632.9	2,687.5	2,278.7
E.1 Financing needs less domestic debt repayments	905.5	1,796.1	1,242.5

( ) = negative.
Sources: Government of Armenia. 2022. *Medium-Term Expenditure Framework, 2023–2025*. Yerevan; and Asian Development Bank exchange rate assumptions.

E. Implementation Arrangements

32. MOF is the executing agency. The CBA and MOE are the implementing agencies. The Ministry of Environment is an implementing partner with regard to climate change actions, and the Ministry of Justice is an implementing partner with regards to bankruptcy reforms. The proposed implementation period is November 2019–September 2022 for subprogram 1, and October 2022–March 2024 for subprogram 2. The proceeds of the policy-based loan will be withdrawn following ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

33. The following due diligence was carried out during the program's preparation:

(i) **Safeguards.** The program is not expected to have any environmental or social safeguard impacts and will not trigger ADB's Safeguard Policy Statement (2009) requirements. It is classified category *C for environment, involuntary resettlement, and indigenous peoples*. No activity will result in or lead to involuntary resettlement, or negatively affect indigenous peoples or the environment

(ii) **Economic and financial.** The program's expected impact is summarized in para. 29. Its potential financial impacts were assessed for illustration purposes. The underlying analysis will be updated during subprogram 2.

(iii) **Climate change action.** The program includes climate change actions under fiscal management and finance sector policy to help achieve the government's mitigation and adaptation objectives (climate change finance ratio for adaptation is 22.2%

[51] The MTEF update led to the requests to ADB and AFD for lending up to $100 million equivalent from each in 2022 (subprogram 1), and for $50 million equivalent from each in 2023 or 2024 (subprogram 2). The World Bank was requested for a $100 million loan in 2022, but that is now very likely to only eventuate in 2023. ADB–AFD can finance 22% of the 2022 financing needs (defined as in line E.1 of Table 1).

and for mitigation is 10%). Although modest in the context of the overall program scope, without the proposed fiscal management mechanisms in reform area 1, Armenia might not have the capacity to systematically implement its climate change action priorities. Similarly, without the finance sector policy proposals in reform area 3, much of the private sector's potential contribution to climate change mitigation objectives could remain unfulfilled.

(iv) **Poverty, social, and gender.** No adverse poverty, social, or gender issues were identified as a consequence of the program. Subprogram 1 includes some gender elements with a policy action related to the piloting and evaluating of gender-responsive budgeting, but subprogram 2 is expected to make a stronger contribution.[52] In addition, the program includes measures that promote business formalization (PA1.1[v] and PA2.1[vi]); and better financial management at microenterprises (and consequently lower credit risk appraisal costs for banks when microenterprises apply for loans; PA1.14[iii]). These measures can have an impact that disproportionally benefits enterprises led by women, given that more than 40% of enterprises led by women are microenterprises. However, these policy initiatives make no explicit reference to gender equality as a formal policy objective, the implementing agencies are not likely to change that, and that doesn't allow these policy actions to count for the gender categorization.

(v) **Governance.** ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government. The government's Anticorruption Council is responsible for setting anticorruption policies, leading investigations, and imposing remedies. Key reforms in this regard since 2018 have been widely recognized.[53] ADB and the government agree on the public financial management, procurement, and anticorruption challenges that lie ahead, and the related capacity development needs. Armenia has steadily improved its budget credibility, comprehensiveness, and transparency.[54] This was followed by other upgrades along the country's strategy of comprehensive public financial management reforms. The recently approved Tax Revenue Management Program for 2022–2025 can pave the way to a more effective and transparent tax system, and the recently approved Public Administration Reform Strategy (2022–2024) charts ambitious reform targets to raise governance and public sector effectiveness.

34. Major risks and mitigating measures are summarized in Table 2 and described in detail in the risk assessment and risk management plan.[55]

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[52] Subprogram 2 is likely to be proposed as *effective gender mainstreaming* since it aims to expand gender-responsive budgeting across all ministries and to set corporate governance requirements for women's representation on the management boards of companies (via the approval of a new corporate governance code).

[53] As the IMF recently commented, "Over the three-year program, the authorities advanced important structural and institutional reforms, including on improving tax compliance, refining the budget process (…) as well as implementing reforms to strengthen governance, foster transparency, and combat corruption. (…) The authorities (…) ambitious medium-term reform program (…) if successfully implemented, could lead to stronger and more inclusive growth."

[54] With one of the few dedicated government finance statistics units in the region, Armenia has started to produce draft consolidated reporting to include state and local noncommercial organizations, SOEs, public sector foundations, and public financial corporations. Its budget classifications are now broadly in line with the recommendations of the 2014 Government Finance Statistics Manual, and quarterly government finance statistics are already available.

[55] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Table 2: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Vulnerability to external shocks, which may directly affect financial stability and spur increases in dollarization	The mitigation of external risks remains a priority of the Government of Armenia. Resilience will be strengthened by implementing reforms such as those in the program, and by increasing the depth of the government's domestic debt and reducing foreign exchange borrowing.
Fiscal instability and foreign currency debt servicing concerns can affect the stability of the domestic debt issuance program	The government's current fiscal strategy envisages medium-term consolidation and a gradual increase in capital expenditure to support economic growth while still reducing public debt to less than 60% of gross domestic product (Armenia's fiscal rule). Its broad-based strategies (e.g., for public financial management reforms, capital market development, and tax administration reform) are expected to keep reducing the risk of fiscal instability and increase public sector efficiency. The government also stepped up plans to strengthen the issuance of more dram denominated debt to reduce foreign currency risk exposures, and to continue strengthening fiscal management.

Source: Asian Development Bank.

IV. ASSURANCES

35. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the draft loan agreement. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

V. RECOMMENDATION

36. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve:

(i) the programmatic approach for the Fiscal Sustainability and Financial Markets Development Program; and

(ii) the loan of $100,000,000 to Armenia for subprogram 1 of the Fiscal Sustainability and Financial Markets Development Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's Flexible Loan Product; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President

24 October 2022

POLICY DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objectives	
Institutional Development (Pillar 6 of the Government's Programme), 2021–2026 Infrastructure Development (Pillar 3 of the Government's Programme), 2021–2026[a]	
Outcome Deepened financial markets in Armenia and strengthened fiscal management and sustainability.	**Risks and Critical Assumptions** R: Geopolitical tensions or regional conflicts can trigger fiscal shocks or exchange rate pressures that affect local currency and fiscal outlook

