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PROJECT REPORT

# Monitoring SME policy reforms in Armenia

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## *Foreword*

In 2014, the OECD Eurasia Competitiveness Programme (ECP) worked with the Government of Armenia to develop two reform roadmaps to strengthen the competitiveness of small and medium-sized enterprises (SMEs). As part of this project, the ECP carried out two thematic reviews and proposed the adoption of tailored policy recommendations in two priority areas: connecting Armenian SMEs with global value chains, with a focus on the agribusiness sector; and linking multinational enterprises with local SMEs, with a focus on the construction materials sector. The two business sectors discussed in the note have been chosen based on the government's priorities at the time of the initial review as well as according to potential growth opportunities.

The reviews were conducted with the support of public-private Working Groups including representatives from the government, the business community, industry experts, academia and development partners based in Armenia. Two thematic policy handbooks were peer reviewed at the 2014 OECD Eurasia Competitiveness Roundtable, where a high-level delegation from the Government of Armenia, led by the Minister of Economic Development and Investments, presented the final results and endorsed the recommendations summarised in the two handbooks (OECD, 2015a and 2015b). The final reports were published and launched in Yerevan in February 2015.

In 2016/17, the OECD monitored the implementation of the recommendations using a variety of tools: fact-finding missions, expert interviews, and consulting legal sources, official documents, statistics and reports. A monitoring workshop with an expert from Ireland was organised in Yerevan on 13 June 2017 to prepare for a second peer review of Armenia. The peer review took place on 25 October 2017 at the fifth session of the OECD Eurasia Competitiveness Roundtable.

This monitoring note assesses the progress made in implementing the recommendations over the last three years and outlines guidelines for further policy reforms. The note was developed in consultation with the Government of Armenia. Unless referenced otherwise, the information presented in this note results from the monitoring process described above. The monitoring assessment has been conducted with available data and statistics on national and international level.

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## *Abbreviations and acronyms*

CIS	Commonwealth of Independent States
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
DFA	Development Foundation of Armenia
EaP	Eastern partner countries
ECP	Eurasia Competitiveness Programme
EE	Energy-efficient
EEN	Enterprise Europe Network
EIA	Export Insurance Agency of Armenia
ENPARD	European Neighbourhood Programme for Agriculture and Rural Development
EU	European Union
FDI	Foreign direct investment
FEZ	Free economic zone
GDP	Gross domestic product
MoEDI	Ministry of Economic Development and Investments
MNE	Multinational enterprises
REX	EU Registered Exporter System
SME	Small and medium-sized enterprises
SME DNC	Small and Medium Entrepreneurship Development National Centre
TFI	Trade facilitation indicators
UNDP	United Nations Development Programme
UAE	United Arab Emirates

## *Executive summary*

In 2014, the OECD conducted a peer review of Armenia focusing on two relevant areas for the internationalisation of small and medium-sized enterprises (SMEs): connecting Armenian SMEs to global value chains in the agribusiness sector and linking SMEs with multinational enterprises in the construction materials sector. Main identified challenges were a lack of export promotion tools, limited export-related infrastructure, low provision of export finance, untapped opportunities for foreign investors and weak SME capabilities, e.g. in the construction materials sector.

Since 2014, the total value of exports of Armenian goods has been growing by roughly 15% per year but export levels still lag behind the regional average for Eastern partner (EaP) countries. Also, net foreign direct investment inflows have continued their downward trend, dropping from 8.1% of GDP in 2008 to just 1.7% in 2015. Nevertheless, following the 2014 OECD recommendations, Armenia has undertaken important reforms to help domestic SMEs internationalise and link with multinational enterprises.

### ***Connecting Armenian SMEs to global value chains: agribusiness***

Modest progress has been registered on export promotion and export-related infrastructure while the provision of export finance has been significantly improved.

- Export promotion of Armenian products cover international trade fairs and product databases. The creation of one national brand and the provision of trainings on internationalisation would be needed to further improve existing activities.
- The government has made substantial efforts to improve customs procedures through the introduction of e-government services. Important steps to tackle the fragmented nature of the agricultural sector were made with the adoption of the law on co-operatives.
- The Export Insurance Agency's (EIA) number of clients has significantly grown. Strengthened co-operation with the Development Foundation of Armenia (DFA) would be needed to further promote EIA's services among Armenian SMEs.

### ***Linking multinational enterprises and Armenian SMEs: Construction materials sector***

Important steps to trigger local demand for construction materials have been taken. However, efforts to improve investment promotion have not yet translated into tangible results and investment projects.

- Amendments to the legal and regulatory framework could help to trigger demand for energy-efficient construction materials. Knowledge and awareness about the economic benefits stemming from energy-saving construction could be further increased as a driver for private investment into the sector.
- The creation of the DFA in 2015 substantially helped to streamline state efforts towards attracting investment. Going forward, the DFA could reach out to potential investors more pro-actively and identify targets and key performance indicators. A supplier development programme for SMEs in priority sectors could be developed to promote linkages with foreign investors.

## *Overview of monitoring assessment*

Policy area	Overall 2014 recommendation	Detailed 2014 recommendations	2017 monitoring assessment	
			Progress status	Way forward
<b>Connecting Armenian SMEs to global value chains: agribusiness</b>	Connecting Armenian SMEs to agribusiness global value chains could help foster SME development in Armenia	1. Improve export promotion and disseminate skills for exporting		Create a national brand and enhance market intelligence with a focus on the agribusiness sector  Provide training on internationalisation to agricultural co-operatives and individual producers
		2. Improve customs procedures, certification and export infrastructure		Promote private investment in agricultural value chains and export infrastructure
		3. Consider expanding the capital and product offering of the newly created EIA		In co-operation with banks and the DFA, increase awareness of existing trade finance products among the SME community
<b>Linking multinational enterprises and Armenian SMEs: construction materials sector</b>	Attracting FDI in the construction materials sector could help foster SME development in Armenia	1. Unlock demand for construction materials produced in Armenia		Increase awareness of the economic benefits of energy-efficient construction  Tailor export-promotion activities to identified target markets in the region
		2. Attract FDI: a renewed approach to investment promotion and a focus on the diaspora		Improve outreach to potential investors according to sectoral targets and key performance indicators  Identify a wider range of potential investment projects, building on the existing database
		3. Increase SME capabilities to create linkages with foreign investors		Design and implement supplier development programmes for SMEs in priority sectors

 Completed
  Close to completion
  Being implemented
  Initiated
  Not started

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## Introduction

1. Since independence in 1991, Armenia's economy has undergone a profound transformation – from being centrally planned to a market-oriented economic model. Since the initial transition recession, it has experienced sustained economic growth interrupted only by a downturn during the global crisis of 2008-09. Indeed, annual average gross domestic product (GDP) growth reached 11.8% between 2000 and 2008, driven primarily by strong capital inflows and remittances. However, post-crisis growth has been moderate, due to the weakness of the recovery in major trading partners and falling investment activity; particularly in the construction sector, which saw its share in GDP decline from 25% in 2008 to 8% in 2016. Pre-crisis growth was driven by the construction industry, while agriculture, services and mining have gained prominence in recent years. Agriculture has remained a steady contributor to the country's GDP (16% in 2016), while services have increased their share to 52% and manufacturing to 9% since 2008 (Armstat 2017a, 2016a and 2010).

### ***Exports to European Union and regional markets are playing an increasing role in the Armenian economy***

2. Armenia's export performance has been volatile since independence, with sharp swings in export growth rates. The ratio of goods and services exports to GDP has fluctuated between 20 and 30% for most of the last two decades, apart from a sharp dip at the time of the global crisis. More recently, export growth has been a bit steadier, but it has also tended to decelerate since the initial post-crisis bounce in 2010. Since 2014, the total value of goods exports has grown by roughly 15%, reaching USD 1.78 billion in 2016 (Figure 1). The European Union (EU) remains Armenia's main trading partner, absorbing 28% of total exports, followed by Russia (16.5%), China (11.1%), Iraq (8.8%) and Georgia (8.4%) (Figure 2). Exports are dominated by minerals such as precious stones and ferrous metals, accounting for about 28% of total exports, followed by beverages and tobacco products that account for almost 20% (Armstat, 2017a and 2017b). The production and processing of higher-value products would help to diversify Armenia's export basket and help local companies move up in global value chains. It would also serve to reduce the extreme volatility of export performance observed in the past, which is in part related to the concentration of exports in terms of both commodities and export markets.

### ***Stronger FDI inflows could support Armenia's participation in global value chains***

3. Net foreign direct investment (FDI) inflows to Armenia dropped from USD 754 million in 2008 to USD 181 million in 2015, accounting for just 1.7% of GDP with the regional average standing at 5%. While the entire Eastern Partnership region experienced a severe decline of FDI after the global crisis in 2008-09, average net FDI inflows have returned to growth across the region in 2014, except in Armenia (see Annex A, Figure 3). To improve Armenia's performance, the government is increasingly engaged in investment climate reforms; it created a dedicated new government agency in 2015, the Development Foundation Armenia (DFA), to attract foreign investors.

***SMEs would benefit from increased internationalisation of the economy, but targeted policies are needed***

4. In Armenia, SMEs constitute 98% of all registered and functioning legal entities. Within the SME sector, micro-enterprises make up 89% of all registered businesses, and small firms around 6%. Roughly 60% of SMEs are engaged in retail and wholesale trade, with only 9% engaged in manufacturing and 1% in transport. Despite improvements since 2002, SMEs' contribution to GDP (33%) and employment (23.7%) remains low (OSCE, 2016). Given the large share of micro-enterprises among Armenian SMEs, policies need to first help them to grow through upgrading their production, and second to overcome the lack of capacity and resources that hinders them from internationalising.

5. Policies to support SME development have recently improved in Armenia. The government has engaged in a continuous effort to implement business environment reforms, simplify the legislative and regulatory framework and enhance its business support infrastructure, co-ordinated by the Small and Medium Entrepreneurship Development National Centre (SME DNC), the national SME agency (OECD et al., 2015). An array of SME-related reforms, e.g. on streamlining export and import procedures, have been carried out with the assistance of the European Bank of Reconstruction and Development's Business Support Office within the framework of the SME Development Council, a public-private dialogue platform chaired by the Republic of Armenia's Prime Minister.

6. However, key challenges remain unaddressed and pose obstacles for the development and internationalisation of SMEs. Despite a strong government focus on export-led growth, SME internationalisation in Armenia remains limited when compared to peer countries in the EU Eastern Partnership: only 6.9% of small and 7.7% of medium-sized enterprises export directly or indirectly, compared to the regional average of 15% of small enterprises and 25.6% of medium-sized enterprises (EBRD, 2014). There is a need to design targeted policies, and implement support programmes, to facilitate Armenian SMEs' participation in global value chains and strengthen their linkages with foreign investors.

