

MARCH-2021



# ANALYSIS

## THE MILITARY AND ECONOMIC CONSEQUENCES OF THE SECOND KARABAKH WAR FOR ARMENIA

### Foreword

Armenia and Azerbaijan have been living in a state of war for 30 years owing to unresolved territorial problems. The first large-scale hostilities between Armenia and Azerbaijan since the ceasefire signed in 1994 were observed in April 2016 and called the “four-day war.” Later, on July 12, 2020, the Armed Forces of Armenia, with the help of artillery and large-caliber weapons, attacked the positions of the Azerbaijani armed forces on the Azerbaijan-Armenia state border in the direction of the village of Agdam, Tovuz region.

The conflict was mediated by the OSCE Minsk Group, co-chaired by Russia, France, and the United States, for about three decades. Despite the four UN Security Council resolutions demanding full and unconditional withdrawal of Armenian troops from the Nagorno-Karabakh region, the OSCE Minsk Group member states did not take a firm stand on the Armenia-Azerbaijan conflict. Unfortunately, the peace process under the auspices of the OSCE Minsk Group was unsuccessful. Therefore, perpetuating the status quo was no longer an option for Azerbaijan.

Armenian Prime Minister Nikol Pashinyan tried to change the format of peace talks with the intention of bringing the separatist regime to the negotiating table. Pashinyan uttered a populist declaration: “Nagorno-Karabakh is Armenia, and that’s it,”<sup>1</sup> and was therefore criticized by both Azerbaijan and international organizations, especially the OSCE Minsk Group. Along with this harsh rhetoric, Armenian Defense Minister David Tonoyan, during his visit to the United States in March 2019, stated at a meeting with the Armenian Diaspora that Armenia has moved from a “trench defense” strategy to an “active deterrence” strategy. In his speech, the Armenian defense minister called his strategy a “new war for new territories.”<sup>2</sup> All these statements had a very negative impact on the peace talks and completely closed the political arena for compromise.

A counter-offensive operation was carried out by Azerbaijan’s Armed Forces in response to the provocations of the Armenian side on September 27, 2020. The 44-day counter-offensive operation by the Azerbaijani Army ended on November 10 with Azerbaijan’s victory. On the same day, the trilateral declaration signed by the Presidents of Azerbaijan and Russia and the Prime Minister of Armenia further consolidated Azerbaijan’s victory. Thus, the decades-long occupation ended, and

---

<sup>1</sup> Pashinyan calls for unification between Armenia and Karabakh, <https://eurasianet.org/pashinyan-calls-for-unification-between-armenia-and-karabakh>

<sup>2</sup> Rationalizing the Tonoyan Doctrine: Armenia’s Active Deterrence Strategy, <https://jamestown.org/program/rationalizing-the-tonoyan-doctrine-armenias-active-deterrence-strategy/>

justice was restored. The Second Karabakh War simultaneously caused great military, demographic and economic damage to Armenia, which will take decades to recover.

## 1. Armenia's Involvement and Military Losses

The way the 44-day war was being operated by the Republic of Armenia clearly exposed the latter's argument about not being a party to the conflict. Looking at the available information, it is clear that the illegal regime in Nagorno-Karabakh region did not have the capabilities necessary for conducting the war and the operation was, instead, entirely controlled by Yerevan. Moreover, just as during the first Nagorno-Karabakh war of the 1990s, there were also mercenaries and foreign fighters fighting on the side of Armenia during the Second Karabakh War.

On September 27, 2020, after the beginning of the military escalation, martial law and full mobilization was declared not only within the region of Nagorno-Karabakh, but also Armenia itself, which undeniably reaffirmed Armenia's active participation in the war. Immediately after, on September 28, Armenian Defense Minister David Tonoyan, together with the so-called "President" of the separatist regime, Arayik Harutyunyan, visited the command post of the "NKR Defense Army" where he got acquainted with the situation on the front line.<sup>3</sup>

There have been public figures and state officials who have confirmed Armenian citizens' participation in the Second Karabakh War. These include Deputy Prime Minister Tigran Avinyan<sup>4</sup> and the Deputy Minister of Justice of Armenia<sup>5</sup> as well as the wife of Prime Minister Nikol Pashinyan, Anna Hakobyan. Prime Minister Pashinyan's son, who only recently returned from his controversial military service in Nagorno-Karabakh, was also confirmed to be fighting in the 44-day war.<sup>6</sup>

These examples all help extinguish the illusion that the separatist regime (the so-called "Nagorno-Karabakh Republic") was conducting the fighting on its own and clearly show that the military operations were being managed and operated by Armenia, rather than the "Nagorno-Karabakh Republic" itself. The Prime Minister, holding a military consultation in Nagorno-Karabakh region on October 5, also confirmed that the operation was being controlled by Armenia.<sup>7</sup> The officially held position of Yerevan that there was not one Armenian military subunit in the Nagorno-Karabakh region is false, a fact that all recognize but none condemn.<sup>8</sup> The service of conscripts from Yerevan in Nagorno-Karabakh (including that of the PM's son) is strong evidence, among other facts, that provides confirmation that Armenian forces of occupation were located within the internationally recognized territories of Azerbaijan.

