

◀ THREE POLITICAL HOTSPOTS IN THE POST-SOVIET SPACE

What the protests in Belarus and Kyrgyzstan and the renewed conflict in Nagorno-Karabakh mean for investors

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Over recent months, three significant trouble spots have emerged in the post-Soviet space. In Belarus, the political crisis prompted by the disputed Presidential elections has continued for more than two months; in Nagorno-Karabakh, an unprecedented military escalation between Armenia and Azerbaijan started in late September and in Kyrgyzstan, the protests after the Parliamentary elections resulted in a quick power transfer in early October.

Larger regional players are involved to some extent in all three conflicts – primarily Russia, which is a member of the Collective Security Treaty Organization (CSTO) and the Eurasian Economic Union (EAEU) along with Belarus, Armenia and Kyrgyzstan, but also Turkey, which has openly declared its support for Azerbaijan in the enduring conflict over Nagorno-Karabakh.

All three crises pose significant risks to investors, from the physical safety of assets and business facilities and the maintenance of financial transactions (Kyrgyzstan, Armenia) to the delayed launch of new projects and wider reputational risk if seen to be taking one side of a sensitive conflict over another.

While all three crises differ vastly in their nature, they all seem likely to endure in the near future and will determine the risks for businesses in the respective countries in the long run. At the same time, there is no universal recipe for corporate sectors directly or indirectly impacted, meaning the role of the public policy function becomes even more critical, both in gauging the scale of and mitigating against the crises, as well as forging a long-term development path in the respective markets.

Given three of the five members of the Eurasian Economic Union are involved, the crises will also have an impact on the Eurasian economic integration. Certainly, all three countries will reduce their activities in the EAEU governing bodies, being engulfed by their domestic political agendas. This will result in delays to the ongoing working processes in the EAEU and especially to internal governmental procedures discussing and approving the supranational level documents.

Please find below our deeper analysis of what the developments in these countries and regions could mean for businesses and recommendations on what actions may be taken in the face of these crises.

MILITARY ESCALATION IN NAGORNO-KARABAKH

In late September, large-scale hostilities erupted in the Nagorno-Karabakh region. This is by far the most significant escalation of the conflict since 1994, shattering the status quo of the last 26 years.¹

This latest escalation was caused by the growing domestic political tensions both in Armenia and Azerbaijan and the worsening economic situation in both countries due to the pandemic and global economic crisis.

In Armenia, domestic political tensions in the months leading up to the conflict were linked to the consolidation of personal power by Prime Minister Nikol Pashinyan and his growing confrontation with the opposition. In Azerbaijan, the main factor was the long lack of progress in the Nagorno-Karabakh settlement and – as a result - increasing influence of Turkey on the country's political leadership.

*The current crisis is not the first outbreak of military hostilities between Armenia and Azerbaijan since the beginning of the year. The previous one happened in July and largely contributed to the ongoing escalation, putting at risk the political stability in Azerbaijan and leading to a landmark government shuffle*²

To date, the hostilities have directly affected a relatively small territory (*the Nagorno-Karabakh region and adjacent areas of Azerbaijan*), but the risks of further escalation bear serious geopolitical implications:

- › A potential for the suspension or even reduction of hostilities is limited by the domestic political situation in Armenia and Azerbaijan:
 - › A change in the *de facto* status of Nagorno-Karabakh, the loss of control over the surrounding areas or significant concessions to Azerbaijan during the negotiations could destabilise the political situation in Armenia, threatening a forced change of power in the country;
 - › In turn, for Azerbaijan, the end of the active phase of the conflict without taking control over significant areas in or around Nagorno-Karabakh could erode confidence in the Government and undermine the domestic political situation.
- › If the conflict spreads beyond Nagorno-Karabakh and the surrounding areas, external forces – especially Russia and Turkey – could step in:
 - › A direct confrontation between Azerbaijan and Armenia outside the current conflict area may lead to the greater involvement of Russia (*however, the possibility of military intervention under the auspices of the CSTO is almost ruled out*).³
 - › The use of foreign mercenaries may be seen by Russia as a terrorist threat and result in more active Russian involvement. If the conflict extends beyond Nagorno-Karabakh and the adjacent territories, Turkey may become involved more even openly.
 - › The destabilisation of Armenia and/or Azerbaijan may well lead to the aggravation of other conflicts in the Caucasus and the adjacent regions, which in turn could put an additional strain on relations between Russia and Turkey or on their ties with third nations.