***Two areas have been identified as priority policy reforms for fostering SME development***

7. This report measures progress in implementing the policy recommendations presented to the government of Armenia in 2014, on connecting Armenian SMEs to global value chains in the agricultural sector and linking multinational enterprises and Armenian SMEs in the construction materials sector. These topics were the subject of two in-depth reviews conducted in 2014-15 (OECD 2015a, 2015b):

- Agribusiness is a strategically important sector in the Armenian economy, and stronger linkages to global value chains could benefit local small and medium-sized firms in the sector. However, challenges remain, related to export promotion, infrastructure and finance. Based on international good practice, three sets of actions were identified to help Armenian agribusinesses internationalise: 1) improving export promotion and dissemination of export knowledge; 2) improving export-related infrastructure; and 3) further developing export financing.
- Foreign direct investment could play a major role in supporting the modernisation of Armenia's construction materials sector, but challenges remain related to the demand side, investment promotion and SME

capabilities. Based on international good practice, three sets of actions were identified to help attract more FDI and develop local SMEs in the construction materials sector: 1) unlocking domestic and external demand for high-value construction materials produced in Armenia; 2) attracting more FDI via a strengthened sectoral approach to investment promotion; and 3) increasing SMEs' capabilities to work with foreign investors.

## Chapter 1

### Connecting Armenian SMEs to global value chains: The case of agribusiness

*In 2014, the OECD carried out a thematic review to identify the main challenges and provide policy recommendations to the Government of Armenia to help local SMEs participate in global value chains, with a focus on the agribusiness sector. The review was conducted with the support of a public-private Working Group and produced a thematic policy handbook, which was published following the peer review of Armenia at the second meeting of the OECD Eurasia Competitiveness Roundtable (OECD, 2015b). This chapter summarises the main findings of the review and monitors the progress made in implementing the recommendations.*

8. The agribusiness sector was selected by the government as an area of interest for the OECD review due to its prominent role in the domestic market and potential for Armenian SMEs to become integrated into global value chains. While agriculture's contribution to the overall economy has declined by 2 percentage points to 16% of GDP between 2014 and 2016, it still accounts for a large share of total employment (35% in 2015) and remains one of Armenia's main economic sectors (Armstat, 2017a). Though only 15% of Armenian land is arable, the climate is especially beneficial for growing fruit and vegetables, which can command higher prices and returns on international markets than other crops. Further, value creation within the agribusiness sector is developing rapidly, with the processing of basic agricultural products becoming an integral part of the sector. Basic crop and animal production account for the largest employment and turnover levels, while food and drink manufacturing has steadily increased over recent years: agricultural output by 60% and food processing output by 35% from 2010 to 2015 (KPMG, 2017). High value-added products such as brandy and wine, as well as processed fruit and vegetables, constitute the largest share of food and drink manufacturing output.

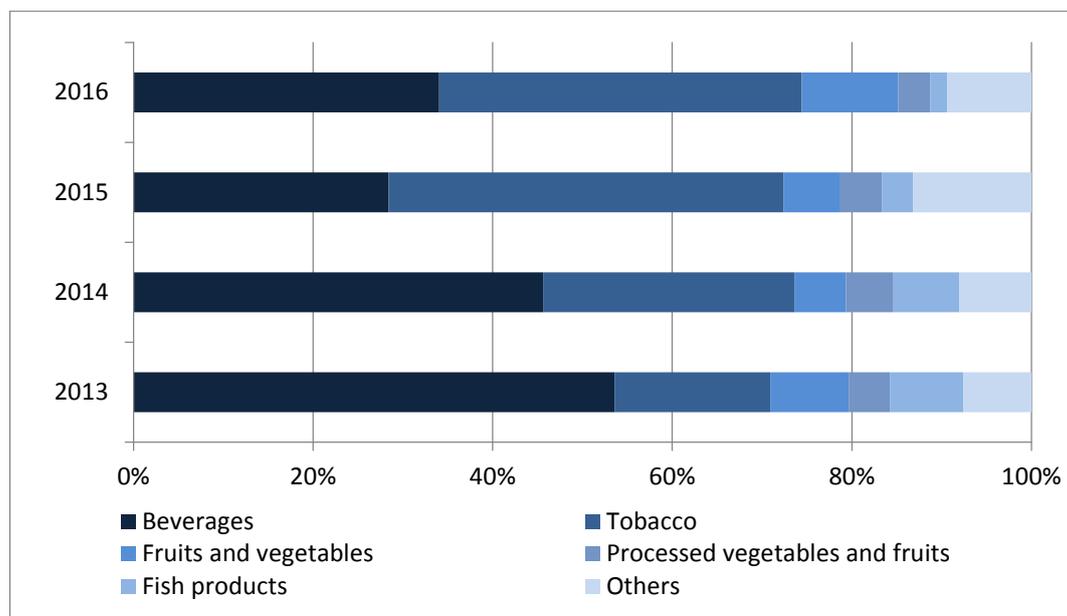
#### *Agricultural products play a growing role in Armenia's export activities*

9. Armenia was long known as a major food provider for the Soviet Union, exporting alcoholic beverages as well as canned fruit and vegetables. After a sharp drop following independence, exports of agro-food products steadily gained prominence in Armenia's trade balance – and in 2016 accounted for 29% of total exports (Armstat, 2017a). Such export dynamics are mainly driven by growing demand from neighbouring countries for Armenian brandy, wine and tobacco products.

10. Between 2014 and 2016, tobacco products made up 37% of agricultural exports, followed by alcoholic and non-alcoholic beverages (36%), raw fruit and vegetables (8%) and processed fruits and vegetables (4%). While exports of raw fruit and vegetables have been volatile due to their high exposure to climate conditions, exports of processed agricultural products been stable at USD 18 million since 2014 (UNComtrade, 2017) (see Annex A, Figure 4). Armenian products still enjoy a high level of recognition and visibility in the Commonwealth of Independent States (CIS) markets, but recent trade

data reveal that food exports are highly concentrated in just a few markets: Russia imported 41% of Armenian agricultural exports in 2015, followed by Iraq with 32%, while the EU market accounted for only 5% of total agricultural exports in 2015 (WITS, 2017).

**Figure 1. Armenia's agricultural exports are dominated by beverages and tobacco products**



Source: Armstat (2016a), *Statistical Yearbook of Armenia 2016*, National Statistical Service of the Republic of Armenia, Yerevan, [www.armstat.am/en/?nid=45&year=2016](http://www.armstat.am/en/?nid=45&year=2016).

11. In light of Armenia's potential for agricultural production and a growing global demand for high-value food products, Armenian firms could tap into high-value niches of the global agribusiness value chain (see Annex A, Figure 5). With international trade in processed fruits and vegetables rising by an annual rate of 2.1% over the last five years (IBISWorld, 2016), Armenian SMEs could focus on the production and export of packaged food and beverages, such as juices, canned and dried fruits and vegetables, which are also less vulnerable to seasonal fluctuations than raw agricultural products. Diversifying export markets could also help to unlock Armenia's export potential for food products and make the country more resilient.

*The internationalisation of Armenia's agricultural sector needs to focus on small and medium enterprises*

12. Policies to promote the development and internationalisation of the Armenian agricultural sector need to focus on small and medium enterprises. SMEs, particularly micro enterprises (fewer than ten employees), make up the largest share of enterprises in the sector, with almost half of all farms operating individually on a subsistence basis. Targeted policy measures could help them to scale up their production and benefit from economies of scale (ICARE, 2015). Over 99% of all agricultural holdings are not registered as companies and are mostly exempt from value-added tax, given their low production and consequently low income. They possess, on average, only 1.48 hectares of

arable land (Armstat, 2016b), compared to an EU average of 16.1ha per agricultural holding (Eurostat, 2015). Nearly 24% of registered SMEs operate in food processing.

13. A major step towards farm consolidation has been taken by adopting a law on agricultural co-operatives. The law aims to overcome the fragmentation of the agricultural sector and increase the productivity of agricultural producers. As money is scarce, there is a lack of investment in cooling, storage and modern production facilities, which could be overcome, at least in part, by pooling existing resources. Agricultural SMEs gain benefits from participating in co-operatives, such as access to pooled competencies and assets, as well as greater bargaining power when negotiating prices for inputs. Ultimately, cheaper inputs and modern technologies can make small agribusinesses more competitive and increase their potential to move up the value chain and reach export markets. By the end of 2016, 53 agricultural (marketing and primary production) co-operatives were registered in Armenia, with the majority engaging in buckwheat production. Some 551 farmers from 67 different communities are engaged in 33 buckwheat production co-operatives; they produced an average of 1.2 tonnes of buckwheat per hectare in 2016.

## Overview of 2014 recommendations

14. The 2014 review highlighted three challenges in connecting Armenian agribusiness SMEs to global value chains. First, Armenian food processing SMEs have only limited knowledge of foreign markets and thus limited capacity to enter global food value chains. State efforts to promote the uniqueness of Armenian products also remain low. Second, missing links between farmers and food-processing companies represent an obstacle to the sector's development and reinforce its fragmentation. With production quantities remaining low, producers are not able to bear the risks and costs associated with export activities, including certification and customs procedures. At the same time, the lack of an adequate export-related infrastructure makes it harder for agribusinesses to engage in export activities. Third, export finance is in its infancy, with limited measures tailored to the specific needs of Armenian SMEs. The following recommendations were provided to address these challenges.

### ***Recommendation 1 – Improve export promotion and disseminate skills for exporting***

15. A dedicated national export promotion agency could help to create and promote a national brand for Armenian products, and improve the export skills of existing and potential exporters. The agency's activities should include collecting and providing detailed information on foreign food markets and related export opportunities. Knowledge and expertise could be disseminated through a variety of tools, including an online database of potential foreign business partners, reports, and workshops for SMEs.

### ***Recommendation 2 – Improve customs procedures, certification and export infrastructure***

16. Customs procedures, certification and the existing export infrastructure should be streamlined and improved to lower costs and administrative burdens for exporting SMEs. Policies should support the creation of local certification bodies, and co-ordination between existing regulatory, food safety and tax bodies should be improved. Furthermore, based on existing success stories, modern infrastructure for storing, cooling and trading

agricultural products could be developed with a certification and customs window to facilitate exports.

***Recommendation 3 – Consider expanding the capacity of the Export Insurance Agency***

17. The new Export Insurance Agency (EIA) should be supported, broadening its mandate and strengthening its links with private banks. The provision of wider export finance beyond export insurance should also be considered – including, for instance, export guarantee schemes. The EIA should eventually become a knowledge hub on export finance, providing services to current and potential exporting SMEs.

**Findings of the 2017 assessment**

***Recommendation 1 – Improve export promotion and disseminate skills for exporting***

18. Moderate progress has been made in implementing this recommendation. The newly created DFA has taken the lead in country-wide efforts to strengthen the export activities of Armenian firms. Since the creation of the DFA, state-supported export promotion activities have been upgraded, particularly the promotion of Armenian products at international trade fairs. At such events, Armenian producers increasingly advertise their products under a common pavilion promoting and benefitting from quality features associated with Armenian products. Efforts to increase SMEs' export skills are still limited, as training is mainly provided by the SME DNC through the EU Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) project, on designing business plans and preparing for investment projects. However, important steps have been taken to upgrade SMEs' capacity in the agribusiness sector to improve the quality and variety of products, which would eventually increase their presence on international markets.

*Action 1: Improve current marketing practices to support the creation of a country/product brand*

19. Private marketing practices in the agribusiness sector are underdeveloped, but the DFA has increased efforts to promote Armenian products beyond traditional CIS markets. Small and medium-sized agribusinesses lack the resources and knowledge to invest in marketing activities or to create an individual brand, and agricultural co-operatives often sell and trade their products in bulk and without branding. A successful example is Spayka, the major co-operative player on the market. It collects fruit and vegetables from local SMEs and, after packaging, sells and exports products under its successful Araratfruit and Araratfood brands. In 2015, the company also set up production sites for juices, canned food and fruits. However, an increased number of market players and competition could help to upgrade the quality and variety of services and ensure its provision in rural regions.

