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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.3.2005  
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**COMMISSION STAFF WORKING PAPER**

**Annex to :**

**”European Neighbourhood Policy”**

**Country Report**

**Armenia**

**{COM(2005) 72 final}**

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## 1. INTRODUCTION

On 1 May 2004, the enlargement of the European Union took place with the accession of ten new Member States. It has brought changes to the EU's political geography offering new opportunities to deepen existing relations between the Union and its neighbours to the East and to the South. The Union is determined to further develop partnerships with its neighbours to mutual benefit, promoting security as well as stability and prosperity. The EU's external borders will not become new dividing lines but the focus of enhanced co-operation.

The European Neighbourhood Policy (ENP) sets ambitious objectives for partnership with neighbouring countries based on commitments to shared values, key foreign policy objectives and political, economic and institutional reforms. Partner countries are invited to enter into closer political, economic and cultural relations with the EU, to enhance cross border co-operation and to share responsibility in conflict prevention and resolution. The Union offers the prospect of a stake in its Internal Market and of further economic integration. The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The policy builds upon the existing framework of co-operation.

Following a recommendation made by the Commission, the Council on 14 June 2004 decided to offer Armenia, Azerbaijan and Georgia the opportunity to participate in the European Neighbourhood Policy, *inter alia* stating:

*"This marks a significant step forward in the Union's engagement with the region. Each country will be given the same opportunity to develop its links with the EU, including through action plans, and will be treated in its individual merits in line with the general policy of the ENP. The Council also invited the Commission, and the SG/HR for issues related to political cooperation and the CFSP, to report on progress made by each country with regard to political and economic reforms".*

In this report<sup>1</sup>, the Commission provides an assessment of bilateral relations between the EU and Armenia. It reflects progress under the Partnership and Co-operation Agreement and describes the current situation in areas of particular interest for this partnership: the development of political institutions based on the values – democracy, the rule of law, human rights – enshrined in the Agreement, regional stability and co-operation in justice and home affairs, and economic and social reforms that will create new opportunities for development and modernisation, for further liberalisation of trade and for gradual participation in the Internal Market. The report provides guidance for the Commission recommendation on developing joint ENP action plans and serves as a basis for assessing future progress in the Union's relations with Armenia.

### 1.1. Relations between the European Union and Armenia

The **EU-Armenia Partnership and Cooperation Agreement (PCA)** was concluded in 1996, entered into force in 1999 and forms the legal basis of EU-Armenia relations. Respect for democracy, principles of international law, human rights and the principles of market economy are the essential elements on which the EU-Armenian partnership is based. The PCA provides for wide-ranging cooperation in the areas of political dialogue, trade,

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<sup>1</sup> For the most part, covering events and developments until 31 December 2004.

investment, economic, legislative and cultural cooperation. This dialogue builds upon the shared commitment to promote international peace and security as well as the peaceful settlement of disputes. Through the PCA, which also eliminates trade quotas and provides for the protection of intellectual, industrial and commercial property rights, the parties have accorded each other Most Favoured Nation (MFN) treatment and Armenia benefits from the EU's Generalised System of Preferences (GSP).

The various joint **institutions** set up under the PCA (Cooperation Council, Cooperation Committee, Sub-Committee on Trade, Economic and Related Legal Affairs, as well as the Parliamentary Cooperation Committee) have functioned smoothly and have ensured a regular political dialogue. Cooperation Council have been held annually since 1999, the latest in Brussels in September 2004.

At the General Affairs Council of February 2001, the EU confirmed its willingness to play a **more active political role in the South Caucasus** region and its intention to look for further ways in which to support efforts at prevention and resolution of conflicts in the region and to participate in post-conflict rehabilitation. The Foreign Ministers of Armenia, as well as Azerbaijan and Georgia, welcomed the EU's commitment to play a more active role in the region in the Joint Communiqué issued on 30 October 2001 on the occasion of the Cooperation Councils with the three countries.

The issue of the **Medzamor Nuclear Power Plant** (MNPP) has been an important item on the bilateral EU-Armenia agenda for a number of years. Early closure of MNPP has been identified as a key EU objective, in line with its general policy towards such first generation Soviet-built plants. In 2001, the EC offered to organise a donors' conference to create a fund to finance alternative energy capacity and to contribute up to €100 million if a binding agreement could be concluded on a closure date for Medzamor. No agreement on this has so far been found within the EC-Armenia dialogue. Armenia has pointed out to the EC that energy capacities must take account of future expected energy needs of Armenia, the need to strengthen energy security and the need to offset the impact of the closure of MNPP on electricity tariffs. The EU has indicated that it will take this position into account in considering Armenia's access to the benefits opened up by its inclusion in ENP.

In July 2003, the EU Council appointed Ambassador Heikki Talvitie as the first **EU Special Representative for the South Caucasus**. Armenia welcomed his appointment. His mandate is, *inter alia*, to assist the Council in developing a comprehensive policy towards the South Caucasus, to contribute to conflict prevention and assist the conflict settlement mechanisms in the region. He has visited Armenia regularly and has paid particular attention to the conflict over Nagorno-Karabakh which he visited in July 2004. The EUSR is in constant contact with the countries of the region as well as other players such as Russia, Turkey and the US.

Following his re-election, **President Kocharian** visited Brussels in December 2003 and expressed Armenia's readiness to deepen its cooperation with the EU, including in the field of science and research. He also indicated Armenia's intention to request the granting of "market economy status" under the EC's anti-dumping Regulation.

On 29 April 2004, the government of Armenia adopted a decree "On organising the activities on elaborating a **National Programme for implementation of the Partnership and Cooperation Agreement** ...". The decree establishes a Coordinating Committee and refers to the role of the EC-funded Armenia-European Policy and Legal Advice Centre in supporting

the Committee. The EC is providing further technical assistance to assist Armenia draw up a draft National Programme by October 2005.

The Council's decision on 14 June 2004 offering the inclusion of Armenia (together with Azerbaijan and Georgia) in the **European Neighbourhood Policy** marks a significant step forward in relations between the EU and Armenia. Armenia has welcomed its inclusion and has expressed its readiness to explore fully the opportunities thus opened up. This decision was followed by visits to Armenia, Azerbaijan and Georgia by Commissioner Potocnik and President Prodi in July and September 2004 respectively.

In September 2004, Armenia and the European Commission signed an agreement transforming the EC Office in Yerevan into a Delegation.

## 1.2. Community assistance

EC assistance to Armenia since 1991 amounts to more than €380 million. Humanitarian assistance (notably ECHO and Food Aid Operations through the European Agricultural Guarantee and Guidance Fund, EAGGF) has accounted for nearly €120 million and has contributed to alleviating the very severe humanitarian situation in the mid-1990s. TACIS national allocations and the Food Security Programme each represent around €100 million.

Since Armenian independence, the **TACIS** programme has contributed to the transition towards market economy, notably by assistance in the fields of legal and regulatory reform, approximation of Armenian legislation to that of the EU and support for Armenia's WTO accession. TACIS has also contributed to Armenia's economic recovery through support to the private sector and small and medium sized enterprises. The Agricultural Cooperative Bank, funded through TACIS and EAGGF food aid counterpart funds, has been highly rated and has contributed to improvements in agricultural production. TACIS has also supported Nuclear Safety.

With the approval of the **Country Strategy Paper** in December 2001, TACIS assistance to Armenia in the period 2002-2006 is focussing on continued support for institutional, legal and administrative reform as well as on support in addressing the social consequences of transition. TACIS is providing essential assistance to the implementation of Armenia's Poverty Reduction Strategy approved in 2003. The 2002-2003 Action Programme (€10 million) is currently being implemented. The 2004-2005 Action Programme (also €10 million) has recently been agreed.

The **Food Security Programme** (FSP) has provided significant budgetary support to key agricultural and social sectors in Armenia and has thus played an important role in tackling poverty in Armenia, notably through its support for family allowances and child care. The combination of budget support and technical assistance through FSP (with complementary TACIS technical assistance) has also enabled significant reforms to be made in the field of land reform and public finance management. Implementation of FSP has been very successful and further such support is envisaged for 2005-2006 (€21 million) notably to assist Armenia in continuing to implement its Poverty Reduction Strategy.

In December 1998, Armenia settled the remaining amount of its debt to the Community. The country subsequently benefited from a new **Macro Financial Assistance** package of a €28 million loan and a total grant of €30 million to be disbursed over the period 1999-2005, subject to macro-economic performance and structural reforms. In the context of the IMF-

supported economic programme, this assistance has contributed to the sustainability of Armenia's external debt.

The EC **European Initiative for Democracy and Human Rights** (EIDHR) Programme launched its activities in support of NGOs in Armenia in 2003 with the objective of promoting and protecting human rights and democratisation as well as conflict prevention and resolution.

