

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR
ARMENIA**

As approved by the Board of Directors at its meeting on 21 April 2009

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EXECUTIVE SUMMARY

Armenia remains committed to the principles of multiparty democracy, pluralism and market economics in accordance with the conditions established in Article 1 of the Agreement Establishing the Bank, although application of these principles in the previous Strategy period has been uneven. While parliamentary elections in May 2007 were deemed generally free and fair by the international community, representing a significant step forward in Armenia's democratisation process, the presidential elections in February 2008 were tainted by allegations of impropriety, resulting in major social unrest followed by the violent suppression of opposition protesters and a twenty-day-long state of emergency.

Armenia's macroeconomic performance in 2006-2008 to date has remained strong. Real economic growth averaged 11.3 per cent over the last three years, underpinned as it was by the booming construction sector. In 2008 real GDP growth at 6.8 per cent has been effected both by the Georgia-Russia conflict in the third quarter of the year and the secondary effect of the financial crises in the final quarter. Armenia has been relatively insulated from the direct effect of the financial crises on its banking sector due to its lack of integration into the global capital markets. The main effect of the global downturn has been directly on the real economy via declining remittances - in particular from Russia - and an overall demand decline from some of Armenia's Western European trading partners. The cyclical impact via remittances has been moderate (overall remittances declined only by 7 per cent in 2008) due to the nature, tenure and commitment of the Armenian Diaspora in comparatively high skill employment abroad.

Monetary policy has been gradually tightened, but inflation nevertheless increased sharply, to 11.5 per cent year-on-year in August of 2008, partially reflecting the rising cost of food and fuel and has slightly moderated to 9 per cent at the end of the year significantly exceeding the Central Bank's ambitious target of 4 per cent (+/- 1.5%). The Armenian Dram appreciated steadily against major currencies for much of the previous Strategy period, although relative stability against the US dollar was achieved in 2008. Since March 2009 - as a condition to the USD 540 million stand-by agreement between the Armenian government and the IMF - the Central Bank returned to a floating exchange rate regime and the exchange rate has depreciated by 20 per cent as a consequence. While the trade deficit has widened, the current account deficit remained largely sustainable thanks to remittances and FDI, which grew steadily in 2005-2008. The external debt situation is adequate, with most outstanding liabilities on concessional terms. Going forward the effect of the financial crises on remittances and FDI will be crucial in assessing the sustainability of the current account deficit and the overall positive but moderated growth prospects.

Little progress has been made toward a resolution of the longstanding dispute over Nagorno Karabakh. This 'frozen' conflict leaves Armenia isolated in the region, impeding the country's economic development and excluding it from regional projects and initiatives. While a major breakthrough was achieved in September 2008 with the first official visit of the Turkish President to Armenia since the 1930s, and Armenia's political leadership remains committed to establishing diplomatic relations and opening the Turkish-Armenian border, rapprochement is likely to prove difficult in the absence of a permanent resolution to the Nagorno Karabakh issue.

The government has made progress in reforming Armenia's fully privatised financial sector by improving corporate governance, raising minimum capital requirements, and increasing the public's trust in the banking system. Although sector consolidation has not taken place, and bank intermediation remains low compared to other CIS countries, increasing competition, including the arrival of foreign banks, has spurred lending. The rapid growth of per capita GDP has placed Armenia on the cusp of being reclassified as a low middle-income country, and the government has declared sustainable development, rather than poverty

reduction, its primary economic goal. Nevertheless, the country remains comparatively poor, with much of the existing wealth concentrated in the capital city, and the government should concentrate on poverty alleviation, including bridging the urban-rural prosperity gap, even as it sets more ambitious economic objectives.

Armenia's key transition challenges are:

- To translate the recent economic boom into sustainable growth that moderates the real sector effects of the global financial crises by promoting diversification of economy;
- To address the lingering post-privatisation flaws in the corporate sector by phasing out monopolies, promoting competition, and improving transparency, as well as corporate governance, across all sectors of the economy;
- To improve the business environment by, *inter alia*, tackling corruption, including politically-motivated interference in the private sector, and emphasising the rule of law;
- To continue to strengthen the financial sector through institutional development and consolidation, as well as through putting in place appropriate mechanisms for developing the securities markets;
- To foster commercialisation of public infrastructure and utilities, with an emphasis on transparency and governance;
- To accelerate Armenia's regional integration, including working within the framework of ENP.

The previous Strategy period saw a rapid growth in the EBRD's activities, largely underpinned by Armenia's reforms momentum, as well as by its participation in the early Transition Countries Initiative (ETCI). The Bank committed EUR125 million for 43 projects, and provided EUR1.9 million in technical assistance funds. The current Strategy period is bound to be more challenging, as Armenia is starting to feel the effects of the global crisis, which may impact the dynamics of the Bank's business, as well as the quality of its portfolio, just as the needs of the private sector are becoming increasingly complex. Armenia likewise stands to derive greater benefit from the Bank's expertise in infrastructure finance, as the financing gap in the public sector remains substantial at the time when charitable financing by the Diaspora is likely to dwindle. Cognisant of these challenges, the EBRD remains committed to Armenia and will thus continue to deepen and expand the scope of its activities in the country.

The Bank's main operational objectives in Armenia will therefore focus on:

- **Enterprise Sector:** with a view to counter potential effects of the economic crisis on the sector, the EBRD will continue to finance MSME's, primarily through credit lines to local partner banks, but also directly through Direct Investment Facility (DIF), Direct Lending Facility (DLF), as well as through co-financing and risk sharing with local banks under the Medium-Sized Co-financing Facility (MCFF). The Bank will selectively finance creditworthy large enterprises, especially where this would support FDI. Additional emphasis will be made on expanding the Bank's TAM/BAS advisory services.
- **Financial Sector:** with the global financial crisis continuing to unfold, the Bank will work to strengthen financial intermediation in Armenia, including by encouraging the much needed consolidation in the banking sector, through financing best local banks. To that end, the EBRD will increase its historical support for the local banks' SME lending and trade financing activities, as well as co-financing activities under MCFF, and will seek to introduce new products, such as energy efficiency loans. To reinforce the local banks' capacity for meeting the private sector's financing needs during these uncertain times, and accelerate transition, the Bank will continue to selectively pursue equity participation in Armenia's best banks. The Bank will also seek to enhance its

involvement with the financial sector through provision of financing to creditworthy NBFIs.

- **Infrastructure:** The EBRD will continue its support of creditworthy renewable energy and energy efficiency projects, and will promote further development of Armenia's energy sector by financing the country's leading privately-owned power generation and distribution companies. The Bank will provide financing to private operators and concessionaires of public utilities and transport infrastructure companies. Where justified by the potential transition impact, the EBRD would pursue sovereign-backed projects, particularly those with a significant component of grant co-financing.

The Bank will continue to ensure that all its operations in Armenia are subject to Environmental Procedures and incorporate, where appropriate, Environmental Action Plans. The Bank will co-operate with other IFIs through co-financing and policy dialogue. The Bank will seek to mobilise donor grant financing from the Early Transition Countries Fund, other multilateral and bilateral donors, and the EBRD Shareholder Special Fund, to support preparation, implementation and grant co-financing of selected investment projects.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AMD	Armenian Dram (national currency of Armenia)
BAS	Business Advisory Service
CBA	Central Bank of Armenia
CIS	Commonwealth of Independent States
DEG	Deutsche Investitions- und Entwicklungsgesellschaft mbH
DFID	Department for International Development
DIF	Direct Investment Facility
DLF	Direct Lending Facility
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
ENP	European Neighbourhood Policy
ETCI	Early Transition Countries Initiative
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FI	Financial Institutions
GDP	Gross Domestic Product
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas Transport to Europe
JBIC	Japan Bank for International Co-operation
KfW	Kreditanstalt für Wiederaufbau
LTT	Legal Transition Team
MBFF	Multi-Bank Framework Facility
MCA	Millennium Challenge Account
MCFF	Medium-Sized Co-Financing Facility
MNPP	Metzamor Nuclear Power Plant
NBFI	Non-bank Financial Institution
MSME	Micro, Small and Medium Enterprises
NEAP	National Environment Action Plan
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
OSCE	Organisation for Security and Cooperation in Europe
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PCF	Prototype Carbon Fund
RAO UES	United Energy Systems
RO	Resident Office
SEEC	South Eastern Europe and Caucasus
SME	Small and Medium Enterprise
TACIS	Technical Assistance for Commonwealth of Independent States
TAM	Turn Around Management
TC	Technical Cooperation
TFP	Trade Facilitation Programme
TRACECA	Transport Corridor of Europe-Caucasus-Asia

UNDP	United Nations Development Programme
USD	US Dollar
USAID	United States Agency for International Development
WB	World Bank
WHO	World Health Organisation
WTO	World Trade Organisation
VAT	Value-Added Tax

COUNTRY STRATEGY

1. THE BANK'S PORTFOLIO

During the past four years, the Bank's portfolio in Armenia more than quadrupled, albeit from a relatively modest base, with the expansion attributable to the rapid economic growth in Armenia, as well as to the impact of the Early Transition Countries Initiative, the establishment of the regional hub in Tbilisi, and strengthened Yerevan Resident Office. Unlike in the past, the portfolio is not dominated by a few relatively large transactions, but is relatively evenly distributed across 43 projects, with the majority of clients qualifying as MSMEs, and is spread across a broad range of sectors. Importantly, the composition of the portfolio has decidedly shifted towards the private sector, which now accounts for 96% of the portfolio.

Table 1: Armenia Portfolio Development 2005-2008

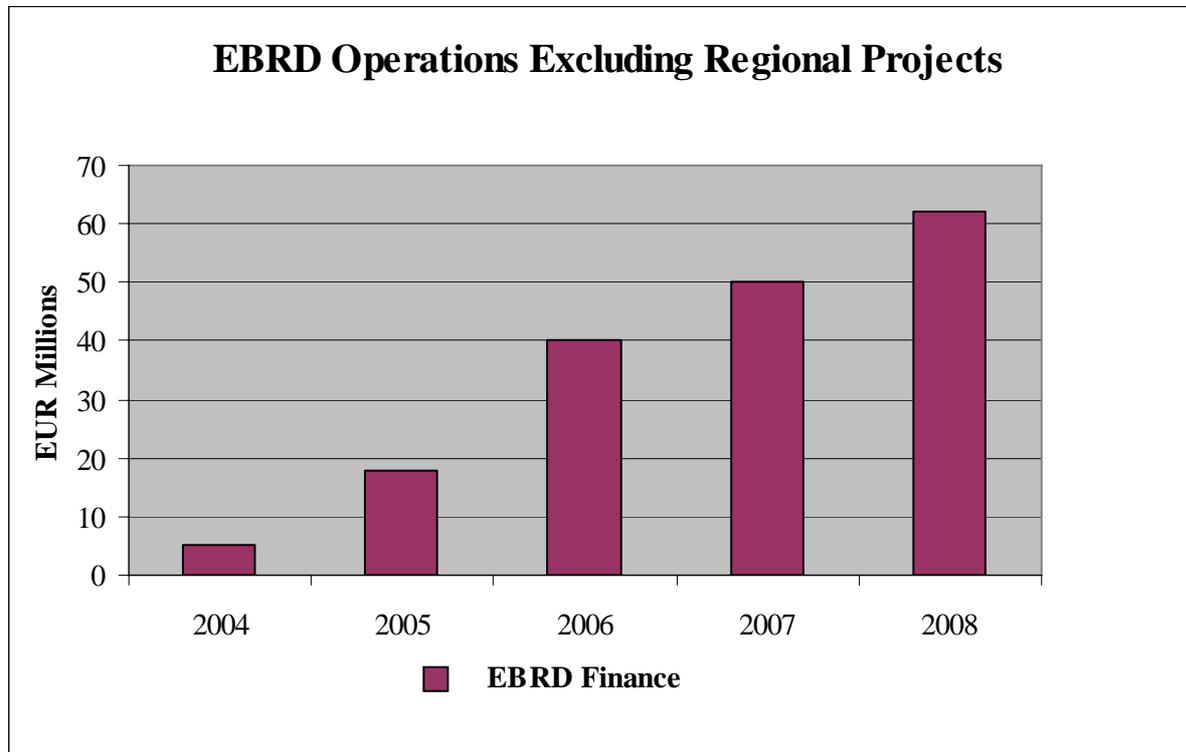
	2005	2006	2007	2008
Net Cumulative Business Volume	116	145	207	307
Number of Projects	22	33	50	64
Current Portfolio Stock	44	70	128	197
Operating Assets	33	46	70	101
Annual New Business	18	40	50	62
Annual Gross Disbursements	9	26	41	45
Annual Cancellations	3	0	0	1
Annual Number of Projects	11	12	20	14
Private Sector Share (% Portfolio)	72%	93%	95%	96%

1.1. Overview of Bank Activities To-Date

During the previous Strategy period, the Bank achieved cumulative new business volume of €91 million, spread among 41 new projects, all but one in the private sector, thus firmly establishing itself as the principal provider of finance to the Armenian private sector. With an average project size of €3 million, most of the projects were aimed at MSME's, whether

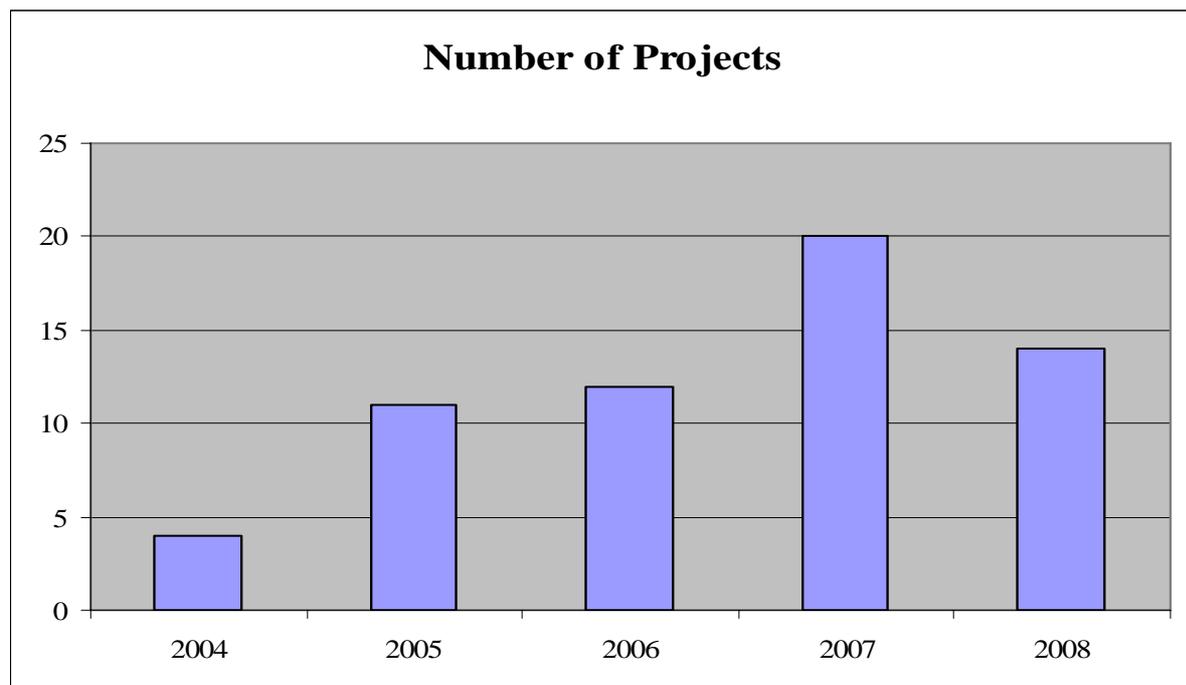
directly or through intermediation by local banks and provided material assistance to Armenia's transition process.

Chart 1:



One of the bank's main objectives in the previous Strategy period was to deliver an increasing number of projects, thus amplifying the transition impact on the economy.

Chart 2:

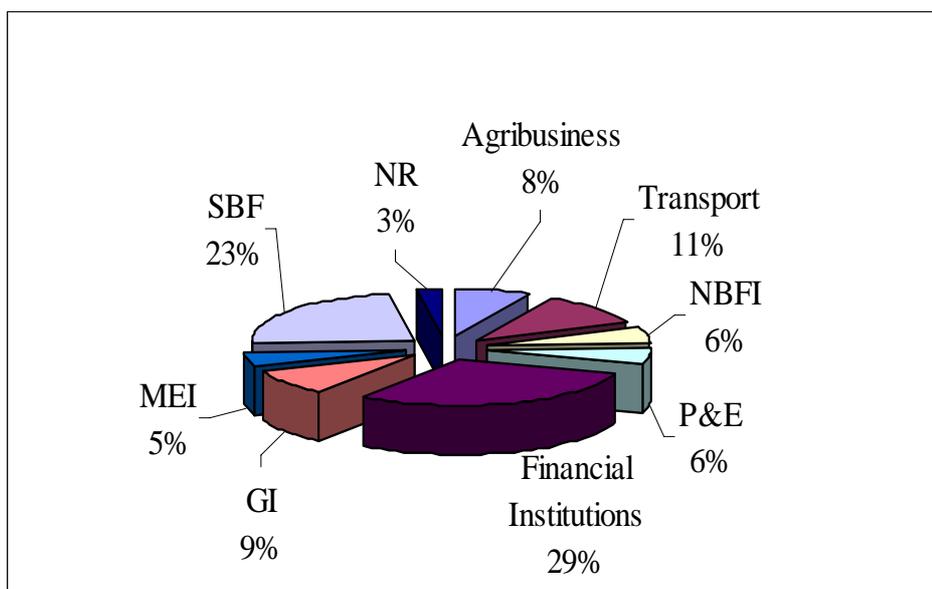


While the improving Armenian economy has fuelled demand for financing, the sharp increase in the Bank's business in Armenia in 2006-2008, including the robust pipeline, is

also attributed to the impact of the ETCI, establishment of the regional hub in Tbilisi, and the strengthening of country-based staff, which was expanded to five professionals, including the RO head, compared to two at the onset of the previous strategy period.