¹ According to this status-quo, Nagorno-Karabakh and the adjacent seven districts of Azerbaijan are controlled by self-proclaimed Nagorno-Karabakh Republic with support of Armenia. At the same time, under international law, Nagorno-Karabakh is recognised as a part of Azerbaijan.

² The dismissal of long-time Foreign Affairs Minister of Azerbaijan Elmar Mammadyarov in front of cameras over the “passive” position of Azerbaijan Foreign Affairs Ministry during the July escalation was an important sign of changes in Azerbaijan’s approach to the conflict, as Mammadyarov was one of the main supporters of the diplomatic solution

³ Russia is currently the main intermediary between the two parties. While Russia has obligations to support Armenia under the CSTO, these obligations are not applicable to Nagorno-Karabakh and could only be activated in case of military aggression against Armenia. Russia’s position in the current crisis (*rather sensitive not only to the conflict itself, but also to the involvement of Turkey*), could partly be explained by hidden tensions with Nikol Pashinyan’s Government of Armenia over its attempts to develop a “multi-vector” foreign policy and build closer relations with the Western institutions and NGOs.

What does the conflict escalation mean for businesses and investors?

The Nagorno-Karabakh crisis may have an impact on businesses directly operating in Armenia and Azerbaijan, as well as companies not represented directly in these countries.

› Risks directly related to the military escalation:

- › **Risks for companies doing business in or with Nagorno-Karabakh.** Today, multinational companies avoid doing business in the region due to its disputed international status. However, some industries providing services to consumers in the region may be exposed indirectly. These are, first of all, telecommunications companies, whose Armenian subsidiaries may do business with communications providers in Nagorno-Karabakh or provide roaming services between Nagorno-Karabakh and other countries.⁴
- › **The physical safety of business facilities in the conflict zone and the adjacent areas cannot be guaranteed.** This concerns not only the facilities located in or close to the Nagorno-Karabakh region, but also a number of major economic and industrial centres in Azerbaijan remote from the conflict zone (Ganja, Mingachevir, etc.).
- › **Security risks for the regional energy infrastructure (the Baku–Tbilisi–Ceyhan and Baku–Supsa oil pipelines and the Baku–Tbilisi–Erzurum gas pipeline).**⁵ The shutdown of these pipelines could have an impact on the regional and global energy market and potentially bring the conflict to a higher level involving third countries.
- › **Probable ban on import of goods from Turkey to Armenia.** On 16 October, the Ministry of Economy of Armenia published a draft government decree announcing a temporary ban on the import of goods produced in Turkey from 31 December 2020 to 30 June 2021. The probability of imposing such ban is high. Goods from Turkey are mostly imported to Armenia through Georgia, with total imports in 2019 amounting to USD 268 million; consumer and light industry goods dominate these imports.
- › **Possible mobilisation of employees in the event of increased hostilities.** Martial law has been declared in both Armenia and Azerbaijan (*effective in the whole of Armenia and parts of Azerbaijan, including Baku*). In addition, Armenia has announced a general mobilisation, while Azerbaijan has introduced a partial mobilisation. At present, the scale of hostilities does not require the involvement of the mobilised troops, but if the conflict intensifies, personnel losses for business are inevitable.⁶
- › **Physical access of employees who have visited one of the conflicting countries to another country.** These risks existed even before the conflict escalated (*an informal ban on persons of Armenian origin entering Azerbaijan, regardless of their nationality*), and they are now taking on added urgency. To avoid these extra risks, companies should be more careful when sending staff to Armenia, Azerbaijan and Turkey.

› Regulatory risks

- › **Difficulties in interaction with the government authorities of both countries.** The military agenda dominates the ongoing work of state authorities in both countries (in Armenia to a greater extent than in Azerbaijan due to the nationwide martial law). It is difficult to hold meetings and participate in events due to the martial law and the continuing sanitary restrictions

⁴ As of 2019, roaming services in Karabakh were provided only by the Russian operator Megafon.

⁵ The shareholders of this energy infrastructure are international consortiums including BP, SOCAR, Equinor (Statoil), Petronas, Eni, ConocoPhillips and other companies.

⁶ The martial law legislation in Armenia requires that the mobilised personnel keep their jobs and salaries.

linked to COVID-19. This could potentially lead to a freeze in the launch of new projects and other business activities until the hostilities are over.