20. Current efforts to promote Armenian products cover trade fairs in foreign countries and different databases of Armenian-produced products. The DFA organises business trips to help companies take part in international trade fairs, where firms are encouraged to jointly advertise their products under one Armenian pavilion. In such cases, the DFA finances all expenses related to firms' participation at the fair. On the other hand, if companies decide to participate independently, only half of the costs are

covered through state funds. Most firms that have joined recent fairs, such as in Iran, operate in the agribusiness sector. The Armenia Expo in Iran in October 2016 gathered 80 companies, of which about 50% have since signed agreements with Iranian companies. Several databases provide an exhaustive list of existing Armenian exporters, such as the Armenia export catalogue ([www.aec.am](http://www.aec.am)), or the DFA's annually published catalogue, *Made in Armenia*. Spayka developed an online platform for Armenian food producers to present their products to potential buyers in Russia ([www.armzon.ru](http://www.armzon.ru)) that could act as example for online platforms covering specific products and markets. However, no specific export promotion strategy has been developed outlining clear-cut targets for state export promotion activities. On the branding side, a "Made in Armenia" trademark has not yet been developed; and attempts by the government to establish an umbrella brand for Armenian wines failed, as no agreement on minimum standards could be reached. Nonetheless, the government has reinitiated efforts to create a single national brand. Recently, a state committee with members from different government bodies has been established to work on the creation of one Armenian national brand promoting the country's products (GoA, 2017c).

21. The government has also paid increasing attention to developing organic agriculture to tap into the emerging global demand for organic products, as defined in Armenia's Sustainable Agriculture Development Strategy (GoA, 2010). In co-operation with the EU Organic Agriculture Support Initiative, the Ministry of Agriculture aims to support agribusinesses to invest in organic agriculture and promote Armenian products in local and global markets. The project helps farmers to upgrade their production facilities through financial support and training, facilitates education on organic farming in universities, and implements awareness-raising campaigns about the benefits of organic agriculture. As of March 2017, there were 43 registered organic producers in Armenia, mostly producing wine and olive oil. Establishing official certification for organic producers enables them to use an organic label that is also recognised in EU countries. Such an initiative could significantly help Armenian food products to gain a foothold in the EU market, which has shown a growing demand for organic products.

22. Producer organisations in the agricultural sector, such as the association of dried food producers of Armenia, play an important role in strengthening the position of agricultural producers on international markets, and help negotiate on an equal footing with international business partners or competitors. They can assist in marketing, selling and distribution of products on export markets. Armenian policy makers should encourage the development of strong producers' organisations and promote membership among Armenian agribusinesses. In light of this, the DFA should increase its corporation with existing producer organisations and align on export promotion activities.

23. Going forward, the DFA should approach a larger number of agro-processing firms and support their participation in international trade fairs promoting Made in Armenia products. The newly established committee on creating a national brand should learn from already successful business cases such as Spayka and enhance co-operation with the company to align outreach activities and learn about agricultural producers' actual needs. Marketing efforts should be strengthened to ensure that such a brand is associated with high quality and potentially organic production, as well as defining and setting common standards.

*Action 2: Collect and build in-house knowledge of foreign markets and potential foreign buyers*

24. Important steps have been taken to improve export intelligence for Armenian companies, in particular on potential business partners on the EU and Russian market. The DFA is collecting information on foreign markets through sectoral studies based on requests and proposals from SMEs. Armenia's SME agency, the SME DNC, provides more in-depth knowledge of the EU market through its participation in the Enterprise Europe Network (EEN) under the framework of the EU COSME project: it includes information on relevant EU legislation, standards and financing opportunities, as well as a database of potential partners for business and technological co-operation. Partnerships are further promoted through organised meetings and networking events. Armenia was the first non-EU member country to join the EEN in 2016. Finally, Armenia's Export Insurance Agency has published a database of potential business partners operating on the EU and Russian markets. This helps Armenian SMEs to find concrete potential buyers and sellers of their products on foreign markets and thus supports initial export steps.

25. Given that the provision of export intelligence is currently limited and fragmented, knowledge of foreign markets and potential buyers could be further improved through a co-ordinated and demand-driven approach. For instance, the DFA could carry out a comprehensive SME-needs analysis to identify the needs of a wider circle of SMEs in sectors with export potential, including those lacking the capacity to associate and request studies. The DFA should align with the EEN Armenia and the EIA to pool information resources and efficiently disseminate it to potential exporters. Information on markets beyond the EU and Russia should also be collected.

*Action 3: Educate current and potential exporters in the specifics of internationalisation*

26. Agricultural extension and advisory services provided by regional support centres have gradually been expanded to upgrade agricultural production and enhance the competitiveness of Armenian agribusinesses in domestic and global markets. Ten agricultural support centres are operating under the Ministry of Agriculture and offer services such as field training and marketing consulting, as well as organising information events. This state programme was established in 2008 and is providing services to an average of 70 000 farms in 914 communities each year (EDRC, 2016). Furthermore, the EU European Neighbourhood Programme for Agriculture and Rural Development (ENPARD) project facilitates support to upgrade producers' skills, to enable them to add value to primary agricultural products. Since programme inception, more than 600 farmers have received training in business skills development, business plan design and establishing co-operatives.

27. Skills development measures are part of the DFA's service portfolio, including training on export promotion. In 2015, representatives from 216 Armenian businesses participated in training courses provided by Armenian and international experts from the public and private sectors, as well as academia. There is no fixed schedule for regular training, and capacity-building activities are organised according to requests from SMEs and representative bodies, such as sectoral unions. This situation may cause duplication with existing business development services provided by other institutions or the private sector that businesses are not aware of.

28. The Ministry of Agriculture could consider expanding the existing set of agricultural extension and advisory services, e.g. by offering tailored training and information on exporting. The DFA could develop a set of training programmes for SMEs with export potential. In doing so, the DFA should conduct a thorough market analysis on SME needs in close corporation with sectoral unions and business associations. Going forward, priority areas need to be defined and become part of the

agency's overall strategic goals and objectives. A closer co-operation with business associations could further help to reach a wider circle of SMEs and increase awareness of the training provided. Furthermore, an online platform could be established to convey information concerning current legislation, customs procedures and available support programmes for potential exporters.

***Recommendation 2 – Improve customs procedures, certification and export infrastructure***

29. The government has made substantial efforts to improve customs procedures, but progress on upgrading the export infrastructure has been somewhat limited. Major improvements to tackle the fragmented nature of the agricultural sector were made with the adoption of the law on co-operatives, which could play a key role in upgrading production and moving up local and global value chains, as well as increasing investment in critical infrastructure. The government should further facilitate linkages between agricultural producers and processors and promote investment in the sector.

*Action 1: Support the creation of affordable certification bodies, streamlining existing regulatory and food safety requirements*

30. Regulatory requirements and trade barriers for Armenian businesses have gradually been reduced, but they remain burdensome. Exporting from Armenia incurs more cost and time for Armenian enterprises than for competitors in neighbouring countries such as Georgia. Border and documentary compliance for Armenian businesses takes an average of 42 hours, whereas Georgian businesses only need to spend 16 hours to meet all requirements (World Bank, 2016). Customs procedures have been significantly simplified following the introduction of an online platform in 2015 (<https://trade.gov.am/trade/>) and companies can now obtain certifications and licences for exporting food products through a single window system. The government is currently creating an online system for customs self-declaration that is expected to start operating by the end of 2017. Further, custom fees have been abolished for export products worth up to EUR 200, which allows small enterprises to export samples of their products without any tariff costs. Lastly, from 2018 Armenia will start applying the EU's Registered Exporter System (REX). Armenian exporters registering through the REX system will be exempt from origin of goods certificates when exporting goods to the EU worth up to EUR 6 000. This system will especially benefit small exporting companies.

31. Food safety requirements play an essential role for Armenian agricultural SMEs seeking to enter foreign markets. The State Food Safety Service of the Ministry of Agriculture is the main institution enforcing food safety laws and issuing certifications and licenses; food producing companies must comply with standards set by Hazard Analysis Critical Control Points. Interpretation of the current food safety law, however, is not always clear; and Armenian producers often lack the capacity to obtain certification and show limited awareness of the benefits of internationally aligned food safety standards (World Bank, 2016).

32. The newly established online platform for trading activities, as well as the online system for customs self-declaration, should be promoted among SMEs through the DFA and business associations. Increasing access to international accreditation services, together with improved enforcement of existing food safety laws, could help agricultural SMEs to upgrade and meet international standards, and eventually translate into greater access to international markets.

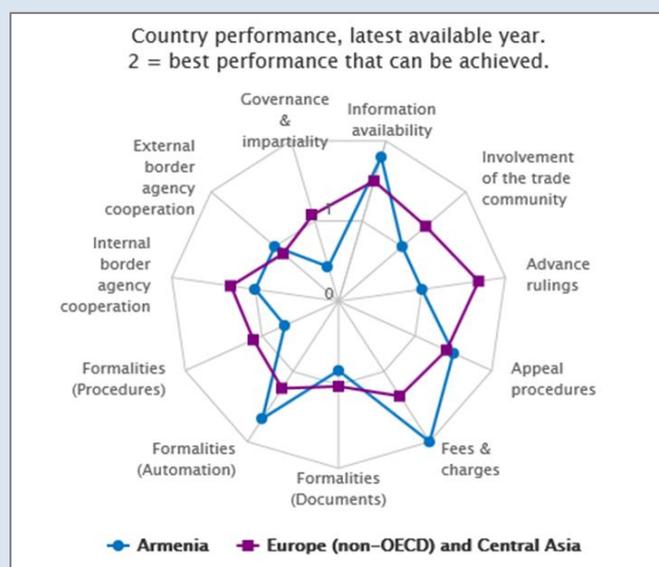
### Box 1. OECD trade facilitation indicators and Armenia

To help governments improve their border procedures, reduce trade costs, boost trade flows and reap greater benefits from international trade, the OECD has developed a set of trade facilitation indicators (TFIs) that identify areas for action and enable the potential impact of reforms to be assessed.

The capital investment and operating costs of implementing the trade facilitation measures featured in the OECD TFIs are relatively low compared to the potential benefits they bring. Trade facilitation measures introduce new ways to fulfill traditional border agency mandates, thereby making them more efficient and effective.

According to the last assessment in 2015, Armenia exceeds best practice countries for information availability, including the publication of trade information and availability of enquiry points; and outperforms on fees and charges imposed on imports and exports. Armenia, however, falls short in areas such as making efforts to support compliance with international standards conventions, or reducing the number of documents and time required for import and export. With regards to governance and impartiality Armenia should further promote effective sanctions against misconduct of border officials and introduce an internal audit mechanism for border agencies.

#### Armenia's trade facilitation indicators



Source: OECD (2015c), OECD Trade Facilitation Indicators, Armenia – Country note, <http://www2.compareyourcountry.org/trade-facilitation> (accessed 6 June 2017).

