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**SUB-COMMITTEE ON
FUTURE SECURITY AND DEFENCE CAPABILITIES**

NATO'S ROLE IN THE SOUTH CAUCASUS REGION

DRAFT REPORT

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* Until this document has been approved by the Defence and Security Committee, it represents only the views of the Rapporteur.

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I. INTRODUCTION

1. Georgia, Armenia and Azerbaijan sit quite literally on a strategic crossroads. Energy from the Caspian Sea region will increasingly flow through those countries on its way to the global market. Drugs from Afghanistan and elsewhere in Central Asia transit through the South Caucasus region as well. Terrorist groups and extremist Islamist organizations operate in nearby regions and view the Southern Caucasus as a potential conduit to Europe and source of potential recruits.

2. The three countries are also tied into a web of commercial and diplomatic interests that complicate the role of NATO in the region when dealing with all three. Armenia is closely tied to Russia and depends on Russia for much of its energy. Armenia also has a tense relationship with its neighbours Turkey and especially Azerbaijan. Azerbaijan for its part remains closer to Turkey and retains good relations with Russia. Georgia, on the other hand has a tense relationship with Russia and is the most western-oriented of the three, preferring closer relations with NATO and other institutions. All three countries maintain good relations with neighbouring Iran. As NATO builds its relationship with the region and each country individually, it must take into account the interlocking interests of the regional actors.

3. All of this play against a volatile background. The South Caucasus region is home to struggling, nascent democracies, unresolved ethnic conflicts that have uprooted hundreds of thousands, high unemployment and high levels of corruption. Targeted assistance, incentives and pressure could help push the region toward stable democratic governance and self-sustaining economic development. But failing to do so could allow the region to slide the other direction into autocracy, ethnic strife and economic stagnation. This would clearly have negative consequences for the members of NATO who all have an interest in seeing the South Caucasus region become a stable transit route for energy resources and a bulwark against drug smuggling and extremist organizations.

4. It should come as no surprise, therefore, that NATO is heavily involved in the South Caucasus Region. That involvement takes several forms. Most importantly, NATO has several forms of partnership with those countries to assist their armed forces to develop in a manner consistent with democratic governance. But questions remain about NATO involvement in the region. How effective are those programs and what have they accomplished so far? What more can and should NATO do to promote the reform agenda in the region? How well are NATO's efforts integrated with other organizations' efforts in the region, and are there more opportunities for cooperation?

5. We will attempt to answer those questions over the course of 2006. The Subcommittee will visit Georgia, Armenia and Azerbaijan to learn more about the political and military situation in each country. We will examine the reform of the security sector in the South Caucasus region and what NATO is doing to assist in the development of regional stability. We will learn about the political situation in each country, the state of the "frozen" conflicts and the prospects for their resolution. We will examine the efforts of other international organizations in the region. The results of those visits will constitute the bulk of the final report to be presented at the Fall Session of the NATO Parliamentary Assembly.

6. This interim report, however, was drafted before those visits could take place. As such, it relies on press accounts, published reports, and interviews with knowledgeable individuals in NATO and other international organizations. Therefore, it should be seen as a background document designed to supply a basis for further inquiry. This assembly has discussed the region in seminars and committee reports in the recent past. For a detailed examination of the situation of ethnic minorities in the South Caucasus region and views on other topical matters, your

Rapporteur refers you to the 2004 report of the Civilian Dimensions of Security Committee and the report of the 61st Rose-Roth Seminar held in Yerevan, Armenia in October 2005.

II. GEORGIA

7. Georgia re-gained its independence in 1991 when an overwhelming majority of Georgians voted to secede from the Soviet Union. But the country's first elected leader, Zviad Gamsakhudia pursued policies that damaged relations with the minority communities in South Ossetia and Abkhazia. A coup in 1992 brought Eduard Shevardnadze to power who remained as president of the country until 2003.

