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ON PROGRESS BY ARMENIA TOWARDS GRADUATION TO MARKET ECONOMY STATUS IN TRADE DEFENCE INVESTIGATIONS

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EXECUTIVE SUMMARY

The assessment of Market Economy Status for Armenia is an exercise aimed at determining whether or not prices and costs in that country can be used for the purposes of trade defence investigations. This assessment is neither a judgement of the overall economy nor a political statement vis-à-vis that country. The focus of the examination is, in fact, more technical and aimed at determining the extent to which State intervention, if any, affects prices and costs on the ground and in turn whether these can be considered reliable for TDI purposes. In order to be granted MES, Armenia must show that it meets all five criteria, which are set out in detail in the document.

The conclusion of this first assessment on Armenia's readiness for MES is that it has already met two criteria and has made significant progress towards some of those remaining. On the basis of this assessment it is considered that Armenia fulfil Criteria 1 and 5. With regard to the first criterion, it appears that the degree of state influence in the economy is not significant. The evidence available suggests that the Governments' role in the allocation of resources or setting of prices is no longer significant. While future anti-dumping cases may present different information these issues can be addressed in the analysis of any market economy treatment requests at the relevant time.

Regarding Criterion 5, significant progress has been made in the Financial Sector – the legislative framework is in place and the Central Bank acts as a regulator over the sector. There has been a return to a floating exchange rate, the banking sector is fully privatised, banks are largely free to determine interest rates, the stock exchange is functioning along with a Central depository for registering shareholders. There is also improved access to credit for businesses and Armenia rates quite well in this category under the World Bank Doing Business report for 2009.

Regarding criterion 2, an anti-dumping case ongoing vis-à-vis Armenia revealed certain information regarding the acquisition of land which made it impossible to grant this criterion. The existence of legislation which allows privatised firms to benefit by acquiring land for free, under certain conditions, shows a distinct carry-over effect from the old regime. Given the criterion specifically requires "an absence of state-induced distortions in the operation of enterprises linked to privatisation….." there is no ambiguity that this criterion cannot be met under present circumstances.

Criterion 3 which requires properly functioning company law is clearly not met by Armenia. While there is a legislative framework in place regarding corporate governance, which is well rated by the World Bank, this does not translate into effective implementation on the ground. Armenia does recognise these shortcomings and is working on effective implementation of its laws in this area as well as the development of a Corporate Governance Code. The latter has not yet been completed and will require further monitoring. On the crucial issue of accounting, the efforts being made by Armenia to bring its accounting laws fully in line with international standards is laudable. However the evidence available would clearly indicate that practical enforcement of accounting laws remains problematic and a lot remains to be done before this is of a requisite standard to meet this criterion.

Similarly, regarding criterion 4 the focus is on effective implementation of the legislation which has been put in place concerning intellectual property rights (IPR) and other property laws. Regarding IPR, implementation and enforcement are problematic particularly in the

areas of piracy and counterfeiting. On the other hand Armenia seems to have made progress regarding its bankruptcy laws which were revised in 2006 with the aim of improving the process and removing some of the problems associated with the process. In this context Armenia scores higher than average regarding its bankruptcy procedures than the average for the region.

In summary, Armenia is moving in the right direction regarding MES. Clearly there are problems remaining which mean that further efforts are needed in order to meet the requirements of criteria 2, 3 and 4 for MES. While serious progress is being made in the enactment of legislation in many relevant areas, this must be backed by good implementation and enforcement of the laws on the ground. When that happens, Armenia should be well positioned to be granted MES. In the meantime the Commission remains strongly committed to helping Armenia to move forward in this context.

1. INTRODUCTION

1.1. Background

In March 2005 Armenia requested that the European Union grant it market economy status (MES) for the purpose of the trade defence investigations. Recognising this status for an economy implies the general absence of state interventions in costs and prices in an economy – an important factor in any trade defence investigation.

This assessment is a technical exercise with the sole purpose of determining how Armenia should be treated in trade defence investigations. It is not a judgement of the general functioning of the Armenian economy or a political judgement on whether a market economy *per se* exists in Armenia.

Currently for the purposes of trade defence investigations, Armenia is considered by the EU as an economy in transition. This means that under the relevant provisions of the EU's anti-dumping laws (Council Regulation 384/96) prices and costs in Armenia cannot normally be used in trade defence investigations, because they are considered to be routinely distorted or rendered unreliable by state intervention and are not a credible measure of the true costs of production. In their place, and in accordance with WTO rules, trade defence investigations use analogue data from other economies that are recognised as market economies. There is however the possibility for Armenian companies who become involved in anti-dumping investigations to apply for Market economy (MET), or individual treatment (IT). Where such a company can show that it meets the criteria for either of these status', dumping calculations will be based more on data from the company itself.

In support of their request for MES, Armenia submitted a lot of detailed information regarding legislative and administrative developments in the country in recent years. In July 2007 a specific MES mission took place in Armenia where many of the relevant issues were discussed with the Armenian authorities. Following on from this mission additional information was submitted in the course of 2008. This material, along with information from other sources has been used as the basis for the current analysis regarding Armenia's readiness to be granted MES. In particular, the fact-finding mission regarding the possibility of establishing a deep and comprehensive free trade area (DCFTA) between the EU and Armenia carried out by the Commission services in Yerevan in February 2009 also provided a lot of relevant information for the purposes of this assessment. It should be noted that while these exercises are not linked, much of the information gathered in the context of the preparations for possible future DCFTA negotiations is particularly relevant for the MES evaluation and is of course very current.

