

PROBLEMS OF STRUCTURAL DEVELOPMENT OF ECONOMY IN ARMENIA

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Abstract: The structure of the economy refers to the forms of organization of economic activity and the proportions existing between different sectors and spheres of the economy, the ratio changes of which determine the process of economic growth and the nature of economic development. On the one hand, economic development is impossible without structural changes, on the other hand, structural changes, in turn, are a consequence of this development. Here, special significance is given to revealing the problems of structural economic development, tasks effective interaction between various structural units and stimulating economic growth. It is of paramount importance in the condition of modern structural complexity of the economy. The current stage of global economic development is characterized by major structural shifts in the economy, leading to a transition to new structural proportions: primary spheres of the economy are giving way to secondary, processing spheres, and secondary ones – to services.

The overall picture of the structural development of the Armenian economy is quite close to the picture of the development of the economies of developed countries: the predominance of the service sector in creating added value in the economy is accompanied by a decrease in the weight of agriculture and industry. However, if we take into account the fact that trade, which is growing rapidly and comprises a big part of the service sector but does not bring added value to the economy, the development of the service sector is at a disadvantage. The structure and quality of the economy are not improving despite the fact that in recent years Armenia has become one of the fastest-growing economies in the world. Structural distortions and adverse shifts in the economy undermine real economic growth. Even more worrisome is the fact that this growth is short-term, caused by the cessation of the influx of people and financial resources to Armenia and/or their possible outflow. This is a serious structural problem of the economy and a serious challenge to economic security.

Keywords: *the structure of the economy, economic growth, gross added value, economic sectors and subsectors, spheres and sub-spheres of the economy, services, structural changes in the economy*

Introduction

Today's global economy is characterized by acceleration of technological changes, market rate fluctuations and increasingly growing competition. For their in-depth understanding, we need to review the structural developments in the economy, in particular, the mutual interaction between the economic structure – value added – economic growth and development and in this context, reveal the structural development challenges. To this end, we have analyzed the developments in the Armenian economy, its sectors and sub-sectors in parallel to modern structural shifts.

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The obtained results may become guidelines for efficient interaction between various structural units and future robust economic growth.

Theoretical and methodical bases of the research and methods of analysis.

Driven by the research purpose and tasks, we conducted our analysis on the basis of domestic and international statistics, publications and international theoretical and practical investigations with the application of comparative analysis and reconciliation, as well as quantitative and qualitative methods and approaches in evaluating the current state of the Armenian economy.

Determinants of Development of Structural Economics. Role and Importance of Structural Analysis

The interpretations of the *Economic structure* concept are numerous owing to increasingly growing manifestations of structural changes. The economic structure refers to forms of organization of economic activities and existing proportions between different sectors. It is reasonable that so far there have been no all-embracing and comprehensive definitions of economic structure. They refer mostly to individual components of economic structure such as institutions, markets, sectors, companies, etc. Douglas North prioritizing the role of institutions in the formation of economic structure, emphasizes the impact of informal constraints and formal rules on economic behavior and performance. (Douglas North, 1990, 17-36). Oliver Williamson focuses on the role of the structure of economic transactions, including the choice between markets and hierarchies in organizing the economy and enhancing efficiency (Oliver Williamson, 1985, 18-19). Ronald Coase also emphasized the role of transaction costs in economic structure, particularly at the enterprise level. (Ronald H. Coase, 1988). Joseph Schumpeter contributed to the perception of the economic structure focusing on the role of creative and innovative minds. He maintains that economic development encompasses an ongoing innovation process replacing the structures that are left behind. Hernando de Soto prioritizes property rights in furthering economic structure (Hernando de Soto, 2000, 59-61). Lalande views the *Structure* concept in terms of its territorial and functional location (**Barre, R.**, 1995, 191). According to F. Perrow, the structure of an economic unit is a set of proportions and interactions depicting the unit at that very moment and under the existing conditions. Jean Lhomme deems the simultaneous use of *proportion and relationship* concepts unacceptable since they are identical, in the opinion of the author. Lhomme viewed social and economic structure as a set of relations, adding time determinant to the location factor which makes it possible to conduct the analysis of the components not only in quantitative terms but also in dynamics, tracing the behavior of components through time (**Roshchina Irina V.**, 2012, 20). R. Barr, the founder of the analysis of national economy structure together with prioritizing the time factor, distinguishes two types of compatible structures:

1. Economic structure in the form of:

- Plain economic entities such as households, organizations, etc.,
- Complex economic entities such as sectors, branches, etc.

2. Framework structure forming the economic environment (institutional structure, social, demographic structure, technological, environmental structure, etc.) (**Barre, R.**., p. 193-195).