The portfolio remains somewhat skewed towards financial institutions, which is to be expected in an ETC environment, where the banking sector is crucial to the transition process, thus warranting particular attention and support from the EBRD, in addition to serving as the Bank’s principal conduit for channelling funds to the private sector. By means of MCFF the Bank has entered such new sectors as healthcare and telecom, in addition to significantly expanding its portfolio of agribusiness loans. For the first time in Armenia, the portfolio includes MEI and Property and Tourism.

Chart 3: Armenia: Portfolio Distribution by Sector



In addition to the above, two Property and Tourism projects are expected to be signed in December 2008.

1.2. Portfolio Pipeline

The 2009 portfolio pipeline is well-diversified across sectors, and includes several relatively large transactions, thus reflecting economic growth in Armenia and the country’s increasing attractiveness to foreign investors. Additional business opportunities are offered by the country’s infrastructure sector, including projects in the public sector (municipal and sovereign). Equity transactions through DIF represent one of the fastest growing portfolio segments in Armenia, which has emerged as the leading DIF country in the Caucasus.

1.3. Implementation of the 2006 Country Strategy

Implementation of the previous Country Strategy (2006 to date) is summarised in the following table:

Table 2: Implementation of the 2006-2008 Country Strategy

Sector	Strategic Priorities 2006 Country Strategy	2006-2008 (to-date) Operational Performance
Enterprise	Expansion of MSME financing, primarily through credit lines to partner banks, but also directly through the Bank's Direct Lending Facility (DLF) and Direct Investment Facility (DIF), as well as through co-financing and risk sharing with local banks under the Bank's Medium-Sized Co-Financing Facility (MCFF). Expansion of microfinance lending through cooperation with local banks as well as non-bank microfinance intermediaries; expansion of TAM/BAS.	Thirteen new MSME lines; direct equity and debt financing through eight DIF projects and two DLF loans, expansion of co-financing with local banks through three MCFF facilities with twelve MCFF sub-loans. In addition to DLF, renewable energy companies have been financed under the Armenian Renewable Energy Programme (AREP). BAS completed 263 projects in the amount of €1.1 million in TC, while TAM delivered 7 projects for €0.5 million in TC.
Financial	Debt and equity financing to financial institutions. Support for local banks' SME lending and trade finance activities. The Bank expands the scale and scope of the Armenian Multibank Framework Facility (MBFF) by including equity and subordinated debt as well as mortgages. Enhanced involvement with Armenia's financial sector through the provision of debt and equity financing to insurance, leasing and regulated micro credit companies.	Three new equity investments, including with foreign strategic co-investors (ProCredit and ITB-Byblos). Four A/B syndications with international commercial banks for ACBA-Credit Agricole and Armeconombank. Loan to a leasing company - ACBA leasing.
Infrastructure	Support of creditworthy renewable energy and energy efficiency projects, non-sovereign/commercial financing of private operators in the transport sector, as well as of operators and concessionaires of public utilities and transport infrastructure companies. Only pursue sovereign backed projects with a significant component of grant co-financing.	First commercial loan to a private international airport concessionaire. First ever MEI transaction in Armenia to finance waste-water treatment in several communities, with the financing taking form of a sovereign loan, with terms rendered concessional by a EU co-financing grant. Continuation of the Armenian Renewable Energy Programme, as well as a stand-alone DLF financing of one mini-hydro.

Enterprise Sector: Armenia has emerged as a leading DIF country in the Caucasus, with eight DIF transactions signed, and one successful exit accomplished (with another one in progress). MCFF proved another effective tool in enterprise financing, although its application in Armenia has not been easy, which enabled the Bank to enter new sectors in Armenia, such as healthcare and telecom. DLF has been used selectively in specialised sectors (renewable energy, natural resources, property) and where the amount of financing exceeded the MCFF partner banks' lending limits. While the Bank has thus significantly expanded direct financing (including co-financing) of the Armenian private sector, as envisaged in the previous Strategy, new EBRD commitments largely flowed to the sector through local banks, which served as the Bank's primary conduit of funds to SMEs, particularly in rural areas. Funds were provided primarily under the Armenia Multi-Bank Framework Facility (MBFF) for subsequent on-lending to SMEs. The performance of the partner banks was excellent, with only a small percentage of non-performing loans. The Bank's BAS and TAM programmes completed 263 and 7 projects, respectively.

Financial Sector: During the previous strategy period, the EBRD expanded the universe of its partner banks in Armenia from four to nine. Seven banks were provided with new credit facilities under the MBFF, including through historic (for Armenia) commercially-syndicated loans. The Bank acquired new equity stakes in three banks. MCFF facilities have been signed with three banks, one institution (Armeconombank) was provided with a mortgage facility, and the first leasing facility in Armenia was signed.

Power and Energy: Supporting development of renewable energy was at the core of the Bank's activities in the sector. To that end, the EBRD joined forces with the WB, USAID, and Cascade Credit (a financing arm of the Armenian-American Cafesdjian Foundation) to launch the Armenian Renewable Energy Programme (AREP). The Bank's participation took the form of a loan to Cascade Credit. The Bank also continued to finance renewable energy projects on its own through DLF, with two such projects signed. In addition to renewable energy, the Bank returned to the mainstream segment of the sector, seeking to support post-privatisation development of the sector with a loan to the Armenian privately-owned power distribution company.

Infrastructure: There were two landmark transactions in the sector. The Bank provided a USD 20 million loan to the private concessionaire of Zvartnots International Airport, Armenia's principal gateway. The loan, a commercial facility with no sovereign support, was complemented by a USD10 million loan from DEG, and its proceeds were used to finance completion of a new passenger terminal. The Bank has also signed its first ever MEI loan in Armenia to improve waste-water treatment in several communities in the vicinity of Lake Sevan. The EUR 7million loan was the first sovereign loan by the EBRD in Armenia since the early 1990's, and was accompanied by a EUR 5 million co-financing grant from EU's Water Initiative.

1.4. Portfolio Performance

The current EBRD portfolio in Armenia has a weighted project risk rating of 6.50 compared with a Bank average of 5.65 for the Bank as a whole. Notwithstanding the above-average risk rating, the existing portfolio has been performing well, while the repayment of two old problem sovereign loans (Zvartnots Air Cargo Terminal, and Hrasdan Unit 5) was completed in 2006-2007.

1.5. Portfolio Ratio

Investments in the private sector now represent 96 per cent of the Bank's portfolio in Armenia. While the pipeline is likewise concentrated in the private sector, it includes two MEI projects in the public sector which, if signed, may raise the ratio of the public sector in the portfolio, albeit to well below 40 per cent.

1.6. Transition Impact of Bank's Activity and Lessons Learned

While the EBRD's cumulative (i.e. from the inception of operations to date) transition impact in Armenia is somewhat diluted by three unsuccessful projects undertaken in the early 1990's, recent years saw a considerable increase in the Bank activities with *Good* to *Excellent* Transition Impact ratings.

The bank's internal transition impact monitoring system includes, as of end 2008, a sample of 30 rated projects. Assessing the transition impact through the bank's operations, the average rating for Armenia stands at 4.30, slightly higher than the overall average stock of Bank projects. Armenia based operations ranked from 1-4 account for 53.3 per cent of the sample. Indicatively, this result falls within the range of 50 to 60 per cent of the institutional target set in 2005 (BDS04-148).

1.6.1. The Financial Sector

Banking – The Bank's activities in the sector have been conducted primarily under the Multi-bank Framework Facility (MBFF), including equity investments, SME lines, and TFP, as well as the provision of TC. The Bank's 2004 investment in Armeconombank (AEB) has demonstrably improved corporate governance (as acknowledged by Central Bank) and risk management.

In 2007, the Bank successfully engaged in setting higher standards of corporate governance in the financial sector by supporting Byblos Bank Armenia (BBA) Former ITB. As a result since the completion of acquisition of ITB from Byblos bank, Byblos Bank Armenia has gone through a restructuring process of corporate governance and change in management, as well as asset and liability structure. The bank has also approved a new business plan that involves branch expansion and introduction of new products.

NBFI – So far, two projects have been financed by the Bank in NBFI. Both are crucial to the extent that they support nascent market segments and carry transition impacts related to enhanced competition as well as the demonstration of new products. Between 2005 and 2007, the EBRD has amassed a 35% stake in Cascade Insurance (CIRCO) under its direct investment facility (DIF). Transition impact in this operation derives from supporting the development of the nascent insurance market in Armenia and enhancing competition in the sector by supporting the expansion of a new-comer in the market. Key prudential financial covenants have also contributed in setting business standards in the industry. In 2008, the Bank signed its first leasing deal in Armenia, a EUR 8 million loan to ACBA-Leasing. Transition impact in this case arises from supporting the still emerging leasing sector in Armenia. Leasing is an important alternative/complement to bank finance in particular for SMEs and provides with a good case for cross market segment competition between Banking and non-Banking Institutions.

SME & MSME – Activities in this sector have been conducted primarily under MBFF (through dedicated SME and MSME lines), which was enhanced by the related TC fund, the

Armenia Microlending Programme (AMP). This TC Fund has been instrumental in providing transition impacts especially as it allowed improvements in lending models and skills. Additional penetration of the corporate sector in the Medium end of the SME segment was achieved through four co-financing facilities (MCFF). AMP started in 2006 and achieved good results including the expansion of MSME lending and establishment of appropriate organisation structures and staffing in a number of participating banks, while MCFF proved a good vehicle for entering such new (for Armenia) industries as healthcare and telecom.

Overall, transition impact within the *Financial Sector* is rated as *Moderate* with projects carrying a 4.3 average ranking. A *key lesson learned* is that partner banks do not have to be good at everything that the Bank aspires to achieve in the sector, and the Bank can deliver better transition impact by carefully matching its products against each bank's comparative advantages.

1.6.2. The Enterprise Sector

Agribusiness - The Bank undertook a successful project with the private sector loan in the Yerevan Brandy Company owned by Pernod Ricard leading to good results for the company as well as spill-over effects to the upstream grape-growing sector. In 2006, an investment in BIH, a regional beverage manufacturer was signed and since then triggered the introduction of new packaging and products with further impact expected over time. In addition, a number of smaller projects were implemented under the Direct Investment Facility (DIF) with supplementing TC funds. The EBRD representation on the Board of Tamara Fruit, for example, was very useful for improving financial reporting, strengthening management, and delivering technical and marketing advice. In this regard, it should be further noted that several of the Bank's agribusiness clients have successfully improved their management practices as a result of TAM/BAS.

General Industry – GI projects have been undertaken primarily under MCFF, DLF, and DIF. A larger project in this sector was a working capital facility to a locally-owned copper smelter in 2002, resulting, *inter alia*, in the introduction of IFRS as well as to improvements in corporate governance, management standards and transparency. In addition, the Bank's equity stake in the construction material's company, Shen Concern (which was followed by a loan under DLF), has helped to improve management practices and increase the company's market share. A *lesson learned* from the Armenian Copper Programme, as well as from Shen, is that a working capital facility can be a decisive first step in client relationship, paving the way for subsequent capital investment projects, including to improve environmental impact, while capital investment as the first step often needs to be followed by working capital facilities to help the company solidify its market position and grow further. Either way, provision of working capital can deliver transition.

Natural Resources – Under the Bank's Direct Lending Facility (DLF) a loan was approved to DENO Gold mining company in 2005 for reconstruction measures with expected transition impacts in terms of restructuring resulting in the introduction of new, replicable products and technologies, as well as high efficiency (the company is now owned by Dundee Precious Metals of Canada).

Telecommunications – Opportunities in the sector have been relatively limited, although some years ago the Bank considered a loan to the dominant operator Armentel but decided not to pursue due to the lack of transparency in granting Armentel's licence. A loan to a local TV station, Shant TV, was extended in 2007 under MCFF.

Overall, transition impact within the *Enterprise Sector* is rated as *Moderate*. A *key lesson learned* from engagements with corporate clients is that in a fast evolving economy transition

impact and high returns, can be realised in a relatively short time period, provided that careful monitoring and board involvement are ensured.

1.6.3. Infrastructure

Power – In 2005 the mini-hydro hydroelectric power station, Bazenc CJSC received a loan under DLF with a view to support renewable energy projects in Armenia. This was followed by a loan to another mini-hydro, Hydrocorporation. The Armenia Renewable Energy Programme (AREP) was signed in 2006 with Cascade Credit with the aim of providing long-term debt financing for renewable energy projects, primarily mini hydro power plants. This last project reflects the Bank's way of tackling the challenge posed by the impending retirement (schedule for 2015) of the Armenian Nuclear Power Plant (ANPP), the potential replacements for the ANPP, and the actions needed to secure a long-term power supply for Armenia. In addressing this issue, the Bank achieved transition impacts such as improved standards of business conduct through imposing due diligence requirements on sub-projects and contributes to building frameworks for markets through testing the new feed-in tariff mechanisms designed to support small hydro and other renewable developments. As a result, private construction of small hydro plants seems to be picking up in the country.

MEI – The Bank's first operation in this sector was signed in 2007. The Lake Sevan Basin Environmental project aims to improve wastewater treatment for five municipalities, as well as to promote tariff reform, commercialisation of the Water Company and private participation. Its TI potential is rated *Good* and derives from tariff reform with improved collection rates, commercialisation of the Water company, improvement of environmental conditions; and demand side incentives through consumption based billing.

A *key lesson learned* here is that in a small country like Armenia, there is no effective delineation of powers between local and central authorities, and obtaining a buy-in at the highest level is essential.

Transport – the Yerevan Air Cargo Terminal project, signed in the early 1990's, was unsuccessful, mainly due to a lower usage of the terminal than that originally forecast. In 2006, the Bank made a commercial loan to the airport's private concessionaire to finance the construction of a new passenger terminal, which has been successfully implemented. This project should send a strong demonstration effect, given that the Bank has also helped to improve the private Concession Agreement significantly, but most importantly, as construction was completed, both the government and the concessionaire were satisfied with the engagement. Additionally, the foreign investor involved in the project has brought measurable skills and technologies further realising projected transition impact.

A *lesson learned* from the Yerevan Air Cargo project is that, while the Bank should be responsive to urgent needs of its countries of operations, project risk assessment in a crisis or post-crisis situation is bound to be difficult.

Overall, transition impact within the *Infrastructure* Sector is rated as *Minimal to Moderate* with even better prospects for the future.

**Transition Impact Potential and Risks Assessment Overview:
All Armenia TIMSed Rated Projects as of Jan-09**

	Excellent			Good			Satisfactory				Total
	high	medium	low	high	medium	low	high	medium	low	Negligible	
Financial Sector											23
Banking		1		6	3			1		2	13
NBFI				1	1						2
SME & MSME				4	4						8
Enterprise Sector											3
Agribusiness						1					1
General Industry					1						1
Natural Resources											0
Telecommunications											0
Property and Tourism				1							1
Infrastructure											4
Power	1	1									2
MEI	1										1
Transport					1						1
Sub-Total	2	2	0	12	10	1	0	1	0	2	30
Total	4			23			3				

2. OPERATIONAL ENVIRONMENT

2.1. General Reform Environment

Since independence in 1992, Armenia has made significant progress toward establishing functioning markets and a democratic and accountable political system. However, while Armenia is ranked among the most advanced countries in the CIS in terms of progress in structural reforms, significant challenges remain, particularly in the areas of the business environment and establishing a level playing field for all private sector participants; developing a modern, well-functioning and financially sustainable infrastructure; and deepening and diversifying the financial system. Moreover, progress in structural reforms has slowed in recent years, as the reform agenda has increasingly focused on the most difficult and politically sensitive third phase, market sustaining reforms in the areas of infrastructure, banking and competition policy. Progress in transition in 2008 as assessed in the 2008 *Transition Report* was limited to two transition indicator upgrades one upgrade in the infrastructure score and one reflecting improvements of the regulatory framework in trading of securities.

Renewed commitment by the Armenian authorities to both political and economic reforms will be necessary to ensure that Armenia successfully consolidates sustainable democratic and market-supporting institutions.

2.2. Political Developments

Presidential elections on 19 February 2008 resulted in a first round victory for incumbent Prime Minister Serzh Sargsian. The Election Observation Mission Final Report by the OSCE's Office of Democratic Institutions and Human Rights concluded that the election "mostly met OSCE commitments and international standards in the pre-election period and during voting hours". However, the Report highlighted "serious challenges to some commitments...especially after election day." The OSCE concluded that the conduct of the elections "displayed an insufficient regard for standards essential to democratic elections and devalued the overall election process." This conclusion was confirmed by the Parliamentary Assembly of the Council of Europe in its Resolutions 1609. These negative assessments were echoed by domestic observers, who alleged wide-scale vote fraud, voter intimidation and ballot-box stuffing.

In the immediate aftermath of the election, the second-placed candidate, former Armenian President Levon Ter-Petrossian, declared that the election had been fraudulent and called on his supporters to begin peaceful protests in support of a re-run of the election. The authorities permitted the opposition to hold a sit-in protest in central Yerevan, as well as daily rallies attracting around 25,000 supporters. However, on 1 March 2008 the sit-in protests were forcefully dispersed by the police and Ter-Petrossian was placed under house arrest. Clashes between the police and protesters escalated, resulting in the deaths of at least eight protesters and two policemen (the precise figure is contested). Heavily armed riot police were then sent on to the streets of Yerevan, and President Kocharian imposed a 20-day state of emergency, including a media blackout. These actions by the Armenian Government, which have significantly damaged Armenians' trust in their political leadership, raise serious concerns about the authorities' commitment to upholding civil and political liberties.

Following his inauguration on 9 April 2008, President Sargsian appointed Tigran Sargsian, the Chairman of the Central Bank, as Prime Minister and invited the opposition to participate in the formation of a new Government. However, while a few new MPs were brought into Government, the Sargsian Cabinet was formed on lines very similar to the previous Government and many of the previous ministers retained their portfolios.

This conflict between the authorities and opposition activists was followed by renewed fighting along the ‘contact line’ separating Armenian and Azeri forces in Nagorno Karabakh. However, while that recent violence dampened hopes of progress on the settlement of the Nagorno Karabakh issue, the Georgia-Russia conflict in August 2008 significantly altered the geopolitical landscape throughout the South Caucasus. One manifestation of this new geopolitical reality was the official visit of the Turkish President, Abdullah Gul, to Armenia in September 2008, the first visit of a Turkish President to Armenia since the 1930s. Subsequent gestures by both Armenia and Turkey suggest that a breakthrough in their bilateral relations might be forthcoming during the Strategy period. An improvement in Armenian-Turkish relations would significantly help to achieve a settlement of the Nagorno Karabakh conflict.