1.2. Criteria

MES requests are evaluated on the basis of five criteria which aim to establish whether the economic conditions in the country concerned have evolved to the extent that prices and costs can reliably be used for the purpose of trade defence investigations. The five criteria stipulate that in the country concerned there must be:

1. a low degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public bodies), for example through the use of state-fixed prices, or discrimination in the tax, trade or currency regimes.

2. an absence of state-induced distortions in the operation of enterprises linked to privatisation and the use of non-market trading or compensation system

3. the existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information).

4. the existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights and the operation of a functioning bankruptcy regime.

5. the existence of a genuine financial sector which operates independently from the state and which in law and practice is subject to sufficient guarantee provisions and adequate supervision.

To obtain technical Market Economy Status for trade defence investigations all five criteria must be met. This is the first report on Armenia's progress vis-à-vis these criteria.

2. ASSESSMENT

2.1. Criterion 1:

Degree of Government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public bodies), for example through the use of state-fixed prices or discrimination in the tax, trade or currency regime

In order to meet this criteria Armenia must demonstrate that the government does not exercise an undue influence over the allocation of economic resources in the economy or decisions of companies. Essentially the aim, in the context of trade defence investigations, is to ensure that the costs and prices of goods in Armenia are determined in response to market forces as opposed to intervention by the Government which could lead to distortions. While the list is non-exhaustive, price fixing, obligations to produce for export, restrictions imposed on exports of raw materials or subsidies for industrial inputs are some of the relevant issues in this context as they can directly impact on the costs of producing goods often giving an unfair competitive advantage.

2.1.1. Trade regime: exports and imports

The state monopoly in foreign trade in Armenia was abolished in 1989 *(WTO)*. It is considered by some external sources (*ADB, EBRD*) that Armenia has a highly liberal trade regime – one of the most open in the CIS. Armenia joined the WTO in February 2003, which served to stabilise its foreign trade policy and has significantly reduced tariff and non-tariff barriers. Tariffs are low by international standards with a two-band tariff regime of 0% and 10%. The simple average applied MFN tariff rate is relatively low (3%) and is substantially lower than Armenia's WTO bound MFN rates (simple average of 8.5%).

While the applied tariffs are low, Customs collects administrative fees (art. 110 of the Customs Code) at the amount equal to approximately 11 USD for customs declaration. In addition, 1000 ADR is collected for 1st ton of cargo and 3000 ADR for each additional ton. Revenue from these fees is allocated at the special (state) budget account for improvement of

customs service. These administrative fees have an equivalent effect to import duties. However there is no evidence to suggest that this practice is applied in a discriminatory manner between different types of enterprises.

There are no restrictions on exports, i.e. no custom duties or quantitative restrictions.

One issue which should be mentioned, though not of major concern, relates to Armenia's Anti-crisis Action Plan. The plan, which was unveiled by the Prime Minister in his address to the National Assembly on the 2009 State budget addressed the "use of subsidizing tools" as one of the steps which the Government will take as part of its plan of action to address the economic crisis. In this context State support to exporters, State guarantees, Credits and subsidies (including agriculture), the creation of specialized exporting enterprises with a focus on Lower export transaction costs were mentioned. What this will mean in practice remains to be seen. However, it would be harsh to cite what are, for the moment, only plans designed to address Armenia's economic crisis, as reasons to deny this criterion.

2.1.2. Customs

The liberal trade regime is partly offset by shortcomings in customs and also certain informal trade barriers. According to a recent study by the *World Bank* in partnership with the Armenian Ministry of Economy, more than half of medium-sized companies engaged in foreign trade operations described customs administration as a major obstacle to doing business. Problems include poor control and inspection powers, cumbersome control methods, not based on risk analysis, undeveloped post clearance audit, poor exchange of information among services, considerable problems with verification of customs value (alleged wide use of reference lists – non-WTO compliant practice), shortcomings on substantive issues such as Rules of origin and IPR protection.

However, efforts are being made to improve in this area with a major reorganisation in the latter half of 2008 which saw the creation of the State Revenue Committee, training systems have improved, a code of Ethics approved and a Complaints Committee established. In addition *The "Customs Administration Strategy for 2008-2012"* has been prepared (with the assistance of the World Bank) with the main objectives being: equal treatment of trade operators, efficient governance in customs, risk based customs control, automation of customs declaration process, development of customs agents system, streamlining of customs procedures, cooperation with stakeholders and upgrading of technical infrastructure. Within the framework of the EU Advisory Group to the Republic of Armenia, the Customs Advisor to the Ministry of Finance has been established in 2009 to streamline and facilitate the customs modernization process and related EU assistance in this area.

The shortcomings in the Customs operations may hinder business activity but it is difficult to identify to what extent this directly affects the costs and prices for trade defence investigations and as a result does not impact on this criterion.