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2[c]** (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
Reform Area 1: Strengthening fiscal management, public debt and fiscal risk management policies and practices, and infrastructure investment sustainability		
1.1. To start linking medium-term fiscal planning and budget allocation decisions to national strategic and sectoral planning directions (and to explicit high-level economic and social objectives/targets), while also enhancing the budget process and analysis requirements to raise the overall design quality and effectiveness/impact of public expenditure, the following set of sub-actions were undertaken: (i) The MOF established a results framework (from current national strategies and action plans) to enable line ministries' compliance in the new budget submissions for FY2023 and onwards, and issues instructions accordingly;[d] (ii) The MOF established requirements for alignment between program budgeting and current national strategic priorities (through the MOF issuance of mandatory new guidelines for MTEF preparation and the 2023 State Budget);[e] (iii) A pilot for gender-sensitive budgeting was implemented in two key ministries,[f] and MOF evaluated and published its	2.1 To improve linkages between medium-term fiscal planning and budget allocation decisions, to national strategic and sectoral planning directions (and its explicit high-level economic and social objectives/targets), while also enhancing the budget process and effectiveness/impact of public expenditure, the government will: (i) approve the required decree and establish/operationalize the institutional set up for national strategic planning of medium-term resource allocation;[m] (ii) through MOF, undertake further reforms to improve MTEF reliability for medium-term fiscal planning and accuracy against ultimate annual budget allocations; (iii) establish and enforce a common ledger of high-level (priority) KPIs to explicitly anchor all program budgeting results-focus, and approve a new template for national strategies to inter alia specifically operationalize this new standard of results-focus in any new sector strategy; (iv) through MOF (and its necessary instructions), mainstream gender-sensitive budgeting across	Performance indicator that is most directly attributable to reform area 1: 1.a For FY2025, 100% of new project investment allocations entering the MTEF have been cleared by Investment Committee meetings in line with PIM legislation (2020 baseline: 0%). Data source: MOF MTEF update report submission to Parliament. Performance indicators that are equally attributable to all reform areas (i.e., the overall program):

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
assessment with lessons and recommendations for action; (iv) MOF approved a budget program evaluation concept and pilot methodology (with full-fledged criteria for Relevance, Effectiveness, Efficiency, Impact and Sustainability) to raise allocative efficiency and enable evidence-based budget management flexibility, and launched three pilot evaluations to ongoing budget programs;[g] (v) To reduce regulatory arbitrage risks and tax compliance burdens on micro-sized enterprises while at the same time raising turnover tax revenue generation potential, the MOF circulated for interministerial review legislative proposals and regulations related to tax incentives and alternative tax systems (covering micro-entrepreneurship) to incentivize microbusinesses to move out of the presumptive regime while continuing to pay lower taxes.; (vi) To start integrating, into medium-term fiscal planning, the new public investment management governance, the MOF established a budget allocation in the MTEF (from FY2023 onwards) for the funding of feasibility studies that pass the Investment Committee stage; and (vii) To improve coordination and sequencing, and sustain the momentum in public budgeting reforms, MOF (a) restructured the Budget Department to transition from an expenditure-based focus to a sector-based focus (also establishing a Methodology Unit); and (b) piloted the establishment of a high-level Budget	all ministries from FY2024 onwards in a more relevant and effective way; (v) through MOF, approve the SDG budget tagging framework for full rollout in 2024 (this is to include a specific module for CC mitigation and adaptation tagging); (vi) submit to Parliament the necessary amendments to the tax code to rationalize the coverage of the micro-entrepreneurship tax regime and reduce regulatory arbitrage and the scope of application of tax privileges;[n] (vii) formalize, upon joint proposals by MOE and MOF, a permanent process through which the new PIM framework links up with the State Budget Process (and MTEF); (viii) through MOF, (a) approve and implement a time-bound Budget Reforms Roadmap for 2022–2024,[o] (b) perform its secretariat role to fully operationalize the high-level Budget Committee to monitor quarterly execution of the State Budget, (c) approve guidelines for (internal) performance reporting and audits, (d) circulate for interministerial review a concept for transformation of the internal audit system (fully acknowledging the trade-offs in centralized vs decentralized systems, and between outsourcing and internal capacity development challenges), and (e) start implementing reforms to the internal audit system in line with its concept; and (ix) Implement reforms to raise allocative efficiency and promote evidence-based budget management flexibility, inter alia, by having the MOF (a) formalize the establishment of the evaluation function, (b) perform evaluations to five additional budget expenditure programs, and on the basis of such evaluations and	b. Percentage of annual net domestic securities issuance in total public debt issued increased to 85% (2020–2021 baseline average: 50%). Data source: MOF reports. b. Term premium between policy rate and average lending rate in local currency (over 1 year) decreased to 300 basis points (end-2020 baseline: 750 basis points). Data source: CBA reports.

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
Committee to monitor quarterly execution of the State Budget and to govern significant reappropriations on the basis of MOF proposals. A Prime Minister Decree was approved to formalize the high-level Budget Committee;[h]	lessons, establish a new budget regulation mechanism (and guidance) to score budget programs and reappraise budget allocation decisions to ONGOING programs (and even discontinuation), (c) formulate and approve budget regulations to ensure that any new 'State Aid' proposals (real economy support programs) by line ministries meet the appraisal requirements of the Law on Protection of Economic Competition, of Government Decree No 46-L (on RIA), of the Law on Environmental Impact Assessment and Expertise, and of the Government Strategy on Green Economy Transition (if approved).	
1.2. To enable linkages between annual and medium-term budget and expenditure planning to climate change adaptation commitments and priorities, the government approved, by government decree, a national climate adaptation plan (2021–2025) identifying key principles to guide integration of climate adaptation into all policy and programming, including a principle on climate-aligned financial decision-making and management, and distributing institutional responsibilities for implementation across sectors;	2.2 To enable linkages between annual and medium-term budget planning to climate target and results, the government will: (i) approve a Financing Strategy and Investment Plan for their NDC to facilitate the broad engagement of relevant interministerial stakeholders towards the coordinated mobilization and targeting of global sources of CC Finance into public and private CC adaptation and mitigation efforts, and develop a Financing Framework for Climate Adaptation; (ii) Amend its National Strategy for Disaster Risk Reduction to eliminate contradictions and bring it in line with the Sendai framework for DRR (i.e., ensuring Armenia's planning coherence and optimization with both the Paris Accord and the Sendai Framework objectives); and (iii) start implementation of budget programs for DRR and for CC adaptation and mitigation (leading agencies: MOF, Ministry of Emergency	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
	Situations and Ministry of Environment) and develop detailed action plans for CC mitigation in at least three sectors;	
1.3. To raise the economic and social impact of overall public investments decisions and the fiscal sustainability of their implementation irrespective of the form of procurement, a high-level, fully-fledged public investment management (PIM) framework was established (through two PM decrees)[i] and operationalized by government (through MOE instructions),[j] to be governed by a quantitative and qualitative multicriteria framework for project prioritization that includes, inter alia: (i) disaster and CC risk adaptation and mitigation objectives embedded in the key identification and prioritization criteria, (ii) full integration with the PPP operational framework, and (iii) integration with medium-term fiscal planning and the State Budget process;	2.3 A post-investment monitoring system and institutional function will be developed and implemented to allow better identification of (i) cases of cost overruns and their causes, and (ii) cases of non-execution or of low execution of projects. Separately, the Government will approve and implement: (a) new PIM Government Decree to raise the legal standing of its mandatory requirements, (b) a comprehensive PIM Manual/Handbook (through MOE), after the formal evaluation of the experience in implementing the 2021 PIM decrees, to be complemented by (or to include) an integration of methodologies to valuate (quantify) CC adaptation and mitigation benefits, and (c) comprehensive technical guidelines for mainstreaming CC mitigation and adaptation, and DRR into public investment (leading agency: MOE);	
1.4. To establish, inter alia, a dedicated PPP procurement mechanism under secondary legislation for the PPP Law, and ensure that all new PPP projects must first be identified, evaluated, prioritized and selected through the procedures set in new PIM framework of the Government, the Public Procurement Law and the PPP Law were amended by Parliament, and the PPP Procedures Decree (the main secondary legislation to the new PPP Law) was approved by Government.[k] In	2.4 All new PPP Guidelines required to implement the PPP Procedures Decree will be established through MOE orders, and enforced. To ensure fiscal sustainability, transparency and reduce possible biases towards off-budget solutions, the Government will standardize (in terms of reporting and accounting) the treatment to all fiscal liabilities, towards enabling a linkage with the fiscal rule. On the basis of methodological proposals and long-term fiscal projections, government (upon submission by MOF and consultations with MOE) will	

