



MEMORANDUM-OF-UNDERSTANDING
ARM: Public Efficiency and Financial Markets Program, Subprogram 2
—Consultation Mission, 17–26 June 2018 —

1. **Scope of the visit.** A consultation mission¹ visited Yerevan from 17 to 26 June 2018 to:
 - (i) Finalize the proposal for Subprogram 2 policy actions under the Public Efficiency and Financial Markets Program (PEFMP), and
 - (ii) Undertake consultations to reach consensus and assess the Authorities' readiness to reflect agreements in a Memorandum of Understanding (MOU). This would enable the mission to be upgraded to Fact-Finding status, quick-starting Subprogram 2 processing within ADB.

2. This visit followed the consultation mission that had been fielded during May 15-21, 2018, to (i) present to the new government and to the new senior leadership of the Ministry of Finance (MOF – The Executing Agency) the reform objectives of the ongoing Public Efficiency and Financial Markets Program (PEFMP), and (ii) seek guidance from the Authorities about the way forward for the PEFMP, including whether it still reflects Armenia's economic policy priorities. The Authorities re-asserted their interest and commitment to the reform agenda of the PEFMP. Through video-con and written communications after the visit, the Authorities confirmed the mission's Aide-Memoire of May 25, 2018, and the proposed way forward for the different reforms that was described in the proposed policy matrix. The consultation mission of June 17-26 was based on this premise, and worked with the various implementing agencies to refine the policy actions and necessary steps for its achievement, as defined in Attachment 1 – Policy Matrix.²

3. **The Authorities' Commitment to the Broad Objectives of the PEFMP.** The consultation mission of June 17-26 also had the opportunity to confirm, once again, the strong ownership that underpins the policy dialogue and the technical assistance efforts that implementing agencies and the ADB team have been pursuing to devise reform solutions that can over time:
 - (i) Strengthen Armenia's public debt and fiscal management,
 - (ii) Enhance fiscal transparency regarding fiscal risks in general, and in private participation in addressing public investment needs in particular,
 - (iii) Improve the efficiency of the government securities market, so that Armenia can rely more on domestic borrowing in Dram (and local savings) to finance government activities and investment,
 - (iv) Increase the depth of financial markets in Armenia – prioritizing the development on money (interbank) markets and systemic liquidity management - to help fiscal sustainability, resilience in the country's financial system and the private sector's access to Dram finance,
 - (v) Enhance corporate transparency to improve the investment climate and increase private investment in the economy.

4. With the recognition that these objectives require continuity in a multi-year sequence of reform efforts going forward (well beyond what's included in the PEFMP), the Authorities and the ADB mission agree that without the processes initiated under the PEFMP it will be very difficult for Armenia to tackle some key constraints to its development outlook: e.g. high-dollarization, high fiscal exposure to currency risks, high public and banking dependence on external (foreign currency-denominated) finance, public debt constraints to public investment, etc.

¹ The ADB mission was led by João Farinha-Fernandes, Senior Financial Sector Economist, and supported by Hanif Rahemtulla, Senior Public Management Specialist, Grigor Gyurjyan, Economics Officer, and Vahe Hovhannisyan, Program Coordinator. Other ADB TA experts joined the consultations.

² This memorandum of understanding (MOU) summarizes the mission's discussions with the Government of Armenia (the Government or the Authorities), which are subject to further iterations and approval by the higher authorities of the Government and ADB management.

5. **Implementation Status of the PEFMP vs. Original Timeline for Approval.** The implementation of Subprogram 2 is back again in progress, after the halt that it had come to between late-March and late-May, 2018. Despite the interruption, and the consequent need to re-initiate some of the reform dialogue processes (or re-confirm earlier understandings on policy trade-offs for outstanding reform actions), the MOF requests the processing of Subprogram 2 to follow the original timeline that was indicated at Subprogram 1 approval, to ensure that budget financing comes in support of the 2018 fiscal year. Appendix 1 presents (in the 3rd column) a stock-take of the status along each of the various reform outputs. The ADB team clarified that in order to keep the original timeline, and for the ADB team to be able to process Subprogram 2 and submit its Report and Recommendation of the President (RRP) to the ADB Board (for approval in October 2018), all 26 reform targets must be met before late-August 2018 (i.e. before loan negotiations).