2.1.3. Price fixing and utility rate setting

Almost all prices have been liberalized since 1995 with controls remaining on irrigation, electricity, hot water and gas, which are supplied exclusively or predominantly by state-owned enterprises. Another exception is the provision of internal voice telephone services, where the private supplier enjoys exclusive rights of provision. Regulation is the

responsibility of the Public Services Regulatory Commission (PSRC) and the Ministry of Transport and Communications for the related sectors.

According to the Armenian Government prices for gas and electricity are adjusted by the PSRC on a regular basis to maintain their real value and to reflect both operational and maintenance costs as well as depreciation and reasonable profit. Subsidies had been granted to gas consumers to alleviate the negative impact of a significant price hike on imports of gas from Russia between April 2006 and May 2008. However, this practice ended in May 2008 and consequently prices for gas increased to reflect the price from the Russian supplier. The information provided by the Armenian authorities' states that there is no discrimination in pricing based on category of user. There is a difference in the price of gas to users based on quantities consumed – i.e. monthly consumption above 10,000 c.m. (mainly enterprises) attracts a price of $153 per 1,000c.m. while consumption rates below that threshold attract a price of over $200 per c.m. However quantitative rebates in this sector would appear normal with the thresholds aimed at creating a distinction between domestic and industrial users.

Entry in oil and other fuels' markets, including import and export, is not obstructed by the legislation. However, de facto monopolies and oligopolies are still dominating the fuel sector and other key sectors (food, sugar) of the economy.

The tariffs applicable in the water sector are also set by the PSRC covering drinking water, irrigation, water supply for industrial purposes, sewerage and liquid waste disposal. According to the submissions from Armenia there are four water suppliers. They supply water to water user associations (WUA) and unions of water users associations (UWUA) and other users. The tariffs of the four water suppliers are set by the PSRC and cover operational and maintenance expenses *but not* depreciation costs, profits or debt reserves. The tariffs charged by the WUA are not regulated. The Government of Armenia also provides subsidies to support the development of WUAs. Subsidies are also provided in the drinking water sector although apparently these are decreasing owing to improved efficiency in the system. The key issue in trade defence investigations is whether or not the prices as set by the PSRC, in the manner outlined above, could have a *significant* distorting effect on the costs and prices of whichever product is under consideration. However, experience in anti-dumping cases would suggest that, in almost all cases, water is not a significant cost-driver in production processes.

2.1.4. Taxation

Following a visit to Armenia in June 2008 to assess the economic reforms, the IMF concluded that there was a need to complete the tax reform agenda. The IMF observed that while there had been a notable improvement in 2007, the tax-to-GDP ratio in Armenia remains lower than in most transition countries, and well below potential. The IMF expressed concern that privileged tax regimes (such as the introduction of new tax holidays and the current presumptive taxes for fuel and tobacco) are inconsistent with the aim of reshaping the tax policy framework to ensure a level playing field for businesses.

The World Bank Doing Business Report 2009 ranked Armenia on paying taxes at 150 out of 181 economies.

In August 2008 a number of laws aimed at improving the tax environment for SMEs were adopted which included a simplified taxation for business with turnover up to €175,000, amendments to VAT (now also applicable to the agriculture sector), taxes, profit tax. The Government adopted a Tax administration Strategy paper 2008-2011 which sets out 7 goals

including consistency and timeframe of large taxpayers' taxation, effective 'soft' tax administration towards small businesses and new policy of tax audits. The goals are backed by an Action plan identifying many implementation steps. In coming years the strategy of the Armenian State Tax Service (STS) will be developed drawing on recommendations from the IMF, World Bank and Fiscal Blueprints elaborated by EC DG TAXUD.

2.1.5. Conclusion

The Armenian State is moving away from interference in the functioning of the economy on the whole. The trade regime in Armenia is liberalised and while this is offset somewhat by the problems outlined in the customs sector it is not evident how these problems could have a distorting impact in the context of prices and costs in trade defence investigations. There is no evidence to show that subsidies are common in Armenia and any proposals to introduce subsidies as a means to address the economic crisis are an exceptional measure. In any event given that the aforementioned subsidies are only plans for the present, it would be severe to refuse this criterion on this basis.

The setting of prices for electricity and water by the Armenian State should not pose problems for trade defence in so far as the costs associated with these inputs seem to largely reflect market values. Furthermore in a recent anti-dumping case concerning Armenia this particular issue was not highlighted as a cause of concern in the evaluation for market economy treatment of the exporter. If it were to arise in future anti-dumping cases that the costs associated with inputs of electricity and water are distorted and, depending on the product, be significant, this could be reflected in the specific market economy treatment analysis.

The first criterion can therefore be considered fulfilled.

2.2. Criterion 2:

Absence of state-induced distortions in the operation of enterprises linked to privatisation (i.e. "carry over" from the old system). Absence of use of non-market trading or compensation system (e.g. barter trade).

In order to meet this criterion, Armenia must show that companies which have been privatised do not benefit from any continued state-induced distortions and operate on a fully commercial basis in all respects. The use of barter trade on a large scale in a country can create difficulties for an investigative team in trade defence cases in that they will be unable to establish *reliable* costs and prices of the investigated product. As a result where any of the cost factors or prices are affected by barter trade the calculation of accurate dumping margins becomes impossible.