#### Action 2: Support value chain development and improve export infrastructure

33. The first Armenian agricultural census since the country's independence was conducted in 2014, giving a complete picture of the sector's role and performance in the

national economy. Accurate data on the sector's structure at the regional level, including non-registered holdings, are essential for evidence-based and targeted policy making. Information on land fragmentation, as well as the size of the informal sector, is particularly important to an understanding of agricultural development in Armenia. According to the census, only 0.1% out of 361 064 surveyed agricultural holdings are legally registered. Legal holdings, however, are much larger, as they possess on average 62 ha each, whereas holdings without a legal status have on average only 1.5ha (Armstat, 2016b).

34. While it is important to process Armenian fruit and vegetables to unlock their export potential, linkages between producers and processors to add value and export agricultural primary products are still weak. Nevertheless, there are signs of growing investment in production facilities, particularly through the EU ENPARD project, which has made a significant contribution to the development of agricultural value chains. The project has so far facilitated the creation of two buckwheat hulling plants, six cheese-producing facilities and six production units for dried fruits and herbs. The project could serve as a driver to further spur private investment in modern production facilities.

35. Infrastructure and services to facilitate trade in agricultural products, such as storing, cooling and packaging, are mostly concentrated in Yerevan. According to the latest agricultural census, 24% of all agricultural holdings have storehouses and only 1% own refrigerators to improve products' durability. While companies such as Spayka and Apaven offer logistics and freight forwarding services, as well as warehousing and customs brokerage, there is still limited access to such services in the regions outside Yerevan, and the capacity of agribusinesses to invest in related assets remains limited (GoA, 2015b).

36. The Armenian government is increasingly aware of the role that foreign investors could play in developing the agricultural sector and related export infrastructure. The Ministry of Agriculture has developed an agro-investment guide and provided a list of investment projects in greenhouses and aquaculture to feed into DFA's sectoral work (ICARE, 2017). To complement this and further attract investments in the sector, the government intends to set up a Free Economic Zone (FEZ) in the Syunik region bordering Iran. The main goal of the Free Economic Zone is to contribute to export volume growth and the creation of new workplaces, as well as ensure the integration of foreign direct investments and the introduction of advanced technologies. It covers several economic sectors including agriculture, the processing industry, energy, transportation and storage services.

### ***Recommendation 3 – Consider expanding the capacity of the Export Insurance Agency***

37. Since 2014, Armenia's Export Insurance Agency has greatly expanded its portfolio and co-operation with other national and international financial institutions. A wide range of awareness-raising activities and strengthened co-operation with domestic banks has helped to enhance the demand for insurance products from SMEs. The market for export finance beyond insurance products is still poorly developed, as it lacks a broader set of public export finance tools.

#### *Action 1: Strengthen EIA's mandate to better match the government's export strategy*

38. The Export Insurance Agency has been created to serve the goals set under the government's export-led industrial policy and EIA's objectives are clearly defined in the

current SME strategy: promoting exports by insuring the risk of non-payment by foreign buyers and spurring the provision of accessible financial resources for SME internationalisation (GoA, 2015). The EIA's objectives clearly match those of the export strategy: expanding and diversifying the exportable sector of the economy whereas financial support and providing access to finance play a fundamental role. The EIA is providing one main tool the export strategy mentions for its implementation – issuing credit guarantees. Further, the agency's compliance with financial regulation is ensured through the supervision of the Central Bank of Armenia.

*Action 2: Promote the pilot EIA to prospective partners among private banks*

39. A number of networking and promotion events have helped increase awareness among Armenian firms of existing export insurance measures. The EIA regularly participates in local business fairs, e.g. the yearly ArmProd Expo, thus reaching out to potential clients, primarily in the agribusiness sector. In 2016, the agency was also represented at the Iran-Armenia business forum. Furthermore, the agency organises working meetings with private sector representatives to discuss export-related challenges and how to improve the agency's services according to the increased needs of export-oriented local firms. Most of these activities are focused on the agribusiness sector, leading to agricultural SMEs making up a major share of EIA clients. Other clients operate in the jewellery, pharmaceutical and IT sectors.

40. Significant progress has been achieved in intensifying co-operation between the agency and domestic banks, resulting in substantial growth in demand for EIA's products and services. While in 2015 only one partnership agreement with a local bank existed, by 2017 the number had increased to seven. Based on these agreements, the EIA provides insurance contracts for short-term supplier credits issued by partner banks. As a result, the agency experienced an increase in the number of clients of more than 300% within one year, from eight in 2015 to 30 in 2016, with a corresponding increase in the number of insurance policies issued, from 20 in 2015 to 116 in 2016. At the end of August 2017 the number of policies issued reached a number of 170. The recent success of the agency is further highlighted through a substantial increase in the size of its portfolio, which doubled between 2015 and 2016 to AMD 2.2 billion (Armenian drams; USD 4.5 million). At the end of August 2017 the size of EIA's portfolio amounted to AMD 2.6 billion (USD 5.4 million) (EIA, 2017).

*Action 3: Move beyond export insurance provision to a wider offering of export finance products*

41. The agency's portfolio has expanded, with pre-export insurance policies in addition to basic export insurance and multiple shipment insurance. Export insurance tools cover any credit, liability and cargo risk stemming from the commercial and political risks of trade transactions. SMEs often encounter difficulties delivering the quality and quantity of ordered products specified in their export contracts. In order to ensure continuity of production, however, pre-export financing insurance allows exporters to receive short-term financing, without requiring collateral.

42. Despite the availability of EIA's risk mitigation tools, private sector export finance provision remains marginal. The overall credit market and the supply of tailored instruments for SMEs are poorly developed, as are non-bank finance and the Armenian capital market. Furthermore, prevailing high interest rates and a lack of local currency funding constrain SME credit growth (EIB, 2016). In order to promote financial market development in Armenia and diversify financing instruments available to SMEs, several

donor projects are being developed; such as the EBRD's planned investment in a private equity fund focused on Armenian SMEs, as part of its Small and Medium Enterprise Finance and Advice Facility (EBRD, 2016).

43. The EIA could consider increasing its co-operation with Armenian banks, to identify remaining obstacles to providing trade finance and to increase awareness of existing products among the SME community.

*Action 4: Ensure the EIA becomes a knowledge hub on export finance that can advise exporters, especially SMEs*

44. The EIA has developed a close collaboration with a network of foreign export insurance agencies. In particular, the EIA has signed a number of co-operation agreements with multiple foreign export insurance agencies seeking to co-operate on information and experience exchange (EIA, 2016). Such horizontal cross-border co-operation enables the EIA to learn about new services and products to support SME internationalisation, while accessing information about potential business opportunities in foreign markets and matching those to Armenian firms. At the time of writing, the EIA has established links with agencies from Belarus, China, the Czech Republic, Germany, Iran, Italy and Russia. These activities and networks could help the EIA to upgrade its portfolio and widen its range of instruments beyond insurance products.

45. Building on its networking activities, the agency introduced a range of relevant informational services on export finance and export intelligence. It has created an extensive database of companies operating in the EU and other countries. The list of companies is organised by sector, mostly covering agribusiness, followed by pharmaceuticals and light industry (EIA, 2015). The database helps Armenian export-oriented companies to find potential business partners and provides them with an overview of international markets. However, limited co-ordination between the EIA and the DFA has restricted both agencies' opportunities to provide more effective export intelligence. They have not gone beyond mere information provision to offer clients advisory or training services to increase SMEs' capacity to export and make use of export financing tools. Going forward, the EIA should take on the task of delivering targeted training on export finance.

46. The EIA could further strengthen its links with foreign export finance institutes to learn about the latest trends on export finance and to gain access to foreign networks of potential business partners for Armenian SMEs. Closer co-operation with the DFA could help to distribute information about potential foreign business opportunities and design adequate advisory services and training programmes on export finance.

## The way forward

*Guideline 1: Upgrade existing export promotion tools and create more target-oriented support measures*

47. Further improving the impact of export promotion activities in the agriculture sector will require more target-oriented support measures. The government could focus on emphasising the quality and uniqueness of Armenian processed and organic goods for those companies that cannot engage in branding and marketing activities of their own. Current efforts to create a national brand should consider protecting it by intellectual property rights under the Lisbon Agreement of the World Intellectual Property Organisation. The participation of Armenian businesses at international trade fairs should

be enhanced to include more target markets and a wider range of sectors. A database with potential buyers in all relevant foreign markets is still missing, and the DFA should compile an extensive list of potential foreign business partners for Armenian SMEs, building on existing information collected by EIA and the EEN.

*Guideline 2: Facilitate the development of agricultural value chains*

48. As an important first step, the government should design new agricultural policies based on the agricultural census results. Building on the adoption of the law on co-operatives, it should also pro-actively support the development of agricultural value chains, including the production of high-value food products beyond beverages, e.g. through targeted training on building co-operatives and specific aspects of business management and internationalisation (e.g. production, marketing, sales). A further consolidation of Armenian farms could help to increase investment into the sector's development, including physical and export infrastructure. It could also decrease transaction costs for individual farmers to access export services, and thus increase their confidence to participate in export markets.

49. In order to further improve trade procedures and reduce costs for Armenian exporters, the government should take its performance into consideration, and the respective recommendations of the OECD trade facilitation indicators assessment. This could include increasing the compliance with international standards conventions and lowering bureaucratic burdens, such as through reducing the number of documents and time required for import and export.

*Guideline 3: Create a level playing field for the development of alternative financing tools*

50. The Export Insurance Agency has made substantial improvements in its provision of export insurance tools. The agency should continue strengthening its co-operation with domestic banks to increase the number of clients targeting SMEs of all economic sectors. A close collaboration with a higher number of foreign export insurance agencies could help to further improve services according to international good practice. The EIA could consider enhancing its training and research activities. In this context, Italy's export guarantee fund SACE marks a good example offering tailored training services to exporters, banks and students, complemented by a comprehensive analysis of economic trends and global markets (OECD, 2015a). Co-operation with the DFA could be strengthened to promote EIA's services among Armenian SMEs and further learn about their needs.

**Box 2. SACE: Training on export finance**

The Italian export guarantee fund, SACE, has been successfully operational for decades. It signed a collaboration agreement with the EIA in 2016 to enhance trade and investment between Italy and Armenia and to exchange information and best practices. Further, they agreed to co-operate on advisory and technical assistance services to help SME's integration into local and global supply chains.

In addition to its core business of providing various export finance tools, SACE invests substantial resources in research and education. They provide affordable training to clients on assessment, taking and managing risks stemming from export activities, including seminars, classroom-based workshops, on-the-job training and video seminars accessible through a dedicated e-learning portal. Training is mainly provided by internal staff members. SACE also offers training to different export finance institutions from emerging countries.

*Source: SACE (2017), EIA (2016).*

**Figure 2. Suggested implementation roadmap: The case of agribusiness**

Recommendations	Indicative implementation timing		
	Short term <1 year	Medium term 1-3 years	Long term >3 years
<b>GUIDELINE 1</b>			
<i>Action 1: Develop and promote national brand</i>			
<i>Action 2: Increase number of agribusinesses participating in international fairs</i>			
<i>Action 3: Promote existing online export database through DFA</i>			
<b>GUIDELINE 2</b>			
<i>Action 1: Regularly conduct agricultural censuses</i>			
<i>Action 2: Increase training on business management and internationalisation</i>			
<b>GUIDELINE 3</b>			
<i>Action 1: EIA to increase partnerships with local banks</i>			
<i>Action 2: EIA to widen international network</i>			
<i>Action 3: EIA to develop training programme on export finance</i>			

## Chapter 2

### Linking multinational enterprises and Armenian SMEs: The case of the construction materials sector

51. In 2014, the OECD carried out a thematic review to identify the main challenges and provide policy recommendations to the Government of Armenia on how to attract multinational enterprises to invest in the country, with a focus on the construction materials sector. The review was conducted with the support of a public-private Working Group, and produced a thematic policy handbook, which was published following the peer review of Armenia at the second meeting of the OECD Eurasia Competitiveness Roundtable (OECD, 2015a). This chapter summarises the main findings of the review and monitors the progress made in implementing the recommendations.