As time passed, *economic structure* definitions became more precise. McConnell and Brue consider the structure of the economy a result of activities of economic entities: state, enterprises, households aimed at the creation of gross national product (McConnell, C., Brue, S., & Flynn, S., 1992, 135). Here, the emphasis falls on the entire structure of the economy formed as a result of interaction between closely interconnected macroeconomic elements. According to a less complicated definition of economic structure, the economy is a composition of prevailing forms of ownership: state, private, mixed and public sectors (Yakovets Yuri V., 1992, 23). These clarifications make it possible to characterize the economic structure as per distinctive features underlying its perception. In particular:

1. by economy sector: it reflects the interrelationships between different economic sectors within the national economy, particularly,
 - Primary sector: it involves the extraction and production of raw materials (farming, mining, forestry),
 - Secondary sector: it includes manufacturing and processing sectors that convert raw materials into finished goods,
 - Tertiary sector: involves services and intangible goods,
2. by process criteria: *reproduction structure – expresses possibilities of economic growth and economic efficiency, as well as the relationship between consumption and accumulation,*
3. by territorial criteria: *territorial structure* (Zhuk, Sergey I., 2005, 37).

The system of national economy is a composition of global, regional and in-country economic relationships within the state endowed with particular features of development of the given country and 'operating within an inherent hierarchical framework of that country' (Kirakosyan G., Khlgatyan I., 2009, 55). The national economic system is formed primarily on the basis of exuberance of internal sources contributing to the system's reproduction, formation of a structure appropriate to the time-period and available resources, regulation of social and economic relationships, external economic interaction. Here, the proper perception and evaluation of the '*pre-industrial -industrial -post-industrial*' development trace is important. The present stage of economic development is characterized by the transition from an industrial labor-intensive economy to a post-industrial, science-intensive economy implying changes in the hierarchy of economic development factors. Particularly, a more decisive role will be ascribed to public needs' structural changes resulting from emerging differences in average income rates and productivity levels in different economic sectors. Thus, the income growth of the population brings about other qualitative structural changes: a significant shift in the structure of population demand for material products to intangible goods of the service sector. So, it is the structural cycle that characterizes the post-industrial society.

Here, the analysis of economic structure plays a vital role.

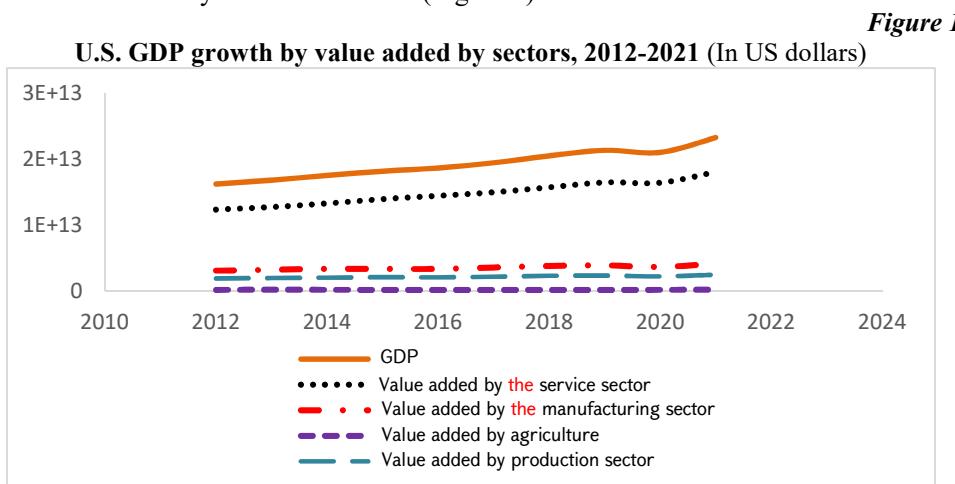
The issues referring to the *analysis of economic structure*, identification of determinants of structural development and formation of flexible economic structure are especially important in the context of balanced development of the economy, robust economic growth, satisfaction of the population's needs and exercise of their rights and interests. The importance of the structural analysis of the economy is more straightforwardly defined by Tinbergen, he maintains that '*a set of structural ratios depicts an architectural image of the economy determining the areas of economic reaction to certain fluctuations*' (Assous M., Carret V., 2021, 17). Structural analysis is especially vital at the national economy level. It

makes it possible to conduct a full-scope analysis of economic phenomena and become a basis for effective interaction between structural components. It plays a crucial role as, *on the one hand, the economic development is impossible without structural changes in economic sectors, on the other hand, structural changes, in their turn, are the result of economic growth*. So, the enhancement of efficiency of manufacturing processes is decisive in ensuring economic sustainability, which may be manifested in an *increase in value added to the cost of the product as it goes through different production stages*.

Modern Structural Economic Dynamics. Characteristics of Developed and Developing Countries

Owing to harmonious interaction between the services and manufacturing sectors and improvement of technology and productivity, countries with developed service sectors move to a new level of development thus contributing to the enhancement of their competitive position in the global market.