Moreover, international media articles covering the situation in Armenia also reflected the direct military involvement of Armenia in the 44-day war. In his article for *Foreign Policy*, Jack Losh quotes a mourner from Yerevan saying, "Everyone here has been touched by the war. My son's friend is still missing in action. We don't know if he's alive or dead."<sup>9</sup> In a further instance in the same article, a

<sup>3</sup> Министр обороны Армении прибыл на командный пункт армии обороны НКР, <https://www.interfax.ru/world/728955>

<sup>4</sup> Ранен вице-премьер Армении, <https://news.day.az/politics/1286144.html>

<sup>5</sup> Замминистра юстиции Армении освобожден от должности - он записался добровольцем, <https://ru.armeniasputnik.am/politics/20201028/25092845/Zamministra-yustitsii-Armenii-osvobozhden-ot-dolzhnosti---on-zapisalsya-dobrovoltsem.html>

<sup>6</sup> Wife of Armenian PM goes to the front in Karabakh war, <https://jam-news.net/armenian-prime-ministers-wife-anna-hakobyan-to-be-sent-to-the-front-in-karabakh-nikol-pashinyan-war-news/>

<sup>7</sup> PM Nikol Pashinyan Holds Consultation in Artsakh, <https://armedia.am/eng/news/87617/pm-nikol-pashinyan-holds-consultation-in-artsakh.html>

<sup>8</sup> "Azerbaijan: Is War Over Nagornyy Karabakh a Realistic Option?" [https://www.files.ethz.ch/isn/87342/08\\_may.pdf](https://www.files.ethz.ch/isn/87342/08_may.pdf)

<sup>9</sup> Armenia Buries Its Dead but Can't Put to Rest the Horrors of Recent War, <https://foreignpolicy.com/2021/01/06/armenia-loss-nagorno-karabakh-azerbaijan-horrors-of-war/>

gravedigger in Yerablur, the military memorial cemetery in Yerevan, is quoted as saying, “Work has never been busier. Every day more bodies arrive. Every day we dig more graves. The hill is filling up.” Another article describes the journey of fathers from Armenia to Khankendi (Stepanakert) to search for news about their sons.<sup>10</sup>

The involvement of military personnel in the fighting on the side of Armenia during the Second Karabakh War went beyond Armenians from Nagorno-Karabakh and Armenia itself. There is ample evidence that foreign fighters (citizens of France,<sup>11</sup> Russia,<sup>12</sup> and Georgia<sup>13</sup>) as well as mercenaries were deployed by the Armenian side.<sup>14</sup> Azerbaijan has launched criminal cases against mercenaries and members of PKK-PYD-YPG terrorist organizations,<sup>15</sup> as well as foreign fighters such as two Lebanese citizens of Armenian origin, Khagop Terziyan and Khagop Khzhiryan.<sup>16</sup> Reports about men from Armenia being sent to the front lines have piled up, unconditionally confirming the role of Yerevan in Nagorno-Karabakh. Recently, there has been confirmation of convicted felons from Armenia being released to go and fight in Nagorno-Karabakh.<sup>17</sup> Clerics from Armenia have also been confirmed as participating in the war; figures such as Hovsep Saakyan.<sup>18</sup> International reporters have talked about “Diggers roam[ing] the cemetery in the capital, Yerevan, constantly digging fresh graves to try to keep up with demand as dozens of families grieve for their loved ones.”<sup>19</sup> Every story about human costs mentions casualties from the Armenian state, like the story of 19-year-old Sargis Hakopyan, who, in July 2019, was drafted into the Armenian army.<sup>20</sup>

The illegal deployment of Armenian personnel has, unfortunately, not ended following the signing of the peace statement on November 10, 2020. Recently, parents and relatives of Armenian soldiers being conscripted to the Karabakh region have protested in front of the Ministry of Defense of Armenia, rejecting the illegal transfer of their sons to the territories of Azerbaijan.<sup>21</sup> This also shows that it is not only volunteers being deployed to the Karabakh region; many soldiers are also being

<sup>10</sup> In Armenia and Azerbaijan, desperate families search for news of the Nagorno-Karabakh war dead, [https://www.washingtonpost.com/world/europe/armenia-azerbaijan-missing-soldiers/2020/12/03/3a4c1c64-33dd-11eb-9699-00d311f13d2d\\_story.html](https://www.washingtonpost.com/world/europe/armenia-azerbaijan-missing-soldiers/2020/12/03/3a4c1c64-33dd-11eb-9699-00d311f13d2d_story.html)

<sup>11</sup> Armenian volunteer returns from France to fight for Nagorno-Karabakh, <https://www.france24.com/en/20201007-armenian-volunteer-returns-from-france-to-fight-for-nagorno-karabakh>

<sup>12</sup> Armenian diaspora rushes to Nagorno-Karabakh to back troops, <https://www.reuters.com/article/armenia-azerbaijan-volunteers-int-idUSKBN26U13N>

<sup>13</sup> From Javakhk to Artsakh: Volunteering with the Black Panther Unit, <https://hetq.am/en/article/123433>  
From Javakhk to Artsakh: Gevorg Avagyan Renounced Georgian Citizenship to Fight, <https://hetq.am/en/article/123750>  
Azerbaijani army liquidated a detachment of Armenian "Javakhk" separatists led by Vahagn Chakhalyan, <http://en.kavkazplus.com/news.php?id=6470#.X6eVQ2gzaUk>

<sup>14</sup> Report on “Use of mercenaries and foreign fighters by Armenia against Azerbaijan” prepared by AIR Center, <https://aircenter.az/uploads/files/Mercenaries%20report.pdf>