2.3. Environmental Issues

Since the implementation of the 2006 Country Strategy, Armenia has progressed in fulfilling its environmental and socio-economic commitments outlined in its national environmental legislation, policies, strategies and international environmental agreements. Despite this progress, areas that continue to present environmental challenges include inefficient exploitation of natural resources, energy instability, waste management, deforestation, degradation of biodiversity, air, water and soil quality and environmental health issues.

Going forward, the Bank will continue to ensure that the projects its supports meet relevant international environmental commitments¹ and EBRD’s Environmental and Social Policy, Performance Requirements and procedures. The Bank will also continue to identify opportunities for external technical assistance to strengthen environmental risk management capacities of local banks as part of the Early Transition Countries Initiative. Finally, EBRD will identify opportunities to develop partnerships with other donor organizations where EBRD financing could have a positive environmental demonstration effect.

2.4. Social and Labour Issues

The Poverty Reduction Strategy Paper (PRSP) was adopted by the government in 2003. To date, the implementation of the PRSP Action Plan has had a positive effect in reducing poverty and inequality in Armenia. Between 2004 and 2007, overall poverty declined sharply from 34.6% to 29%, while the share of extreme poverty decreased to approximately 6.5%. This was mainly driven by rapid economic growth, increasing private and public sector wages and declining unemployment. While overall income levels vary substantially between Yerevan, secondary cities and rural areas, poverty reduction took place across Armenia, with the starkest reduction in Yerevan where the economic growth has increased substantially faster than in the rest of the country. In contrast to urban areas, the poverty level in rural areas is mainly determined by the high rate of rural unemployment (3-5 times the Yerevan rate) and these regional disparities have been increasing in parallel to the overall acceleration of economic growth.

Another important channel for poverty reduction continues to be foreign remittances. Armenia is one of the biggest population exporter in the world measured as the ratio emigrant to the original population. This largely high skilled group of emigrants has contributed between 10-20 per cent of GDP in recent years. Family ties are important but the commitment of the Armenian diaspora extends beyond the immediate family and reaches a relative wide range of distant relative and friends. The EBRD’s Life in Transition Survey

¹ Including the European Principles for the Environment.

(LiTS) in 2006 has shown that households receiving remittances seem to spend significantly more on education and are less likely to receive social benefits from the government. Approximately half of overall remittances are channelled via the banking sector and the latest data from the Central Bank of Armenia suggests that remittances processed through local banks have increased while non-bank wire transfer and cash remittances have dropped, resulting in an overall drop of remittance of 7 per cent in November 2008 compared to the previous year. Remittance flows are particularly vulnerable to economic developments in Russia and while the high skilled Armenian diaspora is less affected than i.e. construction sector migrants the decline will be noticeable in overall growth and poverty figures.

The government has recently revised its PRSP for the period of 2008-2021 with the main five themes being, i) promoting sustainable economic growth through macroeconomic stability and private sector development, ii) improving public infrastructure, iii) enhancing human development and improving social safety nets, iv) implementing prudent fiscal policies and reforming the tax system, and v) improving core public sectors functions. Additionally the IMF has completed a three year Poverty Reduction and Growth Facilities (PRGF) program in 2008 and the authorities have requested a further three year extension focussing next to macroeconomic stability explicitly on generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures.

2.5. Legal Reform

Armenia has continued to build on previous efforts at legal reform, but it continues to face considerable challenges in ensuring that legal rules, institutions and culture are properly entrenched, whilst implementation continues to lag behind the pace of legal reform, thus hindering the impact of such new legislation.

Analysis of key commercial laws that seek to foster a favourable investment climate in Armenia, such as corporate governance legislation, demonstrates that these laws continue to suffer from poor implementation. Surveys conducted by the EBRD confirm that such commercial laws suffer from poor public access and an ineffective institutional environment, both administratively and judicially. This implementation gap both undermines the utility of the specific laws in issue and diminishes the confidence that both Armenians and foreign investors and traders have in the legal system as a whole, in particular in its ability to uphold contractual rights.

There are also notable areas where individual commercial laws fall well below what is generally acceptable internationally. This is particularly true for key laws such as those applicable to concessions in infrastructure, municipal utilities and public services.

Despite this, commercial law has continued to improve generally and further progress has been made over the past two years with respect to legal and regulatory reform in Armenia with a new Judicial Code becoming effective in January 2008 as part of a wider anti-corruption drive. Further progress has also been made particularly in the financial sector. The joint stock company law was amended in 2007 and a comprehensive revision of this law is set to be undertaken in 2009. Whilst a new law on bankruptcy was adopted in December 2006, more recently a new law on the securities market was enacted in March 2008 and a law on covered mortgage bonds became effective in July 2008. Draft mortgage and consumer lending laws are also currently under preparation and are expected to be adopted in 2009. For a more detailed assessment of Legal Reform, see Annex 3.

2.6. Progress in Transition and the Economy's Response

2.6.1. Macroeconomic Environment

The real economy has performed consistently well throughout the Strategy period and real GDP growth averaged at 11.3 per cent moderated to 6.8 per cent in 2008. The non-tradable sector remains the main driver of growth, in particular services, retail trade, construction and financial services. Remittances and inflows of foreign direct investment (FDI) continued to fuel domestic demand.

However the current financial crisis has started to show a second round impact on the Armenian economy. Armenia's banking sector remains largely insulated from global capital markets and continues to be well capitalised and sound, but the global crises has started to have a dampening effect on remittance growth in particular from Russia. In combination with a recession and a potential demand decline in some of Armenia's main Western European trading partners growth prospect still remaining high in regional comparison will moderate in the near future. Thus increasing competitiveness in the tradable sector will be even more crucial in such a crises environment. Output in manufacturing and agriculture lags behind in terms of growth and productivity levels and surging imports helped to widen considerably the trade and current account deficits since 2006 with only small increases in exports. The continuing closure of the Turkish and Azeri borders remains a major impediment to Armenian traders. The weak performance of the industrial sector was mainly because of poorly performing mining enterprises and large falls in production in the machine-building and jewellery sectors. The resumption of the supply of Russian raw diamonds to Armenia, following a new trade agreement in 2007, seems to have halted the decline of Armenia's diamond processing industry, which remains an important contributor to overall growth. Falling base-metal prices will put additional pressure on the countries competitiveness.

Containing inflation while ensuring overall growth in a crises environment remains the major monetary policy challenge. Despite a committed Central Bank to keeping the inflation target, gradual tightening of monetary policy is key (the central bank raised the refinancing rate in several stages to 7.75 per cent in September - from 4 per cent in June 2007). Nevertheless, changes to the refinancing rate have a limited effect on inflation, given the low level of banking intermediation and the underdeveloped money market. Annual CPI inflation rate has remained high, it was 11.3 per cent (year-on-year) in September 2008, and 9 per cent on average in 2008, exceeded the central bank's inflation target of 4 per cent (+/- 1.5 per cent) by a large margin. Inflation was mainly driven by global food and energy prices in the first half of the year declining commodity prices are not being passed through as substantially due to low competition among commodity importers.

Public finances remained sound since the last strategy with a general government deficit of 1.8 per cent in 2007 and a budgeted deficit of 1.8 per cent for 2008. In 2007 tax revenue exceeded expectations, mainly because of a 50 per cent increase in VAT collections, reflecting both an increasing number of unprocessed VAT refunds and advance tax payments. Strong fiscal performance result in a current fiscal surplus of 1.3 per cent of GDP. With second round real economy effects of the crises starting to unfold this leaves the government some room to engage in anti-crises support initiatives. The government has announced a plan designed to lessen the impact of the global financial crises and demand slowdown by setting aside USD 50mn. The main elements include public work initiative and a stimulus package for small and medium sized enterprises. The government does not plan any tax cuts, and the low tax to GDP ratio of 20 per cent remains an issue.

The Central Bank intends to maintain a flexible exchange rate regime and switched from a managed to a free floating exchange rate regime in March 2009. The dram continues to

appreciate both against the dollar and the euro but at a slower rate with continuing upward pressure by FDI, remittance inflows and donor assistance until February and depreciated by 20 per cent as a consequence of the exchange rate regime change.

2.6.2. Transition Success and Transition Challenges

Armenia's progress towards reaching the standards of a market economy has been recognised by the Bank in its annual exercise of monitoring structural reforms developments in its countries of operation. Table 2, illustrates the progress made by Armenia with structural reforms relative to the progress made by other transition countries in the CIS+M. Enterprise and market indicators indicate most progress in reform while financial institutions, infrastructure and competition sectors lag behind the EBRD average, but still above the CIS average.

Transition Indicators 2008

Country	Enterprises			Markets and Trade			Financial Institutions		Infrastructure
	Large-scale privatisation	Small-scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade & Forex system	Competition Policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Overall infrastructure reform
Armenia	4-	4	2+	4+	4+	2+	3-	2+	3-
Azerbaijan	2	4-	2	4	4	2	2+	2-	2
Belarus	2-	2+	2-	3-	2+	2	2	2	1
Georgia	4	4	2+	4+	4+	2	3-	2-	2+
Kazakhstan	3	4	2	4	4-	2	3	3-	3-
Kyrgyz Republic	4-	4	2	4+	4+	2	2+	2	2-
Moldova	3	4	2	4	4+	2+	3	2	2+
Mongolia	3+	4	2	4+	4+	2+	3-	2+	2+
Russia	3	4	2+	4	3+	2+	3-	3	3-
Tajikistan	2+	4	2-	4-	3+	2-	2+	1	1
Turkmenistan	1	2+	1	3-	2	1	1	1	1
Ukraine	3	4	2	4	4+	2+	3	3-	2+
Uzbekistan	3-	3+	2-	3-	2	2-	2-	2	2-
CIS+M average	3-	4-	2-	4-	4-	2	2+	2	2
EBRD average	3+	4-	2+	4	4	2+	3	2+	2+

Note: The index ranges from 1, indicating little or no progress to 4+ pointing to standards similar to advanced economies. See Transition Report 2008 for the detailed definitions.

Liberalisation, Markets and Trade

Armenia has very limited formal trade restrictions and no export quotas. Both exports and imports have been growing rapidly, with imports growing at a faster rate. The benefits of limited trade restrictions are partially off-set by Armenia's land-locked locations with remaining closed borders to two neighbouring countries namely Turkey and Azerbaijan. Improvement in customs reforms have eased trade opportunities further but limit competition among – in particular – commodity importers have caused limited pass-through of following

prices and remains a key challenge. The impact of the global demand slowdown will be particularly felt in the tradable sector, and will put additional pressure on Armenian companies to improve their competitiveness.

Business Environment

The business environment has continued to improve since 2006 and the procedures for registering property and licensing are more straightforward than in most other CIS countries. In comparison to the other two Caucasus countries Azerbaijan and Georgia, Armenia lags behind as shown in the latest World Bank “doing business” ranking assessing the ease of doing business (see below). However, the customs and particular tax administration remains a weak point and corruption a serious problem. The government reforms from August 2008 address several of these issues including the exemption from VAT and other taxes for small retail traders in the non-agricultural sector. In parallel the government had merged the State Tax Service (STS) and the State Customs Committee (SCC) to streamline the overall tax collection process. These reforms also include VAT thresholds and provide small businesses with simplified tax assessment procedures.

Economy		Armenia	Azerbaijan	Georgia
Ease of Doing Business Rank		44	33	15
Starting a Business	Time (days)	18	16	3
	Cost (% of income per capita)	3.6	3.2	4
	Min. capital (% of income per capita)	2.3	0	0
Dealing with Construction Permits	Time (days)	116	207	113
	Cost (% of income per capita)	28	522.6	20.3
Employing Workers	Firing costs (weeks of wages)	13	22	4
Registering Property	Time (days)	4	11	3
	Cost (% of property value)	0.3	0.3	0
	Rank	61	26	43
	Procedures (number)	49	39	36
Enforcing Contracts	Time (days)	285	237	285
	Cost (% of debt)	19	18.5	29.9

Source: Doing Business 2009, World Bank.

The competition regulatory framework that came into force in 2007 was a significant improvement and has granted the Competition Commission additional rights of inspection and imposed stricter sanctions for infringements of the Commission’s rules. However, in particular in the tradable sectors, the commission maintains a low profile and there has until now been very little actual enforcement. This has resulted in existing import monopolies remaining largely unregulated and limiting competition and constraining competitiveness.

Financial Sector

The banking sector was completely privatised and underwent an initial consolidation preceding an increase in minimum capital requirements in mid-2005. Bank and non-bank supervision was consolidated under the CBA in January 2006 which led to significantly increased prudential standards for non-bank financial intermediaries and the revocation of

several licences. Banks have adopted IFRS and a deposit insurance scheme was launched in 2006. In the meantime the banking sector has continued to grow since 2006, mainly due to a rapid expansion of consumer lending and mortgage financing. The government has also adopted a new consumer credit law to increase market transparency and consumer protection. The comparatively strong regulatory system has improved banks' corporate governance. Banks are well-capitalised, liquid and profitable and the loan portfolio quality has remained sound. The Central Bank increased the reserve requirements on foreign currency deposits from 8 to 12 per cent and together with a new law on cash transaction limits these assisted the process of de-dollarisation in the economy. As a result the share of dram-denominated loans and deposits has been increasing approximately around 14 percentage points in the course of 2007. The relative insulation and un-sophistication of the Armenian banking system has also limited the direct impact of the global financial crises on the Armenian financial system. Armenian banks have not been integrated into the global financial system and as a consequence do not suffer significantly under liquidity constraints. Nevertheless some Armenian banks have become more cautious and decreased their mortgage and consumer lending portfolios.

The Armenian capital market remains underdeveloped. The purchase of the Armenian Stock Exchange by Nasdaq-OMX in November 2007 is a positive development and may open up possible funding opportunities for larger enterprises in the medium term. The government has supported the stock-market capitalisation through a number of recent legislations on capital market development that include tax breaks for companies that list on the stock exchange.

Infrastructure

After a large number of privatisations, most of the utilities are managed by the private sector. In particular the water and waste-water sector has seen significant improvements in collection discipline from around 70 per cent in 2003 to 95 per cent in 2007, despite increases in tariffs. Widespread metering has improved the overall performance significantly. This has been complemented by the government securing private sector participation through management contracts in the Yerevan and Lake Sevan district. However the energy infrastructure is still in need for sizeable investments, in particular in rural areas.

After privatisation of the electricity distribution networks in 2003, the government has in 2008 secured concessional bilateral financing from Germany's KfW for Armenia's largest hydroelectric plant, Gurmush, and for building two high-voltage power transmission lines in Shirak in the north of the country and further into Georgia. These investments would create a joint South Caucasus electricity transmission system that could potentially be linked to both Russia and Iran.

While early telecom privatisation being criticised in terms of fairness and transparency, the partial liberalisation of the mobile market have been respecting international standards. An international tender for the third mobile operator in Armenia was launched in May 2008 and won by the French mobile company Orange.

2.6.3. Transition Challenges

The six key transition challenges are:

1. To translate the recent economic boom into a more sustainable growth by promoting diversification of economy;
2. To address competitiveness gaps in the tradable sector in the light of decreasing international demands.

3. To address the lingering post-privatisation flaws in the corporate sector by phasing out monopolies (in particular in the tradable sector), promoting competition, and improving transparency, as well as corporate governance, across all sectors of the economy;
4. To improve the business environment by, *inter alia*, tackling corruption, including politically-motivated interference in the private sector, and emphasising the rule of law;
5. To continue to strengthen the financial sector through institutional development and consolidation, developing mechanisms for revitalising the securities markets;
6. To foster commercialisation of public infrastructure and utilities, with an emphasis on transparency and governance.

2.7. Access to Capital and Investment Requirements

Armenia has substantial investment needs both in the public and private sectors. The rapid growth in the economy has been driven primarily by the construction sector, which has been financed overwhelmingly with investors' own equity. Other sectors of the economy have not been so fortunate. The underdeveloped infrastructure remains a serious bottleneck for the country's continuous development, with some of the key strategic segments, such as the roads network, financed largely by philanthropic Diaspora foundations, such as Lincy Foundation, although some development has been or expected to be supported by WB, ADB, and MCC.

Much of the funding, particularly in the public sector, is provided by bilateral donors and IFIs. Annually, Armenia has received USD300 million, or around 3 per cent of GDP, in Official Development Assistance (ODA) in recent years.

Armenia's relationship with IFI's is generally good (e.g., the World Bank considers Armenia the best performing country in its IDA programme), and the number of IFI's active in the country has increased. In recent years Armenia joined the Asian Development Bank, and signed a memorandum with European Investment Bank (EIB), as well as a USD236 million compact with Millennium Challenge Corporation. At the same time, some of the prominent bilateral programmes (i.e., USAID and DFID) have been scaled down or, in DFID's case, phased-out altogether. Furthermore, because of the drastic appreciation of the Armenian dram against the US dollar, some of the assistance programmes, such as Millennium Challenge's, are falling short of their original development targets, and the Government may have to use its own funds to bridge the financing gap.

Armenia's GDP has increased to the point where the World Bank and IMF are considering reclassifying it as a middle-income country, which will have an effect on Armenia's cost of borrowings. Thus the World Bank is considering phasing in IBRD pricing for Armenia.

The role of the Armenian Diaspora remains important, and the Government is increasingly relying on overseas Armenians for its development objectives. In addition to the more traditional investment from the US and other western diasporas, the impact of the Russian-Armenian community has become more visible. Several Russian companies owned by ethnic Armenians have been active in the construction sector/property development, as well as in the banking sector. Recently, in response to an appeal by the President of Armenia, a number of prominent Russian-Armenian businessmen personally pledged to invest hundreds of millions of dollars in Armenia.

Although Armenia has received sovereign rating (BA2 and BB+, by Moody's and Fitch, respectively), the country has not yet tapped global debt markets. Internally, however, the

government paper is traded, and represents one of the principal investment instruments for domestic institutional investors.