The U.S. holds a rather high position in terms of service development. Around 80% of GDP is created by the service sector (Figure 1).

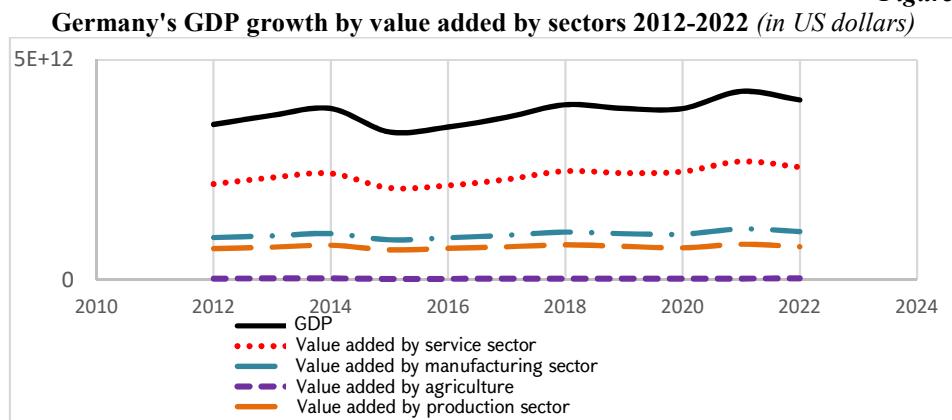


Source: <https://data.worldbank.org/country/US> /last logged in on 20.08.2024/

It is worth noting that in U.S. economic structure, the share of agriculture is the lowest. The share of the manufacturing industry (including construction) is also rather low. The economic growth has progressively weakened in both sectors. In the U.S. economic structure, the percentage of material manufacturing is comparatively high with the processing industry (machinery manufacturing, arms industry) remaining an important factor of economic development contributing to high technical development of other economic sectors.

The structure of the economies of **Germany** and the U.S. are almost identical. Germany's economic growth is hugely dependent on the service sector. The only difference is that in the latter's economic structure the percentage of manufacturing industry is bigger and has more influence compared to the similar sector in the U.S. In Germany, the service sector is largely dependent upon the success of the manufacturing sector (Figure 2).

Figure 2



Source: <https://data.worldbank.org/country/germany> /last logged in on 20.08.2024/

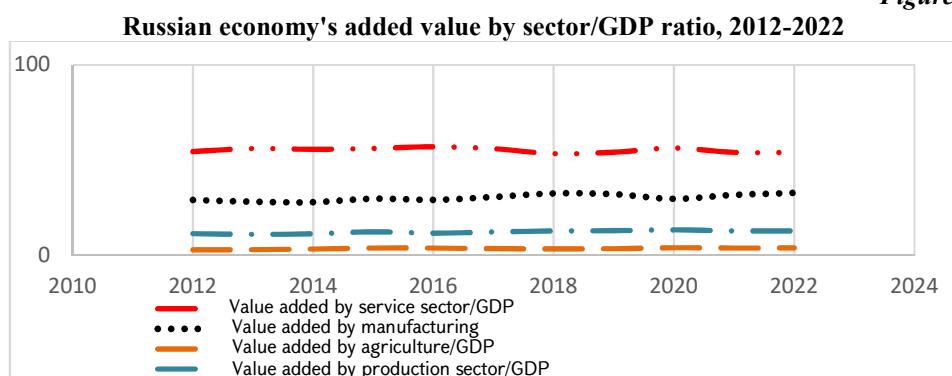
Owing to structural reforms, **China** has become one of the global leaders. China develops its own educational system, encouraging technological innovations, the IT sector, telecommunications, biotechnology and healthcare sectors. Although in 2005, 40.3% of its GDP was created in the service sector, it is still lower than in many other countries (**The Economy of China. Structure of the Chinese Economy, 2021**).

One of the most crucial prerequisites of **Japan's** economic advancement is its efficient structural policy. High-technology sectors such as biotechnology, robot building, conductors and semiconductors manufacturing are the driving force for the Japanese economy.

So, we can state that the developed countries, as a rule, have all the elements of the post-industrial stage which is not the case with **developing countries**.

In spite of economic sanctions, the **Russian** economy demonstrates stable growth. Positive growth rates are observed in agriculture and manufacturing sectors contributing to the augmentation of gross value added in the economy. The service sector having a large share in the Russian economy, has declined in terms of producing added value (Figure 3).

