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INCOME TAX AS A KEY REGULATORY TOOL IN ARMENIA'S CONSTRUCTION SECTOR

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Abstract

This article presents an analysis of the impact of the high income tax rate on informal employment in the construction sector of the Republic of Armenia between 2014 and 2024. Based on official statistical data, the study examines the sector's share in GDP, the dynamics of construction volumes, employment trends, and average wage indicators. The conclusion section provides recommendations for reducing informal employment in Armenia's construction sector, including suggestions for improving tax policy, simplifying hiring procedures, and strengthening enforcement mechanisms.

Keywords: Informal employment, income tax, construction sector, shadow economy, tax reform, undeclared work

Introduction

The objective of this study is to assess the impact of changes in the income tax rate and the process of its collection on the scale of informal employment in Armenia's construction sector. To achieve this goal, the following research tasks were outlined:

- Analyze the dynamics of key sectoral indicators (GDP contribution, construction volume, employment, and wages) during the period 2014–2024;
- Examine the reasons for the persistence of informal labor;
- Review changes in tax policy since 2020;
- Study issues related to the employment of foreign workers;
- Analyze the effects of limiting cash payments;
- Conduct an international comparison to identify general trends and differences;
- Develop corresponding policy recommendations.

The methodological basis of this study consists of both domestic and international academic research, theoretical approaches, and data from official publications

The construction sector is one of the most significant branches of Armenia's economy, ensuring substantial investments and providing employment for hundreds of thousands. In the pre-crisis period of the 2000s, construction played a major role in Armenia's economic growth: its share of GDP was 9.8% in 2000 and nearly 24% by 2008. However, the global economic crisis of 2008–2009 led to a sharp downturn in the sector: in 2009, the volume of construction declined by 37.4%, and its GDP share dropped to 18.4%. In the following years, the industry failed to recover its previous scale, reaching only about 10.3% of GDP by 2013.

Starting in 2020, Armenia began implementing significant tax reforms. Within this context, the flat income tax rate of 23% was gradually reduced to 20%.

At the same time, the construction sector's share in GDP declined from 10% in 2013 to 7% in 2021—a drop of 3 percentage points. However, the period from 2018 to 2024 saw an increase in officially recorded construction volumes and the number of formally employed workers in the sector. Nonetheless, informal employment in construction remains at a high level.

The experiences of other countries—such as Georgia, Poland, Germany, and Kazakhstan—demonstrate that reducing the tax burden on the sector is important but not sufficient to eliminate informal employment.

One of the key characteristics of Armenia's construction industry is the high level of informality. Many workers are employed without formal registration, labor contracts, or tax and social security contributions. For instance, according to some estimates, 58% of those employed in the sector in 2009 worked informally. By contrast, in developed countries, this indicator is significantly lower—around 4% in Germany [1], for example.

High levels of informal employment negatively affect both state revenue collection and the social protection of workers.

Tax Reforms and Sectoral Dynamics (2020–2024)

In recent years, the Armenian government has taken concrete steps to reduce the shadow economy. In 2020, a comprehensive tax administration reform (2020–2024) was launched, one of its goals being to reduce informality and increase economic efficiency [2].

A key element of this process was the introduction of a new income tax regime — transitioning from a progressive system to a flat rate and gradually reducing the tax rate. It was expected that a lower tax burden on payrolls would reduce the incentive for both employers and workers to use informal arrangements, thereby contributing to a decline in undeclared employment.

Given that construction is one of the most informal sectors in the economy, it became a primary focus of these changes.

According to classical economic theory, the scale of informal employment is largely influenced by the level of the tax burden and the effectiveness of public institutions. Higher taxes and administrative complexity create incentives for both businesses and workers to avoid official registration. At the same time, weak oversight and corruption encourage the proliferation of shadow employment. If state institutions fail to enforce legal requirements, companies may reduce costs by not registering workers — gaining a competitive advantage.

Historically, a heavy tax burden and flawed enforcement mechanisms have fostered informality in Armenia. Prior to reforms (2018–2020), the income tax system was considered burdensome and complex, encouraging tax evasion practices [3].

Informality in Armenia's Labor Market

According to the International Labour Organization (ILO), by the early 2020s more than 50% of Armenia's total employment was informal — most of it in agriculture (primarily traditional family farms). In non-agricultural sectors, informal employment made up around

15–20%, with construction and trade showing the highest informality levels. In 2009, 58% of construction workers were informally employed.