8. The "Rose Revolution" of late 2003 ushered in a new era in Georgian political development. Public dissatisfaction with the corrupt governance and deeply flawed elections of the post-Soviet period finally culminated in several weeks of intense popular protest that led to the collapse of the Shevardnadze administration. Mikhail Saakashvili won the election held in January 2004 with an overwhelming majority and he continues as president today. He has pushed for economic reforms and a crackdown on corrupt practices. Most importantly from NATO's perspective, he has pushed for closer integration into Euro-Atlantic institutions. Saakashvili is a western-educated, post-Soviet leader who appears committed to making Georgia a country based on rule of law and more western-oriented while at the same time improving its relationship with Russia.

9. Elections for the parliament held in October 2005 provided some measure of the progress of democracy in Georgia. International election monitors noted some minor problems but overall concluded that the process was reasonably free and fair. This stands in marked contrast to much of the post-Soviet period.

10. In economic policy, the government is committed to a privatization programme of its remaining state-owned enterprises. The president launched a major privatization drive in 2004 that is slated to sell off 1800 enterprises. Although a boon for the government's budget, the privatization process has come with allegations of corrupt practices. This has weakened investor confidence. Several non-governmental organizations, including Transparency International, have given Georgia low scores on perceptions of corruption and cited it as one of the least favourable business environments of those surveyed. This is not a problem unique to Georgia- it is a serious problem across the region- but it will be very difficult to produce the sort of self-sustaining economic growth that is needed unless there is marked progress on this front.

A. INTERNAL CONFLICTS WITH BREAKAWAY REGIONS AND RELATIONS WITH RUSSIA

11. Georgia is faced with three regions that have become autonomous or have declared independence that is not recognized by other countries. Ajara on the Black Sea coast bordering on Turkey is the least problematic region and has more or less rejoined Georgia as an autonomous region. Abkhazia and South Ossetia, however, share a history of bloody warfare and the displacement of hundreds of thousands of ethnic Georgians, Ossetians and Abkhazians from their homes in the course of wars fought with Georgia in the early 1990s. The unresolved situation with Abkhazia and South Ossetia threatens to undermine the security of the region and Georgia's relations with Russia.

12. The troubled relationship between Georgia and the breakaway regions of South Ossetia and Abkhazia may have deep roots, but the current situation is based on the violent confrontations that occurred in the wake of Georgia's independence from the Soviet Union. After an intense war and a decade-long standoff, little has been resolved. Neither region is internationally recognized as an

independent state, but they have the elements of elected government, manage their own internal affairs and maintain independent militaries.

13. The conflict between South Ossetia and Georgia began with disagreements over the autonomy of the region. Some Ossetians, a minority group with its own language, pushed for greater autonomy from Georgia. Georgian leaders at the time were insisting on removing some of the autonomy the region enjoyed in Soviet times, such as the right to use Ossetian as an official language. Violent conflict began in 1991 and more than 100,000 refugees - Georgian and Ossetian - were created. The problem of internally displaced persons and refugees remains a serious problem. One complicating factor is that Ossetia is not a contiguous area. It is a patchwork of areas populated by Georgians and Ossetians, which makes it very difficult to define ethnically homogeneous regions without creating still more internally displaced persons.

14. Relations between Georgia and the Abkhazian region followed a similar unfortunate trajectory. Concerns over losing the autonomy of the region and the right to use the Abkhazian language led to violent clashes between Georgians and Abkhazians. In 1992 Abkhazian leaders effectively declared the independence of the region and Georgian troops moved in to take back the capital city. Heavy fighting between Georgian forces and Abkhazian forces supported by paramilitary volunteers from Russia left thousands dead and some 250,000 refugees.

15. Over the past few months, the South Ossetia region has become something of a flashpoint. On 22 January, two natural gas pipelines on the Russian side of the border in North Ossetia exploded under mysterious circumstances in the middle of one of the coldest winters in recent memory. On 1 February there was a car accident between Georgian civilians and Russian peacekeepers that degenerated into a brawl and on 8 February some Russian peacekeepers were detained by Georgian authorities for lacking the proper papers. Those are just some recent examples of the tense situation in the region.

