

The cost of stalemate

economic aspects of the Nagorny Karabakh conflict

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Since 1994, when the armed conflict between Armenia and Azerbaijan over Nagorny Karabakh gave way to a situation of 'no war, no peace', the different parties have faced mixed economic prospects. While oil has fed the coffers of government and a small elite in Azerbaijan, economic security for the majority remains cripplingly low. In Armenia the psychological benefits of military victory over Azerbaijan are tarnished by lost economic opportunities, while economic migration to Russia and the West has arguably halved the population. Karabakh itself suffers from severe under-employment and is increasingly dependent on 'external' support, particularly from Armenian diaspora groups in the West and from 'inter-state' loans from Armenia. It seems that only elites are winning.

Balancing symbolic and material resources

On the whole, understandings of the economic costs of conflict are minimal on all sides, while the potential for a 'peace dividend' has not resulted in visible policy changes by any party. What kind of economic leverage can each side bring to bear on the other in the ongoing diplomatic struggle? Azerbaijan has oil and this is certainly part of the dynamic of diplomacy. Not only is the prospect of oil revenues cited to support statements about increased military capacity, but it is also used to court the support of the international community. Research conducted by International Alert in 2003-4, in rural areas of Azerbaijan far removed from Baku, demonstrated that oil was regarded as key to the return of lost territories amongst the Azerbaijani population. A commonly held opinion amongst these communities is that oil brings funds for the army and guarantees support from those Western governments whose companies extract Azeri oil, which will bring an end to economic hardship and, moreover, lead to the return of Karabakh. It is also a theory of change that suits those who want to strengthen stereotypes of the 'Armenian enemy' already prominent within these same communities.



If Azerbaijan has the resources but not the military victory, then Armenia has the victory but lacks the resources. However, it too has its entrepreneurs, who have sought to reach out to Turkey through informal business-to-business contacts. Indeed, in seeking to hold onto victory Armenian business interests look towards strengthening ties with Turkey, rather than towards resolving differences with Azerbaijan. Yet the Turkish option is not an easy one either. Although there are flights from Turkey to Armenia and movement of people across borders in this sense, the physical border between Armenia and Turkey is closed - a diplomatic impasse deriving from a combination of the disputed assessment of the Ottoman Empire's treatment of its Armenian community in 1915 plus Turkey's alliance with its Turkic neighbour Azerbaijan over the Karabakh conflict. Turkey's partnership with Azerbaijan has been reinforced by the construction of the Baku-Tbilisi-Ceyhan pipeline, which strategically aligns Azerbaijan, Georgia and Turkey and thereby amplifies the conflict fault-line in the region.

Oil: a resource for peace or war?

The significance of oil as an economic force in the South Caucasus and a component of the conflict dynamic is worth unpacking. At one level impacts within Azerbaijan can be categorized in ways suggested by Stanford University's Terry Lynn Karl and others. These impacts are generic in that they can also

be seen in countries such as Angola, Colombia and Nigeria, and Western oil-producing countries, such as the UK and Norway. In particular, large revenues from oil tend to strengthen the currencies of the oil producer, making its exports less competitive ('the Dutch Disease'). According to Caspian Revenue Watch, at a price of US\$25 per barrel, between 2003 and 2010 the government of Azerbaijan's share of oil profits from the Azerbaijani-Chirag and deepwater Gunashli oil fields will amount to about US\$16 billion. At US\$18 per barrel Azerbaijan's total earnings would come to US\$7.2 billion. In such a context it is hard to imagine Azerbaijan's agricultural sector recovering to provide goods for export to Russia, which used to be Azerbaijan's largest agricultural export market.

