DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR TURKMENISTAN

As approved by the Board of Directors at its meeting on 7 May 2014

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Over the years the Bank has been concerned with Turkmenistan's slow progress towards multi-party democracy, pluralism and a market-based economy in keeping with Article 1 of the Agreement Establishing the Bank. In March 2010 the Bank adopted a "calibrated strategic approach" for Turkmenistan, which introduced political and economic benchmarks against which reforms could be measured and the Bank's operational response more finely tailored. This increased the Bank's flexibility and enhanced its ability to match the scale and scope of operational responses to changes in the economic, business and political environment of the country.

While the Bank was unable to deploy the full range of its investment tools under the calibrated approach given the limited progress in reform, it nevertheless expanded private sector operations in the corporate and financial institutions sectors, engaged in targeted policy dialogue, fostered coordination among IFIs and donor organisations, and strengthened its reputation as a prominent agent of transition to a market economy.

Overall, the progress with reforms during the past strategy period has been slow. Some progress was made on three of the four economic benchmarks, but no substantial progress was registered on the three political benchmarks contained in the calibrated Country Strategy, although some positive steps were noted. At the same time, there was no clear evidence of regression.

The current circumstances in Turkmenistan warrant the continued application of a calibrated strategic approach, incorporating political and economic benchmarks to gauge the country's progress (or regress) against its key Article 1 commitments and adjusting the Bank's operational response accordingly. During the Strategy period, the Bank will monitor the following political and economic benchmarks:

In the political sphere:

- Progress toward genuine political pluralism and meaningful political accountability, including strengthening checks and balances in the political system, registration of independent political parties, free functioning of NGOs and civil society groups, and even-handed application of the rule of law.
- Substantial progress in increasing media freedom and freedom of expression.
- Significant progress in improving the country's overall human rights record, including the release of political prisoners and lifting restrictions on the freedom of movement.

In the economic sphere:

- Increased space for the establishment, operations and growth of private sector companies in a competitive environment.
- Significant reduction of arbitrary and distortionary state intervention in the economy, including through price controls, uneconomical tariff setting, and directed lending.

- Strengthening market-supporting institutions and development of the legal and regulatory framework for operation of privately-owned firms across various sectors of the economy.
- Improving public finance transparency in line with best international practice, building on positive progress made in the previous Strategy period.

For the new Strategy period the Bank will closely monitor developments against these political and economic benchmarks. Where progress against these benchmarks is noted, the Bank will be able to consider a wider range of investment activities in Turkmenistan. Conversely, if regress is noted against these benchmarks the Bank will further limit the scope of its engagement, particularly outside the private sector.

Strategic Priorities

Turkmenistan has made some progress in transforming its economy but remains one of the least reformed countries in the region. The overarching transition challenges include developing the private sector supported by a well-functioning financial system, increasing economic openness through international economic integration, and commercialising municipal utilities and infrastructure. In response to these challenges, the Bank will concentrate its activities in the private sector in following strategic areas:

Supporting private sector development. Turkmenistan’s economy continues to be characterised by pervasive state intervention and state ownership. Although the number of private entrepreneurs and companies is growing, the private sector remains small and closely regulated by the state. In response to these broad reform challenges, during the next Strategy period the Bank will continue to focus its activities in Turkmenistan on supporting private sector development, both directly and indirectly via local partner banks. The Bank will provide financing to privately-owned companies outside the oil and gas sectors, focusing on food processing and distribution, logistics, transport services, packaging, furniture, and hospitality. To support the development of effective and sustainable financial intermediation to the private sector, the Bank will prioritise strengthening the financial sector to enable it to fund the economy by introducing market-oriented principles, and will launch a new banking framework agreement with existing and potentially new partner banks to channel funds to private sector MSME clients.

Promoting international integration. To support enhanced integration of Turkmenistan’s economy into the global economy, the Bank will seek opportunities to attract much-needed FDI by investing alongside foreign strategic investors, and will promote cross-border trade through the Trade Facilitation Programme with eligible partner banks. The Bank may consider supporting regional transport operations, particularly for projects with a sound business rationale and which are integrated into the CAREC transport corridors or the EU-TRACECA programme.

Laying the foundations for future reforms. In some sectors, particularly energy efficiency, power and municipal services, reforms have been insufficient to enable the Bank to engage fully. The Bank will therefore limit its activities in these areas to selective and targeted policy dialogue, as requested by the authorities, to promote the adoption of reforms leading to market-based solutions to the challenges in these sectors.

The Bank’s activities in addressing these challenges will continue to be guided by its mandate and its adherence to the principles of Article 1, and the Bank will continue to calibrate its engagement with the Turkmen state and public sector based on progress or regress against the political and economic benchmarks, including in the annual Country Strategy Updates. In addition, the Bank will continue to apply sector-specific criteria in relation to its engagement with public entities and will ensure that no investment operations will provide a direct financial benefit to the country’s central government authorities.

1 THE BANK'S PORTFOLIO

1.1 Overview of Bank activities to date

The Bank's operations in Turkmenistan commenced in 1994. In the early years the portfolio grew steadily with investments in infrastructure, textiles, private oil and gas and a sovereign-guaranteed SME credit line. From 2000 onwards, successive Strategies restricted the Bank's operations to the private sector, keeping activities to a modest level. The introduction of the calibrated strategic approach to Turkmenistan in 2010 retained a focus on promoting private sector development, and in line with the calibrated Strategy the Bank's current portfolio is fully invested in the private sector.

As of 31 March 2014 the Bank has signed 43 projects in total in Turkmenistan for a net cumulative business volume of €177 million and a total project value of €632 million. The current portfolio amounts to €44 million of which 83 per cent has been disbursed. The industry, commerce and agribusiness (ICA) sector now represents 94 per cent of the portfolio. The Bank has cumulatively financed 35 ICA projects for a total of €99 million.

Table 1: Cumulative Business Volume and Portfolio as of 31 March 2014

Sector Group	Sector Team	NCBI # operations	Net Cumulative Business Inv. (NCBI)	% NCBI	Portfolio number of operations	Portfolio	% Portfolio	Operating Assets	% Operating Assets
Energy	Natural Resources	3	45	25%	1	1	2%	0	0%
	Power and Energy	0	0	0%	0	0	0%	0	0%
		3	**45**	**25%**	**1**	**1**	**2%**	**0**	**0%**
Financial Institutions	Depository Credit (banks)	4	11	6%	3	2	4%	1	3%
	Insurance, Pension, Funds	0	0	0%	0	0	0%	0	0%
		4	**11**	**6%**	**3**	**2**	**4%**	**1**	**3%**
Industry, Commerce & Agribusiness	Agribusiness	17	40	23%	15	27	60%	23	63%
	Equity Funds	5	5	3%	1	0	0%	0	0%
	ICT	1	9	5%	0	0	0%	0	0%
	Manufacturing & Services	11	45	26%	8	15	33%	12	33%
	Property and Tourism	1	0	0%	1	0	0%	0	0%
		35	**99**	**56%**	**25**	**42**	**94%**	**35**	**97%**
Infrastructure	Transport	1	22	12%	0	0	0%	0	0%
		1	**22**	**12%**	**0**	**0**	**0%**	**0**	**0%**
Summary		**43**	**177**	**100%**	**29**	**44**	**100%**	**37**	**100%**

The financial sector represents 4 per cent of the Bank's current portfolio. The Bank works with three partner banks to which it has provided SME credit lines contributing thus far 14 sub-loans to local SMEs as well as access to its TFP programme to two of them.