In the private sector, access to finance is generally inadequate. At 26.1 per cent of GDP, bank intermediation in Armenia remains low (although up slightly from the previous Strategy period) even by CIS standards. On the other hand, Armenian commercial banks, perhaps feeling the heat from the increasing competition including from foreign banks, have been slightly more active and their terms have somewhat improved from the previous Strategy period (tenors of three years for best corporate clients have not been unheard of). Access to bank financing for SMEs and MSEs, particularly in the remote regions, remains limited.

CBA has enacted some measures to stimulate development of capital markets. Leading Armenian companies have received credit rating from CBA, which enabled them to issue bonds, mostly with a one-year tenor, although longer maturities have been contemplated. The bonds have been purchased primarily by institutional investors (mostly, banks). The stock market remains virtually non-existent, although the Government has attempted to breathe some life into it. Thus CBA welcomed the sale of the Armenian stock exchange (Armex) to the Scandinavian bourse operator Nasdaq-OMX, and has contemplated various incentives, such as tax amnesty, for the companies willing to list. Despite these measures, there are objective factors hampering development of the Armenian capital markets, key of them lack of disclosure.

The impact of the global credit crisis on Armenia has not impacted through the financial sector but rather through a delayed effect on the real sector through declining remittances and dampening demand. Banks have not yet complained about a lack of liquidity, but it is generally understood that a significant decline in remittances from Russia and other countries channelled through the banking sector may trigger a liquidity crisis.

3. STRATEGIC ORIENTATIONS

3.1. Bank's Priorities for the Strategy Period

In contrast to the preceding period, the new strategy period will likely be driven less by managing growth than by pro-actively and constructively responding to the economic downturn. Whilst Armenia's relative insulation may prove a blessing in disguise by absorbing some of the negative impact from global trends, particularly in the banking sector, the crisis will likely reach Armenia through diminishing Diaspora remittances and investment, the end of the construction boom, and declining prices for its main exports, such as metals. In the crisis environment, the Bank's role as a principal supporter of the banking sector and provider of capital to the enterprise sector can be expected to be further accentuated. Taking this into account, and in line with its core mandate, the Bank will continue over the new Strategy period, to support primarily the private sector, whose continuous development is essential for countering the near-term effects of the crisis, as well as for the country's sustainable development in the medium-term through GDP growth, job creation, and rising incomes. The Bank will also pursue selected projects in the public sector, primarily in MEI and Transport, provided they promote transition and sector reform. While the Bank will seek to provide infrastructure financing without sovereign support whenever possible, the reality of Armenia is such that sovereign support may be appropriate in some cases.

During the past strategy period the Bank involvement with the Armenian private sector was driven primarily by ETCI. This will continue in the new strategy period. Despite the increase in the Armenian GDP per capita in the last few years, and the prospect of Armenia being reclassified as a low-middle income country by the likes of the World Bank and ADB, it would be fallacious to contemplate any "graduation" of Armenia from ETCI at this juncture. Its achievements notwithstanding, Armenia remains an early transition country, whose attractiveness to foreign investors is tempered *inter alia* by partial isolation and the small size of the domestic market, and where the wealth is disproportionately concentrated in the capital city. Armenia's fledgling prosperity is likely to be severely tested in the difficult years ahead, and the country's best hope for weathering the crisis lies with developing its SME's, including in the still poor rural areas, which naturally benefit from ETCI financing instruments and technical assistance. ETCI will thus enable the Bank to remain pro-actively engaged with the Armenian private sector in the new strategy period, particularly in its challenging near-term.

The Bank will also support post-privatisation restructuring and competitiveness enhancement of larger enterprises, particularly in the context of supporting FDI.

Opportunities for the Bank's new investments will also depend on the investment climate. To that end, in addition to project-related policy dialogue, the Bank will maintain a policy dialogue aimed at development of an overall enabling climate for private investment. This will be accomplished primarily through the Bank's participation in the Business Support Council. The Bank will also participate in the Government's Competitiveness Advisory Board, as appropriate, and will continue to assist in the development of relevant components of the Armenian legislation, such as Corporate Governance Code, and PPP legislation. The Bank will continue to co-operate with other IFIs on policy dialogue.

This Strategy does not apply to the disputed territory of Nagorno-Karabakh.

3.2. Sectoral Challenges and Bank Objectives

3.2.1. Enterprise Sector

ETCI will remain the principal driver for the Bank's activities in the enterprise sector. The expansion of the regional hub in Tbilisi, and continuous addition of dedicated sector bankers to its staff, will further accelerate the Bank's activities in the Armenian enterprise sector. Armenia has proved a fertile ground for DIF, and the Bank will continue to grow its equity portfolio. MCFE will likely remain an important instrument for provision of debt financing to the private sector, and the number of participating banks will be selectively increased. DLF will be used for selected projects in specialised industries, such as renewable energy, property and natural resources. As an integral part of the crisis response, credit lines to partner banks for subsequent on-lending to SMEs will be likely further increased, with sub-lending limits raised.

The Bank will continue to ensure that its funds are reaching SME's in rural areas, including by working with such banks as ACBA-Credit Agricole, which specialises in rural lending, and will work to leverage off TAM-BAS's gender-oriented programmes to seek ways to provide additional support to women entrepreneurs. The scope of co-operation with banks should be expanded to include renewable energy loans. The Bank will seek to expand microfinance lending through cooperation with non-bank microfinance intermediaries, as they become regulated by the Central Bank.

While the focus on MSME will remain at the core of the Bank's activities in the enterprise sector, the EBRD will also seek to counter the effects of the crisis by pursuing larger transactions in strategic industries, such as energy and infrastructure, particularly in cases where the Bank would be assisting international investors.

Additional emphasis will be made on expanding the Bank's TAM/BAS advisory services, as well as on strengthening their links with Banking Teams and the RO.

The following sectors offer likely potential for private sector investment:

Agribusiness – The Bank will continue to support this sector, which is of particular importance to the Armenian economy, in addition to likely being able to prove the least cyclical. The Bank will seek bankable opportunities in livestock farming and processing (including poultry and aquatic farming), specialised produce farming, beer and soft drinks, frozen and dried fruit, dairy, and baked goods, as well as in food retailing. Both equity and debt instruments will be used.

Manufacturing – Although the sector has been lagging in its development, the Bank will support industry leaders in selected fields, such as construction materials, who have proved their competitiveness.

Extraction/Natural Resources – While the immediate prospects in the sector are dimmed by the current decline in metals prices, the sector is one of the primary exporting sectors of the Armenian economy, in addition to being a prime target for foreign investors, and could give rise to significant investment possibilities if the privatisation or sale of important non-ferrous metals mines is conducted in a fair and transparent manner and attracts credible strategic investors. The Bank will eventually seek to expand its co-operation with existing clients, as the markets recover, as well as to establish new relationships with creditworthy companies of good integrity, including with international companies.

Property and Tourism – The sector has been the principal driver behind Armenia’s economic growth, and is likely to continue to benefit from the significant demand for quality housing and modern commercial space in the medium term, but its near-term prospects will be likely negatively affected by the economic downturn. The Bank will carefully consider selected bankable projects with sound economics in residential and commercial development in cases where such projects benefit the middle class and contribute to the improvement in quality of life for the general population. The Bank will also support bankable projects in the hospitality sector, particularly in the mid-level category, involving reputable developers and professional international operators.

High-technologies – Armenia has some potential for developing a credible high-technology industry, partially leveraging off the research and development capacity inherited from the USSR. The Government hopes to develop the sector as part of its Sustainable Growth Programme. The Bank will support selected projects with proven technology and strong sponsors, including in traditional industries that utilise modern domestic technology (e.g., property projects utilising advanced seismic-protection technologies).

The Bank will pursue repeat business with its existing clients across the sectors, in cases where such transactions will continue to deliver transition impact.

3.2.2. Financial Sector

Although the relatively insulated Armenian banking system has not yet been materially affected by the liquidity crisis, Armenian banks are vulnerable to external shocks, such as possible decline in remittances from Russia, which may impinge on their ability to provide funds to the private sector.

Supporting the still weak Armenian financial sector against the backdrop of the global “credit crunch” is a priority for the Bank in Armenia, and the Bank will, on a number of levels, continue to promote strengthening financial intermediation in the country. This will include provision of finance in the form of debt and equity to the country’s best bank and non-bank financial intermediaries with a view to reinforce their sustainability.

As the number of the EBRD partner banks has grown to nine in the previous strategy period, with four more banks in the process of becoming clients before the end of Q1 2009, the emphasis will be on expanding and diversifying relationship with the existing client base, introducing such new products as energy efficiency lending, and increasing the number of MCFE participants, rather than on adding new banks to the client list, although as reputable foreign banks continue to enter the Armenian market, the EBRD will seek to support the process, which is highly beneficial for the sector.

The Bank is poised to support consolidation of the Armenian banking sector, which is long overdue. With this in mind, the Bank will selectively pursue additional opportunities for equity participation in Armenia’s best financial institutions, in cases where such participation will eventually foster consolidation.

The Bank will continue to promote and expand its Trade Facilitation Programme (TFP) by expanding the number of participating banks and encouraging active utilisation of TFP lines by the existing participants.

The Bank will also seek to expand its involvement with the financial sector through inclusion of such non-bank intermediaries as insurance, non-bank credit, leasing, and regulated micro

credit companies, via provision of equity and debt financing, as well as through possible co-financing.

The Bank will advance its policy dialogue with the Central Bank, and will support the Central Bank in its efforts to improve corporate governance and organisational structure in the banking sector through possible assistance in developing relevant legislation, as well as by using its influence with local banks, particularly those in which the Bank has an equity stake. Where possible, the Bank will work to facilitate the dialogue between Central Bank and the banking community through knowledge exchange, including sharing experience from the Bank's other countries of operation.

3.2.3. Infrastructure Sector

Power and Energy

The EBRD will continue to focus on renewable energy projects, mostly hydro, both through the participation in the Armenian Renewable Energy Programme (AREP) with Cascade Credit, an offshoot of the Cafesjian Foundation, while pursuing bankable stand-alone larger independent renewable energy projects, such as wind and hydro, provided their economic feasibility is based on sustainable and affordable tariffs.

Whilst emphasizing renewable energy, the Bank will assist in the transition of Armenia's energy sector by supporting private operators. At the time of this writing, the Bank is in advanced stages of a €42 million loan to Armenia's power distribution company. Loan(s) to privately-owned generating companies are envisaged for the new Strategy period.

In matters of policy, the Bank will, through Technical Cooperation assistance, support the independent regulator in the effective implementation of third party access by 2013, as already covenanted in the Armenian energy law, thus ensuring fair access to the market to electricity suppliers, fair prices to end users and helping to develop further alternative source of electricity. The Bank will continue to closely co-ordinate with and support the EU and US in the matter of decommissioning the Metzamor Nuclear Plant.

Transport

The Bank will continue to provide commercial financing to private operators of state-owned infrastructure, starting with the second phase of the Zvartnots International Airport development project. The EBRD will monitor the progress of RZD, the Russian railway company that won the concession for operating the Armenian railway, in its efforts to upgrade and modernise the railway, although the prospects for the Bank's participation may not be immediate.

The EBRD will work with the Government of Armenia to help develop potential priority projects for the sector and identify opportunities for the Bank's participation, such as possible rehabilitation of Armenia's life-line road network, which the Government is considering as part of its anti-crisis measures. These may include development of such vital links as the North-South road transport corridor to Georgia, or rehabilitation of some of the rural roads to help bridge the shortfall (due to the weakening of the US dollar) in Millennium Challenge (MCA) programme of rural roads rehabilitation. Such projects can be only undertaken with sovereign support, and, as such, would be considered in conjunction with sector reform, and in cases where the EBRD financing can be complemented by a capital co-financing grant, and/or provided in conjunction with EIB, ADB or MCA itself.

Municipal and Environmental Infrastructure

The Bank will continue to increase its involvement in the Armenian municipal sector. Building on the model of the Lake Sevan Environment Project, the approach would be to seek sovereign guarantees and co-finance the investments with capital grants for high priority projects. The Bank will consider new projects in sectors where the expected transition impact and availability of sufficient grant co-financing would warrant providing a sovereign loan. These projects could include rehabilitation of urban transport in Yerevan, the municipal water supply in Yerevan and solid waste management in the regions. The Bank will also monitor the situation with Yerevan's municipal budget, expected to be adopted in 2009, with a view to structure a possible sub-sovereign transaction once the City has achieved financial autonomy. Co-financing with other financial institutions will be considered where justified by the size of the investment.

Telecommunications

Because of the de-facto monopolistic situation in the market for much of the previous strategy period, the Bank's activities in the sector to-date have been limited to financing a local television station through MCFF. The government has been gradually chipping away at Armentel's monopoly, and its long-running dispute with OTE ended with a sale to Vypelcom of Russia. The second mobile operator has been taken over by MTS of Russia, while the third license has been won by Orange, a division of France Telecom, which presents an opportunity for the Bank to get involved, subject to its satisfaction with the tender process. In addition to telecom operators, the Bank will consider extending financing to companies which rely on advertising as a source of their revenues, including cable television, information technology related companies as well as companies which rely on advertising as a source of their revenues, including cable TV, print and outdoor advertising.

4. CO-OPERATION WITH OTHER IFIS AND BILATERAL DONORS

To-date, close cooperation between the EBRD and other IFIs and donors has been maintained *inter alia* through regular and ad hoc donor co-ordination meetings attended by the Bank's Resident Office in Yerevan, senior management contacts, both during visits to Armenia and at respective headquarters, regular contacts at working level on a bilateral or multilateral basis, exchange of programme documents, etc, and several joint projects have been undertaken.

In the crisis environment, close co-operation and co-ordination of anti-crisis measures between the Bank and other donors will become doubly important, both on the project and policy dialogue levels. The Bank will thus seek to increase further its already extensive co-operation with IFIs and bilateral donors through co-financing, complimentary projects and close co-ordination of policy dialogue.

The Bank and other IFIs will continue to jointly participate in a variety of the Armenian government's initiatives and government-sponsored bodies, such as the Competitiveness Board. The Bank will seek to mobilise increased donor grant co-financing of selected investment projects, as well as policy dialogue on measures to improve the investment climate, including through legal transition work.

The Bank has worked and will continue to work closely with the World Bank in coordinating its activities, including joint participation in the Government's Competitiveness Board, co-ordination of urban transport initiatives in Yerevan, and, in the new strategy period, possible co-ordination of SME-financing programmes. Co-financing with IFC has not been extensive, as IFC's scale of operations in Armenia is significantly lower than the EBRD's, but such joint undertakings as co-financing of Second Phase of Zvartnots Airport may be considered, in addition to co-operating in the field of technical assistance (e.g., PPP policy framework).

Consultations will continue to be maintained and policy dialogue coordinated with the IMF.

Cooperation with the European Union will be continued in the field of business advisory services, technical assistance, and policy dialogue in conjunction with the European Neighbourhood Policy (ENP). The Bank is ready to co-operate with the EC and other donors in the implementation of the EC-proposed Medzamor Decommissioning Fund initiative through advice and sharing of experience on similar projects.

The Bank has worked closely with USAID in the past strategy period. Thus, the EBRD has benefited from USAID's support to the Bank's Armenian Micro-lending Programme, and its support of TAM/BAS. In the new strategy period, the Bank will work closely with the USAID in the SME and financial sector development, although USAID's scaling down of its activities in Armenia may affect this process. The Bank will continue to look for opportunities for co-operation with Millennium Challenge Armenia (MCA), including in rural road development, and renewable energy (as extension of MCA's rural irrigation project). It should be noted that, notwithstanding partial suspension of its activities, MCA remains operational in Armenia.

Co-operation with KfW in the financial sector has included SME co-financing, e.g., through parallel investment in ProCredit Bank, and will continue in the new strategy period. The EBRD joined forces with DEG to co-finance Phase I of the Zvartnots Airport project, and plans to extend this cooperation to Phase II of the project in 2009.

In 2008, the EBRD and Black Sea Trade Development Bank co-operated in providing financing to an Armenian food processing company, whereby the Bank's equity investment

was complemented by a loan from BSTDB. This was EBRD's first co-financing with BSTDB in Armenia, and the Bank will look for other similar opportunities for co-operation.

The EBRD has stayed in close contact and is ready to co-operate with the Asian Development Bank, as well as with the European Investment Bank (EIB). In December 2006 the Bank, the EIB and the European Commission signed a Memorandum of Understanding which reinforces the close cooperation between the three institutions. The Bank is in the process of developing a joint pilot project with EIB to finance energy-saving and safety measures for the Yerevan Underground (Metro), and will look for opportunities for co-financing of larger projects.

The Bank will seek opportunities to co-finance jointly or in parallel with ADB selected infrastructure projects, such as the pending life-line road projects connecting Armenia to its neighbours.

Please, refer to Annex 9 for a more detailed description of the IFIs and donor activities in Armenia.

