



CENTER OF ANALYSIS OF INTERNATIONAL RELATIONS  
BEYNLƏXALQ MÜNASİBƏTLƏRİN TƏHLİLİ MƏRKƏZİ

# BULLETIN

HIGHLIGHT OF THE FOREIGN POLICY OF REPUBLIC OF AZERBAIJAN

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## **I. The West should support a new post-war configuration in the South Caucasus**

On April 28, US Secretary of State Antony Blinken and President Ilham Aliyev had a phone conversation. According to the presidential press service, the US Secretary of State spoke about the importance of further strengthening of bilateral relations, cooperation in the energy and regional security spheres, the successful implementation of the Southern Gas Corridor project, and hailed Azerbaijan's participation in the peacekeeping mission in Afghanistan. He also said that the waiver of Section 907 of the Freedom Support Act was extended for Azerbaijan for 2021. Mentioning the cooperation in the field of regional security, President Ilham Aliyev stressed the significance of Azerbaijan's participation in the peacekeeping mission in Afghanistan since the initial stage. During the conversation, the sides exchanged views on the situation after the Armenia-Azerbaijan war. President Ilham Aliyev affirmed Azerbaijan's position on this issue, noting that restoration works are underway in the country's territories destroyed by Armenians. President Ilham Aliyev also noted the significance of opening communications in the region and stressed Azerbaijan's position on ensuring long-term peace. President Ilham Aliyev and the US Secretary of State also discussed the future activities of the OSCE Minsk Group. During the phone conversation, the sides stressed the development of democratic processes, the importance of ensuring human rights, preservation and providing of political pluralism in Azerbaijan. At the same time, referring to the US President's recent statement on the so-called Armenian genocide, the President of Azerbaijan said Turkey was Azerbaijan's close friend and ally,

which played a critical and positive role in the region in the post-conflict period, adding that the US President's statement was met with concern by Azerbaijan's leadership and the public.

With the Second Karabakh War, the balance of power in the region has sharply shifted in favor of Azerbaijan. As an artificial Soviet creation of 1923, the term "Nagorno-Karabakh" has also lost its relevance after the Second Karabakh War. President Ilham Aliyev has repeatedly underscored the fact that "there is presently no administrative unit named Nagorno-Karabakh. Azerbaijan has resolved this issue, achieved a historic victory and started restoration work in the destroyed areas". Karabakh with its flat and mountainous parts is an integral part of Azerbaijan. The U.S. and other western powers can help in solidifying peace in the region after the Second Karabakh War. However, this largely depends on the willingness of the western powers to take a more unwavering position towards both revanchist and separatist aspirations, making sure that there is no room for ambiguity, while pushing Armenian to fulfill its obligations under the November 10<sup>th</sup> ceasefire agreement. The lack of consistency in the West toward this issue is not only detrimental to the West's capacity to present a coherent policy towards the region, but also undermines the fragile post-war security situation in the South Caucasus. The revanchists see the inconsistency in the West's position as a validation of their destructive aspirations, which emboldens them to take drastic steps in order to undermine the fragile peace in the region. The West should avoid creating the perception that it may be willing to prop up revanchists and separatists. Instead, efforts should be made to explain to revanchists and wannabe separatists why their unilateral destructive actions and attempts at revisions

cannot and will not be accepted. The West should learn to act responsibly and be more aware of the unintended consequences of its actions. Consistency is a virtue. A clear and unwavering stance on the territorial integrity of Azerbaijan would protect the West from accusations of hypocrisy and double standards, while preventing would-be revanchists from setting up unrealistic expectations and destroying the nascent peace in the region.

## **II. The Iskander-M debacle looms large over Russia-Azerbaijan relations**

On April 2, the Mine Action Agency of the Republic of Azerbaijan (ANAMA) reported the finding of the remnants of the Iskander missiles, also known as SS-26 Stone in NATO reporting name, in Shusha, a town in the Karabakh region liberated by the armed forces of Azerbaijan during the war of last autumn. It should be especially highlighted that the detected remains of missiles under the 9M723 index code belong to Iskander-M type. Iskander-M with a maximum range of 500 km is exclusive for Russian military use, while the Iskander-E (9M720) with maximum range of 280 km aimed for export. Armenia was the first buyer of this complex. The Iskander-E missiles were obtained and shown by Armenia at the military parade in September 2016. This finding, however, due to the facts that Iskander-M with a maximum range of 500 km is considered solely for the Russian army, prohibited for exports under the international agreements and only the export version of these missiles called Iskander-E is listed in Armenia's arsenal, caused a massive outcry in Azerbaijan. Commenting on the findings on April 12, President Ilham Aliyev addressed the Russian leadership asking for an explanation

how the Iskander-M missiles which Armenia could not import were fired against the Azerbaijanis. This issue was discussed by President Ilham Aliyev and President Vladimir Putin during a telephone conversation on April, 1, 2021, and Azerbaijan's Defense Ministry sent a request with video and photo materials confirming the use of Iskander-M to the Russian side. Azerbaijan has not received adequate explanation from Russia. According to Russian President's Spokesperson Dmitry Peskov – “Iskander missiles were not used in Nagorno-Karabakh in the fall of 2020”.