6. As of July 10, 2018:

- a. Four (4) reform actions have already been completed;
- b. Ongoing efforts towards the completion of nineteen (19) more reform actions before mid-August 2018 are on track, but require close monitoring.

7. **Reform targets that are at risk within the original timeline.** The completion of three (3) reform actions is at risk, and requires key efforts by the Authorities for completion before loan negotiations:

- a. **Policy Action #9.** Teams from MEDI and CSI are now actively improving the legal proposals (new law and parallel law amendments), with ADB TA support, and significant progress is being made to address the weaknesses that had been identified earlier. This progress is very encouraging, but the timeline is a challenge. Additional ADB TA support is available to support inter-ministerial discussions, if necessary.
- b. **Policy Action #17.** The first round of training to financial markets participants on the GMRA already took place with ADB TA support, and preparation for the second round needs to take place now. CBA needs to undertake two assessments that are crucial for decisions regarding GMRA adoption, but the timeline is a challenge. ADB expects there to be no serious obstacles to overcome, in terms of CBA system adaptability. Recent discussions with CBA did indicate serious concerns about the lack of justification for the equal regulatory treatment between GMRA and repo agreements currently in use by banks, and the assessment by CBA is expected to result in a determined communication to banks if that preliminary view is confirmed, before end-August (with a plan to address the problem). Additional ADB TA support is available to support these exercises, if necessary.
- c. **Policy Action #19.** The CDA and NASDAQ OMX are undertaking key efforts to prepare important decisions for the Steering Committee of the Repo Project regarding the tri-party repo system for collateral management. ADB TA is supporting this effort. Once an assessment is completed, regarding the economic cost-benefit of the 2 options in question, ADB expects a swift policy decision to take place. The timeline is challenging. Additional ADB TA support is available to support these exercises, if necessary.

8. **Subprogram 2 Reforms Narrative and Presentation.** Appendix 2 presents the written narrative on which the ADB team will base its internal processing and presentation of Armenia's recent reform efforts and achievements, specifically in the various draft versions of the RRP. Feedback by the different implementing agencies on Appendix 2 would be appreciated, and the Authorities can provide requests and suggestions on it till next July 25. In the invitation for loan negotiations, the ADB team will share the RRP "package" with the Authorities, should the latter wish to convey any concerns about its public disclosure after ADB Board approval.

9. Post-Program Engagement Framework (PPEF). During consultations, it became apparent that across the different reform fronts of the PEFMP a number of follow-up reform steps will be crucial and could benefit from further ADB TA and programmatic support. The ADB team suggested the importance of developing a PPEF through which ADB and the Authorities can lock-in a commitment to jointly-achieve the "next phase" of associated reform targets (i.e. reforms that are either a natural sequence or actually necessary for Subprogram 2 reforms to come to full fruition in terms of impact on the ground). The ADB team made reference to this proposal throughout its consultations in the May 2018 mission, and received support of the Authorities for it. Appendix 3 makes a broad proposal for the reform efforts herein. Further feedback by the different implementing agencies on Appendix 3 would be appreciated, and the Authorities can provide requests and suggestions on it till next July 25.

10. Conclusions. A Wrap-Up meeting was held on June 26 with Mr. Armen Hayrapetyan, Deputy Minister of Finance (and ADB Alternate Governor), to discuss the findings of the consultation mission and possible way forward. After the visit to Armenia, consultations continued. Agreement was reached on:

- a. The program of Subprogram 2 reforms that is reflected in Appendix 1;
- b. Including a Post-Program Engagement Framework (PPEF) on which to reflect crucial reform efforts going forward (see Para 9 above);
- c. Proposing that the consultation mission of 17-26 June, 2018, be upgraded to 'Fact-Finding' status, in order for ADB internal processing of the RRP for the PEFMP Subprogram 2 to start immediately, with the following indicative timeline:

Key Step	Dates
Fact-Finding Mission (upgraded from consultation mission)	17-26 June, 2018
Management review Meeting	30 July
Invitation for Loan Negotiations sent to Government of Armenia	1 st week of August
Loan Negotiations	1 st week of September
Circulation to the ADB Board	3 rd week of September
Board Approval Date	2 nd week of October 2018

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 (July 12, 2018)
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