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2. Armenia Project Pipeline 2009-2010
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Annex 1: Signed Bank Operations

(as of 30 November 2008, €million)

Operation Name	COMMITMENTS						NET PORTFOLIO			Public/ Private	Year of signing
	Total Project Cost	Debt	Equity	Guarantees	Total EBRD Funding	Disburse d	Portfolio	Undrawn commitments	Operating Assets		
Financial Institutions											
Armenia Multi Bank FW – Anelik Bank	0.8	0.8			0.8	0.8	0.6	0.0	0.6	Private	2002
Armenia Multi Bank FW – Armeconombank	0.8	0.8			0.8	0.8	0.0	0.0	0.0	Private	2000
CBG Armenia (sub project of CBG FW) (equity)	1.1		1.1		1.1	1.1	0.0	0.0	0.0	Private	1999
Regional TFP: Armeconombank	1.0			1.0	1.0	0.0	1.0	1.0	0.0	Private	2002
Regional TFP: Armpimpexbank	0.0			0.0	0.0	0.0	0.0	0.0	0.0	Private	2001
Armenia Multi Bank FW – ACBA	2.5	2.5			2.5	2.5	2.5	0.0	2.5	Private	2003
Regional TFP: Anelik Bank	0.3			0.3	0.3	0.0	0.3	0.3	0.0	Private	2003
Regional TFP: ACBA	0.1			0.1	0.1	0.0	0.1	0.1	0.0	Private	2004
Armenia Multi Bank FW – Anelik Bank	2.1	2.1			2.1	2.1	2.1	0.0	2.1	Private	2004
Armeconombank Equity	1.4		1.4		1.4	0.9	0.9	0.0	0.9	Private	2004
Regional TFP: Ineco Bank	0.0			0.0	0.0	0.0	0.0	0.0	0.0	Private	2005
Armenia Multi Bank FW – ACBA	2.5	2.5			2.5	2.5	2.5	0.0	2.5	Private	2005
Armenia Multi Bank FW – Ineco Bank	0.8	0.8			0.8	0.4	0.8	0.4	0.4	Private	2005
MCFF- ACBA Full Recourse	1.2	1.2			1.2	0.0	1.2	1.2	0.0	Private	2005
DIF: Cascade Insurance and Reinsurance	0.4		0.4		0.4	0.0	0.2	0.2	0.0	Private	2005
Armenia Multi Bank FW Armeconombank	1.7	1.7			1.7	0.8	1.7	0.8	0.8	Private	2005
Byblos Bank Armenia (BBA) Former ITB	6.3		5.0		5.0	2.8	5.0	2.2	2.8	Private	2007
Araratbank equity investment	5.1		5.1		5.1	0.0	5.1	5.1	0.0	Private	2008
MCFF - ACBA Scarlet Ltd. Sub-Loan (NRP)	0.3	0.2			0.2	0.2	0.2	0.0	0.2	Private	2006
AMBFF F/W II - Anelik Bank SME Credit Line III	1.9	1.9			1.9	1.9	1.9	0.0	1.9	Private	2006
MCFF- Anelik Bank Full Recourse Portion	1.5	1.5			1.5	0.3	1.5	1.2	0.3	Private	2007
AMBFF F/W II - Armeconombank Mortgage Facility	1.5	1.5			1.5	1.5	1.5	0.0	1.5	Private	2006
AMBFF F/W II - Armeconombank - A/B Loan	11.5	3.8			3.8	3.8	3.8	0.0	3.8	Private	2007
Armenia MBFF II - Inecobank SME Credit	3.8	3.8			3.8	3.8	3.8	0.0	3.8	Private	2007

Line											
Armenia MBFF II - Cascade Bank SME Credit Line	3.8	3.8			3.8	1.4	3.8	2.4	1.4	Private	2008
Armenia Multi Bank FW - Araratbank	2.6	2.3			2.3	1.8	2.3	0.5	1.8	Private	2007
ACBA Credit Agricole Bank - Syndicated Loan	6.9	2.1			2.1	0.0	2.1	2.1	0.0	Private	2008
Regional TFP: Ararat Bank	0.1			0.1	0.1	0.0	0.1	0.1	0.0	Private	2007
Small Business Finance											
Armenia Multi-Bank FW - ACBA Bank	9.2	4.6			4.6	4.6	4.6	0.0	4.6	Private	2007
Armenia Multi Bank Framework II - ArmeconomBank	2.3	2.3			2.3	2.3	2.3	0.0	2.3	Private	2007
Armenia Multi-Bank FW II - Anelik Bank	5.0	5.0			5.0	5.0	5.0	0.0	5.0	Private	2007
Armenia Multi-Bank FW II - Inecobank	3.8	3.8			3.8	3.8	3.8	0.0	3.8	Private	2006
AMBFF F/W II - ACBA A/B Loan	15.4	5.4			5.4	5.4	5.4	0.0	5.4	Private	2007
Procredit Bank Armenia - Equity	2.1	2.1			2.1	2.1	2.1	0.0	2.1	Private	2007
Armenia Multi Bank FW - Araratbank	1.3	1.5			1.5	1.5	1.5	0.0	1.5	Private	2007
ACBA Credit Agricole Bank - Syndicated Loan	6.9	4.9			4.9	0.0	4.9	4.9	0.0	Private	2008
AMBFF II - Procredit Bank Armenia (Capital Increase)	0.1	0.1			0.1	0.0	0.1	0.1	0.0	Private	2008
SUB TOTAL	108.1	63.0	13.0	1.5	77.5	54.1	74.7	22.6	52.0		
Infrastructure											
<i>Energy</i>											
DLF: Bazenc CJSC	1.1	1.1			1.1	0.4	1.1	0.7	0.4	Private	2005
Hrasdan No. 5, Republic of Armenia	74.4	47.9			47.9	47.9	12.1	0.0	12.1	Public	1993
Armenian Renewable Energy Programme	11.5	5.4			5.4	1.9	5.4	3.5	1.9	Private	2006
DLF - Hydro Corporation	1.4	1.4			1.4	0.0	1.4	1.4	0.0	Private	2007
<i>Telecom and Transport</i>											
Yerevan (Zvartnots) Air Cargo Terminal	21.9	17.8			17.8	17.8	2.6	0.0	2.6	Public	1994
Armenia International Airport - Passenger Terminal	48.4	15.4			15.4	15.3	15.4	0.1	15.3	Private	2006
MCFF- Armeconombank "Shant" LLC (NRP)	0.4	0.4			0.4	0.4	0.4	0.0	0.4	Private	2007
<i>Municipal and Env Inf</i>											
Armenia Lake Sevan Basin Environmental Project	12.0	7.0			7.0	0.0	7.0	7.0	0.0	Public	2007
SUB TOTAL	171.1	96.4			96.4	83.7	45.4	12.7	32.7		
Enterprise support											
<i>Agribusiness</i>											
Wholesale Market Project	2.6	0.6			0.6	0.6	0.0	0.0	0.0	Public	1995
Yerevan Brandy Company	41.5	16.6			16.6	16.6	3.7	0.0	3.7	Private	2000
MCFF - ACBA Mush Sub-Loan (NRP)	0.3	0.1			0.1	0.1	0.1	0.0	0.1	Private	2006
MCFF - Armeconombank	0.6	0.3			0.3	0.3	0.3	0.0	0.3	Private	2006

Daroink LLC Sub-loan (NRP)											
MCFF - Anelik Bank "Yerevan Beer" CJSC	0.5	0.5			0.5	0.5	0.5	0.0	0.5	Private	2008
MCFF - Armeconombank Daroink LLC Sub-Loan 2	0.2	0.2			0.2	0.2	0.2	0.0	0.2	Private	2008
DIF - Tamara Fruit	1.1	1.1			1.1	1.1	0.8	0.3	0.8	Private	2006
DIF - Star Group	6.2	6.2			6.2	3.1	3.1	3.1	3.1	Private	2006
DIF - Natfood/Biella	1.3	1.3			1.3	1.3	1.3	0.0	1.3	Private	2008
MCFF - Anelik Bank "Arzni BML" LLC	0.6	0.6			0.6	0.6	0.6	0.0	0.6	Private	2008
General Industry											
Armenian Copper Programme	6.8	4.5			4.5	0.9	3.6	2.3	1.2	Private	2002
DIF: Shen Concern CJSC	1.3		1.3		1.3	1.3	1.3	0.0	1.3	Private	2004
DIF: Liqvor CJSC	2.8	0.6	0.4		1.0	0.0	1.0	1.0	0.0	Private	2005
MCFF-ACBA MavaTerm Sub-Loan (NRP)	0.1	0.1			0.1	0.1	0.1	0.0	0.1	Private	2007
MCFF-Armeconombank Malayan Ophthalmologic Center Sub-Loan (N	0.2	0.2			0.2	0.2	0.2	0.0	0.2	Private	2006
MCFF-Armeconombank "Nairi" Medical Center	0.5	0.5			0.5	0.5	0.5	0.0	0.5	Private	2007
DLF - Shen Concern	3.9	3.9			3.9	3.9	3.9	0.0	3.9	Private	2007
MCFF - Armeconombank "Selena Service" Sub-Loan	0.3	0.3			0.3	0.3	0.3	0.0	0.3	Private	2008
DIF - Alpha Pharma	4.4		4.4		4.4	3.2	4.4	1.2	3.2	Private	2007
SUB TOTAL	75.2	37.6	6.3		43.7	34.8	25.9	7.9	21.3		
Country Total	354.4	197	19.3		217.6	172.6	146	43.2	106		
Total projects					66		60		45		

ANNEX 2: ARMENIA PROJECT PIPELINE 2009-2010

Client/project type	Euro m	2009%	Sector	Debt/equity
Local Bank-TFP	0.4	50%	FI	debt
Foreign bank SME facility	3.9	50%	FI	debt
Local bank SME	7.8	50%	FI	debt
Local bank SME	1.9	50%	FI	debt
-Local bank	3.9	50%	FI	debt
-Local Bank	7.8	50%	FI	debt
Airport development	15.6	50%	T	debt
Power distribution company	42.0	50%	P&E	debt
Poultry producer	3.1	50%	Agri	equity
Residential property development	4.3	50%	P&T	debt
Non-Bank MFI	3.1	50%	NBFI	debt
Bank Senior Loan	3.9	50%	FI	debt
TOTAL "A" list (Core):	98		# ops	12

Project Name	Euro m	2009%	Sector	Debt/equity
Bank TFP	0.8	40%	FI	debt
Agribusiness - DLF	1.6	40%	Agri	debt
Bank-SME	2.3	30%	FI	debt
Bank-Loan	3.5	30%	FI	debt
ETC Non-Bank MFI F/WII	1.6	40%	NBFI	debt
ETC Non-Bank MFI F/WII-	0.8	40%	NBFI	debt
Yerevan-Metro-Loan	5.0	40%	MEI	Debt
Bank TFP	2.3	40%	FI	Debt
Manufacturer	5.5	40%	GI	Equity
TOTAL "B" List:	23		# ops	9

Project Name	Euro m	2009%	Sector	Debt/equity
Hospitality -DLF	2.5	10%	P&T	Debt
Power generation company	20.0	10%	P&E	Debt
Water utility	2.5	0%	MEI	Debt
Computer assembly company	3.1	30%	TIM	Debt
Landfill project	2.0	20%	MEI	Debt
IT company	1.1	10%	GI	equity
Bank-MCFF	10.0	20%	FI	Debt

Data processing - DLF	2.0	20%	TIM	Debt
Plastics - DLF	2.0	20%	GI	Debt
Mining company loan	23.5	10%	NR	debt

Total "C" list EUR 60 million

ANNEX 3: POLITICAL ASSESSMENT

Compliance with Article 1

Armenia is committed to the principles of multiparty democracy, pluralism and market economics in accordance with the conditions outlined in Article 1 of the Agreement Establishing the Bank, although application of these principles in the previous Strategy period has been uneven. Although significant shortcomings were noted, the conduct of the May 2007 parliamentary elections was deemed by the international community to have been generally free and fair, representing an important step forward in Armenia's democratisation process. However, the February 2008 presidential election, by contrast, was tainted by serious allegations of impropriety, leading international monitors to conclude that the election had not been fully free and fair and raising concerns about the Armenian authorities' commitment to upholding internationally recognised democratic standards. The authorities' unwillingness to accommodate opposition demands for an impartial investigation of the conduct of the election, the ensuing social unrest, and the authorities' disproportionately heavy-handed response to peaceful protests against the conduct of the presidential election significantly heightened these concerns.

Political Accountability

The Armenian Constitution provides political accountability through the separation of executive, legislative and judicial powers and regular, direct, contested elections for both the presidency and the unicameral legislature, the National Assembly. The National Assembly is composed of 131 deputies, 90 of whom are elected by party lists and 41 in single-member districts. The Armenian political system remains strongly presidential, despite constitutional amendments advocated by the OSCE and the Council of Europe's Venice Commission that were designed to strengthen the legislature and judiciary vis-à-vis the presidency and which were adopted in a national referendum in November 2005. As a result, the constitutional system of checks and balances remains weak in practice. This weakness in Armenia's system of constitutional checks and balances has contributed to a series of national and local elections that have fallen short of international standards.

The most recent presidential election, on 19 February 2008, resulted in a first round victory for the incumbent Prime Minister and leader of the Republican Party, Serzh Sargsian. The International Election Observation Mission, led by the OSCE's Office of Democratic Institutions and Human Rights and the Council of Europe, concluded that the election "mostly met OSCE commitments and international standards in the pre-election period and during voting hours". However, the Report concluded that there had been major violations of Armenia's international commitments in the longer-term conduct of the election, including "serious challenges to some commitments...especially after election day," and concluded that the elections "displayed an insufficient regard for standards essential to democratic elections and devalued the overall election process." This negative assessment was echoed by domestic observers, who alleged wide-scale vote fraud, voter intimidation and ballot-box stuffing.

As soon as the election result was declared, the second-placed candidate, former Armenian President Levon Ter-Petrossian, publicly claimed that the election had been fraudulent and called on his supporters to begin peaceful protests in support of a re-run of the election. The authorities permitted the opposition to hold a sit-in protest in central Yerevan, as well as daily rallies attracting around 25,000 supporters. However, on 1 March 2008 the sit-in protests were forcefully dispersed by the police – who alleged that protesters were accumulating weapons and intended to orchestrate the overthrow of the constitutional order – and Ter-Petrossian was placed under house arrest. During the course of 1 March, clashes

between the police and protesters escalated, eventually resulting in the deaths of at least eight protesters and one policeman (the precise number is contested). Riot police were sent on to the streets of Yerevan, and President Kocharian imposed a 20-day state of emergency, including a media blackout. These actions by the Armenian Government raise serious concerns about the authorities' commitment to upholding civil and political liberties. Furthermore, the use of lethal violence against opposition protesters has seriously undermined many Armenians' trust in their own government. Restoring the public's trust in the accountability of Armenia's democratically elected leaders will require a concerted effort on the part of the authorities, evidence of which is currently lacking.

Following his inauguration on 9 April 2008, President Sargsian appointed Tigran Sargsian, the then-Chairman of the Central Bank, as Prime Minister and invited the opposition to participate in the formation of a new Government. However, while a few new MPs were brought into Government, the Tigran Sargsian Cabinet was formed on lines very similar to the previous Government and many of the previous ministers retained their portfolios.

The new Government has declared that its overarching objectives include improving Armenia's international competitiveness by improving the business environment, combating corruption and the shadow economy, and implementing reform to the tax administration. If successful, these measures should help to reduce the influence of a small number of powerful oligarchic groups and weaken the *de facto* monopolisation of significant sectors of the economy. This in turn would strengthen political accountability in Armenia. However, overcoming these powerful vested interests will require strong and sustained commitment to fundamental political reform and strengthening the rule of law.

The past several years have witnessed strong growth in the number and professionalism of civil society organisations (CSOs) in Armenia. However, after a period in which the Government was actively engaged with civil society representations and the influence of these CSOs on the policymaking process was strengthened, the Armenian Government has more recently reverted to its older practice of largely marginalising CSOs in the policymaking process.

The Rule of Law

The Armenian Constitution provides for an independent judiciary and the guarantee of basic rights, including the presumption of innocence. However, in practice, the judiciary continues to suffer from both politically and commercially motivated interference, and opposition activists in particular have been detained and held for long periods without trial on a regular basis. This is particularly true of the aftermath of the 1 March 2008 crackdown on opposition protesters, during the course of which several hundred protesters were detained. Many of these remain imprisoned awaiting trial on a range of charges, from civil disorder to attempting to overthrow the constitutional order through force.

Both administrative corruption and state capture remain significant problems in Armenia. According to the most recent report from Transparency International, Armenia's score on the Corruption Perceptions Index fell to 2.9 in 2008 from 3.0 reported in 2007, resulting in a fall in the global rankings from 99th in 2007 to 109th in 2008. Although Armenia continues to score the highest (jointly with Moldova) among the CIS countries, the whole region's relative global ranking has been steadily falling over recent years, reflecting both the stagnation in the fight against corruption in the CIS countries, as well as progress in anti-corruption efforts elsewhere in the world.

The Government has committed itself to strengthening the fight against corruption and combating the influence of powerful vested interests on economic policymaking. The

Government's 2003 Anti-Corruption Strategy and Action Plan led to the formation of a Prime Ministerial-led Council for Combating Corruption, and some important anti-corruption legislation and amendments have been adopted in recent years as a result of that Council's efforts. However, enforcement of anti-corruption legislation remains a major obstacle, and the judiciary's relative weakness and lack of professionalism have further undermined efforts to combat both administrative and high-level corruption. Progress in rolling back state capture, in particular, will depend on broader efforts to fully democratise the Armenian state and promote genuine competition across all sectors of the economy.

Civil and Human Rights

The Constitution of Armenia in theory guarantees equal protection for citizens' civil and human rights under the law. However, in practice, implementation of these constitutional guarantees has been uneven. According to the 2007 Country Report on Human Rights Practices published by the US State Department's Bureau of Democracy, Human Rights, and Labor in March 2008, the Armenian Government's "human rights record remained poor, and serious problems remained." The Report highlighted particular concerns about the ability of Armenian citizens to freely change their government; the widescale practice of arbitrary arrest and detention; the treatment of pre-trial detainees; the accountability of the police and National Security Service; and the imposition of restrictions on citizens' privacy, the freedom of the press, and freedom of assembly.

The political opposition, in particular, has routinely had their basic civil and human rights denied through the abuse of both executive and judicial powers. This is particularly true with regard to the protesters against the conduct and outcome of the 1 February 2008 presidential election, many of whom remain imprisoned on a variety of charges. The international community, including the OSCE and Council of Europe, have repeatedly called for the immediate release of all prisoners deemed to have been arrested on politically motivated grounds and an impartial official investigation of the events leading up to and taking place during the course of the crackdown on opposition protesters on 1 March 2008. To date, the Armenian authorities have not complied with calls for the release of all prisoners deemed to have been arrested on politically motivated grounds. While a parliamentary ad hoc committee of inquiry has been established, there are concerns about the committee's impartiality. Furthermore, opposition politicians have repeatedly asserted that the freedom of assembly has been under attack in the aftermath of the 1 March events, as the authorities have routinely denied legal permission for opposition meeting and rallies without justification.