- › **Blockage/difficulties in cross-border money transfers under martial law.** In Armenia, the introduction of martial law has effectively made it impossible for legal entities abroad to withdraw large sums of money. As a result, deals involving large, cross-border transactions have been suspended.⁷ It is difficult to predict how long the restrictions will last due to their informal nature and the lack of regulatory documents governing them.
 - › **Delivery of goods that may be classified as dual-use items by one of the parties to the conflict.** Such deliveries may be perceived as hostile actions by the authorities of Armenia or Azerbaijan. **Most social media and other Internet services were blocked in Azerbaijan from late September and access has still not fully resumed.** While the active stage of the conflict continues, such restrictions are unlikely to be removed as they are justified under national security reasons.
- › **Other indirect risks**
- › **Provision of services in Nagorno-Karabakh from the territory of Armenia / using offices or infrastructure in Armenia.** Azerbaijan's official position is that any business activity in Nagorno-Karabakh must be approved by the country's authorities (which is de-facto impossible). Accordingly, any direct or indirect commercial activity in the region carried out from the territory of Armenia is regarded as illegal. As a rule, the Azerbaijani authorities respond to such activities by raising the issue to the industry regulators of the respective countries.
 - › **An image or description of the territory of Nagorno-Karabakh indicating, directly or indirectly, that it belongs to Armenia or has the status of an independent state** in online resources (e.g. maps) or marketing materials of companies. In Azerbaijan, such materials are considered a violation of the country's territorial integrity, which entails both official reaction from the government authorities and reputational implications.
 - › Potential risks also include the use by companies of either **exclusively Armenian or the Azerbaijani names of settlements in Nagorno-Karabakh** and the adjacent areas (both Armenian and Azerbaijani names should be used if possible).
 - › **The participation of companies in humanitarian and CSR programmes related to the supply of products (food, medicines, etc.) to the conflict region.** Such involvement can be interpreted as supporting one of the parties of the conflict. In particular, the Azerbaijani authorities are closely monitoring such instances.⁸
 - › **Formal and informal relations of the owners and/or management of companies with Armenia/Azerbaijan** may become an obstacle to doing business in Azerbaijan and vice versa (difficulty entering the country, obtaining permits, etc.). This was a problem even before the escalation, and it is now in the focus of government agencies and activists on both sides, and may also affect business operations in Turkey.

⁷ For example, it is known that the sale of mobile operator Veon Armenia (Veon holding company) has been suspended due to these restrictions.

⁸ For example, the Central Bank of Azerbaijan has sent a complaint to Russia's Sberbank and the Central Bank of Russia over the use of correspondent accounts of financial institutions to collect aid for Karabakh.

THE ONGOING POLITICAL CRISIS IN BELARUS

Opposition protests in Belarus have persisted since the Presidential elections on 9 August 2020 (*please click [here](#) and [here](#) for our earlier memos on the crisis*), although they have subsided somewhat since the beginning of September, when school and business activities resumed. On the whole, President Alexander Lukashenko has managed to reassert his authority: on 23 September, he was inaugurated as President, and there has been no indication that he has lost control of the state apparatus, despite the crisis. Government agencies are operating as usual.

At the same time, the crisis is far from over, although its nature has changed. With street rallies being suppressed by law enforcement agencies, the opposition has turned to strikes as the main form of protest, which could stop or complicate the work of the country's largest companies and at the same time expose the Government's lack of control over the industrial sector.

Given Belarus' growing international isolation, business disruptions may trigger a new wave of protests and raise the question of the legitimacy of the authorities.

The constitutional reforms announced by President Lukashenko may serve as a mechanism for resolving the crisis (*if the amendments to the Constitution become a tool of compromise and gradual transfer of power from Lukashenko's hands to other institutions*) or, alternatively, could provoke a new wave of protests.