A 2013 estimate by the State Revenue Committee and independent experts placed non-agricultural informal employment at 19.7%, down from 24.6% in 2009-attributed to improved tax administration.However,a significant number of workers remained unregistered even in recent years [4].In theory, reducing the income tax rate should reduce the attractiveness of informal employment. Lower taxes mean that the gap between net informal income and taxed wages narrows.

In such conditions, informal work becomes less appealing for employees and more risky for employers. Yet empirical research shows mixed results, depending on tax enforcement capacity and the country's tax culture.

In post-Soviet states where under-the-table payments are deeply rooted, even modest tax reductions may fail to change employer behavior unless enforcement is strong. Therefore, reducing informal employment requires a comprehensive approach — combining rational tax policy, enhanced oversight, simplified regulations, and greater public trust in institutions.

Research Results

To provide a broader context, the study includes a comparison between Armenia and several countries selected for their varying tax regimes and levels of informal employment.

- Georgia – A neighboring country with a comparable economy, which transitioned to a flat income tax system earlier than Armenia.
- Kazakhstan – A member of the Eurasian Economic Union (EAEU), with a low income tax rate (10%) and significant labor migration.
- Poland – A former socialist country and now EU member that has successfully reduced informality while retaining a progressive tax system.
- Germany – A developed economy with very low levels of informality and highly effective tax administration.

The comparison includes the following indicators:

- Share of informal employment;
- Income tax rates;
- Policy measures aimed at reducing informal work.

This benchmarking approach made it possible to align Armenia's experience with international best practices and to identify effective strategies.

Statistical Overview of Armenia's Construction Sector (2014–2024)

The statistical analysis of Armenia's construction sector includes:

- Share of construction in GDP;
- Changes in construction volumes;
- Employment levels in the sector;

Growth in average wages before and after reforms.

Post-2020 Developments: Recovery, Wages, and Formalization

Between 2014 and 2019, the construction sector contributed 7–10% of Armenia's GDP. Following the 2009 financial crisis, the sector's share steadily declined — from 18% in 2009 to 10.3% in 2013, and approximately 8.4% in 2014, when output totaled about AMD 433 billion ($1.05 billion). The following years showed relative stability without significant growth.

Table 1

Key Indicators of Armenia's Construction Sector (2014–2024)

Indicator	2014 2016 2018 2020	2021 2022 2023 2024
Construction Volume (current prices, AMD)	433.2 bln	709.5 bln
Share of GDP	8.4%	7.0% (est.)
Official Employment	-	17,000 workers
Total Employment (incl. informal)	~80,000 (est.)	-
Avg. Monthly Wage (AMD)	~150,000 (est.)	376,000
Avg. Monthly Wage (USD)	~$360	~$960

Note: 2014 is treated as the baseline year prior to reforms, while 2024 represents the final year of the analyzed period. The 2014 wage level is estimated based on economy-wide averages.

A modest recovery was observed in 2017–2018; however, by 2019, construction had still not regained its pre-crisis levels (e.g., 2008: AMD 842 billion). Thus, prior to the reforms, the sector's role in the economy remained modest.

Despite economic challenges in 2020 — including COVID-19 and war — construction showed resilience due to ongoing projects and government support. While GDP fell by 7.2%, construction activity remained relatively stable. In 2021, the economy rebounded with 5.7% GDP growth and +12.5% growth in construction. This trend continued into 2022–2024: construction output reached AMD 709.5 billion (~$1.8 billion) in 2024 — a 14.5% year-over-year increase.

In 2024, the sector's share of GDP was ~7%, within a total GDP of ~AMD 10.13 trillion. Construction accounted for approximately 13.5% of total economic growth that year, underscoring its importance in post-crisis recovery.

Recent years saw a rise in private investment: in 2024, 48.3% of construction projects were financed by the private sector.The state budget contributed ~26%, while households accounted for ~20%.International loans increased by 54%, funding infrastructure such as roads and energy projects [5].

This diversification of funding sources created conditions for growth in both officially recorded construction activity and formal employment.