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addition, to establish a full-fledged risk vetting and monitoring framework for PPPs towards future full integration with the fiscal rule, and to complete the operational framework for PPPs, government approved: (i) A 'PPP Contingent Liabilities' Government Decree (with methodologies and tools for identification, assessment and calculation of risks and reporting in State Budget documentation, as well as requirements for benchmarking against PPP "fiscal affordability" ceilings); (ii) More detailed methodological guidelines and tools—in consistency with the new PPP CLs Govt Decree; and (iii) Two government decrees to establish PPP "fiscal affordability" ceiling mechanisms for both contingent liabilities and direct liabilities;	approve legal proposals to align budgetary system law with the Public Debt Law to explicitly link up the (stock) PPP "fiscal affordability" ceiling to the debt ceiling of the fiscal rule; 2.5 The MOF will produce a financial protection plan recommendation (i.e., an integrated and coherent set of adaptation/mitigation measures, including estimation costs, that is to serve as a crucial coordinated reference for line ministries' action) against disasters derived at least from geological and hydrometeorological hazards, taking into account CC uncertainties (with reference costing of baseline scenario);	
1.5. To improve financial transparency and start strengthening the centralized fiscal monitoring of SOEs: (i) the amendments to the laws on accounting (i.e., issues of Financial Accounting, regulation of Accounting and Audit activities) were enacted by Parliament ensure all SOEs above a specific size threshold (and other large companies) are obliged to have their financial reports audited; and (ii) the Fiscal risks management function at MOF (FRSD) established and operationalized the collection of financial information on all SOE a new SOE database, including financial SOEs, and	2.6 To improve financial transparency, strengthen centralized fiscal monitoring and oversight of, and establish corporate governance and operational performance in SOEs, the: (i) Government—through MOF—will upgrade the compliance monitoring functions for SOEs' publication of audited financial statements (e.g., a new separate corporate web portal/ registry becomes operational);[p] (ii) Government will amend the decree that sets oversights functions on SOEs to (a) rationalize the current institutional set up between State Property Management Committee and MOF's dual roles (FRM, dividend collection), (b) streamline MOF's access to financial	

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ensures it remains current at 2022 (i.e., already includes 2021 data) 1.6. To promote fiscal transparency and continue sustaining the ongoing institutional strengthening efforts into a more comprehensive and integrated FRM function at MOF (now already including the covering of disaster and CC risks): (i) the MOF (through the FRMD) significantly upgrades the comprehensiveness of its disclosure of fiscal risks (by publishing more comprehensive Fiscal Risks Statements for the 2021 and 2022 budget laws), now presenting (a) a calculation of headline contingent liability exposures to major SOEs and selected PPPs (including PPAs), (b) a discussion on key fiscal risks, and (c) an explicitly acknowledgment and quantification of fiscal risks deriving from disaster risk and CC (the MOF also produced the first two MTEF updates with a report on fiscal risks deriving from disaster risk and CC); (ii) the MOF established internal periodic comprehensive reporting of PPP Contingent Liabilities (including the operationalization of a PPP fiscal commitments database and risk assessment matrixes for each PPP) as a "living-document" analysis application of the newly approved methodologies (presenting a more detailed calculation of contingent liability exposures per risk category and selected PPPs [including	information; and (c) align performance appraisal to target efficiency gains; and (iii) The Government will, through a separate decree, (a) approve that the new corporate Governance code is made mandatory to SOEs above a specific (size) threshold (including mandatory compliance reporting), and (b) establish and operationalize, through a specific institutional location, compliance monitoring functions for corporate governance requirements; 2.7 To reduce fiscal inefficiencies and promote impact in direct forms of investment promotion, Government will undertake a comprehensive policy review of state-owned equity funds and other financial SOEs and bring them under a new Ownership Policy orientation, with: (i) binding strategic mandates (and sector focus/investment policies) that eliminate crowding-out of the private sector, and provide a value-for-money rationale for their existence. This is to be complemented by operating procedures that rationalize activities solely on the basis of addressing market failures; (ii) transparency with regards to their use of state-allocated resources, scope of operations and performance indicators (with introduction of performance reviews); (iii) fundamental aspects of corporate governance (including the need to refrain from influencing policy and legal setting, and introducing mandatory reporting regarding such cases); (iv) operational policy/standard operating procedures that rationalize activities solely on the basis of addressing market failures;	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
PPAs] than what was included in the 2021 State Budget law documentation), to serve as the basis for any MTEF annual update or annual budget submission; and (iii) the MOF approved the updated Fiscal Risk Management Roadmap for 2022–2023, charting the objectives to, by end-2023 and inter alia, achieve: (a) full operationalization of the ‘Vetting’ and ‘Mitigation Recommendations’ functions, and (b) systematic coverage of all material sources of risk, including ‘Budgetary Lending’, ‘State Guarantees’, ‘Legacy PPPs and PPAs’, ‘disasters caused by natural and man-made hazards (including biological and technological) and from CC’, and ‘potential environmental liabilities of the State’. 1.7. To promote more effective, efficient and transparent procurement practices while also embedding key	(v) clear requirements for external financial audits; and (vi) all state-owned equity funds and other financial SOEs that are instruments of investment promotion are brought under the ownership oversight (and policy coordination of MOE); 2.8 To establish a transparent governing framework for PPP renegotiations (for pre-PPP Law PPPs, i.e., “legacy” PPPs) and amendments to other long-term contracts, Parliament will approve the necessary legal amendments (to e.g., the Law on Budget Process); 2.9 In addition to sustaining the upgrades in public disclosure of fiscal risks of 2021–2022 into 2023–2024, to establish the legal anchoring for MOF’s FRM responsibilities and function and strengthen its systemic relevance: (i) Parliament will approve legal amendment proposals to inter alia introduce the Fiscal Risks Management Council as well as Staffing Certification Requirements; (ii) MOF will activate the fiscal mitigation function of FRM (through regular periodic production of fiscal risks mitigation reports where risk mitigation actions are specifically recommended and followed-up on in subsequent reports); and (iii) the Government will formalize and operationalize an inter-institutions mechanism ensuring that all relevant State Bodies and relevant MOF Depts contribute with the necessary information to a fully functioning Integrated FRM Framework; 2.10 Government will approve any necessary procurement reform legislation changes and start	