Figure 3

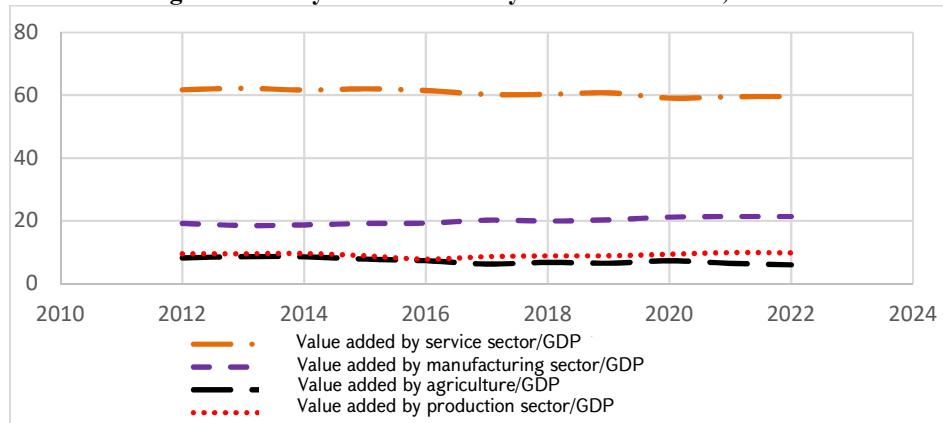


Source: <https://data.worldbank.org/country/Ru> /last logged in on 20.08.2024/

After the economic decline in 2020, the **Georgian** economy has demonstrated significant growth rates in all sectors of the economy. The percentage of the service sector is the largest although it yields to the manufacturing industry in terms of the creation of added value. The agriculture sector also has a downward trend in terms of the creation of added value (Figure 4).

Figure 4

Georgian economy's added value by sector/GDP ratio, 2012-2022

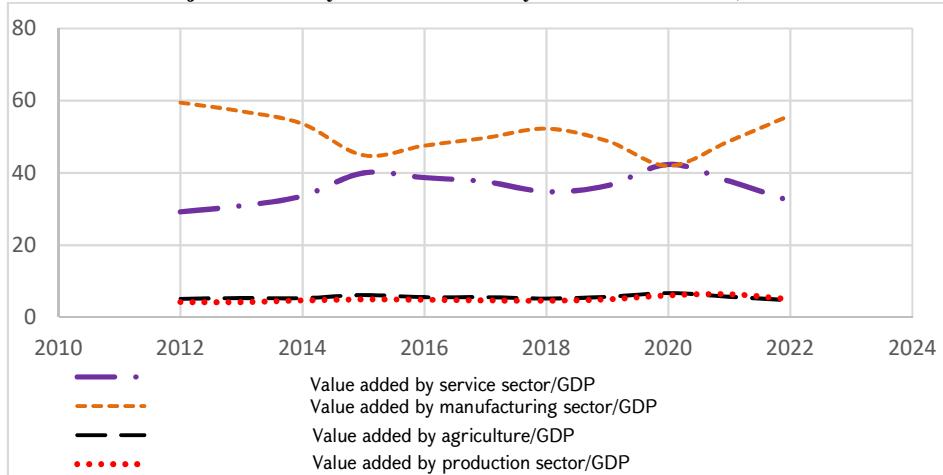


Source: <https://data.worldbank.org/country/Georgia> /Last logged in on 20.08.2024/

The structure of Azerbaijan's GDP significantly differs from the economic structure of other developing countries /Figure 5/.

Figure 5

Azerbaijani economy's added value by sector/GDP ratio, 2012-2022



Source: <https://data.worldbank.org/country/AZ> /Last logged in on 20.08.2024/

The main driving force is the manufacturing industry in which the share of oil extraction is significant. The service sector's share is essentially lower than that of the manufacturing industry and agriculture. Interestingly, since 2012, the percentage of agriculture almost hasn't changed, while the shares of the manufacturing industry and services underwent changes with the retention of the prevailing role of the manufacturing industry.

To sum up, we can state that *the present stage of global economic development is characterized by significant structural shifts for transition to new structural proportions: primary economic sectors are yielding their primary role to secondary – processing sectors, while the latter in turn are surrendering positions to services.*

Structural Developments in the Armenian Economy: Dynamics and Challenges

During the last ten years the growth rates of the Armenian economy were unstable (Table 1).

Table 1**GDP indicators of the Armenian economy**

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026 fore cased
	expected										Fore cased	fore cased
GDP(USD, million)	10,55	0,55	11,53	12,46	13,62	12,64	13,86	19,51	24.21	25.41	27.15	29.15
GDP (annual % change)	3,3	0,2	7,5	5,2	7,6	-7,2	5,7	12,6	8,7	6,0	5,3	4,5

Source: LLOYD BANK, Armenia: Economic and Political Overview, <https://www.lloydsbanktrade.com/en/market-potential/armenia/economical-context#/>, World Bank Data <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=AM>

In 2019, GDP growth rate was the highest - 7.6%, followed by COVID-19 pandemic-triggered economic decline in 2020 with GDP going down by up to 7.2%, and thereafter, by positive though fluctuating growth rates of GDP. The economic growth rate of 12.6% in 2022 (which is attributed to a sharp upward trend in the jewelry sector in November-December 2022) was followed by a decline to 8.7% in 2023 with retention of the external impacts which according to predictions, will still be effective also in 2024, 2025, and 2026.