Implications for investors

› Risks associated with the international isolation of Belarus

- › **Sanctions against Lukashenko and his entourage.** In early October, the EU approved a list of almost 40 people who are subject to restrictions (visa and entry bans, freezing of financial assets). Later, the EU warned it could further extend the sanctions, including against President Lukashenko himself. It is important for businesses to monitor the sanctions list and to minimise direct contact with those impacted.
- › **Prospects for trade wars between Belarus and neighbouring countries.** At the end of September, the Belarusian customs services stopped letting in goods from Poland. However, there is no official document on import restrictions. As the crisis continues to unfold, an official or unofficial ban on the import of all or certain groups of goods from Poland, Lithuania, Latvia, Estonia and Ukraine, which Minsk accuses of hostile actions, cannot be ruled out.
- › **Potential emigration of highly skilled specialists from Belarus to other countries** may lead to a shortage of human resources. The shutdown of businesses and pressure from law enforcement agencies may force specialists (*in particular from the IT industry*) to move to neighbouring countries, including Poland, Ukraine and Russia.⁹ Foreign companies may face even greater staff shortages.

› Risks associated with the actions of the opposition and the authorities

- › **Amendments to the Constitution and reconfiguration of the state apparatus.** The constitutional amendments announced by Alexander Lukashenko are currently seen as possible grounds for a compromise to settle the crisis. The agenda includes the transfer of some presidential powers to parliament and the Government; the constitutional changes may therefore lead to the

⁹ In early October, President of Ukraine Volodymyr Zelensky signed a decree making it easier for highly qualified Belarusian specialists to stay in Ukraine.

transformation of Lukashenko's personal power regime.¹⁰ However, it is not certain that any changes will be sufficient to overcome the political impasse.

- › **Possible strikes at enterprises.** In mid-October, former presidential candidate Svetlana Tikhanovskaya presented a “people’s ultimatum” to Lukashenko. If the conditions are not met (*the resignation of Lukashenko, the cessation of violence by law enforcement agencies, the release of opposition leaders*), a national strike could start on 25 October. Therefore, the authorities are expected to monitor both public and private enterprises more closely.
- › **The financial and economic situation in Belarus may deteriorate significantly** from even a partial shutdown of large companies. In this situation, we can expect the country’s financial authorities to impose restrictive measures (withdrawal of capital abroad, currency exchange, etc.), unplanned inspections and other restrictions.
- › **Potential split within the national elites.** This could happen as the result of a new wave of protests and the President’s loss of control over the situation. The risk of Russian interference will increase in this case. ¹¹

THE POLITICAL CRISIS IN KYRGYZSTAN

The parliamentary elections in the Kyrgyzstan on October 4 effectively brought about a change of power in the country (*please click [here](#) for our earlier memo on the crisis*). The election results were annulled two days later, on 6 October, with the resignation of President Sooronbay Jeenbekov following on 15 October. The new Prime Minister, Sadyr Japarov, who was approved by Parliament on 14 October, announced the transfer of presidential powers to his own office.

However, both the resignation of the President and the transfer of his powers to the Prime Minister do not fully comply with the procedures established by the Constitution, which undermines the legitimacy of the new government and other authorities formed during the political crisis.

The prospect of new elections ¹², the difficult economic situation and the devaluation of the national currency mean that the country could be facing a protracted political crisis that may escalate further, including risks of violent confrontation, the disintegration of territories and the collapse of the public administration system. Therefore, the investors will face the following challenges:

- › **Ensuring safety of assets and cash.** The protests in Kyrgyzstan are accompanied by attacks on individual businesses (in particular gold mines) and looting in Bishkek and other major cities. In these circumstances, the issue of asset security is of particular importance.
- › **The risk of populist steps by the new authorities is increasing amidst the crisis**, including risks related to the revision of business and taxation requirements for key foreign investors in Kyrgyzstan. In particular, Prime Minister Sadyr Japarov has already come out in favour of revising the agreements for the development of the Jerooy (*owned by a number of Russian structures*), Kumtor (*owned by Centerra Gold*) and other gold mines, which account for a significant portion of the country’s budget revenues.

¹⁰ The proposed amendments to the Constitution are to be announced by 25 October.

¹¹ So far, Russia has publicly supported Lukashenko, but at the same time is pushing him to start Constitutional reforms leading to a new distribution of power. Russia’s support for Lukashenko in the crisis is rather opportunistic as he guarantees the unchanged geopolitical orientation of Belarus. At the same time, Russia wants him to begin the preparation for a power transfer in order to maintain long-term political stability and find an acceptable way out of the crisis.