**Total EC grants to Armenia since 1991** (in addition to the figures below, Armenia benefits from grants under the Tacis Regional Programme)

	1991-1993	1994	1995	1996	1997	1998	1999	2000	2001	2002-2003	2004-2006	Total (M €)
Tacis National Allocations	28.90	-	6.00	14.00	-	10.00	-	10.00	-	10.00	20.00	<b>98.90</b>
Nuclear Safety	-	-	-	10.00	1.00	-	-	11.00	-	-	7-	<b>29.00</b>
Humanitarian	10.40	19.90	23.96	4.97	1.96	1.60	2,30	1.10	2.10	0.5	-	<b>68.79</b>
EAGGF	-	-	34.00	13.20	-	-	-	3.00	-	-	-	<b>50.20</b>
FSP	-	-	-	13.00	6.00	12.00	10.00	10.00	10.00	20.30	21.00	<b>102.30</b>
Macro financial assistance (disbursed)	-	5.70	-	-	-	8.00	4.00	-	-	11.00	7.00	<b>35.70</b>
Aid against effects of Russian financial crisis	-	-	-	-	-	-	1.50	-	-	-	-	<b>1.50</b>
<b>Total (M€)</b>	<b>38.30</b>	<b>25.60</b>	<b>63.96</b>	<b>55.17</b>	<b>8,96</b>	<b>31.60</b>	<b>17.80</b>	<b>35.10</b>	<b>12.10</b>	<b>41.80</b>	<b>55.00</b>	<b>386,39</b>

## 2. POLITICAL ISSUES

### 2.1. Democracy and the rule of law

Armenia is a presidential republic based on the principle of separation of powers. Its Constitution was adopted in 1995. The **President** is the Head of State. He is directly elected for a five-year term and can only serve two consecutive terms. He appoints and dismisses the Prime Minister and the other members of the government on the Prime Minister's recommendation. Armenia has a unicameral parliament, the National Assembly, with 131 members elected every 4 years, 75 of whom are elected on a proportional, party list basis and the rest by a one-round majority system for 56 single seat constituencies. The President may dissolve the National Assembly except during the last six months of his term. Following parliamentary elections, the Government's programme is presented to the National Assembly and a vote of no-confidence may be called for. The latest presidential elections were held in March 2003 and parliamentary elections were held in May of the same year. In the Presidential elections, President Kocharian was re-elected for a second (and final) 5-year term in office with a majority of 67.52%. Following the parliamentary elections, President Kocharian asked the incumbent Prime Minister, Andranik Markarian, to form a government

relying on a three party coalition (Republican Party, *Orinats Yerkir* – Country of Law - and the Armenian Revolutionary Federation – *Dashnaktsutiun*).

In its final report on the parliamentary elections, OSCE/ODIHR stated that the elections marked an improvement over the 2003 presidential election in both campaign and media coverage but fell short of international standards for democratic elections in a number of key respects, in particular the counting and tabulation of votes. The reports on both elections set out detailed recommendations including changes to the legislative framework, notably the electoral code, and improvements in electoral administration. The losing candidate in the presidential elections challenged the results of the second round of voting. The Constitutional Court did not refute his arguments but did not invalidate the results of the election. The Court recommended that the newly elected National Assembly and President hold a “referendum of confidence” within a year, but later reversed its position. The government, for its part, considered such a referendum not to be provided for in the Constitution. In April 2004, as the Court’s “deadline” approached, the opposition organised demonstrations calling for a referendum. During the demonstration a large number of administrative arrests was made, the offices of several political parties were raided and attacks against journalists took place. As a result of these events, Armenia’s parliamentary opposition has been observing a partial boycott of parliament. This has hampered work on the revision of the Constitution and electoral code. The EU Special Representative for the South Caucasus, the Council of Europe and other international bodies have called upon the opposition to enhance its dialogue with the authorities and to participate fully in the work of parliament.

A referendum on **constitutional amendments** - covering human rights, President-government relations, independence of the judiciary and local self government - was held but invalidated due to low turnout. Various drafts of constitutional amendments, currently being examined by the National Assembly, are also important for the effective implementation of a number of key laws. The Council of Europe has requested that the amendments be presented for the Venice Commission’s expert appraisal.

Armenia is divided into 11 regions (*marzer*) each run by a governor appointed by central government. Yerevan constitutes one of the regions and its Mayor is nominated by the Prime Minister and appointed by the President. Each region is divided into rural and urban communities (*Hamaynker*). In 2002, the Law on **local self government** was adopted. In the same year Armenia also ratified the European Charter of Local Self Government. A 2003 Council of Europe report concluded that local self government remains very weak and that large elements of the European Charter remain unimplemented. Further education and training is needed.

Following the adoption of the 1995 Constitution, a new **judicial system** came into being in 1999. The judicial structure is based on provincial courts of first instance and appeals courts for criminal, civil, commercial and military matters, as well as a Constitutional Court. A new Criminal Code was adopted in 2003 and work is ongoing on reform of the Criminal Procedural Code. Draft laws on the status of judges, the judiciary and the judicial council should follow the revision of the Constitution.

NGOs have expressed concerns about the independence of the judiciary, lengthy pre-trial detentions, partiality, inefficiency and corruption. Among Armenia’s Council of Europe accession commitments, the passing and implementation of reform of the judicial system remains to be fulfilled. At present, the President is the guarantor of the independence of the judicial authorities, chairs the Judicial Council and appoints the Prosecutor-General.

A law on the **civil service** was adopted in 2001. Implementation and enforcement of legislation remains weak and corruption is a general problem.

The law on the Human Rights Defender (**Ombudsman**), whose role is to protect human rights and fundamental freedoms violated by central and local government agencies and their officials, was adopted in 2003 and, pending the revision of the Constitution, provides for the appointment of the Ombudsman by the President rather than the National Assembly. The Council of Europe has asked the Armenian authorities to already invest the Ombudsman with the necessary independence.

**Corruption** remains of serious concern. In 2004 the Transparency International's *Corruption Perception Index* ranked the country in 82<sup>nd</sup> place which indicates that there is perceived to be a high level of corruption. Armenia signed and ratified the Council of Europe Criminal and Civil Law Conventions on Corruption but has not signed the UN Convention against Corruption. In 2003, an anti-corruption strategy and action plan were adopted and Armenia acceded to the Council of Europe's Group of States against corruption (GRECO). The Criminal Code contains a number of provisions criminalising corruption, although the scope of these definitions does not fully meet international standards. In June 2004, the President issued a decree establishing a Council to Fight Corruption, chaired by the Prime Minister, to supervise the implementation of the strategy. A June 2004 OECD report on the review of the legal and institutional framework for fighting corruption in Armenia noted that prosecution and conviction for bribery and corruption-related offences remain too low in the context of the reported level of corruption.

## 2.2. Human rights and fundamental freedoms

Armenia has ratified the core UN Human Rights Conventions except the Second Optional Protocol to the International Covenant on Civil and Political Rights, the Optional Protocol to the Convention on the Elimination of All Forms of Discrimination against Women and the Optional Protocol to the Convention against Torture and other Cruel, Inhuman and Degrading Treatment or Punishment. It ratified the two Optional Protocols to the Convention of the Rights of the Child in 2004. It has ratified three out of the eight ILO Conventions on core labour standards (collective bargaining, forced labour and equal remuneration).

Armenia acceded to the Council of Europe (CoE) in 2001. It has satisfied almost all of its commitments regarding ratification of Council of Europe Conventions.

However, the 2003 elections and the events of April 2004 have highlighted important problems in the human rights area.

In terms of **freedom of expression**, laws on the press and media, on freedom of information and on radio and television broadcasting were adopted in 2003. Amendments to the Criminal Code were introduced in July 2004 partially decriminalising defamation and libel. The Council of Europe and the OSCE have expressed reservations with regard to the new provisions which are seen as offering greater protection to public officials than ordinary citizens. Serious concerns exist regarding the independence of the media as the members of the two regulatory bodies for public and private broadcasters are appointed by the President. Concerns have also been raised regarding the awarding of certain broadcasting licenses.

In terms of **religious freedoms**, the community of Jehovah's Witnesses received state registration in October 2004, implementing a Council of Europe commitment. This

registration has however been denounced by the Supreme Spiritual Council of the Armenian Orthodox Church.

In terms of **freedom of assembly**, a new law on the organisation of gatherings, meetings, rallies and demonstrations came into force in May 2004. The Council of Europe, describing it as a step forward but not in full compliance with Armenia's international commitments, made relevant recommendations, as did the OSCE. The Constitution protects the right to **freedom of association**. However, no association law has been enacted to implement this right. According to the Council of Europe, NGOs are subject to restrictions by authorities.

In terms of freedom of association, the Constitution provides employees with the right to form and join **trade unions** and to strike. In practice, due to high unemployment and the poor economy, labour organisations remain weak and collective bargaining is not practiced. Unions are free to affiliate with international organisations; however, to date none have done so.

The provisions concerning **administrative detention** - which enables detention for up to 15 days without access to a lawyer - have been widely criticised by civil society. The international community has called on Armenia to cease this practice forthwith. The European Committee for the Prevention of **Torture** and Inhuman or Degrading Treatment or Punishment (CPT) visited Armenia in 2002. Its report, published in 2004, concluded that "persons deprived of their liberty by the police in Armenia run a significant risk of being ill-treated." According to the CPT, the transfer of responsibility for the prison system from the Ministry of Internal Affairs to the Ministry of Justice in 2001 has been a positive step but detention conditions remain poor. Following the CPT recommendation on reform of the penitentiary system, a civil society monitoring board for the penitentiary institutions was set up in July 2004.

Armenia ratified Protocol No 6 (but has not signed Protocol 13) to the European Convention on Human Rights concerning the abolition of the **death penalty** in September 2003 and the European Social Charter in January 2004.

Armenia signed the Rome Statute of the **International Criminal Court** in 1999. However, the Constitutional Court delivered a negative opinion on the compatibility of the Rome Statute with national legislation thus preventing ratification pending the revision of the Constitution.

The Constitution provides for sexual equality but high levels of unemployment and poverty have severely affected the position of **women** in Armenia. According to the Armenian National Office of Statistics, 68% of officially registered unemployed are women. Domestic violence and sexual harassment against women is of some concern. In May 2004, Armenia adopted a "National plan for improving the status of women and enhancing their role in society". The welfare of **children**, particularly in terms of education and health care, has been seriously affected by Armenia's economic conditions since independence. The EC is currently providing assistance for reform in the field of child welfare.