<sup>15</sup> Criminal case initiated against a group of persons affiliated with PKK-PYD-YPG terrorist organizations, <https://apa.az/en/azerbaijan-army-azerbaijani-armed-forces/Criminal-case-initiated-against-a-group-of-persons-affiliated-with-PKK-PYD-YPG-terrorist-organizations-335431>

<sup>16</sup> Azerbaijan launches criminal case against two foreigners fighting in Karabakh war, <https://www.azernews.az/karabakh/175354.html>

<sup>17</sup> Минюст Армении одобрил отправку ээков на фронт, <https://vestikavkaza.ru/news/minust-armenii-odobril-otpravku-zekov-na-front.html>

<sup>18</sup> Армения заставляет воевать священнослужителей, <https://vestikavkaza.ru/news/armenia-zastavlaet-voevat-svasennosluzitelej.html>

<sup>19</sup> Report: ‘We Don’t Believe in a Political Solution’ in Nagorno-Karabakh, Fighters Say, <https://foreignpolicy.com/2020/10/29/fighters-say-no-political-solution-nagorno-karabakh-armenia-azerbaijan-war/>

<sup>20</sup> Nagorno-Karabakh conflict: Human cost of two nations fighting for 'Motherland' - BBC News  
Nagorno-Karabakh conflict: Human cost of two nations fighting for 'Motherland', <https://www.bbc.com/news/world-europe-54723662>

<sup>21</sup> "Не хотим, чтобы наши дети служили в Карабахе": родители солдат протестуют у МО Армении, <https://ru.armeniasputnik.am/politics/20210225/26574899/Ne-khotim-chtoby-nashi-det-sluzhili-v-Karabakhe-roditeli-soldat-protestyut-u-MO-Armenii.html>

sent against their will.

When it comes to the numbers of military personnel killed during the Second Karabakh War, the statistics of Armenia and the so-called “Nagorno-Karabakh Republic” differ. According to the Health Ministry of Armenia, as of February 13, 2021, the death toll of military personnel is 3,450 people.<sup>22</sup> The March 15, 2021 statistics from the so-called “Ministry of Defense of the Republic of Nagorno-Karabakh,” however, put the death toll at 2,460.<sup>23</sup> In addition, there were more than 10,000 deserters from the Armenian army during the war.<sup>24</sup>

The biggest impact of the latest war on Armenia, where the population is decreasing every year, will surely be demographic. A country with a population of just 2.9 million and a fertility rate of 1.7 is a vanishing country. Along with the low fertility and migration, the decades-long war with Azerbaijan is the key factor here that also influences demographics.

Against the background of the lost war in Karabakh, the economic downturn and political chaos in Armenia have intensified the question of mass emigration. It turns out that the birth rate in Armenia in 2020 increased by 0.9% compared with 2019 (from 36,041 to 36,448). However, during the same period, the death rate in the country recorded an increase of 35% (from 26,186 to 35,371); that despite the fact that not all those killed during the Karabakh War are included in these statistics. In other words, the natural population growth was 1,077 people.<sup>25</sup> Now, it is expected that, following the war, the number of Armenian people leaving the country will increase as soon as global borders reopen.



<sup>22</sup> Минобороны НКР опубликовало новый список погибших в Карабахе, <https://www.interfax.ru/world/751160>

<sup>23</sup> Минобороны Республики Арцах опубликовало новый список погибших в войне солдат, <https://voskanapat.info/?p=39555&l=ru>

<sup>24</sup> A Victory parade dedicated to Victory in the Patriotic war was held at Azadlig Square, Baku, <https://mod.gov.az/en/news/a-victory-parade-dedicated-to-victory-in-the-patriotic-war-was-held-at-azadlig-square-baku-34045.html>

<sup>25</sup> Армения. Демография в цифрах, <https://ru.armeniasputnik.am/infographics/20210211/26405564/Demograficheskie-itogi-2020-goda-armenia.html>