16. President Saakashvili has declared his intent to reunite South Ossetia and Abkhazia with Georgia, and Georgia's parliament is pushing for the withdrawal of Russian peacekeeping forces from the region. The parliament passed a non-binding resolution in 2005 that called for the removal of Russian peacekeeping forces from South Ossetia by February 2006 unless there is substantial progress on resolving the status of the region. Some within the Georgian government have been more in favour of a military solution to the situation, but they are kept in check by more moderate voices and pressure from some NATO members. Russia - which supports the separatist movement in South Ossetia - reacted angrily to the increased Georgian pressure on South Ossetia. As long as Russia remains materially supportive of South Ossetia as a separate entity from Georgia, little progress can be made that will satisfy Georgian concerns.

17. A Georgian peace plan for South Ossetia featuring a substantial amount of autonomy was offered in 2005, but this was not enough to arouse interest in opening talks among the leaders of South Ossetia. Georgia has also suspended its participation in the Joint Control Commission (JCC), the body responsible for maintaining stability in the region and working toward a solution. But the JCC is composed of representatives from South Ossetia, Georgia, Russia and North Ossetia, an autonomous region of Russia. The Georgian government is seeking to find another international forum for the negotiations because they believe the composition of the JCC favours maintaining the current situation. President Saakashvili has called on the United Nations and the European Union to become more involved in settling the situation in South Ossetia.

18. Georgia's relationship with Abkhazia is somewhat more stable. Abkhazia seems to be a stronger entity and Georgia appears to be taking a more restrained approach to the region than with South Ossetia. Georgia and Abkhazia have worked on mutually beneficial economic arrangements, including reopening rail links. Nevertheless, the situation remains unresolved:

hundreds of thousands of individuals remain displaced as a result of the conflict and Abkhazia is not internationally recognized as an independent country.

19. The relationship between Georgia and Ajara is far less problematic. After the former leader of this region was forced from power by street demonstrations, Levan Varshalomidze was installed and has worked to reduce corruption and revitalize the economy. He is a protégé of Georgian President Mikhail Saakashvili and the two reportedly continue to maintain a good relationship. Georgia hopes that the limited autonomy enjoyed by Ajara will persuade the regions of South Ossetia and Abkhazia to accept a similar arrangement, but this appears unlikely given the current level of hostility and the recent history of violence.

20. Georgia's relationship with Russia is strained. In large part, the tension revolves around the Russian military bases on Georgian soil. Russia has agreed to close its two remaining military bases in the country in May 2006, so this should remove one point of tension. But the situation in South Ossetia and the recent tendency of Russia to use its energy resources as a means of pressuring its neighbours including Georgia will continue to test the relationship.

B. SECURITY SECTOR REFORM AND NATO ASSISTANCE

21. Georgia has expressed its clear desire for a close partnership with NATO culminating in eventual membership in the Alliance. Georgia is currently within the Partnership Action Plan for Defence Institution Building programme (PAP-DIP), the main aim of which is to improve the operational capability of the military while simultaneously subordinating the military to civilian authorities. This has been a long-standing aspect of NATO's engagement with potential members. In the early 1990s NATO worked closely with the governments and militaries of Central and Eastern Europe to assist in the construction of military forces that were firmly under civilian control.

22. This is not a simple task as the countries in question all came from a Soviet-style model of civil-military relations that subordinated the military to the Communist Party. Changing to a model appropriate for democratic governance required a wholesale change in the thinking of military officers. It also required building a cadre of civilians capable of managing defence ministries.

23. Ultimately, however, this program was successful across Central and Eastern Europe. NATO is able to exploit this success in working with Georgia and other countries in the region. Latvian military officers, for example, are currently advising their Georgian counterparts on how to implement the reform process. As a new NATO member that was formerly part of the Soviet Union, Latvia can offer advice that is highly relevant to the Georgian military reform effort.

