



## The Karabakh Conflict, and its Geopolitical and Economic Impacts on Georgia

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### ABSTRACT

Georgia has been a land hub between Europe and Asia since ancient times, when trade began in the second century BC. The Great Silk Road trailheaded in Sian, and, in Dunghuan, it split into two branches heading westward: north of the first Lobnor Lake, and Turfan, to the south of the same lake - Khotani and st. Via Yarkend - St. Kashgar. From there, the northern road connected with the Caspian Sea and the Transcaucasus, and crossed Georgia to reach the Byzantine and Roman Black Sea via the Phasis. The second road went from Kashgar to Balkh and northern Iran, and from there to the shores of the Mediterranean Sea. In 1998, on the initiative of Senator Brownbeck, the United States Senate passed a resolution to support the development of a New Silk Road. The TRACECA, as well as the Baku-Tbilisi-Ceyhan "Great Oil Pipeline" and the Baku-Tbilisi-Erzurum "Great Gas Pipeline" are already operating under the auspices of the New Silk Road, significantly changing the economic reality in the Caspian-Black Sea region, creating new conditions for development, and strengthening that region - not only regarding the energy security of the countries there, but the energy security of Europe as a whole (The Silk Road History, 2021; Elisseeff, 2001; Li & Taube, 2018).

Considering this, the resumption of the Nagorno-Karabakh conflict (the so-called Third Karabakh War) has affected Georgia more than it may seem at first glance.

The results of this war in reality present huge threats and challenges to the geopolitical and economic environment of Georgia, and a naïve understanding of the status quo could be very unfortunate for the country. In this paper, we will explain why the new Karabakh status quo is more threatening to the Georgian economy than the current situation, what challenges it poses to the country, and what we can do to either completely circumvent these threats or, at worst, minimize them.

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### Historical-Geographical Overview

In general, Georgians tend to know little of the history of Azerbaijan and Armenia, often because there is no emphasis on the need for such knowledge of its neighboring countries in economic or political terms. It is this very historical uncertainty that leads to endless disputes and conflicts over the delimitation of borders in the Caucasus region, to which the main contribution has been made by Russia, which has planted its “mines” in the region over the centuries and is always quick to use them. In the words of Beka Kobakhidze, Associate Professor, Head of the Master’s Program: “The ‘Boundless Caucasus’, based on the Schengen model, is still a chimera, which follows Georgia on its path to European integration” (Kobakhidze, 2020).

We read about the historical-geographical perspective in the article of Sandro Samadbegishvili, a Geocase analyst: The history of Nagorno-Karabakh (called “Artsakh” in Armenian) and its affiliation, is a controversial issue, which on the one hand is difficult to enter and on the other is not an essential factor of analysis. The reality is that the territory of Nagorno-Karabakh (alongside other various parts of the Caucasus region) has historically passed from hand to hand, and on it we find traces of Albanian and Azerbaijani, Armenian and Persian. Each mosque, church, inscription or cemetery provides the different sides with arguments to substantiate their positions. Nevertheless, the indisputable fact is that the Nagorno-Karabakh Autonomous Region was part of the Soviet Socialist Republic of Azerbaijan and is now an integral part of the territory of independent Azerbaijan, recognized by the world community.

Even before the collapse of the Soviet Union, relations between ethnic Armenians

living in Nagorno-Karabakh and the Azerbaijanis were strained, linked to the desire of those Armenians for autonomy and to be annexed to Armenia.

To better understand the status quo established in 1994 and in the aftermath of the 2020 conflict, we need to understand what Nagorno-Karabakh is geographically. The region is an enclave, an island deep in the territory of Azerbaijan, and it has no geographical border with Armenia. Therefore, in order to ensure the connection of the “Armenian satellite” Nagorno-Karabakh with “Armenia proper,” it was necessary to build a sort of bridge between them. The Lachin Corridor, which connects the last city of Goris in Armenia with Nagorno-Karabakh, is a 6 km serpentine bridge. For years, the Lachin Corridor was the only route between Nagorno-Karabakh and Armenia. Thus, the Nagorno-Karabakh conflict for Azerbaijan was not limited to the loss of direct control over Nagorno-Karabakh but, at the very least, lost control of the corridor.

But that’s not all. The consequences of the 1990s conflict were far worse for Azerbaijan, seeing it lose control not only of Nagorno-Karabakh (which covers an area of about 4,400 sq. km.), but also of the seven districts around Nagorno-Karabakh, which were not at all part of Nagorno-Karabakh. In total, the de facto Nagorno-Karabakh Republic established control of about 11,500 sq. km. For the de facto government of Nagorno-Karabakh and Armenia, the occupied territories beyond Nagorno-Karabakh functioned as a buffer zone and trade area of great importance. The occupied territories beyond Karabakh are about the size of Abkhazia, and are home to more than half a million IDPs. The interesting thing is that neither Armenia nor Karabakh had a legal or logical argument for occupying the territory beyond Nagorno-Karabakh.

