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MEMORANDUM TO THE ENPI MANAGEMENT COMMITTEE

ANNEX I

Annual Action Programme covering the programming document National Indicative Programme 2007-2010 for the ENPI for Armenia for 2007¹

1. IDENTIFICATION

Budget heading	19080103
Total cost	21 million Euro
Legal basis	ENPI Regulation (EC)1638/2006

2. COUNTRY BACKGROUND

EU-Armenia Relations

The principal recent achievement in EU-Armenia bilateral relations has been the endorsement of ENP Action Plan (ENP AP) by the EU-Armenia Cooperation Council on 14 November 2006. By agreeing an ENP Action Plan, Armenia and the EU have committed to develop deeper economic integration and to strengthen bilateral political cooperation, including on foreign and security policy.

The main actions foreseen under the ENP AP are grouped under 8 priority areas: (i) Strengthening of democratic structures, of the rule of law, including reform of the judiciary and combat of fraud and corruption; (ii) Strengthening of respect for human rights and fundamental freedoms, in compliance with international commitments of Armenia (PCA, CoE, OSCE, UN); (iii) Encourage further economic development, enhance poverty reduction efforts and social cohesion, thereby contributing to the long term objective of sustainable development, including the protection of the environment; (iv) Further improvement of investment climate and strengthening of private sector-led growth; (v) Further convergence of economic legislation and administrative practices; (vi) Development of an energy strategy, including an early decommissioning of the Medzamor Nuclear Power Plant (MNPP); (vii) Contribute to a peaceful solution of the Nagorno-Karabakh conflict; (viii) Enhanced efforts in the field of regional cooperation.

Since January 1st, 2007 TACIS and other thematic budget lines instruments have been replaced by a single instrument, the European Neighbourhood and Partnership Instrument (ENPI). This policy-driven instrument, designed to target sustainable development and approximation to EU policies and standards in the framework of agreed priorities under the ENP AP and/or the PCA, offers more flexibility thanks to the possibility of using aid delivery mechanisms such as , inter alia, sectoral or general budget support, Twinning or TAIEX.

¹ In the preparation of the present Annual Action Programme, due account has been taken of the observations made by the European Parliament on the ENPI Strategy Papers 2007-2013 and the Indicative Programmes 2007-2010.

Country developments

Armenia is a land-locked and resource poor country² which has paradoxically been enjoying a strong double-digit economic growth over the recent years allowing a rapid reduction of poverty, down from approximately 50% of the population in 2001 to 30% in 2005. GDP growth has averaged 12.6% since 2004, a growth driven mostly by steadily increasing private investment, heavy remittances and a strong donor financed development program. Prudent macroeconomic policies have maintained sustainable external and internal balances, kept inflation low, and reduced Armenia's debt burden. The dram has however appreciated significantly in nominal terms over the past three years.

The three party coalition led by President Kocharyan has governed Armenia with stability in recent years. A national referendum in November 2005 approved changes to the Constitution aimed at strengthening the independence of the judiciary and restructuring relations between the executive and legislative branches. However, the voting process was marred by irregularities and criticized by the OSCE as not meeting international standards. The government has pledged to improve the conduct of the 2007 and 2008 elections. On the occasion of the Parliamentary elections, which took place on May 12, 2007, progress were indeed noted by the International Election Observation Mission, which concluded that the *"elections demonstrated improvement from previous ones and were largely in accordance with international commitments, although some issues remain unaddressed"*.

The conflict with Azerbaijan over Nagorno-Karabakh remains unresolved. However, discussions are continuing between the Presidents in order to make progress towards a settlement. Borders with both Azerbaijan and Turkey remain closed. Armenia is also vulnerable to possible impacts of other regional tensions.

Armenia has adopted in 2003 a strong poverty reduction strategy, the PRSP (Poverty Reduction Strategy Paper). Progress reports in April 2005 and June 2006 concluded that Armenia has had a successful first two years of PRSP implementation, in which most of the targets have been met or exceeded. Key achievements include: (i) stronger than anticipated economic growth and poverty reduction; (ii) improvements in fiscal resources and policy, though tax and customs administrations continue to require strengthening; (iii) increased spending in the social sectors and good progress in initiating systemic social sector reforms – social spending in real terms is higher than anticipated in the PRSP, though it did not achieve targets as a percent of GDP because GDP itself grew more rapidly than anticipated in the PRSP; and (iv) good progress in infrastructure and rural development, although further increasing private sector involvement and reducing rural poverty remain challenges. Armenia is preparing a full PRSP update in mid-2007 with revised targets.

