

## PUZZLE OF ECONOMIC GROWTH: IN THE TRAILS OF CONSTRUCTION

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**Key words:** *economic growth, construction, crisis, uncertainty, income tax*

*The final issue of the series focuses on the construction sector. Throughout the history of independence, events in the RA economy forced us to re-evaluate and re-assess the role of this fundamental factor in economic growth, which led to economic booms and, conversely, sharp declines. The paper explores the construction sector's role in the economy, its development, and expectations. It also seeks to identify the vulnerabilities of construction within the framework of both uncertain and certain future scenarios.*

In the previous issue of the paper series<sup>1</sup>, we emphasized that Armenia faced various waves of economic crises throughout its independent history, which have left their mark on the economy. Each crisis has been a unique lesson for our economy, resulting in a chain of periodic restructuring, role redistributions, and movements in the structure of the economy.


One of the similar crises both in the global economy and in Armenia directly stemmed from the construction sector. The result of the latter was the registration of an economic record among the CIS countries - a double-digit decline, the consequences of which the RA economy suffered in the following period. The period following the crisis of 2008-2009 in the RA economy can be considered a period of “fear of construction”, when the sector’s weight in the economic structure first declined sharply and then continued to decrease at a relatively slow pace. The role of the construction



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<sup>1</sup> Petrosyan N., Puzzle of Economic Growth". In the Trails of Agriculture, Amberd, N4, Yerevan, Economist, 2024, <https://asue.am/upload/files/amberd/2024-year-4/2.pdf>

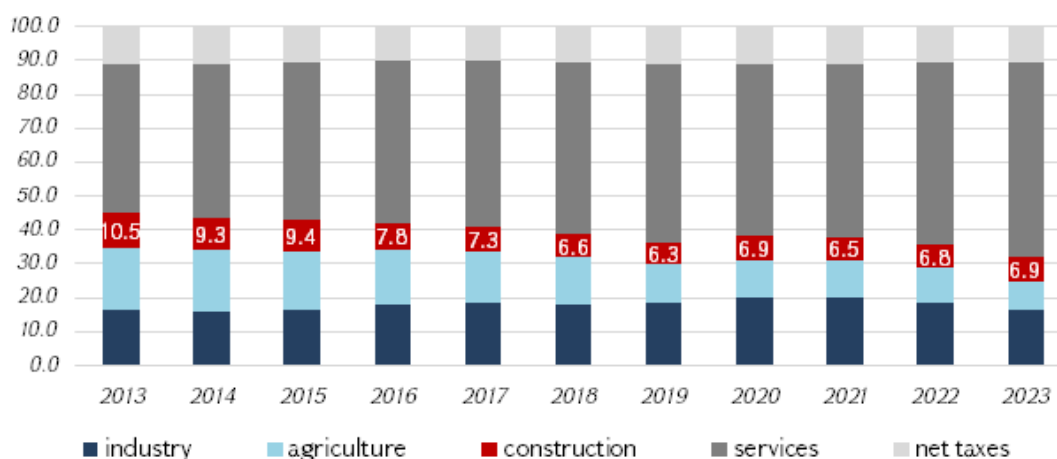


FIGURE 1

### Development of the structure of the Armenian economy, 2013-2023<sup>2</sup> (%)

sector in the Armenian economy has gradually begun to be revalued, especially in the last two years. Moreover, the latter's weight in the economic structure has stabilized at around 7% (Figure 1).

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Looking at the economic growth of Armenia, we can see that the role of construction continued to remain stable in 2024, with some acceleration, unlike other sectors of the economy, whose growth and economic role are continuously subject to role

redistributions. While such high double-digit growth in construction is essential for the economy and promises short-term stability in the developments of the sector, it must be stated that this growth will eventually, at best, slow down and fade away, or at worst, lead to a new crisis.

#### *After all, what will be the turning point for the growth of construction?*

It is impossible to answer this question unequivocally, especially when the palette of opinions among experts is quite rich: from stable growth to the alarm of a new crisis. Our version of the answer to this question stems from the study of development and expectations of economic growth, construction, and sectors related to it.