According to labor force studies, total employment in construction (including self-employed and informal workers) ranged between 70,000 and 80,000 in the mid-2010s. For instance, estimates placed total employment at 82,900 during that period, of which ~58% were informal — only 30,000 to 35,000 workers were formally registered [6].

Shifts Toward Formal Employment

After 2020, the situation began to improve. Data from the Ministry of Economy show that between May 2020 and May 2024, the number of registered workers in construction nearly doubled — from 9,000 to 17,000. This indicates a clear trend toward formalization.

A similar trend was observed in the food services sector, where formal employment rose from 16,500 to 31,500. Nevertheless, informality remains high: as of 2022, informal employment outside agriculture was ~15%, and in construction — 30–40%, meaning around one in three workers was still unregistered (often working in small crews, on a temporary basis, or as foreign laborers).

Wages, Informality, and the Microbusiness Regime

Wage levels in construction are a critical indicator reflecting structural changes in the labor market. Traditionally, construction wages in Armenia were lower than the national average due to the sector's seasonal nature and labor surplus.

In 2014, the average monthly wage in construction was estimated at around AMD 150,000 (~$360), compared to a national average of AMD 160,000. Many employers paid a portion of wages "under the table," which skewed official statistics.

However, following tax reforms and economic growth after 2020, the situation significantly improved. According to official data, the average wage in construction has increased steadily over the past five years:

- 2020: AMD 226,000
- 2024: AMD 376,000 (~$960) [7]

By 2024, construction wages had reached the level of banking sector salaries seen in the mid-2010s. This served as a strong incentive for transitioning from informal to formal employment.

Revenue Growth and Reform Outcomes

In recent years, income tax and social contribution revenues to the state budget have increased. According to the State Revenue Committee (SRC), construction is expected to be one of the main contributors to tax revenue growth in 2025.

Despite these improvements, a high level of informality persists in Armenia's construction sector — driven by a combination of economic, legal, and social factors. These include:

1. Historical Tax Burden:
Prior to reforms, income tax could reach up to 36% for high earners, with additional mandatory pension and social contributions. This created a cost increase of ~30% for formal wage registration, prompting many companies to avoid it and opt for informal payments — especially small, unregistered crews that could offer lower prices.
2. Seasonality and Project-Based Work:
Construction projects are often short-term. Many firms hire labor temporarily, making formal registration cumbersome or inefficient. Typically, only core staff are registered, while others are hired informally.
3. Weak Oversight:
Until recently, labor inspections at private construction sites were rare. Small companies and individual clients often avoided scrutiny. This gave rise to a culture of working "without papers," where even workers preferred full cash payments over formal contracts.
4. Semi-Legal Work Crews:
Major construction firms often subcontract tasks to small teams without verifying their legal status. Before the introduction of the microbusiness regime, registration was costly and complex for such teams.
5. Worker Behavior and Perception:
Due to historically low construction wages, many workers did not prioritize formal employment or social benefits. For many, especially newcomers or migrant laborers, formal contracts were viewed as unnecessary.

6. No Licensing Requirements:
   Unlike some countries that require licenses or certifications for construction workers, Armenia does not. Anyone can claim to be a builder and find employment without formal qualifications.
7. Foreign Labor Migration:
   Many skilled workers prefer working abroad, particularly in Russia. Those who remain are often low-skilled or young. Employers are less inclined to formally register them. Additionally, foreign laborers often work informally (discussed further below).
8. Low Trust in the State:
   Many employers and workers believe the state does not offer sufficient returns in exchange for taxes. Pensions, for example, are viewed as inadequate. As a result, many prefer immediate full payments over long-term benefits. This reflects a broader crisis of the social contract in transitional economies.

Tax Reform in Armenia (2020–2024): From Progressivity to Flat Rate

In 2020, Armenia launched a comprehensive tax reform primarily targeting personal income taxation. Prior to the reform, a progressive tax scale was in place:

- 23% for low incomes, 28% for medium-high incomes, 36% for high incomes.

In practice, however, this system incentivized shadow practices — especially among highly paid professionals and their employers. Starting in 2020, Armenia transitioned to a flat income tax rate of 23%, with a predefined schedule for gradual reductions:

- 2020 – 23%, 2021 – 22%, 2022 – 21%, 2023 and beyond – 20%

Thus, over a four-year period, the income tax rate was reduced by 3 percentage points. In parallel, the mandatory funded pension contribution gradually increased (from 2.5% to 5% between 2020–2023). However, citizens viewed this pension contribution as a personal saving rather than a loss.