24. Georgia, as well as Azerbaijan and Armenia, is part of the Individual Partnership Action Plan (IPAP). The purpose of IPAP is to spell out an individual programme for reforms spanning the range of civil and military issues. The first chapter deals with democratic, judicial, economic and other civil reforms. The second chapter focuses on defence reform, in particular, budgeting and planning, equipment standardization and improving interoperability with NATO member militaries. The third chapter of the plan looks at civil emergency planning and scientific cooperation. In some ways this chapter may offer the most tangible benefits to the partner country. NATO's Disaster Response Coordination Center has proven to be an important resource for partner countries in coping with natural disasters.

BOX 1: A PRIMER ON NATO PARTNERSHIPS

EAPC:	Euro-Atlantic Partnership Council
PfP:	Partnership for Peace
IPP:	Individual Partnership Programme
PWP:	Partnership Work Programme
PARP:	Planning and Review Process (PfP)
IPAP:	Individual Partnership Action Plan
PAP-DIB:	Partnership Action Plan on Defence Institution Building
MAP:	Membership Action Plan

Countries who choose to participate in the Partnership for Peace (P-f-P) program become simultaneously members of the Euro-Atlantic Partnership Council (EAPC), although the organisations are separate and PfP officials report to the EAPC in a roughly similar way to how NATO officials report to the North Atlantic Council.

In broad terms, there are three levels of NATO PfP cooperation. The first level is formulating an Individual Partnership Plan (IPP). The IPP is constructed from a huge list of activities in which the partnering country can choose to participate. Every year there are around 1,500 events that include everything from assuming observer status at NATO military manoeuvres to basic military training and/or language training at various NATO-affiliated or NATO-run officer schools such as the NATO school at Oberammergau. There are many training schools, most run by NATO allies, with centres in Ljubljana, Budapest, Ankara, and elsewhere. A partnering country typically selects the activities that fit its program and then submits its list. NATO then checks the selection and approves or rejects specific projects. NATO then has to ensure that the partnership country actually participates in the events it chooses because oftentimes funding is an issue. NATO countries provide some assistance and sometimes end up funding 100% of the participation costs.

Should a partnering country choose to deepen its relationship with NATO, it can choose to participate in the Partnership Action Plan on Defence Institution Building (PAP-DIP). NATO created PAP-DIB at the June 2004 Istanbul Summit as a way of promoting concrete defence reform among PfP countries. The 'ten commandments' of PAP-DIP reform, listed on pages 76-77 of the Istanbul Summit Reader's Guide, include developing transparent and democratic control of defence activities (the first objective), promoting civilian participation in defence and security policy development (the second), and establishing legislative and judicial oversight over the defence sector (the third).

Ostensibly, all partnering countries even those following only an IPP can participate in the PAP-DIP, choosing IPP activities in accordance with a PAP-DIP strategy that concentrates on institutional reform. In practice, countries following a PAP-DIP also choose to participate in the PfP Planning And Review Process (PARP) and may adopt an Individual Partnership Action (IPAP). The PARP and an IPAP constitute the primary instruments for pursuing PAP-DIP objectives. A PARP, for its part, is designed on a country-by-country basis to identify and evaluate forces and capabilities in a PfP member's military that could be made available for multinational training, exercise and operations with Alliance forces. It is a qualitatively higher degree of cooperation than an IPP that concentrates on upgrading capabilities with a view towards eventually interoperability.

The adoption of an IPAP constitutes, roughly speaking, the third and most intensive level of PfP cooperation. In distinction to the PARP, an IPAP contains political reforms such as enhanced judicial oversight and democratic and civilian control over a PfP member's defence sector. Many countries with IPAPs have already cooperated with alliance members in peacekeeping and peace support operations. Kazakhstan, for example, has recently adopted an IPAP and currently contributes a 29-man-strong de-mining unit to the Polish-led division in Iraq. The adoption of a Membership Action Plan (MAP) could involve a PfP member more intimately with alliance activities. This would, however, place that member on the road to full Alliance membership.

III. ARMENIA

25. Armenia re-gained its independence in 1990 when the non-communist Armenian National Movement led by Levon Ter-Petrosian gained a majority of seats in the Armenian Supreme Soviet. Mr. Ter-Petrosian led the country until 1998 but became less tolerant of opposition parties, banning some that challenged his leadership. Suspicions of electoral fraud led to increasing popular discontent.