Armenia ratified the Framework Convention on **National Minorities** in 1998. According to the Council of Europe, insufficient attention and resources have been devoted, to date, to the promotion of minorities' linguistic and cultural heritage.

### 2.3. Foreign Relations - General

Armenia is a **member** of the UN, the Council of Europe, OSCE, the Commonwealth of Independent States (CIS), the Black Sea Economic Cooperation (BSEC) as well as the IMF, the World Bank, the EBRD and WTO. It is a member of NATO's Euro-Atlantic Cooperation Council and participates in the Partnership for Peace programme. It has recently obtained observer status in the Organisation Internationale de la Francophonie and in the League of Arab States.

Armenia's **regional geopolitical situation** is complex. It is a land-locked country whose borders to the West with Turkey and to the East with Azerbaijan are closed, mainly as a result of the conflict over Nagorno-Karabakh. Armenia's foreign policy is based on the pursuit of "multidirectional complementarity" whereby the country seeks to maintain strong relations with the EU, Russia and the US. Its relations with its neighbours are conditioned by the conflict with Azerbaijan over Nagorno-Karabakh (*see 2.4*).

**Russia** has traditionally been Armenia's most important ally. Armenia is a member of the Commonwealth of Independent States and has joined the Collective Security Agreement. Russia maintains a military presence in Yerevan and Gyumri and provides many of the border guards at the Armenia-Turkey and Armenia-Iran borders as well as at Yerevan's international airport. Russia also plays a significant economic role in Armenia. In order to pay off its extensive energy debts, Armenia has sold most of its energy infrastructure to Russia and in 2003 signed a five-year renewable agreement transferring to the Russian state company RAO UES the financial management of the Medzamor Nuclear Power Plant. Remittances from the 1 million-strong Armenian diaspora in Russia are especially important for poor rural families.

Armenia benefits from one of the highest levels of US per capita assistance, funding important capital expenditure programmes, notably infrastructure, in addition to substantial remittances. Armenia has recently qualified for significant additional funding from the US through the Millennium Challenge Account and is currently elaborating its proposals.

Armenia has welcomed the **EU's** enlargement in May 2004 and its inclusion in June 2004 in the European Neighbourhood Policy. It maintains a strong relationship with France due to the significant Armenian diaspora there and has important commercial links with Greece.

**Georgia**, to the North, has been Armenia's main road and rail access to the outside world. Co-operation with Georgia during the Shevardnadze era was difficult and further complicated by the presence of a significant Armenian minority, located in an extremely poor area and almost totally economically dependent on the Russian military base in Akhalkalaki which Georgia is calling to be withdrawn in accordance with the commitments taken at the 1999 OSCE Istanbul Summit.

Armenia has made great efforts to develop its relations with **Iran** as an alternative transport route and an alternative source of energy. 20% of Armenian land trade now passes across its border with Iran. In May 2004, Armenia and Iran signed an agreement to construct a gas pipeline between the two countries. Cooperation is also taking place in the field of hydro-electric power along the Arax river.

Armenia's relations with **Turkey** are particularly complex, with long-standing differences over each country's interpretation of the tragic events of 1915. Since the war over Nagorno-Karabakh, the Turkish-Armenian border has remained closed and there are no diplomatic

relations. Some contacts have been held recently between Foreign Ministers and a group of Armenian MPs has recently visited Turkey. There are a number of sensitive unresolved issues between the two countries which need to be addressed with a view to improving mutual relations.

Armenia is a participating State of the UN Programme of Action to Prevent, Combat and Eradicate the Illicit Trade in Small Arms and Light Weapons in All its Aspects (UNPoA). Although it is very much affected by landmines, with no reliable figures, it has not yet acceded to the 1997 Ottawa Convention on the Prohibition of the Use, Stockpiling, Production and transfer of Anti-Personnel Mines and on their Destruction, in part because of regional issues.. Armenia is not a member of the Convention on Conventional Weapons (CCW) but reports that it is considering acceding to Protocol II covering landmines.

US military assistance has re-started in response to the events of 11 September 2001 but Armenia has generally played a low-key role in **counter-terrorism**. It has taken into account its relations with Russia and Iran, the Armenian communities in Iraq and the Middle East more generally and the fact that Yerevan is only 750 km from Baghdad. Armenia is committed to fighting terrorism within the international framework and is in the process of adjusting its domestic ant-terrorism legislation to international standards. A Draft Law on Combating Terrorism has been submitted to the Council of Europe.

#### **2.4. Territorial conflicts and other conflicts/disputes**

Ethnic tensions over **Nagorno-Karabakh** increased in the period 1988-1991. Following the collapse of the Soviet Union in 1991, war broke out between Armenia and Azerbaijan over the region. The two countries agreed on a cease-fire in 1994 after a war which had resulted in the deaths of more than 30,000 people and created numbers of refugees on both sides. Estimates put the numbers of Azeri refugees and Internally Displaced Persons (IDPs) from Nagorno-Karabakh, adjacent occupied districts and Armenia at 800,000 and of Armenian refugees from Azerbaijan at 300,000. Portions of Azerbaijan's territory remain under Armenian occupation. Although the cease-fire has held since 1994, significant numbers of incidents along the "line of contact" take place each year: in 2004 alone there have been more than 30 casualties.

As a consequence of the Nagorno-Karabakh conflict, Azerbaijan is very reluctant to engage in any co-operation with Armenia, either on a bilateral basis or within the framework of international organisations. There is very limited regional co-operation in the Southern Caucasus.

Since 1992, the Organisation for Security and Co-operation in Europe (OSCE) has been the primary forum for mediation efforts, led by a subset of OSCE members - the Minsk Group, co-chaired by Russia, the US and France. Dialogue between the Presidents of Armenia and Azerbaijan led in 2001 to a high-level meeting in the US that did not result in a breakthrough. Following the elections in the two countries in 2003, dialogue was resumed. The Armenian and Azerbaijani Foreign Ministers meet regularly in the context of the so-called Prague Process. Presidents Robert Kocharian and Ilham Aliiev had a long bilateral discussion in the margins of the September 2004 CIS Summit held in Astana (Kazakhstan). The Minsk Group co-chairs are continuing to assist the parties in their dialogue.

The European Union, including through the EU Special Representative to Southern Caucasus, continues to provide strong political support to the mediation efforts of the OSCE Minsk Group.

## 2.5. Justice and Home Affairs

The 1988 Armenian earthquake, the economic consequences of the break-up of the Soviet Union and the conflict over Nagorno-Karabakh have produced large migration flows and have resulted in the population of Armenia dropping by roughly 1 million over the past 10-15 years to the current level of around 3 million. In terms of migration, Armenia is a country of origin and, to a much smaller extent, a transit country to Western Europe .

Most of the estimated 251,000 **refugees** in Armenia are ethnic Armenians displaced from neighbouring countries due to conflicts, including Nagorno-Karabakh, Chechnya and Abkhazia. In 1993, Armenia acceded to the 1951 Geneva Convention on the status of refugees and its Protocol and the 1999 Law on Refugees defines the overall asylum framework in Armenia. Amendments to this law which entered into force in April 2004 have brought it more into line with international standards. While refugees are granted basic social and economic rights under the new law, their integration remains a challenge. Armenia has signed **readmission agreements** with, among others, Lithuania and Russia.

The **police** force comes under the responsibility of the Ministry of Interior. It has a declining budget and lack of modern equipment. Police reform (in particular professional training including in modern investigation techniques) has been identified as a priority, notably by the Council of Europe's Committee for the Prevention of Torture. The OSCE is planning an assistance programme for the Armenian police aimed at building trust between police and society and contributing to developing a community-based police model.

In terms of international **judicial cooperation**, Armenia has ratified the 1957 European Convention on Extradition and the 1959 European Convention on Mutual Assistance in Criminal Matters as well as its 1978 Additional Protocol. It has not signed the Second Protocol on Mutual assistance on Criminal Matters and is not party to the 1980 Hague Convention on Child Abduction.

Armenia is a source and transit country for women and girls **trafficked** for sexual exploitation, mainly to the United Arab Emirates and Turkey as well as to Russia and European countries. Trafficking to Russia, Turkey and the UAE for the purposes of labour exploitation is an increasingly significant problem. The 2003 Criminal Code criminalised trafficking in persons and in January 2004 the Armenian government adopted an Action Plan for the Prevention of Trafficking of persons.

Armenia is not a major **drug**-producing country and the level of domestic abuse is relatively low. Poor infrastructure makes Armenia a secondary trafficking route. Armenia has signed the three UN Conventions on drugs (1961, 1971, 1988) and adopted a national Law on Drugs and Psychotropic Substances in 2003. The EU funds SCAD (Southern Caucasus Action Programme on Drugs), one of three regional programmes located on heroin routes.

In 2003, Armenia ratified the UN Convention against Transnational **Organised Crime** and its protocols relating to the trafficking of persons and to the smuggling of migrants. It has not signed the Protocol against the Illicit Manufacturing of and Trafficking in Firearms.

Armenia's economy is still largely cash-based but high unemployment, low salaries, corruption and a large shadow economy contribute to its vulnerability to **money-laundering**. Casinos are spreading, with around 30 on the outskirts of Yerevan. Progress has been made since 2003 to bring legislation and structural capacity up to international standards, especially with regard to overseeing commercial banking. In 2003, Armenia ratified the CoE Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime. Armenia is also a member of the Council of Europe's Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL). The Criminal Code, Law on Banks and Banking and the Central Bank's regulations contain provisions prohibiting money laundering and requiring financial institutions to carry out checks on deposits over a certain value. A draft law on money laundering and suppressing financing of terrorism, which provides for the creation of a Financial Intelligence Unit, is expected to be adopted early in 2005.