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CC action objectives, a Procurement Development/Reform Concept was approved by PM Decree, to include (i) analyses of the feasibility of introducing green procurement, and (ii) proposals for the standardization of procurement packages in the recurrent budget;	implementing the approved action plan, to include (i) the feasibility assessment work to introduce green procurement, and (ii) the implementation of the standardization of procurement packages in the recurrent budget;	
1.8. To formulate green economy policy and align economic policy tools with climate mitigation and adaptation targets: (i) the MOE issued for the review of co-implementing ministries a proposed concept for ‘Green Economy Transition’;[l] (ii) the MOE created an operational unit dedicated to the Green Economy Transition and operationalizes it;	2.11 Government approves: (i) the national strategy on 'Green and Sustainable Economic Development' (including implementation arrangements), and (ii) the concept paper (by legal decree) and the implementation action plan (Minister’s order) for establishing the preconditions for 'circular economy' activities;[q]	
1.9. Government's debt management implementation and medium-term strategic communication to the markets aligned further to continue reducing public debt exposures to exchange rate risk and develop the domestic government securities market, while institutional mechanisms were designed to gradually insulate the government securities issuance program from short-term macroeconomic risks. These were achieved through the following reform and institutional upgrade efforts: (i) Submission by Government to Parliament of proposed legal amendments to the Law of the Treasury System and the Law on Budget System to Parliament in order to ensure that the Stabilization Account strictly acts as a government debt refinancing risk management and a countercyclical stabilization support mechanism with good governance; and	2.12 The MOF will: (i) implement the MTDS, 2022–2024, within its benchmark targets for refinancing risk, interest rate risk and exchange rate risk, with minimal deviations; and through the approved MTDS for 2023–2025, it will: (a) raise further the objectives in terms of reduction of exchange rate risk (and projected structure of deficit financing through domestic and external net borrowings), and (b) improve the exchange rate risk benchmark indicators (i.e., the share of public domestic debt in total debt and the share of dram denominated debt in total debt to be minimum 30%); (ii) submit legal amendment proposals to government for upgrading the Public Debt Law to address identified shortcomings; and	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
(ii) MTDS (2020–2022) was implemented within its benchmark targets for refinancing risk, interest rate risk and exchange rate risk (with minimal deviations), and the approved MTDS (i.e. for 2021–2023) (a) raised the objectives in terms of reduction of exchange rate risk (and projected structure of deficit financing through domestic and external net borrowings), and (b) improved the exchange rate risk benchmark indicators (.e. the share of domestic debt in total debt and the share of dram denominated debt in total debt to be minimum 25% instead of minimum 20% envisaged by the previous strategy.	(iii) subsequently to the approval by Parliament of legal amendments to the Law of the Treasury System and the Law on Budget System, submits to government any necessary decree (or any other implementing legislation that may be necessary) to regulate the process of replenishment and utilization of the Stabilization Account.	
Reform Area 2: Improving government securities market and money markets infrastructure		
1.10. To keep reform momentum and strengthen coordination and joint action towards financial and capital markets development, the: (i) Government approved and commenced implementation of a Capital Markets Development Program (jointly prepared by CBA, MOE and MOF); (ii) MOE established a Capital Markets Development Division to take on the coordination role for overall implementation; and (iii) MOF (PDMD) implemented the following money markets development and systemic liquidity management-enabling practices: (a) New issuance program of 6-months securities as benchmark was initiated and ramped-up (as the main issued security) to increase its benchmark reference for other segments of the	2.13 The Government will ensure the implementation of the Capital Markets Development Strategy time-bound action plan will remain on track, and specifically implement the following sub-actions: (i) the MOE will publicly disclose the status of implementation of the Capital Markets Development Strategy; (ii) the MOE circulates for interministerial review legal and regulatory reform proposals to promote the development of private equity and venture capital industries; (iii) to smooth the debt redemption profile further and decrease refinancing risk spikes, the MOF will continue all necessary issuance practices and forms of active debt management (e.g., buybacks/exchanges), and ensure that bond switch auction options become fully operational on the AMX platform; and (iv) the PDMD (MOF) will widen its role in the coordinated liquidity forecasting framework with	Performance indicators that are most directly attributable to reform area 2: 2.a Trading Turnover in government bonds (secondary market transactions at both AMX and OTC, in volume) in percentage of nominal GDP increased to 9% (2019 baseline: 6.9%). Data source: AMX and MOF reports. 2.b Demand to placement ratio for government bonds

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
capital market and increase liquidity in repo (interbank) markets; (b) While continuing buybacks (and other forms of active debt management), initiated exchanges (of the off-the-run government treasury securities) aimed at accelerating the smoothing of the government debt redemption profile, at decreasing clustered refinancing risks, and at improving liquidity management; (c) Technical specifications were finalized by MOF and AMX to enable the implementation of bond switch auctions; and (d) PDMD (MOF) widened its role in the coordinated liquidity forecasting framework with CBA by adopting a new cash forecasting responsibility and framework/template for FX cash-flow data to more effectively support CBA's systemic liquidity management efforts;[r]	CBA, by also obtaining the necessary tax revenue forecasts and integrate these information flows and routines to more effectively support CBA's systemic liquidity management efforts and contribute towards reducing interbank rates volatlity;[t]	reaches 2.5 (2020 baseline: 1.7) Data source: MOF reports.
1.11. To establish truly secured interbank markets in Armenia and significantly improve liquidity in money markets, the following sub-actions were implemented: (i) Amendments to the civil code were approved by Parliament to resolve, inter alia, re-characterization risks in repo transactions (and other issues that are key for the ICMA -certified GMRA Legal Opinion); (ii) CBA approved the necessary amendments to its regulations to ensure GMRA applicability in Armenia to all counterparties; and	2.14 To promote the systemic relevance of money markets to the Armenian financial system, the CBA will: (i) implement market-moving and/or regulatory initiatives to promote the transition in the financial sector towards the GMRA,[u] (ii) take measures for implementing GMRA in its open-market operations, (iii) Implement any necessary measures to enable interbank interest rate benchmarking (O/N) to become feasible, and (iv) will establish and fully operationalize the new money markets trading platform.	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	**Policy Actions: Subprogram 2**[c] (October 2022 to March 2024)	**Outcome Indicators** (by end-2025, unless stipulated otherwise)
(iii) CBA obtained ICMA-certified GMRA Legal Opinion (duly published in ICMA's website to establish financial markets recognition of GMRA applicability in Armenia to all counterparties).[s]		
Reform Area 3: Broadening the base of financial instruments and investors, and enhancing corporate transparency		
1.12. To promote new financial instruments and investors, the following sub-actions are implemented: (i) Parliament approved legal amendments to the law on 'Currency regulation and Currency Control' to encourage corporate debt issuances and enable flexibility in the currency denomination of repo contracts' settlement; (ii) CBA amended its regulations to introduce clearer rules for market-making in corporate bonds in line with international best practices; (iii) CBA implemented a new regulatory framework to (a) address regulatory gaps and eliminate uncertainties with derivative instruments, and (b) promote participation of foreign institutional investors in the local debt markets; and (iv) Parliament approved amendments to the Law on the Joint-Stock Companies to enable the issuance of common shares of various classes, etc.;	2.15 . To promote new financial instruments and investors, the following sub-actions are implemented: (i) To promote international integration of Armenia's capital markets, the MOF and CBA will approve and implement solutions to establish nonresidents' easier (and direct) access to the government securities market in Armenia (onshore or offshore); and (ii) Parliament will approve amendments to the Law on Joint-Stock Companies (and instruct for the approval of adjacent regulations) to e.g.: (a) promote project finance, by clarifying the separation between ordinary and preferred shares, and aligning the rules governing negative equity balance with the insolvency legislation; (b) enable corporate governance policy setting, by giving government the authority to set corporate governance requirements (namely MOE). Subsequent to the latter, the new corporate governance code (setting, inter alia, a minimum 30% of women in management boards) will be approved by Government Decree;	Performance indicator that is most directly attributable to reform area 3: 3.a Corporate securities trading turnover at the stock exchange (including AMX outright trading and 'Addressed Deals'), in % of GDP, reached 3% (2020 baseline: 0.44%). Data source: AMX annual reporting and direct queries.
1.13. To pre-empt financial stability risks and ensure market integrity and sustainability in the potential proliferation of green finance instruments, the CBA formally launched and operationalized a working group to study options for the development of green finance and assess if climate chance risks to banking stability justify a specific adjustment to the current regulatory approach;	2.16 To pre-empt financial stability risks and ensure market integrity and sustainability in the potential proliferation of green finance instruments, the CBA[w] will: (i) adopt a Roadmap for Sustainable Finance in Armenia with time-bound actions and milestones; and	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	Policy Actions: Subprogram 2[c] (October 2022 to March 2024)	Outcome Indicators (by end-2025, unless stipulated otherwise)
	(ii) introduce an integrated framework of corporate reporting standards on ESG to its supervisees, and issues proposals on a new framework to certify banks' green finance internal tagging and classification frameworks (to address risks of green washing);	
1.14. To fundamentally enhance corporate transparency conditions in Armenia and establish proper governance and effectiveness in the professions that underpin it, the following set of reform activities was implemented: (i) Parliament approved amendment proposals to the Laws on Accounting and Audit, and a new proposed Law on Regulation and Public Oversight of Audit and Accounting to delegate key regulatory functions to a POB and the prospective CAAA. This includes legislative proposals such as mandatory audits. This new legal architecture enters into force; (ii) The POB was created and operationalized, to be lead by MOF and with members from MOE, CBA and State Revenue Committee. Private sector stakeholders participate with consultative vote rights. Secondary legislation was approved to define the procedure for registration of auditors, expert accountants, and audit organizations. The electronic register was established; and (iii) The POB, chaired by the MOF, approved and endorsed the use of a simplified manual of financial reporting by micro-sized enterprises in Armenia;[v] and	2.17 The Monitoring guidelines on quality assurance of audit companies, auditors and expert accountants, and the methodology and operational procedures for the oversight of PAOs will be established; and	