26. But the final blow to Mr. Ter-Petrosian's presidency came in 1998 when he appeared to accept a plan for settling the Nagorny-Karabakh conflict. The compromise was opposed by the leaders of Nagorny-Karabakh and many in the Armenian government, including the prime minister at the time, Robert Kocharian. Mr. Ter-Petrosian resigned as was replaced by Mr. Kocharian who remains president today.

27. Mr. Kocharian was re-elected in 2003 for a five-year term. But that election was criticized by international monitors and the main opposition parties did not accept the outcome. Parliamentary elections held later in 2003 were also judged by election monitors as having failed to meet international standards. As a result the opposition parties began a boycott of the parliament starting in 2004 and organized street demonstrations. Those protests failed to unseat Mr. Kocharian and some opposition parties returned to parliament to discuss the proposed changes to the constitution that would in large part distribute some power away from the presidency. The reforms were put to a referendum in late 2005 and passed by a majority of the voters.

28. Armenia is struggling to become a stable democracy, but several problems are notable and cannot be overlooked. As with its neighbours in the region, unemployment and corruption remain serious concerns. Elections have been judged as significantly flawed by international monitoring organizations. Other broad civil reforms need to be addressed. Freedom House, a non-governmental organization that ranks countries based on the civil liberties of their citizens, recently downgraded its ranking of Armenia.

29. Armenia maintains good relations with Russia, Georgia and Iran. Russia is Armenia's largest trading partner, an important source of energy and other products critical to Armenia's economy. Armenia also provides Russia with a military foothold in the region and the Russian bases it hosts are all the more significant now that Georgia and Russia have agreed to remove Russian bases from Georgia.

30. Its relationship with Turkey, however, is strained. As Turkey is the NATO member with borders on two of the three countries of the South Caucasus region, its relations with those states is a significant element in NATO's relationship with the region. Turkey's support for Azerbaijan is one factor for the tense relationship with Armenia, but the other is the massive number of Armenian deaths that occurred during the last days of the Ottoman Empire in 1915-1922. Armenian and its international supporters maintain that the death of an estimated 1.5 million Armenians in the course of forced removals from their homeland constituted an intentional policy of genocide. Turkey maintains that the deaths that occurred during this time were not the result of an intentional effort to eradicate the Armenian population. It is a sensitive issue to say the least, but the end result is that the border between Turkey and Armenia remains closed. There are now direct flights between Armenia and Turkey, but full diplomatic relations are on hold until there is some resolution of the historic grievance between the two countries.

A. ARMENIA'S RELATIONS WITH NATO

31. Armenia has no plans to seek full membership, owing largely to its status as Russia's principal partner in the region. Despite this, it has developed a fairly intensive degree of cooperation with the alliance. Armenia joined the PfP programme in 1994 and the country adopted an IPAP in December of last year. Armenia is participating in NATO missions and has troops deployed as part of international missions in Kosovo and Iraq.

32. The familiar litany of problems regarding the conversion of Soviet-style to all-volunteer professional militaries under civilian control applies no less for Armenia, with the complicating factor of a large – and strategically vital – Russian military presence in the country. Armenia is, however, an enthusiastic participant in its PfP activities, and Armenian officers participate in a variety of NATO-sponsored training programs.

IV. AZERBAIJAN

33. Azerbaijan is also a significant player in the South Caucasus region, not the least because it is an exporter of oil and gas, and its weight will increase as more pipelines from the Caspian region come on line in the next few years. Azerbaijan is also a predominantly Muslim country with ties to Central Asia. As NATO increasingly engages with countries with largely Muslim populations, it may become important to have partner militaries with that cultural and ethnic background who will have an intuitive understanding of issues that must otherwise be taught to European and North American militaries.