2.2.1. Privatisation

Privatisation progressed relatively rapidly in Armenia. Six privatisation programs have been completed since the start of the mass-scale privatisation process in early 1995. These included most companies in the fields of industry, agriculture and transport including small enterprises and unfinished construction sites. Privatization of state property in Armenia is governed by Law of the Republic of Armenia on Privatization of State Property. Foreign legal and natural persons were free to participate in the privatisation of any state assets. Certain industries and sectors of the economy are not subject to privatisation e.g. in such areas as defence and security, standardisation, roads and railways.

A further round of privatisation is currently under way with approximately 100 medium to large companies still to be privatised. During the recent fact-finding mission in Armenia (February 2009) carried out in the framework of preparations for possible future negotiations of a bilateral DCFTA Commission officials were informed that these companies would be sold on the securities market. The State retains ownership of the some companies because of a lack of interest from investors. Mass scale privatisation may be considered as completed and current structural reforms are focused on the improvement of the business and investment environment.

In the context of privatisation an issue of concern relates to the acquisition of formerly state-owned land by newly-privatised business. This specific issue came to light in the context of an anti-dumping investigation concerning Armenia highlighting the importance of information gathered in the context of actual investigations for this exercise. The investigation uncovered an amendment to the Land Code in 2005 which provided that those corporations which had previously acquired the right to use land could now receive full ownership rights to that land *for free*. While the impact of this on an anti-dumping may not be immediately apparent it is nevertheless quite significant. The most obvious effect is the fact that a company benefitting from this provision does not incur acquisition costs for the land. This in turn has an impact on the cost of financing for any company benefitting in this way. A less obvious effect is the fact that the company balance sheet is clearly healthier hence improving that companies' access to financing for other operations, with collateral to offer. All of this impacts directly on the costs associated with business activities and hence can affect the outcome of anti-dumping investigations. It also confers an unfair competitive advantage on those firms which have been privatised and have had land use rights converted to ownership rights at no cost.

2.2.2. Barter trade and payment of debt via compensation of debt.

In 1996 the Armenian Government renounced barter trade and none of the barter trade arrangements previously in force were continued. Payment via compensation of debts was common place in the early stages of economic reforms. However, this practice was largely restricted in 2001 and since 2002 the Government is not using this debt clearing mechanism at all.

2.2.3. Conclusion

The transition to a market economy in Armenia is clearly underway with privatisation having progressed relatively rapidly since 1994. As the process continues the focus moves to the creation of a legal and regulatory framework to allow businesses to develop in response to market signals while avoiding undue State influence in the market.

One of the many elements necessary in creating a stable environment for business to flourish in a free-market environment is the need to establish an institutional and legal framework to secure property rights. Armenia's progress in this context is addressed under Criteria 4 and it is considered, on the whole, that significant progress has been made, albeit not without some problems. However in order to fulfil the second criteria it is necessary for Armenia to show that privatisation has not brought with it a 'legacy' from the previously existing State-led regime. In this context, the existence of a law which appears to 'give' land for free to formerly State-owned enterprises where land use rights could be proven is of serious concern. This provision is not only discriminatory favouring previously State-owned enterprises but can also alter the results in a TDI investigation given the impact on costs for an exporting company.

This issue is clearly a carry-over from the 'old' regime and indicative that serious distortions can still arise as a result of state intervention in the economy. As result it is considered that Armenia has not yet met this criterion.

2.3. Criterion 3:

Existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance, the application of international accounting standards, protection of shareholders` rights and public availability of accurate company information

In order to meet this criterion it is necessary for a state to demonstrate that within its economy companies are subject to a transparent and rigorous system of company law. This includes being subject to international accounting standards and international standards for shareholder protection and transparency. Transparent and reliable company records are absolutely central to trade defence investigations, as they are the chief means of determining a company's costs.

2.3.1. Management of state assets, corporate governance

Regarding Corporate Governance(CG), Armenia has in place a number of relevant laws including The Civil Code, The Law on Joint Stock companies, The law on LLCs, Law on Banks and Banking Activities (amended 2005), New law on Securities Market (March 2008), The Law on Insurance and Insurance Activity (2007) and Law on Accounting (see below).

The Joint Stock Company Law defines the rights and responsibilities of shareholders, the means to protect those rights and interests as well as the equitable treatment of shareholders (including minority and non-residents). It also imposes a requirement for independent audit for all open joint stock companies.

However, while the legislation in place is ranked highly, the issue of implementation of the relevant laws remains problematic. The World Bank's Report on Observance of Standards and Codes (ROSC) of 2005 highlighted that there is little compliance with Corporate Governance laws and enforcement mechanisms and sanctions remain weak. Lack of transparency, poor disclosure requirements, as well as the absence of a national Gazette, are some of the problems in this area. In addition the functions of corporate governance bodies as well as the right's of shareholders are not clearly defined while protection of investors, creditors and minority shareholders are not ensured. Furthermore, the absence of independent judicial or administrative authorities contributes to a lack of control in the incorporation or legality of certain acts.