The Bank is currently not active in the public sector; however in the past it financed the modernisation of the rail terminal at Turkmenbashi port, a project that has been completed and was repaid in full in February 2013. There is also one project in the energy sector support signed in 2013.

The ETC Initiative has enabled the Bank to step up its operations in Turkmenistan significantly. Since its launch in Turkmenistan in 2009, the Bank has financed 33 projects for a total of €53 million.

Table 2: Portfolio Development in Turkmenistan, 2010 - 1Q2014

	2010	2011	2012	2013	2014
Net Cumulative Business Inv. (NCBI)	134.9	161.5	172.4	174.7	176.7
of which TFPs	0.9	1.5	1.5	1.4	1.4
NCBI (# of ops)	28	33	39	42	43
Portfolio	23.3	41.6	49.2	47.3	44.3
Number of portfolio operations	17	20	27	29	29
Operating Assets	19.7	37.9	39.4	37.6	36.6
% undrawn	16%	9%	20%	21%	17%
Annual Bank Investment	6.1	22.9	14.3	8.2	1.3
Annual number of operations	8	9	8	6	2
Annual Disbursements	6.4	22.4	7.2	7.0	2.2
Annual Cancellations	1.3	0.5	0.4	0.4	0.7
Pipeline Stock - Reported Rate	33.9	63.4	6.1	7.3	9.7
Private Sector Share (% Portfolio)	78%	92%	98%	98%	98%
Non Sovereign Share (% Portfolio)	78%	92%	98%	100%	100%
Equity Share (% Portfolio)	42%	22%	19%	18%	19%

1.2 Implementation of the previous Country Strategy

In March 2010, EBRD adopted a calibrated Strategy for Turkmenistan following the introduction of limited but important economic and political reforms. The calibrated Strategy was based on three key pillars: political reform benchmarks, economic and structural reform benchmarks, and sector-specific reform criteria to assess progress and provide incentives for further reforms. The calibrated approach gave the Bank the flexibility to respond to changes in the political and structural reform environment in Turkmenistan: to broaden the Bank’s engagement if political and/or economic reforms were adopted, and to narrow the Bank’s engagement if the political and/or economic environment worsened. The political and economic reform benchmarks in the 2010 Country Strategy were as follows:

Political benchmarks

- Progress toward genuine political pluralism and meaningful political accountability, including the strengthening of checks and balances in the political system, removal of impediments to registration and free functioning of NGOs and even-handed application of the rule of law.
- Substantial progress in increasing media freedom and freedom of expression.
- Further significant progress in improving the country’s human rights record. The priority areas requiring urgent attention include:
    - The release of political prisoners,
    - Free access of the International Committee of the Red Cross (ICRC) to places of detention,
    - Lifting the remaining restrictions on foreign travel, and
    - Freedom for the media and free functioning of civil society groups.

Economic benchmarks

- Progress in private sector development including lowering barriers to entry of new private businesses, reducing and streamlining of regulatory burden on existing private businesses, progress towards independent competition authorities, and functioning secured transaction legislation.

- Progress in strengthening the financial sector and increasing financial depth through expansion of commercially based MSME finance and introduction of private sector banks and non-bank financial institutions.
- Significant reduction in arbitrary and distortionary state intervention in the economy, including through directed lending in state-owned banks, subsidised interest rates, price controls and production targets in the agriculture and textile sector, and state procurement of agricultural inputs.
- Improving transparency in the budgetary process and public sector finances in general, including the publication of investment rules and governing principles of the stabilisation fund and other operating foreign exchange funds. Improving accountability and efficiency in the provision of public services by steps towards fiscal decentralisation.

During the previous Strategy period, Turkmenistan did not make meaningful progress against the three political benchmarks. Although the Constitution provides for the independence of legislative, executive and judiciary pillars of sovereign authority, political power remains concentrated in the presidency and is not balanced by the legislature or judiciary. The last presidential election, held on 12 February 2012, was not monitored by the OSCE/ODIHR as the electoral framework of the country did not meet international standards for competitive elections. Although the first alternative political party was created in August 2012, its introduction, while formally breaking the one-party system, has yet to contribute to increasing genuine political pluralism in Turkmenistan. Freedom of the media remains a serious problem and the country's overall human rights record needs to be significantly improved.

Overall, the progress with economic reforms in the previous Strategy period was modest. Some progress was made on three of the four economic benchmarks. While barriers to entry for new private businesses remain very large, there is evidence that they were reduced somewhat in 2011-12 and growth of credit to the private sector accelerated markedly, albeit from a very low base. While a draft budget code aimed at ensuring transparency and accountability in fiscal policy has been prepared with assistance from the European Union, this has not yet been adopted. No major progress has been made on the benchmark related to transparency of revenue management. A significant part of hydrocarbon revenues continue to be accumulated in the Foreign Exchange Reserve Fund (FERF), an off-budget account, and these revenues continue to be spent in a highly non-transparent way.

Despite the lack of significant progress against the political and economic benchmarks, the calibrated strategic approach – with its clearly specified sectoral reform criteria – has nevertheless enabled the Bank to engage in Turkmenistan's private sector development in a more granular way. The Bank's previous Strategy for Turkmenistan prioritised engagement in support of the following objectives:

- **Development of private sector** in particular through enhanced access to finance for MSMEs.
- **Strengthening of financial institutions** including the establishment of new bank for private sector development, adequate provision of trade finance and MSME credit lines. Policy dialogue in this areas targeted efforts to develop a proper

understanding on the part of the Turkmen authorities that a well-functioning, strong and sustainable financial system based on market principles is the key to the future development of the country's private sector.

- **Improvement of the business environment for the private sector** in particular in the banking and specialised industry sectors by improving transparency and corporate governance, by promoting regulatory reform and FDI, by enhancing the commercialisation and privatisation of state owned industries and by encouraging trade liberalisation.
- **Promotion of energy efficiency** across selected commercialising sectors of the economy particularly in its highly inefficient manufacturing and infrastructure sectors. Support for development of legal and institutional framework and the introduction of economic incentives for energy efficiency improvements and exploitation of renewable energy sources.
- **Improvements in selective important regional transport infrastructure,** which is a part of CAREC corridors, with other IFIs or key bi-lateral donors including key Caspian sea port infrastructure projects.

The calibrated strategic approach has enabled the Bank to remain actively engaged in Turkmenistan across these areas over the previous Strategy period, though with certain limitations. The increased flexibility has enabled the Bank to finance the real economy and to respond, albeit cautiously, to improvements in some sectors. Under the calibrated approach, the Bank expanded its operations in the corporate and financial institutions sectors, engaged in targeted policy dialogue, fostered coordination among IFIs and donor organisations, and strengthened its profile as an agent of transition to a market economy.

With regards to **private sector development,** there has been a gradual convergence of the government's policies and the Bank's strategic orientations. In response to the Government's 2020 private sector development goal the Bank extended access to the Direct Lending Facility (DLF) in 2008, which has resulted in a growing project pipeline. At the same time, the strong growth in export revenues from oil and gas led to growing foreign exchange reserves which has reduced the need for funding from IFIs. Despite this, the Bank has established a strong base for financing the private sector in Turkmenistan.

