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# Armenia's Critical Economic Reliance on Russia

## Can the West Eliminate It?

*Orkhan Baghirov*

Lately one of the most discussed political issues related to the South Caucasus region is Armenia's attempt to incline towards the West by trying to move away from Russia's sphere of influence. This has been manifested both geopolitically and economically. However, Armenia's potential strategic shift away from its centuries-old political alignment with Russia raises questions about the future of the overall relationship between the two countries. A key concern revolves around the challenges Armenia may face due to its significant *economic* dependence on Russia.

For such a shift to occur successfully, Armenia would have to not only strengthen its political and security ties with the West, but also develop the ability to replace Russia

with Western partners in key economic sectors. Thus, the primary objective of the essay is to assess the degree to which Armenia could economically substitute Russia with the West, determining the feasibility of this transition. To achieve this, we should identify the critical level of Armenia's reliance on Russia across diverse economic sectors and assess the extent to which the West can mitigate this dependency in anything resembling a realistic timeframe, without, that is, critically endangering Armenia's economic wellbeing.

### *Foreign Trade*

Armenia's foreign trade dynamics reveal a significant increase in trade with Russia during January-August 2023. The trade

turnover surged by 56.3 percent to \$4.2 billion, with exports to Russia more than doubling to \$2.3 billion and imports rising by 16.1 percent to around \$2 billion. In this period, Russia's share in Armenia's foreign trade turnover reached 34.7 percent, accounting for 51.7 percent of exports and 25.9 percent of imports.

Comparing the above figures with those from 2022, it is evident that Russia's influence has grown, with an increased share in both exports and imports. In 2022, Russia held a 34 percent share in Armenia's overall trade turnover: 36.7 percent in exports and 32.3 percent in imports. This trend indicates a substantial increase in Armenia's exports to Russia, while the level of imports has almost remained the same.

Conversely, Armenia's trade with the European Union in the first 8 months of 2023 saw a 36.7 percent increase in turnover, amounting to \$1.9 billion. However, exports to the EU decreased by 5.3 percent to \$516 million, while imports rose significantly by 64.3 percent to \$1.4 billion. Consequently, the

EU's share in Armenia's foreign trade turnover during this period was 15.8 percent, comprising 18.5 percent of imports and 11.2 percent of exports.

We can also compare the above data with 2021 so as to gain a fuller understanding of how the position of Russia and the EU has changed in Armenia's foreign trade since the start of the Russia-Ukraine war and the EU's

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choice to respond to this conflict by imposing an economic sanctions regime on Russia. In the first 8 months of 2023, compared to 2021, Armenia's foreign trade turnover increased by \$3.64 billion, exports by \$1.46 billion,

and imports by \$2.18 billion. In this same period, Armenia's trade turnover with Russia increased by \$1.35 billion, and exports to Russia increased by \$1.45 billion. Imports from Russia decreased to \$100 million. In the case of the EU, Armenia's trade turnover with the EU increased by \$244 million, and imports from the EU increased by \$400 million. Simultaneously, exports to the EU decreased by \$156 million.

*Orkhan Baghirov is a Senior Research Fellow at the Baku-based Center for Studies of the South Caucasus (CSSC) and a former Leading Adviser at the Center of Analysis of International Relations (AIRCenter). The views expressed in this essay are his own.*

As a consequence of these shifts, between 2021 and 2023, Russia's share in Armenia's exports climbed from 28.2 percent to 51 percent, while its portion in imports declined from 37.3 percent to 25 percent. This represents a notable transformation, indicating that Russia has now become Armenia's primary trade partner with a more substantial share in both exports and imports.

In contrast, the EU's role in Armenian trade has seen a decline. The EU's share in exports has decreased from 21.8 percent to 11.2 percent, while its share in imports has remained unchanged. This signifies a reversal in the trade dynamics observed in 2021, where Russia held a larger share in imports, and the EU had a greater share in exports. The significant boost in Russia's export share by 1.8 times, coupled with a 12.3 percent reduction in its import share, highlights the strengthening of trade relations between Armenia and Russia, to the detriment of the European Union.