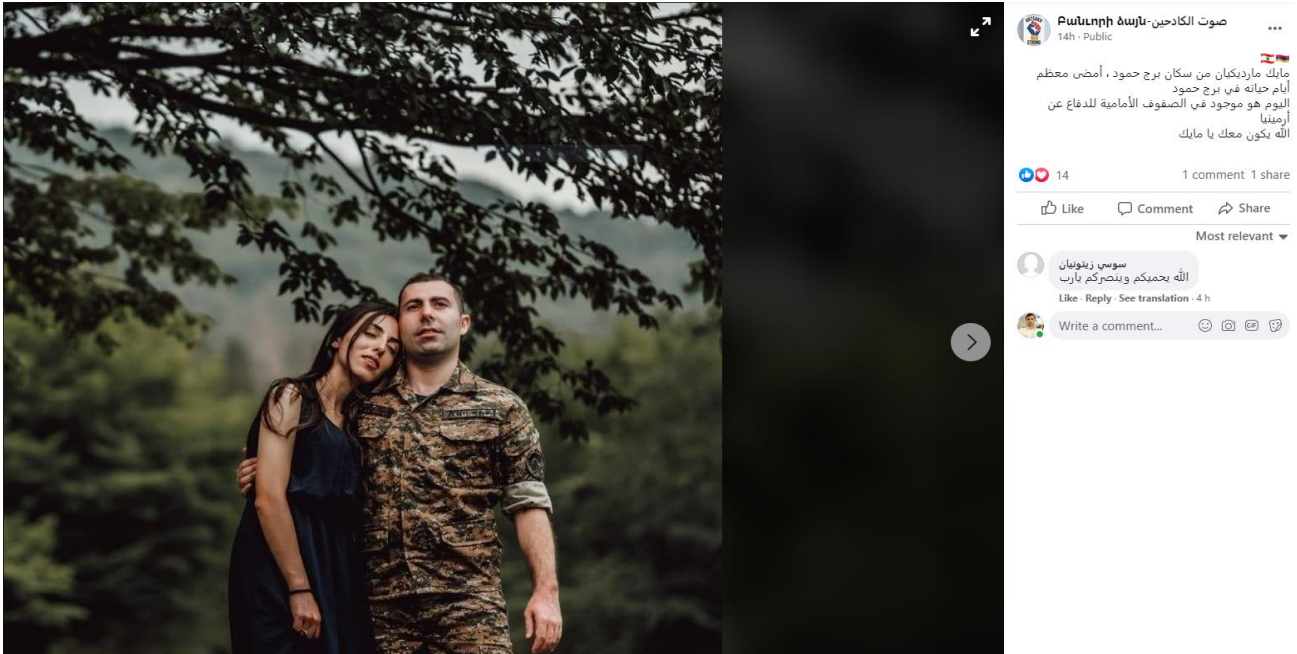
*Armenian Defense Minister David Tonoyan at the headquarters of the “NKR Defense Army,” where he got acquainted with the course of military operations in Nagorno-Karabakh region. Photo: Shushan Stepanyan, September 28*



*Arayik Harutyunyan met with a volunteer detachment of the Armenian community of Abkhazia / November*



*Arzumanyan and Black Panther detachment comrades – Georgia’s ethnic Armenians live in Samtskhe–Javakheti region*



*Mike Mardikian, a resident of Bourj Hammoud / Lebanon*



*Yerablur Military Pantheon cemetery in Yerevan, Armenia. Photo: Foreign Policy*



*Armenian Prime Minister Nikol Pashinyan visits Yerablur Military Pantheon cemetery in Yerevan on the day of nationwide mourning for those killed in a conflict over the region of Nagorno-Karabakh. Armenia, December 19, 2020. Vahram Baghdasaryan/Photolure via REUTERS*

## **2. Military Equipment Losses**

Azerbaijan named a long list of military losses of the Armenian side in Karabakh, which will be impossible to restore in the near future. President of Azerbaijan Ilham Aliyev, in his address to the nation, named a long list of destroyed Russian-made military equipment.<sup>26</sup>

### *The destroyed equipment of the Armenian army includes:*

Anti-tank weapons – 53 pieces; “Smerch” heavy multiple rocket launcher – 4 units; “Grad” truck-mounted multiple rocket launcher – 97 units; “Uragan” self-propelled multiple rocket launcher – 2 units; “TOS” thermobaric weapon – 1 unit; “S-300” anti-aircraft missile system – 7 launchers, a S-300 radar and 2 S-300 detection stations; “Defense” radar station – 1 unit; “TOR” air defense systems – 5 units; “OSA” air defense systems – 40 units; “KUB” air defense systems – 4 units; “KRUG” air defense systems – 1 unit; “ZASTAVA” air defense systems – 14 units; “S-125” air defense systems – 2 units; UAVs – 22 units; tactical-operational missile system “Elbrus” – 2 units; ballistic missile – 1 unit; “Tochka-U” missile complex – 1 unit; radio electronic warfare systems – 5 units; command and staff vehicle “R-142” – 2 units; “Sky-M” radar station – 1 unit; various radars – 7 units; and “Repellent” electronic warfare system – 4 units.

### *The list of hardware destroyed and taken as war trophies includes:*

Self-propelled artillery installations “Acacia” and “Carnation” – 28 destroyed and 5 taken as trophies; cannons of various calibers – 315 and 37 taken as trophies; mortars – 63 destroyed and 62 taken as trophies; specialized vehicles – 10 destroyed and 93 taken as trophies; grenade launchers – 178

<sup>26</sup> Ilham Aliyev addressed the nation, <https://en.president.az/articles/48205>  
Mirza İbrahimov 8, Baku, AZ1100, Azerbaijan, Phone: (+994 12) 596-82-39, (+994 12) 596-82-41, E-mail: info@aircenter.az

taken as trophies; tractors – 10 taken as trophies; anti-aircraft guns “Shilka” – 5 taken as trophies; and 1,380 small arms were taken as trophies. Seven command posts and 11 ammunition depots were destroyed. Tanks – 287 destroyed and 79 taken as trophies (366 in total). The list goes on: Infantry fighting vehicles – 69 destroyed and 47 taken as trophies; Su-25 – 5 aircraft destroyed; trucks – 252 destroyed and 270 taken as trophies.