Armenia continues to make progress on the reform agenda, but important challenges remain. Though wages have been increasing and new jobs are being generated (some 20,000 new small and medium enterprises have been established over the last three years), unemployment remains high at one-third of the labour force. While remittances have grown, their value has been partially offset by exchange rate appreciation. Many aspects of governance have improved, but there is still a considerable agenda to be tackled. The World Bank has issued various surveys, showing that the rule of law, government effectiveness, regulation and

² Per capita GDP of 1,626 US\$ in 2005, up from a 409 US\$ in 1995 (source: national statistics)

business procedures have all improved significantly. At the same time, they point remaining issues in corruption and accountability.

Apart from the ENP Action Plan signed in November 2006, Armenia signed as well a compact with the US Millennium Challenge Corporation (236 mln \$ to be disbursed over the period 2006-2010 mainly in rural roads and irrigation). Armenia also remains on tracks to achieve most if not all of its Millennium Development Goals (MDGs) by 2015.

3. SUMMARY OF THE ACTION PROGRAMME

The overall objective of this Annual Action Programme, the first one since the signature of the ENP AP in November 2006, is to support the implementation of the priority areas of assistance defined in the National Indicative Programme (NIP) 2007-2010 in line with the ENP AP.

The NIP for Armenia identifies 3 main priority areas for cooperation for the period 2007-2010:

- Strengthening of democratic structures and good governance
- Support for regulatory reform and administrative capacity building
- Support for poverty reduction efforts

Each priority is divided into more detailed sub-priorities³.

As this 2007 Action Programme (AP07) is the first one under the new ENPI, it is designed to support transition from the assistance provided under TACIS to a broader range of measures available under the ENP. It was agreed in 2006 that the main component of this AP07 would be a sector policy support programme (SPSP), which would focus on one single area of assistance to keep a significant leverage effect. Vocational Education Training reforms have been identified by the European Commission in agreement with the National Coordinator, the Ministry of Finance and Economy (MFE) as the core element of this AP07. As explained in the NIP and the Country Strategy Paper (CSP) for Armenia, all the identified priorities listed above and in the CSP and NIP will be addressed during the period 2007-2013.

The following elements explain this choice:

Support to VET reforms is recognised by the PRSP as a priority to fight unemployment and contribute to poverty reduction in Armenia, a priority acknowledged as well under the third priority of the NIP;

- TACIS has been supporting VET reforms in Armenia since 2003 and as a result of this cooperation three major documents have been elaborated and adopted: Strategy on Preliminary and Middle VET (2004); VET Law (2005) and VET Modernisation Priorities Paper and Action Plan (2005-2008). These documents need now to be implemented;

³ See NIP for more details (document C(2007)672)

- A part of the TACIS AP06 was designed with a component of sectoral support to reforms in VET to pave the way to wider budgetary support operations under the ENP and ensure that necessary capacity is built within the beneficiary institutions to qualify for assistance provided under budgetary support mechanism, as compared to other fields covered by the NIP and CSP;
- Because of parliamentary elections in Armenia in May 2007 and presidential ones in 2008 it was important to identify an area of intervention not likely to be questioned by the newly elected Government.

This AP07 will therefore be divided into two components:

- The first one will be a Sector Policy Support Programme (SPSP) focusing on support to VET reforms;
- The second one will focus on the first Twinning operations in Armenia in areas covered by the NIP. First Twinning projects are likely to start in early 2008.

a) Action 1: Support to VET reforms

The PRSP I, adopted in 2003, recognises the role of VET in poverty reduction and economic development. It indicates that reform of the VET system in Armenia, including rehabilitation and strengthening of its offer, is the principal way to reduce the existing high rate of structural unemployment. The PRSP I gave top priority to general education that received considerable allocations, but the revised PRSP II, to be adopted in 2007, is raising the importance and priority of VET in the development agenda of the country. This opens new positive perspectives in terms of growth of state budget allocations for VET in 2008 and further, as announced by the sector Ministry and the MFE.