The freedom and independence of the media in Armenia remain severely restricted. While opposition newspapers are permitted to operate, their circulation remains very small and almost entirely restricted to the capital, Yerevan. The country's only independent television station, A1 Plus, lost its broadcasting license in 2003 and has still not succeeded in having it restored, despite numerous attempts to do so. Access to more balanced international radio and television news sources is limited, and the authorities have actively persecuted certain news sources. In July 2008 Armenian state-owned Public Radio adopted a new policy regarding foreign broadcasting that resulted in the cancellation of broadcasts by the US-funded Radio Free Europe/Radio Liberty (RFE/RL), the only major radio broadcaster in Armenia to air viewpoints critical of the authorities. Investigative journalists, particularly those who investigate and publish exposes about political and administrative corruption, face regular persecution, including regular checks by the Security Service and the tax inspectorate, and there have been numerous reports of violent attacks on such journalists.

Human trafficking remains a significant problem in Armenia. According to the US State Department's 2008 Trafficking in Persons Report, Armenia is primarily a source for

trafficking of women and girls for the purpose of sexual exploitation in Turkey and the Middle East, and the Government of Armenia “does not fully comply with the minimum standards for the elimination of trafficking.” As a result, Armenia has been classified by the US State Department as a ‘Tier-2 Watch List’ country since 2005. The Report notes that the Armenian authorities are making significant efforts to combat trafficking in persons, including the adoption of a National Action Plan and drafting of a National Referral Mechanism, but concludes that tangible progress in identifying and protecting victims of trafficking or in tackling government officials’ complicity in trafficking is lacking.

External Relations

Armenia continues to maintain close strategic relations with the Russian Federation, with which the country also shares strong financial and commercial ties. Armenia’s relations with the West, mediated through a series of bilateral and multilateral agreements, have by contrast been tested as a result of the conduct of the presidential election of February 2008 and the ensuing crackdown on opposition protesters. The EU and US have called for an impartial, internationally sanctioned investigation of the election and its aftermath, and the US’ Millennium Challenge Corporation (MCC) has suspended its Compact programme with Armenia pending a review of political developments at end-2008. While the Armenian authorities continue to express at least rhetorical support for Armenia’s integration with Western and in particular European structures, further progress on the European path will depend in large part on a recommitment on the part of the Armenian authorities to deeper democratisation and enhanced structural reform.

Little concrete progress has been made toward a resolution of the longstanding dispute over Nagorno Karabakh. This ‘frozen’ conflict leaves Armenia isolated in the region, impeding the country’s economic development and excluding it from regional projects and initiatives, including transborder development projects incorporating Armenia’s neighbours Georgia and Azerbaijan. However, the Georgia-Russia conflict of August 2008 significantly altered the geopolitical landscape in the South Caucasus. One manifestation of this changed landscape, and an important step toward regional conflict resolution, was the September 2008 visit to Yerevan by Turkish President Abdullah Gul, the first official visit of a Turkish President to Armenia since the 1930s. While no concrete steps have yet resulted from that visit, the Armenian political leadership is more committed than at any time since the break-up of the Soviet Union to establishing diplomatic relations with Turkey and securing the opening of the Turkish-Armenian border. An improvement in Armenian-Turkish relations would help to promote a settlement of the Nagorno Karabakh conflict. However, full rapprochement between Turkey and Armenia is likely to prove elusive in the absence of at least concrete steps toward a permanent resolution of the Nagorno Karabakh issue.

ANNEX 4: SELECTED ECONOMIC INDICATORS

Armenia	2003	2004	2005	2006	2007	2008 <i>Estimate</i>	2009 <i>Projection</i>
Output and expenditure							
	<i>(Percentage change in real terms)</i>						
GDP	13.9	10.1	14.0	13.2	13.8	6.8	-5.5
Private consumption	11.5	16.3	7.6	13.3	16.1	na	na
Public consumption	21.9	17.0	21.9	13.3	24.2	na	na
Gross fixed capital formation	30.0	21.9	46.8	41.2	21.3	na	na
Exports of goods and services	30.6	0.0	23.7	-4.0	-2.6	na	na
Imports of goods and services	28.1	-1.1	20.6	7.5	18.3	na	na
Industrial gross output	15.3	2.1	7.5	-0.9	2.6	2.0	na
Agricultural gross output	4.0	14.5	11.2	0.4	9.6	1.3	na
Employment							
	<i>(Percentage change)</i>						
Labour force (end-year)	-0.6	-0.5	0.6	0.5	-1.1	na	na
Employment (end-year) ¹	0.5	-4.6	2.6	-0.3	0.1	na	na
	<i>(In per cent of labour force)</i>						
Unemployment (annual average) ²	10.1	9.7	7.9	7.4	6.7	na	na
Prices and wages							
	<i>(Percentage change)</i>						
Consumer prices (annual average)	4.7	7.0	0.6	2.9	4.3	9.0	8.0
Consumer prices (end-year)	8.6	1.9	-0.2	5.2	6.6	5.2	8.0
Producer prices (annual average)	8.9	-13.3	7.7	0.9	0.6	2.2	na
Producer prices (end-year)	21.1	25.3	-4.0	na	na	na	na
Gross average monthly earnings in economy (annual average)	26.7	23.7	23.9	22.9	20.9	na	na
Government sector³							
	<i>(In per cent of GDP)</i>						
General government balance	-1.1	-1.8	-2.6	-2.8	-2.2	-1.4	-1.5
General government expenditure	18.9	17.1	17.6	18.5	19.2	19.6	na
General government debt	40.9	51.5	39.7	34.2	20.0	na	na
Monetary sector							
	<i>(Percentage change)</i>						
Broad money (M2, end-year)	10.4	22.3	27.8	32.9	42.3	na	na
Domestic credit (end-year)	-10.1	41.2	54.6	8.7	78.4	na	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	14.4	15.0	16.3	18.2	21.4	na	na
Interest and exchange rates							
	<i>(In per cent per annum, end-year)</i>						
Refinancing rate	7.0	3.8	3.5	4.1	4.8	na	na
Money market rate	7.5	4.2	3.2	na	5.1	na	na
Deposit rate	6.9	4.9	5.8	na	6.2	na	na
Lending rate	20.8	18.6	18.0	16.5	17.5	na	na
	<i>(Drams per US dollar)</i>						
Exchange rate (end-year)	566.0	486.3	450.2	363.5	304.2	299.1	na
Exchange rate (annual average)	578.8	533.5	457.8	416.0	342.1	304.1	na
External sector							
	<i>(In millions of US dollars)</i>						
Current account	-189.4	-161.7	-193.1	-117.0	-589.0	-1,173.0	-1,516.0
Trade balance	-434.1	-457.9	-588.0	-896.0	-1,600.0	-2,466.0	-3,110.0
Merchandise exports	696.1	738.3	1,005.0	1,025.0	1,197.0	1,269.0	1,403.0
Merchandise imports	1,130.2	1,196.3	1,593.0	1,921.0	2,797.0	3,735.0	4,513.0
Foreign direct investment, net	121.0	217.0	252.0	340.0	455.0	482.0	na
Gross reserves, excluding gold (end-year)	502.0	547.8	669.5	1,071.9	1,246.0	na	na
External debt stock	1,788.1	1,868.0	1,860.2	2,052.7	2,200.0	na	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	4.3	4.3	4.0	5.1	4.2	na	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	15.6	9.7	4.6	3.9	2.9	na	na
Memorandum items							
	<i>(Denominations as indicated)</i>						
Population (end-year, million)	3.2	3.2	3.2	3.2	3.2	3.2	na
GDP (in billions of drams)	1,624.6	1,907.9	2,244.0	2,665.0	3,233.0	3,632.4	3,707.2
GDP per capita (in US dollars)	873.9	1,112.8	1,510.0	1,989.4	2,936.4	3,711.2	na
Share of industry in GDP (in per cent)	19.9	19.7	na	na	na	na	na
Share of agriculture in GDP (in per cent)	21.3	22.5	na	na	na	na	na
Current account/GDP (in per cent)	-6.7	-4.5	-3.9	-1.8	-6.2	-9.8	-11.2
External debt - reserves (in US\$ million)	1,286.1	1,320.2	1,190.7	980.7	954.0	na	na
External debt/GDP (in per cent)	63.7	52.2	38.0	32.0	23.3	na	na
External debt/exports of goods and services (in per cent)	197.9	189.7	139.1	135.9	123.8	na	na

¹ people who work

² Registered unemployed only.

³ Central government account only.

ANNEX 5: LEGAL REFORM

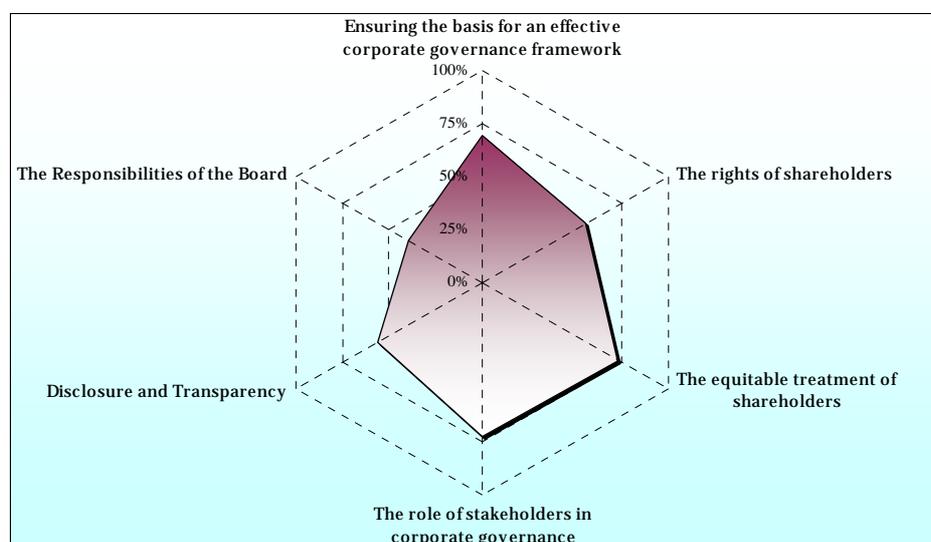
The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Armenia, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Company Law and Corporate Governance

The principal law dealing with corporate governance in Armenia is the Law on Joint-Stock Companies (the “JSCL”), which was enacted in December 2001 and most recently amended in April 2007. The Ministry of Justice is currently working on a comprehensive revision of the law which should be finalised in late 2009.

There is no voluntary corporate governance code in the country, but the EBRD is currently working with the Ministry of Economy and the Global Corporate Governance Forum on the development of a code applicable to listed companies, banks and state owned enterprises.

Quality of corporate governance legislation – Armenia (2008)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2008 assessment

According to the results of the EBRD’s 2008 Corporate Governance Sector Assessment, (see chart above) through which the quality of corporate governance legislation in force in November 2007 was assessed, Armenia was assessed to be in “medium compliance” with the relevant international standards (the OECD Principles of Corporate Governance). Among the shortcomings highlighted by the assessment was the need for improvement in the regulation defining the responsibilities of the board, disclosure and transparency.

In 2005, the EBRD conducted a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated (i) the position of a minority shareholder seeking to access corporate information on a related-party transaction presumed to have been entered

into by the company; and, (ii) how compensation could be obtained in case damage was suffered. The effectiveness of the system for both questions was assessed based on four principal variables: complexity, speed, enforceability and institutional environment. The survey revealed that there are very limited avenues for minority shareholder to pursue to obtain disclosure or redress in Armenia. Where they exist, procedures are complex, lengthy and enforceability is a problem. The institutional environment is ineffective: competence and experience of courts, prosecutors and market regulator needs to be improved; case law collections are generally not available; financial reporting is weak, while corruption and partiality of judgements are still reported as problems.

Concessions

On a general policy framework level, there is an indirect reference to improving the legal environment and promoting Public Private Partnership (PPP) in Armenia's Poverty Reduction Strategy Paper. A PPP status and policy paper is due to be presented by the Ministry of Economy to the Government late in 2008 which may include a follow-on action plan as far as the policy, legal and institutional frameworks in PPP are concerned.

Armenia is one of the very few EBRD countries of operations that does not have a specialist single-act concession law applicable to infrastructure, municipal utilities and public services. General laws do not refer to or regulate concessions apart from a general reference in the Law on Foreign Investments, providing that concessions are one of the forms of foreign investment.

The Law on Concession of Subsurface for Purposes of Mineral Prospecting and Mining (the "Mining Law"), dated April 2003, is a fairly detailed piece of legislation which regulates mineral rights, provision of licenses and contracts in the industry and which is expected to facilitate investment into the sector. Pursuant to the Mining Law, a concession agency is to be created within the Ministry of Trade and Economic Development. This agency is expected to deal with the granting of mining rights and supervision of their use, as well as generally representing the Government in these issues. By way of implementing the requirements of the Mining Law, the Government has also approved model template agreements. Water industry legislation also provides for private sector contracts, including for the use of assets and their pledging as collateral for lease and concession contracts. However, such laws do not contain clear definitions and need to be improved regarding the selection procedures (even though the general rule is that concessions are granted based on a tender/auction). Water sector legislation also refers to a model concession agreement, the use of which is fortunately optional.

Government support and financial security interests are defined in the general legislation (Civil Code, Law on Budgetary System) and allow, to a certain extent, such elements. No clear reference is made to international arbitration, although international arbitration has been allowed in privatisation contracts.

The EBRD's recent Assessment of Concessions Laws undertaken to evaluate applicable regimes throughout the EBRD's 29 countries of operations (the laws on the books only rather than how they work in practice), assessed Armenian laws as having a "Very Low Compliance" with internationally accepted standards of concession law. Ideally, therefore, comprehensive concessions legislation should be developed.

Insolvency

Armenia adopted a new bankruptcy law in December 2006 (the "New Insolvency Law"). The EBRD's last assessment of Armenia's insolvency legislation was completed in June 2006,

therefore the EBRD has not yet assessed the extent to which this new law approximates international standards of best practice. A complete assessment of all insolvency laws in the Bank's countries of operations, including Armenia, will be completed in 2009.

Based on a preliminary review of the New Insolvency Law, however, it appears a number of changes have been introduced that may make reorganisation of a distressed company more efficient and potentially maximise the recovery rate for creditors. Among other things, the New Bankruptcy Law introduces time limits for reorganisations, and gives creditors a greater say in the reorganisation process by allowing only creditors with approved claims (and not the debtor's owners) to vote on a plan.

Secured Transactions

The Civil Code, which entered into force in 1999, governs secured transactions over movable and immovable property. Articles 226-272 provide for a security right over movable property without a requirement to transfer the collateral to the creditor. These security rights can be registered if the parties wish to do so (and in practice, this is recommended, see further details below).

The scope of assets that can be offered as collateral remains limited since the Civil Code does not allow for the general description of the collateral or the charging of a fluctuating pool of assets except in the case of charges over commodities in circulation (e.g., stocks of goods, raw materials, supplies, semi-fabricates, etc). Even so, the total value of those commodities must remain constant and the borrower must keep records of all changes in the composition or the natural form of the assets, including their processing. Should the borrower fail to do so, the lender would have the right to place signs over the goods to prevent their further use. Therefore, inventories and other types of property, which may also be subject to constant change (some equipment, for example) cannot in practice be used to secure a debt. Moreover, assets, like accounts receivables, are also excluded.

Until 2004, a major problem that creditors faced when taking security in Armenia was the lack of reliable public information. The Resolution of the Government of the Republic of Armenia No 1678-N dated 29 October 2004 transferred to the State Committee of Real Estate Cadastre the authority to carry out registration of the right of pledge over movables. As a result, it is now possible, after signature of a pledge contract, to submit a copy of the pledge contract and the application form in hard copy at a territorial sub-division of the State Committee of Real Estate Cadastre. During the business day following the day in which the application is submitted, the "Kentron" sub-division of Real Estate Cadastre registers the right of pledge by making an entry in the registry and issues the pledge certificate, provided that no grounds for rejection of registration are identified. It is worth adding that before signing the pledge contract, the creditor should always obtain a confirmation that no encumbrances exist in respect of the asset over which the pledge will be registered.

Enforcement is still very uncertain: in 2003 the EBRD prepared an assessment of the efficiency of enforcement of charges throughout its countries of operations,. The results for Armenia were among the worst in the region: a creditor is likely to face a very uncertain and lengthy process, fraught with difficulties. Although parties could, in theory, agree on the mode of enforcement such as a direct sale of the collateral, evidence shows that this is very unlikely to be implemented.

The system is clearly far from optimal but it is a step in the right direction to strengthen creditors' rights and further reform should be undertaken to modernise the registration system and address problems existing in the substantive law.

Mortgage law has received more attention and it seems that draft mortgage and consumer lending laws are currently under preparation and are expected to be adopted in 2009. A new Law on Covered Mortgage Bonds was adopted in May 2008 and became effective in July 2008. The current credit crisis is likely however to negatively impact on the development of the secondary mortgage market.

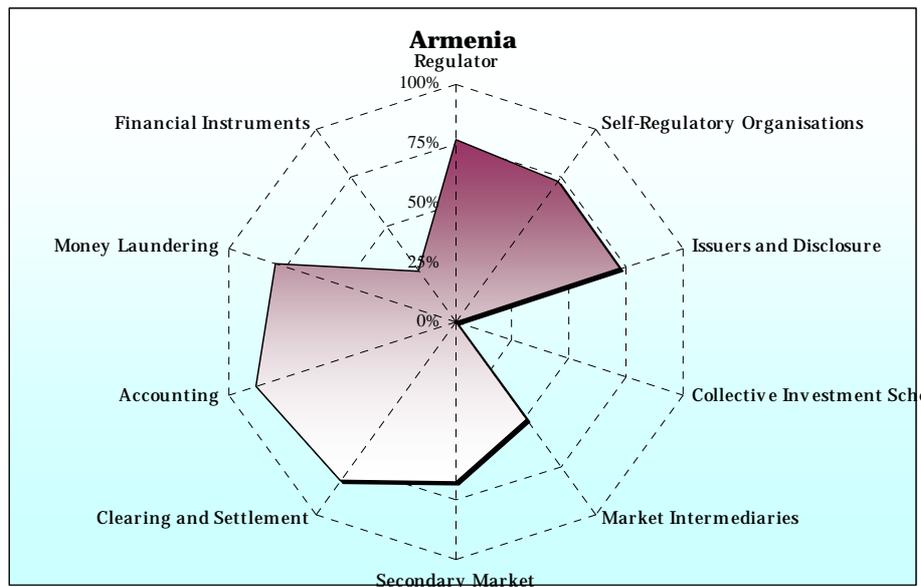
Securities Markets

The Armenian securities markets legal framework is contained in the new Law on Securities Market enacted in March, 2008. The new law supersedes the previous Law on Securities Market Regulation enacted on 1st August 2000 and most recently amended in April 2007.

