European Commission

Ex-post Evaluation of Macro Financial Assistance (MFA) operation to Armenia

European Commission, Directorate-General for Economic and Financial Affairs

Executive Summary
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Executive Summary

This Report presents the results of the ex-post evaluation of the Macro-Financial Assistance (MFA) to Armenia (2011 to 2012). The evaluation was commissioned by the Directorate-General for Economic and Financial Affairs (DG ECFIN). The work was undertaken by ICF GHK in association with Cambridge Econometrics and with inputs from a local economist based in Armenia.

The MFA operation in Armenia

Armenia's economy was badly hit by the global economic crisis: real GDP contracted sharply in 2009 (by more than 14 per cent) and the poverty rate shot from 23.5 per cent in 2008 to 34.1 per cent in 2009 after more than a decade of continuous decline. The Government of Armenia responded rapidly with (i) a counter-cyclical fiscal 'stimulus' aimed at maintaining essential social expenditure; (ii) temporary loosening of monetary policy to counteract the output contraction; (iii) and return to a flexible exchange rate regime in March 2009 to restore external balance. To offset lower private capital inflows and budget revenues, the Government also requested for international assistance from various sources, including the International Monetary Fund (IMF) and macro financial assistance from the EU.

In response, the European Parliament and the Council approved an MFA operation consisting of a grant of EUR 35 million and a loan of EUR 65 million in November 2009 (Decision No 890/2009/EU). Further details including the number of tranches, approximate timing of disbursements and conditions related to implementation of structural reforms were agreed in the Memorandum of Understanding (MoU) signed by European Union and the Government of Armenia in February 2011. The total size of the MFA operation was substantial, accounting for circa 1.7 per cent of the Armenian GDP between the third quarter of 2011 and first quarter of 2012 (when the MFA was disbursed), and representing 9 per cent of the total international assistance received by Armenia in the form of budget support between 2009 and 2012. The MFA operation was linked to the IMF programme under its Extended Credit Facility/ Extended Fund Facility (ECF/EFF) Facility approved in June 2010 and amounting to SDR 266.80 million (approximately EUR 513.2 million).

The MFA was disbursed in two instalments:

- The first instalment of EUR 40 million was disbursed in July 2011;
- The second and final instalment of EUR 60 million was disbursed in December 2011.

Evaluation objectives and methods

The overall objective of this evaluation is to provide an independent assessment of the MFA operation in Armenia, focusing in particular on the following three areas of analysis:

- The macroeconomic impact of the operation on the Armenian economy (with and without IMF involvement);
- Sustainability of the country's external position as a result of the assistance;

- Value added of EU intervention.

The evaluation is both summative and formative, and attempts to draw lessons which could be applied to the design and implementation of future MFA operations.

The evaluation is based on a mixed-methods approach. A variety of quantitative and qualitative techniques have been used to build the evidence base for the evaluation and to provide the basis for triangulation of results: (i) a review of relevant literature and official documentation; (ii) semi-structured interviews with key informants during two missions in Armenia, missions to Brussels and Washington DC. During these missions, consultations were conducted with European Commission officials, Government officials in the relevant ministries and departments in Armenia, international financial institutions / multilateral development banks (IMF, World Bank, Asian Development Bank and Eurasian Development Bank), key development partners (e.g. GIZ) and the EU Delegation in Armenia; (iii) a focus group discussion with non-governmental stakeholders in Yerevan; (iv) desk based analyses of macroeconomic outcomes and impacts of structural reforms; and (v) macroeconomic modelling.

Results of the evaluation: Macroeconomic and external sustainability impact

The evaluation concludes that the MFA contributed to macroeconomic stability in Armenia and supported the country's post-crisis recovery. The MFA allowed for a smoother fiscal adjustment path from 2009 onwards and overall, had a net positive impact on the Armenian economy. This conclusion is supported by model-based simulation which shows that Armenia's GDP growth would have been 0.3 to 0.6 per cent lower in 2011 and up to 0.3 per cent lower in 2012 in the counterfactual scenario.

The MFA was closely linked to the IMF programme[1] and the combined macroeconomic impact of these two operations is found to have been substantially larger than the impact of the MFA alone. Specifically, the modelling exercise suggests that the joint EU-IMF support helped to avoid a much more severe recession in 2009: the decline in GDP could, potentially have been closer to 20 per cent in the counterfactual scenario (i.e. 6 per cent more than the observed level of 14.1 per cent). In the counterfactual scenario, without the IMF and MFA support, it is highly unlikely that Armenia would have had access to alternative external (or domestic) financing on a similar scale and on similar concessional terms. By implication, the combined impact of the MFA assistance and the IMF programme on Armenia's external sustainability is also likely to have been positive.

