Structural Vulnerability of the Three South Caucasus States

After the End of the Russia-Ukraine War

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Executive Summary

The end of the Russia-Ukraine war can serve as the trigger that exposes the structural vulnerability embedded in the war-driven inflow economies of the three South Caucasus states. Their wartime expansion was not generated by endogenous growth. It was generated by external inflows that the war itself forced into the region, and one cannot rule out the possibility that they were temporarily inflated by those externally forced inflows rather than durably expanded by them.

The key postwar variable is not inflow persistence. It is what exits, how fast, and toward where. When current employment structure, wage levels, price levels, and real estate valuations are read together, the postwar reverse-flow shock operates through a structure under which the downside effect of outflow exceeds the upside effect of inflow. Georgia is positioned for the fastest transmission because the erosion of its tourism base and low-cost competitiveness now overlaps with wartime price inflation. Armenia faces pressure through the reversal of external talent concentration and urban demand. Azerbaijan faces pressure through the weakening of non-oil sector expectations and real estate pricing narratives.

In sum, the end of the Russia-Ukraine war does not mark a new growth cycle for the three South Caucasus states. It is highly probable that it functions as a tipping point at which structural vulnerability, previously masked by wartime special demand, is forced into visibility through conversion into self-reinforcing downside pressure.

The Russia-Ukraine War and Growth in the Three South Caucasus States

After the outbreak of the Russia-Ukraine war, the three South Caucasus states absorbed the reflected gains of external shock. Armenia and Georgia experienced accelerated short-term growth through the inflow of refugees, firms, capital, skilled labor, and consumer demand. Azerbaijan absorbed part of the indirect effect through non-oil activity, construction, logistics, and real estate repricing.

That growth did not represent a structural leap in endogenous competitiveness. It represented growth driven by bypass demand and temporary settlement demand that the war forcibly created in the periphery. The postwar phase is therefore not a stabilization phase. It is an adjustment phase in which the wartime inflow structure reverses direction.

The Prewar Baseline Structure

To see this clearly, we must first recall the prewar economic structure. The three South Caucasus states did not begin from a deep large-scale high-wage industrial base. Armenia depended on a narrow domestic market, external dependence, remittances, services, and limited manufacturing and IT expansion. Georgia depended on tourism, logistics, services, real estate, and foreign consumption. Azerbaijan depended far more explicitly on energy exports and state-led investment.

Across all three states, labor-market differentiation remained shallow and low-wage employment retained a high share. At the same time, asset prices were structurally capable of moving ahead of productivity. In other words, even before the war, these were not markets in which real estate could easily be described as cheap relative to wages, nor were they markets in which the balance between living conditions and housing costs was structurally stable.

The Short-Term Payoff Created by Wartime Inflows

Wartime inflows generated different payoff structures across the three states. In Armenia, the mechanism operated through IT labor inflow, corporate relocation, urban consumption expansion, and demand appreciation centered on Yerevan real estate. In Georgia, it operated through tourism recovery, long-stay foreign residents, relocation of IT and service firms, and increased financial and real estate transactions. In Azerbaijan, the direct safe-haven effect was weaker, but the war still expanded expectations around logistics reallocation, non-oil investment, construction, and urban development.

The common payoff structure was clear. Short-term growth accelerated. Consumption expanded. Tax revenue increased. Real estate prices rose. Service sectors widened. The problem is that this payoff structure was not a permanent-settlement payoff structure. During the war, the three South Caucasus states functioned less as final destinations than as avoidance zones, bypass zones, temporary settlement zones, and cost-adjustment zones. The same variables therefore begin to operate in the opposite direction once the war ends.

The Reverse Gravity Field Created by Postwar Reconstruction

The end of the Russia-Ukraine war is not merely the cessation of hostilities. It is the opening of reconstruction demand. Reconstruction generates new demand for large-scale capital, skilled labor, mid-skill technical labor, manual labor, logistics workers, construction equipment, and technical services. In the postwar phase, people and capital do not simply gain the option to return. They acquire an economic incentive to return.

This is the central mechanism. After a large-scale war, roads, railways, power grids, housing, warehouses, ports, communications systems, hospitals, schools, and other infrastructure must be rebuilt. That process generates strong pull not only for engineers, construction managers, IT workers, and financial capital, but also for manual labor and field-level workers. During the war, the operative logic was “leave now.” After the war, it becomes “move to where the reconstruction pays.”

The decisive postwar variable for the three South Caucasus states is therefore not inflow persistence but outflow reacceleration. The structure permits broad-based movement by skilled labor, mid-skill workers, manual labor, and capital at the same time.

The Structural Asymmetry Between Wages, Prices, and Real Estate

The vulnerability of the three South Caucasus states becomes especially clear in the asymmetry linking real estate and wages. As external population and capital entered during the war, rents and asset prices rose rapidly. Income structure did not rise at the same speed. Much of the labor market remained concentrated in low-wage services, basic commerce, tourism, and informal or semi-formal sectors. What opened the upside was not a region-wide productivity increase. It was external inflow.