The Armenian side did not refute the fact that, in just a month and a half of fighting, 287 tanks were destroyed and another 79 were taken as trophies. So, the total losses in tanks amounted to 366 units, the Azerbaijani side claims. Approximately the same number was lost by the Soviet troops in the battle of Prokhorovka in 1943, or the Syrian troops in the battle for the Golan Heights with Israel in 1973. For a more detailed comparison: In the battle of Prokhorovka, Soviet troops lost, according to various estimates, 343 tanks. And in the battles for the Golan Heights in 1973, the Syrians lost about 350 tanks.<sup>27</sup>

A detailed list of the destroyed and captured vehicles of Armenian Army published by Oryx Blog can be seen below.<sup>28</sup>

- Tanks: 232, of which destroyed: 130, damaged: 5, captured: 97;
- Armored fighting vehicles: 73, of which destroyed: 25, captured: 48;
- Infantry fighting vehicles: 74, of which destroyed: 28, captured: 46;
- Self-propelled anti-tank missile systems: 16, of which destroyed: 3, captured: 13;
- Towed artillery: 220, of which destroyed: 120, damaged: 10, captured: 90;
- Self-propelled artillery: 23, of which destroyed: 16, captured: 7;
- Multiple rocket launchers: 77, of which destroyed: 72, captured: 4 abandoned: 1;
- Ballistic Missiles: 1, of which destroyed: 1;
- Mortars: 47, of which destroyed: 4, captured: 43;
- Anti-tank guided missiles: 116, of which destroyed: 3, captured 113, of which 19 launcher or optic;
- Man-Portable Air Defense Systems: 6, of which captured: 6;
- (Self-propelled) anti-aircraft guns: 10, of which destroyed: 1, captured: 9;
- Surface-to-air missile systems: 32, of which destroyed: 27, captured: 5;
- Radars: 16, of which destroyed: 12, captured: 4;
- Jammers and deception systems: 3, of which destroyed: 3;
- Aircraft and helicopters: 2, of which destroyed: 2;
- Unmanned Aerial Vehicles: 5, of which destroyed: 5;
- Trucks, vehicles and jeeps: 606, of which destroyed: 276, damaged: 8, captured: 324;
- Decoys: 2, of which destroyed: 2; and
- Strategic locations hit: 22.

This list includes only destroyed vehicles and equipment of which photo- or videographic evidence is available. Therefore, the amount of equipment destroyed is undoubtedly higher than recorded here. Small arms, munitions, derelict vehicles and non-strategic targets such as checkpoints are not included in this list.

According to the Treaty on Conventional Armed Forces in Europe (CFE), the following limits on the number of troops and weapons were established for the Republic of Armenia: personnel, 60

<sup>27</sup> Беззащитная военная техника на 3 миллиарда долларов, [https://www.ng.ru/armies/2020-12-06/100\\_tech06122020.html](https://www.ng.ru/armies/2020-12-06/100_tech06122020.html)

<sup>28</sup> The Fight For Nagorno-Karabakh: Documenting Losses On The Sides Of Armenia And Azerbaijan.

[https://www.oryxspioenkop.com/2020/09/the-fight-for-nagorno-karabakh.html?m=1&fbclid=IwAR05Yj8kMGlQXYh9EBNR5HwPWxepctV1Df3\\_SYGK4q\\_1QyXVtMtjbUZbDbU](https://www.oryxspioenkop.com/2020/09/the-fight-for-nagorno-karabakh.html?m=1&fbclid=IwAR05Yj8kMGlQXYh9EBNR5HwPWxepctV1Df3_SYGK4q_1QyXVtMtjbUZbDbU)  
Mirza Ibrahimov 8, Baku, AZ1100, Azerbaijan, Phone: (+994 12) 596-82-39, (+994 12) 596-82-41, E-mail: info@aircenter.az



thousand; main battle tanks, 220; infantry fighting vehicles (BMP) and armored personnel carriers (APC), 220; artillery systems with a caliber of more than 100 mm, 285; combat aircraft, 100; and attack helicopters, 50. Therefore, the above-mentioned facts about Armenia's military losses raise questions relating to its compliance with the provisions of the treaty.



*A destroyed military vehicle belonging to the Armenian forces displayed during a military parade to mark the victory in the Nagorno-Karabakh conflict. Baku, Azerbaijan, Dec. 10, 2020. Photo: Daily Sabah*



*Azerbaijani soldier with a war trophy captured from the Armenian side. Photo source: Unknown*

### 3. Economic Damage of the Second Karabakh War for Armenia

Through Armenia's defeat in the war, its army suffered the loss of most of its military equipment and combat potential. In the war, the Armed Forces of Armenia lost military equipment and installations, as described above, costing hundreds of millions of dollars. It is estimated that the value of Armenian military equipment destroyed or taken as trophies by the Azerbaijani Army during the war is about \$3.8 billion.<sup>29</sup>

If we compare the military expenditure of Armenia in recent years to its losses in the war, we can see a clear picture of how devastating were the losses to Armenia. In the last 10 years, the annual military expenditure of Armenia approximately doubled, from \$357 million to \$716 million (see Chart 1). Despite the fact that the annual level of military expenditure of Armenia cannot be considered high compared with countries that spend a considerable amount of money on militarization, for a small country such as Armenia with limited economic resources, this is a huge financial expense. In the past decade, the share of the military expenditure of Armenia in its Gross Domestic Product (GDP) was about 4% and reached almost 5% in 2019.<sup>30</sup> That figure is even greater than those of countries such as the U.S.A. (3.4%) and Russia (3.9%) that dedicate substantial financial resources to militarization. With the existence of substantial economic problems in Armenia, spending huge financial resources for military purposes proves the approach of the Armenian government towards territorial occupation.