Results of the evaluation: Impact on structural reforms

The disbursement of the second tranche of the MFA assistance was, inter alia, dependent on satisfactory fulfilment of nine reform conditions, agreed in the Memorandum of Understanding between the EU and the Government of Armenia. The MFA conditionality targeted the following areas:

- Public Finance Management (PFM) reforms focusing on public debt management, public internal financial control and external audit;

[1] The study takes into account both of the IMF programmes: the Stand-by Agreement (SBA) operational from March 2009 to March 2010 (SDR 350.43 million); and Extended Credit Facility/ Extended Fund Facility (ECF/EFF) operational from June 2010 to December 2012 (SDR 133.40 million).

- Improving legislation in the areas of public procurement and pension system;
- Upgrading tax administration; and
- Compliance with the World Trade Organisation's (WTO's) rules on tax and customs policy.

The conditionality attached to the MFA was selected on the basis of (i) an operational assessment of Armenia's PFM systems which was carried out in February 2010 by independent consultants on behalf of the European Commission; and (ii) discussions with Armenian authorities, the EU Delegation, the EU Advisory Group and other development partners, in particular the IMF.

The choice of conditionality was based on several factors, notably:

- Key reform priorities as identified by the Government of Armenia;
- Reforms concerning PFM as identified in the Operational Assessment; and
- Areas of interest to the EU.

Moreover, the conditionality was designed to be consistent with the policy lines anchored in the IMF programme and the priorities of the European Neighbourhood Policy Instrument (ENPI) and Eastern Partnership. This seems to have been the case with the MFA supporting reforms in the areas of good economic governance and efficiency of public spending (e.g. internal and external audit and public procurement), trade and investment (e.g. tax administration and tax and customs policy) which were complementary to those supported via ENPI. The conditionality did not focus on socio-economic reforms or sustainable development issues, also supported by ENPI, apart from pension reform that can be seen to support this goal.

Reforms were generally well targeted, focusing on key issues that could be effectively targeted within the short timeframe available for the implementation of an MFA instrument. For example, there is a strong consensus among stakeholders (international and non-governmental national stakeholders) that the most crucial challenge facing the country is to improve its business environment. The MFA conditionality relating to implementation of a customs valuation system that is in line with the WTO Valuation Agreement was an example of conditionality aimed at improving the business environment.

As regards progress, all conditions were fully met technically, as the Armenian authorities implemented the necessary actions. The evaluation found evidence of reinforcing effect of the MFA in the areas of tax and customs policy reforms. These are areas where international donors considered the EU to have had considerable leverage through the Deep and Comprehensive Free Trade Agreement (DCFTA) negotiations. The MFA was seen to have reinforced meeting the prerequisite requirements in a timely manner and prepare Armenia's accession for the DCFTA negotiations. In the area of PFM reform, particularly reforms relating to internal and external audit, MFA potentially reinforced the internationally agreed reform agenda and possibly helped to support the implementation timeframe, although it is difficult to be conclusive given the number of international actors involved in this area supporting the Armenian government.

However, in other areas, the evaluation is inconclusive as regards the political or reinforcing effect of the MFA. These are typically reform areas where domestic ownership was high and consequently, it is highly likely that these reforms would have been undertaken by Armenian authorities even in the absence of the MFA. This was particularly the case with the pension reform, which was already a part of the Government Programme for 2008-2012[2]. In addition, conditionality relating to the establishment of public procurement legislation compliant with the EU Directives and international standards was already adopted in December 2010, and effective from January 2011, prior to the signature of the MoU. The Armenian Government had also agreed to acquire a new debt recording system financed by the World Bank before the signature of the MoU, even if the system itself was installed at a later date. These conditionalities were probably relevant when the discussions on the MFA first started in 2009. However, given the long negotiation and approval process of the MoU these reforms had either been successfully implemented or were at an advanced stage by the time the MFA-MoU was signed. Overall, reforms in some areas progressed more quickly than the MFA negotiations, and in these areas, it is particularly difficult to identify the added value of MFA reforms. It is plausible that the MFA negotiations[3] might have influenced the shape and or timetable of these reforms when they were at an early stage, but this cannot be concluded with certainty in absence of any substantive supporting evidence.

The assessment of impact varies between the conditions. The most tangible impacts can be seen in two areas:

- Customs policy and tobacco taxation: the MFA removed bottlenecks and facilitated the subsequent commencement of the DCFTA negotiations in May 2012 and their completion in July 2013[4]. The MFA played a key role in furthering tax and customs policy reforms, whose fulfilment acted as part of the preconditions for the negotiations[5].

- Tax administration reforms: the actions included in the tax administration reform will provide benefits to the Armenian citizens through the implementation of tax service centres and e-filing of tax returns.

Most of the reforms are however long term in nature and tangible impacts are expected to accrue in the future, beyond the timeframe of this evaluation.