Prior Actions: Subprogram 1[b] (Completed; November 2019 to September 2022)	Policy Actions: Subprogram 2[c] (October 2022 to March 2024)	Outcome Indicators (by end-2025, unless stipulated otherwise)
1.15. To continue establishing a more effective insolvency regime and stronger protection of creditor's rights: (i) amendments to the Bankruptcy Law were approved by Parliament to provide additional and effective mechanisms for maximum satisfaction of creditors' claims. In particular, the law provides the procedure for declaration of the debtor's property, the inventory of debtor's property. Procedures for the realization of the object of a secured right have also been clarified and made more cost efficient (e.g., the amount of the administrator's remuneration has been reduced) and (ii) an e-bankruptcy system (e.g., for selecting candidates of bankruptcy administrators) has also been procured by the Ministry of Justice.	2.18 To continue strengthening the insolvency regime and the protection of creditor's rights: (i) The Ministry of Justice will launch and fully operationalize the e-bankruptcy system; and (ii) The Ministry of Justice and the CBA will formalize a joint effort to diagnose issues in the Armenian bankruptcy regime to identify future reform efforts, namely in the fields of financial rehabilitation and sale of assets, and circulate a New Insolvency Code for interministerial review and consultations.	

Budget Support
ADB: $100 million for Subprogram 1, and $50 million for Subprogram 2 (indicative)
AFD: €100 million for Subprogram 1, and €50 million for Subprogram 2 (indicative)

ADB = Asian Development Bank, AFD = Agence Française de Développement; AMX = Armenia Stock Exchange, CAAA = Chamber of Expert Accountants and Auditors of Armenia, CBA = Central Bank of Armenia, CC = climate change, DRR = Disaster Risk Reduction, ESG = Environment, Social and Governance, FRM = fiscal risk management, FRMD = Fiscal Risk Management Department, FY = fiscal year, GDP = gross domestic product, GMRA = Global Master Repurchase Agreement, KPI = key performance indicators, ICMA = International Capital Market Association, MOE = Ministry of Economy, MOF = Ministry of Finance, MTDS = Medium-Term Development Strategy, MTEF = Medium-Term Expenditure Framework, NDC = Nationally Determined Contribution, NGO = non-governmental organization, OTC = over-the-counter, PAO = professional accountancy organizations, PDMF = policy design and monitoring framework, PIM = public investment management, POB = Public Oversight Board, PPA = power purchase agreement, PPP = public–private partnership, R = risk, SDG = sustainable development goal, SOE = state-owned enterprise.

[a] Government of Armenia. 2021. Programme of the Government of the Republic of Armenia, 2021–2026. Annex to Decision of the Government of the Republic of Armenia 1363-N of 18 August. With 'Security' and 'Diplomatic Relations' issues set upfront as a first pillar, the more conventional body of the strategy comprises five pillars: Economy (pillar 2), with emphasis on tradables (including one tradable service sector: Tourism), SME development and business climate reforms as objectives (there is also an important acknowledgment that export diversification and development are crucial for Armenia's growth development); Infrastructure development (pillar 3), with specific project references in energy, transport, etc.; Human capital development (pillar 4), with references to employment and social protection reforms, health reforms, education reforms; Law and Justice (pillar 5), with anticorruption and judicial reforms; and Institutional Development (pillar 6 – see description in the para. 29 of the main text).

[b] In Armenia, when government/Parliament approve a legislative/regulatory proposal, it enters into force very shortly after (it is strictly governed by formalized practice), unless a specific provision in the legislation aligns it with the annual fiscal cycle for a well-justified reason (in which case, the new rules enter into force

from January 1 of the following year). The same principles apply to any form of secondary legislation (i.e., government decree, PM decree, government approval of strategies, ministerial orders or regulations).

[c] Under the programmatic approach the RRP for the first subprogram 1 should present in its PDMF the indicative policy actions for subsequent subprograms. The programmatic approach allows a degree of flexibility, but any substantive change from original indicative actions in the preceding subprogram to prior actions of the current subprogram should be presented and justified in the RRP.

[d] The MOF (a) established a complete internal mapping of objectives and indicators of existing strategic documents (i.e. Government action plans and current budget program's objectives and indicators across government) to identify current gaps in links and in budget outcome indicators, (b) issued the interministerial circular with the mapping framework and instructions for line ministries' corrections in their forthcoming budget submissions, and (c) indicated the timeline for publication/issuance of corresponding methodological guidelines and training.

[e] The MOF approved and issued to all line ministries new guidelines (with immediate effect) on MTEF preparation and FY2023 Budget, by inter alia: (a) redefining timeline requirements of existing budget programs/measures include in new budget proposals; (b) requiring all budget proposals to justify the link between both existing programs/measures (expenditure commitments) as well as new proposed initiatives, and the sectoral strategic documents and the Program of the Government of the Republic of Armenia 2021–2026. (c) requiring information on compliance of budget programs with strategic documents, defined goals, achievement progress, program content, structure and outcomes. (d) requiring each competent authority's budget message on expenditure programs to focus on the program classification of budget expenditures' objectives and outcomes; (e) requiring a restoration of logical frameworks of programs and measures from "applicants", so that line ministries review and clearly show how each program and measure contributes to the achievement of their ultimate objective.

[f] Ministry of Labor and Social Affairs and Ministry of Health.

[g] Education - Safe School Program; Agriculture - Agriculture Modernization Program; Administration - Aviation Control and Regulation Program.