<sup>29</sup> Center for Analysis of Economic Reforms and Communication: Military equipment losses of Armenia amount to 3.8 billion dollars, <https://apa.az/en/finance-news/Center-for-Analysis-of-Economic-Reforms-and-Communication-Military-equipment-losses-of-Armenia-amount-to-38-billion-dollars-coloredPHOTOcolor-336840>

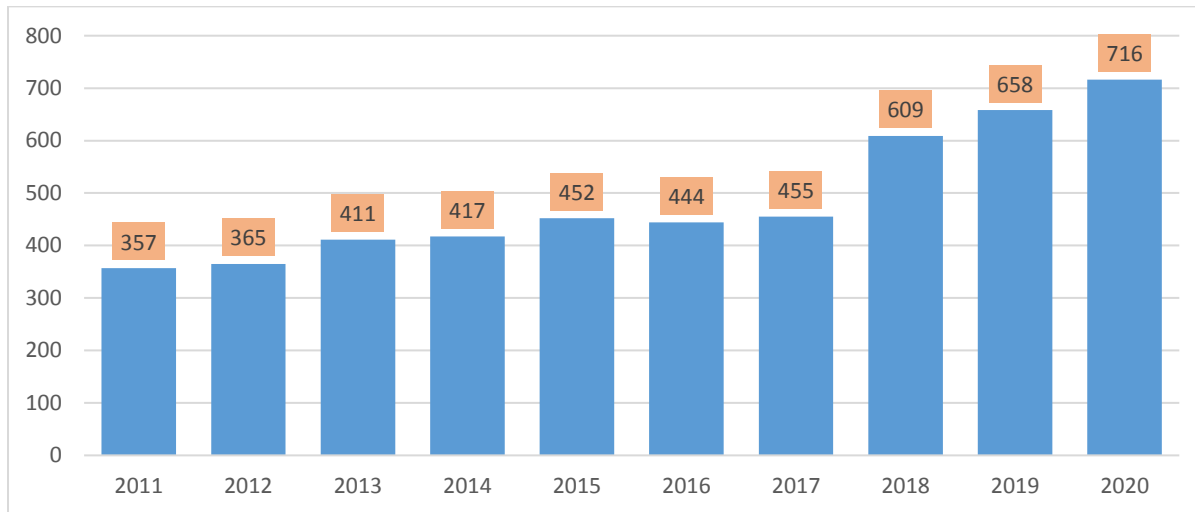
<sup>30</sup> Military expenditure (% of GDP) – Armenia,

<https://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS?locations=AM>

Mirza Ibrahimov 8, Baku, AZ1100, Azerbaijan, Phone: (+994 12) 596-82-39, (+994 12) 596-82-41, E-mail: info@aircenter.az

The total military expenditure of Armenia in the most recent ten years was \$4.9 billion (Chart 1). Thus, we come to the conclusion that the value of military equipment lost by Armenia in the Second Karabakh War constitutes more than 77% of the total military spend in the past ten years. If we take into account the other losses of Armenia, such as military personnel (officially about 4,000<sup>31</sup>) and war-related economic damage, we see that in the Second Karabakh War Armenia was deprived of the greater part of its military capabilities that had been accumulated over a period of ten years. Therefore, given its existing economic and financial problems, Armenia will need several decades to recover its military potential.

**Chart 1. Military Expenditure of Armenia (million U.S. dollar)**



Source: [SIPRI](#)

Calculations based on military expenditure statistics show that, in the most recent ten years, the average annual amount of the money spent for military purposes in Armenia was about \$490 million. With spending at this average value, to recover the \$3.8 billion in damage that Armenia experienced in the war will need at least eight years. However, Armenia cannot mobilize all of its financial resources for the recovery of its military capabilities. Because of the pandemic and the war, Armenia is faced with serious economic and social problems. In order to solve these problems and head off rising social discontent in the country, the Armenian government also needs to allocate financial resources for economic development. Thus, with the existence of economic and financial problems, Armenia will need many years to rebuild its army.

Taking into account all of its economic and financial problems, the Armenian government plans to cut military expenditure, as envisaged in the 2021 state budget.<sup>32</sup> Meetings among government members and the defense ministry were held for planning military cuts. Despite the fact that there are disagreements in the Ministry of Defense over decreasing the military budget, the Armenian government does not have any other choice. Utilization of a substantial part of its limited financial resources for military purposes would leave other economic problems unresolved. This, in turn, could further increase the already growing social tensions because of the war. Considering the impossibility of restoring the army in a short time, the Armenian government is currently focusing more on the economic and social problems.

Armenia is faced with economic damage not only because of its military losses, but also because of

<sup>31</sup> Forensic examination conducted over bodies of 3,577 people, <https://news.am/eng/news/629364.html>

<sup>32</sup> Armenia may cut military budget, <https://report.az/en/region/armenia-may-cut-military-budget/>

the loss of various natural resources in the territories that were under its occupation for about 30 years. During the occupation, Armenia exploited all energy, mineral, and agricultural resources in the occupied territories. These resources played an important role in the energy, food, and financial security of Armenia. Now, as Azerbaijan has liberated its territories, Armenia is deprived of those resources, which creates additional economic problems for Armenia. To replace the lost resources, Armenia needs to import them from other countries, which will increase the financial burden on the country.