The main factor that contributed to these changes was the start of the Russia-Ukraine war, which enabled Armenia to actively participate in the re-export of Western-sanctioned products to Russia. Therefore, there has been

a great increase in the volume of exports to Russia, and Russia's trade relations with Armenia have strengthened. Despite Armenia's official representatives consistently denying their country's involvement in the re-export of sanctioned products, Armenia's finance minister, Vahe Hovhannisyan, told lawmakers on 25 September 2023 at a session of his country's Financial-Credit and Budgetary Affairs Committee that "in the first half of 2023, compared to the same period of last year, re-exports contributed significantly, by nearly 187 percentage points, to the nearly 215 percent dollar growth in the exports of goods to Russia, whereas the exports of Armenian-made goods contributed by 28 percentage points."

That being said, the overall trade statistics suggest that Western countries, particularly EU member states, could potentially serve as a viable alternative to Russia as Armenia's primary trade partner. However, an analysis of Armenia's foreign trade structure at the product level reveals a substantial reliance on Russia for the import of strategic products, beginning with the energy sector. Finding alternative sources for these key products would prove to be a strategically challenging task.

## *The Energy Sector*

Armenia's greatest dependence on Russia is evident in the energy sector, where Russia serves as the primary supplier of various energy products, including natural and liquefied gas, gasoline, and diesel. While Armenia generates electricity through local thermal power plants, hydroelectric power plants, and a nuclear power plant, the raw materials crucial for these facilities to function are mostly imported from Russia. Thermal power plants operate using gas overwhelmingly imported from Russia, and even the Metsamor Nuclear Power Plant (NPP) relies on nuclear fuel (uranium) sourced exclusively from Russia. Consequently, Russia not only stands as the main provider of gas and fuel; it also indirectly plays a significant role in the electricity production of Armenia, contributing to 70 percent of the country's electricity generation in 2022 (according to the International Energy Agency).

In 2022, Armenia experienced a 6.4 percent increase in natural gas imports, totaling 2.966 million cubic meters, according to the Customs Service of Armenia. Russia dominated in the import of

natural gas, constituting 87.7 percent, with Iran contributing 12.1 percent. In this period, the volume of gas imported from Russia rose by 6.1 percent, while the volume from Iran increased by 7.9 percent. The import of liquefied gas also saw a notable uptick, rising by 22.7 percent to reach 90.26 thousand tons. The vast majority of liquefied gas imports (90.3 percent) came from Russia, with the remaining 9.2 percent originating from Iran. Notably, the import of liquid gas from Russia surged by 4.1 times during 2022, while the import from Iran witnessed a significant decline of 80.7 percent. Compared to 2021, Russia's share in liquefied gas imports increased from 26.8 percent to 90.3 percent.

Along with gas, Russia is Armenia's primary provider of oil products, especially gasoline and diesel. In 2022, Russia accounted for 76.1 percent (519 thousand tons) of the oil products imported by Armenia. Iran and Greece contributed 10.2 percent and 8.2 percent, respectively, to Armenia's oil product imports during that period. In the first half of 2023, there was a 10.3 percent increase in the volume of oil product imports, with Russia solidifying its position as the leading supplier, providing 74.3 percent of Armenia's total oil product imports.

One of the main components of Armenia's energy security is the Metsamor NPP, which plays a critical role in ensuring Armenia's energy security, supplying 35 percent of the country's electricity for many years. Despite its importance, major concerns have arisen due to the plant's aging infrastructure, reaching 40 years, leading to debates about potential regional risks. In 2016, significant renovation efforts extended the plant's operational period until 2027, with Russia providing a \$270 million loan and a \$30 million grant to Armenia. The renovation was carried out by the Russian company Atomenergoremont. Despite these improvements, the aging infrastructure remains a major challenge for Armenia's energy security, with the EU repeatedly calling on Armenia to close it down permanently—in 2021, an EU Commission report put it this way: “the nuclear power plant located in Metsamor cannot be upgraded to meet internationally accepted nuclear safety standards fully, and therefore requires an early closure and safe decommissioning.”

Nonetheless, it continues to operate. The management of the Metsamor station is fully entrusted to Russia's Rosatom. Furthermore, the uranium essential for the station's operation is entirely imported from Russia, with another Russian

company handling the processing of the plant's radioactive waste. Therefore, the Metsamor station—a primary contributor to Armenia's electricity production—is under the comprehensive control of Russia.