Since the unification of the exchange rate in May 2008, EBRD support for capacity building in the private sector has produced tangible results. Development of capacities at every level, especially among entrepreneurs, remains an important component in the development of the burgeoning private sector. The Enterprise Growth Programme (formerly TAM programme) conducted its first enterprise screenings in September 2008 and to date has completed 7 operations while an additional 4 are under way. In particular the EGP has enabled local companies to address specific issues such as introducing management information systems, marketing and branding. The consultancy sector is small but growing. The Turkmen Business Advisory Services (BAS) programme was launched in March 2011 and to date has accomplished 70 projects while another 30 are targeted for 2014.

The Bank produced tangible results in selected segments of **the corporate sector**, primarily in agribusiness, manufacturing and the services sector. The Bank has been able to conclude six to nine projects per year during the 2010-2013 period, compared with just three operations in 2009. Despite the rather small average size of each transaction, the Bank was instrumental in introducing cash-flow based direct lending to private sector borrowers with significant growth prospects in the food processing, beverages, packaging and small-scale manufacturing sectors. Besides providing financing, EBRD, through its EGP programme tools, was instrumental in improving core competencies within these beneficiaries.

During the previous Strategy period, the Bank's ability to deliver on **strengthening the financial sector** has been restricted by the dominance of state owned banks and state directed lending. However, through a framework agreement for the banking sector the Bank was able to sign MSME credit lines with the only privately owned bank in the country and one commercially operating state-owned bank. Under this framework, the Bank provided technical assistance for capacity building to support these beneficiary banks' credit and back office procedures and improve service levels. The end-beneficiaries of these credit lines – 14 in total – were spread over a number of sectors of the real economy including manufacturing, trade and services. The Bank's work in 2011 to establish a new MSME bank was stopped when it was deemed not possible to secure agreement on key conditions, such as interest rates-setting, among key stakeholders. However, the Bank reactivated its efforts to support the development of the microfinance sector by providing TC and conducting policy dialogue on the legislative and regulatory framework for microfinance. EBRD also organised seminars explaining how the Trade Finance Programme can benefit local banks, as well as exporters and importers, by introducing standards used by international banks.

Turkmenistan became a beneficiary of the ETC initiative during the last Strategy period. This supported the allocation of Bank resources to smaller private transactions with higher risk, and enabled the Bank to leverage its own technical assistance to underpin much-needed policy dialogue and institutional capacity-building for its projects. EBRD also launched its BAS programme in the second half of the previous Strategy period and, in a relatively short period of time, has supported numerous business capacity improvement projects and helped kick-start the local consulting industry, which is key to addressing the Bank's private sector capacity improvement objectives. BAS has undertaken 30 operations in Turkmenistan in 2013 alone.

More modest progress has been achieved in the **regional transport sector**, where dialogue was conducted with the Turkmen authorities to promote reforms to move toward cost recovery, allow the private sector access to infrastructure sub-contracting, and introduce compliance standards for environmental impacts of new facilities. The Bank and the Turkmen authorities have also discussed options for specific projects under the Turkmenbashi port development programme and currently the Bank continues deliberations with the authorities.

EBRD has not been able to advance transition in those sectors where structural constraints proved difficult to overcome and the authorities were not committed to reform. In particular, no significant progress was achieved in the **private oil and gas sector** as the majority of hydrocarbon revenues and fiscal spending continue to take place outside the budget framework with the Foreign Exchange Reserve Fund (FERF). As a result, in the 2012 Country Strategy Update EBRD excluded the possibility of supporting the private oil and gas sector pending progress with improving the transparency of revenues from the sector. In the **energy efficiency and renewables sectors**, there was insufficient progress in adopting appropriate regulatory frameworks to foster long term investments and remove the very high subsidies on energy to enable the Bank to engage in those sectors.

An important dimension of the Bank's activities has been **proactive policy dialogue** with the authorities, donors and other stakeholders. The Bank encouraged the government to implement further political and economic reforms in keeping with Article 1 of the Agreement Establishing the Bank. There have been some signs of progress and the Bank's broader operational engagement has given it greater credibility as a partner in reform and policy dialogue. The Bank played a crucial role in protecting private property rights by securing the recovery of our collateral and the protection of our partners in a contested case, sending a strong positive signal to the private sector.

On balance, operational performance under the calibrated Strategy in relation to the country's political and economic reform progress suggest a continuation of the Bank's efforts to broaden and deepen its engagement with the private sector and the Turkmen authorities within the areas identified as strategic priorities.

1.3 Transition impact of the Bank's portfolio

During the last Strategy period the Bank had some impact in those sectors in which there was commitment to private sector-led development within the government. The Bank had little or no impact in sectors in which the Turkmen government still perceives the state-led model of economic development to be appropriate.

From March 2010, when the previous strategy was adopted, until end-March 2014, four individually transition-rated operations were signed in Turkmenistan. Two of these projects were signed with the country's commercial banks, while the remaining two operations were signed in the agribusiness and manufacturing sectors respectively. All four operations were rated Good or Excellent, thus significantly above the institution-wide target of 80 per cent of projects to be assessed "Good" or better. Reflecting specifics of the Bank's limited activities in Turkmenistan during the strategy period, demonstration effect of new replicable financial products was the main transition objective targeted by the new operations signed.

One project, an SME lending support loan to Senagat Bank, a bank with majority private ownership, was rated with Excellent transition impact potential. Through an institution building plan the project supports the development of IFRS audits and introduces necessary skills in local banks to lend to SMEs thus developing sustainable lending practices in the country's financial sector. Additionally, the project will support an increase in bank lending to the private sector, in particular SMEs.

Apart from these four operations, twenty three additional operations were not individually rated for transition impact since they were signed under the Direct Lending Facility (DLF), which is rated "Good" and monitored on the framework level only. These DLF operations' main objectives included setting business conduct standards and increasing competition and skills transfer. Fourteen were in the agribusiness sector, seven in manufacturing and services, one in energy sector support and the remaining one in property and tourism. Other non-rated projects in the Bank's active portfolio include one regional equity fund and one manufacturing and services operation under corporate recovery.

The projects in the Bank's active TIMS portfolio in Turkmenistan are overall performing well from the transition perspective, with all four operations in the portfolio on track to achieving their transition impact as of end-March 2014.[1] The average rank of Turkmenistan's active TIMS portfolio at end-March 2014 stood at 4.86, which is worse than the average for all operations of the Bank (4.05). This is due to the fact that most of the operations in the Bank's active portfolio in Turkmenistan are at the initial phase of their implementation (three out of four operations in the portfolio have only been signed during the previous Strategy period) and in such small number of operations, the average is skewed. The average rank of the portfolio is expected to improve as the country's portfolio matures. DLF has so far performed well from a transition perspective, with achievement of key transition objectives currently on track.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

The Bank remains concerned about the slow progress Turkmenistan has made toward multiparty democracy and pluralism. In the context of the latest presidential election, held on 12 February 2012, the international observers of the OSCE/ODIHR decided not to deploy a mission to observe the election as the country's electoral framework did not meet international standards for competitive election. The incumbent President Gurbanguly Berdymuhamedov was re-elected for a second five-year term with 97 per cent of the vote on a turnout of 96 per cent.