As a result Armenia is now working on improving Corporate Governance. In this context a Working Group has been set up, under the Ministry of Economy, in order to draft a Code on Corporate Governance which it hopes to finalise by the end of 2009, with the assistance of the EBRD. This new code will cover SOEs, listed companies and banks. A concept paper prepared by the consultants GBRW on the creation of a CG Code sets out many detailed suggestions for inclusion in the Code which will apply to all. The Code is expected to concentrate on the protection of minority shareholders, disclosure and transparency issues, responsibilities of board members, related party transactions, accountability and independence rules. Regarding suggestions made for SOEs in the GBRW concept paper, the overriding aim appears to be that the State should stay clear of day to day management of the business e.g. a

recommendation that decision-making prerogatives of the State should be disclosed in the Annual Report.

2.3.2. Setting up business

In order to set up business in Armenia registration with a number of state bodies is required, including: The Agency of State Register of the Ministry of Justice, The Agency of Intellectual Property of the Ministry of Trade and Economic Development, The State Tax Service, The State Fund for Social Insurance of the Ministry of Welfare and Social Affairs and The National Statistical Service. There are very few restrictions on setting up business in Armenia – some activities are prohibited (criminal etc.) while some others require licences e.g. production of alcohol, organisation of lotteries, provision of mobile phone services, internet services.

According to the World Bank Doing Business Report 2009, setting up a business in Armenia takes 18 days (world average 38 days) and involves 9 procedures. It is ranked 66 overall out of 181 economies worldwide. Armenia is in the process of trying to simplify procedures applicable to registering new business. Some improvements which came into effect in February 2009 include the elimination of minimum capital requirement for registrations of legal entities as well as eliminating the mandatory requirement of having a seal and reducing the number of documents required. In addition it is hoped to establish by in 2009 Business Support Centres which will provide public services on a one-stop-shop basis. The State Register is available to the public. However there is no official gazette where the information on registered companies is published.

Officially foreign and domestic investors are treated equally and have the same rights to establish business in nearly all sectors. Foreign investors receive full national treatment and any restrictions on investment are applied on a non-discriminatory basis between national and foreign investors with the exception that non-citizens cannot own land (Article 28 - Constitution) – under the Land Code they have however the right to lease land in Armenia.

Wage formation in the private sector is fully decentralised – employees' wages depend on supply and demand in the labour market, quality and quantity of labour, and the results of the enterprise's activities. Discrimination is prohibited.

2.3.3. Accounting Standards

Armenia adopted the Law on Accounting in December 2002 which was based on International Accounting Standards (IAS) applicable at that time. Since then, IAS have been revised, the International Reporting Standards (IFRS) were introduced and incorporated with IAS under a common framework known as IFRS. The Armenian Translation and Review Committee, set up by the Ministry of Finance is currently in the process of translating the latest version of these standards to ensure their implementation in Armenia by the end of 2009. The application of IFRS in the banking sector was apparently compulsory from 31 December 2008. However, the intervening time period where translation has not been completed puts this implementation into question. For listed companies the implementation of IFRS will be compulsory from 2010 apparently. For other companies it is not clear which accounting rules are applied. For the present, SMEs continue to apply the current Armenian accounting rules which were developed in 2002 which, given the changes in IFRS in intervening years are no longer consistent with international standards. It is not clear what

rules will apply to SMEs in the future once the Armenian Translation and Review Committee has finished its current work.

The lack of clarity regarding the relevant accounting laws is further exacerbated by poor implementation on the ground. In this context the ongoing anti-dumping investigation concerning aluminium from Armenia highlighted serious problems. Company accounts, according to the auditors report, were not in line with IFRS. Some of the problems highlighted in the auditors report included a failure to depreciate idle property, plant and equipment, as well as certain assets being valued at less than their fair value.

The effective implementation and regulation of accounting standards is a key issue for TDI as the accuracy of accounts is critical as a basis for calculations. In this context plans to set up an independent regulatory body by the end of 2009 for accounting and auditing, which is now the responsibility of the Ministry of Finance is a positive development, although to date the establishment of such a body has not yet been confirmed.

Listed companies, companies of public interest and companies whose turnover is higher then €1.5m must publish their financial statements and be audited by external auditors. Both National and international auditing companies operate in AR with the Ministry of Finance issuing certificates for auditors. The Armenian Association of Auditors, member of the International Accounting Federation, can also issue certificates subject to approval by the Ministry of Finance. Armenia recognises all certifications issued by international federations of accountants.

There is a World Bank project ongoing (US $10-15m) in Armenia dedicated to improving accounting, auditing and financial performance.

2.3.4. Conclusion:

It is clear that Armenia is making some efforts to improve its accounting rules and bring them in line with international standards. The ongoing work to translate and implement IFRS by the end of 2009 is a very important development especially in the context of TDI given the need for accurate and reliable accounts in that process. However some ambiguities remain with regard to the scope of the IFRS and what sectors/organisations etc will implement them and when. This is further compounded by the fact that enforcement of accounting rules remains problematic. This was very clearly demonstrated by one example which arose in an AD case which indicated that the accounts were not reliable. For the purposes of TDI this is a very critical issue. Accounting information provides the basis on which calculations are made and it is therefore imperative that this are reliable and accurately reflect the costs associated with the product under consideration in any investigation.

The ongoing work on developing a Corporate Governance Code is a very positive development and will help in the effective enforcement of legislation in that area which has been ranked quite highly by the World Bank. The development and actual implementation of the relevant legislation in force as well as the draft Corporate Governance are issues which the European Commission will track closely and re-evaluate in future MES assessments.