### *Trade in Other Strategic Products*

Beyond energy products, Armenia is heavily dependent on Russia for the import of various strategic goods, particularly in the food sector. In 2022, nearly all of Armenia's wheat imports (99.9 percent) and wheat flour imports (99.2 percent) were sourced from Russia. Russia also played a crucial role in supplying 98.8 percent of Armenia's corn imports during the same period. Furthermore, substantial portions of other food products are heavily reliant on Russia, including 82.2 percent of pasta imports, 72 percent of margarine oil imports, and 66.6 percent of bread and flour products imports.

These statistics demonstrate Russia's substantial presence not only in Armenia's general trade relations and the energy sector, but also in ensuring the country's food security. The mentioned food products, predominantly imported from Russia, are vital components of the

population's main consumption basket, which directly contributes to the food security of Armenia.

### *Remittances*

Russia also plays a key role in the inflow of remittances into Armenia, primarily driven by the substantial Armenian expat community residing in Russia. The onset of the Russia-Ukraine war in February 2022 has further heightened Russia's significance in this aspect, with approximately 110,000 Russian citizens relocating to Armenia permanently due to the conflict.

The share of Russia in providing remittances to Armenia increased notably, rising from 55 percent in 2021 to 70 percent in 2022. In 2022, \$3.6 billion was transferred to Armenia solely from Russia, marking a fourfold increase from the previous year. In this period, the overall volume of remittances more than doubled.

Remittances hold substantial importance in Armenia's economy, as evidenced by their high contribution to the country's Gross Domestic Product (GDP). In 2022, the share of all remittances in Armenia's GDP reached 19 percent; just the remittances originating

in Russia amounted to about 13 percent of Armenia's GDP. This financial leverage forms a significant political and economic tool for Russia, providing the potential to strategically shape the course of Armenia's future developments.

### *Foreign Investments*

Along with the mentioned directions, Russia also acts as one of the main investors in Armenia's economy, as outlined by data from the Statistical Committee of Armenia. In 2022, the total volume of foreign investments in Armenia reached \$506.44 million, with 92 percent of it categorized as foreign direct investments. Indeed, Russia is the country's leading investor by far, contributing significantly to the economic development of Armenia. In 2022, Russia's share of the country's total foreign investments was an impressive 80 percent, and its involvement in foreign direct investments stood at 60 percent.

It is noteworthy that the volume of investments attracted from Russia in 2022 experienced a substantial surge compared to the previous year. This growth was remarkable, increasing fivefold for total foreign investments and more than tripling for direct foreign investments. This

underscores the substantial and growing influence of Russian investments in Armenia, a trend that has intensified since the onset of the Russia-Ukraine war.

### *Influence of Russian Companies*

In addition to the existing dependence in the mentioned directions, in various key sectors of the Armenian economy, Russian companies hold significant stakes, reinforcing their influence in Armenia. Notably, Gazprom Armenia, which is responsible for gas supply in Armenia, is entirely owned by Russia's Gazprom, making it the country's second-largest taxpayer and a major employer.

Another noteworthy player is Armenia Electric Networks (EES), a leading electricity distributor in Armenia. EES is owned by the Russian Tashhir Group, which is headed by Samvel Karapetyan, a Russian-Armenian billionaire. EES, which employs the largest internal workforce in Armenia whilst serving a

substantial customer base, further solidifies Russian presence in the energy sector.

The South Caucasus Railway, which is the primary railway company in Armenia, is fully owned by the Russian Railways state company. The Armenian government's concession of the South Caucasus Railway to Russian Railways in 2008, spanning a 30-year period with a possible 10-year extension, underscores Russia's control in this strategic sector as well.

### *Can the West Substitute Russia?*

This essay's brief analysis demonstrates Armenia's substantial and strategic economic reliance on Russia, which is evident across trade, energy, food security, transport, and various other vital sectors. This dependence has intensified since the onset of the Russia-Ukraine war. Despite Yerevan's recent political posturing against Russia, Armenia's economic ties to Russia have

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deepened, driven by the prospect of increased income amid the conflict. To put it bluntly, Armenia is an economic beneficiary of the conflict over Ukraine; indeed, the longer the conflict lasts and the Western sanctions against Russia are maintained, the better it will be for Armenia.

