



Press Statement—IMF Staff Visit to Armenia

June 17, 2008

An IMF staff team visited Yerevan during June 11-17, 2008 to review recent economic developments, and discuss the macroeconomic policies and structural reform priorities of the new government. The discussions prepared the ground for negotiations of a new IMF-supported program in September. The team was pleased with the government's strong commitment to economic reform, in particular with the focus on strengthening tax policy and tax administration. To ensure the credibility of the reform effort, it will be crucial to implement the various reform initiatives fully and without delay.

Macroeconomic Performance and Outlook

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

Following international developments, CPI inflation in Armenia has risen sharply in recent months. But it is still lower than in neighboring countries, thanks to a gradual tightening of monetary policy (with increasing interest rates) and a prudent fiscal policy. While the surge in inflation to around 10 percent was mainly due to higher food import prices, non-food inflation has picked up as well, reflecting high international oil prices and strong domestic demand. Barring further external supply shocks, the 12-month rate of inflation is expected to fall later in the year, to around 7 percent in December.

Fiscal developments have been positive, mainly on account of strong revenue performance, particularly regarding VAT. If the higher-than-expected tax revenue is saved, the fiscal deficit for 2008 can be significantly lower than budgeted, allowing fiscal policy to support monetary policy in its efforts to reduce inflationary pressures.

Policy Discussions

Controlling inflation: monetary and fiscal policy need to be tightened

Rising energy and food import prices, recent and planned pension and wage increases, and rapid credit growth will likely keep inflationary pressures high in Armenia. Against this background, the challenge for monetary policy is to limit the second-round effects of higher food and energy prices, and thus contain inflationary expectations. Fiscal policy should also play a role in containing inflation by prioritizing government expenditures and saving, rather than spending, any higher-than-expected revenues in 2008. Finally, reducing monopolistic practices in the import sector will also contribute to lower prices.

Tax reform: the new government reform agenda is encouraging

To address ***tax administration weaknesses***, the State Tax Service (STS) has developed a comprehensive plan to modernize tax administration, in line with previous advice from the IMF and other donors. The IMF fully supports the immediate priorities reflected in the plan, including restructuring the STS, addressing corruption, speeding up VAT refunds, strengthening large taxpayer administration, and enhancing taxpayer services, particularly for small businesses. However, to sustain the reform effort and increase its credibility, the government should make sure that appropriate funding is allocated for the tax reform program.

The IMF also supports the government's plans to address ***tax policy deficiencies*** by introducing a VAT threshold and providing small businesses with simpler procedures to assess and pay their taxes. However, given the government's goal to create equal conditions for all businesses, the IMF opposes privileged tax regimes (such as tax incentives for listing on the stock exchange, and the current presumptive taxes for fuel and tobacco).

Pension reform: fiscal costs and timeline should be realistically assessed

The IMF supports the new government's plans to modernize Armenia's pension system. Given that this will necessarily entail fiscal costs, these should be realistically estimated in light of competing priorities. Since investment in new systems and procedures will be required, adequate time needs to be given for effective planning and implementation before the new pension system can be in place.