[h] Aside from the monitoring of quarterly execution of the State Budget and the forming of decisions to govern reappropriations, the Budget Committee will also be consulted for more significant annual budget decisions as performance evaluation results start providing evidence of impact and effectiveness. The Budget Committee will also be consulted: (i) for meeting any unexpected demand upon the resources of the state when such resources cannot be forecasted at the time of budget preparation; (ii) before MOF moves any proposals for any exceptional grant which forms no part of the current service in the financial year; (iii) before MOF moves any supplementary adjustments in the budget (e.g., if the amount authorized in accordance with the budgetary provisions to be expended for a particular service for the current financial year is found to be insufficient for the purpose of that year or when a need has arisen during the current financial year for supplementary or additional expenditure upon some new service that was not contemplated); (iv) as part of its oversight role regarding the overall sanctity of the budget exercise (e.g. ensure that re-appropriation from a Revenue expenditure head to a Capital expenditure head and vice versa is not permissible or to examine specific cases where expenditure has been incurred without the corresponding budgetary approvals); (v) whenever it is important to (a) advise line ministries and departments to regularize specific cases where excess expenditure has been incurred on the basis of supporting evidence and justification warranting such expenditure; and (b) help MOF identify line items where there is persistent savings and ascertain reasons behind such occurrences. This will help to better allocate resources among other competing agencies.

[i] Through the necessary Prime Minister decrees, and to ensure an effective gateway for public investment prioritization and approval — in complete integration with the new PPP operational framework and with a key role for MOF, the Government established: (a) a new framework for Public Investment Management (PIM), with mandatory nature to all investment projects above a minimum size threshold, ensuring that only project concepts duly scored can be submitted to the Investment Committee, (b) a coordinating role for MOE, and (c) the Investment Committee (composition and decision-making) chaired by Prime Minister.

[j] A set of PIM Instructions was approved to (a) establish an early-PPP bankability test (for indicative purposes only), and (b) govern the scoring of public investment proposals along a new multicriteria framework, with the following: (1) Impact on Human Capital (through a matrix that considers issues like impact on child survival, increase in expected years of schooling, improvement of quality of school education, quality of graduate education, improvements of skills of adult beneficiaries, increase in life expectancy, and capacity of generation of income of beneficiaries, etc.); (2) Criticality of the Infrastructure (through a matrix that considers issues like whether the asset is essential for the life of direct beneficiaries, if it is highly demanded by the community with strong grounds that usage volumes will be close to its capacity, if it contributes to disaster risk mitigation or personal safety of beneficiaries, etc.); (3) Alignment with sector-specific strategy (through a matrix that considers ways of ensuring strategic alignment is strictly followed, and Climate Change mitigation and adaptation decrees signed by Prime Minister are taken into account; (4) Level of risk (through a matrix that considers whether risks are properly identified, if risks identified have been quantified in their impact, if there are mitigation measures in the scope of the project, if the implementing agency has experience in similar projects, etc.); (5) EIRR Calculation (through a scoring matrix that e.g. attributes zero points to projects with EIRR below the benchmark of the Government).

[k] The new PPP Procedures Decree, inter alia: (a) establishes regulatory solutions that are consistent with best practice and take into account the still-weak institutional capacity of Armenia to assess PPP risks, project and implement a PPP pipeline, or monitor its implementation; (b) mitigates key risks produced in the legal amendments of June 2021 on USPs, by ensuring that UNCITRAL guidance on intellectual property and innovation is adhered to in terms of the scope for USPs.
[l] 'Green Economy Transition' understood as the process of economy transformation away from economic activities with high carbon footprint and towards activities with low carbon footprint or activities of strategic importance to such transition.
[m] To ensure medium-term resource allocation follows explicit alignment requirements of national strategic planning.
[n] The MOF will also (i) submit the necessary proposals for approval of a tax treaty policy framework, including a model tax treaty, to guide the scope and substance of tax treaties that Armenia negotiates with other countries in order to relieve double taxation and reduce tax evasion and avoidance in cross-border transactions and investment, (ii) approve a systematic and standardized framework to analyze and assess the cost-benefit of tax incentives and estimate and report foregone revenue (through tax incentives), (iii) adopt and implement the reform plan to meet minimum standard in the G20's base erosion and profit shifting (BEPS) inclusive framework by (a) completing a self-assessment of existing preferential tax regimes, and (b) assessing the gaps found in double tax treaties against the BEPS standard.
[o] This roadmap is to include the initiation of reviews to program structures and content, specific measures to empower program managers, and building in-house capacity at MOF for both audit and evaluation (general inspectorates).
[p] The CAPEX requirements for this will be studied. Financing support from ADB and/or AFD will be crucial for its implementation.
[q] Broadly defined as economic production processes and relationships focused on maintaining natural resources longer in the economic cycle.
[r] PDMD initiated the provision of foreign exchange cash-flow forecast for other flows of the State Budget for the next 3 months with weekly disaggregation and provides it to CBA with debt flow foreign currency forecasts to CBA.
[s] Obtaining the legal opinion, having it accepted and published by ICMA, and making it publicly available is the culmination of the legal reform process and the beginning of the market-moving phase of the reform.
[t] The tax data part of the liquidity forecasting template shall be coordinated with the State Revenue Committee separately, and based on which the new expected weekly revenue flows for the next three months calculated and shared by MOF with CBA as part of its new weekly 3-month forecast updates (with daily disaggregation of the first four-week periods).
[u] This may include the necessary differentiated treatment in prudential regulation to promote adoption of GMRA by all regulated counterparties.
[v] This is expected to lead to spontaneous and widespread adoption of this new financial accounting and reporting tool across a large section of the private sector in Armenia, in good part without the need for firms to hire accounting professionals. The Chamber of Accountants and Auditors of Armenia will undertake training activities (ADB will be exploring support for deploying training for women-led microenterprises), but no follow-up policy action is needed in subprogram 2.
[w] As a result of recommendations of the Working Group.
Source: Asian Development Bank.

Contribution to Strategy 2030 Operational Priorities: Operational priority indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).
Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS
http://www.adb.org/Documents/RRPs/?id=55103-001-3

1. Loan Agreement
2. Sector Assessment (Summary): Finance (Money and Capital Markets) and Public Sector Management (Public Expenditure and Fiscal Management)
3. Contribution to Strategy 2030 Operational Priorities
4. Development Coordination
5. International Monetary Fund Assessment Letter[1]
6. Summary Poverty Reduction and Social Strategy
7. Risk Assessment and Risk Management Plan
8. Program Economic and Impact Assessment
9. List of Ineligible Items
10. Management-Approved Concept Paper: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to Armenia for the Fiscal Sustainability and Financial Markets Development Program
11. Matrix of Potential Environmental and Social Impacts and Measures
12. Climate Change Assessment

[1] The International Monetary Fund (IMF) confirmed on 21 July 2022 that the attached public release of 27 June 2022 may serve as the International Monetary Fund Assessment Letter. Also attached is the Press Release of the IMF Executive Board completion of the Sixth and Final Review under the Stand-by Arrangement with Armenia.

DEVELOPMENT POLICY LETTER

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MINISTRY OF FINANCE OF THE REPUBLIC OF ARMENIA
MINISTER
МИНИСТЕРСТВО ФИНАНСОВ РЕСПУБЛИКИ АРМЕНИЯ
МИНИСТР

0010, Երևան, Մելիք-Ադամյան փող. 1
0010, Ереван ул. Мелик-Адамяна 1
1 Melik-Adamyan str., Yerevan, 0010
www. minfin.am
E-mail: secretariat@minfin.am
Phone: (+374 11) 800 002

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DEVELOPMENT POLICY LETTER

To: Mr. Masatsugu Asakawa
President of Asian Development Bank
Manila, Philippines

Subject: Fiscal Sustainability and Financial Markets Development Program– Subprogram 1

Dear President Asakawa,

On behalf of the Government of the Republic of Armenia we would like to express our appreciation for the support of the Asian Development Bank (ADB) to our reform efforts and development agenda.