Expected results:

The proposed EC programme, as discussed and agreed with the Ministry of Education and Science (MoES), Ministry of Labour and Social Affairs (MoLS) and Ministry of Finance and Economy (MFE), is designed to achieve the following results:

- Boosted job-creation for young workforce (in particular for graduates of VET institutions), to be encouraged through the introduction of appropriate incentives;

A single statutory framework for the whole VET system is developed and adopted, in line with the strategy of Preliminary and Middle Professional Education and Training approved by the Government of Armenia in 2004 but not enforced yet;

An improved governance and management of VET institutions: empowerment of local and regional players (schools, local authorities, civil organisations) in all issues related to skills development strategy and implementation in order to achieve better responsiveness to local socio-economies;

A stable social partnership is established and institutionalized, in line with the above-mentioned strategy through a VET council comprising representatives of employers organization, trade unions and interested ministries under the auspices of the MoES;

New funding mechanisms of the VET sector are identified, developed and adopted, mainly through public-private partnership;

A National Centre for VET Development outlined in the VET Modernization Priorities Paper is established, with a technical support and quality assurance function;

- A National Classifier of Occupations by the MoES in line with ISO system is established;
- A tariff-qualification information bulletin (occupational standards) by each economic sector by the MoLSA is established;

Labour market analysis tools are adopted and used by MoLSA.

- Clear evidence of linkage to Government objectives and policy priorities (particularly PRSP) and policy – expenditure linkage in the MTEF and budget submission;
- Annual Budget Plan contains non-financial performance information, that is measurable and verifiable, including:
 - Quantity indicators for key services for all budget programmes (policy actions)
 - Quality indicators of services
 - Clearly stated information on outcomes sought
- Annual report on MoES financial and non-financial performance reflects clear evidence of improved policy focus and analysis
- Internal audit function is fully institutionalized and operational

Indicators allowing measurement of the overall programme objectives are described in the Project Fiche.

b) Action 2: Twinning facility component

The Twinning instrument has proved to be very effective in institutional building and administrative capacity development of candidate countries in the process of approximation to the legislation, norms and standards of the EU and their related reforms. Under the ENPI, this instrument has now been made available to Armenia.

The proposed Twinning Facility will provide the necessary resources aiming at starting the first Twinning projects as of 2008/2009. The assistance provided will be focused mainly on the priority areas 1 and 2 of the National Indicative Programme (NIP) which makes reference to the “Strengthening of Democratic Structures and Good Governance” and “Support for Regulatory Reform and Administrative Capacity Building”.

The programme objective is to support the Armenian administration and relevant institutions in the implementation of the ENP AP in areas with the potential to strengthen democratic structures and good governance and support administrative reforms and capacity building.

Expected Results

The project expected results are:

- Modernisation of the Armenian administration in order to effectively implement the ENP AP;
- Regulatory and institutional approximation, and related reforms, notably in areas with the potential to enhance trade, investment and growth.

Within the identified (sub)priority areas for assistance, the facility should be flexible in terms of the areas of intervention. In addition, a thorough campaign of information and sensitisation is necessary for the effective start of Twinning in Armenia. This information campaign will help also in defining further the areas and institutions that are most suitable for “*Twinnable*” projects in cooperation with the Programme Administration Office (PAO) to be set-up in the Ministry of Finance.

4. PAST EC ASSISTANCE AND LESSONS LEARNT

In the period 1992-2006 the European Commission has provided more than 400 million euro in grant through a wide range of instruments, the most important ones being TACIS, ECHO, Food Security Programme (FSP), European Initiative for Democracy and Human Rights (EIDHR) and Macro-Financial Assistance (MFA).

Since independence, the TACIS programme has contributed to the transition towards a market economy and building democratic institutions, notably by providing assistance in the field of legal and regulatory reforms, in the approximation process of Armenian legislation to that of the EU and in addressing the social consequences of transition.

As regard the EC assistance, best results have been attained when there was full convergence on the EU-Armenia priorities and stronger ownership by the Government. The endorsement of the ENP AP should bring a new impetus in the process of reforms and serve as an enhanced political framework for EU-Armenia cooperation.

According to the 2005 evaluation of the TACIS programme⁴, the efficiency of TACIS has been hampered by inadequate delivery mechanisms, focused more on stand-alone projects rather than programmes. In Armenia, past experience has shown that the effectiveness and visibility of EC cooperation have increased when it focused on a limited number of sectors, combining different instruments and applying a more strategic and sector approach. This approach was already applied starting from TACIS AP 2006 in the case, for instance, of the assistance in the field of support to VET reforms and Childcare reforms.

The FSP and the MFA have shown that Armenia qualifies for budget support and that the system is well understood and appreciated by the Government. Budget support is a powerful tool for increasing ownership, boosting the leverage of the assistance and improving policy dialogue. At the same time, budget support allows for timely disbursement of allocated resources and for a diminution of transaction costs.