### **3. ECONOMIC AND SOCIAL SITUATION**

#### **3.1. Macroeconomic and social outlook**

##### *3.1.1. Recent economic developments and outlook*

Armenia is a small open economy with a population of about 3 million and a nominal GDP level of US\$2.8 billion in 2003. With a GNI per capita at about US\$950 (US\$3,770 in terms of purchasing power parity), Armenia is in the group of lower middle income countries. Real GDP growth has accelerated each year since 1999, reaching a record high of 13.9% in 2003. GDP composition has changed as construction and trade have picked up, supported by remittances and other private transfers, while agriculture has declined in relative terms (but still accounts for 21.5% of GDP, equal to industry). Industrial production is supported by new investment in mining, metallurgy, diamond polishing and food processing sectors. With continued strong economic growth, Armenia is expected to reach its pre-transition (1990) level of real GDP in 2005. Tourism and information and communication technologies are identified by the government as potential new growth areas but substantial new investment has yet to materialise.

The full benefits of an overall liberal trade regime have not yet been achieved. Closed borders with Azerbaijan and Turkey as well as poor transport and communications infrastructure are significant constraints to the economic development of this landlocked country. According to World Bank estimates, these restrictions have resulted in a cost of 10-18% of GDP in 2003 either directly (abnormally high transport costs) or indirectly (including through a higher perceived risk premium for foreign direct investment). In 2004 Armenia continued to rely on external assistance and workers' remittances to finance its trade deficit. From 1999 until 2002, consumer price inflation was comfortably contained below the 3%-target of the Central Bank of Armenia (CBA). However, at the end of 2003 the annual inflation rate increased to 8.6%, mainly because of high import prices for wheat. Upward pressure on inflation has continued in 2004, again mainly through food prices and some tariff increases.

**Table. Armenia - Selected Economic Indicators, 2000-2004**

	2000	2001	2002	2003	2004*
Real GDP growth (%)	6.0	9.6	13.2	13.9	10.1
Nominal GDP (billions of drams)	1,031	1,176	1,363	1,623	1,970
Consumer price inflation (% , period average)	-0.8	3.1	1.1	4.7	7.0
Unemployment rate (registered)	11.7	10.4	10.8	10.1	9.4
Poverty rate (% of population)	Na	50.9	49.7	42.9	43
Fiscal balance (% of GDP, cash basis)	-4.6	-4.0	-2.6	-1.5	-1.3
Broad money (% change)	38.6	4.3	34.0	10.4	15.0
Exports of goods and services (% of GDP)	23.3	25.5	29.4	32.2	29.0
Imports of goods and services (% of GDP)	50.5	46.1	46.6	50.1	44.3
Current account balance (% of GDP)	-14.5	-9.5	-6.2	-6.8	-5.6
Gross international reserves (months of imports)	3.8	3.6	3.7	4.0	3.7
External public debt (% of GDP)	45.0	43.2	44.0	38.3	31.3
External debt service (% of exports)	10.8	9.7	9.5	7.2	6.8
Domestic public debt (% of GDP)	Na	2.1	2.6	2.6	2.4

Sources: IMF, Eurostat

\* Projection

### 3.1.2. Fiscal management, monetary and exchange rate policy

The overall fiscal balance deteriorated in the late 1990s, reaching a deficit of 7.2% in 1999, but has since then been reduced to an average of 2% in 2000-2003. Concurrently, the stock of expenditure arrears was cleared. Quasi-fiscal deficits in the energy sector as well as in water supply and irrigation have also been reduced to an estimated 0.4 % of GDP. Because of persisting weaknesses in tax and customs administration, a large gap remains between actual and potential revenue collection. Tax revenues as a percentage of GDP are at a relatively low level, at below 15% of GDP, and despite strong economic growth tax collection as a ratio to GDP, actually declined in 2003 to 14.1%. In its Poverty Reduction Strategy Paper (PRSP) the government has projected tax revenues at the level of 16.2% of GDP by 2006. (See 3.3).

Good progress has been made in developing a Medium-Term Expenditure Framework, but recent reviews conducted by the EC encourage the authorities to continue reforms in the entire budget system (planning, budgeting, accounting, treasury management, and internal and external audits). The recent fiscal decentralisation reform should be carefully evaluated in terms of fiscal accountability to ensure its successful implementation.

The CBA consistently maintains a prudent monetary policy. In 1993, Armenia introduced its national currency, the *dram*, which has been allowed to float since then with minimal intervention by the CBA. The *dram* depreciated gradually both in nominal and real effective terms until 2004 when the trend has been reversed, driven by a stronger inflow of transfers. No exchange restrictions are maintained on current international transactions. The IMF and the EC have found that safeguards to ensure sound management are generally adequate at the CBA.

### 3.1.3. External situation

Over the past ten years, a progressive reorientation in Armenia's trade flows has been visible as the share of CIS countries in exports and imports has declined to 19 and 24% respectively in 2003 (from 81 and 66% in 1993). Armenia relies heavily on imports of food products as well as of energy, and therefore has a large trade deficit, which has however decreased from over 30% in the late 1990s to below 20% in 2003.

At the time of the financial crisis in Russia in 1998, the current account deficit reached 21% of GDP but it has subsequently narrowed down to an estimated 7% (2003). The trade deficit is partly offset by remittances and external assistance. Remittances and private transfers are a significant factor supporting demand in Armenia, averaging about 11% of GDP in recent years. Inward processing of diamonds has become a prominent sector in trade flows (for both imports and exports). To enhance longer-term external sustainability of the economy, greater export diversification will be necessary. The gross international reserves of the CBA are at a comfortable level equivalent to about four months of imports.

Armenia's external debt became more manageable after the conclusion of debt reduction agreements with Russia in 2003. Public and publicly-guaranteed external debt totalled about US\$1.1 billion at the end of 2004 (31% of GDP, down from 46% in 1999). Moreover, the debt stock consists mainly of concessional loans from multilateral sources (90%).

### 3.1.4. Social situation and human development policies

Economic growth has started to have an impact on poverty indicators. The proportion of the population living below the **poverty** line fell from 56% in 1998/1999 to 49% in 2001/2002, and the share of extreme poverty from 26% to 17%. Available data for 2003 indicate that the positive trend in poverty reduction has continued. Regional disparities have widened, however, as the rise in living standards is concentrated in the capital whereas other regions have been largely left behind. About 5% of the population still live in temporary shelter (refugees and those in the 1988 earthquake zone). Unemployment is persistently high, despite accelerating economic growth since 2000. Officially registered unemployment is around 10%, but household surveys indicate unemployment rates between 25-30%, with the highest rates concentrated in rural areas.

The World Bank estimates that Armenia is likely to meet the Millennium Development Goals for gender and education, may meet the goals for poverty reduction, infectious diseases and environmental sustainability, but is unlikely to meet those on child mortality and maternal health. Armenia compared relatively well with non-transition countries at the same level of income in 1990; and therefore in terms of MDG the main challenge is to restore basic health and education services in today's economic environment.

Around 70% of total employment is located in self-employment, small enterprises and agriculture, i.e. largely in the informal economy. It has been estimated that the informal economy constitutes about 46% of gross national income. Levels of income inequalities are relatively high, although on a declining trend since late 1990s, as measured by the Gini coefficient (0.434 for 2003). On the basis of consumption surveys, a lower Gini coefficient (i.e. lower inequality) is estimated (0.27 for 2002, more or less unchanged since 1998/99).

Emigration has radically changed Armenia's demographics and labour force since the beginning of the 1990s. Around one million persons, or about 25% of the population, have

left the country. While contributing to private consumption in Armenia through remittances, emigration has resulted in an aging population, a gender imbalance and a loss of skilled labour. There has been a sharp fall in the birth rate from 21.6 per 1000 (1989) to 10.1 in 2002 whereas the death rate increased over the same period from 6.5 to 8 per 1000. Nearly two thirds of the population live in urban areas, the capital Yerevan having alone about one third of the total population.

In August 2003, the Armenian government adopted a **Poverty Reduction Strategy Paper** (PRSP), which is based on a real GDP growth rate assumption of 6% over medium term. Due to its main focus on redistribution issues, the strategy addresses sustainability and the sources of future economic growth at a fairly general level. Substantial job creation in new small and medium sized businesses is a key for meeting the poverty reduction targets. At the same time, continued public sector modernisation should provide better access to basic services for all. Total government expenditures as a percentage of GDP are actually on a declining trend (19% in 2003) as the revenue potential is not being realised, although the PRSP envisages a 14% per annum increase over the period 2004-2015.

Social transfers are equivalent to only about 4.5% of GDP. The current level of pensions is below the minimum subsistence level. The CBA has put forward initial proposals for the future development of Armenia's pension system, but broadly-based robust economic growth would be necessary to develop the social protection system in Armenia on a sustainable basis.

Public spending on **health** and **education** has remained at low levels in recent years (about 1.2 and 2.2% of GDP respectively in 2002). The deterioration of physical infrastructure has also been evident in the education sector due to under-funding. The PRSP pays particular attention to ensuring quality of education in order to better meet the needs of employers. In the health sector, private financing (mainly informal payments) are estimated to account for two-thirds of total health expenditure. The health system has been decentralised and given more responsibility for managing its finances. The PRSP identifies the health sector as a main priority and foresees a substantial increase in public funding for 2004-2007 with the objective of reaching 2.5% of GDP by 2015.