34. Azerbaijan shares a number of similarities with its neighbours. It is struggling to develop the institutions that will allow it to more closely integrate with the European Union and NATO. It maintains a balance between its relations with the West, Russia, and Iran. But what separates Azerbaijan from Armenia and Georgia is that it is an increasingly important exporter of oil and gas. This has potentially positive and negative aspects. On the positive side, the revenues from those natural resources could be poured into public goods such as education and infrastructure in a way that would let the country develop a diversified economic base. On the negative side, some regional experts warn that Azerbaijan could go the way of all too many countries that find themselves as the beneficiaries of oil wealth: an over reliance on the easy money resulting from current high oil prices, squandered financial resources, and governments that use the revenue to placate the population and reduce demands for political and economic reforms that would benefit the country in the long term.

35. Azerbaijan held its most recent elections for parliament in November 2005. Those were judged by international observers to be deeply flawed. A wide range of irregularities was reported by the OSCE and other monitoring groups, leaving many with concerns about the direction of Azerbaijan's political development. This is part of a trend- previous elections were marred by serious irregularities. At the same, the opposition to the ruling party does not appear to have the popular support to confront the situation and bring about the sort of political transformation that occurred in Ukraine or Georgia after similarly flawed elections. In fact, the ruling party appears to be genuinely popular, which makes the unwillingness to allow truly free elections all the more curious.

BOX 2: ENERGY RESOURCES IN THE CASPIAN REGION

The Caspian basin has long since been an exporter of oil and natural gas, but recent developments will make it a more significant region for global energy markets. Azerbaijan is the main producer in the South Caucasus region, but Both Georgia and Armenia stand to gain considerably from the pipelines being constructed across their territory. Those pipelines will carry energy resources from Azerbaijan and Central Asia to the Mediterranean where they will enter the global market.

The main conduit for oil is the Baku-Tbilisi-Ceyhan pipeline project that spans the three countries of the South Caucasus. It is already operational and is expected to transport 800,000 barrels per day (BPD) starting in 2007. The South Caucasus pipeline for natural gas is being constructed alongside the oil pipeline. It is expected to carry a considerable volume of natural gas for consumption in Europe and elsewhere.

Another aspect of the two pipelines is that they decrease the reliance of the South Caucasus on Russia for energy. The disruption of the pipelines from Russia to Georgia in the winter of 2005 demonstrated the vulnerability of that supply line. By diversifying its supply of gas and oil, Georgia may find its relations with Russia assuming a different shape.

The Caspian Basin is currently producing 2,2 million barrels per day (BPD) and that is expected to grow to 4,2 million BPD by 2010 and 5.3 million BPD by 2015. All of those development projects are viable at much lower oil prices so they are very likely to be completed.

Nonetheless, this is a relatively small amount of production compared to the major producers or global demand. Saudi Arabia, the largest producer, is currently pumping 10 million BPD. The entire Caspian Basin will produce approximately as much oil as moderately large producers such as Iraq or Venezuela. Global consumption is currently over 81 million BPD and is expected to continue to rise albeit at a somewhat slower pace than recent years.

Despite the relatively small volume, the fact that the region is going to produce significant amounts of oil for export in the next year or two is potentially significant for global oil prices. The 800,000 BPD in the Baku-Tbilisi-Ceyhan pipeline will nearly double the current global excess production capacity, which would likely have a calming effect on oil prices.

A. AZERBAIJAN AND NATO

36. Since becoming independent in 1991, Azerbaijan has taken a variety of steps to integrate into Euro-Atlantic institutions. It joined PfP in 1994 and is a member of EAPC. The Individual Partnership Programme provides Azerbaijan with a means to cooperate more closely with NATO in achieving its specific defence reform related goals, and Azeri military officers participate in training activities. In addition, NATO approved an Azerbaijani IPAP in 2005 that should encourage a certain amount of economic, political, and defence-sector reform.

37. Some NATO officials describe Azerbaijan as the least enthusiastic of NATO Partners in the South Caucasus. It is believed that anticipated revenue of the Baku-Tbilisi-Ceylon pipeline may be discouraging meaningful changes in the defence sector. This, in turn, has delayed reforms intended to bring about greater interoperability with alliance members. Of the South Caucasus countries, Azerbaijan may experience the most difficulty generating the necessary political will to fully implement its IPAP.