Logic Behind the Reform

The government's rationale was that a simplified, transparent, and relatively low tax would ease administration and encourage formal wage reporting. Employers and employees would no longer be motivated to operate in the shadow economy.

For example, for a high-skilled engineer earning AMD 1,000,000:

- Before the reform, income tax would be AMD 280,000–360,000;
- In 2023, it was reduced to AMD 200,000.

This difference made official "white" salaries more attractive. Even for low-income workers, the savings (~AMD 3,000 per AMD 100,000 of income) could influence behavior.

Budgetary Outcomes

According to official data, the income tax rate reduction did not lead to budget losses. On the contrary, state revenues continued to grow — thanks to increased formal employment and rising wages. Reports by the Ministry of Finance confirm that the tax base expanded despite the lower rate.

This means that due to the "whitening" of the economy, the state actually benefited. These reforms were also accompanied by stronger tax administration. In collaboration with French partners, the Armenian SRC implemented the "Support for Tax Administration Reform 2020–2024" project.

Key measures included:

- Introduction of electronic payroll reconciliation tools;
- Comparison of declared payroll against sector averages;
- Joint inspections with the Labor Inspectorate at construction sites.

Inspections at construction sites began to focus on verifying the existence of labor contracts [8].

The combination of tax reduction and enhanced enforcement created dual motivation: It became cheaper to pay the 20% tax than to risk penalties (AMD 50,000–100,000 per unregistered worker).

Initial Results as of 2024:

- The number of registered construction workers had doubled;
- Income tax revenues had not declined;
- Average wages had increased by over 60%;
- SRC reports cited a clear rise in formal employment as a direct result of reforms.

Limitations of the Tax Policy and the Role of Foreign Workers

Despite the overall success of the tax reform, it is not a standalone solution. Certain groups still consider even a 20% income tax rate burdensome:

- Micro-enterprises;
- Small construction brigades.

For them, Armenia introduced the microbusiness regime — 0% tax on turnover up to AMD 24 million annually. Additional measures include raising the non-taxable minimum and adjusting social contributions.

Thus, tax reform has played a key role in reducing informality in the construction sector, but achieving full formalization requires other policy tools.

Foreign Workers in the Construction Sector: Legalization Challenges

The Armenian construction sector has traditionally attracted foreign workers, especially during the execution of large-scale projects. Over the years, laborers from China, Iran, India, and Central Asian countries have worked on Armenian sites. In recent years, there has been a noticeable increase in workers from India and Iran, particularly on multi-apartment building projects in Yerevan.

Reasons for Hiring Foreign Labor:

- Shortage of qualified domestic workers, especially in specialized trades;
- Ability to offer lower wages with fewer social guarantees.

However, these workers are often hired informally, as the legalization process involves bureaucratic obstacles and additional costs.

Legal Procedure for Work Permits (Non-EAEU Nationals). To legally employ foreign workers from outside the EAEU (e.g., India, Iran), Armenian employers must:

1. Apply via the special migration portal (workpermit.am);
2. Pass a labor market test (to prove there is no suitable local candidate);
3. Pay a state duty of AMD 105,000 (~$270) per worker.

Permits are usually valid for 1 year and must be renewed with additional fees. Workers from EAEU countries (Russia, Belarus, Kazakhstan, Kyrgyzstan) are exempt from these requirements.

Why Employers Avoid Formal Hiring:

Small and medium-sized construction firms often avoid the official process due to its cost and complexity — especially if the worker is needed only for 2–3 months.

As a result, employers choose informal paths:

- Workers enter Armenia as tourists or visa-free visitors (where allowed);
- They work without registration until the visa period expires;
- Some later attempt to legalize their status, often through loopholes (e.g., registering as "students" or "interns").

Cash Payment Restrictions and Their Effects

Restricting the use of cash has shown effectiveness as a tool for reducing the shadow economy. However, it has also created new challenges — namely, the emergence of redesigned avoidance schemes. To counter these developments, the state must invest in analytical and technological tools to detect and prevent fraudulent transactions.