The liberation of the occupied territories by Azerbaijan has created problems for the energy security of Armenia. As those territories have huge water resources, many hydroelectric power stations were built there during the period of occupation. The electricity produced in those stations met the energy demands of the Armenians living in the occupied territories and surplus electricity was exported to Armenia in both spring and summer. In recent years, electricity imported from the occupied territories made up about 7% of the electricity supply in Armenia. However, as a result of the war, 30 hydroelectric power stations out of the 36 that existed in the occupied territories came under the control of Azerbaijan.<sup>33</sup> This led to the loss of 60% of the electricity production capacity for Armenians in the previously occupied territories. In 2020, Armenia planned to import about 330 million kWh of electricity from the occupied territories. However, owing to the war, only a fraction of the planned volume was delivered and this created an electricity shortage in Armenia. It is also worth mentioning that Armenia now not only has to import electricity from abroad, but also should export electricity to support the Armenian population left in the previously occupied territories.

Because of the war, Armenia also lost the large agricultural lands of Azerbaijan that it exploited over the last thirty years and which played a crucial role in the provision of food security. As a result of the war, Azerbaijan has liberated more than 90,000 hectares of arable land used for grain production. This means that Armenia has lost about 90% of arable land in the previously occupied territories. Those territories were producing 150,000 tons of various grain crops annually, of which 100,000 tons were exported to Armenia. As the total demand for grain products in Armenia is about 450,000 tons, the grain products imported from the occupied territories provided about 20–25% of the country's total demand. Therefore, the Second Karabakh War has noticeably affected the agriculture sector and food security of Armenia. As with the energy sector, because of the lost agricultural resources, Armenia must substantially increase grain imports in order to meet the needs of its population.

The Second Karabakh War also put serious pressure on the fiscal sector of Armenia. Owing to the increased military expenditure during the war, in October the Armenian Parliament approved a bill amending the law implementing the 2020 State Budget; this proposed to increase budget expenditure by about \$85 million.<sup>34</sup> Before that, in April, due to pandemic-related economic problems, the Armenian government had made the first amendments to the state budget. As a result of these budget amendments, the budget expenditure of Armenia reached \$3.44 billion, which was about 30% of GDP in 2020. The increasing budget expenditure also led to an increase in the budget deficit; its level reached \$964 million, or 7.56% of GDP, in 2020.

As a result of budget changes in 2020, budget income decreased about \$590 million (17.5%) and the budget deficit increased by about three times. The high level of the budget deficit, in turn, created substantial financial security problems for Armenia. In order to serve the high budget deficit and solve its financial problems, Armenia had to incur foreign debt. Despite the fact that the rising level

<sup>33</sup> MP: Armenia's energy sector likely to face serious problems this year, <https://energycentral.com/news/mp-armenia%E2%80%99s-energy-sector-likely-face-serious-problems-year>

<sup>34</sup> Parliament approves bill on increasing current expenditures by 40 billion drams, <https://armenpress.am/eng/news/1030725.html>

of public debt is one of the main economic problems in Armenia, it did not have any other choice than attracting financial resources from other countries or institutions. Doing so resulted in the continuation of an increasing level of public debt in Armenia. According to official data from the Armenian government, in 2020, the total public debt of Armenia increased by about \$1.37 billion (18.5%), amounting to \$8.74 billion at the end of the year.<sup>35</sup>

High public debt, in turn, worsened the economic situation in Armenia, threatening the financial security of the country. Because of the increasing public debt, the Debt to GDP ratio, one of the main indicators that reflects the level of financial security of a country, reached a dangerous level. After the second amendment to the state budget, the Armenian government predicted that Debt to GDP ratio would reach nearly 67%, passing the 60% threshold.<sup>36</sup> However, as the recorded decline of GDP was greater than the predictions of the government, by the end of the year the Debt to GDP ratio of Armenia had reached 69%. Owing to existing economic problems, it is expected that this ratio will reach even higher levels in 2021 and subsequent years.

As the existing problems have deepened the financial crisis, the Armenian government now cannot carry out its accepted budget projects for 2021. In December 2020, the Armenian Parliament had approved its budget projects for the following year. Despite the existing economic problems, the Armenian government made budget predictions that were close to the predictions for 2020 that had been accepted in 2019. This raised doubts about the possibility of achieving those predictions. Since its predictions were unrealistic, the Armenian government began to face problems in implementing its budget projects and decided to cut some budgeted expenditures. In February, the Deputy Prime Minister of Armenia confirmed that the government is discussing the possibility of reducing the cost of maintaining the state apparatus.<sup>37</sup> A reduction in state institutions of about 10% is planned.

The economic situation in the post-war period in Armenia has also negatively affected the exchange rate of the national currency, the dram, against the U.S. dollar. The depreciation of the dram began before the war because of pandemic-related economic problems. However, as a result of the war, the depreciation process accelerated. During the war, from September 27 to November 9 2020, the dram fell about 1.9% against the US dollar, which was lower than expectations (Chart 2).

However, as the negative economic effects of the war began to be felt after the end of the war, the depreciation of the dram accelerated. From November 13, 2020 to March 15, 2021, the dram fell by about 6.3%. More broadly, from the beginning of the war up to March 2021, the dram depreciated by about 8.6%. As pandemic-related restrictions are still effective in Armenia and other countries, this moderates the outflow of foreign currency from the country. This, in turn, prevents the rapid depreciation of the currency. Therefore, the dram is expected to continue to fall even in the post-pandemic period. In order to maintain the stability of the currency, the Armenian government has to use its limited foreign exchange reserves, which also creates financial problems for the country.