38. That said, many joint NATO-Azeri projects have achieved meaningful results, including NATO involvement in the clearance of unexploded ordnance from the war in Nagorny-Karabakh and the destruction of anti-personnel landmine stocks funded by the PfP Trust Fund. Other successful projects tend to be of a scientific nature, such as the construction of the Virtual Silk Highway promoting Internet development and the establishment of an environmental pilot project intended to observe the Caspian Sea ecosystem.

B. NARGORNY-KARABAKH

39. The origins of the Nagorny-Karabakh conflict stretch back to Stalin's decision to incorporate an Armenian enclave within the administrative boundary of Azerbaijan. This mattered less in practice until the collapse of the Soviet Union, which brought lingering ethnic tensions and demands for self-determination to the forefront. Demonstrators in Armenia demanded that the region be incorporated in Armenia and in 1988 ethnic Armenians in an Azerbaijani town were massacred. Azerbaijan blockaded the region in 1989, but the residents declared it to be a part of Armenia. More violence in Azerbaijan against ethnic Armenians led to Soviet troops being placed in and around Nagorny-Karabakh to keep the peace. But with the complete collapse of the Soviet Union and the withdrawal of Soviet troops, the lingering conflict turned to open warfare. Armenia was not officially involved in the battle for Nagorny-Karabakh, but it supplied the region with everything it needed to conduct the war. Armenian forces overcame Azerbaijani forces and by 1993 controlled not just Nagorny-Karabakh, but a substantial buffer zone around the region. A cease-fire was declared in 1994 that is still in place today.

40. It is difficult to overestimate the bitterness on both sides. Tens of thousands of refugees created by the conflict are present in both countries. Azerbaijan lost 13 % of its territory to what they perceive as Armenian aggression. Armenia lost thousands of ethnic Armenians living in Azerbaijan.

41. Despite this, there appears to be some progress toward a settlement of the conflict in a mutually acceptable manner. Armenian officials have spoken increasingly in the past year about the need for compromise and there are some indications that the two sides may be moving toward a solution that involves aspects of both countries proposed resolutions. It is possible that a phased plan returning some contested regions to Azerbaijan could be married with a referendum in Nagorny-Karabakh over the future of the region. But all of this depends on securing some level of popular support for a compromise, and hostility on both sides in the general population still runs high.

42. The Organization for Security and Cooperation In Europe (OSCE) has the lead role in assisting Armenia and Azerbaijan to resolve their dispute over Nagorny-Karabakh. Some experts involved in the process express optimism that meetings scheduled for 2006 could produce substantial progress toward a solution. This could pave the way to more economic growth in the entire region. Armenia has been unable to trade with Turkey and Azerbaijan since the start of the conflict. Reopening commercial ties, transit links and other contacts would undoubtedly benefit all concerned.

V. CONCLUSION

43. The countries of the South Caucasus region share some similarities. All are struggling to implement the necessary political, economic, and defence reforms necessary for closer integration into Euro-Atlantic institutions. But the differences between them mean that the nature of NATO's involvement will vary considerably from country to country. Georgia clearly desires to join NATO as soon as possible, but neither Armenia nor Azerbaijan has expressed such a desire. Azerbaijan's oil wealth may help or hinder its reform process. Armenia's difficult relationship with Azerbaijan and Turkey may slow economic progress across the region. NATO at some level is already drawn into the complex nexus of reform, ethnic conflict and delicate relations with Russia that characterize the Southern Caucasus. How NATO as an organization manages its engagement in the region will have lasting effects.

44. Regardless of the differences among the three countries, it is important for NATO to build positive lasting relationships with all three. The Subcommittee will visit Georgia, Armenia and Azerbaijan over the course of 2006. Those visits will aim to inform the members about the effectiveness of NATO efforts in the region and each country's progress in the reform process. The final report of the subcommittee will incorporate the knowledge gained from those visits and offer recommendations for further action in the region.