International Perspective: Informality and Tax Policy

Shadow employment is a global issue, but its scale, causes, and government responses vary by country — depending on institutional development, tax culture, and enforcement capabilities.The table below presents a summary comparison between Armenia and selected countries. Notably, high tax rates do not necessarily hinder the functioning of a formal labor market when accompanied by strong social guarantees.

Table 2

Comparative Overview

Country	Income Tax Rate	Informal Employment (Total)	Informality in Construction	Characteristics
Armenia [9]	20% (flat)	~35%	~30–40%	Stronger enforcement, microbusiness regime
Georgia [10]	20% (flat)	~30%	~30%	Simplified administration, digitalization
Kazakhstan [11]	10% (flat)	~35%	~40%	Weak oversight, corruption
Poland [12]	17–32% (progressive)	~12%	~15%	Licensing, high minimum wage, labor rights
Germany [13]	Up to 45% (progressive)	~5–6%	~10%	High public trust, strong enforcement

Conclusions

The tax reforms implemented in Armenia's construction sector — particularly the reduction in income tax rates and simplification of tax administration — have had a positive impact on reducing informal employment. However, these results are not sufficient to significantly lower the scale of undeclared work.

Key conclusions and recommendations include:

1. The construction sector has historically been a hub of informal labor, involving both local and foreign workers without formal registration.
2. The reduction of the income tax rate (23% → 20%) has positively influenced wage formalization and increased the number of registered employees.
3. From 2020 to 2024, the number of officially registered construction workers nearly doubled, indicating a clear trend toward formalization.
4. Average wages in the sector rose significantly — reaching AMD 376,000 by 2024.

5. Cash transaction limitations helped reduce shadow turnover, although they also led to the creation of new avoidance schemes.
6. The employment of foreign workers often remains informal due to bureaucratic hurdles in the work permit system.
   Policy Implications: While tax rates are an important factor in combating informality, they are not sufficient on their own. Sustainable reduction in informal employment requires: Effective enforcement; Simplified administration; Reliable social security systems; Legal obligations with real consequences; Modern digital technologies in tax governance.

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Ա.Վ. Առուստամյան
Հայաստանի պետական տնտեսագիտական համալսարան

Հոդվածում ներկայացվում է ՀՀ շինարարության ոլորտում՝ 2014-2024 թվականներին եկամտային հարկի բարձր դրույքաչափի ազդեցությունը ոչ ֆորմալ զբաղվածության վրա: Պաշտոնական վիճակագրական տվյալների հիման վրա վեր են լուծվել շինարարության ոլորտի մասնաբաժինը ՀՆԱ-ում, շինարարական աշխատանքների ծավալի դինամիկան, ոլորտում զբաղվածության և միջին աշխատավարձի ցուցանիշների շարժընթացը: Ներկայացված են առաջարկություններ՝ Հայաստանի շինարարության ոլորտում ոչ ֆորմալ զբաղվածության կրճատման վերաբերյալ, այդ թվում՝ հարկային քաղաքականության կատարելագործման, աշխատանքի ընդունման ընթացակարգերի պարզեցման և վերահսկողության ուժեղացման միջոցով:

Բանալի բառեր՝ ոչ ֆորմալ զբաղվածություն, եկամտային հարկ, շինարարության ոլորտ, ստվերային տնտեսություն, հարկային բարեփոխում, ոչ ֆորմալ զբաղվածություն:

ОТРИЦАТЕЛЬНАЯ РОЛЬ ВЫСОКОЙ СТАВКИ ПОДОХОДНОГО НАЛОГА В СОКРАЩЕНИИ НЕФОРМАЛЬНОЙ ЗАНЯТОСТИ В СТРОИТЕЛЬНОМ СЕКТОРЕ РЕСПУБЛИКИ АРМЕНИЯ

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В статье представлен анализ влияния высокой ставки подоходного налога на уровень неформальной занятости в строительном секторе Республики Армения в 2014–2024 гг. На основе официальных статистических данных рассмотрены доля строительной отрасли в ВВП, динамика объёмов строительных работ, изменения уровня занятости и средних заработных плат в секторе. Представлены рекомендации по сокращению неформальной занятости в строительной отрасли Армении, включая совершенствование налоговой политики, упрощение процедур найма и усиление механизмов контроля.

***Ключевые слова*:** неформальная занятость, подоходный налог, строительный сектор, теневая экономика, налоговая реформа, незарегистрированная занятость.

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