Russia's dismissal of the news about the deployment of Iskander-M by Armenia in the course of the Karabakh war raises eyebrows in Baku and, for President Ilham Aliyev, this begs the question of whether Russia controls military warehouses in Armenia. “Pashinyan is the Prime Minister of Armenia. He says we [Armenia] used this missile. A Russian Defense Ministry official said they did not use it. What does it mean? Does this mean that the Russian Defense Ministry controls the Armenian Defense Ministry?” President Ilham Aliyev asked at an international conference in Baku.

It could be speculated that Russia has sold Iskander-M missiles to Armenia instead of Iskander-E, and Armenian armed forces used those missiles against Azerbaijan. In this case, official Moscow violates the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies. In addition, Russian officials always claim that Iskander-M is a serious offensive weapon, and naturally, the complex will not be exported to other states. Second assumption might be that Armenia through diaspora bought illegally Iskander-M missile systems, smuggled it through Russian customs and used them against Azerbaijan. In such situation, serious investigations must be launched in the Russian army to find out

responsible persons. Illegal acquisition of such a strategic weapon is a serious threat not only to regional security but also to the whole world. Therefore, the official Kremlin should start its investigation into the remains of Iskander-M missiles in Karabakh as soon as possible. However, experts are sceptic with regard to a possibility to smuggle such weapon from Russia. And the third assumption as some experts claim Russia could use Iskander-M missiles against Azerbaijan in order to stop successful military operations of the Azerbaijani army. It is worth remembering that military operations were stopped after the Russian intervention of November 10, 2020. Russia, Azerbaijan and Armenia signed the Trilateral Agreement, and the official Kremlin became a key guarantor for the ceasefire and peace. According to the agreement, 1,960 armed troops, 90 armored vehicles, and 380 motor vehicles and special equipment units have been deployed to the Karabakh region. By this, Russia got military presence in all three South Caucasian countries. If Russia used Iskander-M missiles against Azerbaijan then it may completely damage the image and credibility of the Russian peacekeeping forces in Azerbaijan.

The debate about the use of Iskander missiles had, in fact, started in the immediate aftermath of the conclusion of the 44-day war in November last year when Armenian ex-army chief, colonel-general Movses Hakobyan declared that Iskander was used during the war but refused to provide the details. This was confirmed by Armenian Prime Minister Nikol Pashinyan on February 23. Countering the accusations by the former Armenian President Serzh Sargsyan who had asked why these ballistic missiles were not launched against Azerbaijan during the war as it would have tilted the balance in favor of Armenia, Pashinyan admitted the use of Iskander but

regretted that only ten percent of the missiles exploded. His derogatory remarks about Russia's well-known military product outraged the Armenian army leaders and Russia's political and expert community. Facing the threat of a military coup and Russia's objections, Pashinyan's office later recanted his statement saying Prime Minister had been misinformed, adding that "there is no doubt that Russian weapons are one of the best in the world".

The precarious balance Azerbaijan has maintained with its northern neighbor is challenged by Russia's continuous military support to Armenia and Russia-supported modernization of the Armenian army as well. Many Armenian military experts have highlighted the importance of acquiring Iskander-E missile systems for Armenian military forces, which had tried to change the balance in favor of Armenia. However, official Baku acquired the Belarusian-made Polonez multiple-launch rocket system as well as Israeli-made LORA operational-tactical missile system to keep balance in the region. So far, Azerbaijan has managed to counterbalance Armenia's military capacity and sent a clear message to Armenia about the risks of use of the Iskander missiles against Azerbaijan. In addition, Azerbaijan strengthened its ballistic missile defence by purchasing the Israeli-made Barak-8 air defense system.

In his press conference with the representatives of foreign and local media in late February, President Ilham Aliyev underscored the potential repercussions of this process stating that "The provision of weapons like Iskandar missiles to Armenia does not serve to stability in the South Caucasus." President Ilham Aliyev also warned against the externally supported plans to modernize Armenian army, stating "Russian side says that it is ready to modernize the

Armenian Armed Forces.” “But if we are talking about lasting peace, is it worth doing it?”, President Ilham Aliyev rhetorically asked.