Excluding war-related re-exported products, Armenia's primary exports to Russia consist of agriculture, food products (61 percent of the total of these are exported to Russia), and high-value processed industrial goods. The export of those products serves as a crucial source of income for those Armenians living in the country's impoverished provinces and countryside. If Armenia aims to shift exports of these products to Western markets, especially to the EU, challenges will arise. Not only because the demand for these products in the West is limited due to substantial domestic production, but also because both their quality and production standards often fall short of the EU's requirements. Therefore, transitioning away from a strategic

reliance on the Russian market to Western markets would constitute a truly challenging task for local producers and manufacturers. This shift could result in decreased production levels, heightened unemployment rates, and increased social discontent, which would particularly affect the country's most economically vulnerable class—i.e., those residing outside of Yerevan and the country's few other urban centers.

Armenia heavily relies on Russia for crucial imports such as gas, oil products, wheat, corn, and vegetable oils. Changing the source of these imports to Western countries would also be challenging, sometimes impossible, and certainly more expensive. For instance, Armenia's primary gas supplier is Russia, and the infrastructure limitations make it physically impossible to replace Russian gas with Iranian gas. Constructing a new pipeline would be expensive, time-consuming, and politically complex. Russia controls the existing pipeline that traverses through Georgia. Thus, only

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Azerbaijan can act as an alternative to Armenia regarding energy imports.

As noted above, the Metsamor NPP, which is one of the key energy sources of Armenia, is fully under the control of Russian interests. While the EU advocates for its closure by 2026 due to safety concerns and a failure to meet energy security standards, completely removing it from Russia's control is effectually impossible. How would this be done, exactly? The alternative—closure and decommissioning, as demanded by the EU—would present a significant risk of triggering a structural energy crisis in Armenia that could not easily or rapidly be remedied. Therefore, finding viable alternatives remains a complex and challenging task for Armenia. It is also worth mentioning that, recently, the Armenian government approved a draft agreement with Rusatom Service worth \$65 million, signaling its commitment to extending the operational life of Metsamor NPP to at least 2036. The project, which is slated to be implemented between 2023 and 2026, comes amid deliberations about replacing Metsamor with a new U.S.-designed NPP and the EU's insistence on shutting down the station by 2026.

Another essential factor to consider is the significant number

of Armenian migrant workers employed in Russia, whose remittances constitute a vital component of Armenia's economy. The expulsion of these migrants from Russia (on whatever pretext could be found) would pose a severe challenge for Armenia, as finding equivalent employment opportunities in the West is highly, highly unlikely due to a mismatch in skills and labor market demands. The potential mass return of this workforce to Armenia would result in substantial unemployment and financial difficulties for those concerned and their families, leading almost certainly to great social dissatisfaction that would be exceedingly difficult for any Armenian government to manage, much less overcome.

Economically, the West would face considerable challenges in replacing Russia's role in Armenia, with some aspects being practically impossible. This assumes, of course, the existence of sufficient political will—not exactly a foregone conclusion. Achieving energy security independent of Russia in the coming decades appears daunting for Armenia. Furthermore, the continuation of Western sanctions against Russia suggests that, for Armenia, it remains more practical to sustain income through re-exports, as a

complete halt to such exports could lead to a significant economic setback.

To begin to shift to a strategic economic relationship with the West would also require it to make institutional changes in its relationship with Russia-led regional organizations. Currently, Armenia is a member of the Collective Security Treaty Organization (CSTO), the Commonwealth of Independent States, and the Eurasian Economic Union (EAEU). This last is particularly relevant, although membership in the other two is of great political and security significance (particularly the CSTO). For example, EAEU membership brings huge economic dividends for Armenia (participation in re-exports to Russia and Iran, low-duty export opportunities), and domestic production capabilities have been adapted to the EAEU

market standards. Thus, leaving the EAEU could pose significant challenges for Armenia. In fact, Armenia flirted with this idea once before but stopped short of taking the plunge; Ukraine managed to do so, but at an enormous cost. Frankly, no scenario in which such an outcome increases in likelihood should be championed by those who wish Armenia well.

Not to put too fine a point on it, but Armenia's military alliance with Russia (both bilaterally and through the CSTO) is intertwined with its economic cooperation with Russia. If Armenia wishes to leave the CSTO, then it would be politically impossible for it to remain a member of the EAEU. Therefore, if Armenia wants to leave Russia's sphere of influence, it would be obliged to do so politically, militarily, and economically. And all at once. Talk about shock therapy on steroids... **BD**

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