Prices responded first to wartime special demand, but wages and productivity did not rise on a comparable structural basis. Once population and capital begin to leave, high living costs and elevated real estate prices remain while the endogenous demand base capable of supporting them weakens. The three South Caucasus states are therefore left with an economy made expensive by inflow, precisely when the inflow itself enters a postwar exit structure.

Country-Specific Vulnerabilities

Armenia's vulnerability is concentrated in its dependence on external talent and urban demand. After the war began, Yerevan emerged as a hub for external talent, technology firms, and consumer demand, but that emergence cannot be explained by Yerevan's endogenous absorption capacity alone. External technology workers and relocated firms generated premium service demand and real estate pressure, and construction and commerce expanded on top of that base.

Once reconstruction begins after the war, however, that talent and capital move toward larger markets and higher-return opportunities. The resulting Armenian shock is not a simple population decline. It is a chained adjustment mechanism involving consumption downgrading, rental demand weakening, commercial vacancy expansion, and the erosion of the valuation logic that supported real estate prices.

Georgia occupies the most sensitive position among the three states because nearly every major growth channel strengthened during the war was directly tied to external demand. Tourism, short-term residence, real estate, foreign consumption, services, IT relocation, and part of logistics and finance all depended on the continued presence of external population and external capital.

At the same time, wartime inflows already pushed prices and rents substantially upward. One of Georgia's traditional advantages was relative low-cost competitiveness. Once that advantage is impaired while productivity and high-value-added industry fail to rise proportionally, what remains is a high-cost, low-wage service economy. That structure is postwar-negative by design.

Tourism is especially exposed. Georgia's tourism competitiveness did not rest on absolute attractiveness alone. It rested on perceived value for money, produced by the combination of accessibility, ease of stay, and low costs in food, lodging, and mobility. Once prices and real estate values have already risen, the withdrawal of external residents and consumption leaves Georgia exposed to competition without its former low-cost advantage. The result is a transmission chain in which tourism contraction pressures hospitality, restaurants, urban retail, short-term rentals, transport, distribution, and commercial real estate yields at the same time.

Azerbaijan may appear less vulnerable because energy exports and state finance continue to anchor the economy. That does not imply immunity. It merely represents a different topology of vulnerability. Azerbaijan's pressure point lies not in refugee-style population inflow, but in non-oil expansion expectations and the pricing structure of real estate and construction.

Non-oil growth, construction expansion, urban development, transport, and logistics reconfiguration were all fueled by expectations tied to broader external environment reallocation. Once international capital shifts toward more direct reconstruction markets after the war, the domestic narrative supporting non-oil investment in Azerbaijan weakens. In real estate, a market that rose under constrained supply can lose conviction before it loses price. In construction, a shift in investment direction can produce rapid cooling.

The Asymmetry Between Inflow and Outflow

The critical point is that inflow and outflow do not operate symmetrically. Wartime inflow was a dispersed movement generated by fear and avoidance. People left first. Firms created bypass routes first. Capital searched for safety first. Postwar outflow operates with far clearer directionality. Reconstruction supplies high-return real demand. Return migration supplies political and social justification. Re-entry into original markets supplies operating efficiency for firms.

The mechanics of exit therefore operate with greater velocity than the mechanics of entry. Wartime inflow carried temporary dispersion and provisional settlement logic. Postwar outflow carries profitability and directional clarity. Under such a structure, it is not an exception but a structural result that the force of outflow exceeds the force of prior inflow.

The Payoff Structure of Population and Capital Movement

The payoff of population inflow takes the form of higher consumption, stronger rental income, service-sector expansion, greater tax intake, and urban commercial activation. The payoff of capital inflow takes the form of price appreciation, project expansion, improved investment sentiment, and expansion in construction and services. The payoff of skilled labor inflow takes the form of urban productivity gains, wage-expectation increases, and greater demand for premium services.

The payoff structure of outflow operates in reverse. Rental income weakens. Vacancy rises. Domestic demand contracts. Service-sector employment falls. Price adjustment pressure spreads across regions and capital cities. Investment sentiment deteriorates.

Capital outflow reduces transactions and weakens price justification. Skilled labor outflow erodes premium consumption and productivity expectations first. If even manual labor exits, construction and on-site service sectors themselves become unstable.

The core asymmetry is therefore clear. The gains from inflow are experienced diffusely. The shock from outflow becomes visible in concentrated form across asset markets and labor markets.

Self-Reinforcing Downside Pressure

During the war, population, capital, skilled labor, consumption, and real estate moved in the same direction and reinforced one another. After the war, the same variables move in the opposite direction and again reinforce one another. Population decline reduces consumption. Consumption contraction compresses services. Service compression reduces employment. Employment decline weakens the valuation logic supporting rents and asset prices. That erosion then induces further outflow. The structure therefore generates self-reinforcing downside pressure.

What the three South Caucasus states face after the end of the war is not simple growth deceleration. It is a simultaneous test of population retention capacity, capital anchoring capacity, employment continuity, tourism competitiveness, and real estate sustainability.