In the end, it is important to underline that the war is over. On the one hand, there are still some challenges such as the illegal transit of Armenian armed forces and weapons through the Lachin corridor to Karabakh, as well as the Armenian armed forces’ withdrawal from Azerbaijani territories, on the other hand, there are important opportunities for regional integration and stability. Armenia and Azerbaijan can support the reconciliation process by showing goodwill. Towards this end, official Yerevan should implement all clauses of the November agreement as well as recognize the territorial integrity of Azerbaijan. Last but not least, the processes of disarmament within the context of post-conflict reconciliation should begin as soon as possible. The Iskander-M missile system is a serious threat to the whole region, and the Shusha case demonstrated clearly that arms control is very important to strengthen peace and stability in the region. As a guarantor of the ceasefire and the post-war regional arrangements, Russia should aim at de-escalation in the region and help the implementation of the peace-building initiatives such as the re-opening of regional transportation and communication channels between Armenia and Azerbaijan. The moves in the opposite direction, such as Moscow’s upgrading of the Armenian army and its military supplies to Armenia raise numerous questions about the future of Russia – Azerbaijan relations.

### **III. Azerbaijan continues the construction of strategic Nakhchivan railway despite Armenian provocations**

The construction of the railroad that will connect Azerbaijan proper with its exclave, Nakhchivan Autonomous Republic, via the Zangezur (Syunik) region of Armenia will be a historic achievement for Azerbaijan as Nakhchivan has largely been isolated since the First Karabakh War of the early 1990s, which resulted in the termination of the land route linking mainland Azerbaijan and its exclave via the “Zangezur corridor”. For Azerbaijan, the reopening of the corridor has geostrategic importance in multiple domains. This route was the most direct land passage between mainland Azerbaijan and its Nakhchivan exclave soon after World War I, when the historical Zangezur (now Syunik) province was granted to Armenia and the autonomous Nakhchivan territory came under Azerbaijani protection under the Treaty of Kars (1921). The termination of the Zangezur land route connection with Nakhchivan following the breakout of the First Karabakh War of the early 1990s, however, seriously isolated the Azerbaijani exclave. Since then, Baku could physically reach Nakhchivan only by air or by circumventing Armenia to the south, via Iranian territory. The latter route came with myriads of security and geopolitical challenges to Azerbaijan, in addition to notable economic consequences. At the same time, Azerbaijan’s dependence on the Iranian land bridge, coupled with Iran’s supply of energy resources to the Azerbaijani exclave, provided Tehran with significant clout in its relations with Baku. This situation is expected to be changed in favor of Baku following the opening of the Zangezur corridor. The Zangezur corridor will provide Azerbaijan with a direct route for natural gas supplies to the Nakhchivan region

and, consequently, save on transit fees via Iran. According to the 2004 swap agreement between Baku and Tehran, in return for Azerbaijan's supply of gas to Iran's northwestern border city of Astara, Iran supplies 85 percent of that volume to Nakhchivan, counting the remaining 15 percent as a transit fee, which Baku has long sought to re-negotiate.

Securing the Nakhchivan Autonomous Republic (NAR) has been a particular concern for Azerbaijan against the backdrop of irredentist claims from the Armenian side. These mounting security threats compelled Baku to, in 2013, establish the Nakhchivan-based Combined Army on the basis of the 5th Army Corps, in order to reinforce the defensive capacity of the enclave. The lack of direct access to the region also pushed Azerbaijan to more energetically promote military ties between Turkey, Azerbaijan's strategic ally, and the NAR through joint military exercises and consultations.

The direct land route with Nakhchivan will shorten transit between Azerbaijan and Turkey. Although the two countries are already linked via the Baku–Tbilisi–Kars Railroad and roads across Georgia, the shorter route through Zangezur has the potential to boost economic and human ties between the two sides. Overland transit via the Armenian territories will boost trade turnover between Azerbaijan and Turkey by raising the potential of the Middle Corridor connecting Europe with Asia. The two Turkic states enjoy a preferential trade agreement since March 1 and are discussing the possibility of signing a free-trade agreement and switching to national currencies in bilateral trade. The two sides seek to increase their bilateral trade to \$15 billion by 2023.

This corridor could also play an important role in the regional integration of the Turkic states, which have been developing an ambitious agenda toward this goal over the last few years. Addressing the informal summit of the Turkic Council, held online on March 31, President Ilham Aliyev stated that "transport, communications, [and] infrastructure projects passing through Zangezur will unite the entire Turkic world," mentioning also opportunities for building cross-border railways with other regional countries, including Armenia.