52. The construction materials sub-sector was selected by the government as an area of interest for the OECD review. This was due to the role played by small and medium-sized enterprises (SMEs) – which are responsible for around 50% of the sector’s value added – and Armenia’s endowment of non-metal natural resources that could be used to produce construction materials (ERDSC, 2014a, 2014b). High-grade natural stone, clay, gypsum and limestone are available in large quantities in Armenia’s subsoil, and the country has particularly abundant mineral reserves of volcanic origin, such as perlites, basalts, dolomites, pumices and zeolites, which are of particular relevance for energy-efficient construction (see Annex A, Figure 5).

#### *The demand for construction materials is driven by the construction industry*

53. Building materials account for roughly half of the total construction industry’s inputs, with non-metallic mineral products taking the lion’s share of costs (see Annex A, Figure 6). The dynamics of the construction industry in residential, non-residential and infrastructure projects therefore affect the market for intermediate products and services upstream in the value chain, including the demand for construction materials. In Armenia, this sub-sector is still small, accounting for between 1 and 2% of gross domestic product (GDP) in 2012 (ERDSC, 2014b). It covers several economic activities, from mining raw materials (e.g. travertine and basalt) to manufacturing intermediate goods (e.g. cement and insulators) and final products for use in construction (e.g. ceramic tiles and windows).

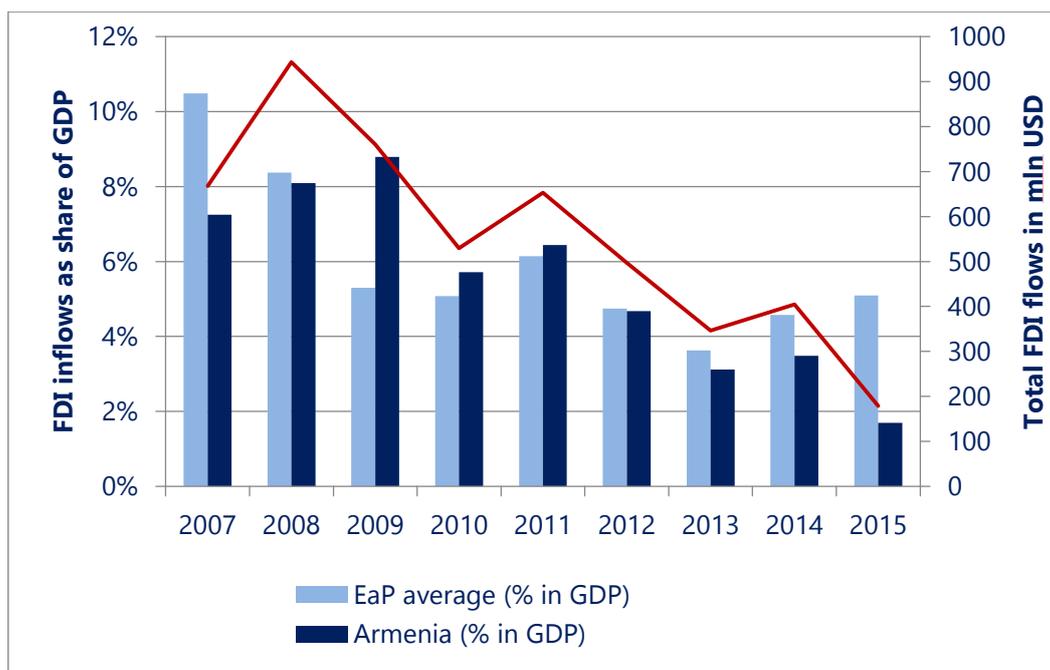
54. Construction in Armenia has steadily declined from its peak of 25% of GDP in 2008. Since 2014, it has maintained this downward trend, accounting for an average of 8.9% of GDP in the period 2014-16, and does not show strong signs of recovery to pre-crisis levels (Armstat, 2017a). The domestic market for Armenian construction materials therefore presents limited growth opportunities for businesses in the sector.

#### *Foreign direct investment could help to develop the construction materials sector*

55. Foreign direct investment (FDI) could introduce the technology required to manufacture high-value, exportable products. High transportation costs constrain the tradability of certain products, and Armenian construction material companies can only benefit from the growth of regional and global markets if they manufacture high-value

products that can be traded at a profit beyond domestic borders, or else find attractive niche markets in the national economy. Energy-efficient construction materials offer an example of high-value products for both domestic and foreign markets that could be developed using local natural resources.

**Figure 3. FDI inflows in Armenia continue to decrease sharply**



Source: World Bank (2017a), *World Development Indicators* (database), <http://data.worldbank.org> (accessed 10 May 2017).

56. However, FDI in the construction materials sector in Armenia has been low historically, and no leading global firm has made flagship investments in the country. More broadly, Armenia is currently experiencing a downward trend in FDI with a particularly sharp drop since 2014, with net inflows standing at 1.6% of GDP in 2015. This amounts to a fall of 7 percentage points since its peak in 2009, and reveals how Armenia has suffered most severely among the Eastern partner countries from falling foreign investment in the wake of the global financial crisis (World Bank, 2017a).

*Local SMEs could benefit from more multinational enterprises investing in the sector*

57. Once a major supplier of building materials to the former Soviet Union, Armenia has seen its processing and export of non-metal minerals decrease around tenfold since 1991. The collapse of the Soviet Union, the major investor in the country, has resulted in progressive decay of the equipment used to process construction materials, and almost no effort has been made to upgrade the available technology (ERDSC, 2014a).

58. Multinational enterprises (MNEs) could provide local SMEs with the opportunity to integrate in their value chain as suppliers of intermediate inputs, and tap into larger volumes through international production and distribution networks. In doing so, MNEs could provide specific technical assistance and training to raise the quality of suppliers' output and ensure that production standards are met upstream.

## Overview of 2014 recommendations

59. The 2014 review concluded with the three main challenges to attracting multinational enterprises in the construction materials sector in Armenia. First, a small domestic market poses a natural limit to business opportunities in Armenia, and obstacles in the business environment for construction companies increase uncertainty and add frictions in the supply to an already limited internal demand. Such issues may discourage foreign investors from entering or expanding their operations in Armenia. Second, sector-specific FDI promotion activities that could help to increase the low level of FDI in the construction materials sectors are scarce and sporadic. Third, low capabilities among manufacturing SMEs in the construction materials sector may discourage multinational enterprises from investing and further developing the sector. The following sets of recommendations were provided to address these challenges.

### ***Recommendation 1 – Unlock demand for construction materials produced in Armenia***

60. First, upgrading regulations on energy-efficiency requirements in buildings and supporting their enforcement may unlock demand for insulating and other high-value construction materials. Second, as both consumers and SMEs appear to have only limited information on the benefits of energy-efficient and other innovative construction products, the government could promote awareness of the economic benefits of energy efficiency in construction. Third, streamlining the procedures for obtaining construction permits could help construction companies overcome existing administrative barriers to their activities. Fourth, to boost foreign demand for Armenian construction materials, the government should enhance export intelligence and promotion, and support SMEs engaging in export activities.

### ***Recommendation 2 – Attract FDI: a new approach to investment promotion***

61. First, upgrading the national investment promotion agency – by adopting a strengthened sectoral approach, and acting as a one-stop shop through all phases of the investment cycle – may help to attract new investors. Second, to leverage Armenia's large diaspora, the government could devise actions to target Armenians abroad as a potential source of FDI, and develop mentoring and matchmaking initiatives to link domestic entrepreneurs with potential investors.

### ***Recommendation 3 – Increase SME capabilities to work with foreign investors***

62. An FDI-SME linkage programme could be designed to maximise business opportunities for Armenian SMEs, as well as technology and knowledge spill-overs from foreign investments into the local economy. Such a programme could start with an assessment of investors' needs and identify both skills and business development programmes for local firms. It could be piloted in the construction materials sector, where Armenian SMEs often lack the equipment, technology and information needed to produce high-value products.

## Findings of the 2017 assessment

63. This section details progress in implementing the 2014 policy recommendations on linking multinational enterprises and Armenian SMEs in the construction materials sector. The assessment is structured around the three recommendations presented above.

### *Recommendation 1 – Unlock demand for construction materials produced in Armenia*

64. Significant efforts have been made to promote energy-efficient construction, which could help to increase domestic demand for high-value insulating construction materials. Amendments to the legal and regulatory framework were introduced, including mandatory requirements for energy-efficient construction in public buildings. Furthermore, the construction sector overall has benefitted from streamlined administrative procedures for obtaining construction permits. However, limited progress has been achieved in promoting the export of Armenian construction materials in regional markets, due to a general decline in the construction sector of neighbouring countries following the economic crisis.

#### *Action 1: Upgrade regulation to enforce energy-efficiency requirements in construction*

65. At the institutional level, the Ministry of Energy Infrastructure and Natural Resources and the State Committee for Urban Development are the main bodies responsible for energy efficiency regulation. Energy saving and efficiency has been assigned high-priority status by the government, and the new Energy Efficiency Action Plan 2017-2018 includes several measures impacting the construction industry, such as introducing requirements for buildings' energy performance and adopting labelling systems for construction materials.

66. Armenia's legislative framework regulating construction has been amended to promote energy-efficient techniques in public buildings. In May 2016, the government introduced mandatory requirements for energy efficiency in public buildings through amendments to the Law on Energy Efficiency and Renewable Energy. Several technical requirements are being defined to ensure the law's implementation, and a number of energy efficiency codes and standards required for obtaining a construction permit have been updated. In particular, a new building code on "Thermal protection of buildings" as well as 17 EU and ISO (International Organization for Standardization) standards on energy efficiency have been introduced, which transpose the main provisions of the law into secondary legislation, and ultimately should spur demand for insulating and other high-value construction materials (GoA, 2017b).

67. The United Nations Development Programme (UNDP) Improving Energy Efficiency in Buildings programme has played an important role in revising the legal and regulatory framework and increasing the capacity of sector specialists to apply new standards and certifications (UNDP, 2010). In addition, several buildings, including social housing and schools, have been constructed or refurbished in accordance with the energy efficiency measure designed and financed with the support of UNDP. Such measures led, among others, to an estimated reduction in energy consumption of 58% in the respective buildings, and provide evidence of the positive impact and economic rationale of adopting insulating and energy-efficient construction techniques (UNDP, 2017).

68. Minor steps have been taken to ensure adequate enforcement of energy-efficiency regulations at the national as well as the regional level. Energy audits in buildings have become mandatory for all state-funded buildings as outlined in the governmental decree on “Energy audit procedure”. Furthermore, training has been provided to the State Urban Inspectorate, a state body that is primarily responsible for enforcing urban construction and planning requirements at national and regional level, with the support of a network of 11 territorial offices. Despite those efforts, the impact of existing polices has been reduced by a lack of nation-wide targets for energy savings in buildings, and a lack of evaluation mechanisms in the Energy Efficiency Action Plan.