### *3.1.5. Sustainable development*

As regards **sustainable development**, a National Sustainable Development Concept Paper and a Strategy are under elaboration. Key elements considered are land and forest degradation, management of water resources and wastes, restoration of Lake Sevan, biodiversity, mountainous areas, as well as education and public awareness.

In 2002 the Government established a National Council for Sustainable Development Its task is to enhance inter-sector cooperation on sustainable development efforts and to promote integration of environment considerations into various sector policies. The Council consists of representatives of different Ministries and departments, National Assembly, NGOs, youth and the business sector.

## **3.2. Structural reforms and progress towards a functioning and competitive market economy**

### *3.2.1. State involvement in the economy and privatisation*

About 75% of GDP is produced by the private sector. Commercially viable state owned enterprises (SOEs) have largely been privatised already (approx. 7230 small enterprises and approx. 1890 medium and large-scale enterprises by mid-2004). Therefore, the government has also begun to pay attention to the expedition of liquidation processes for non-viable SOEs which it has not been able to privatise. Given the unfavourable geographical location, small size of the local market and the perceived risks related to the business climate, Armenia has made slow progress in attracting strategic investors for the remaining state assets which are subject to privatisation.

Land reform was carried out in the early stages of transition, and by 1994 nearly 90% of agricultural land had been privatised. Private farms are small in size (mostly subsistence farming), and the lack of a functioning land market as well as an underdeveloped wholesale market infrastructure for agricultural products constrain the sector's further development.

Most recently, private operators have taken over power sector companies, and as a result, the sector has been stabilised, notably through better tariff collection. Collection rates of almost 100% were reached in 2003, and technical and other losses of electricity have been reduced remarkably. Market-based functioning of the energy sector will be further strengthened through direct contracting and by effectively dismantling the single buyer mechanism. In power generation, Russian operators have been given a large role as a consequence of settling Armenia's external debt.

In terms of price liberalisation, Armenia has reached the level of advanced industrial economies with only a small number of administered prices, notably for natural monopolies. Administered prices account for about 8% of the consumer price index. A single utility regulatory commission has been established for the energy, telecommunications and water sectors. The commission would benefit from further strengthening, however, in order to function effectively. Gradual increases in water and irrigation tariffs towards cost recovery levels are underway to strengthen these sectors, which are essential for agricultural production and have long suffered from lack of investments. Upon accession to the WTO in 2003, Armenia committed itself to introducing VAT on domestic agricultural production by 2009.

### *3.2.2. Regulatory framework and private sector development*

The private sector is polarised between a largely informal economy of self-employment and small enterprises and a heavily concentrated formal economy. Armenia has successfully implemented a wide range of first generation structural reforms, which is reflected in indicators reported by the World Bank and the EBRD. For instance, according to World Bank 2004 indicators, Armenia compares relatively well in the region and also among countries at its level of income in terms of efficient regulation for starting a business, enforcing contracts and registering property. Armenia's employment legislation was also found to be relatively flexible in international comparison. The indicators show that further progress should be made in enhancing corporate disclosure. Collateral and bankruptcy provisions should be further defined and enforced so that they enable an expansion in lending to businesses and households through financial intermediaries. Some serious deficiencies exist in corporate governance and audit standards.

The Constitution guarantees free economic **competition**, and a Law on the Protection of Economic Competition, which builds on international guidelines, entered into force in 2001. This prohibits anti-competitive agreements and abuse of a dominant position, defines concentrations and creates a notification obligation above a certain threshold. The Law also established an enforcement authority, the State Commission on the Protection of Economic Competition, and its seven members were appointed by the President in 2001. The Commission has the power to make decisions, issue warnings, impose sanctions and penalties and initiate court proceedings; however it does not have the power to carry out on-the-spot checks. Institutionally, the Commission is independent from other state bodies but lacks the administrative capacity, resources, and a proper implementing framework to effectively enforce the legislation. An EC-financed project currently provides support to the authority on developing implementing regulations. There is currently no uniform **state aid** surveillance or control regime comparable with that of the EU.

Government procurement of goods and services through formal tender procedures has increased under the new Procurement Law which entered into force in 2000. 240 bids were conducted in 2003 with the participation of about 600 businesses in the bidding for a total of AMD15 billion of goods, services and works procured. This is a considerable increase compared to AMD 5.5 billion procured in 2001. Shortcomings in the implementation of the legislation have been reported.

### 3.2.3. *Financial sector*

The Central Bank of Armenia (CBA) was established in December 1991. It is the sole regulator of **banking** activity in Armenia. It has exclusive authority to issue banking licenses and may impose sanctions for violations of the law including withdrawal of licenses. The 1996 Law on Banks and Banking is the legislative framework for the development of the Armenian banking sector. After a period of consolidation, there are 19 commercial banks operating in Armenia, all under private control (30 banks in 1997). With total assets of about 17% of GDP, the banking sector is still underdeveloped and financial intermediation does not yet function effectively, which is reflected in high risk premiums. Average lending rates have been slightly below 20% in 2004. Dollarisation remains high at about 70% of bank deposits and in the light of international experience is unlikely to shrink rapidly. Mortgage lending is being introduced in Armenia and the first developments in this area have been encouraging.

The adoption of the Basle Convention's capital adequacy requirements stimulated a gradual recapitalisation of the remaining banks, while a loan provisioning programme helped reduce bad loans to about 4.9% of total loan portfolio. The minimum capital requirement will be increased to the equivalent of US\$5 million in July 2005. The CBA applies the CAMEL rating methodology for supervisory and regulatory purposes. The CBA has established a deposit insurance scheme which will become fully operational in 2005. A credit registry has been in operation since 2003. International Accounting Standards are applied.

The non-bank financial sector is in the very early stages of development. Legislation concerning the **insurance** sector dates from 1996-7. There are 19 insurance companies operating in Armenia with total liabilities of about AMD 700 billion (approx. 40% of GDP) on concluded insurance contracts at the end of 2003. Under new legislation on credit organisation, six organisations have been established, including two leasing companies. The insurance supervisory authority is the Insurance Inspectorate of the Ministry of Finance and Economy. Although it has made a number of important achievements, there is substantial scope for strengthening supervisory and institutional capacity of the insurance sector

supervision authority. Current legislation does not require the Inspectorate to assess the suitability of owners, actuaries, and auditors, as a condition for licensing. The Insurance Inspectorate has developed a strategy paper for the development of the insurance market.

Under the **Securities Market** Regulation Law of 2000 a Securities Commission and a Central Depository have been established. The Securities Commission deals with the issuance, registration and public trading of securities. It also contains rules governing the activities of professional participants in the securities market, self-regulatory organisations (including Central Depository) and stock exchanges. Some 190 companies have been listed on Armenia's stock exchange since it started trading in July 2001 with a total market capitalisation of AMD 7.6 billion (as of mid-November 2004, approx. €1.1 billion). Overall trading volumes are low, mainly concentrating on Treasury bills.

#### *3.2.4. Relations with other donors*

Since Armenia's independence, both the IMF and the World Bank have provided the country with concessional funds and large-scale technical assistance. Armenia's macroeconomic stability has been strengthened during the three-year arrangement (2001-2004) that the country had with the IMF under the Poverty Reduction and Growth Facility. The World Bank approved in June 2004 a new Country Assistance Strategy which focuses on promoting private sector led economic growth, on making growth more pro-poor and on reducing non-income poverty. The EBRD continues to focus on SME and micro-enterprise financing through local banks and is also considering equity investments in the local financial sector. Given the limited sovereign borrowing capacity, financing for infrastructure and utilities could be made available by the EBRD on a non-sovereign basis if accompanied by appropriate regulatory and institutional reforms (EBRD Country Strategy adopted in November 2003).

Armenia is eligible for grants from the US Millennium Challenge Corporation to which the Government has submitted a proposal, including for new investments in rural infrastructure and budget support to the social sector. Several other bilateral donors have been active in Armenia, including substantial assistance from EU Member States. Armenia has not suffered from lack of donor funds. On the other hand, only fairly modest results have been visible so far in terms of attracting private investment (FDI fairly stagnant at around 5% of GDP in recent years). The relatively high volume of donor funds requires close coordination among donors, and extensive structures have been established for this purpose within the donor community in Yerevan.

### **3.3. Trade-related issues, market and regulatory reform**

Since 1991, Armenia has pursued free market reforms, with emphasis on trade liberalisation, stabilisation and economic restructuring. Armenia acceded to the WTO in 2003.

A landlocked country, with few natural resources, Armenia accounts for a very small share of world trade, reflecting insufficient integration into global trade networks. Its trade is very concentrated, both regionally and on a sectoral basis. In particular, its five principal trading partners account for 80% of its total trade.

The EU is Armenia's first import and export partner, accounting for some 38% of its total trade. Yet EU bilateral trade with Armenia is very low: €474 million in 2003 (figures

recalculated for EU-25). Russia and Israel are the second and third trading partners of Armenia, representing 13% and 10% of its total trade respectively.

Regional trade links are seriously limited by the conflict with Azerbaijan over Nagorno-Karabakh.

Since 2000, EU trade with Armenia has followed a somewhat erratic trend. EU imports plunged in 2001 (-38%), to subsequently double between 2001 and 2002. In 2003, EU imports from Armenia decreased marginally in value, by 2.7%. Similarly, EU exports to Armenia declined sharply in 2001 (-16.5%) but have since then increased steadily, by respectively 18% and 22% in 2002 and 2003.

Armenia's trade with the EU is very concentrated, dominated by trade in precious stones which are imported, polished and subsequently re-exported to the EU. These account for, respectively, 63% of EU imports (€99 million) from Armenia and 34% (€108 million) of EU exports to this country. The EU also imports base metals (essentially aluminium), worth some €38 million. EU exports are mostly machinery, equipment and vehicles which, together, account for 30% of EU exports to Armenia.