Although the separation of powers between the executive, legislative and judiciary is enshrined in the Constitution, the decision-making process in the country is concentrated in the presidency and is not sufficiently balanced by other branches of power. Some progress has been registered on the economic side of transition but genuine democratic transformation has yet to be initiated. The democratic deficits are evident in all areas and remained practically unchanged during the previous Strategy period, despite some positive steps undertaken by the authorities.

A new law on political parties, adopted in January 2012, came too late to have an impact on the February election. The first alternative political party – the Party of Industrialists and Entrepreneurs – was created in August 2012 but its introduction has yet to contribute to increasing political pluralism in the country. The President has mentioned the possibility of another party being established, the Agrarian Party. Parliamentary elections on 15 December 2013 tested the extent to which these changes represented a meaningful effort towards a multiparty system in Turkmenistan as OSCE/ODIHR sent a group of 15 experts at the invitation of the government to assess the compliance of the election with international standards. The mission issued

[1] All active operations more than 6 months since signing and monitored for their transition impact at least once.

a report on 4 March 2014 concluding that "the absence of political pluralism and an insufficient separation of powers between different branches of government, as well as the lack of respect for fundamental freedoms, contributed to elections that need to be significantly improved to live up to OSCE commitments and other international obligations for genuine and democratic elections".

There have been some positive developments in a few individual cases, but the country's overall human rights record remains poor and more progress is needed. The implementation of the country's commitments under the international treaties on civil and political rights needs to be significantly improved.

Please refer to Annex 1 for a detailed description of the current political environment.

2.2 Macroeconomic context

The economy of Turkmenistan has remained largely insulated from the global recession due to the limited degree of integration into international financial markets to date. An explosion at a pipeline in April 2009 caused a drop in the volumes of gas off-take by Russia, which resulted in deterioration of current account balance in 2009. Over time, lower volumes of exports to Russia were more than offset by expansion of gas exports to China and Iran.

Despite lower gas sales, GDP growth remained robust in 2009 at over 6 per cent. It has subsequently accelerated to reach 14.7 per cent in 2011 and 11.1 per cent in 2012. The acceleration was driven mainly by growth of gas exports with more diversified off-take. The government expanded infrastructure spending considerably, leading to a decline in budget surpluses. The current account turned negative in 2009 owing to interruption of gas exports to Russia after the explosion, but returned to surplus in 2010.

Inflation remained moderate due to existing administrative controls of prices and tariffs, although such controls have been gradually relaxed over time, in particular for meat and wheat products. Price of bread, for instance, increased threefold in July 2012, after the authorities eliminated flour rationing. Further price increases may be authorised in view of lower-than-expected wheat production. Moreover, the announced 10 per cent increase in government wages and 15 per cent in pensions from 2013 may cause inflation to accelerate.

After the redenomination of the local currency in January 2009 and unification of the exchange rates, the manat – US dollar rate has remained fixed at 2.85 manats per dollar. The central bank engaged in sizeable sterilisation operations to keep foreign exchange inflows from boosting the money supply and creating inflationary pressures. Credit growth reached around 30 per cent in 2011 and 2012 mainly due to state-supported lending programmes financed by stabilisation fund resources. Most of lending continued to be channelled to state-owned enterprises. However, there has been a decrease in directed lending and some increase in private sector credit, in part owing to subsidised government programmes, including cheaper loans for MSMEs.

Growth is likely to stay high in 2013 and the medium term, driven by expanding hydrocarbon production and further diversification of export routes. However, there are significant downside risks arising from the heavy, and increasing, dependence of the economy on gas exports and continued excessive state regulation and intervention.

See Annex 7 for a table with selected economic indicators.

2.3 Structural reform context

Despite certain progress in recent years, transition gaps in Turkmenistan are assessed as large across all sectors both in terms of market-supporting institutions and in terms of market structure. The economy remains largely under the state control with widespread state intervention across all sectors (see Figure 1). A number of sectors remain distorted by production targets and subsidised inputs that hamper productivity growth and effective use of resources.

The authorities have expressed their intention to begin a serious privatisation process and increase the share of the private sector in value added to 70 per cent of the non-hydrocarbon GDP by 2020. To this end, a privatisation plan covering the period 2013-2016 was approved by the Cabinet of Ministers in January 2013, in line with the National Programme of Socio-Economic Development, 2011-2030.

Some steps have been taken to support the development of small and medium-sized enterprises. For example, in 2011 a “State Programme to Support Small and Medium-sized Enterprises in Turkmenistan 2011-2015” was adopted together with an action plan.

Progress was made with strengthening the banking sector as the government adopted a special programme to develop the banking system over the period 2010-30. A number of new laws were adopted including a Law on Accounting and Financial Reporting Standards (July 2010), new laws on the Central Bank and on Lending Institutions and Banking (March 2011) and a Law on Microfinance (April 2011). The authorities have stated their intention to start phased privatisation of state banks from 2016. Important reforms in the sector also include the introduction of IFRS reporting standards in all banks as of January 2012, and the transfer of all state-directed loans financed by the stabilisation fund to the newly created State Development Bank as of November 2011. This has helped to clean banks’ balance sheets (directed lending financed by the stabilisation fund is estimated to have accounted for over 70 per cent of bank assets in the past) and could increase competition between banks for private sector projects.

Some progress has been made in terms of relaxing foreign exchange and trade restrictions. In particular, local private small and medium-sized enterprises (SMEs) can now have foreign currency accounts to conduct import/export operations without the need for a license or permission from the cabinet of ministers. Moreover, under the new foreign exchange law adopted in October 2011, residents are allowed to provide partial trade credit to non-residents (that is, to make partial advance payments for imports or partially defer payments for exports). In addition, it allows banks to conduct foreign exchange transactions with non-public customers without seeking prior approval from the Central Bank.

Several liberalisation measures have been adopted in agriculture. In mid-2012 the government cancelled the flour rationing introduced in the early 2000s as a social protection measure. The maximum price of bread increased threefold and controls over the meat price were eased.

At the same time, transparency of financial flows in the natural resource sector remains limited. A major step forward was the establishment of a stabilisation fund in 2008, followed by further consolidation of some extra-budgetary funds in the budget. However, the investment rules and governing principles of the stabilisation fund as well as its accounts are yet to be published. Furthermore, a significant part of hydrocarbon revenues continue to be accumulated in the Foreign Exchange Reserve Fund (FERF), an off-budget account, and these revenues continue to be accrued and spent in a non-transparent way.