On February 14, President Ilham Aliyev, during his visit to the Azerbaijani territories liberated following the Second Karabakh War laid the foundation for a railway that, when completed, will connect the towns of Horadiz (Fuzuli district) and Agbend (Zangilan district). Agbend is located in the southwesternmost part of mainland Azerbaijan, at the politically sensitive junction of the borders of Azerbaijan, Armenia, and Iran. The 100-kilometer-long Horadiz–Agbend railway constitutes a part of a larger project to link Azerbaijan proper with Nakhchivan. Speaking at the groundbreaking ceremony for the Horadiz–Agbend railway, President Aliyev underscored the "great importance" of the project for the transportation of passengers and freight to the liberated territories. "After a long hiatus," President Ilham Aliyev noted, "Azerbaijan and its integral part of the Nakhchivan Autonomous Republic will be connected to each other by rail, thus achieving our strategic, economic and political goals". This railway route, established during the Soviet period, had been entirely dismantled over the last three decades of Armenian occupation of Karabakh and surrounding Azerbaijani districts. The 43.4 km section of the railway that passed through Armenia from the Armenian border (Meghri district) to

Nakhchivan and was owned by Azerbaijan Railways had not been in use since then.

At the same time, since the start of the construction of the Horadiz–Agbend railway, the Armenian side has been very inconsistent and provocative about the prospects of the revitalizing the Zangezur corridor. “Today Armenia shies away from cooperation, attempts to hamper the implementation of the Zangazur corridor,” President Aliyev revealed in his address to the seventh assembly of the ruling New Azerbaijan Party (YAP) in March, adding that “but they will fail.”

Armenia lacks the estimated \$3.5 billion needed to finance the construction of its own railway to Iran via the Syunik region. The only existing land route between Iran and Armenia—the Meghri–Kapan–Goris highway—suffers from seasonal challenges to passage. And the northern route to Russia via Georgia is often unavailable for the same reason. The railway path to Iran through Nakhchivan would, thus, relieve Armenia of the financial burden of building its own railway via the Syunik region. The rail route to Iran via Nakhchivan could also help Armenia reach the long-awaited \$1 billion annual trade turnover target with its southern neighbor. As such, Yerevan has no real immediate alternatives to improving this situation but to unblock the transportation links via Azerbaijani territory.

Nonetheless, inconsistent and provocative messages from the Armenian side imply that Yerevan might try to reconsider these projects after the upcoming June 20 snap parliamentary elections. However, Armenia’s rejection of the Zangezur corridor would jeopardize the entire post-war negotiation process and undermine the November 10th ceasefire agreement, which constitutes the foundation for these negotiations. Many in Armenia understand this. On March 20,

Armenia’s Prime Minister Nikol Pashinyan, at a meeting with residents of the Armenian village of Nerkin Bazmaberd, declared passionate support for the opening of regional transportation channels. Assuring that this will be advantageous for both Armenia and Azerbaijan, Pashinyan noted that “this is beneficial for Azerbaijan because it should have communication with Nakhchivan. This is beneficial in Armenia because we need to obtain a reliable rail and land connection with the Russian Federation and the Islamic Republic of Iran. This means that the economy of our country can change significantly. In another meeting with the local Armenian community, on March 28, Prime Minister Pashinyan once again emphasized the significance of opening up transit channels with Azerbaijan for the Armenian economy. To support his claim, Pashinyan cited the example of the copper ore mining industry of Armenia, saying that it would be “impossible” to modernize the industry and create capacities for smelting copper without unblocking regional transport infrastructure. “We must understand that we cannot get a path through the territory of Azerbaijan [to Russia and Iran] while, at the same time, refusing to give a path to Azerbaijan through our territory. We must be able to mutually use the existing routes,” Pashinyan said, highlighting the importance for Armenia to look at the region “from a different angle”.

It will take a significant amount of financial resources to complete the rehabilitation of the east-west rail route via the Zangezur corridor, which needs to be entirely rebuilt in most sections, even though the existence of the previously used track bed helps ameliorate costs. According to some unofficial estimates, the construction of the missing parts of the railway along the Kars–Gyumri–Nakhchivan–Meghri–Baku route (KGNMB) might cost up to