This letter outlines Armenia's recent economic developments; provides information on our development strategy and provides information on how the proposed Fiscal Sustainability and Financial Markets Development Program contributes to strengthening of fiscal sustainability and financial markets through reforms in the areas of public finance and money markets.

A. Armenia's Recent Economic and Fiscal Performance

Armenia's macroeconomic policies remain sound and solid. With the lagged effects of the 2020 fiscal response (and a neutral stance in 2021), and despite two waves of COVID-19 and the heightened political uncertainties that resulted in snap elections in June 2021, the economy grew by 5.7% in 2021. Growth in 2021 came mainly from recovery in services, increased investment, and strong remittances that boosted private consumption.

Despite the challenging external environment, the Armenian economy managed to maintain the stability in the first half of 2022, with limited implications on economic fundamentals. Reflecting a buoyant aggregate demand, the economy grew by a strong 11.0% in the first half of 2022, as compared with 3.8% growth in the same period of 2021. On the supply side, services propelled expansion with solid growth by 16.3%, reflecting increases in all subsectors but led primarily by vigorous expansion by more than 25% in finance, transportation, hospitality, and information and communications services. Industry expanded by 4.6% as gains in manufacturing, electricity generation, and water and waste management outweighed 11.1% decline in mining and quarrying. Construction grew by a robust 21.9%, reflecting higher investment. Less favorable weather in the first half caused agriculture to shrink by 1.8%. On the demand side, private consumption rose by 10.4%, reflecting unusually large inward money transfers. Public consumption contracted by 2.7% as current fiscal expenditure tightened. Gross fixed capital formation, grew by 17.6% on higher government and private capital spending. With robust economic activity in the first half of the year, we, we expect that the economy will grew by more than 7.0% in 2022.

Fiscal policy adheres to the government's medium-term budget framework, which envisages continued fiscal consolidation over the medium term and gradual increase in the share of capital expenditure to support growth, while reducing the ratio of government debt to GDP below the 60% ceiling in Armenia's fiscal rule. The budget deficit narrowed to 4.6% in 2021 from 5.4% of GDP in 2020 and versus the 5.3% target in the 2021 budget. Economic growth, higher revenue collection and prudent spending allowed to reduce public debt to 63.4% of GDP in 2021 from 67.4% of GDP in 2020. External public debt declined by about 10.8% to equal 45.7% of GDP. Domestic public debt increased by 24.3% to equal 17.7% of GDP and, in line with government efforts to gradually increase the domestic share, minimum 30.0% of **government** debt.

The current account deficit widened slightly to 4.0% of GDP in 2021 from 3.8% in 2020, as wider trade deficit was partially offset by higher personal transfers, and a larger surplus in services. Gross international reserves rose by 23.5% to $3.2 billion at the end of 2021, cover for 6.3 months of imports of goods and services.

Monetary conditions remain stable. Buoyant domestic demand, rising global commodity prices, and the pass-through effect of higher electricity tariffs from February 2022 and natural gas price hikes from April 2022 all propelled the acceleration of inflation in the first nine months of the year. To counter inflationary pressure, the central bank tightened monetary policy, raising the policy rate by 175 basis points in three steps to 9.5% in June 2022.

B. Development Strategy

We remain strongly committed to our reform agenda. Our development agenda and reform efforts are currently guided by the following overarching strategic documents:

i) Armenia Transformation Strategy 2050
ii) The government program for 2021-2026 approved by the Parliament in June 2021
iii) The action plan for implementation of the government program for 2021-2026, approved by the Government in November 2021.

The Armenia Transformation strategy 2050 serves as the basis for our medium-term, sectoral and other program documents. The strategy sets 16 mega-goals for country's transformation by 2050: educated and capable nation and citizen; protected Armenia; efficient and accountable public governance; healthy and secure nation and citizen; prosperous family with many children; Armenia governed by rule of law; mass export of manufactured production; clean and green Armenia; rational territorial development; mass repatriation and integration; globally connected Armenia; productive and responsible farming; renewable energy accessible to public; business-attractive Armenia; knowledge-based Armenia; and recognized, respected and hospitable Armenia.

The government's program for 2021-2026 was developed and approved following the snap Parliamentary elections in June 2021. Within the program we envisage broad ranges of reforms across six areas: (i) security and foreign policy, (ii) economy, (iii) infrastructure development, (iv) human capital development, (v) law and justice, and (vi) institutional development. The action plan for implementation of the government program lists all actions and set deadlines across all areas of our reform agenda over the next five years.

The Government of Armenia recognizes the importance of the agenda of the climate change to the country's development. Armenia's Nationally Determined Contributions 2021-2030 (approved in 2021) demonstrates not only our increased climate ambitions, but also sets country's approach of rethinking of economic development patterns and accelerating actions towards the transition to a more sustainable, resilient and low-carbon economy. Armenia formally joined the Nationally Determined Contributions Partnership in 2018. Through this partnership, Armenia has been receiving targeted and coordinated technical assistance, but a wide array of efforts is still needed to reflect climate change national and sectoral development policies into actual implementation of mitigation and adaptation projects.

Armenia's recent high-level formal decisions on climate change action shows the country's strong commitment to climate change mitigation and adaptation measures, identifying its targeted efforts in national greenhouse gas reduction efforts. In Armenia, key sectors identified for adaptation action include: natural ecosystems, human health, water resources management, agriculture, forestry, and fisheries, energy, human settlements, infrastructure, and tourism. As access to financial support in bilateral and multilateral formats remains crucial to support Armenia in meeting its adaptation goals and climate change commitments. The rapid onset and long-term changes in key climate parameters, as well as impacts of these changes on communities, livelihoods and economies, are already underway. Due to a combination of political, geographic, and social factors, Armenia is recognized as vulnerable to climate change impacts, ranked 57th out of 181 countries in the 2020 ND-GAIN Index. It is crucial to design reforms in fiscal management and financial sector policy to support the achievement of the government's mitigation and adaptation objectives. Without key fiscal management mechanisms, might not have the capacity to systematically implement its climate change action priorities. Similarly, without new financial sector policy upgrades, much of the private sector potential contribution to climate change mitigation objectives could remain unfulfilled.

Armenia has also made significant progress in its measures to counter corruption. We have introduced ambitious reform programs in several areas in an attempt to improve the legal and institutional framework for safeguarding transparency, integrity and efficiency of the public systems. Armenia's progress in strengthening anticorruption policies and systems has been widely recognized, an agenda that has been speared by the government's Anticorruption Council but supported at the highest level of government. Armenia has also steadily improved its budget credibility, comprehensiveness and transparency. This steady progress has been followed by other upgrades along the country's comprehensive PFM reform strategy. Going forward, we expect the recently-approved Tax Revenue Management Program for 2022-2025 to be an effective roadmap towards a more effective and transparent tax system, and the recently-approved Public Administration Reforms Strategy (2022-2024) to help Armenia's public sector and public institutions raise governance and public sector effectiveness.