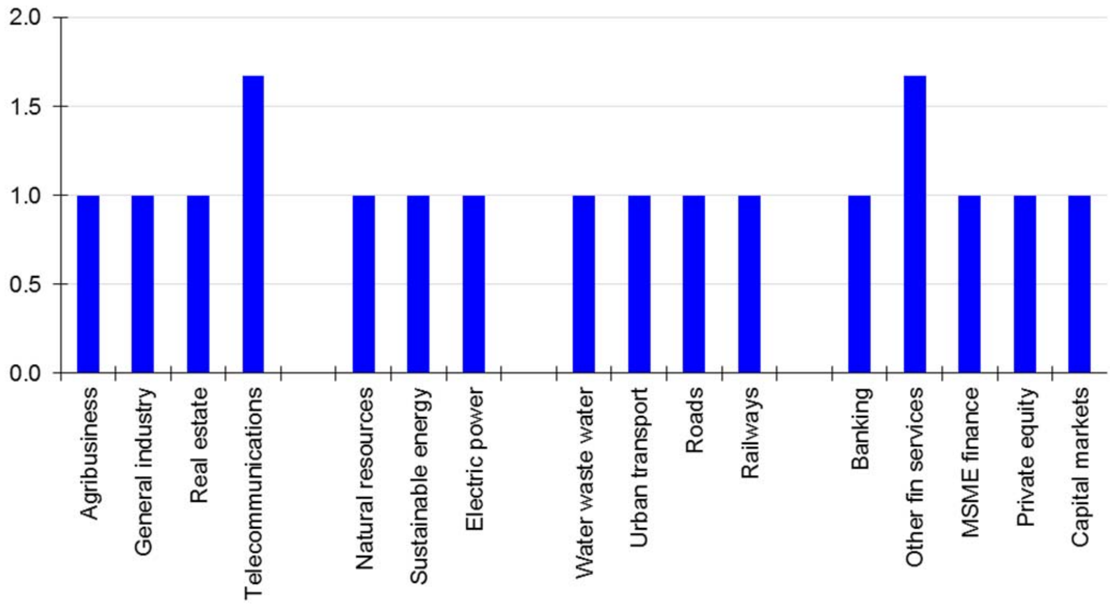
Transport infrastructure remains largely unreformed, predominantly owned and operated by the state. Progress with reforms to improve commercial orientation, increase the efficiency of services and create space for the private sector has been slow. The willingness of the government to introduce such reforms is as yet untested, although discussions are taking place regarding improvements in tariff methodologies, financial reporting standards and corporate governance in the transport sector.

The economy of Turkmenistan remains heavily dependent on the hydrocarbon wealth. New onshore discoveries and changes in the foreign investment law have led to significant increase in FDI since 2009, mainly in the hydrocarbon sector. As a result Turkmenistan ranked 9th in the UNCTAD FDI Attraction Index published in the World Investment Report 2012, which ranks countries by FDI received in absolute terms and relative to their economic size. FDI inflows reached around USD 3.5 billion in both 2011 and 2012, with the oil and gas sectors accounting for the vast majority of these investments.

Turkmenistan has recently expressed its intention to assess the potential benefits and costs of joining the World Trade Organisation (WTO).

There have been efforts to move to international standards for statistics. The authorities are committed to improving the quality and accessibility of data by joining the IMF’s General Data Dissemination System (GDDS).

Figure 1. EBRD Transition Indicators for Turkmenistan



Source: EBRD Transition Report 2012.

2.4 Business environment

The business environment in Turkmenistan remains difficult, although a comparative assessment of the business climate cannot be made using widely used surveys. For instance, the country currently does not participate in the World Bank Doing Business survey, which covers 184 countries worldwide, or the Business Environment and Enterprise Performance Survey (BEEPS) conducted by EBRD and the World Bank in all other countries where EBRD operates.

In the World Bank's Worldwide Governance Indicators 2011 Turkmenistan received low scores in virtually all areas, including control of corruption, government effectiveness, regulatory quality and rule of law (where the country ranks in the bottom 10 per cent in all cases). The exception is political stability, where Turkmenistan scores just below average. Turkmenistan's ranking in Transparency International's Corruption Perception Index (CPI) has remained low (170th out of 174 countries in 2012).

Although barriers to entry for new businesses remain large overall, certain steps were made in 2011 to make registering small enterprises easier. State duties for registration of a firm have been reduced and certain commissions eliminated. It is also no longer necessary to re-register a company when a new shareholder is added. Certain restrictions on operations with foreign currency and import-export operations have been lifted.

2.5 Social context

Turkmenistan is included in the upper middle income group of countries in the World Bank classification with a Gross National Income (GNI) per capita of over US$ 4,000 in 2011. According to the IMF, Turkmenistan's per capita GDP in PPP terms stood at around USD 8,700 in 2012. This reflects high rates of economic growth over the last decade (14 per cent on average since 2000) owing to rapidly increasing hydrocarbon production and exports. However, Turkmenistan ranked 102nd out of 187 countries in the 2011 UN Human Development Index, reflecting both moderate income, as estimated by the UN, and moderate life expectancy of around 71 years (68 years for men and 74 years for women).

Per capita social spending has been rising fast in recent years, supported by overall economic growth, and increased by around 50 per cent between 2007 and 2010, according to IMF estimates. In relative terms, however, the social component of state spending (education, health, social security) declined from 67 per cent in 2007 to about 50 per cent in 2010. Education is free and basic education is universally provided, with an estimated literacy rate of around 99 per cent.

In 2007, the authorities adopted a "National Programme on Improving Social and Living Condition" in villages, communities, towns and district centres. The Programme, which aims to improve the living standards of the rural population, is designed to run until 2020. The Programme includes an element to provide clean drinking water to human settlements.

The government provides large, predominantly untargeted, subsidies for consumption of basic goods and services. Prices for essential staples, such as bread, for utilities, including water and electricity, and gasoline, are kept very low, in absolute terms and compared with other countries in the Central Asia region. Transportation, rents and mortgages for public sector employees are also heavily subsidised. A certain amount of natural gas is provided to households free of charge, and consumption of gas is not always properly metered, especially in rural areas. The IMF estimates the overall cost of implicit and explicit energy subsidies at 20 per cent of GDP in 2010.

According to a 2011 UNDP report, the quality of public services requires major improvements. Most of the utilities infrastructure was built during the Soviet era and little has been done to reform the management and maintenance practices in the sector. In particular, the quality of water supply services declined significantly, with quality and volume requirements for water a particular challenge, while the existing sewerage systems are only available in bigger cities are generally very poor. The development of proper sanitation facilities has therefore become a matter of the highest priority. To address these issues a number of measures have been taken, and in 2011 the General Programme to provide clean drinking water to human settlements was adopted. The programme envisages construction and rehabilitation of the water supply and sewerage systems.

The government of Turkmenistan is committed to gender equality. The country signed up to international conventions and passed laws on equal rights and opportunities. Female labour force participation rate estimates vary between 46 and 62 per cent, depending on the source (World Bank, UN) but are generally in line with levels observed in other transition countries.

2.6 Legal context

Whilst some parts of the legal framework in Turkmenistan have been amended during the last decade in order to reflect new realities and encourage investment in particular sectors, the quality of commercial laws remains sub-optimal and falls short of compliance with international standards of best practice. In addition, the implementation of existing laws remains very haphazard and dependent upon high level state bodies and implementing authorities. As a result, Turkmenistan systematically lags behind other central Asian countries in comparative assessments of legal and regulatory frameworks conducted by the Bank. All legal topics relevant to private sector activities are in serious need of reform. This applies in particular to the framework for taking security, corporate governance and insolvency. The judiciary is not considered to be independent from the government, thus creating a rather opaque environment for resolving investment disputes. The legislation for public-private partnerships (PPPs) is rudimentary and not designed to support meaningful private sector involvement in the infrastructure or utilities sectors. Similarly, there is no legislative framework to promote renewable energy and energy efficiency. Extensive improvements are necessary in order to create an appropriate legal framework for attracting investment. However, such changes will depend to a great extent on a real commitment by government to foster transition to the market economy.