\$433.7 million, with the Azerbaijani section of the line costing \$277.1 million, the Armenian section requiring \$104.6 million, and the Turkish section—\$52 million. According to other estimates, the reconstruction of the Armenian section of the railway could cost about \$210 million, while rebuilding the Azerbaijani section could take more than \$400 million. Even though the price tag on the construction of this railway generally exceeds projections from seven years ago, a revitalized KGNMB still seems more economical than its alternatives. For instance, the building of a new railroad between Iran and Armenia is anticipated to cost \$3.5 billion. At the same time, it remains an open question who will undertake the construction of the Armenian section of the route, between mainland Azerbaijan and Nakhchivan. In fact, the contract between Russian-owned South Caucasus Railway and Armenia, which designated the company as the owner and operator of Armenia's railroads, specifically does not include the Syunik (Zangezur) branch, listing it as an “unused line.” Armenian experts, therefore, expect that Yerevan may seek to draw the necessary funds from international organizations such as the Asian Infrastructure Investment Bank (AIIB), World Bank and the European Bank for Reconstruction and Development (EBRD).

#### **IV. Suez Canal blockage highlights the importance of the Middle Corridor for the global shipping**

On March 23 of 2021, a container ship called the “Ever Given” ran aground in Suez Canal, one of the most important waterways in the world, and blocked other vessels from using it. This human-made waterway is one of the world’s most heavily used shipping lanes, carrying over 12% of world trade. This canal is

also responsible for the transportation of 7% of the world’s oil and 30% of daily container shipments. Therefore, the blockage of the canal has considerably affected global trade. According to Lloyd’s List, a London-based shipping news journal, the estimated daily value of cargos passing through the canal is \$9.7 billion, with \$5.1 billion traveling westward and \$4.6 billion traveling to eastward directions. The incident forced some ships to use the alternative route around Africa’s southern tip, which is dangerous and increases the transportation costs and time.

Shipment delays because of the incident in the Suez Canal also negatively affected the already-disrupted global supply chain. Since the start of the pandemic, shipping delays and shortages have considerably strained the global supply chain. As the commodities become increasingly difficult to obtain and produce for the companies, customers face limited options and higher prices. Several big companies such as Nike, Honda, and Samsung have already expressed that supply-chain issues have significantly impeded production volumes. Thus, the blockage of the canal made the supply chain crisis even worse.

Almost a week after the “Ever Given” halted the canal, on March 29, it became possible to free the vessel and the Suez Canal opened for business again; tugboats managed to refloat the stuck vessel away from the canal’s sandy bank. During the blockage, at least 367 vessels were left waiting for the canal to be unblocked. However, it remains unclear when the traffic in the canal will return to normal, as it will take a couple of days to clear the backlog of ships. Some experts have estimated that it could take more than 10 days.

Despite the fact that the canal was freed, it has raised questions on the risks of the world’s overreliance on this route. The economic

damage of the blockade of the Suez Canal proved the fragility of global transportation architecture. This in turn brought up the issue of the development of alternative land or maritime transport routes. Hence, after the incident, Russia and Iran have called for the need to find alternative shipping routes, especially recalling potentials of the Northern Sea Route (NSR) and International North-South Transport Corridor (INST). By explaining the reasons for considering the NSR, on its official social media account Russian state company Rosatomflot declared that rapid melting of the Arctic and the existence of powerful Russian icebreakers improve the accessibility of the North Sea, which could become an alternative to the Suez Canal. Iranian officials, on other hand, called for the activation of the INSTC as a reliable and "low risk" alternative.

The other alternative route that has the potential to become one of the mainland routes for the transportation of goods between Asia and Europe is the Trans-Caspian East-West-Middle Corridor Initiative, shortly called "The Middle Corridor". This corridor is considered as one of the most important routes in reviving the ancient Silk Road. The Middle Corridor begins in Turkey, passes through the territories of Azerbaijan and Georgia, crosses the Caspian Sea, reaches Central Asia, and extends to China through the Turkmenistan-Uzbekistan-Kyrgyzstan or Kazakhstan routes.

The formation and development of the Middle Corridor began after the November of 2013, when as a part of the II International Transport and Logistics Business Forum "New Silk Road" in Astana, the leaders of JSC "National Company" of Kazakhstan, CJSC "Azerbaijan Railways" and JSC "Georgian Railway" signed the agreement on the establishment of Coordination Committee for the development

of the Trans-Caspian International Transport Route. In December 2016, the participants of the Coordinating Committee decided to establish the International Association "Trans-Caspian International Transport Route", which started its activities in the following year. The main goal of this project is to increase the volume of freight transportation between East Asia, Central Asia, the Caspian and Black Sea basins and European countries by creating alternative or complement to the traditional land routes that go through the territory of Russia.