The external factors, although manifested in economic growth rates, should be viewed as a short-term phenomenon requiring measures to prevent potential impediments to other economic sectors. Here, structural analysis at the national level is needed in order to reveal the challenges posed to economic growth and identify the problems arising out of structural shifts.

Dynamics of structural development by economic sector, control criteria and type of economic activity

The value added as a component of national accounts makes it possible to present the GDP by structural unit and sector and share in the formation of GDP. Within the RA national accounts system (NAS), structural units with consideration of their main functions, behavior and goals, are grouped into five main structural sectors:

1. non-financial corporations
2. financial corporations
3. general government
4. households
5. non-profit institutions serving households (NPISH).

The dynamics of gross value added in 2016-2022 show that the biggest portion of gross value added (55.5% on average) is created by non-financial corporations which during the mentioned period went up by around 1.8 times. The next big portion (26.4% on average) belongs to householders (its share has been reduced by 5.7% due to householders growth slowdown). Instead, the value added by the public sector in 2022 went up by 1.5 times compared to 2016, its share in GDP averaged 10.3%. During the same period, the value added by financial corporations also went up by around 3.2 times making 9% of GDP (Socio-economic situation of the RA, 2018, National accounts of Armenia, 2017- 2022, 119): *To summarize, we can state that during 2016-2022 the percentage of households in gross value added went down, in contrast to the public sector and financial corporations, which is a rather negative phenomenon. The distribution of gross value added by control criterion is also an important determinant of the structural picture of the economy (Table 2).*

Table 2

Structure of gross value added by sector and control criterion (in % of total value, at basic prices)

	2018				2020				2022			
	Distribution by institutions' control criterion											
	pub- lic	na- tional pri- vate	for- eign	total	pub- lic	na- tional pri- vate	for- eign	total	pub- lic	na- tional pri- vate	for- eign	total
Non-financial corporations	3.8	35.8	14.1	53.7	3.7	39.6	13.0	56.3	3.5	40.7	12.2	56.4
Financial corporations	0.4	2.9	2.6	6.0	0.3	3.6	3.7	7.6	0.1	4.6	4.3	9.0
General government	9.3	-	-	9.3	11.7	-	-	11.7	9.4	-	-	9.4
Households	-	30.5	-	30.5	-	23.9	-	23.9	-	24.8	-	24.8
Non-profit institutions serving households (NPISH)	-	0.5	-	0.5	-	0.5	-	0.5	-	0.4	-	0.4
Total value added	13.5	69.8	16.7	100	15.7	67.6	16.7	100	13.0	70.5	16.5	100

Source: Socio-economic situation of the Republic of Armenia, National accounts of Armenia, 2021, p. 113, 2023, p. 110, January-May 2024, p. 16, Gross value added by sub-sector.

In 2018 – 2022, the share of the national private sector in gross value added is rather high, which went up from 69.8% in 2018 to 70.5% in 2022 owing to participation of non-financial corporations by 40.7% and households by 24.8%. Some investments were made by financial corporations whose share increased from 2018 to 2022 by 1.7% p.p., amounting to 4.6%. *The growth of the national private sector's share was accompanied by an augmentation of the share of non-financial corporations and a reduction in households' share.*

The dynamics of gross value added by the publicly controlled sector fluctuate, with the total value of GVA amounting to 13.5% in 2018, 15.7% in 2020 and 13% in 2022. The contribution of the public sector in gross value added was ensured by general government and non-financial corporations. The share of foreign-controlled entities in gross value added has remained almost the same, making 16.5% in 2022. It was accompanied by a stable reduction in the share of non-financial corporations and steadfast growth of financial corporations, amounting to 12.2% and 4.3% in 2022.

The gross value added by foreign-controlled entities by economic activities is worth noting. In particular, in 2022, foreign-controlled entities have a rather high share in gross value added in the following sectors: mining and quarrying - 86.5%, electricity, gas, steam and air conditioning supply - 67.6%, water supply, sewerage, waste management and remediation - 73.2%, information and communication - 42.2%, financial and insurance activities - 47.4% (National accounts of Armenia, 2023 p., 100]. *In fact, the sectors of strategic importance are foreign-controlled and directly depend on foreign capital which is a serious challenge to national security.*

The structure of gross value added by non-financial and financial corporations is noteworthy in terms of economic activities. In particular, in 2022 the contribution of agriculture was 11.1%, processing industry - 12.5%, construction - 7.5%, wholesale and retail trade - 12.8%, real estate activities - 8.9%, information and communication - 4.9% (Socio-economic situation of the RA, 2024, 16, 14-16, 112). *The declining share of the mentioned*