2.7 Energy efficiency and climate change context

Turkmenistan is a country with a rich resource base in fossil fuels and a major exporter of crude oil, oil products, and natural gas, with over half of production being exported. Energy tariffs are highly subsidised, and the energy intensity of the economy is very high as a result.

In the absence of a policy framework supporting investments in sustainable energy it is not likely that a push by the Bank to develop Sustainable Energy Initiative (SEI) or Sustainable Resource Initiative (SRI) projects in Turkmenistan would be successful. While the Bank will continue to consider any realistic opportunity for private sector investment that arises in this field, it will not be a focus of the Bank’s activities during the Strategy period.

3 STRATEGIC ORIENTATIONS

3.1 Calibrated strategic approach

The current political, economic and structural reform environment in Turkmenistan, as described above, warrant the continued application of a calibrated strategic approach, incorporating political and economic benchmarks to gauge the country’s progress (or regress) against its key Article 1 commitments and adjusting the Bank’s operational response accordingly. In the next Strategy period the Bank will monitor the following political and economic benchmarks:

In the political sphere:

- Progress toward genuine political pluralism and meaningful political accountability, including strengthening checks and balances in the political system, registration of independent political parties, free functioning of NGOs and civil society groups, and even-handed application of the rule of law.
- Substantial progress in increasing media freedom and freedom of expression.
- Significant progress in improving the country's overall human rights record, including the release of political prisoners and lifting restrictions on the freedom of movement.

In the economic sphere:

- Increased space for the establishment, operations and growth of private sector companies in a competitive environment.
- Significant reduction of arbitrary and distortionary state intervention in the economy, including through price controls, uneconomical tariff setting, and directed lending.
- Strengthening market-supporting institutions and development of the legal and regulatory framework for operation of privately-owned firms across various sectors of the economy.
- Improving public finance transparency in line with best international practice, building on positive progress made in the previous Strategy period.

For the new Strategy period the Bank will closely monitor developments against these political and economic benchmarks. Where progress against these benchmarks is noted, the Bank will be able to consider broadening its engagement in Turkmenistan. Conversely, if regress is noted against these benchmarks the Bank will further narrow its engagement.

3.2 Transition challenges

Turkmenistan's key transition challenges remain largely unchanged since the last Strategy period: promoting the development of the private sector by improving transparency and corporate governance; levelling the playing field for private and state-owned businesses; developing the financial sector by increasing financial depth and reducing state interference; introducing private banks and non-bank financial institutions; promoting economic diversification, given that two thirds of all exports originate from gas and much of the remainder from oil, oil by-products and minerals; promoting sustainable development and the introduction of international best practice in the private oil and gas sector; modernising infrastructure, which operates below cost recovery levels and utilises non-transparent practices; and attracting private investment into municipal and other infrastructure developments by introducing commercialisation, accountability and fiscal decentralisation.

Turkmenistan has made some progress in transforming its economy but remains one of the least reformed countries in the region. The overarching transition challenges include development of the private sector supported by a well-functioning financial system, increasing economic openness through international economic integration and commercialisation in municipal utilities and infrastructure sectors.

- **Developing the private sector.** Turkmenistan's economy continues to be heavily dominated by state intervention and state ownership. Although the number of private entrepreneurs and companies is growing, the private sector remains small and closely regulated by the state. A well-functioning financial system based on market-based principles is key to the development of the country's private sector.
- **Integrating into international markets.** To foster systemic change and reinforce private sector development, Turkmenistan's economy needs to become more open. An effective way to achieve greater openness while at the same time strengthening cooperation with neighbours is through deeper integration within the Central Asian region. Deeper integration in turn requires facilitation of foreign investment and trade as well as significant improvements in sectors such as transport, which would help move Turkmenistan away from its dependence on hydrocarbons exports.
- **Commercialising service provision.** In some sectors, particularly energy efficiency, power and municipal services, there is a need to commercialise provision of services.

3.3 Bank's priorities for the Strategy period

The Bank's priorities in the Strategy period will remain **championing private sector development**, focusing on providing financing either directly or through selected financial intermediaries to those segments of the real economy with the best growth prospects and the most likely prospects of reform, such as agribusiness, industry, commerce, tourism and logistics. The Bank will also enhance activities to support micro, small and medium sized enterprises (MSMEs) in key sectors through the Enterprise Growth Programme (EGP). The Bank should also continue to work to develop a viable financial sector that would be able to support the private sector and serve as a conduit for financial flows from the oil and gas sector to non-extractive sectors. This will remain dependent on the authorities' acting to abolish directed lending and opening the country to foreign direct investment. Further, EBRD will foster change through policy dialogue and technical assistance and shall seek to provide the authorities with expert advice on key transition challenges such as commercialisation and privatisation of state owned entities, financial institutions capacity building, corporate governance, attraction of foreign direct investment, public procurement, legal reform and transparency in public finances.

The Bank will **support Turkmenistan's enhanced international integration** through foreign investment, international trade and showcase operations in priority sectors such as regional transport infrastructure. These operations will be subject to strict conditionalities, including adoption of commercial principles such as cost recovery, transparency and accountability. EBRD will also seek opportunities to act as an enabler and catalyst to attract much-needed FDI by investing alongside foreign strategic investors, in addition to assisting in the development of local companies which in due course may also attract foreign investment. The Bank will promote cross-border trade through the Trade Facilitation Programme with eligible partner banks.

In some sectors, particularly energy efficiency, power and municipal services, there are major reform challenges but little political will to adopt market-oriented reforms. As a result, reforms within these sectors to date have been insufficient to enable the Bank to engage fully. The Bank will therefore limit its activities in these areas to **selective and targeted policy dialogue for institutional and regulatory reforms**, including privatisation of state-owned assets across a number of sectors as requested by the authorities, to promote the adoption of reforms leading to market-oriented solutions to the challenges in these sectors. The Bank will share with the Turkmen authorities the lessons of its experience of supporting privatisation, regional transport infrastructure, energy efficiency and municipal services elsewhere in the CIS region.

The ETC initiative and grant financing provided by various donors played a crucial role in the implementation of the Bank's previous Strategy for Turkmenistan. This role will remain essential throughout the new Strategy period. The Bank will seek increased donor grant financing to fund project preparation and implementation and support policy dialogue, to maximise transition impact.

3.4 Strategic priorities' challenges and Bank operational response

3.4.1 Supporting private sector development

Key challenges

- The Turkmen economy continues to be dominated by the state across virtually all sectors. State interference in the economy through price controls, low tariffs, subsidies, and non-commercial lending practices leads to the inefficient allocation of resources and hinders economic diversification. Privatisation of enterprises would further help modernise the manufacturing base and develop the institutional framework underpinning competitive markets.
- Building on recent measures to facilitate the creation and operations of small enterprises, the business environment needs to be further improved through relaxation of restrictions on entry, exit and operations of enterprises.
- Most agricultural commodities, including grain and cotton, are subject to high levels of government intervention, subsidies and price controls, both for input and farm gate prices. Irrigation, infrastructure and food processing are in need of sizeable investments. Modern retail outlets are at an early stage of development, in particular outside the capital.
- The banking sector is undercapitalised, dominated by state-owned banks and subject to extensive state interference, resulting in limited private sector lending. Only one bank out of eleven is privately owned. The key challenge is to commercialise lending practices, finance SMEs, and phase out directed lending to state-owned enterprises at artificially low interest rates.
- The legal framework for financial services needs to be developed, including in the areas of credit information systems, registration and use of right over immovable and movable property, creditor rights, and capital markets.