On the basis of the issues outlined above it is clear that for the present time Armenia has not met this criterion.

2.4. Criterion 4:

Existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights including intellectual property rights and the operation of a functioning bankruptcy regime

To meet this criterion a state must demonstrate that within its economy an effective legal regime operates with respect to property rights, bankruptcy, and the protection of intellectual property. Ambiguities over private ownership are important in trade defence investigations because they can affect access to credit by private companies, and non-payment of royalties for the use of intellectual property can obviously constitute an unfair cost distortion.

2.4.1. Property rights

General rules applicable to the ownership of property in Armenia are defined in the Constitution (Article 11, 28) as well as in the Civil Code 1998. Other legislation applicable includes The Law of Armenia on State Registration of rights to the Property as well as The Land Code.

According to the FTA Feasibility Study (March 2008) the legal and regulatory framework in Armenia regarding property rights is relatively well-developed when compared with other economies in transition. The main problem according to that report relates to effective implementation of the laws.

Property is registered with the State Committee of the Real Property Cadastre of the Republic of Armenia. Under the World Bank Doing Business Report 2009 Armenia rates very highly with regard to the ease of registering property and is ranked 5th overall out of 181 economies. The procedure takes 4 days and involves 5 procedures.

According to the legislation foreign citizens and persons without citizenship, unlike citizens of RA have no rights to ownership on land (industrial as well, as agricultural) on the territory of Armenia according to Art. 28 of the Constitution and Art. 2 and 5 of "Land Code". Even if a foreigner comes into ownership of land in Armenia as a result of inheritance or a gift, he must liquidate (by sale or other transfer) this property within one year. This provision discriminates in favour of Armenian enterprises conferring an advantage over foreign owned enterprises. This may be relevant in the context of access to credit where security based in Armenia can be required.

An additional concern regarding the issue of land arises in relation to the direct sale of State and Community land. According to the Armenians (submission August 2007) the price is defined according to the cadastral price of the given land which is determined by the Government on an annual basis. This approach would appear to be in conflict with the idea of free market principles Furthermore this type of intervention in the property market would appear to be discriminatory in favour of Armenian companies/citizens given the restrictions on foreigners owning land. The terms, conditions and prices for leasing and purchase of privately owned land are not subject to regulation with the only requirement being land registration.

2.4.2. Intellectual property rights

Armenian legislation on intellectual property is based on treaties and conventions implemented by the World Intellectual Property Organisation (WIPO) and the WTO and

include, among others, the Law on Patents, the Law on Trademarks, Service Marks and Appellations of Origin, and the Law on Copyright and Related Rights.

Regarding IPR legislation Armenia has been very active. Two new laws entered into force on 1st January 2009 relating to inventions and designs as well as on trade names. Further laws on geographical indications and appellation of origin as well as law on trademarks are under discussion in the government:

The Intellectual Property Agency of Armenia (formed by merger of two intellectual property bodies in 2002) is a separate division within the Ministry of Trade and Economic Development.

Under the Law on Trademarks, Service Marks and Appellations of Origin, foreign individual manufacturers and legal persons have the same rights and liabilities as the individual manufacturers and legal persons in Armenia, in accordance with international Agreements to which Armenia is party or on the basis of the principle of reciprocity. The right to register and use an appellation of origin in Armenia is granted to individual manufacturers and legal persons of States that grant a reciprocal right. Under the Law on Copyright and Neighbouring Rights foreigners have the same rights as the citizens and residents of Armenia.

The main problem regarding IPR protection lies in poor implementation and weak enforcement of the legislation. This is probably due to a lack of capacity/competence of law enforcement bodies (police and customs have no ex-officio powers) and lack of judicial system to deal with IPR infringements.

Where IPR rights are not always respected and royalties are not paid, then costs and prices of products, including input products, do not reflect their real economic value and can act as a significant cost distortion for certain products. This remains a concern in the context of TDI investigations.

2.4.3. Bankruptcy procedures

Armenia adopted a new bankruptcy law in December 2006 (the "New Insolvency Law"). The legislation applies to all legal entities (except financial sector) and no distinction is made between state-owned and privately owned enterprises. The law also applies to foreign citizens operating in Armenia except where specific provisions exist in international agreements entered into by the country. The lack of any other specific provisions regulating bankruptcy for natural monopolies and entities with monopole position in the market mean that the general law on bankruptcy is applied in these cases. The Law on Bankruptcy of Banks and Credit Organizations adopted in 2001 governs the bankruptcy of banks and credit organisations and insurance companies.

According to a preliminary assessment of the new 2006 law by the EBRD (full assessment to be completed during 2009) it appears a number of changes have been introduced that may make reorganisation of a distressed company more efficient and potentially maximise the recovery rate for creditors. Among other things, the New Bankruptcy Law introduces time limits for reorganisations, and gives creditors a greater say in the reorganisation process by allowing only creditors with approved claims (and not the debtor's owners) to vote on a plan.

According to AR Centre of excellence Action plan, certain weaknesses in bankruptcy procedures were identified and a plan of action was devised aimed at reducing the number of steps in the procedure and the time frame for bankruptcy process. At present it takes an

average of 1.9 years and costs 4% of the overall estate to complete a bankruptcy procedure. The World Bank Doing Business Report for 2009 ranks Armenia 47th out of 181 economies in assessing its bankruptcy procedures.