All that was left after that was for Azerbaijan to consolidate its military potential, forge an even stronger coalition with its Turkish allies, react to the potential negotiation with Russia, and wait for the best moment to resolve the issue, militarily, at least (Samadbegishvili, 2020).

### **Analysis of the Political Environment of the Region**

It would be interesting to explore who gained or lost what with the ending of the war and reaching of a peace agreement, as well as what echoes the new order in the Caucasus region may have in the future.

#### **Azerbaijan**

Territorial integrity has always been a priority for Azerbaijan, so the agreement was a direct personal victory for President Ilham Aliyev. Under the agreement, Azerbaijan regained control of the Nagorno-Karabakh Autonomous Region and the city of Shusha.

#### **Armenia**

After the war, Armenia and its interests suffered the most. The concession of Karabakh was painful for the Armenians, and clear proof of this can be found in the October 27, 1999 assassination of the Speaker of the Parliament Karen Demirchyan, Prime Minister Vazgen Sargsyan, and other politicians of the Armenian Parliament who, on their part, expressed willingness to make concessions on the Karabakh issue.

Even Nikol Pashinyan, who survived the revolution in 2018, could not escape these clichés, and he also repeatedly stated that “Artsakh [the Armenian name for Karabakh] is Armenia.”

By sitting down at the negotiating table, Pashinyan might have avoided the Third

Karabakh War and had to give up less, but he could not escape the prevailing thinking that “everything can be given up except Karabakh,” and, in the end, he got what he got.

Like Azerbaijan, another setback for Armenia can be considered in the appearance of Russian “peacekeepers” in Karabakh, which further limits Armenia’s actions within the borders of the protected territories.

However, if there is one thing that can be seen in a positive light regarding Armenia’s position, it is the preservation of the capital of Karabakh, Stepanakert (Khankendi), its surroundings, and the corridor of Lachin, as well as the rest of Azerbaijan-Nakhichevan. Maximum obstruction of the issue of the land corridor connecting Azerbaijan and Nakhichevan will be a small victory for Armenia. If it fails, the role of Armenia as “the loser” may be further aggravated, and may even become a humiliation for them.

#### **Russia**

From the first day of the Second Karabakh War, the main question was related to Russia’s passivity. Why did Russia not fulfill its commitment to allied Armenia? Moscow’s formal response to this was that the war was taking place in the territory of another country, and there was no legal basis for interference. Yet Moscow did not even use its levers of pressure on Baku.

Russia, with its silent strategy, achieved the maximum, as always. Russia won Aliyev’s favor, punishing the entire Armenian diaspora. Only Pashinyan was unaffected, with his ambitions to escape from Russia’s orbit, develop a democratic country and, most importantly, to do so in the only conflict region in the Caucasus where Russia had not previously been present.

When a third airport was captured in the Caucasus region (the former Gudauta

Airport, located in Georgian territory in the Russian-occupied region of Abkhazia), the Erebuni Airport in Armenia was added to the Hojal Airport on the territory of Azerbaijan, 7 km from Stefanakert.

Now, Russian military transport planes are flying from Russia via Azerbaijani airspace and the city of Ganja, to Yerevan, which was before unthinkable. Soon, though, the Karabakh-based military springboard will no longer have to use Yerevan for logistical support, with its difficult 300 km of hard terrain road; it can instead use Hojal Airport.

Everyone is well aware of the trump card Russia has with its own “peacekeeping force” in the region of its interest. Both Azerbaijan and Armenia are in the grip of Russia with this decision, and a step taken incorrectly in the perception of Russia could land on them like the sword of Damocles (Russian Gambit, 2020).

### **Georgia**

In 2021, in Azerbaijan, the President of Turkey, Recep Tayyip Erdogan, green-lighted a profitable format, the 3 + 3, which envisages the formation of a joint group comprised of Turkey, Russia, Iran, Azerbaijan, Armenia and Georgia, and the holding of negotiations between them.

The next step was to discuss the format at a meeting between Turkish Foreign Minister Mevlüt Çavuşoğlu and his Georgian counterpart Davit Zalkaliani in March 2021, which was followed by Zalkaliani’s following comment: “The country should not lose its role and function, not at the expense of state interests and concessions to the occupier.”