C. Reforms Priorities in public finance and financial markets

We have made substantial progress over the past years in improving sustainability, transparency and predictability in our public finances through reforms in the areas of public financial management and financial and money markets. In this context, specific achievements under ADB's past policy-based loans - Public Efficiency and Financial Markets program (with two subprograms in 2018-2019) and Second Public Efficiency and Financial Markets Program (with subprogram 1 in 2020 followed by Post-program Partnership Framework in 2021-2022) were indeed crucial.

To achieve the above mentioned the RA Government program for 2021-2026 program envisages the following actions:

In the field of state expenditures (Pillar 6 of the government program- Institutional development)

The strategic objectives of reforms in the system of public finance management will be aimed at showing the best result of the public management system and providing quality public services to the society, as well as create an effective environment for implementation of the program policies for improving public life.

- The effectiveness of the public administration system is directly linked to efficient spending of public funds. From the perspective of increase of effectiveness of the policy on expenditures, the Government will continue to attach importance to the targeted, economical and effective use of public finance. To ensure this, the Government will introduce a modern toolkit with the aim to create added value, which will allow to advance the operation of the target-based budgeting system by setting qualitative indicators in the system of public finance management. The Government will continue to adopt an approach through which it will impartially track effective and addressable implementation of state expenditures. The function-authority-responsibility-outcome-evaluation chain, which is a logical chain, will be clearly enshrined in the public administration system; the principle of universal, standardized, and objective approaches and cost-efficient solutions will be characteristic of the public administration system. In terms of making expenditures more relevant, transition will be made to strategic planning, the existing strategies will be reviewed as well, the latter and all the strategic documents to be developed will be combined with the five-year programs, mid-term expenditure programs and annual budget program of the Government.

- In order to increase effectiveness and usefulness of the program, a regular process of assessment of budget programs will be introduced, the absence of which restricts the opportunities of the Government to assess the outcomes and impact of budget programs, as well as to review and improve budget programs.
- To assess the specific impact of the use of public funds, the standards of assessment of budget programs and standards of accountability that will be introduced will be the standards that will allow to improve effectiveness of spending of resources and financial discipline.
- To increase effectiveness of the organizing of procurement procedures, it is planned to introduce a new system of electronic procurement complying with modern functional requirements by the year 2025, and this will raise the level of transparency and effectiveness of the system.

In the field of public investments management (Pillar 6 of the government program-Institutional development)
The Government attaches importance to effective disposal of public resources. In regard to the solution to this problem, targeted use of public investment funds for the creation and enhancement of quality infrastructures and effective management of programs will be a priority. In this sense, the Government has set the goal to establish a bank for Public Investment Programs. Simultaneously, to solve the public issues, there will be more opportunities to use the resources, including the innovative ideas and management capacities of the private sector through the public private partnership (PPP) system.
The following actions will be implemented:

- ✓ the field for regulation of the PPP will be completed, ensuring selection of the best programs and the private partners that will implement them;
- ✓ a database of Public Investment Programs will be formed, which will increase predictability for the public and the business community;
- ✓ the system of monitoring and evaluation of programs will be improved, and will be brought into compliance with the current capacities and requirements.

In the field of Economy (Pillar 2 of the government program), **t**he priority goals of the Government for improvement of the business and investment environment are to: i) increase availability of capital and financial resources; ii) increase flexibility of business and employment relations; iii) increase availability of infrastructures and resources, as well as reduce risks for priority programs; and v) raise the level of digitization of the economy and access to information.

In particular, (and in addition to other actions listed in the government program), the Government will i) take steps for intensification and development of the securities market in order to improve the business and investment environment and ii) support will be provided for the introduction of modern corporate management systems in companies and the development of those companies through additional incentives.

In addition to the above mentioned, specific actions are also envisaged under the Capital Market Development Program approved by the Government in July 2020. The action plan of

the program sets time-bound actions in the context of capital market development, covering capital market instruments and their markets, demand-side investors, market infrastructure, capital market regulation and oversight. This is a very challenging reform agenda, for its technical complexity and interagency coordination requirements, and ongoing support from several development partners (including ADB) is paramount.

D. Reforms under the Fiscal Sustainability and Financial Markets Development Program

Given the commitment of the Government of the Republic of Armenia to ensure continuity of the reform agenda as well as to achieve the medium-term objectives that financial and capital markets developments require, reforms efforts in Armenia – in partnership with ADB (and AFD and other donors) – have been focused on the constrains that the proposed Fiscal Sustainability and Financial Markets Development Program targets.

Our government remains fully committed to sustaining of already launched reforms initiated under previous ADB assistances. Our institutions remain committed to continue:

(i) strengthening fiscal management, public debt and fiscal risk management policies and practices, and infrastructure investment and services delivery;
(ii) improving government securities market and money market infrastructure;
(iii) broadening the base of financial instruments and investors and enhancing corporate transparency.

We believe that the proposed Fiscal Sustainability and Financial Markets Development Program will support the government's reforms objectives in these important areas. Namely

(i) **Fiscal risks.** To ensure fiscal sustainability and reduce risk premiums, public liability management functions must become more effective and credible in meeting their core objectives, especially at controlling fiscal risks (e.g., of PPPs and SOEs). To ensure strategic value addition, financial governance and operational transparency, we are committed to bring these entities within a new State Ownership Policy orientation and to address all governance challenges. It is also crucial that public expenditure and investment decisions embedded in medium-term budget planning reflect national priorities and strategies, and that economic and social impact becomes the guiding principle for public expenditure approvals. To ensure efficiency-enhancing and fiscally-sustainable infrastructure development, completing an effective legal and regulatory framework for private participation in infrastructure is a priority.

(ii) **Government securities and money markets**. There is a need to take actions to increase liquidity in secured interbank markets, improve price discovery, and develop the standardized safe instruments for interbank trading that are missing. Formalized processes of consultation with markets on market development strategic options are nascent, and public debt management implementation must become sustainably in line with announced strategic orientation.

(iii) **Capital markets.** Gaps in legal frameworks and corporate transparency, and deficiencies in key legal and tax frameworks for financial instruments (and vehicles) and for protection of investors stand in the way of corporate equity and debt markets development in Armenia. Market design efforts must also improve international financial integration of Armenia's financial and capital markets.

Our Request to ADB

Dear President Asakawa,

We remain committed to the implementation of our ambitious structural reform agenda and are confident that the reform initiatives supported under the proposed program constitute important prerequisites for long-term sustainable and inclusive growth.

We believe that the reforms implemented under the proposed Fiscal Sustainability and Financial Markets Development Program, in complement to our government's wider reform efforts, will help us further deepen financial markets in Armenia and further strengthen fiscal management and sustainability. These reforms will also help build fiscal credibility (and lower country risk premiums) and raise the economic impact of public investment and policies. Reforms will help lower liquidity risk premiums in money and government securities markets and help the financial system lower the term premium in pricing local currency loans to the private sector.

To help financing the program we request that ADB provide a loan from its Ordinary Capital Resources in the amount of $150 million equivalent. Of this amount, we would request that $100 million equivalent be disbursed upon effectiveness of the appropriate Loan Agreement and after completion of the Subprogram 1 Policy actions with the balance of $50 million (tentative and subject to further discussions) to be disbursed after completion of the Subprogram 2 Policy actions.

We would like to thank ADB for working closely with the Government of Armenia in developing this prorgam and look forward to continuing the fruitful cooperation.

Sincerely Yours,

Tigran Khachatryan