Bankruptcy cases are investigated by a special court, the Economic Court of the Republic of Armenia. In the period from 2003 up to and including the first quarter of 2007, 4077 cases were examined by Court of which 3934 were awarded claims and 110 were dismissed. At the end of the 1st quarter of 2007, there were over 1300 cases pending.

2.4.4. Competition policy

The legislative and institutional framework regarding competition policy is relatively well developed in Armenia.

The Law on Protection of Economic Competition was adopted in 2000, and revised in 2007. Its main purpose is the protection and promotion of economic competition, ensuring appropriate environment for fair competition, fostering the development of entrepreneurship and protection of consumer rights. The law addresses agreements between undertakings, abuse of dominant position, concentrations, unfair competition and State aid. The law applies to all sectors and all economic entities, including state and local government bodies. Unlike international practice, the law on economic competition in Armenia does not include separate provisions for the financial sector.

The State Commission for the Protection of Economic Competition of the Republic of Armenia was established January 2001. The Commission is independent of other state bodies and is entrusted with ensuring the implementation of the relevant laws on competition matters. However, implementation of competition law remains weak in Armenia largely due to weaknesses in enforcement powers and institutional capacity. There are no regulations in place concerning implementation of the legislation in the area of competition. This is further exacerbated by an alleged lack of sufficient knowledge on economic competition among the judiciary in the Civil Courts. In addition the level of fines which the competition authority may impose for infringement of the law is rather low and as such does not have the required deterrent effect

2.4.5. Conclusions

While there has been a lot of progress by Armenia in putting in place a legislative framework in support of IPR, other property ownership and competition laws, there remain clear shortcomings regarding the practical and effective enforcement of these laws. Whether this is to do with institutional capacity or lack of implementing rules and guidelines, until the practical application on the ground ensures that a clear regulatory framework is de facto in place this criterion cannot be considered as met.

2.5. Criterion 5:

Existence of a genuine financial sector which operates independently from the state and which in law and practice is subject to sufficient guarantee provisions and adequate supervision

To meet this criterion Armenia must show that the reform of the financial sector has led to freedom from state control and that business in the sector is conducted on the basis of commercial standards. In the context of trade defence investigations, costs associated with

access to credit are relevant and it is imperative that companies are treated equally with no advantage granted, for example by granting credit at special rates.

2.5.1. Financial sector overview

The Armenian financial sector is relatively small with 22 commercial banks (all private), 26 credit organisations, 11 insurance companies, 5 insurances brokerages and 10 investment companies in the security market. The assets of the sector are estimated at $3bn with 90% in banking. The level of financial intermediation in the economy is low (bank assets 30% of GDP).

Banking

Armenia started a program of reforms in the banking sector in the early nineties. Starting from 2002 and following privatisation of the state-owned Savings bank the entire banking system is now privatised.

There are no special restrictions on foreign ownership in the banking sector and there are foreign banks present in the market e.g. HSBC and the French Crédit Agricole being a shareholder in Agricultural Cooperative Bank of Armenia.

Since 2006, The Central Bank of Armenia acts as the main regulatory body of the financial sector in the country. The legislative framework for the sector consists of the laws on Central Bank 1996, on Banks and Banking 1996, Bankruptcy of Banks and Credit Organisations2001, Banking secrecy 1996 and 31 Central Bank regulations. The Central Bank's supervising regulations for the sector are based on the Basel Committee Standards from the Bank for International Settlements.

Banks apply IFRS since 1 January 2009 with other financial institutions applying them from January 2010.

Insurance

The insurance sector in Armenia is governed by the Law on Insurance and Insurance activities imposed in 2007. The sector is very small. In order to develop the sector further the Armenian government outlined its intentions in a report to the IMF in September 2008 that it will finalize classification of insurance companies assets as well as introduce a minimum capital requirement for new companies from January 2009 as well as plans to introduce further legislation in the area.

Securities market

The 'Armenian Stock exchange', as it was then known, began trading in July 2001. It commenced trading in foreign currency on November 2005, the first corporate bond trading in December 2005 and the first Government bonds were launched in January 2008. The Armenian Stock exchange became fully owned by the world's largest exchange company, NASDAQ OMX Group in February 2008 and was renamed "NASDAQ OMX Armenia" in January 2009.

The Central Depository of Armenia (CDA), established in 1996, is the entity responsible for shareholders registers and securities accounts. The CDA also provides clearing and settlement on securities transactions. It is wholly owned by "NASDAQ OMX Armenia". It provides

shareholders register keeping services to joint stock companies, as well as securities account opening and maintenance service to corporate and individual customers. It has approximately 1200 companies and over 150,000 securities accounts.

In January 2006 the Central Bank of Armenia replaced the Securities market of Armenia as the regulator of the securities market. In October 2007, a new law "On Securities Market" was adopted and currently governs all aspects of activity in the Armenian Securities market. Certain aspects of the professional activities in the Armenian securities market are covered by the regulations and resolutions of the Armenian Central Bank.

In terms of shareholders protection, The World Bank rates Armenia as 88th out of 181 economies worldwide in its Doing Business Report 2009.

2.5.2. Access to credit by private sector (SMEs)

The access to finance for SMEs has improved since 2000 via the banking system and state programs. The government provides support through subsidising interest rate payments and offering state guarantees.