Oil revenues also fuel corruption and thereby strengthen 'corruption networks' (detailed further below). Oil-driven development, and the opportunities it offers to distribute patronage and largesse, tends to strengthen elites who will do anything to hold onto office given that it becomes the main source of power and prosperity. If efforts to reduce corruption are coupled with the gradual increase in the influence of local 'oil watchdog' non-governmental organizations (NGOs), and with the international community's backing of transparency initiatives such as the Extractive Industry Transparency Initiative (EITI), then Azerbaijan may yet move decisively towards more transparent state structures that can regulate the

oil-dominated economy effectively. However, if future electoral practice reinforces the clan-based politics of the past, then the business environment in Azerbaijan is likely to remain problematic, with the continuation of patronage politics, neglect of the non-oil sector and, despite Azerbaijan joining the EITI, little or no support for capacity building of NGOs to scrutinize transparency in oil revenues. In particular, communities outside the capital will remain impoverished, fuelling discontent, much of which will be directed towards Armenia in a context of unabated militant propaganda. Oil, seen through the eyes of these communities, then becomes the solution to both economic betterment and the return of Nagorny Karabakh – and a resource for war.

On the other hand, if oil money can be kept within the formal economy and directed towards strengthening the non-oil sector, then there are prospects for the benefits to be felt beyond those cocooned in Baku. If this happens (in tandem with positive policy developments at the international level), there is a possibility that peace will become a greater political and economic motivator for Azerbaijan than conflict. The EITI may then gather momentum and Azerbaijan will begin to develop a more far-reaching economic role as the hub for regional economic development in the South Caucasus region.

Unofficial trade and informal authority

The region's economic dynamic is further characterized by blockades and fault-lines. Land borders between Armenia and Turkey and between Azerbaijan and Armenia are closed, not to mention blockades further north between Georgia and Abkhazia and Georgia and South Ossetia. This has created a particular economic dynamic in the region that is both a consequence and feeder of the conflict. In reality, the blockades are porous, giving rise to unregulated trade across borders, whilst the conventional wisdom of the international community prevents international economic actors from lending economic support to unrecognized entities such as Nagorny Karabakh.

Existing trade links functioning in spite of these conditions are testament to the inevitability of business activity. Trade is a key component of community life in that it provides the lifeblood for employment and income generation. Without trade of some kind, communities cannot survive. Traditionally, trade between Armenia and Azerbaijan was commonplace and dynamic. The official closing of borders put a stop to much of this, but it has not stopped altogether. The Armenian news agency ArCNews estimates that unofficial trade between Azerbaijan and Armenia reached US\$40 million annually by 2002, whilst trade

between Armenia and Turkey reached US\$60-80 million. Georgia and Iran play the role of middlemen to enable Armenian goods to find their way to Azerbaijan and vice versa.

Lacking regulation, this unofficial trade clearly affects the fiscal relationship between the governments of Azerbaijan and Armenia and their citizens. The rhetoric of good governance and democracy suggests that governments elected by the people for the people should have the legitimacy to tax their citizens in order to provide the services required for society's needs to be met. Lack of trade regulation means that these taxes are not collected and that service provision based on democratic principles is replaced by inconsistent provision and 'protection' by what some refer to as 'corruption networks'. In a narrow sense this term refers to the cross-border links between people of comparable levels of authority and resourcefulness. Most often these are local authorities and specialized law-enforcement institutions, namely police, border guards and customs officials. Such a context certainly provides alternatives for survival to those trading in legitimate goods, but it also creates space within which exploitation is commonplace and criminality prospers. Criminal activities, such as trade in weapons and drugs, endure with some degree of overlap with the corruption networks within the public sphere of the South Caucasus sovereign states and unrecognized republics.

Stability without regulation

The Sadakhlo market is a clear example of this dynamic – a space created by the conflict where, amongst other goods, flour, bran and salt are sold into Armenia and Armenian smoked fish into Azerbaijan. Located on Georgian territory at the point where Georgian, Azerbaijani and Armenian borders meet, it was the only place where cross border trade was possible between the two conflicting sides in 1991-92. The dependence of this market on the conflict dynamic is perhaps best illustrated by the nervousness with which its traders view the prospect of an opening up of the Armenian-Turkish border. This would arguably spell the death of the market through the competition it would create. The traders dependent upon Sadakhlo want the stability that it brings, in a context devoid of effective public institutions. The price of stability is the unregulated system, which sustains the 'no war, no peace' situation. For this context to be transformed into positive peace, efforts must be made to establish just, efficient and transparent state structures which can work in partnership with the private sector and civil society. But can the private sector play a role in such a transformation process?