As can be seen from Figure 2, the role of construction in the economy has stabilized and demonstrated a growth trend in subsequent quarters, and this change in the role occurred mainly due to a decrease in the role of other industries, even in the case when Armenia is experiencing a continuing trend of slowing economic growth. At the same time, when we look at the indicators of the output of the construction industry (Figure 3), we notice that in the first 10 months, the vast

<sup>2</sup> RA Statistical Committee. Other databases. National accounts, <https://armstat.am/file/doc/99547248.xls>

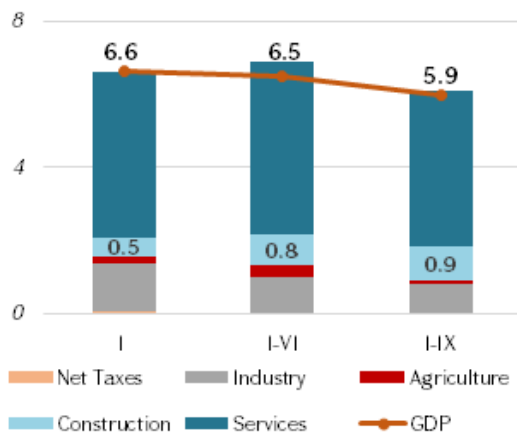


FIGURE 2

**Real GDP growth by sector and contributions<sup>3</sup>(%)**

majority of construction was financed by the population, and then by the state budget. And here the role of construction financed by organizations has been constantly decreasing, or, in other words, developers who have been rapidly erecting apartment buildings and houses in the past 10 years, especially in the capital, have slowed down this year, although they are gradually recovering.

#### *Where to look for signs of growth?*

The construction boom in the RA, particularly in Yerevan began in 2015-2016 with the launch of the income tax refund program. In other words, the program that contributed to the excessive activation of construction is now aimed at freezing it by terminating the income tax refund program in Yerevan. This can be explained by the fact that, as a rule, the duration of an urban development project is 2-4 years, and in the case of a gradual termination of the income tax program, in the case of the implementation of a new urban development project, the liquidity of new buildings for developers is questionable due to a possible decrease in demand. This circumstance leads to a revision of the investment plans of developers, which in some cases makes the industry less attractive, which is another alarming signal in terms of

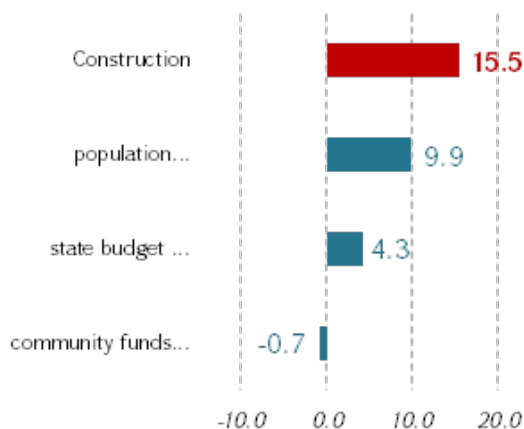


FIGURE 3

**Construction output growth (%) and contributions (2024, January-October)<sup>4</sup>**

emerging economic risks. The construction sector is directly linked to the real estate market, global economic events, geopolitical uncertainty, and various legislative changes that have left their mark on the latter at different stages of the historical construction cycle.

#### *The "shifting" picture of the real estate and construction market.*

The real estate market of Armenia has found itself at the center of discussions and debates for various reasons. The picture is as follows: in October 2024<sup>5</sup>, the number of state registration transactions for real estate rights increased by 11.6 percent, with 29.2 percent of transactions occurring in Yerevan alone. At the same time, there is an increase in transactions in the marzes, both in urban areas (25.9%) and in rural areas (9.5%), which is a particularly positive factor. The trend in terms of mitigating the problems of uneven territorial development is reflected in the structure of transactions. Expropriation transactions had a high weight - about 36.2 percent, and primary registration transactions also increased significantly - 16.8 percent. Transactions for the purchase of land (40.1%) and apartments (24.4%) predominate. They increased by 16.4%, while transactions carried

<sup>3</sup> RA Statistical Committee. National accounts. Gross domestic product, annual, <https://armstat.am/am/?nid=202>

<sup>4</sup> Socio-economic Situation of the Republic of Armenia in 2024. January-October, <https://armstat.am/am/?nid=82&id=2702>

<sup>5</sup> Real Estate Market Analysis, October 2024, <https://www.cadastre.am/storage/files/102024.pdf>