Armenia benefits from the EU's Generalised System of Preferences (GSP) scheme and its preferential imports have increased strongly since 2001. The global utilisation rate (eligible imports compared to effective GSP imports) stands at 63%, which is above the average rate for all beneficiaries. In particular, the GSP utilisation rates for industrial and agricultural sectors have improved notably.

Overall, Armenia registers a negative trade balance of approximately €525 million, which translates in a negative current account balance of approximately 7.7% of GDP, in a decreasing trend compared to previous years.

Bilateral agreement on trade in textiles lapsed with the accession of Armenia to the WTO. Trade in textiles is consequently conducted without any quantitative restrictions or surveillance, on an MFN basis. Armenia has concluded Free Trade Agreements with most CIS countries. It has also concluded MFN trade and cooperation agreements with a number of non-EU countries.

The **agricultural sector** represents today 20% of the GDP. Production is characterised by mountain farming. Farming land counts for 1.4 million hectares of cultivable land, only about 400,000 of which are arable. The sector is mainly subsistence farming. The food-processing industry is rather small and requires important investments. Armenia is known for its fine varieties of grape and apricot. The main agriculture export goods are spirits and tomato paste.

Regarding **veterinary and phytosanitary issues**, Armenia adopted legislation covering veterinary, food safety and plant protection issues in 1999-2000. Although this legislation provided for reforms, competences and priorities at national and regional level as well as between public and private actors are not set. The sector lacks funding to ensure adequate nationwide coverage of veterinary and phytosanitary services. Various Ministries (Agriculture, Health, Industry) have a role in food safety, leading to coordination difficulties. The lack of an animal identification system allowing control of endemic animal diseases, limited and ill equipped laboratories, badly trained staff and non-internationally harmonised food standards hamper further development of the food sector. The insufficient number of slaughterhouses undermines food safety of meat production. Armenia is currently upgrading

its food safety arrangements regarding the export of certain fishery products to the EU market. Armenia is a member of the WTO, the Food and Agriculture Organisation (FAO), World Health Organisation (WHO) and the International Office for Epizootics (OIE) but is not a signatory to the International Plant Protection Convention (IPPC).

The **Customs** department, set up in 1992, was transformed into the State Customs Committee (SCC) in 2001, under direct responsibility of the Government, and is in charge of the management of the customs policy of Armenia. There are six regional customs houses and 11 customs points in the country. Borders with Azerbaijan and with Turkey are closed to commercial traffic, although customs crossing points are in place. Armenia has applied the Harmonised System of Commodity Classification (HS) since 1991. A new WTO compliant Customs Code entered into force on 1 January 2001. With a 2003 amendment, the legal basis for post-clearance control was created. However, the implementation of customs legislation needs to be further strengthened, as in the case of customs valuation. There is no single piece of legislation to implement the code, but a great number of laws and decisions covering all customs related fields. A law on Customs Service entered into force in 2002, however there is no Code of Ethics specific to the SCC. Its adoption would assist in tackling corruption and reducing discretion in the customs administration.

Armenia applies the Single Administrative Document (SAD) for customs procedures. A customs declaration-processing system (ASYCUDA) based on selectivity is in place. However, the use of risk analysis should be further developed. A committee to exchange information and to discuss customs issues with traders and other stakeholders is in place and a multi-lingual web-site containing customs-related information and legislation is available to the public. Several customs fees are applied to customs formalities in addition to customs duties. Armenia signed a bilateral agreement on transit with Georgia.

As far as **taxation** is concerned, there is no unified tax code covering all taxes applied in Armenia. The existence of several pieces of legislation as well their frequent changes affect legal certainty in this area. The Law on Profit tax entered into force in January 1998. A single 20% rate is applicable to residents, while taxable income of non residents is charged with a 5 or 10% rates, according to the nature of the income. There is no capital gains tax in Armenia, and capital gains fall within the profit tax remit.

VAT is the main source of tax revenue in the country. It was introduced in 1997, with a standard rate of 20% applicable to national and imported goods. Several products are zero-rated for VAT purposes and some goods and services are exempted from VAT. For some imported products, for which no customs or excise duties are due, VAT is not collected by customs at import but by the tax authorities at the moment of the sale or consumption. Domestic agricultural output sold by farmers as well as sales of domestic veterinary drugs are currently exempted by VAT. In order to comply with WTO requirements, Armenia adopted an amendment to the VAT law eliminating these discriminations as from 1.1.2009. According to the Law on simplified tax of 2000, undertakings below a certain threshold are not subject to profit tax and VAT and all trading activities are subject to an 8 or 13% rate according to turnover, while for retail shops the applicable rates are 5 and 7%. Some sectors are excluded (e.g. producers of excisable goods) while other sectors are liable to the tax even if they exceed the threshold (e.g. retail shops, restaurants). Excise taxes are applicable to spirits and alcoholic beverages, tobacco and oil products.

The State Tax Service Armenia was established in 2002, based of the former Ministry of the State Revenues. The Service consists of four main departments with 26 territorial tax

inspection departments, and three special departments. Efforts both in terms of legislation and administrative capacity are still needed, particularly as regards the fight against corruption, the strengthening of revenue collection and simplification of the tax procedures, including VAT refunds.

As regards **technical regulations and standards for industrial products**, two new laws were adopted in 1999 in order to further strengthen the compliance of Armenia's legislation with the principles of the WTO Agreement on Technical Barriers to Trade: the Law on Standardization and the Law on Conformity Assessment of Products and Services to the Normative Requirements (hereinafter Law on Conformity Assessment). Governmental Decree of 2000 on Preparation, Adoption and Application of Technical Regulations was also adopted. The Law on Standardization and Certification provides the legal basis for the standardization as well as certification of products, services, labour (processes) and quality systems. This was applicable to the bodies of State governance, enterprises, institutions and private entrepreneurs and defined the means for the protection of interests of consumers and the State through the elaboration and application of normative documents on standardization.

The Department for Standardization, Metrology and Certification (SARM) is the coordinator of standardization, meteorological and certification activities. Its responsibilities include *inter alia* the creation and administration of national standardization and certification systems; the adoption of national standards and classifiers; the application of international standards; accreditation of certification bodies and testing laboratories; dealing with appeals and disputes on certification matters. The non-discrimination principle, as it concerns the treatment of domestic and foreign products and services, as well as the principle of equivalency with the regulations of other countries is reflected in a Decree of 2000. The Law on Conformity Assessment regulates the activities for voluntary and compulsory conformity assessment of production, goods, labours and services to normative requirements. The Law also established the legal basis for State activity in that field, as well as determined the modalities for conformity assessment, conditions of product marketing and the rights and obligations of parties to conformity assessment. The National Standards Institute (CJSC) was established under the SARM.

The procedure for accreditation of certification bodies and testing laboratories has been established in a 2000 Decree. Local and foreign bodies and laboratories have the same rights to be accredited in the National System for conformity assessment. Armenia is a member of the International Standardisation Organisation (ISO) and Euro-Asian Council for Standardisation, Metrology and Certification (EASC). Efforts are being deployed for the completion of the process of translating relevant EU standards into Armenian and establishment and licensing independent laboratories where safety requirements specified in technical regulations may be tested.

Legislation provides for the **protection of intellectual and industrial property rights** on literary, scientific and artistic works including computer programs and databases, patents, utility models, industrial designs, trademarks and service marks, trade names, layout designs of integrated circuits, copyrights and related rights and appellations of origin. Armenia became a member of the World Intellectual Property Organisation (WIPO) in 1993. Since becoming a WTO member in 2003, Armenia must ensure its legislation is consistent with the TRIPS Agreement. The PCA requires Armenia to provide for a level of IPR protection similar to that existing in the EC, including effective enforcement means. Armenia has now acceded to key IPR treaties and conventions, but further steps are needed to ensure full compliance with the relevant PCA obligation. Policy formulation and implementation in this field is the

responsibility of the Armenian Intellectual Property Agency acting within the Ministry of Trade and Economic Development. It is responsible for approving industrial property rights applications, maintaining the State Register of industrial property rights, issuing an official bulletin reflecting its decisions, and cooperating with foreign institutions and international organizations. Despite the legislation and organisational structures in place, implementation and enforcement in the IPR field remains weak with piracy and counterfeiting being of particular concern especially in the audio-visual sector.

The National Statistical Service of the Republic of Armenia (NSS) acts on statistical legislation from 2000, being based on the fundamental UN principles on **statistics** and renewed with technical support from the EU. NSS has a high reputation among governmental institutions. As the state budget is not sufficient for further developing the statistical system, external financing is essential. The statistical system employs in total (including Information Collection Program) 814 persons, 217 of which in the Central Office. The NSS functions as co-ordinator of the statistical system of the country, programming of statistical activities and working out of normative documents is one of its strengths. It receives some data from other ministries and governmental institutions. The NSS has access to certain registers and other administrative sources. Governmental services remain the most important users, but the needs of other users are also taken into account. There is a permanent exchange of external trade data with Eurostat. The present statistical system needs assistance in order to make further improvement towards compliance with international standards, with emphasis on those used in the EU.