What role for the private sector?

There is certainly potential to engage the 'legitimate' business community (as opposed to those involved in the trade of guns, drugs and people). A meeting of business people from across the South Caucasus convened by International Alert in Trabzon in December 2004 demonstrated that there is an outward-looking business community in the Caucasus aware of the status quo's detrimental effects to their interests, and which in response seeks 'to improve the legal framework for business, strengthen the dialogue between business and state and expand the reach of business from a national to a regional level'. Regional meetings of this nature are one way of establishing a safe space for Azerbaijani and Armenian business people to engage with one another. However, it is impossible to imagine concrete business ventures materializing without a change in the political context. The role of business must therefore be to first lobby for political support for cross-border economic collaboration, and second to prepare to act swiftly when the political context offers opportunities to do so.

The importance of regional approaches

In crafting such roles for business communities, peacebuilding organizations can bring a conflict-sensitive lens to the development of business ideas, for it cannot be assumed that business will always act in the interests of peace. In addition, taking a regional approach to economic cooperation is likely to bring greater rewards. The term 'regional' is used here in the broadest sense of the word, to include a consideration of links between Azerbaijan, Armenia, Georgia and Turkey, including Abkhazia, South Ossetia and Nagorny Karabakh. Such a regional outlook should ideally also consider Russia and Iran. The debate surrounding potential rail links in the South Caucasus is an example of the importance of taking a regional perspective. Whilst some argue for opening a Baku-Nakhichevan-Yerevan-Gyumri-Kars railway link connecting Azerbaijan and Armenia that would take in Nagorny Karabakh, others suggest opening the Baku-Ijevan-Yerevan-Nakhichevan route, which would avoid and exclude Karabakh. Meanwhile, Georgia actively lobbies for a Tbilisi-Kars rail link that would connect Azerbaijan with Turkey via Georgia, thereby marginalizing Armenia. Economic and political interests are impossible to separate and some kind of regional approach will be required if compromises acceptable to Azerbaijan and Armenia are to be found.

The oil industry operating out of Baku has not as yet managed to lend its considerable weight to such a regional approach, with the Baku-Tbilisi-Ceyhan pipeline bypassing Armenia and reinforcing East-West alliances between Azerbaijan, Georgia and Turkey. However, the new neighbourhood policy of the European Union (EU) does offer potential for a more inclusive approach to economic cooperation. With Turkey now progressing towards membership, the EU may yet offer an economic framework, (succeeding that provided by the Soviet Union before 1990), in which Armenia and Azerbaijan can find ways of developing transparent and regulated economic linkages.

Looking to the future

This article has sought to sketch a picture of some of the economic dimensions of the Karabakh conflict. The conflict has starved the conflicting sides of opportunities for transparent and regulated trade, leading inevitably to a questioning among broader societies of the benefits of transition to a market economy. In place of regulated business, cross-border trade is by necessity conducted through unregulated networks that both feed and feed off corrupt practices. This context is more likely to sustain the 'no war, no peace' status quo than to offer any new openings for positive peace. Local business networks do have the potential to contribute to transforming this context, however, especially if they are able to partner with peacebuilding organizations and adopt regional approaches that provide opportunities for Azerbaijani, Karabakh and Armenian business people to meet. The EU's new neighbourhood policy also has potential to offer a new framework for economic cooperation. In the meantime, each party has its own sources of economic support allowing it to continue surviving the current impasse. In particular, oil in Azerbaijan remains cause for concern, although international and local efforts are being made to ensure that the 'black gold' is more a benefit than a curse.