⁴ TACIS Evaluation Synthesis report October 2005

5. COMPLEMENTARY ACTIONS

The activities foreseen under this Action Programme will build on and complement activities of on-going projects financed under TACIS and other instruments. The Sector Policy Support Programme to further VET reforms will build on achievement of previous TACIS projects in this field (the first one was launched in 2003) and Sectoral Support implemented under AP 2006.

A PFM (Public Finance Management) component has been added to the conditionalities elaborated under the Support to VET reforms component to foster reforms in this field, building on the acquis of more than ten years of successful budgetary support in Armenia through the Food Security Programme (FSP).

Moreover, line ministries will directly or indirectly continue benefiting from horizontal projects like the AEPLAC (Armenian European Policy and Legal Advice Centre) focusing on PCA implementation and improvement of the business environment. Support to justice reforms is also provided for under AP 2006.

The Twinning facility will serve to start Twinning projects as of 2008, building from the results achieved by previous preparatory TACIS projects in the related fields. The partnership between Armenian and EU administration foreseen under Twinning will bring to the process increased ownership and sustainability of the reforms.

6. DONOR CO-ORDINATION

The Sector Policy Support Programme in the area of VET reforms will be clearly complementary to the assistance programmes of other donors involved in PRSP implementation as well as PFM reforms.

In particular, this component has been designed in close cooperation with UNDP currently implementing a 1.2 mln \$ project in four Armenian marzes (provinces) for the revision of curricula, rehabilitation of buildings and refurbishment of four colleges in the agriculture, industrial and tourism sectors. The World Bank has provided support for the training of 7.000 subject specialists, coming from 55 craftsmanship colleges. GTZ funded a regional programme and a teachers' training project, oriented to introduction of participative methods. Other international NGOs develop studies and debates in the area of adult education (IIZ-DVV, Germany) and lobby for the elaboration of a high level framework for lifelong learning.

As during previous assistance projects under TACIS, Donors coordination will be ensured in the framework of the PRSP, the major forum for dialogue and co-ordination of donors around the overarching socio-economic development programmes of Armenia.

The Ministry of Finance and Economy (MFE) is the leading institution coordinating donors' financial support (grants and loans) to who reports the TACIS National Co-ordinating Unit (NCU). This NCU is also in charge of the coordination of Twinning and TAIEX projects, as the National Coordinator (the Minister of Finance) has appointed the NCU Director as well Head of the Twinning-Taiex Project Administration Office (PAO).

The MFE introduced a unified information system covering donors' strategies and projects. However, leadership and ownership of the government in effective co-ordination of donor strategies around the adopted state VET strategy and policy priorities is still in development.

The coordination ensured by the ministry of Finance does not qualify for real donor coordination and other line ministries or donors themselves continue to be the most active players in terms of coordination. Regular exchanges of information take place between donors, often at projects level, or in more institutional format like monthly Donors' meetings or their recently introduced thematic working groups. With the appointment of a chargé d'affaires in Yerevan and expectations to open a fully fledged delegation in Armenia, the Delegation of the European Commission in this country is likely to take the lead of those meetings, on a rotating basis with UNDP, WB, IMF or USAID as in other countries.

Coordination with Member States is mainly formal and ensured mainly through monthly EU Heads of Mission meetings hosted by the EU embassy representing locally the presidency of the EU Council.

7. COMMUNICATION AND VISIBILITY

The Delegation ensures, mainly through its Press and Information Department, that all EC assistance in Armenia receive sufficient visibility. In the case of budgetary support to VET reforms, the Delegation will undertake all necessary measures to make sure that the broad public is informed about the objectives and achievements of the programme through press conferences and visibility events organised jointly with the beneficiary institutions.

As far as Twinning is concerned, there is a need to develop important information and sensitising campaign to increase awareness of this new tool. Member States' participation in Twinning operation will guarantee a higher degree of political commitment and visibility of EC cooperation.

8. COST AND FINANCING

The overall amount of the 2007 Action Programme for Armenia is €21 million, indicatively distributed within the different actions in the following terms:

Action A: Support to VET reforms	€16 million
Action B: Twinning Facility	€5 million
Total amount of the action programme	€21 million

Within the maximum indicative budget of all the specific actions, cumulated changes not exceeding 20% of the maximum contribution of the Community, are not considered to be substantial provided that they do not significantly affect the nature and objectives of the Annual Action Programme.

The authorising officer may adopt such changes in accordance with the principles of sound financial management.