Bank's operational response

The Bank will provide financing to privately-owned companies in the non-oil and gas sectors, primarily through the use of ETC instruments such as DLF. The Bank will focus on food processing and distribution, logistics, transport services, packaging, furniture, and hospitality. In case of privately owned industrial companies, priority will be given to those introducing innovative technologies reducing environmental impact or improving energy efficiency.

To improve MSMEs' access to market-oriented bank financing, EBRD will launch a new banking framework agreement with existing and potentially new partner banks to channel funds to private sector MSME clients. The Bank will seek to provide new MSME credit lines, expand its Trade Facilitation Programme to additional banks, and continue to support local banks to adopt best practices in credit extension including improving their institutional capabilities through technical assistance. To enhance the competitiveness of the MSME sector, the Bank will combine advice and mentoring at the enterprise level with the development of a sustainable infrastructure of MSME support at the market level through its SBS operations as well as facilitating public/private dialogue and supporting local institutional development. Planned operations will strengthen enterprise performance in areas such as organisational development, information and communication technology, marketing and quality management. Key priority sectors include agribusiness, retail and wholesale distribution and transport and logistics. The Bank will also actively promote rural development, energy efficiency and female entrepreneurship.

Although the Turkmen authorities have made limited progress on privatisation in recent years, the Bank will nevertheless remain willing to support any privatisation opportunities as they may arise. The Bank will also seek to assist the authorities in developing a regulatory framework to implement the new MFI law and explore the possibility of extending microfinance credit lines to interested local partner banks and provide the required technical assistance to promote their successful implementation.

The Bank will seek to supplement the delivery of management and advisory services with increased access to finance through the implementation of a targeted Accounting Improvement Programme and linkages with EBRD banking teams, partner banks and other financial institutions in Turkmenistan.

Policy dialogue

Policy dialogue will be key to putting state-owned enterprises on a more commercial footing in order to increase productivity and efficiency as well as set the stage for possible privatisation. Through its SBS (BAS and EGP) advisory instruments, the Bank will promote development of SMEs to improve local management skills, support international certification and assist with business planning and restructuring.

Policy dialogue and technical assistance to develop the implementing legislation underpinning the new Privatisation Law will remain a priority for the Bank during the new Strategy period. In response to the government's stated goal of privatising the banking system between 2016-2020, the Bank will continue pursuing policy dialogue and consider providing TC to advise and possibly engage in the privatisation of state-owned commercial banks. The Bank will also continue to support the development of microfinance by providing training and conducting policy dialogue with the authorities on the relevant legislative and regulatory framework implementation.

Policy dialogue on commercialisation and privatisation may include exploring opportunities to address capacity building and advisory needs in cooperation with the Turkmen authorities through existing and possibly new donor resources, including cost-shared technical assistance funds.

Criteria for engaging with state-owned or public entities

The Bank will continue to use eligible conduits of MSME finance, including selected state-owned banks, provided they demonstrate high standards of commercialisation, financial transparency, corporate governance, integrity and management autonomy in carrying out their activities. Onlending of the Bank's MSME credit lines will be restricted to privately owned end-borrowers. State-owned enterprises will not be eligible for borrowing under such credit lines, whether provided via private or state-owned banks.

The Bank will support the privatisation of state-owned enterprises and state-owned banks and provide technical assistance for the adoption and implementation of the relevant enabling legislation only if it is persuaded that the privatisation process will be conducted in a transparent and competitive manner, with a clear timeframe for transfer of majority ownership and control to private investors. Participating companies are also expected to make steps towards high standards of corporate governance and financial transparency.

If these criteria are met, the Bank may offer equity and/or debt financing in the context of majority privatisations provided that no investment operations offer a direct financial benefit to the country's central government authorities, including through the payment of dividends from a partially privatised firm to the state as a remaining minority shareholder. The demonstration of clear commitment to privatisation by the authorities would also enable the Bank to consider engaging in policy dialogue and advisory work as well as undertaking specific pre-privatisation investment projects in the banking sector.

3.4.2 Promoting international integration

Key challenges

- Foreign investment in non-resource sectors remains very limited and trade is dominated by the hydrocarbons sector. Various barriers to trade such as limitations on prepayment for imports by corporate entities need to be relaxed. The private sector plays only a limited role in support of the economy's international integration through foreign investment and trade.
- Efficient transport infrastructure is essential to support international integration and economic development, and the investment needs to modernise transport infrastructure are enormous. Most transport infrastructure in Turkmenistan is owned and operated by the state. Investment decisions have often been arbitrary and there has been little progress with reform to improve commercial orientation, increase the efficiency of transport services and private sector participation.
- Road infrastructure is improving but major export routes still rely on very poor inter-city roads. The road sector remains unreformed in all aspects (institutions,

road user charges, private sector participation). The first challenge is to establish a semi-autonomous road agency and build technical and financial capacity to carry out road construction and maintenance under contractual arrangements.

- While the railways are corporatised, core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. The key challenge is to establish an arms-length relationship between the government and management and improve governance, financial transparency and sustainability of operations.

Bank's operational response

EBRD will seek opportunities to act as an enabler and catalyst to attract much-needed FDI by investing alongside foreign strategic investors, in addition to assisting in the development of local companies which in due course may also attract foreign investment.

The Bank will promote cross-border trade through the Trade Facilitation Programme with selected eligible partner banks to remedy the dearth of such instruments, which limits Turkmenistan's foreign trade in the non-extractive sectors. Signing TFP agreements with local commercial banks will be a priority for the new Strategy period. EBRD will also continue to assist its partner banks in improving their abilities to facilitate trade by promoting TFP alongside improving these banks' risk management and corporate governance.

The Bank may consider regional transport operations, particularly for projects with a sound business rationale and which are integrated into the CAREC transport corridors or the EU-TRACECA programme including key Caspian Sea port infrastructure projects with other IFIs or key bilateral donors.

Policy dialogue

Where appropriate, the Bank will provide technical assistance to support partner banks' utilisation of trade finance.

Policy dialogue on transport sector reform will focus on advancing commercialisation and providing a role for the private sector as well as enabling independent market participants' access to infrastructure. The Bank will continue its intensive policy dialogue on potential participation in the expansion of the Turkmenbashi port facilities to promote the introduction of commercial principles, environmental standards and transparent procurement rules.

The near-term opportunities for financial support in other infrastructure sectors are likely to be very limited. However, EBRD will continue to push for much-needed enabling reforms in the sector.

Criteria for engaging with state-owned or public entities

As with MSME credit lines, TFP via state-owned banks will be restricted to privately owned end-borrowers; state-owned enterprises will not be eligible for the Bank's TFP lending.

The Bank's engagement in support of selected regional transport projects such as key Caspian Sea port infrastructure projects with other IFIs or key bilateral donors would be structured under strict conditionalities to ensure that the projects generate revenue streams in support of debt service, promote environmentally sustainable development and benefit the private sector through internationally procured subcontracting arrangements. The pre-conditions for engagement with public entities include a clear commitment by the government to introduce specific reform measures with an emphasis on introducing commercial principles into transport operations, including movement towards cost recovery pricing, transparency, good corporate governance, and compliance with internationally acceptable standards to address environmental impacts as well as conformity with the Bank's procurement rules.