Since January 2006, the market regulator in Armenia has been the Central Bank of Armenia, replacing the Securities Exchange Commission. ARMEX is the only stock exchange in Armenia. Clearing and settlement of securities is performed by the Central Depository.

The 2007 EBRD Securities Markets Legislation Assessment (see chart below), found Armenia in “medium compliance” with the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO). However, major shortcomings were found in the weak regulation on collective investment schemes, bonds and derivatives.

Quality of securities market legislation – Armenia (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2007

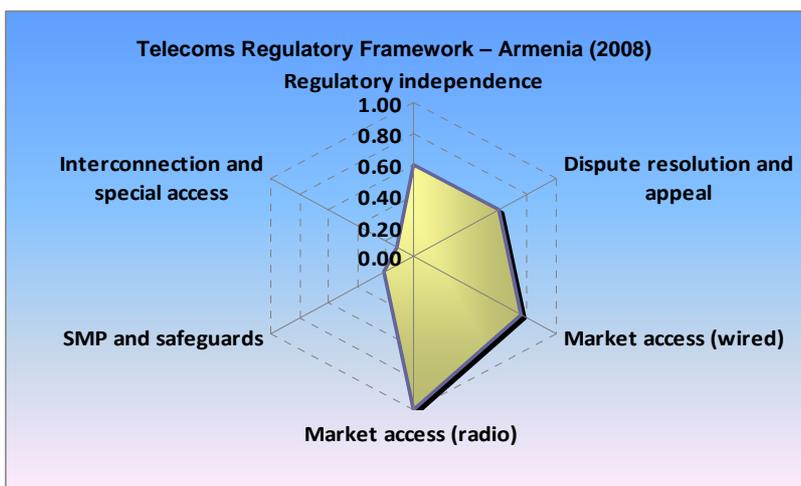
In addition to the above legal assessment, in order to understand how securities markets legislation works in practice, the EBRD recently conducted its 2007 Legal Indicator Survey (“the LIS”). Practitioners in the region were asked to comment on a hypothetical case study, advising an investor who lost his savings after buying shares in a national company’s Initial Public Offering (IPO), having been misled by erroneous information in the prospectus. In particular, the LIS concentrated on the effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and the authority of the market regulator. The LIS revealed that IPOs in Armenia are rarely used as a source of corporate funding, concluded that disclosure practices need to be improved and that financial reporting is weak. The LIS also pointed to a need for the courts, prosecutor and regulator need to develop expertise in investigating securities cases. It was also noted that private enforcement

mechanisms (i.e. legal action before a court) can be lengthy and characterised by heavy burdens of proof. The regulator seems to have the necessary regulatory power but lacks investigative powers, especially in international cases.

Telecommunications

The Telecommunications Department of the Public Services Regulatory Commission (the “Commission”) is the Armenian regulator. The Commission is responsible for activities in the sectors of electric power, natural gas, thermal energy and water in addition to communications. It has an objective to ensure the competitiveness of the market and its responsibilities include licensing, SMP designation and dispute resolution. The Ministry of Transport and Communications (the “Ministry”) is responsible for policy, universal service objectives and the development of the radio spectrum allocation table. Privatisation is complete and the state has no ownership stake in any operator.

During the course of 2008 EBRD conducted an assessment of the communications sectors in all of its countries of operation. The assessment measured key sector indicators against an EBRD assessment model based on the World Trade Organisation (WTO) Reference Paper on Basic Telecommunications Services, though with many of the specific indicators are drawn from the examples provided by the EU electronic communications framework. The results of that assessment for Armenia are presented below in the form of a spider diagram. Based on that assessment Armenia has been determined to be in the category of countries that are in “Medium Compliance” with the international best practice represented in the EBRD assessment model.



ANNEX 6: ENVIRONMENT AND SOCIAL ASSESSMENT

Introduction

Since the implementation of the 2006 Country Strategy, Armenia has made progress in addressing key environmental and social issues identified by the EBRD and other IFIs. This section outlines the progress made by Armenia in the areas related to environmental and social legislation, policies and international conventions, as well as the country's Environmental Action Programme, European Neighbourhood Plan and Millennium Development Goals. This assessment will also present important environmental and social challenges that still face the country as well as potential opportunities for EBRD to have a positive impact in the projects it supports.

Environmental and Social Legislation, Policies and International Commitments

Armenia's environmental and social legislation and policies are largely the responsibility of the Ministry of Nature Protection, with assistance from the Ministries of Health, Labour and Social Affairs, Territorial Administration, Urban Development, Justice and Finance. Important pieces of legislation include *the Law on Environmental Impact Assessment* (1995) and the *Principles of Legislation on Nature Protection* (1991), together which grant the public the right to request environmental and social information and be involved in the decision making process.

Recently, the Ministry of Nature Protection has introduced new environmental quality standards aimed at meeting international best practice and EU standards with the adoption of a new Land Code, Water Code and Mineral Resources Code. Other recent environmental legislation adopted by Armenia includes laws on specially protected areas, hunting and hunting economy, ozone depleting substances, the national water programme, as well as government decisions related to waste. Laws on "environmental state expertise", genetically modified organisms and self-monitoring of compliance are under preparation, while the *Law on Environmental Impact Assessment* is currently undergoing revisions.

Regarding labour policies and standards, Armenia recently adopted a new Labour Code in January 2006. The code outlines the rights and obligations of employees, employers and trade unions; while legislation related to social protection in case of unemployment, social assistance and on state pensions remains to be fully implemented. Armenia has also implemented a National Action Plan 2004-2010, on "Improving the situation of women and enhancing their role in society". This plan has led to the recent revisions to the *Law on Gender Equality*.

As of 2008, Armenia has ratified and signed 26 international multilateral environmental agreements, including but not limited to the Kyoto Protocol, Aarhus Convention, RAMSAR Convention, Convention on Long-range Transboundary Air Pollution, the Espoo Convention and the Convention on Biological Diversity. Armenia is also the co-founder (together with Georgia, Azerbaijan and the European Commission) of the Caucasus Regional Environmental Centre (REC). The REC Caucasus, with headquarters in Tbilisi, promotes capacity building and co-operation between various stakeholders and neighbouring countries.

National Environmental Action Programme

In 1998, the Government approved a National Environmental Action Programme (NEAP-1), the country's first environmental policy framework planning document. Key areas of focus under this landmark programme included environmental legislative reform, the development of sectoral guidelines and policies, the protection of Lake Sevan and its surrounding ecosystem, the conservation of biological and landscape diversity and desertification. In 2006, both the Ministry of Nature Protection and UNDP concluded that many of the proposals and activities originally formulated under the NEAP-1 had been achieved, although additional opportunities and/or areas for improvement existed. As a result, the government launched its second National Environmental Action Programme (NEAP-2) to address these concerns.

According to the Ministry of Nature Protection, the primary goal of the NEAP-2 is to “provide an overall strategy for integrated environmental management in Armenia that optimizes utilization of the country's natural resources with respect to environmental and economic sustainability”. In accordance with this goal, the new NEAP comprises a harmonized set of environmental policy instruments focused on various priority issues including but not limited to land, biodiversity, forestry, water resources and hazardous waste management, atmospheric protection and climate change, inter-sectoral issues related to sustainable management and environmental monitoring. The program is currently ongoing and is expected to be reviewed again in 2012.

Millennium Development Goals

Armenia was one of 191 countries that signed the UN Millennium Declaration in 2000. As a signatory, Armenia agreed to achieve the eight Millennium Development Goals (MDGs) by 2015, which range from eradicating extreme poverty and hunger (Goal 1), to ensuring environmental sustainability (Goal 7).

In 2005, Armenia published its first progress report on meeting the MDGs. According to the report, Armenia remains on target to achieve most of its MDGs by 2015. However challenges persist in the areas of promoting gender equality, ensuring environmental sustainability, and implementing the Government's anti-corruption agenda. Results from the 2008 MDG Progress Report are anticipated to be released shortly.

Poverty Reduction Strategy

The government adopted a Poverty Reduction Strategy Paper (PRSP) in 2003 and undertook measures to implement it through the development of an Action Plan. The PRSP was developed in close cooperation with state governance bodies, the private sector, civil society and international donor community and was been designed to incorporate the country's MDGs. To date, the implementation of the PRSP has had a positive effect in reducing poverty in Armenia. Between 2004-2007, poverty declined sharply from 34.6% to 29%, while the share of extreme poverty decreased to approximately 6.5%. These results can be attributed to various factors including increases in wages and social transfers.

More recently, the government has revised its PRSP for the period of 2008-2021. Although the PRSP will continue to be aligned with the MDGs, the revised strategy has five main themes, i) promoting sustainable economic growth through macroeconomic stability and private sector development, ii) improving public infrastructure, iii) enhancing human development and improving social safety nets, iv) implementing prudent fiscal policies and reforming the tax system, and v) improving core public sectors functions.

Environmental and Social Challenges

Since 2006, the government has had measurable success in fulfilling its environmental and socio-economic commitments outlined in its national policies, strategies and international agreements. Despite this progress, areas that continue to present challenges include environmental governance, environmental protection, poverty reduction in rural areas, biodiversity conservation and land resource management.

Environmental Governance

Although the 2008 MDG National Report remains outstanding, indicators recorded in 1990, 2001, 2003 and 2005 suggests that it is unlikely that Armenia will achieve its 2015 targets related to MDG 7: *Ensure Environmental Sustainability*. Despite positive reforms to national environmental policies and legislation, the government continues to lack resources as well as adequate implementation and enforcement mechanisms to fulfil many of its international environmental commitments under these revised and/or new laws. For example, there is no single act stipulating the framework for national environmental policy in Armenia. As a result, environmental priorities are poorly integrated within national and regional development plans aimed at improving various sectors of public life. The government is however taking positive steps to close these gaps. For example, the law on EIA is currently under review by the Ministry of Nature Protection and in September 2008, the Ministry of Social and Labour Affairs signed a Code of Participatory Cooperation with the NGO “Professionals for Civil Society” to begin discussions related to potential Charter amendments that will ensure full cooperation with public organizations and government ministries.

Environmental Protection

Environmental challenges that continue to face Armenia include inefficient exploitation of natural resources, energy instability, waste management, deforestation, degradation of biodiversity, air, water and soil quality and environmental health issues. The single largest “polluter of concern” continues to be the Metzamor Nuclear Power Plant. Notwithstanding the EU’s warnings to decommission the facility, the government continues to be non-committal in its plans.

Although environmental protection programmes have been highlighted as a top priority for the government, these programmes continue to receive inadequate funding to be effective. According to international experts, Armenia’s present economic growth causes environmental damage commensurate with 8-10% of the country’s GDP. However current budget revenues from environmental taxes and tariffs do not exceed 0.27% of the GDP. Moreover, only a proportion of these taxes are actually used to finance environmental protection programs. Finally, capacity building of the relevant agencies to apply these programs, including the various commitments outlined in the NEAP-2, as well as environmental monitoring and enforcement requires significant improvement.

Poverty Reduction in Rural Areas

Poverty and unemployment remain at extremely high levels in Armenia, especially in the rural areas. An estimated 25% of the national workforce is either un- or underemployed, with over 40% of the population being engaged in agriculture, one of the country’s least productive sectors. Despite significant poverty reduction in Yerevan and other urban centres (e.g. Gyumri, Vanadzor), basic infrastructure and social services are below MDG standards in most rural areas. Moreover, a significant proportion of the rural population are unable to

meet what the UNDP defines as “basic survival needs”. Income inequality is also prevalent, with a greater proportion of women and children living under the poverty line. Despite considerable economic improvements related to the implementation of the country’s poverty reduction strategy, government expenditures on environmental (eg. water, waste management) and social services remain relatively low in rural areas.

Biodiversity Conservation

Although Armenia occupies only 6.7% of the Caucasus territory, the country is home to over 3,500 plant and 17,500 animal species. Armenia is therefore considered to be a “biodiversity hotspot” by organisations such as Conservation International. To help conserve these natural resources, the government has developed successful partnership programs with several IFIs (eg. UNDP, World Bank) and prominent NGOs. The Ministry of Nature Protection is also responsible for the management of 3 state reserves, 2 national parks and 245 state sanctuaries which cover approximately 6% of the country’s total land mass. Despite these measures, major threats to biodiversity continue to include planned and ongoing extractive resources exploitation (eg. mining), deforestation and illegal logging, infrastructure development (eg. roads, pipelines), agricultural intensification and air, water and soil degradation. Going forward, key challenges facing the government include the implementation of the country’s national *Biodiversity Strategy and Action Plan*, the allocation of sufficient resources to biodiversity research, monitoring and enforcement, education and public awareness and the management of biodiversity on public lands.

Land Resource Management

The Ministry of Territorial Administration is responsible for all land administration, including land registration and classification, acquisitions by the state, expropriation and resettlement. Current policies and procedures governing land administration however are weak and often implemented inconsistently across the country, especially with respect to land valuation in rural areas. As a result, a significant portion of the complaints filed with the Office of the Ombudsman (Human Rights Defender) currently challenge government land rulings and/or related valuations and compensation. As part of the World Bank *Public Sector Modernization Program*, the government is currently investigating opportunities to decentralise land administration responsibilities from the central government to the territorial and regional governments in order to make the land administration process more accountable and transparent. Although this initiative is a good first step in improving current land administration practices, the lack of a clear national land use policy and inadequate capacity and resources within the regions will continue to present management challenges for the government, potential developers and private land owners.

ANNEX 7: TECHNICAL COOPERATION PROJECTS

Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Business Group
Armenian Copper Programme - Environmental Audit	CA3F	24,425	24,425	19/09/02	Closed	Manufacturing	SEEC
Continuation of TMG Programmes in the Armenia, Azerbaijan and Georgia - Women in business: Fashion Training Center in Armenia	CACS	50,952	50,952	11/12/06	Closed	Manufacturing	SEEC
TAM - Armenian Copper Programme	CAT2	83,511	73,154	20/12/05	Disbursing	Manufacturing	SEEC
TAM - Valletta	CAT2	26,361	26,361	16/02/06	Closed	Manufacturing	SEEC
TAM - Tamara Fruits	CAT2	32,624	5,011	23/02/06	Disbursing	Manufacturing	SEEC
ProCredit Bank Armenia (PCBA) - Start-up and Regional Expansion	CATC	323,240	314,929	21/08/07	Disbursing	Finance, Business	Deputy Vice President
TAM Programme in Armenia	ECAR	411,035	411,035	30/08/02	Closed	Manufacturing	SEEC
BAS Programme in Armenia	ECAR	925,459	925,459	07/10/02	Closed	Manufacturing	SEEC
Telecommunications regulatory development programme	ECT	131,744	131,744	02/09/99	Closed	Telecommunications	Non-Banking
Armeconombank (AEB) - Institution building	EIPF	462,113	462,113	06/05/05	Closed	Finance, Business	Financial Institutions
Armenia: Conference on Trade Finance	EIPF	22,260	22,260	18/11/05	Closed	Finance, Business	Financial Institutions
Armenia Microlending Programme (AMP)	ETCF	141,220	141,220	28/08/05	Closed	Finance, Business	Deputy Vice President
TAM - Shen Concern	ETCF	21,759	21,759	27/01/06	Closed	Manufacturing	SEEC
Legal Assistance for Armenian Renewables Programme	ETCF	50,000	49,788	16/03/06	Disbursing	Energy	Energy
TAM - Darink	ETCF	74,440	50,255	19/09/06	Disbursing	Manufacturing	SEEC
Armenia: Risk Management and Corporate Governance Support to an Armenian Bank	ETCF	350,000	187,350	23/10/06	Disbursing	Finance, Business	Financial Institutions
Armenia: Armeconombank ('AEB') - Assistance with Mortgage Lending	ETCF	150,000	111,770	30/11/06	Disbursing	Finance, Business	SEEC
PPC Project Financing Workshop in Armenia	ETCF	21,102	21,102	30/11/06	Closed	CEALs, CoFinancing Lines & RVF's	Non-Banking
Armenia: Lake Sevan Basin Environmental Project - Engineering	ETCF	890,000	133,220	27/02/07	Disbursing	Local Authority Services	SEEC
Armenia: Lake Sevan Basin Environmental Project - PPP	ETCF	256,000	0	27/02/07	Committed	Local Authority Services	SEEC
Armenia: Investment Council Framework	ETCF	193,921	30,702	04/05/07	Disbursing	Community/Social Services	SEEC
Armenia Microlending Programme (AMP)	ETCF	119,720	0	31/08/07	Committed	Finance, Business	Deputy Vice President
Armenia: Multi Bank Financing Framework Facility - Credit Advisory Services and Institutional Building	ETCF	350,000	8,000	14/12/07	Disbursing	Finance, Business	Financial Institutions
Armenia - Development and Implementation of Corporate Governance Code	ETCF	180,000	21,909	18/03/08	Committed	Community/Social Services	Non-Banking
Armenia: Training for TFP Factoring	ETCF	35,000	0	23/04/08	Committed	Finance, Business	Financial Institutions
FAO Framework Agreement - Tamara Fruit	HOL	21,217	21,217	13/06/05	Closed	Manufacturing	Specialised Industries
Armenia: Trade Finance Advisory Services	IRL	45,295	45,295	31/03/04	Closed	Finance, Business	Financial Institutions
SME Line of Credit (Central Bank of Armenia)	JAP	735,190	735,190	20/08/98	Closed	Finance, Business	Financial Institutions