Commercial lending has increased with collateral based in Armenia required.

The World Bank Doing Business Report ranks Armenia 28 out of 181 economies in terms of access to credit.

On March 31, 2009, The World-Bank financed project of Access to Finance for Small and Medium Enterprises (AFSME), was presented at a meeting with participating commercial bank at the Central Bank of Armenia. The credit line to SMEs, in the total amount $50million, will help the Armenian Government to strengthen access to finance for SME borrowers and improve the resilience of Armenia's private and financial sectors in the face of the impacts of the global financial crisis. In December 2008 the EBRD also extended a loan to help continued access to credit by banks for SMEs in Armenia. .

2.5.3. Interest and Exchange rates

Since 2006 the Central bank of Armenia has used the reference interest rate as its main instrument to target inflation as part of its monetary policy strategy. This rate is set each month by the Board of the Central Bank, having reference to the deposit and loan rates in order to get, in essence, the average of the current market rates.

With regard to commercial lending, banks have freedom to set the rates with only one limitation applying in that the commercial interest rates may not be more than double the applicable reference rate at the time of the granting of the loan.

In regulating the sector, the Central Bank and the Commission for the Protection of Economic Competition in Armenia work jointly to ensure that no anti-competitive practices are conducted between the banks e.g. agreements between banks related to consumer credit. The purpose of their initiatives is to ensure protection for the consumer as well as improved efficiency and competitiveness in the sector.

Exchange rate conversions are regulated by the Central Bank of Armenia in accordance with the Law on Foreign Exchange Regulation and Currency Control. Under that law no restrictions apply to current account transactions, payments can be made in any currency

agreed by the partners, no restrictions apply to either residents or non-residents of Armenia regarding the import or export of foreign currency (except individual persons require prior approval to export more than $10000) and no restrictions apply on opening bank accounts in foreign currency and foreign non-resident banks.

Since March 2009, The Central bank of Armenia no longer routinely intervenes in the foreign exchange rate market. The return to a floating exchange rate was a condition imposed by the IMF in relation to the granting of loans. The World Bank also supported the move. The immediate consequences of the decision to go back to a floating exchange rate were depreciation of the currency (-22% approx), and a steep rise in inflation from 1% to 3.1%. Since then, financial sector conditions have stabilized. The banking system losses from depreciation have been contained and no deposit outflows were triggered. The move to a floating exchange rate is hoped to improve the competitiveness of Armenian exports and help the country better adjust to the worsening global environment.

2.5.4. Conclusions

Despite the fact that the Armenian financial sector is small, significant reforms have taken place with the banking sector fully privatised, the legislative framework in place and the Central Bank acting as regulator in the sector. The return to a floating exchange rate, as well as improved access to financing are also positive factors in this context. On the basis of the above Armenia would appear to meet this criterion.

3. GENERAL CONCLUSIONS

On the basis of the foregoing it is clear that Armenia has make significant progress in its transition towards a functioning market economy. In this context the information available would show that 2 out of 5 criteria are already met. The lack of government influence in the decisions of enterprises is a key indicator as to the independence of the market. In addition the development of an independent, yet well-regulated financial sector is also an important element in creating the right environment for industry to develop.

However, there are some areas where further reforms are needed before Armenia can be considered to have met the 3 remaining criteria. As a general and overriding comment while Armenia has put in place much of the legislative framework needed, the effective enforcement of these laws must be evident before granting any further criteria. For example corporate governance, effective implementation of accountancy laws on the ground as well as IPR enforcement, to mention a few, must all be improved. Furthermore Armenia will need to consider the negative impact of certain legislative provisions that remain on their statute books. e.g. land acquisition for free. The elements outlined above can have a distorting effect on costs and prices of a company and in turn impact on any anti-dumping investigations putting the results into question. For these reasons the European Union cannot for the moment grant market economy status to Armenia. In the meantime, in any anti-dumping investigation concerning the country, Armenian companies will have the option of requesting Market Economy or Individual treatment.

4. THE WAY AHEAD

The European Union is fully committed to granting MES to Armenia for the purpose of trade defence investigations once Armenia can show that the remaining criteria are met. We are

confident that further real progress will be made and the remaining obstacles will be removed. In this context there is a lot of support for the transition process in Armenia from organisations such as the World Bank, the EBRD, the IMF not to mention the ongoing work by the EU in the context of the European Neighbourhood Policy now further enhanced in relation to the ENP new Eastern dimension (Eastern Partnership initiative), including assistance to help them in preparing for a future possible deep and comprehensive free trade area with the EU.

The Commission services will discuss the issues relating to MES with the Armenian authorities and remain in close contact with a view to resolving the remaining problems as early as possible. Some of the specific issues of concern highlighted in the report including accountancy laws and their implementation, land acquisition for privatised companies and poor enforcement in the area of IPR for example will provide a basis for future discussion.

The Armenian authorities are also invited to submit any updates of progress on the remaining points and to notify the European Commission as soon as the outstanding issues have been addressed.

The European Union reiterates its support and encouragement to Armenia's development toward an effectively functioning market economy.

5. SOURCES OF INFORMATION

A) INFORMATION FROM ARMENIAN AUTHORITIES

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