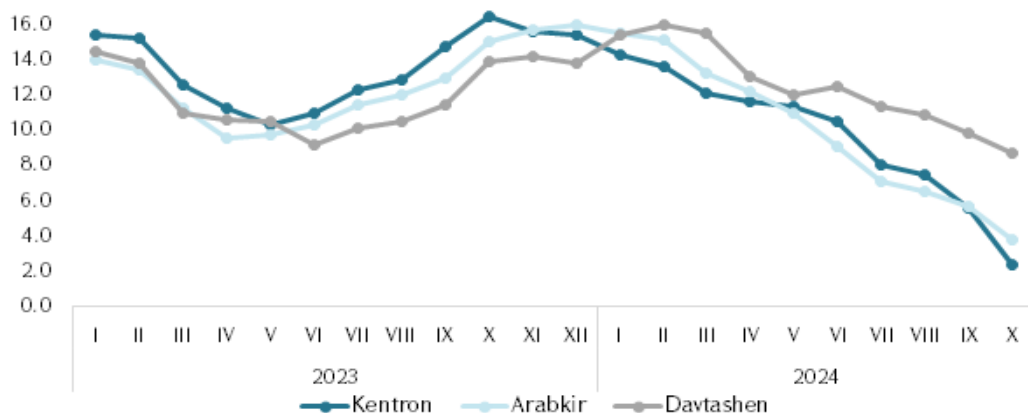


FIGURE 4

### Average market prices per 1 square meter, 2023-2024<sup>6</sup>(AMD)

out in the direction of land (41.6%) and apartments (28.5%) have priority over the results of completed construction, that is, after the issuance of the certificate of completion of work and state registration of the object property rights, this is reflected in purchase and sale transactions. That is this increase in transactions. is deceptive and reflects the activity of previous years. The real picture of current market activity will become clearer in 3-4 years.

Changes in the pricing sphere are also unpredictable and sometimes indistinguishable. Over the past 3 years, market prices for apartments have been growing at an extremely fast pace. The problem is especially acute in the Kentron administrative district, where apartment prices have recorded an annual increase of 300,000 drams over the past 3 years rising from 633,000 AMD in 2021 to 906,000 AMD in the first 10 months of 2024. The increase in apartment prices has also been observed in the regions, but this growth is mainly concentrated in cities considered large or tourist centers: Tsaghkadzor, Abovyan, and Vagharshapat, which is primarily due to the duration of the income tax refund mechanism. Since each taxpayer can use the program only once, this contributes to some stabilization of prices in the market.

*What does this mean and what can we expect?*

To address the problems of the construction sector and its impact on the real estate market, it is essential to have a clear understanding of this market. However, the real estate market in Armenia is highly unpredictable in this regard, which is also tied to methodological and regulatory issues. Perhaps the most striking example was the noise caused by rental transactions in the previous 2 years when there was a significant influx of foreign citizens. This was not accompanied by an increase in rental transactions, which points to significant problems in terms of market regulation. Some steps are currently being taken in this direction, for example, a fine of \$5 of the cadastral value of the property is levied for failing to register rental transactions but not more than 500,000 AMD. If a similar violation is detected for the second time, the amount will increase to 10% with an upper limit of 1,000,000 AMD. This serves as a deterrent instrument that allows for a certain degree of market regulation. However, in this case, priority is given to improving the control mechanisms for identifying hidden transactions, which is quite difficult. Another problem is related to the risks of possible market overheating. Overheating at some point may develop into a crisis, engulfing the real estate market, the banking system, and construction companies, as well as the entire construction sector and its segments.

<sup>6</sup> Real Estate Market Analysis, October 2024, <https://www.cadastre.am/storage/files/102024.pdf>

However, the risks of overheating of the real estate and mortgage lending markets are interconnected. First of all, they arise due to an unjustified increase in mortgage volumes, which stimulates inflated real estate prices. To put it more figuratively, one might say the real estate market has become a "plague" for the state budget. As a result of the application of the income tax refund mechanism, the growth of mortgage lending has stopped. The last 5 years have been accompanied by an increase in real estate prices, which exceed the volume of mortgage lending, a result of excessive growth. As a result, in 2021 approximately 36 billion drams were paid from the state budget under the mortgage interest repayment program, in 2022 this amount rose to 52 billion drams, in 2023 it reached around 80 billion drams, increasing the burden and pressure on the state budget. Another question is how well the program has fulfilled its task. Now as the program is gradually approaching its logical conclusion, we must ask: Are the results satisfactory. Do the significant costs incurred truly reflect its social impact and importance?

#### *How and why did the demand of the future appear in the present?*

To answer this series of questions, we need to think about what changes can be made to the existing legal norms, what developments in the main macroeconomic indicators can be expected, and finally, how the societal expectations affect the developments in the construction industry?

The income tax refund program was initially available in Yerevan, and then expanded to the regions. As a result, by the end of 2024, all those who have not yet taken advantage of the program will, at best, try to purchase housing on the primary market, not missing the last opportunity to directly transfer a significant part of future demand to the market. This can help support both the real estate market and construction activity in the coming years.