Concerning **financial control**, the Chamber of Control (COC) of the National Assembly is the supreme audit institution in Armenia. The COC supervises the execution of the national budget and the use of foreign loans and grants. The Chairman and members of the COC are appointed and can be dismissed by the National Assembly, which also establishes the audit programme and the content and nature of the reports of the Chamber. This has a clear impact on its independent nature. The Supervision Service of the President, the Supervision Service of the Prime Minister and the Supervision Service of the Ministry of Finance and Economy are the other control agencies. There is currently a duplication of work among all existing bodies, as well as a need for further exchange of information. The COC, which is a member of the International Organisation of Supreme Auditing Institutions (INTOSAI) needs further strengthening in terms of organizational capacity, audit methodologies and financial and human resources.

A new law was adopted in 2000 setting out the principles and procedures for modernizing the **public procurement** regime. In drafting the law, the authorities were guided by their desire to ensure general compatibility with EU directives and the WTO's Government Procurement Agreement. The law's provisions are compatible with the UNCITRAL Model Law and additional changes will be important to ensure a well-functioning procurement system. Procurement for the needs of defence and national security, as for other government needs, is subject to the LP, with an additional provision for closed tendering only when state secrets are involved. Armenia has indicated its intention to accede to the WTO Agreement on Government Procurement. The implementation and supervisory body is the State Procurement Agency (SPA) which has been converted in 2002 into a state non-commercial organization responsible to the Ministry of Finance and Economy. It provides legal opinions on the legality of actions of Tender Committee members during the bid process.

Concerning **provision of services and the right of establishment**, Armenia's investment policy is among the most open in the CIS. With an economy that largely depends on foreign

trade and investment, the government has made significant efforts to attract investment. Basic provisions regulating the investment climate are set by the Law on Foreign Investment of 1994 (the "FIL"). The FIL's main objective is to attract foreign investment. Nevertheless, privileges are granted only to entities in which a foreign investment is at least 30% of the capital. All sectors of the economy are open to foreign investments, however to engage in business activities in specific sectors (such as banking, securities market, insurance business, etc.) foreign investors must obtain a license. The benefits provided by the FIL include *inter alia* national treatment for foreign investors; protection against expropriation and confiscation; compensation for unlawful government acts; and a 5-year exemption from adverse changes in national legislation. The key investment agencies are the Ministry of Trade and Economic Development which is responsible for formulation of foreign investment policy and its execution, and the Armenian Development Agency (ADA) set up in 1998, responsible for investment promotion, provides for one-stop shop service to investors and exporters. In view of ADA's existing organizational weakness, the execution by the Agency of its main function consisting of promoting and facilitating investment is not adequate and needs to be reviewed.

Armenia's 1997 Law on Privatization (amended in 1999) states that foreign companies have the same rights to participate in the privatization processes as Armenian companies.

### **3.4. Transport, energy, information society, environment, research and innovation, people- to- people issues**

The Ministry of **Transport** and Communications is responsible for the setting of transport policy. Currently, the national transport policy is under review with a view to clarifying the policy formulation and regulatory functions of the Ministry following the privatization of most formerly state-owned transport companies. Insufficient transport links are a major concern for land-locked Armenia, with its closed borders with Turkey and Azerbaijan. Inland transport links are provided by roads to Georgia and Iran, as well as by a rail line to Georgia. The rail line linking Georgia with Turkey via Gyumri in northern Armenia is currently out of operation given the closed border with Turkey. Armenia therefore relies heavily on civil air transport. The very poor state of the physical infrastructure and unusually high transport costs (also due to the closed Armenian-Turkish border) aggravate the situation. Infrastructure rehabilitation is being pursued and Armenia's participation from the outset in the TRACECA initiative (TRANsport Corridor Europe-Caucasus-Asia) has played an import role in the efforts to develop the transport links, but substantial further infrastructure and institutional development is needed in order to further facilitate co-operation across the whole of the corridor.

In the **road sector**, infrastructure development and maintenance is entrusted to the government agency "SSCC Armenia Roads", which is currently being strengthened. Inter-Urban Road freight and passenger operations are privatized. The Ministry is responsible for regulation and sector oversight, which has recently been strengthened by the creation of an inspection department. Road safety is an issue of concern, which is also being addressed by the National Road Safety Council. The road worthiness of vehicles is not tested.

In the **rail sector**, the state-owned operator, Armenia railways (ARD) was restructured in 1998 into three separate companies (rail freight, rail rolling stock and rail infrastructure), separating infrastructure management from the provision of services. In 2001 and 2002 this resulted in the freight operations being profitable for the first time. However at the end of

2002 the three entities have been merged again into one single state company. Both the rail network in general and the rolling stock are in need of significant upgrading.

In the **aviation sector**, the Main Department of Civil Aviation (MDCA) – completely separated from the Ministry - acts as the state regulatory aviation body. It also created several separate economic entities in the form of state enterprises, including the recently liquidated national airline – Armenian Airlines, five enterprises to provide fuelling, training, medical, construction, and recreation operations as well as the three airports: Zvartnots and Erebuni in Yerevan and Shirak in Gyumri, the second largest city. In 2002 a concession has been granted for a major refurbishment and development of Zvartnots airports. The MDCA is appointed by the Government of Armenia to manage the state-owned shares of Armenian Airlines, which was a fully state-owned company. The privately-owned Armavia started its operations in 2001. Another private carrier, Armenian International Airways (AIA), was created in June 2002. Both Armavia and AIA are in negotiations with the Government to gain Armenian Airlines' routes and to become its de facto successor. Preliminary contacts between the Commission and the Armenian authorities have taken place with a view to negotiating a horizontal air transport agreement.

In satellite navigation, initial exchanges of information started within the TRACECA framework in 2004 on the contribution that GALILEO navigation, tracking and positioning services can make to the safety and efficiency of land, maritime and air travel both nationally and regionally.

Armenia's **energy** sector is exposed to serious challenges including the bad state of infrastructure and networks suffering from losses including theft, inefficiencies, high dependence on one source (Russia), underinvestment, non-payment of debts and dependence on a nuclear power plant to be closed. Tackling these deficiencies is of key importance for economic growth and poverty reduction.

Armenia is almost exclusively dependent on Russian energy imports (all gas and nuclear fuel, large share of oil products). It has substantial hydropower capacity (about 30% of electricity production) and non-exploited coal and oil shale resources. Hydrocarbon exploration continues. There are neither refineries nor oil pipelines. Armenia's supply security is furthermore strained by the closure of network interconnections with Turkey and Azerbaijan. Gas is imported from Georgia through a single pipeline, while oil products are imported by rail and road. Armenia wishes to develop further gas and electricity interconnections with Iran including for Turkmen gas imports. In May 2004, Armenia and Iran signed an agreement to construct a gas pipeline by 2007. The country also plans to increase hydropower generation and exports, mainly to Georgia.

Armenia currently operates one out of its two Soviet type VVER 440 pressurised light water reactors (440 MW each) at the Medzamor Nuclear Power Plant (MNPP). MNPP was closed in 1989 after the earthquake, but Unit-2 was restarted in 1995 to cater for severe energy shortages. Unit-2 accounts for 35-40% of the country's electricity production. The Ministry for Energy owns the plant which is since 2003, after a debt settlement related mainly to unpaid deliveries of nuclear fuels, financially managed by Russia's UES (United Energy Systems). The EU considers MNPP cannot be upgraded to internationally accepted nuclear safety standards at reasonable costs. In 1996, President Ter-Petrosian informed the Commission of the government's intention to keep Medzamor operating only for as long as it took to put in place alternative sources of energy. The Commission has provided assistance (€21 million up to 2003) for nuclear safety and decommissioning measures at MNPP and

funded studies to develop a long-term strategy for Armenia. A Law on the use of nuclear energy for peaceful purposes is in force and was recently amended with view to establishing a decommissioning fund. The nuclear regulator functions under the Ministry of Nature Protection. Armenia also operates two nuclear research facilities, at Yerevan and Analitsark. The control of radioactive sources, including nuclear waste management and avoiding illicit trafficking, requires attention.

The Energy Law, the Law on Public Services Regulatory Commission and the Law on Licensing constitute the basic framework for the electricity, gas and heat sectors. The independent Public Service Regulatory Commission (PSRC) oversees these sectors. Armenia's energy strategy principles, based on the Energy Law, include the improvement of supply security, enhancement of competition, environmental protection and increase of energy efficiency and the use of renewable energy sources. A National Energy Strategy is in preparation. The Energy Institute and the Energy Strategy Centre, under the Ministry of Energy, support energy policy activities including energy efficiency and renewable energy projects. Energy sector restructuring including privatisation progressed substantially. However, much more needs to be done including the gradual elimination of price distortions.

ArmEnergy, the formerly vertically integrated electricity company, was separated into generation, transmission and distribution. Since October 2004 it ceased its activities (e.g. electricity wholesale and dispatching) and awaits liquidation. UES owns, as part of a debt-equity swap, large generation assets (Hrazdan heat and power plant and the Sevan-Hrazdan cascade) and a UK-registered company (Midland Resources Ltd) owns the distribution sector. Hydropower plants were to a large extent privatised. The transmission networks are operated by the state company High Voltage Power Lines. Armrusgasprom (45% state; 45% Russian Gazprom; and 10% Itera International) dominates the gas sector as sole importer and as owner and operator of the transmission, distribution and underground gas storage facilities. The oil products sector has generally been liberalised. Armenia is committed to use more renewable energy sources (small hydro mainly but there is a good potential for wind, biomass and geothermal), which will improve the environment, decrease the import bill and enhance supply security. PSRC aims to promote, through tariff setting, the use of renewables. Energy efficiency should be improved. Laws on renewables and energy efficiency have been adopted in September 2004.