Armenia Institution Building Programme	JAP	498,260	498,260	01/05/01	Closed	Finance, Business	Financial Institutions
Anelik Bank	JAP	12,874	12,874	18/12/02	Closed	Finance, Business	Financial Institutions
DIF - Maralik Legal Due Diligence	NLT	7,560	7,560	30/09/03	Closed	Finance, Business	Financial Institutions
Assessment of Armenian Wood Sector	SWE2	15,086	15,086	31/07/02	Closed	Manufacturing	Specialised Industries
Hrasdan unit 5 Privatisation Project	SWI	115,895	115,895	07/07/98	Closed	Energy	Energy
Shen Concern Technical Due Diligence Part B	SWI	15,466	15,466	12/11/03	Closed	Finance, Business	Financial Institutions
Shen Concern Legal Due Diligence	SWI	13,000	13,000	12/08/04	Closed	Finance, Business	SEEC
Shen Concern Follow-up Technical Due Diligence	SWI	3,750	3,750	12/08/04	Closed	Finance, Business	SEEC
Shen Concern Environmental Due Diligence	SWI	6,000	6,000	26/08/04	Closed	Finance, Business	SEEC
FAO Framework Agreement	TCS	5,599	5,599	30/07/02	Closed	Manufacturing	Specialised Industries
Shen Concern Technical Due Diligence Part A	TCS	13,745	13,745	10/11/03	Closed	Finance, Business	Financial Institutions
TAM - Unicom	TWTC	74,440	19,045	31/01/07	Disbursing	Manufacturing	SEEC
Armenia Power Distribution Privatisation Legal Due Diligence	UKD	146,737	146,737	13/09/99	Closed	Energy	Energy
Maralik Financial Due Diligence	UKD	3,900	3,900	17/03/03	Closed	Finance, Business	SEEC
Research study on BDS providers capacity building in Gegharkunik and Tavush Marzs of Armenia	UKD	29,705	29,705	31/08/05	Closed	Manufacturing	SEEC
Armenian Renewable Energy: Regulatory Assistance	UKD	42,437	39,298	21/02/07	Disbursing	Energy	Energy
Armenian Renewable Energy: Regulatory Assistance	UKS	4,000	4,000	15/11/07	Committed	Energy	Energy
Armenia Renewable Energy Programme Implementation Support	UKS	45,000	2,500	23/11/07	Committed	Energy	Energy
Armenia Microlending Programme (AMP) - Small and Micro Credit Advisors	US07	504,959	504,959	28/03/06	Closed	Finance, Business	Deputy Vice President
Armenia Microlending Programme (AMP)	US07	537,378	133,455	31/08/07	Disbursing	Finance, Business	Deputy Vice President
BAS Continuation in Armenia with USAID Support	USAR	205,079	205,079	29/05/07	Closed	Manufacturing	SEEC
Continuation of BAS Programme in Armenia with USAID Support II	USAR	220,606	206,902	05/12/07	Disbursing	Manufacturing	SEEC
BAS Continuation in Armenia with USAID Support III	USAR	80,750	48,413	28/03/08	Committed	Manufacturing	SEEC
		8,730,816	6,077,449				

8,730,816 6,077,449

No of Commitments: 51

ANNEX 8: TAM/BAS IN ARMENIA

Previous TAM/BAS experience in Armenia

The TAM/BAS Programme supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises in the EBRD countries of operation. Since inception in 2003, TAM/BAS in Armenia has mobilised €5.2 million. Donor funding has been provided by USAID, the EU, EBRD Special Shareholder's Fund, Canada, Taiwan and the UK.

TAM *TAM supports the introduction of international best practice in SMEs with the potential of becoming future leaders in their market through the introduction of international Advisors from developed countries with 15-20 years professional experience in the relevant sector. TAM projects typically last around 18 months. The Programme also carries out seminar and training activities promoting international best practices by disseminating successful case-studies to entrepreneurs.*

TAM has undertaken a total of 18 projects, 5 of which are still in progress, with more enterprises at the pre-project screening stage. TAM has a wide industry spread, with food manufacturing the most common sector. There has been a geographic concentration of projects in the capital, Yerevan. Sales & Marketing, General Management and Support to Production are the most common objectives for TAM in Armenia. Of projects fully completed, all but one has been rated satisfactory or better. What has been identified as a key factor for TAM project success has been the degree of willingness and eagerness of the staff of assisted enterprises to learn from the TAM teams.

BAS *BAS acts as a facilitator for the use of local, private-sector consultants by MSMEs to obtain a diverse array of services. BAS works on the demand and the supply side. By assisting individual enterprises to engage with local consultants on narrowly-based, specific projects with a rapid payback, it stimulates demand and the understanding of the potential benefits of using external consultants. It also directly increases the supply and quality of local advisory services, through targeted market development activities. BAS supported projects typically last around four months.*

At end-September 2008, BAS in Armenia has undertaken a total of 534 projects with 440 MSMEs, engaging 79 consultants – 65 which are local. A total of 396 projects have been internally evaluated in Armenia, with over 92% as being successful. BAS has also undertaken over 25 different market development activities, promoting the development of local consultants and MSME managers from multiple industries. BAS has assisted enterprises of all sizes, but especially micro enterprises. The broad industry distribution of BAS-assisted enterprises with Trade, Food, Construction and Tourism the most common sectors has not changed dramatically over time. However, the proportion of projects with wholesale and retail trade enterprises has increased significantly. In terms of types of projects supported, advice targeted to improving Management Effectiveness and Market Performance has been most popular throughout the period, while environmental issues are steadily becoming more important. Although the overall distribution between projects in the capital and other areas is broadly equal since inception, there has been a rise in recent years of the proportion of projects located outside the capital. Since 2004, the Programme has also run a number of Women in Business initiatives specifically promoting women entrepreneurship.

Linkages with banking

To date, 20 TAM/BAS assisted companies in Armenia have attracted 25 investments from the EBRD or EBRD related financial intermediaries mobilising a total project value of over €30 million. Furthermore, TAM/BAS energy efficiency training qualifies companies

that attended the course for EBRD energy efficiency credit lines, when one is established.

An underdeveloped MSME sector

There are very few large enterprises in Armenia, but the MSME sector accounts for just two-fifths of GDP and a mere one-third of employment. The distribution of MSMEs across size classes and regions is disproportional. The MSME sector is characterised by low export penetration and low business sophistication.

Strong need for TAM/BAS

A change in attitudes and business orientations is required for Armenian businesses to become more competitive. Training is particularly important in the areas of quality management and certification, international best practices, market analysis, development planning and HR.

At present yet heterogeneous infrastructure of business support

Despite increased governmental financial support, the national SME agency still suffers from a lack of resources while the government lacks more awareness that it should not only be a regulator but also a supporter/promoter of business. The number of business service providers has increased and the quality of the sector has been improving. However, many business service providers still lack specialisation and focus on the larger cities. Many consulting firms offer little value to their clients in terms of international market insights, innovation, or actionable strategies which may explain why demand for advisory services is low. Due to good results achieved by programmes such as TAM/BAS, general demand for advisory services is increasing, however.

Numerous international donor programmes

Various donors provide Armenia with funds aimed at MSME and competitiveness development. Several providers focus on export competitiveness and development of human resources. In 2007, USAID agreed to co-finance the BAS Programme in Armenia, with a \$1.64 million grant from 2007-2010 – a contribution equivalent to 74% of the programme cost, with the EBRD's ETC Fund providing the remaining \$0.5 million. The three-year USAID-ETC Fund "co-share" BAS program is an excellent example of USAID's objective to enhance donor collaboration and cooperation, and TAM/BAS will explore future opportunities with USAID in the other Caucasus countries.

Continuation of TAM

The main impediments faced by Armenian MSMEs relate to poor organization, marketing and management skills, business planning and lack of exposure to international best practices. TAM should target tourism, manufacturing, services, food processing and ICT that were identified as industries with growth potential on the basis of export performance and GDP contribution.

and BAS

According to the BAS Grant Guideline Matrix, BAS should particularly target smaller enterprises, enterprises located outside the capital and projects aiming to introduce HR management and strategic planning. Targeted market development activities should be a big component of BAS.

in addition to targeted market development activities

It is recommended to complement TAM/BAS assistance at the enterprise level with market development activities in order to maximise the Programme's transition impact:

- *Visibility/dissemination*: promote advisory services by disseminating successful case-studies
- *MSME and consultancy training*: continue address the existing gaps in the supply of advisory services by providing trainings and seminars covering industry specific skills and production advice, HR policies and labour codes, international best practices and QMS/certification.
- *Support to and development of existing relevant local institutions*: Help Armenia's local consultancy market provide specialised services targeted at the enterprises' specific needs.

with a strengthened focus on addressing cross cutting issues

TAM/BAS should promote measures to increase energy efficiency in production and reduce environmental pollution. However, such measures will only be successful if entrepreneurs understand the potential future payback and do not only act under donor pressure. TAM/BAS should also devote efforts to supporting women entrepreneurs and encouraging women's access to middle management and executive positions primarily by the continuation of initiatives such as the ongoing BAS Women in Business Programme. Reaching areas outside of the capital should remain a high priority.

Contribution to EBRD's policy dialogue

The TAM/BAS Country Brief strengthens the EBRD's policy dialogue toolkit by analysing the business environment and identifying key challenges faced by the MSME sector. Future challenges for the government are identified as reforming the taxation, customs, and inspection regime, improving law enforcement, education and access to finance, reducing arbitrariness and corruption.

An input for enhancing linkages with banking

In line with TAM/BAS Strategic Plan 2008-2010, TAM/BAS should continue to assist the Bank to meet its objective of creating a commercially viable project pipeline for Bank's direct investments by:

- i) identifying potential pipeline (pre-investment)
- ii) providing "consulting and business" services for the preparation and support of Bank private enterprise financing projects and for the enterprises themselves
- iii) providing candidates for non-executive board member positions.

TAM/BAS should link MSMEs in need of finance with local financial institutions supported by the EU/EBRD SME Finance Facility. This will strengthen the Bank's impact in the enterprise and financial sector, as outlined in the EBRD Country Strategy for Armenia.

ANNEX 9: OTHER IFIS AND DONORS IN ARMENIA

International Monetary Fund

Armenia became a member of the IMF in 1992. Since then, the IMF has provided four programs to support macro stabilization and structural reforms in Armenia, including the Poverty Reduction and Growth Facility (PRGF). Armenia's relationship with the IMF is generally good. Following successful resolution of the IMF's discussion with the government on the tax system, a USD34 million program under PRGF was approved by the IMF Board in June 2005. The Fund is in the process of negotiating a new 3-year USD 15 million PRGF programme, focused on strengthening the fiscal and the monetary frameworks, rather than budget support.

The World Bank

The World Bank (WB) is the largest multilateral donor in Armenia (natural resource management and poverty reduction, foreign investment and export promotion, information technologies, infrastructure, education, health, social sector, agricultural reform, municipal development, transport, and judicial reform). Armenia joined the WB in 1992 and the International Development Association (IDA) in 1993. The IDA lending has helped finance infrastructure rehabilitation, including support for earthquake reconstruction, irrigation, power, road maintenance, and municipal water. The IDA credits supporting the social safety net and improving access to services have included operations in health, education, and a social investment fund aimed at improving basic social and economic infrastructure. The WB's commitments in Armenia to-date have totalled USD1.1 billion, divided among 50 projects, of which USD947 million has been disbursed. The active portfolio consists of 17 IDA loans with total commitment of USD291.7 million. The Bank is in the process of negotiating a new Country Partnership Strategy, scheduled to be approved in 2009, in which IBRD funding will largely supplant IDA, and which will include support for SMEs.

Armenia has been a member of the International Finance Corporation (IFC) since 1995. The IFC made a first investment in 2000, providing USD3.6 million in equity finance to Hotel Armenia (currently in the process of exit). IFC's more recent projects have included a corporate loan to Armenia's leading private airline (not yet disbursed), and equity and debt financing of two banks, including Armeconombank, with the EBRD. As part of the World Bank's new Country Partnership Strategy it is being envisaged that IFC will provide up to USD 50 million in new financing in Armenia in the next three years.

The European Union (EU)

Co-operation between the EU and Armenia has focused on development of political institutions, the rule of law and human rights, regional stability, economic and social reforms, including gradual participation of Armenia in the EU market. In 1991-2003, the EU has provided Armenia with EUR331.9 million in assistance (not counting member states' bilateral programmes), primarily through TACIS, Food Security Programme, and ECHO. Armenia also benefited from regional programmes such as TRACECA and INOGATE. In 2004-2006 the EU assistance to Armenia was estimated at EUR55 million. Co-operation between the EU and Armenia has further increased with the inclusion of Armenia in the European Neighbourhood Policy (ENP).

The current framework for EU assistance is the Country Strategy Paper (CSP) 2007-2013 is based on the new European Neighbourhood and Partnership Instrument (ENPI), established within the ENP framework, with the funding levels estimated at €98 million for Armenia. In addition, Armenia stands to benefit from allocations under a number of regional programmes,

such as CBC (Black Sea Programme). The principal objective of EU-Armenia co-operation is deepening of ties, including political and economic co-operation, formulated in three key strategic objectives:

- Strengthening of democratic structures and good governance
- Further support to regulatory reform and administrative capacity building, and
- Support for poverty reduction efforts

The Black Sea Trade Development Bank (BSTDB)

The BSTDB commenced operations in Armenia in February 2003 by launching an SME financial program jointly with Izmirlyan Foundation (a Swiss-Armenian investment and charity organization). The programme provides SMEs with up to 5 years term loans, in the amount of up to USD500,000 to finance capital expenditures and working capital. In June 2005, Armenia hosted the BSTDB's Annual Shareholders Meeting, in which it was decided to expand the Bank's activities in Armenia. The main priorities of the BSTDB in Armenia for the forthcoming years remain SME financing with emphasis on transport, food processing, manufacturing.

The Asian Development Bank (ADB)

Armenia joined ADB in 2007. ADB intends to provide soft loans as well as market-priced financing. ADB is involved in two infrastructure projects (rural road financing and wastewater), to be provided on "soft" terms, in addition to having provided a loan to one Armenian bank on market terms.

The European Investment Bank (EIB)

In December 2006 the Council of the European Union granted the EIB a new mandate for the period from 2007 to 2013. The new mandate enables EIB to lend up to €7 billion in Russia, Ukraine, Moldova and the Caucasus for projects of significant interest to the EU in transport, energy, telecommunications and environmental infrastructure. Priority will be given to projects on extended major trans-European network axes, projects with cross-border implications for one or more Member States and major projects favouring regional integration through increased connectivity. In the energy sector, strategic energy supply and energy transport projects are of particular importance. In 2008 the EIB concluded a framework agreement with Armenia paving the way for future EIB investments in the country. In December 2006 the Bank, the EIB and the European Commission signed a Memorandum of Understanding which reinforces the close cooperation between the three institutions, including in Armenia.

Main Bilateral Programmes

United States

The United States, historically acting primarily through the USAID, is the largest bilateral donor to Armenia, having contributed well over USD1 billion of aid to-date, in addition to humanitarian aid. Ongoing programs include economic restructuring, financial sector deepening, energy sector reform, healthcare, democracy and government, and agricultural support. Importantly, in the previous Strategy period, the USAID provided USD1.5 million to support EBRD's Armenia Micro-lending Programme, and another USD1 million to support BAS. While the USAID had historically provided over USD50 million p.a, its programme has been significantly scaled down in the past two years, with Millennium Challenge Corporation having emerged as the principal conduit of American aid.

In 2006 the Millennium Challenge Corporation signed a five-year \$235.65 million Compact with the Government of Armenia. The Compact is focused on reduction of rural poverty through a sustainable increase in the economic performance of the agricultural sector. Armenia plans to achieve this goal through a five-year program of strategic investments in rural roads, irrigation infrastructure and technical and financial assistance to improve the supply of water and to support farmers and agribusinesses.

Although MCA-Armenia Compact continues to operate, as an expression of serious concern about recent developments in Armenia, last Spring MCC halted the contracting process for the major 273 km Compact-funded road works. In response, the Armenian government proposed and formally agreed to use \$16.8 million of its own resources to proceed with the initial phase of the road program. That decision gave Armenia extra time during which MCC hopes to see signs that the Government of Armenia is committed to improving the performance criteria central to MCC eligibility. At the moment, the \$16.8 million provided by the Government of Armenia has not been fully exhausted.

On 11 December 2008, the MCC Board met in Washington and reviewed progress made on reform measures initiated by the government of Armenia in recent months. The Board reiterated its concerns about the status of democratic governance in the country and underlined its expectation that the government of Armenia will fulfil commitments to implement substantive reforms. The Board noted that it would again review Armenia's performance and examine continued collaboration with the country at its March meeting.

Germany

Germany is the second largest donor to Armenia. The main directions for assistance provided by Germany to Armenia are the projects implemented by the German Enterprise for Technical Cooperation (known by its German initials GTZ), and KfW, which first opened its office in Armenia in 1998, as well as through DEG, KfW's investment banking arm. GTZ's main focus is on economic reform and the development of the market system, including promotion of SME activities. GTZ's ongoing projects in Armenia total EUR5.5 million. KfW's current programme is €64 million, of which €10 million is to support the housing programme, with the balance aimed at rehabilitation of power generation plants and high-voltage transmission lines. In 2006 the EBRD and DEG co-financed the First Phase of the Zvartnots Airport project, and are now poised for further co-operation within Phase Two of the project, while in 2007 KfW and the EBRD co-invested in ProCredit Armenia bank.

United Kingdom

The main implementing agency for direct UK Government assistance to Armenia is the Department for International Development (DFID). With a combined budget of GBP11 million, was active in Armenia in the past Strategy period. It will, however, discontinue its programmes in Armenia by the end of 2008.

France

France has traditionally provided assistance to Armenia in the field of humanities, such as education and culture. In 2007, however, France broke with the tradition, having provided a €25 million soft loan to Yerevan Water, the city of Yerevan water utility, which is managed by Veolia of France.

Japan

Japan began its bilateral assistance (ODA) to Armenia in 1991. Over USD30 million has been disbursed at the end of 2003. The priority areas of Japanese assistance are (i) consolidating the basic economic structure, (ii) the energy sector, (iii) transport infrastructure, (iv) improvement of the irrigation and water supply systems, and (v) the social sector (health and medical care, education, and mitigating hardships faced by the unemployed and the low-income population). Implementation of a JPY5, 400 million loan for an electricity transmission and distribution network project began in 2001. A loan of JPY15.92 billion was made in 2005 to finance the Yerevan Combined Cycle Co-Generation Power Plant project.