69. On the financing side, several incentives have been introduced to stimulate private sector investment in energy-efficient (EE) construction, which should trigger demand for construction materials. Between 2012 and 2016, the Armenia Renewable Resources and Energy Efficiency Fund facilitated the construction of 64 energy-efficient public buildings through its own resources as well as through loans provided by the World Bank, totalling USD 10 million. The German-Armenian Fund, an instrument jointly financed by the governments of Armenia and Germany, has provided loans and grants through local banks to promote energy efficiency in private buildings. Currently, its resources include USD 20 million to loan to SMEs investing in EE buildings. Moreover, most Armenian banks have established a separate product line for EE lending, offering lower interest rates. In general, as access to finance improves for SMEs and individuals willing to invest in EE buildings, private sector demand for EE construction materials is expected to grow.

*Action 2: Promote awareness of the benefits of energy efficiency in construction*

70. Awareness-raising campaigns in the mass media and a training programme have been developed to inform the public about the potential benefits of using renewable energy, energy-saving measures and energy efficiency. Evidence collected through UNDP projects has revealed that energy consumption can decrease by up to 40-60% in buildings constructed according to energy-efficient standards. Therefore, initial investment in energy efficiency will be offset by lower long-term costs for energy consumption. In light of the government's decision to eliminate subsidies for domestic electricity retail prices in 2016, such benefits become even more relevant for end consumers. In 2014 and 2017, the Armenian government held their first and second Energy Week events, a forum covering various energy efficiency topics, including energy-saving measures in construction. Building on existing activities, the recently adopted EE action plan includes awareness-raising measures, such as social advertising campaigns and regular industry forums to be carried out by the Armenia Renewable Resources and Energy Efficiency Fund. However, no additional measures have been introduced to roll out information campaigns targeted at private consumers that are planning to build or renovate houses, which could help to further stimulate demand for energy-efficient construction.

71. Within the framework of the UNDP Improving Energy Efficiency in Buildings project, a large number of promotional and educational activities have been carried out. First, information material has been designed and distributed among experts and the general public. A database on insulation construction materials and lighting equipment produced and imported in Armenia was updated in 2016, and a catalogue of energy-efficient replicable design options for residential building has been made publicly available to serve as a good practice guide for architects and engineers. In recent years, the UNDP has also organised several training programmes and competitions for Armenian journalists to provide adequate information on energy efficiency issues, which

increased media coverage of the topic. Further capacity-building activities were organised for engineers, construction companies, and other specialists (UNDP, 2016).

72. Lastly, steps have been taken to make energy efficiency and the training of relevant specialists an integral part of university curricula. The National University of Architecture and Construction introduced ten different modules on energy efficiency issues in its curriculum. A textbook on “green architecture” in the Armenian construction sector has been published and integrated into university teaching. Furthermore, the government seeks to promote energy efficiency studies in research and education through the introduction of master programmes on energy efficiency and mandatory training for different professions, such as construction specialists (GoA, 2017b).

73. Going forward, the government could build on recent efforts to promote the benefits of energy-efficient construction and extend awareness-raising activities beyond industry and research audiences to target individual consumers and households as well. This should also include the promotion of existing financial investment incentives.

*Action 3: Streamline procedures for obtaining construction permits*

74. The government has taken important steps to streamline the procedures required to obtain construction permits. This has helped to alleviate administrative burdens, one of the key factors impeding investments in the construction sector. As reported by the World Bank Doing Business report, in the last three years Armenia has reduced the number of procedures by three to 19 in total, which remains twice as high as international best practice (World Bank, 2017b). Furthermore, the government created a one-stop shop in Yerevan to centralise the issuance of construction permits and set up an online system to file applications, reducing time for applicants and ensuring transparency throughout the process. However, the government of Armenia should aim to improve its ranking in the World Bank Doing Business report.

75. While construction one-stop shops outside Yerevan do not exist, the government could consider setting up similar offices to reduce the time and administrative costs required to engage in construction activities and remove some of the barriers hindering the sector’s growth in Armenia’s regions. As the user base of the new online system grows, additional information could be conveyed to construction companies – such as upcoming industry events and updates on relevant regulations.

*Action 4: Enhance export intelligence and promotion*

76. Given the small size of the domestic economy, foreign markets could be explored as an additional source of demand for Armenia’s high-value construction materials. The newly established Development Foundation of Armenia (DFA) has been created under the Ministry of Economic Development and Investments (MoEDI) as the main body responsible for designing and implementing export intelligence and promotion activities.

77. The DFA provides a wide range of services such as training, networking and marketing events, as well as co-funding for certification, to exporters and firms that plan to start exporting – though as yet, without a sector-specific approach. Also, no export intelligence is provided to firms operating in the construction materials sector. In this respect, a diligent analysis of potential export markets – including a database on foreign firms operating along the construction value chain – could help domestic firms determine export partners and increase their participation in global value chains. A closer look should be taken at neighbouring markets such as Georgia and Iran, where the construction

sector is growing; these will be better linked to the Armenian market due to the extensive transport infrastructure projects that are planned or taking place.

***Recommendation 2 – Attract FDI: a new approach to investment promotion***

78. In recent years, the Government of Armenia has paid increasing attention to attracting and promoting investment. The creation of the Development Foundation of Armenia in 2015 substantially helped to tailor and streamline state efforts towards attracting investment. A first Investment Forum was organised in New York in October 2016, to engage Armenia’s large diaspora community in investment activities and promote the country among international investors. Signalling the importance of investment attraction in the government’s agenda, the prime minister has established the Centre for Strategic Initiatives. This public-private body is tasked with analysing and aligning existing government strategies in order to attract long-term sustainable investments and increase Armenian exports.

***Action 1: Upgrade investment promotion with a stronger sectoral approach***

79. The Development Foundation of Armenia was established with a mandate covering three policy areas: investment services and aftercare; export promotion; and tourism promotion. As of April 2017, the DFA was provided with an annual budget of USD 1 million and 45 staff members. The investment department has a capacity of ten staff members, three of whom are responsible for setting up and operating aftercare services. The EU twinning project, “Strengthening the investment promotion and investment policy institutional framework of Armenia”, in co-operation with Business France, has provided significant input to improve DFA’s investment promotion activities and to establish aftercare services. Currently, however, the agency is restructuring significantly to reorient its focus on attracting investment and developing sound business cases for foreign investors. According to the new Government Programme of the Republic of Armenia 2017-2022, adopted in June 2017, the government intends to build the agency’s capacity to develop sound investment programmes according to international standards. In light of this, the DFA is expected to operate as a one-stop-shop for existing and potential foreign investors by the end of 2017 (GoA, 2017a).

80. Since the creation of the DFA, the palette of investment promotion measures has significantly increased. The DFA has identified eleven priority economic sectors to optimise sectoral expertise and deliver tailored information to potential investors. Reports designed in co-operation with the respective ministries for each sector are available online and include basic parameters and key potential investment areas. The mining sector is one of those priorities, and presents basic information on the construction materials sub-sector.

81. The DFA team offers a comprehensive range of free services to interested foreign investors, including market intelligence and analyses of investment opportunities. The aftercare department is also responsible for providing developmental support to retain investors in the country, and to encourage expansions and follow-up investments. In addition, the department is concerned with arranging ad hoc visits and interactions between prospective investors and high-level government representatives. Such interactions could help raise awareness at the highest political level about key barriers faced by investors, and reflect political commitment to support the DFA’s activities.

82. In February 2017, the Ministry of Economic Development and Investments established an online database (<http://investmentprojects.am>), which featured more than

35 investment projects at the time of writing. The list of advertised projects covers different economic sectors, including construction materials, and provides dedicated investment plans. Whereas the Ministry's database seeks individual investors for specific projects, the DFA follows a more holistic approach in endorsing the country as an investment destination.

83. The government has adopted a new investment policy concept under the current Government Programme 2017-2022. The government aims to apply a more target-based approach to create concrete business cases and complement efforts to improve the investment climate. Five sector strategies are to be implemented by the end of 2020 with respective background reviews; SWOT (strengths, weaknesses, opportunities and threats) analysis and value propositions have already been prepared. The new approach pays particular attention to strengthening bilateral relations with MNEs. Additional activities are dedicated to investment image-building, developing practical approaches to economic diplomacy and supporting Armenia's accession to the OECD FDI Regulatory Restrictiveness Index, which measures statutory restrictions on foreign direct investment. The government is also currently developing an FDI strategy. Sectoral targets, as well as a monitoring and evaluation system, will ensure effective implementation of the strategy that should eventually lead to the successful creation of business cases. Essential support in this area is provided by the International Finance Corporation's Armenia Investment Climate Project II (IFC, 2017) and the EU twinning project, "Strengthening the investment promotion and investment policy institutional framework of Armenia". At the beginning of 2017, the Government of Armenia established the Centre for Strategic Initiatives Foundation to consolidate and analyse government-wide reform efforts in attracting long-term FDI. One of its tasks will be to review and provide inputs to elaborate the draft FDI strategy, which will substantially contribute to streamlining and evaluating existing investment promotion activities.

84. Despite the significant progress achieved, and in light of the DFA's current restructuring, some shortcomings need to be addressed in order to increase the impact of existing policy measures. Services of the newly established DFA are manifold, yet partially fall short of effective implementation. Current DFA activities mostly react to potential investors enquiring about specific opportunities, rather than pro-actively approaching businesses that could be a good fit for sectoral targets and might be interested in investing in Armenia. Based on a thorough market analysis, the DFA needs to identify the country's competitive advantages by sector, and directly sell it to potential investors. Furthermore, the DFA investment department lacks sufficient capacity to fulfil the extensive range of activities and requests from potential investors, local SMEs and other government bodies. In addition, the government could consider facilitating more projects requiring smaller investment volumes, thus broadening the range of potential investors to include companies with lower financial resources than large established enterprises. Lastly, investment promotion activities are currently carried out by different state institutions. This has led to fragmented public investment promotion efforts. In future, existing initiatives should be co-ordinated to benefit from synergies and pool resources from relevant stakeholders. With the adoption of a new investment policy concept the government has already taken crucial steps to start addressing those challenges.

*Action 2: Devise actions to target diaspora investors, with a pilot in construction materials*

85. The Ministry of Economic Development and Investments and the Ministry of Diaspora have forged horizontal links to build synergies in the field of investment promotion. Within the Ministry of Diaspora, a new unit has been established to spur investment activities among influential Armenian diaspora members. Its activities are supervised by a Working Group comprised of representatives from different ministries and government agencies, such as the Ministry of Economic Development and Investments, the DFA and the Small and Medium Entrepreneurship Development National Centre (SME DNC). Furthermore, information on investment statistics and opportunities is conveyed on an ad hoc basis among diaspora members through the Armenian trade network, consisting of Armenian chambers of commerce abroad. Investment brochures by the Ministry of Economic Development and Investments, as well as descriptions of potential investment projects, are also distributed among the large diaspora community through the trade network to improve awareness of investment opportunities in Armenia.