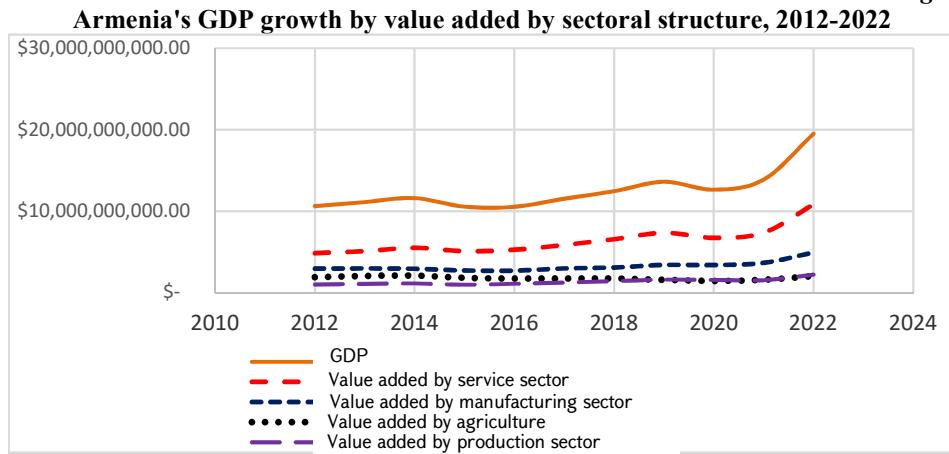
types of activities in GDP gives rise to concerns. Thus, the major part of the Armenian economy is contributed by the national private sector. It is mainly contributed by non-financial corporations encompassing almost all sectors of economic activities, except agriculture whose contributors are households with an increasingly declining share.

Manifestations and challenges of structural development of the Armenian economy

The sectoral structure of the economy attributed to component features and nature of manifestations, predetermines the course of economic development. Here, the issues referring to structural development and their interaction with the economy are of special importance.

The review of the economic growth with dynamics of value added by GDP structural components is worth noting /Figure 6/.

Figure 6

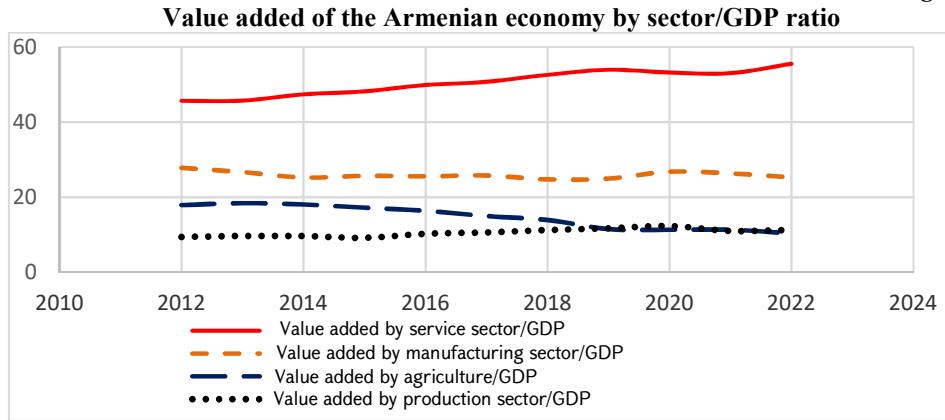


Source: <https://data.worldbank.org/country/AM>, last logged in on 20.08.2024

So, the 12.6% growth rate of the Armenian economy was contributed to by the service sector, manufacturing industry, agriculture, whose values added amounted to 47%, 34%, 28%, 44% respectively (<https://data.worldbank.org/country/AM>).

In the structure of GDP, the share of the service sector was 55.5%, manufacturing industry - 25.2%. While agriculture recorded a double-digit growth rate of 21%, its impact on GDP growth was insignificant. Thus, in 2020, the 12.6% growth rate of GDP was contributed to by growth of the service sector of around 26.5% and the manufacturing industry by 8.5%. The dominance of the service sector in the formation of value added was accompanied by a decrease in shares of agriculture and manufacturing industry (Figure 7).

