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**Statement by Mr. Saarenheimo and Ms. Leemets on Republic of Armenia
(Preliminary)
Executive Board Meeting 07/103
November 26, 2007**

We thank staff for the well-written report and Mr. Yakusha for the informative Buff. We support the Proposed Decision and are broadly in agreement with staff's assessment on the challenges faced by the authorities. We would like to offer just some points for emphasis.

Fiscal policy

We congratulate the Armenian authorities for their country's strong economic performance. In a small and open economy with double-digit growth, weakening trade balance and high capital inflows, fiscal policy is the main tool to maintain confidence and signal discipline. Hence, the authorities' commitment to keep the fiscal policy constrained is welcome. The ratio of tax revenues to GDP has increased considerably and the tax administration has improved in the last years, although challenges still remain. In reforming the tax system and tax administration we, like staff, recommend minimizing the use of tax exemptions and other discretionary measures that create loopholes in the tax system and ease the possibilities for tax evasion.

Monetary and financial sector policies

The Central Bank of Armenia has been tightening the monetary policy which may have helped to contain inflation expectations until recently. However, external price developments have put the official target again under pressure. With apparently sustained inflows of remittances, we would support staff and other colleagues for more cautious stance on the activist monetary policy measures, including the unsterilized interventions in the foreign exchange market, particularly given the potential inflationary impact. Also, in view of ensuring a broader exchange rate pass-through of the benefits of lower imported prices for domestic consumers, it seems that the authorities would need to take measures to enhance competition between the importers of certain products.

The banking sector appears strong and well-supervised. Considering the fast growth in bank

lending, strong vigilance is required from the banking supervisors, also as the financial markets develop and more (foreign) players enter the market. Also, the development of a well-capitalized stock market will be important in that respect. However, we note with concern that the package of measures the authorities are considering for stock market development includes potential tax incentives or even tax amnesties for companies that will be listed in the stock exchange. We support staff in advising against using discretionary measures when building a market where a level playing field is an important source of credibility and competition.

Structural policies

The authorities have made strong progress with the pension reform. That said, we are a bit concerned that, given the relatively low level of social tax contributions, the pension system could become a heavy cost for the budget over the medium term. Like staff, we would rather see a gradual implementation of the pension reform with other necessary measures, like securing the financing of the first pillar, in place. On a related note, we understand that the political pressures of the parliamentary elections in June this year, and the presidential elections early next year have been an important force behind the significant increase in pensions in 2008. However, the magnitude of this increase, approximately 1 percent of GDP, is adding to the potential need for long-term debt financing of the budget. As Messrs. Mirakhor and Monajemi, we emphasize the need for longer-term perspective in formulating fiscal policy. Budget planning needs to be improved and tax revenues need to be increased in a transparent and non-discretionary manner. The authorities' commitment, as conveyed by Mr. Yakusha, in this regard is welcome.

We are encouraged by the achievements of the Armenian authorities and wish them every success going forward.