86. Several networking and matchmaking events have been organised to engage Armenian diaspora members in different countries. In October 2016, the DFA organised an Armenia Investment Forum in New York. As the largest Armenian investment promotion event of the last ten years, it aimed to increase awareness of the country and its economic potential among US-based investors. During the forum, several presentations focused on high-potential sectors of the Armenian economy, including specific investment opportunities featuring Armenia's competitive advantages. A similar investment forum took place in the United Arab Emirates (UAE) and another is planned in Lebanon, building on increasing trade relations between Armenia and the two countries. The forum in the UAE resulted in three investment projects being signed, including one on renewable energy and two on developing the organic food sector. In addition, business missions are planned to facilitate targeted matchmaking between foreign investors and Armenian businesses. Under the framework of the EU twinning project, Business France has helped to organise a business mission to France. Meetings with 25 French businesses from different sectors eventually led to six signed projects. Based on this successful experience, the DFA currently appoints representatives abroad, also in order to leverage links with high-level diaspora members.

87. Last year's investment forum in New York was an important first step to proactively engage the diaspora community in investment activities. However, these initiatives have lacked strategic goals, such as targets for the number of diaspora members attracted, projects implemented through diaspora engagement, and formal outreach mechanisms. Future activities should be organised according to explicit targets, such as the number of business meetings held and agreements made, in order to increase and quantify their impact as well as their return on public expenses. The government of Armenia should work with diaspora members as partners in developing contacts to key companies and in sourcing new investment and business opportunities.

### **Box 3. Armenia's legislative framework for investment promotion**

The legislative framework for investment attraction is currently being revised to modernise and strengthen foreign investors' rights. The existing Law on Foreign Investment dates from 1994 and covers a set of basic rights for foreign investors. However, the law does not include essential protection mechanisms for foreign investors, such as the principle of Fair and Equitable Treatment that ensures a due process for investors, protecting them against discrimination by incorporating transparency principles and providing guarantees against denials of justice. A new FDI law will be drafted by the end of 2017. It captures key World Trade Organization trading principles, such as the national treatment and most-favoured-nation treatment; specifies guarantees; and provides mechanisms for dispute settlement for foreign investors.

A law on free economic zones (FEZs) was adopted in 2011, providing tax and customs exemptions within existing FEZs. It will still have to be updated to align its framework with the requirements of the Eurasian Economic Union, of which Armenia became a member in 2015 (World Bank, 2015). Improvements to the existing law will be finalised by the end of 2017.

### ***Recommendation 3 – Increase SME capabilities to create linkages with foreign investors***

88. Although no specific FDI-SME linkage programme has been designed and implemented, initial steps have been taken to bring together foreign investors and local SMEs. The DFA helps foreign investors to find adequate investment projects in Armenia on an ad hoc basis and, further, offers training to Armenian SMEs to improve their absorptive capacity to benefit from FDI.

#### *Action 1: Design an FDI-SME linkage programme, with a pilot in construction materials*

89. No specific support programme has been developed to create linkages between local SMEs and foreign investors. Beyond an online database of investment projects, there is no sectoral information about SMEs that could enter into business linkages with investors as suppliers of intermediate inputs or service contractors. Furthermore, no tailored tools to match foreign investors with local SMEs have been put into place, such as joint product development, supply-chain financing or technology transfers, which would help local SMEs better integrate into regional and global value chains.

90. The DFA's investment department, however, has increased efforts to match potential foreign investors with local SMEs, providing examples of potential Armenian business partners based on investors' individual requests. For instance, the DFA helped a German chemicals producer to invest in manufacture dispensers by Armenian SMEs. Furthermore, the establishment of an aftercare department in the DFA significantly helped to upgrade services for investors and thus spur re-investment and expansion of existing projects. In this respect, the DFA offers a comprehensive ad hoc analysis of the Armenian context to identify ways for foreign firms to re-invest or expand their activities. Efforts to strengthen SMEs' absorptive capacity are limited to training provided by the DFA, in response to requests from business unions and sectoral associations seeking to obtain sectoral expertise from industry experts. Going forward, a comprehensive database

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of existing local suppliers and business service providers should be established. An overall closer co-operation between the DFA and private consulting companies and educational institutions could help to promote the use of business development services among SMEs and improve direct services provided by the DFA.

91. Going forward, existing training should be redirected and take into consideration foreign investors' needs and an analysis of corresponding skills gaps in the SME sector. Business case study research should be conducted to understand factors that motivate MNEs to make investment decisions and to learn about the main drivers of their sourcing strategies. Furthermore, a pilot programme to link multinational enterprises and SMEs in the construction materials sector remains an option to develop the sector, and provide a blueprint for future support programmes to be implemented in other sectors of the economy.

#### **Box 4. Investment promotion in Ireland and linking Irish SMEs and foreign investors**

Best practice examples of successful investment promotion from Ireland have been shared with Armenian policy makers throughout the monitoring exercise. Ireland has been one of the most successful OECD member countries in attracting high-quality FDI, leading to the economy's development and more jobs in the country. About 3 300 companies operating in Ireland are foreign-owned, of which one third are clients of Ireland's inwards investment promotion agency, IDA Ireland. The agency has been implementing Ireland's FDI promotion and development since 1994. Today, foreign-owned companies in Ireland contribute to 10% of employment, 64% of national exports and spend on average EUR 1.4 billion on research and development.

Ireland's investment policy framework follows clear objectives including strategic targets for source markets, selected growth sectors and priority modes of FDI that the country aims to attract. Ireland's investment policies are based on a horizontal approach covering a wide range of different policy areas, such as a sound regulation framework to create an enabling and stable business environment. Furthermore, policies to increase the competitiveness of Irish companies through skills development increase the economy's attractiveness to foreign investors. Targeted cluster policies have been developed in order to more specifically improve the ecosystem for key economic sectors.

The IDA is leading the country's investment promotion activities. Its portfolio covers a wide range of activities, such as information provision for potential investors on the country's competitive advantages; creating and promoting a positive image of the country; direct selling of investment projects and developing unique selling propositions; and eventually facilitating investment projects. In order to ensure sustainable investment, the IDA continuously monitors investment projects and provides aftercare services to retain investment or initiate reinvestment. IDA further helps create linkages between foreign investors and domestic businesses to facilitate the development of positive spill-overs from FDI, including knowledge and technology transfer. In doing so, the agency seeks to pro-actively approach multinational enterprises as well as domestic firms, in order to become a regular investor and export partner facilitating project negotiations and implementation. IDA's activities follow a target-driven approach. Between 2010 and 2014 it aimed to help create 10 500 new jobs, 640 investments and 20% of greenfield investments from emerging markets.

In 1986, the National Linkage Programme was established to root FDI in the local economy and support the creation of a competitive supplier base for foreign investors. Based on in-depth sector analysis, as well as foreign investors' and SMEs' needs analyses, the IDA helped to develop new domestic suppliers for FDI companies and to increase the capacity of existing supplier networks. To bring together SMEs and foreign investors, the IDA organised networking events and business-to-business meetings. As a result, after one year the average annual sales of 51 previously identified Irish companies grew by 71%, output per employee by 42% and company employment increased on average by 14%. The programme has now been replaced by the Global Sourcing Initiative, a joint programme of the IDA and Enterprise Ireland, the country's entrepreneurship development agency. The initiative's success is based on strong political support, as trade and investment missions are regularly accompanied by Irish representatives at minister level. Meetings and networking events still represent the core activities to link Irish companies with multinational enterprises. Since the Global

Sourcing initiative began in 2012, 21 new contracts have been secured by Irish companies valued at EUR 10.5 million.

*Source:* IDA Ireland (2017), Murphy (2017)

## The way forward

### *Guideline 1: Increase private investment in energy-efficient construction*

92. Private investments in energy-efficient construction are critical to increasing the demand for construction materials in the long term. The government could help to promote SMEs' use of financial investment incentives on energy efficiency from local banks or donor-sponsored funds. An increased knowledge and awareness about the economic benefits stemming from energy-saving construction would be an additional driver for private investment. As such, media campaigns and promotional activities should be further supported by the government.

### *Guideline 2: Improve co-ordination of existing investment promotion activities and ensure effective implementation of the new FDI strategy*

93. The new investment policy concept, FDI law and strategy provide an opportunity to rationalise and co-ordinate investment promotion activities and SME development programmes across ministries and government bodies. In particular, the MoEDI should promote policy consistency and ensure that the relevant agencies contribute to various government efforts according to their mandate. To do so, an effective implementation of the newly designed investment policy concept is critical. Further, the upcoming FDI strategy should outline dedicated monitoring and evaluation mechanisms based on key performance indicators that help assess the existing investment promotion activities and, in particular, the agency's effectiveness – and suggest areas for improvement.

### *Guideline 3: Develop a co-ordinated strategy to strengthen SME capabilities to attract FDI*

94. The MoEDI should consider facilitating linkages between SMEs and foreign investors by helping to co-ordinate the activities of the two agencies, SME DNC and DFA. Based on identifying a priority economic sector, a first step would be to design supplier development programmes in co-operation with universities and training providers to upgrade local SMEs' capabilities and enable them to become potential business partners with foreign investors. Following this, a dedicated linkage programme to match FDI with local SMEs could be developed, e.g. through internship schemes, secondments, supply and financing schemes or matchmaking events. The programme should identify investors that could generate positive spill-overs to domestic SMEs and complement this with training and information services provided to high-potential SMEs. In addition, the DFA should actively assist Armenian firms to negotiate for beneficial partnership agreements with foreign investors. The programme's successful implementation depends on clear-cut targets, e.g. companies contacted, companies met, company projects identified, site visits to Armenia, suitable site locations identified and eventually projects agreed.

**Figure 4. Suggested implementation roadmap: The case of construction materials**

Recommendations	Indicative implementation timing		
	Short term <1 year	Medium term 1-3 years	Long term >3 years
<b>GUIDELINE 1</b>  <i>Action 1:</i> Develop promotional activities on economic benefits for energy-efficient construction			
<b>GUIDELINE 2</b>  <i>Action 1:</i> Develop key performance indicators, monitoring and evaluation mechanisms for FDI strategy			
<b>GUIDELINE 3</b>  <i>Action 1:</i> Develop supplier development programme  <i>Action 2:</i> Develop FDI-SME linkage programme  <i>Action 3:</i> Monitor and evaluate programmes			