Middle Corridor has several advantages in comparison to traditional transportation routes. Compared with the Trans-Siberian Railway, which is also called the "Northern Corridor", it is 2 thousand km shorter and has more favorable climate conditions. Compared with the traditional sea route, it shortens the travel time of goods between Europe and China by about three times, making it only 15 days. In 2015, the first pilot shipment took place and a container train, which started its trip from Western China reached Baku through Kazakhstan and the Caspian Sea in 6 days. Besides, the Middle Corridor creates great opportunities for cargo transportation within Asia and to Africa. Using this corridor, cargos from east and south-east Asia could be easily transported to the Middle East, North Africa and the Mediterranean regions using port infrastructures of participating states.

The Middle Corridor initiative is also supported by Afghanistan and Tajikistan as this route creates new transportation opportunities for them. By integrating the "Lapis Lazuli" corridor, an international transit route that links Afghanistan to Turkey, to the Middle Corridor, these countries could easily transport their goods in all directions in Asia. Integration of these corridors is also advantageous for the participating countries

of the Middle Corridor. The agreement on the establishment of the Lapis Lazuli corridor was signed by Georgia, Afghanistan, Turkmenistan, Azerbaijan and Turkey in November 2017, which added a new artery to the Middle Corridor in the southern direction.

Along with the mentioned advantages, the Middle Corridor also holds precedence in comparison to other proposed alternatives, which have obvious shortcomings. In the case of NSR, most of the year it is covered in snow and for transportation of goods through this road ships of special nature and capabilities are required. So, the competition of NSR with the Suez Canal could only be of seasonal nature. The INSTR on the other hand, despite its advantages, cannot become the direct competitor to the Suez Canal as it serves for the connection of the Indian Ocean and the Persian Gulf with Northern Europe, not for the connection of east and south-east Asia like the Suez Canal. It could compete with the Suez Canal only if it is integrated into the Middle Corridor. Hence, the advantages of the Middle Corridor and shortcomings of other alternatives reveal the importance of the Middle Corridor and make it the best alternative for the transportation route that goes through the Suez Canal.

## **V. Economic implications of the Second Karabakh War for Armenia**

The heavy defeat of Armenia in the Second Karabakh War and the enormous loss of military personnel created a severe political and social crisis in the country. Armenian citizens began mass protests against the government, demanding the resignation of the Prime Minister. Despite the fact that, in the following months, some progress in Armenia's political situation was achieved, instability and

war-related protests still continue. Along with political problems, the Second Karabakh War has also created economic problems for Armenia. Taking into account that even before the war Armenia had a fragile economy and was dependent on foreign aid, war-related financial problems have made the situation even worse.

War affected the Armenian economy in different spheres. First of all, the military sector of Armenia faced substantial losses. According to the initial estimations, the minimal cost of Armenia's military equipment, destroyed or taken as trophies by the armed forces of Azerbaijan during the war amounts to \$3.8 billion. In the last ten years, the annual military expenditure of Armenia doubled and reached \$716 million, which is a quite large amount for a small country like Armenia. Therefore, Armenia has one of the highest military expenditure to GDP ratio worldwide. This indicator reached almost 5% in 2019, which is even bigger compared to Russia and the U.S. However, despite the huge military expenditures, Armenia was also faced with heavy defeat and financial damage in the war. The cost of military equipment of Armenia in the Second Karabakh War makes up 77% of the total military expenditures that were spent in the last ten years. Consequently, the Armenian army lost its combat capability and its recovery requires many years.

Along with military losses, the Second Karabakh war created problems in the energy, agriculture and financial sectors of Armenia. During the occupation of about thirty years, Armenia illegally exploited natural resources in the occupied territories, which played an important role in the economic development of Armenia. Previously occupied territories have great energy potential. The Hydroelectric Power Stations (HPS) situated in those territories played important role in meeting

the energy demand of the illegally settled Armenian population. Starting from 2018, even the surplus of the produced energy was being exported to Armenia which accounted for 7% of the energy supply of Armenia. As a result of the war, Armenians lost control over the 30 HPSs out of the 36 that existed in the previously occupied territories, which were responsible for 53% of electricity production. In 2020, Armenia planned to import about 330 million kWh of electricity from Karabakh, but due to the war, only some part of the planned volume was imported.

As Armenia got deprived of electricity import from Karabakh, it started to face energy shortage. Now Armenia not only has to import the energy to meet the local energy demand but also has to export electricity to the Armenian population that is left in Karabakh. To eliminate energy shortage, Armenia should increase the share of the Thermal Power Plants which operate with gas or increase the volume of imported energy from abroad. In both cases, it will lead to an increase in the energy prices in Armenia. Already, starting from February 1, electricity prices for households in Armenia have increased by about 7% and more increases are expected.