In the field of **Information Society**, the Ministry of Transport and Communications (MTC) is responsible for development of sector policy and strategy. The Ministry has also regulatory responsibility and licenses telecommunications services. The Law on Public Utilities Regulation Commission, adopted in 2003, provides for the regulation of telecommunications to be transferred to an independent, multi-sector regulatory authority. This regulatory authority will only be established once the new law on electronic communications has been adopted. The IT Development Supporting Council (ITDSC), with advisory status, was established by a 2001 Presidential Decree in order to establish a formalized dialogue between Government, the IT industry, and civil society groups.

In 1997, the Armenian Telecommunications Company (Armentel) was privatised, and was granted an exclusive licence for 15 years for the provision of fixed infrastructure, fixed voice telephony, mobile communications and cable television. Data transmission has been liberalised subject to licensing by MTC, but requires the leasing of lines from Armentel. In 2002 Armentel closed subscription to mobile telephony to new users due to lack of infrastructure. Penetration of mobile telephony is the lowest in the region, at 1.7 per 100 inhabitants. Penetration of fixed line services is better at 14 per 100 inhabitants, but services

are unavailable in some rural areas. In view of the extremely high cost of internet access, the penetration of internet services is very low, estimated at less than 3% of the population.

A dispute between the Armenian authorities and OTE as the owner of 90% of Armentel shares, ended with an out-of-court settlement at the end of 2004, abolishing Armentel's monopoly in mobile telephony. A second license for mobile telephony was then hastily awarded to K Telekom.

Regarding the **audiovisual sector**, Armenia has both public and private TV and radio companies. The 2002 Law "On Television and Radio Broadcasting" is the main legal framework for the sector. The independent National Commission of Television and Radio, based on this law, is responsible for licensing and monitoring of the private TV and radio companies. Armenia's ancient and rich cultural heritage is a good basis for enhancing exchanges and is a key reference for building citizenship. Armenia considers enhancing cultural participation as a tool in combating poverty.

As regards **environment**, Armenia developed a National Environmental Action Plan in 1998 (revised in 2004) setting as priorities: air, land and water pollution; overexploitation of natural resources and threatened ecosystems; and environmental health problems and hazards. A National Environmental Health Action Plan was approved in 2002. The 2003 Poverty Reduction Strategy Paper also identifies environment as it's a priority area.

The Constitution requires the State to protect the environment as well as to ensure rational use and reproduction of natural resources. No framework legislation on environment has been adopted, and therefore the sector is regulated by the Civil, Administrative, and Criminal Codes, the Law on Inspections and the Law on Licensing. A Law on Environmental Impact Assessment was adopted in 1995 which, together with the 1991 Principles of Legislation on Nature Protection, grant citizens the right to request environmental information and be involved in the decision making process. In 2002 an information centre on environment was established.

The Ministry of Nature Protection was established in 1991. A number of other Ministries are involved in environment matters, such as the Ministries of Finance and Economy, Health, Agriculture, Internal Affairs, Justice and State Revenues. The State Environmental Inspectorate is responsible for emission control, which is performed also by regional inspectorates. Water-supply issues are dealt with under the State Committee on Water Management.

The Ministry of Nature Protection has been preparing laws to introduce new environment quality standards aiming to reflect international practice and EU legislation. A new Land Code was adopted 2001 and a Water Code as well as mineral resources code in 2002. Laws are currently under preparation on permits, public participation, seismic safety, mineral research, environmental fees as well as environmental education.

Sector-specific action plans and strategies have been elaborated on desertification, biodiversity and specially protected areas, ozone-depleting substances, integrated water resource management and persistent organic pollutants. An action plan on Lake Sevan has been adopted in 1998 and a draft law on water policy has been presented to the Parliament. The Environmental Monitoring Centre, Hydro-meteorological Department and Geological Department carry out environmental monitoring activities.

Armenia has ratified several international and regional environment conventions to which it is party and has in particular acceded to the Kyoto Protocol on climate change.

In Armenia there is a strong commitment to support **Research and Innovation** activities, with total expenditure estimated 0.9% of GDP annually, but with plans for further increase. The Government has approved a Research and Innovation strategic plan that covers eight topics. Of these, five perfectly match the thematic priorities of the 6<sup>th</sup> Framework Programme: Information & Communication Technologies, Life Sciences, Food Security & Quality, Environment & Energy and Nanotechnologies. The Armenian Academy of Science is responsible for the implementation of the research policy. The Minister of Education & Science is a member of its Presidium, ensuring overall coordination with the Government and with the Universities. The Academy owns about 40 Institutes with a staff of around 4,000 researchers. It is short of funding to maintain buildings and acquire state of the art equipment and its inability to offer internationally competitive salaries to researchers makes it difficult to retain qualified staff.

Armenia participated in 15 research contracts under the 5th Framework Programme. These concerned joint research projects using thematic networks and co-ordinated actions involving 17 Armenian participants, the majority of which were from Academia. Objectives focused on specific measures for international cooperation, information technology and energy. The Armenian Academy of Sciences has set up a National Contact Point structure (one general section covering the full 6th Framework Programme and another dedicated to Information Society Technologies).

By April 2004, 26 Armenian bodies participated in the first two calls for proposals under the 6th R&D Framework Programme, submitting 23 proposals of which none was selected. The proposals were principally addressed at specific measures for international co-operation, information technology and environment

The **educational system**, both public and private institutions, includes pre-primary, primary (7-9 years), basic (10-14 years), secondary, higher and post-graduate levels. Education is compulsory at primary and basic levels. Enrolment rates are very high at basic level. Education in the public sector is theoretically free, but widespread informal payments (e.g. fees, school supplies) affect notably children of vulnerable groups including rural population, which results in higher drop out rates. Education and training are in need of reform, which is even more urgent after the 1988 earthquake. Challenges include: declining quality (e.g. unclear standards and assessments), corruption (e.g. payments to obtain diplomas), weak strategic planning, under-funding (e.g. for remuneration, equipment including learning material, buildings), organisational inefficiencies, insufficient market relevance, reduced access and risk of dropouts for children of vulnerable groups. The Government, desiring to integrate progressively the European Higher Education Area (Bologna process), is committed to further improve the situation and modify its legislation to bring it in line with the principles of the Bologna Declaration. Human resources development is among the main pillars of the Government's Poverty Reduction Strategy. This strategy views the improvement of general education as top priority, but higher education and secondary vocational sectors are also among the priorities. General education is considered both as basis to increase enrolment in senior schools and the professional education system, particularly for children from vulnerable families. The State Programme for Educational Development 2001-2005, the 2004 Vocational Education Training (VET) Programme and the Education Law underpin reform activities. A VET Law and a higher/postgraduate education law are in preparation. Armenia participates in the Tempus programme for the modernisation of higher education, through

bottom-up exchange projects and structural measures that aim at reinforcing local reform capacities. It also participates in the Youth Programme which enhances cooperation in the field of non formal education for young people particularly through multilateral youth exchanges, transnational European voluntary service as well as training for youth workers and capacity building for youth NGOs. Regional youth activities are conducive to creating a new generation with an open mind towards the region. Current visa requirements and procedures create certain difficulties for youth mobility.

The government funds **Public Health** Care service providers, but is conscious that it needs to increase funding and to encourage communities to participate in designing and implementing health projects. As the insurance industries are not developed yet, the market fails to provide adequate private health insurance. The country's Poverty Reduction Strategy aims at maintaining public health through a substantial increase in accessibility and quality of health care services granted by the State. In practice, income disparity contributes to unequal access to medical services. To support the poor, the Government has created a Basic Benefit Package (BBP) to be provided without charge to a list of vulnerable groups of all categories. Payments to hospitals and polyclinics are provided through the State Health Agency, but they only add up to 45% of the costs of health services. Only a fraction of the capacity of the large number of hospitals, hospital beds, nurses and doctors is being used. The sector remains marred by overcapacity, non-affordability and low demand of existing hospitals. Equally, there is an oversupply of doctors in Armenia whose official pay is very low. To address the excess of medical staff, soon after independence, Armenia made efforts to reduce the number of medical students which fell from 700 in 1992 to 250 in 1995. The country runs a single public medical school accredited by the Ministry of Health. Polyclinics provide specialist medical care, whilst small clinics called *ambulatories* concentrate on primary health care. These *ambulatories* are usually located in the provinces and owned by local governments; only a few are in Yerevan where they are operated directly by the Ministry of Health. They provide services free of charge. Family medicine has been the main vehicle of preventive health care, but many polyclinics lack family physicians.

Primary health care involves education of the public about health issues, maternal and child care, immunisation and treatment of common infectious diseases. Infant immunisation coverage is generally very good. Whilst overall numbers still remain low, since 1998, Armenia has recorded a spread of HIV/AIDS, mostly transmitted through unemployed migrant workers seeking jobs in Russia and Ukraine, as well as through unprotected sex and drug abuse. In recent years, deaths from tuberculosis have also been rising, though not as dramatically as in other ex-Soviet countries. In line with the state of development of the country, modern lifestyle health risks do not prevail: mortality from cardiovascular diseases is among the lowest in ex-Soviet countries, but still above the EU average; mortality from cerebrovascular diseases is also low. However, diabetes and female breast-cancer are comparatively widespread causes of death. As in other Southern Caucasus countries, the high rate of tobacco smoking is also leaving its marks. Armenia has benefited of an EU-funded Social Insurance Identification Number System and the USAID Social Transition Programme that has aimed to render the Armenian social system, including the provision of healthcare, sustainable through the reform of health benefits and the restructuring of health sector financing. This programme also seeks to expand primary health care services, based on family medicine and community-based health education, and to upgrade the skills of staff at rural health posts, health care outreach to isolated rural communities. The European Community has also provided financial assistance to NGOs working on mental health issues as well as the provision of clean drinking water to hospitals in Gyumri.