Figure 7

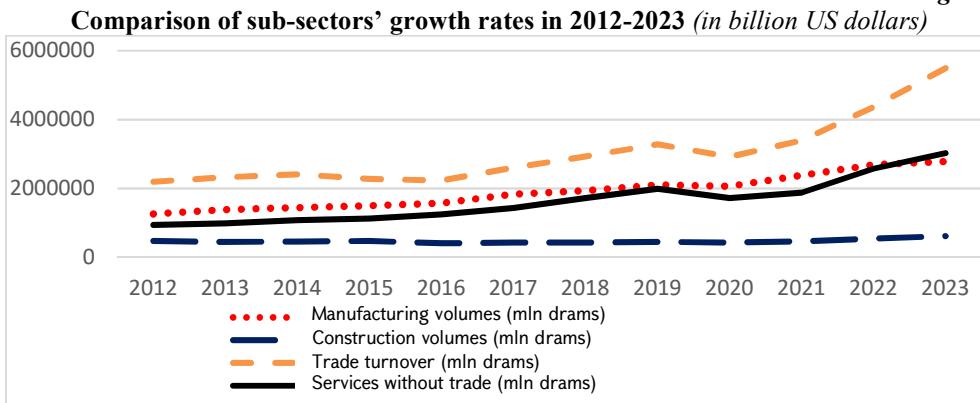


Source: <https://data.worldbank.org/country/AM> /last logged in on 20.08.2024/

In essence, the overall picture of sectoral developments of the Armenian economy is similar to the picture of developed countries with the service sector having a high share in the economy, and a relatively lower share of manufacturing industry while the contribution of the agriculture sector is not significant and has a downward trend.

For a more comprehensive analysis it is necessary to review the structure of the Armenian economy by sub-sector (Figure 8).

Figure 8



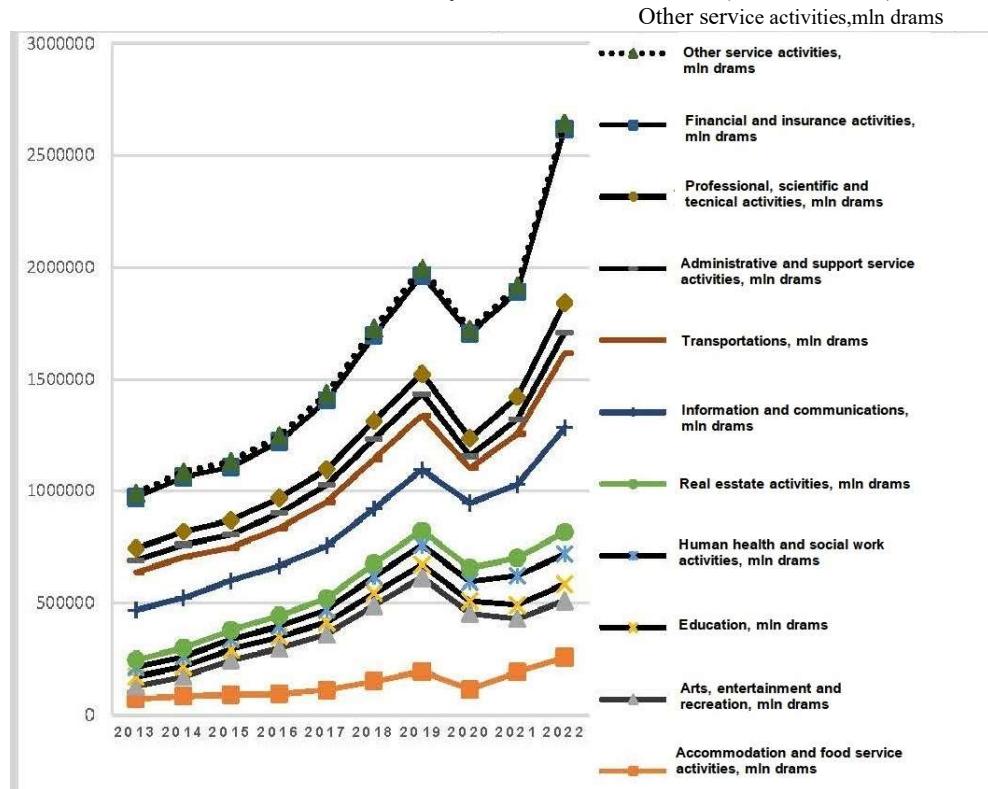
Source: <https://statbank.armstat.am/pxweb/hy/ArmStatBank/ArmStatBank>

Thus, during 2012-2023, the manufacturing industry recorded impressive growth. Here, the structural developments in the manufacturing sector are worth noting by sub-sector breakdown (<https://statbank.armstat.am/pxweb/hy/ArmStatBank/ArmStatBank>), industry sector). The Armenian manufacturing industry includes over 39 sub-sectors, with mining and its related subsectors holding the major portion (growth of 173%), in spite of its decline by around 14% in 2022. In 2012-2022, the metal mining sector recorded a growth of around 158% while in 2021-2022 it declined by 15%. Other sectors of metal mining and quarrying grew by 294%, and only in 2021-2022 - by 18%. The share of the process industry in the manufacturing sector is significant – around 12.5%. During 2012-2022, it rose by around 124% and only in 2021-2022 - by 23%. Thus, in spite of some downward trends in the

manufacturing sector, and particularly in mining, some growth was officially acknowledged. The *construction* sector recorded a 30% growth rate basically due to the effectiveness of the income tax refund program and as a consequence, growth in mortgage loans as well as augmentation of market demand for real property attributed to regional developments.