Results of the evaluation: Design and implementation issues

Timetable

The commitment for EU MFA was made at the end of November 2009 when the Council Decision on providing macro-financial assistance came into force. Although the first fact finding mission to Armenia took place three months later in February 2010, the EU MFA operation was considerably delayed. The MoU was signed 15-months after the coming into force of the Council Decision (in February 2011 and 12 months after the fact-finding mission). One explanation for the long gestation period could be that the crisis had abated and there was therefore little urgency on part of the Armenian authorities to sign the MoU, as evident from the timeline of the negotiation process.

[2] The Government programme 2008-2012 was approved in April 2008, and can be accessed here: http://www.gov.am/files/docs/77.pdf.
[3] According to the official documentation, the dialogue on conditionality started in 2009
[4] It should be noted that the political context changed dramatically during the final stages of the evaluation. On 3 September 2013, the Armenian president announced that Armenia will join the Russian-led "Customs Union," thereby ending any possibility of forging the pending Deep and Comprehensive Free Trade Area (DCFTA) element of the Association Agreement between the EU and Armenia.
[5] WTO membership, and adherence to its rules, is a precondition to entering negotiations on DCFTA with the EU.

Consequently, the support arrived after the crisis was over and Armenian economy had returned to a growth path – although it should be noted that output remained below pre-crisis levels during the period the MFA was disbursed.

Size and form of assistance

The assistance was provided on highly concessional terms which was considered favourable by the Armenian government and which made it an attractive form of funding, especially helpful in the context of the country's rising debt burden and the need to consolidate public spending. In line with the IMF's concessional funding (the combined ECF/EFF intervention), the EU MFA offered a 35 per cent grant element – 5 per cent above the minimum 30 per cent grant element required by the IMF. The MFA also fit in well with Armenia's gradual fiscal adjustment favoured by the IMF so as not to endanger recovery.

The assistance corresponded to 33 per cent of the residual financing needs in 2010-11 and was appropriately sized given the General Criteria[6].

Visibility

The MFA instrument lacks visibility among Armenian stakeholders beyond the Government, and is typically confused with the EU budget support. With the exception of the IMF, international development partners were unable to distinguish MFA from other EU support. As such, the MFA instrument cannot be expected to play much of a role in improving the broader perceptions of the EU as a partner of Armenia.

Results of the evaluation: EU Value Added

The provision of the support on concessional terms was an important element distinguishing MFA from other international support available to Armenia in the post-crisis environment. Specifically, the bullet re-payment made the MFA extremely attractive for the Government of Armenia.

MFA supported a more gradual fiscal adjustment path thus allowing the Government to maintain essential social expenditure. This avoided further deterioration of the social and economic situation in the country[7].

From the EU perspective, MFA accelerated the process of implementing customs valuation system that in operational terms adheres to the WTO Valuation Agreement. This was particularly important for preparing Armenia to commence negotiations on acceding to Deep and Comprehensive Free Trade Area (DCFTA) with the EU. In more general terms, the MFA contributed to economic and social stability in the region by supporting an orderly adjustment and economic recovery.

Considerations for future

The MFA instrument would be strengthened by better aligning its declared objectives with the design and implementation practice. Maintaining the focus on dealing with

[6] The General Criteria provide a broad "political" framework for MFAs. They set out some basic principles that an MFA operation must conform to.
[7] Although the nature of fiscal adjustment is controversial – some stakeholders criticise that the Government's fiscal response mainly focused on maintaining social expenditure and not sufficiently on growth enhancing measures

serious short-term balance-of-payments or budget difficulties would require shortening of the approval procedures. Moreover, the EU would have greater leverage in promoting sound macroeconomic policies, structural reforms and political relationships if the MFA could be deployed as a genuine anti-crisis instrument providing speedy support.

A stronger focus on supporting structural reform efforts in beneficiary countries might benefit from introducing more flexibility in the way the conditions are formulated. Specifically, it could be beneficial if conditionality could be adapted to evolving circumstances during the MFA implementation period (e.g. dropping already fulfilled conditions, adjusting conditions that become infeasible / controversial in view of changed macroeconomic and /or political realities). It is recognised that these recommendations would require high level political decisions.

The quick-disbursing nature of the MFA instrument implies that conditions will need to continue being specified in terms of expected short-term outputs. However, it is recommended that expected longer-term outcomes and impact of conditionality should also be explicitly explained to strengthen domestic ownership, minimise the risk of implementation deficit (the difference between *de jure* and *de facto* reforms), and to provide the basis for future ex-post evaluations and follow-up through EU budget support.

An independent reforms assessment (similar to the Operational Assessment of PFM systems) and conditionality framework could be used as tools to guide the selection of conditionality.

It is also recommended to better communicate to both targeted stakeholder groups and general public in Armenia about the MFA as an element of the broader package of EU assistance. The level of knowledge of the instrument is rather low, and in comparison to other international actors, the overall promotion of EU as a supporter of specific activities is lacking in visibility.