Because of the war, the agricultural sector of Armenia also has been significantly affected. Like the energy resources, the agricultural resources also have been exploited by Armenia in the previously occupied territories. As those territories are rich with arable land and pastures, it creates great opportunities for the development of crop production and animal husbandry. Agriculture products imported from Karabakh played important role in the provision of food security in Armenia. As a result of the war, 90 thousand hectares or 90% of arable land in those territories came under the control of Azerbaijan. Annually, in those arable lands,

150 thousand tons of different grain products were being produced , 66% of which was being exported to Armenia. Imported grain products from Karabakh met about 25% of the local demand in Armenia. Hence, for preventing a potential food crisis, the Armenian government has to substantially increase the grain imports from other countries. Increasing the share of imported grain in turn will have an enhancing effect on inflation and will worsen the social situation in the country.

The war also had a considerable impact on the financial sector of Armenia. Despite limited financial resources, during the war, Armenia had to increase the budget expenditures in order to meet the increasing military expenses. In October 2020, based on the amendments to State Budget 2020, budget expenditures were increased by about \$85 million. As a result of the amendments, in 2020, the budget expenditure reached 27% of GDP and the budget deficit was increased by about three times compared to the initial predictions and constituted 7.6% of GDP. All these changes created substantial economic risks which were reflected in the Debt to GDP ratio (DGR), one of the main indicators of the financial security of the countries. In 2020, the DGR of Armenia passed the 60% threshold and reached at least 66.5%. As the mentioned problems have deepened the financial crisis, the Armenian government now cannot carry out budget projects for 2021. Therefore, the government is planning to reduce the cost of maintaining the state apparatus (10%) and military expenditures.

The formed financial problems in turn affected the macroeconomic situation in Armenia. Despite the initial predictions of negative 5%, because of the war, GDP was diminished by about 8.5% at the end of 2020, which was the worst economic development indicator compared to other regional countries. War

also had a direct impact on the exchange rate of the national currency of Armenia (Dram). From the start of the war until the March of 2021, Dram has been depreciated by about 8.6%, forming an inflationary environment. To curb the further depreciation of the currency and inflation risks, the Central Bank of Armenia increased the refinancing rate twice in less than two months. In December 2020, it was raised by about 1% and set at 5.25% and in February it was increased to 5.5%.

All the mentioned economic and financial problems demonstrate that the Second Karabakh War had a significant impact on the Armenian economy. After the war, the dependence of the Armenian economy on foreign debt increased, which was one of the main economic problems. As a result of the loss of the occupied territories, Armenia also faced energy and food shortages which will lead to price increases and growing social discontent. On the other hand, reduced financial resources and deteriorating macroeconomic indicators undermine the economic development perspectives. Therefore, the economic damage of the war will have serious economic implications for Armenia in the long-term period undermining its financial security. As Orkhan Baghirov, a leading advisor at Center of Analysis of International Relations (AIR Center), [puts](#) it “all these problems also show that the aggressive and occupational policy against the neighbors never leads to development and the only way for Armenia to achieve rapid economic recovery is to join the regional cooperation”.

## **VI. Building *Pax Caucasia*: opportunities and challenges**

The Second Karabakh War ended with the signing of the trilateral declaration between Armenia, Azerbaijan, and Russia on November 10, 2020. The declaration, which stopped the

war and laid the foundation for solving other thorny issues between Armenia and Azerbaijan, including the liberation of the remaining territories under occupation (Aghdam, Kalbajar, Lachin) as well as the unblocking of all economic and transport communications in the region, may have heralded the dawning of a different period in the history of a long war-ravaged region of the South Caucasus. This is evidenced by the announcement of new cooperation initiatives such as the “six-party cooperation platform” and the establishment of the “Zangezur corridor,” which aims not only to link Armenia and Azerbaijan, but also to play a wider role in enhancing the region’s standing by providing interconnectivity across diverse geographic and geopolitical zones. This process has already involved Russia and Turkey and will potentially facilitate links between Central Asia and Europe. There is much going on in the region in this regard and talks about the probability of building a *Pax Caucasia* in the South Caucasus are more than mere hype.

There have already been reports and testimonies about Azerbaijan’s intention to move on, post-Second Karabakh War, and adopt a maximally cooperative and magnanimous approach towards Armenia following the latter’s defeat in the war. This was apparent in the many concessions made by Azerbaijan in the post-war period, such as providing a ten-day extension (from November 15 to November 25, 2020) of the deadline for the Armenian Armed Forces and the Armenian population that had settled in Kalbajar during the occupation to leave the region, and the return to Armenia of 69 Armenian nationals detained in Azerbaijan and 1400 bodies. Moreover, as a gesture of good will, Azerbaijan helped with the transfer of humanitarian aid to Armenian residents in Karabakh; facilitated the transfer of goods through Azerbaijan’s

main territory; allowed Armenian citizens to continue using the parts of the Gorus–Kafan highway that pass through the newly liberated Azerbaijani territories; and last, but definitely not least, for the first time in three decades the transportation of Russian natural gas to Armenia through Azerbaijan became a reality.