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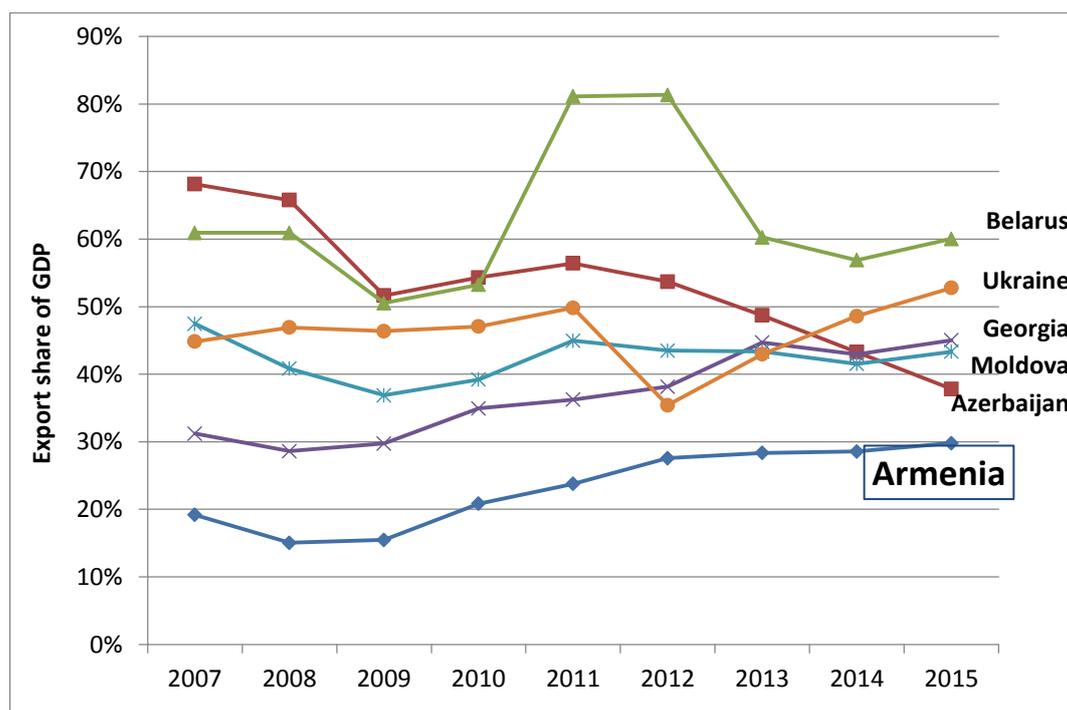
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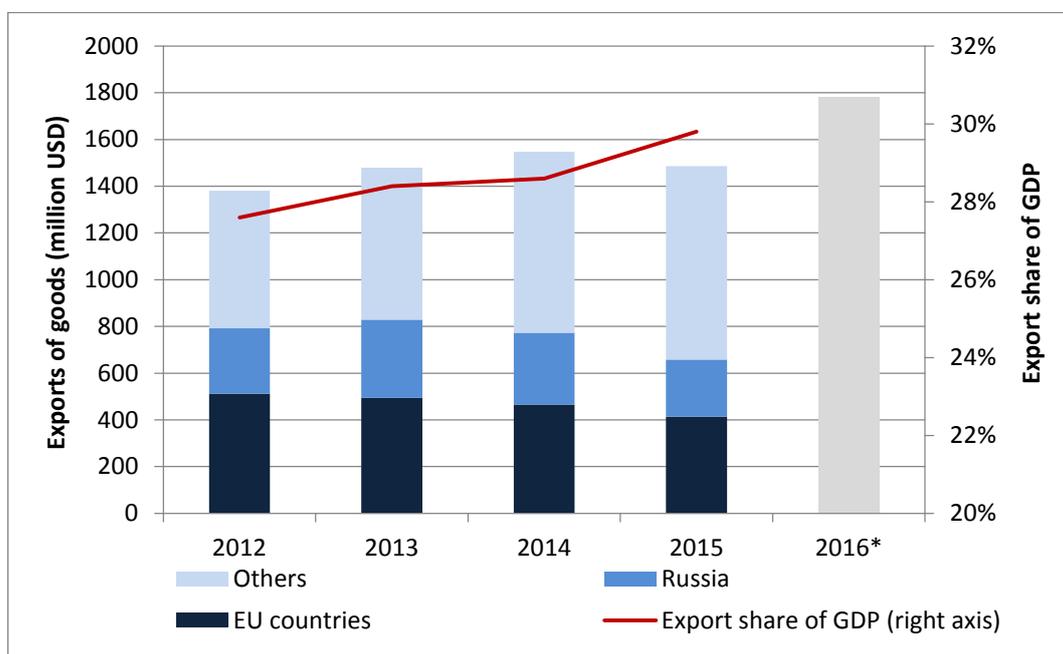
## Annex A. Tables and figures

Figure A.1. Exports from Eastern Partner countries



Source: World Bank (2017a), *World Development Indicators* (database), <http://data.worldbank.org> (accessed 10 May 2017).

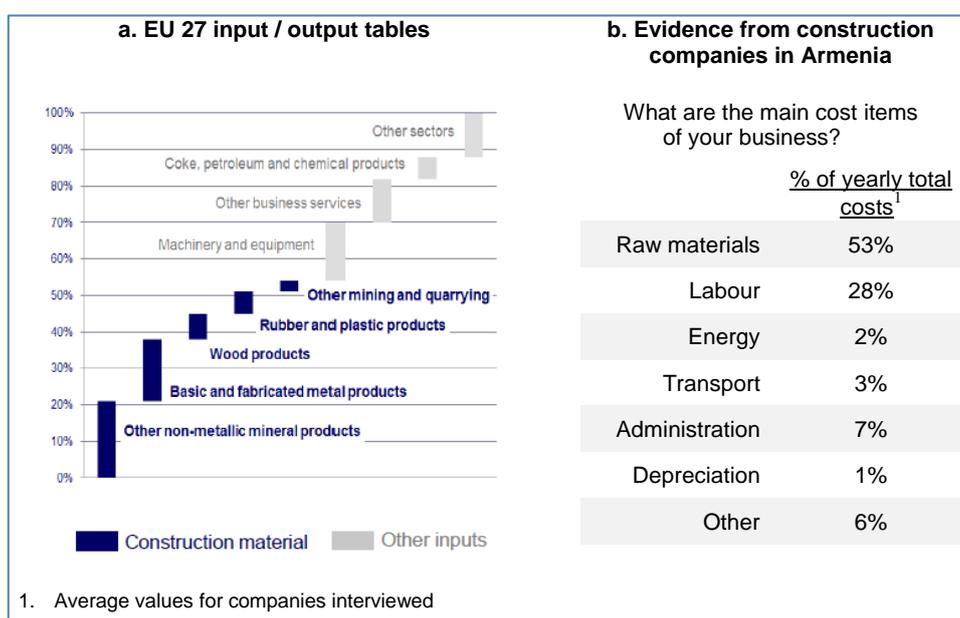
Figure A.2. EU remains Armenia's main export partner



Note: \*Only data on total exports available.

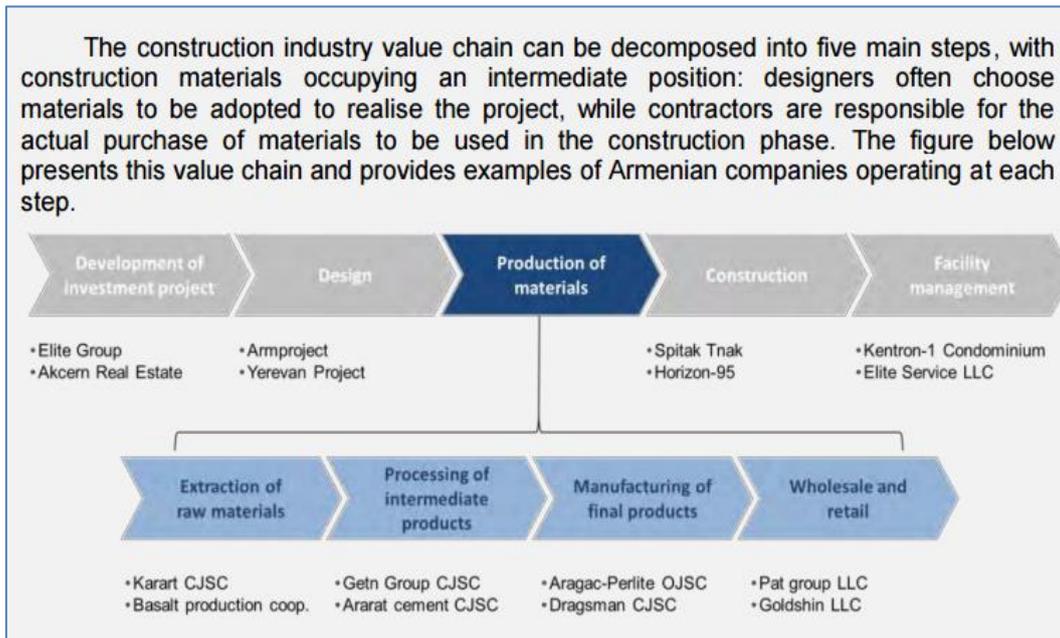
Source: Armstat (2016a), *Statistical Yearbook of Armenia 2016*, National Statistical Service of the Republic of Armenia, Yerevan, [www.armstat.am/en/?nid=45&year=2016](http://www.armstat.am/en/?nid=45&year=2016).

**Figure A.3. Materials' share of construction input costs**



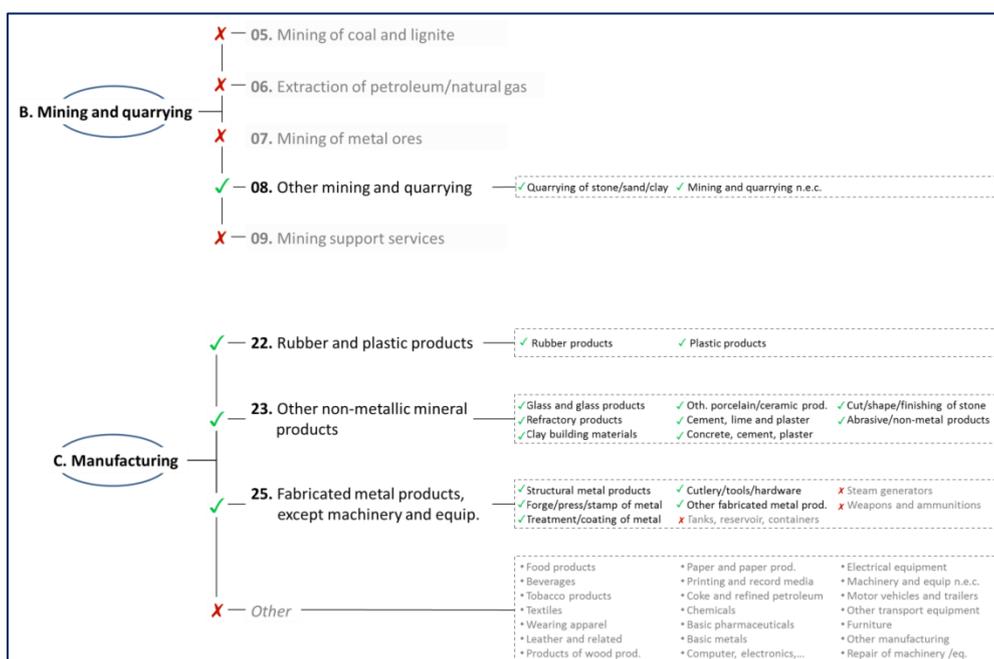
Source: OECD analysis of Ecorys (2012), *FWC Sector Competitiveness. Studies N° BI/ENTR/06/054: Sustainable Competitiveness of the Construction Sector, Final Report*, Ecorys Research and Consulting, Rotterdam; ERDSC (2014b), "Private sector survey of Armenian construction materials companies", internal working document for the OECD, ERDSC, Yerevan.

**Figure A.4. The construction value chain decomposed into five main steps**



Source: OECD analysis; ERDSC (2014a), “Market overview of the construction materials industry in Armenia”, ERDSC, internal working document for the OECD, Yerevan; Habitec (2014), “A cluster experience in green building and renewable energy”, presentation at the OECD capacity-building seminar Enhancing SME Policies in the Eastern Partner Countries, Trento, Italy, 19-22 May 2014.

**Figure A.5. Classification of construction materials by economic activity**



Source: Eurostat (2008), *NACE Rev. 2: Statistical Classification of Economic Activities in the European Community*, Eurostat, European Commission, Brussels; ERDSC (2014a), “Market overview of the construction materials industry in Armenia”, internal working document for the OECD, ERDSC, Yerevan.