This wording was both disturbing and negatively perceived, because in the first place it is impossible to negotiate with the occupier

until it fulfills its obligation, restores the status quo, and withdraws its declarations of independence of Abkhazia and South Ossetia. Only then could this format be discussed, and only in a modified form of 3 + 5, where, in addition to the above-mentioned states, the US and the EU would join. In all other cases, Georgia would be left vulnerable and without an ally.

Another drawback for Georgia in the 3 + 3 format is that Turkey will be a lobbyist for Azerbaijan, and, in addition to its own interests, it will defend the interests of Azerbaijan. This will hit Georgia unequivocally hard, because it still has many disputed border zones with Azerbaijan. Thus, this format will have a clear negative impact on Georgia’s interests.

As unbelievable as it may sound, besides Russia, Iran can be. A clear example of this is the tense situation on the new border between Iran and Azerbaijan, coming as a result of strict control of Iranian truck drivers by Azeri border guards. As such, Russia, the “unpredictable” state, will be the defender of Armenia’s interests along with its own. And in light of all this, Georgia will find itself in such a losing position that it may face irremediable problems; besides the eventual loss of the regions currently occupied by Russia, many more border lines may be lost in favor of Azerbaijan, Armenia and Turkey (What is the 3 + 3 format, 2021).

### **Economic Impacts and Challenges**

2020 turned out to be one of the worst years for the South Caucasus. By the end of the year, Georgia’s economy had reduced by 6.2%, and Armenia and Azerbaijan’s by 7.5% and 4.3%, respectively, not only due to the restrictions imposed by the governments to

combat the pandemic, but also as a result of falling oil prices from the beginning of March.

The same year, the economies of the Caucasus region received a third shock: The course of events between Armenia and Azerbaijan, which affected both the countries involved and the wider region (including Central Asia). The reason was the trade chain, if we do not consider Armenia-Azerbaijan and partly Armenia-Turkey economic relations in the region separately.

According to 2019 data, Georgia's trade turnover with Armenia and Azerbaijan is 13.3%, and is worth \$1,767.7 million. In terms of exports, the second largest export country for Georgia is Azerbaijan, and the third largest is Armenia. These two countries hold 24.8% of Georgia's total exports, and, while they do not trade with each other, they have close trade relations with other countries in the region.

Both Armenia and Azerbaijan play an important role not only for Georgia, but also for other economies of the region. Consequently, the negative impact of the Karabakh wars on Georgia, reflected indirectly from these countries, sees a complicating of the economic situation in the region.

Foreign trade is not the only negative impact of the Karabakh conflict affecting the Georgian economy. The negative effects of the war also impact foreign investment, on the one hand reducing foreign investment from these countries and, on the other, making the entire Caucasus region less attractive to the rest of the world. Due to instability in the region, the risks for potential investors increase, which in many cases can lead to their reconsidering large-scale capital investments. This cause-and-effect relationship has been confirmed many times.

Foreign investments in particular play an important role in the case of Georgia and Armenia, as it is the main source of financing for local consumption. In particular, 68% of the current account deficit is financed by foreign direct investments (FDI). In other equal conditions, when there is less inflow of foreign capital, local consumption decreases, which leads to a reduction in the economy and, consequently, a worsening in the living standards of the population. In contrast, in oil-exporting countries like Azerbaijan, the main source of funding for domestic consumption is revenue from the latter, and foreign investment in the economy does not play the same role as in the rest of the Caucasus.

In Georgia, FDI averages 6.9% of the total economy. In Armenia, it averages 3.0%. Thus, in Georgia's case, foreign investment has a special role, which is essential for long-term, stable growth. While the accompaniment of foreign investment is the import of knowledge and technology, which improves the productivity of the economy, the latter is crucial for sustainable economic development (Shamugia, 2021).

In addition to these problems, after the war, the new redistribution may lead to disruption of the supply chain, whose main transit corridor is Georgia, from Turkey to Azerbaijan (and vice versa).

Azerbaijan and Turkey have a mere 10 kilometres of land border between Armenia and Iran. Those few kilometres change a lot today, and may become the kindle for another war in the South Caucasus, this time on the Azerbaijan-Armenia border.

After the victory in the Third Karabakh War, and the liberation of the previously occupied seven Azerbaijani regions, as well as the takeover of parts of Nagorno-Karabakh, Official Baku has a new and very large per-

spective, the implementation of which could completely change the reality of the South Caucasus over the next century. Azerbaijan includes the Nakhichevan Autonomous Republic, with which Azerbaijan is divided by the Syunik region of the territory of Armenia: The shortest distance between Azerbaijan and Nakhichevan is a straight line of just 37 km.