However, this cautious optimism about the nascent prospects of peace and cooperation in the region is facing a number of challenges. These include Armenia's flouting of Article 4 of the November 10, 2020 declaration that demanded the withdrawal of all remaining armed groups from Azerbaijani territories; purposeful misrepresentation by Armenia of militia members captured by Azerbaijan as a result of counter-terrorist operations since November 10 as prisoners of war (PoW) and resultant attempts to exert pressure on Azerbaijan; and the newly intensified debate on who might have launched Iskandar M missiles against the Azerbaijani city of Shusha during the 44-day war. The latter issue in particular seems to boggle the mind after the Azerbaijani National Agency for Mine Action (ANAMA) recently discovered the remnants of an Iskandar M ballistic missile in Shusha. According to the Missile Technology Control Regime (MTCR), the export version of this missile is the Iskandar E, which the Russian Federation exported only to Armenia. The Iskandar M, the remnants of one of which were discovered in Shusha, is in the sole possession of the Russian Federation. The story behind this discovery definitely has a dark side that needs to be clarified, as the absence of plausible answers may generate dangerous speculation. Either way, this issue, along with the others discussed above, is also inhibiting a seamless transition to the post-conflict rehabilitation period.

In addition to the above, the danger posed by the landmines planted in the previously

occupied Azerbaijani territories is very acute. According to some estimates, Armenia spent \$350 million on planting landmines in and around the Nagorno-Karabakh region. ANAMA is currently undertaking operations towards clearing the areas contaminated with landmines and unexploded ordnance (UXO) and initial estimates suggest that the neutralization of UXO, missiles, and the remaining ammunition in the combat areas could require 5–6 years, while it might take some 10–13 years before the mined areas are completely cleared. Although Azerbaijan is also receiving help from its friends, partners, and international organizations, including Turkey, Russia, and the United Nations, in the form of staff training, delivery of mine-clearing equipment, and financial assistance, this is obviously not yet sufficient for tackling this very difficult and precarious work.

The issue is further exacerbated by the fact that, in response to all the gestures of goodwill by Azerbaijan aimed at turning the page on hostility and embarking on building a cooperative relationship with Armenia, the latter still refuses to give Azerbaijan maps of the landmines planted in its formerly occupied territories. Worse still, as noted by the Assistant to the President of the Republic of Azerbaijan – Head of the Department of Foreign Policy Affairs of the Presidential Administration at the [briefing](#) held for the diplomatic corps on the occasion of the “International Day for Mine Awareness and Assistance in Mine Action” (April 5, 2021), on the one occasion when Azerbaijan was able to obtain maps of purported mined areas from Armenia, these maps turned out to contain false information, as ANAMA was unable to find anything based on the coordinates therein. “This could mean that Armenia purposefully misled Azerbaijan,” Mr. Hajiyev noted. Apparently, there is still no progress

whatsoever in terms of persuading Armenia to cooperate on the issue of landmines. However, this is hugely important, as refusal to collaborate on such a crucial issue may diminish the already meagre prospects for achieving lasting peace and cooperation between the erstwhile enemies in the wake of Azerbaijan's one-sided concessions to Armenia.

International conventions prohibit anti-personnel landmines (APL), the most dangerous form used against civilians. Every year, reputable organizations in the field, such as the International Campaign to Ban Landmines (ICBL), report thousands of people dying or being injured owing to landmines. Post-Second Karabakh war, Azerbaijan has already reported the deaths of dozens of its citizens as well as military servicemen, including Russian peacekeepers, who have

died or been maimed as result of anti-personnel landmine explosions. If the correct maps of the mined areas are not given to the Azerbaijani side in due time, the numbers of casualties will increase, adding to the already daunting global statistics of human deaths due to landmines. It is hoped that Armenia will not realize too late that civilians should not be at the receiving end of the regime's frustration and resentfulness over the war that was lost.

As Dr. Esmira Jafarova, the Board Member of the Center of Analysis of International Relations (AIR Center), has noted, "there are clearly visible challenges of the post-conflict period that need to be overcome. The complexity of the outstanding issues demands transparency, cooperation, and mutual compromise if there is a genuine wish to move away from the horrors of the past".