As shown in figure 7, during the observed period, the *services* without trade recorded a 220% growth rate, while the trade volumes went up by 150%. The growth gained momentum as a result of financial and migration inflows due to the Russian-Ukrainian war in 2022. Although we observed some activation of the service sector and augmentation of its share in GDP, the service proportions were not favorable in terms of gross value added with a high share of trade that does not create added value, rather, it is a channel of distribution of goods and services. Here, the service component's behavioral tracking is important (Figure 9).

Figure 9
Breakdown of service sector by sub-sector, 2012-2022 (AMD, million)



Source: <https://statbank.armstat.am/pxweb/hy/ArmStatBank/ArmStatBank>

During the observed period, the sub-sector of financial and other insurance activities held the highest share in services, growing from AMD 228030.9 million in 2013 to AMD 776502.6 million (by around 3.4 times). The second sub-sector is information and communication which rose by around 2.1 times during the mentioned period. It is worth tracking the dynamics of education, professional development and healthcare sub-sectors, which significantly contribute to the value added by the service sector, have moderate shares and demonstrate modest growth of 1.7, 2.4, 3 times respectively. In contrast to it, higher growth rates were recorded in sub-

sectors generating less added value such as accommodation and food service activities (growth by around 3.5 times) and arts and entertainment (growth by around 4.6 times).

Thus, in spite of certain downward trends, the official statistical data acknowledge double-digit economic growth. Armenia became one of the fastest-growing economies in the world. Meanwhile, such growth rates don't improve the economic situation at all. The quality and structure of the economy are not getting better. Moreover, production volumes are going down, and exports are declining requiring urgent measures and in-depth understanding of the nature of the mentioned growth.

It is worth noting that the huge portion of growth recorded in the economy, its sectors and sub-sectors is attributed to 2022, 2023 and 2024. In the first half of 2024, the economic activity indicator grew by 10.4% compared to the same period in 2023. Interestingly, the economic growth was due to the *manufacturing* sector (18,2%), primarily owing to precious metals. During the observed period, the *service* sector grew owing to the financial sector (19,0%, mostly mortgage and interrelated consumer loans which maintained high growth rates in the construction sector (in January to June - 15,7%, annual)). In the first half of 2024, external trade volumes rose by 2,3 times: precious stones and metals reached 71% of overall export volumes (8,1 times higher than in the first half of 2023), and imports rose by 86,5 % mainly due to precious stones and metals (with their volume rising by 9.4 times) (https://statbank.armstat.am/pxweb/hy/ArmStatBank/ArmStatBank_services).

In fact, the growth rates are hardly linked to Armenian economic performance: the national economy, especially the manufacturing sector would have sharply declined had it been filtered out of external factors. In particular, the production of precious metals and stones grew more than the entire manufacturing sector. This is a huge structural problem and a serious challenge to national security. Re-export, which has fueled the growth of the Armenian economy, has brought about structural distortions and economic imbalance thus undermining the real economic development and advancement of the service sector and as a consequence, the generation of added value.

According to analysts of the Eurasian Development Bank, since the economy cannot be expanding any more, it will no longer grow and in the second half it will slow down to a 7.5% annual growth rate (Eurasian Development Bank, 2024).

The economic situation gives rise to concerns not only in terms of unfavorable structural shifts but also sometimes illogical economic dynamics. It is worrisome that these growth rates are of situational nature caused by migration and financial inflows and their possible outflow may bring about extra economic problems the external manifestations of which are already evident.

Conclusion

Structural analysis of the economy is particularly important at the national level, in terms of identifying both the challenges and opportunities involved in ensuring a harmonious relationship between economic growth and the resulting structural changes.

The current phase of global economic development is marked by significant structural shifts, driving a transition toward new sectoral proportions: the primary sectors of the economy are giving way to secondary, processing sectors, which are themselves being overtaken by services. In this context, the importance of knowledge-intensive industries, based on high technologies, is crucial. The sectoral structure of the Armenian economy closely mirrors that of developed countries. Industry's contribution to the economy is relatively

small, while agriculture represents a modest and declining share. The services sector, however, accounts for a significant portion of the economy. The emerging picture is still concerning, particularly regarding the insufficient added value being generated in the services sector. The increase in re-exports has resulted in situational economic growth in Armenia during 2022, 2023, and 2024, causing structural distortions and economic imbalances. This hampers the real economic growth and the development of the services sector that supports it, as well as the generation of added value, moving Armenia further away from the potential of achieving a post-industrial structural economy.

The research conducted provides a more in-depth understanding of the structural development challenges facing Armenia's economy. It can serve as a guiding framework for future economic policy directions and the initiatives necessary for their implementation.

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