During the Soviet era, the railway from Azerbaijan to Armenia ran along the Araks River, along the Iranian border. Today, this line no longer exists, having long ago been scrapped, but for some reason President Putin wants to restore the transport corridor through the Syunik region, an initiative which appeared in the last paragraph of the ceasefire agreement of the last war in Karabakh.

It may be in Russia's strategic interest not to depend solely on Georgia's "whim" to reach Armenia from Russia by land, and is thus looking to prepare a spare option from Azerbaijan as well. Cutting off such a transport corridor directly from Azerbaijan to Nakhichevan via the Armenian Syunik is a good opportunity for Baku and Ankara.

If this corridor is put into operation, Azerbaijan and Turkey will acquire the shortest connecting land route through Nakhichevan, which will strengthen Ankara's influence in Azerbaijan and the whole South Caucasus. This will also significantly impact Georgia's budget, as a large part of the cargo transported from Turkey to Azerbaijan, and vice versa, via the roads of Georgia, will no longer need to come via Georgia.

One year has passed since the end of the Third Karabakh War, but the last paragraph of the above-mentioned tripartite agreement has not yet been fulfilled. The main reason

for this is that Yerevan is preparing for new parliamentary elections, which should bring some clarity to the political direction of the country as a loser in the war. But while Armenian politicians blame each other for that loss, the President of Azerbaijan has no intention of wasting time, and is taking advantage of the current military-political weakness of Armenia.

President Aliyev is just 37 km away from fulfilling the centuries-old dream of Azerbaijan to claim the Nakhichevan territory. "If the Armenians have occupied seven other regions of Azerbaijan in addition to Nagorno-Karabakh for the last 30 years, which were never part of the Soviet-era Nagorno-Karabakh Autonomous District, then why can't Azerbaijan, in the Syunik region, which was historically ours and was called Zangezuri, cut the corridor to Nakhichevan?!" is the widespread sentiment in Azerbaijan.

The future of the Georgian transit hub may depend on these 37 kilometres. If Azerbaijan finally fulfills this dream, a large part of the cargo going from Turkey to Azerbaijan and vice versa will move in this direction. Controlled by the Russian "peacekeepers", they will likely use this transit corridor for their own benefit to supply their bases (Aladashvili, 2021).

Also, after some time, if this corridor gains credibility, it will lead to the relocation of those energy carriers (the Baku-Tbilisi-Ceyhan oil pipeline, Baku-Supsa oil pipeline, and Baku-Tbilisi-Erzurum gas pipeline), because it will be more favourable for Baku and Ankara. This will reduce the costs paid to Georgia for its transit function, and ultimately, in the long run, Georgia will lose its role as the main transit hub in the Caucasus.



### Conclusion and Recommendations

It is clear that the new status quo is not a good sign for Georgia, either politically or economically. The country is surrounded by a neighbourhood of totalitarian rule, and the general environment is aggravated. Of course, Georgia does not and will not be able to resist the above, and must accept these new challenges and take new steps forward to pursue alternative solutions.

There is urgent need for a deep-water port in Anaklia, and blocking it was a blow to Russia's mill and a major blow to the country's economic interests. Large container ships should be able to enter and load/unload their cargoes, yet the existing ports in Georgia are not able to receive them. Anaklia Deep Sea Port is also very important in terms of political security, as it will allow Georgia to share the role of an Asia-Europe maritime hub with Turkey. It is further vital in terms of political security, because Georgia, as a country striving toward NATO member-

ship, will have the opportunity to welcome, berth, and perhaps even build large warships for the North Atlantic Alliance, which will definitely serve as an additional security measure against potential Russian threats, as well as increase the level of security and safety in the eyes of potential investors looking for additional security guarantees in an otherwise uncertain region.

Another unequivocally positive factor is Kutaisi Airport being a base for Hungarian budget airline Wizz Air. A leader of civil transportation in the Georgian aviation market, it has a 15% market share (Wizz Air base, 2020). With the right tactics from the government, it is possible to mobilize other budget companies, which will have a positive impact on Georgia's economy, create new jobs, increase the number of foreign visitors and make Georgia a new global destination. Within a stable environment, this can provide a great resource for diversification and will bring numerous economic benefits to the country.

In conclusion, the Euro-Atlantic aspirations and the unwavering implementation of democracy should remain Georgia's primary aspirations, which will unequivocally lead to additional investments, market diversification, and the strengthening of Georgia's role and economic progress. In doing so, the country ensures it will not be shorthanded with just a new (and perhaps lesser) land hub function.

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