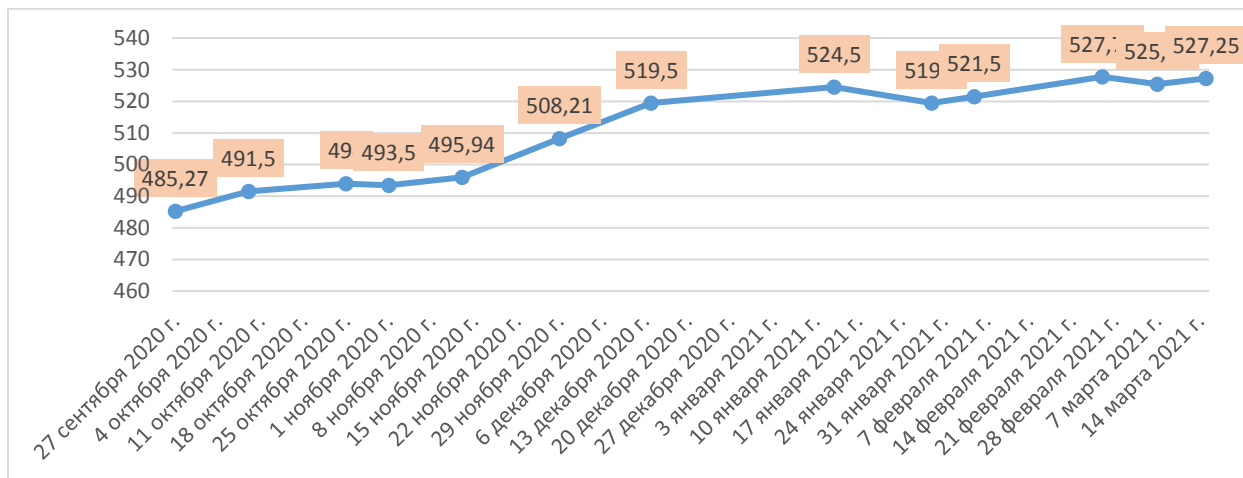
<sup>35</sup> Armenia's overall public debt grows to \$7.97 billion,

[https://arka.am/en/news/economy/armenia\\_s\\_overall\\_public\\_debt\\_grows\\_to\\_7\\_97\\_billion/#:~:text=The%20government's%20external%20debt%20at.%20Don%20year%20to%20%20%241.915](https://arka.am/en/news/economy/armenia_s_overall_public_debt_grows_to_7_97_billion/#:~:text=The%20government's%20external%20debt%20at.%20Don%20year%20to%20%20%241.915).

<sup>36</sup> Armenia plans to increase current expenditures by 40 billion drams, <https://armenpress.am/eng/news/1030384.html>

<sup>37</sup> В госсекторе Армении могут произойти новые сокращения,

<https://ru.armeniasputnik.am/economy/20210210/26403496/V-gossektore-Armenii-mogut-proizoyti-novye-sokrascheniya.html>

**Chart 2. Exchange rate of the dram against the US dollar (dram to \$1)**

Source: The Central Bank of Armenia

## Conclusion

The Second Karabakh War (September 27, 2020–November 10, 2020), which continued for 44 days and ended with the signing of trilateral declaration, ended the decades-long Armenian occupation and led to the restoration of the territorial integrity of Azerbaijan. Furthermore, defeat in the war caused multiple losses to the Armenian side. As our analysis shows, Armenia is facing serious military, demographic, and economic damage as a result of the 44-day war.

The financial cost of the war to Armenia is almost equal to Armenia's total military expenditure for the last ten years. Therefore, it will take many years for Armenia to rebuild its army. Because of the war, Armenia also lost access to the natural resources situated in the occupied territories of Azerbaijan and exploited by Armenia for about thirty years. Those resources played an important role in the provision of food and energy security in Armenia. Now, Armenia has to increase its imports of energy and food products in order to substitute lost resources from the previously occupied territories.

Moreover, the war also significantly affected the fiscal sector of Armenia and deepened its financial crisis. During the war, Armenia had to make changes to its budget because of the increasing military and social costs. Increased budget expenditures, in turn, necessitated the attraction of foreign finance, which created additional financial security problems for Armenia. As a result, the Debt to GDP ratio of Armenia has reached a dangerous level and is expected to increase in the coming years. Because of these financial problems, Armenia cannot achieve the approved state budget projections for 2021. Thus, government members are actively discussing decreasing budget expenditures in public institutions and in the military sector. Along with the fiscal sector, economic problems have also put pressure on the national currency of Armenia. Since the war, depreciation of the currency has accelerated, and this has induced the Armenian government to use its currency reserves to stabilize the dram.

All the economic damage and financial problems that Armenia is facing indicate that, for the restoration of the army and establishment of a sustainable economy, Armenia needs many years and a huge amount of financial resources. In the current situation, the only way for Armenia to achieve economic development and restoration is to abandon its aggressive policy against its neighbors and join regional initiatives. By supporting regional cooperation, Armenia could get support from its neighbors and become part of regional projects. Thus, the liberation of the

occupied territories of Azerbaijan creates great potential for the provision of sustainable economic development and durable peace in the region.