On the other hand, new, significantly increased local fees and duties were introduced for builders in Yerevan<sup>7</sup>, setting a base fee of 4 million drams and a base duty of 7 million drams, while previously developers paid only 700,000 drams to receive construction permit. To some extent, this looks like an attempt to mitigate the problems of the capital's real estate market, which has turned into a construction site as a result of the application of the income tax mechanism.

We should not forget about the resettlement of forcibly displaced people from Artsakh<sup>8</sup>, which is also another factor destabilizing the construction sector and the real estate market. By the decision of the RA government, residents of Artsakh are provided with certificates for the purchase of new apartments. This circumstance may lead to another illogical increase in prices, and the funds provided may not be enough to purchase an apartment. As a result, the market will again become unjustifiably overcrowded, and the housing problems of our compatriots from Artsakh will continue to be relevant.

In summary, it is important to note that at present there is a gap between the primary and secondary real estate markets both in price and in demand. The problem is that the primary market assumes new, better construction conditions. In addition, there is a mechanism for the return of income tax when purchasing apartments on the primary market, as a result of which it becomes more attractive to the population. The secondary market is now much more passive. If in previous years favorable external factors stimulated high activity of the secondary market, now these factors have practically disappeared, and Russian citizens who activated the market have returned home. At the same time, the developments in the construction sector indicate that we are artificially suppressing this market by using various stimulating or restricting instruments.

<sup>7</sup> RA Law "On Local Duties and Charges", December 26, 1997, <https://www.arlis.am/documentview.aspx?docid=80280>

<sup>8</sup> "On Approval of the Procedure for the Implementation of the State Support Program for Providing Housing to Families Internally Displaced from Nagorno-Karabakh" RA Government Resolution No. 898-L, June 14, 2024, <https://www.arlis.am/documentview.aspx?docid=194011>

As a result, new components are introduced (increase in administrative fees, various tax payments, and income tax refunds), which artificially maintain high real estate prices and stimulate construction. I believe that the real estate market should be able to self-regulate with minimal artificial barriers, which will curb the artificial risks that the RA economy and the construction sector are currently facing in the context of high prices, still unabated demand, and unnecessary

great structures. I sincerely hope that in the future, the construction industry will reach a point where the real estate market is no longer artificially stimulated. Instead, the self-regulation of the market and the relatively low externalities will eventually stabilize the "constantly moving prices" of the real estate market and make it possible to see a real estate market formed on the real foundations of the growth of the construction industry.

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ՆԱՐԻՆԵ ՊԵՏՐՈՍՅԱՆ  
Ասպիրանտ, ՀՊՏՀ

ՏՆՏԵՍԱՌԹՅԱՆ ԶԱՐԿԵՐԱԿ

ՏՆՏԵՍԱԿԱՆ ԱՃԻ ԳԼՈՒԽԿՈՏՐՈՒԿԸ. ԶԻՆԱՐԱՐՈՒԹՅԱՆ ՀԵՏՔԵՐՈՎ

Հոդվածաշարի եզրափակիչ այս նյութում ուշադրության կենտրոնում է շինարարությունը՝ որպես պերմանենտ աճող ոլորտ: Անկախության պատմության ընթացքում ՀՀ տնտեսությունում տեղի ունեցող զարգացումները պարբերաբար ստիպել են վերաթևոթել և վերագնահատել տնտեսական աճի այս հիմնարարի դերը՝ տանելով տնտեսական բումերի և հակառակը՝ կտրուկ անկումների:

Տնտեսության մեջ շինարարության դերի, դրա զարգացումների ու ակնկալիքների մասին է սույն հոդվածը, որտեղ փորձ է արվում թիրախավորելու ոլորտի խոցելի կողմերը՝ ապագայի անորոշ ու որոշյալ սպասելիքների գունապնակում:

**Հիմնաբառեր.** տնտեսական աճ, շինարարություն, ճգնաժամ, անորոշություն, եկամտային հարկ

Нарине ПЕТРОСЯН  
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ПУЛЬС ЭКОНОМИКИ

ГОЛОВОЛОМКА ЭКОНОМИЧЕСКОГО РОСТА. ПО СЛЕДАМ СТРОИТЕЛЬСТВА

В заключительном выпуске серии основное внимание уделяется строительному сектору. За историю независимости события в экономике РА заставили переоценить и переоценить роль этого фундаментального фактора экономического роста, что привело к Экономические бумы и, наоборот, резкие спады. О роли строительного сектора в экономике, его развитии и ожиданиях рассказывается в этой статье, где делается попытка выявить уязвимые места строительства в палитре неопределенных и определенных ожиданий будущего.

**Ключевые слова:** экономический рост, строительство, кризис, неопределенность, подоходный налог