¹² Parliamentary elections must be held by December 20, Presidential elections by January 10, 2021

- › **Restrictions on cross-border money transfers.** On 7 October, the National Bank of Kyrgyzstan announced the suspension of payments using the SWIFT system and other similar systems. Operations using SWIFT resumed on 13 October, but not in full: cross-border transfers are only allowed for previously concluded transactions, and in volumes not exceeding the average volumes for specific companies. A number of transactions (*such as currency purchases*) are permitted under control of the regulator.
- › **Lack of legitimate procedures.** With the authorities plunged into chaos, a significant portion of decisions can be made in circumvention of the Constitution and laws, particularly on appointments to key positions in the State. Potentially, this could lead to the power vacuum giving way to a dual or triple system of governance with several decision-making centres, which is fraught with inevitable conflicts between different branches of power (president and parliament, parliament and government, etc.).

Under these circumstances, there is no guarantee that any communication between businesses and the authorities will be respected. Actions should be based on the circumstances rather than on procedures. Based on the experience of the previous revolutions in Kyrgyzstan (in 2005 and 2010), it would be best to take a wait-and-see approach until the state apparatus returns to normal.

The likelihood of a negative scenario should also be considered. The resignation of President Jeenbekov does not mean victory for one of the conflicting parties in the Kyrgyzstan. On the contrary, the political standoff may drag on for some time in the absence of legitimate centres of power. Parliamentary and presidential elections in December-January could result either in a power reset or another round of the political standoff.

In the event the power vacuum persists, the risks associated with the disintegration of state institutions cannot be ruled out. Such prospects make investments in the Kyrgyzstan extremely risky.

WHAT THE CRISES HOLD FOR THE FUTURE OF THE EAEU

Armenia

There is no formal link between Armenia's participation in the EAEU and Russia's obligation to provide military assistance in the event of an act of aggression against Armenia within the CSTO. However, the reality of the matter is that Armenia's participation in Eurasian regional integration was largely driven by Russia's security guarantees. In 2013, Armenia refused to sign an Association agreement with the EU and joined the Customs Union of Russia, Belarus and Kazakhstan, a move which was partly dictated by security considerations.

The transfer of a part or all of Nagorno-Karabakh under the control of Azerbaijan may affect Armenia's foreign policy, including its involvement in the EAEU, especially if Russia does nothing to prevent it. It is therefore unlikely that Russia would allow Azerbaijan to take control of all of Nagorno-Karabakh. However, Armenia's next steps within the framework of the Eurasian integration structures will to a great degree depend on the state of affairs once active hostilities have come to an end.

Belarus

In the past, Minsk counted on Moscow's preference for Belarusian business support in connection with Belarus' integration into the EAEU and the Union State of Russia and Belarus. However, this is no longer the case. The instability of Lukashenko's regime, the international isolation of Belarus and the likelihood of trade and sanctions wars with Poland, the Baltic States and Ukraine dictate the need for rapprochement with Russia on more favourable terms for the latter.

At the moment, however, it is difficult to outline the position that Belarus will take on integration within the EAEU moving forward. At the same time, integration processes within the Union State of Russia and Belarus, first of all the roadmaps in different areas (including issues related to the single currency issuer), may indirectly affect the EAEU agenda.

Kyrgyzstan

Due to the ongoing crisis, Kyrgyzstan is currently not involved in ongoing EAEU activities.¹³ At the same time, the key aspect of the country's participation in the Union is the status of its relations with Russia. The coronavirus pandemic has already dealt a significant blow to the Kyrgyz economy, with many migrant workers from the country having been forced to leave Russia.

Against the backdrop of the political crisis, Moscow announced that it would be suspending financial aid to Kyrgyzstan (non-performing loans and debt cancellation) until the situation normalizes. The prospects for further integration within the EAEU depend on how quickly Kyrgyzstan will be able to return to legitimacy, as well as on the interests of the political elites who will eventually take power in the country.

In general, the crises described above may have a direct impact on the EAEU's prospects. Armenia will take the outcome of the Nagorno-Karabakh conflict into account when defining its priorities within the EAEU; Belarus will be more focused on tackling its internal problems and will consider its participation in the EAEU from this point of view; and Kyrgyzstan's full-fledged involvement directly depends on how quickly its state apparatus will be restored.

About Kesarev

Kesarev is the leading independent consultancy in Russia, the post-Soviet region, Central, Eastern Europe, Turkey, and Israel, covering 25 countries and specializing in government relations services, risk and corporate reputation management.

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¹³ The Kyrgyz delegation was not represented in full at the last meeting of the EAEU Intergovernmental Council (the Prime Minister was absent).