For all public sector projects, the Bank will ensure that its financing is disbursed to contractors who will have been selected in accordance with EBRD Procurement Rules.

Given that the sector criteria for Bank involvement in road or railway projects have not yet been met, projects in this area will not be pursued.

3.4.3 Laying the foundations for future reforms

Key challenges

- **Oil and gas revenue transparency**. It is crucial to increase the transparency of the management of the country's hydrocarbons wealth. Turkmenistan has substantial oil and gas reserves, which are explored through joint ventures between the state oil company and several international oil companies. The key challenge is to increase transparency of management of the country's resource wealth, while the scope of private sector oil and gas production remains very limited.
- **Energy efficiency.** Turkmenistan remains one of the most energy- and carbon-intensive economies in the region. This is in part due to low prices of energy maintained on the back of substantial hydrocarbon reserves. Government subsidies to domestic and commercial end-users for gas, electricity and other fuels are guaranteed by presidential decree until 2030. The regulatory framework to foster long term investments on an economical basis is absent. Incentives for improving energy efficiency need to be strengthened across all sectors of the economy through moving towards market pricing of energy and other appropriate policies.
- **Municipal sector.** Water and wastewater assets are owned and operated by the government and there is a clear need to improve their financial and operational efficiency. Market-oriented reforms in municipal infrastructure – in the areas of water supply, solid waste management, district heating and urban transport infrastructure – are yet to start. In urban transport, bus services are not fully autonomous and arm-length relationships in the sector are yet to be established. The key challenges are the establishment of companies with arms-length relationships with the central government and development of a modern tariff methodology and contractual arrangements between the owner/policy maker and the company.

Policy dialogue

The Bank would be able to engage operationally in these sectors only if satisfactory reforms, in line with the political and economic benchmarks and sector-related criteria, are undertaken first. To push for such reforms, the Bank will first engage in **policy dialogue initiatives** in a number of areas.

The Bank will continue to advocate the benefits of strengthening budget transparency, with an emphasis on disclosure of the governance, oversight and management principles of the FERF and stabilisation fund and moving the FERF under the budget.

The Bank will promote the adoption of energy efficiency laws and regulations that underpin a tariff system geared towards cost recovery. This will eventually facilitate the adoption of market-oriented lending rates reflecting risk to interested corporates that would benefit from energy savings.

To address significant transition gaps at the municipal level in the water, district heating, urban transport, and waste management segments, the Bank will promote reforms aimed at decentralised decision making; movement toward cost recovery; a modern regulatory framework; enhanced accountability, transparency and corporate governance of corporatised municipal utilities; public consultation; and wider private sector participation through competitive tenders.

In order to help improve the business environment in Turkmenistan, the Bank will join efforts by international organisations and other IFIs as well as by the authorities to address the issue of corruption.

3.5 Environmental and social implications of the Bank's proposed activities

Potential agribusiness projects may face issues associated with a general shortage and inadequate management of water resources. Turkmenistan's arid ecosystems and limited water resources make the country vulnerable to environmental damage. Lack of water metering systems at end-user level, high water intake rate for irrigation by the cotton industry, along with low efficiency of irrigation system, all take their toll. Irregular supplies and quality of drinking water (especially in rural areas), potentially polluted by an agricultural run-off containing traces of pesticide and chemical fertilisers, pose a high risk of water-borne diseases. A growing number of construction projects as well as a development of small and medium enterprises may be associated with occupational health and safety and labour issues due to general lack of risk assessment and insufficient enforcement of relevant requirements. Port infrastructure projects need to take into account a presence of existing contamination from refinery and oil transporting operations and the presence of obsolete offshore oil production platforms in the Turkmen sector of the Caspian Sea, which pose the risk of collisions, oil spills and marine pollution. Lack of ballast water management facilities will also need to be addressed. EBRD will assess potential environmental, health and safety and labour issues on its projects and develop Environmental and Social Action Plans to ensure activities funded by the Bank achieve compliance with the EBRD's Performance Requirements.

The Bank's recently approved Strategic Gender Initiative found that Turkmenistan has large gender gaps in a number of areas and therefore included it as a priority country for the Bank's gender work. The Bank will therefore attempt to develop and implement projects in relevant sectors in Turkmenistan, as the opportunities arise. In the Industry, Commerce and Agribusiness sectors, the Bank will, where practicable, encourage its clients to promote equal opportunities in the workplace and provide support where necessary. In the Infrastructure and Energy sectors, the Bank will attempt to ensure that the services are designed and implemented in a way that is responsive to the needs of both men and women. The Bank will endeavour to work with its clients in the Financial Institutions sector to identify ways to support women entrepreneurs by facilitating their access to finance and supporting their business activities. However, the extent of EBRD's involvement in gender projects in Turkmenistan will remain dependent on the opportunities that the Bank's calibrated Strategy and the limited number of operations in the country could offer.

See Annex 8 for a more detailed description of gender issues in Turkmenistan.

4 ACCESS TO CAPITAL

4.1 Private sources of finance

Turkmenistan has not been significantly affected by the global financial crisis due to its lack of integration into international financial markets. The economy has largely relied on its hydrocarbon wealth as a source of financing growth and development: Turkmenistan possesses the 4th largest gas reserves in the world. Exports of hydrocarbons enabled Turkmenistan to maintain large fiscal and external surpluses over the last decade with the exception of a brief period in 2009 and early 2010 when off-take by Russia fell sharply following a massive explosion on the gas pipeline.

FDI inflows have increased significantly in the last decade but from a very low base. Investors targeted mainly oil and gas sectors. External debt has remained low.

Banking sector remains small and highly concentrated, with assets to GDP at around 52 per cent. The six largest state-owned banks account for over 90 per cent of the loans. Credit to the private sector is estimated at around 4 per cent of GDP at end-2012, up from 2 per cent in 2009. Development of private sector lending is constrained by a relatively low capital base of banks, low demand owing to difficult operational environment for private sector enterprises, and moral suasion for banks to provide loans to state-owned enterprises at low interest rates.

As a result, access to credit for MSMEs is limited and non-bank sources of finance such as leasing are almost non-existent. In 2009, a new law was passed setting out the government policies to support the development of private sector SMEs, both through government funds and commercial bank lending with subsidised interest rates of 5 per cent per annum.

Capital markets are highly underdeveloped while commercial private equity sector is yet to emerge. There is currently no private equity capital active and capital available for investment remains negligible.

Turkmenistan currently does not have a credit rating assigned by any leading international credit agency. Moody's withdrew its rating (B2 long-term local currency) in September 2010 due to lack of sufficient data and information to maintain coverage. Fitch has not rated Turkmenistan since 2005.

4.2 Cooperation with other IFIs and multilateral donors

The Bank will continue cooperating very closely with other IFIs, donors and international organisations with a presence in Turkmenistan, joining forces to address key political, social, investment climate and regional impact issues.

World Bank

The World Bank's current Interim Strategy Note for Turkmenistan does not include any financing operations. It does however focus on implementing technical assistance to diversify and modernise the economy and address challenges associated with vocational training and climate change. The majority of technical assistance to be provided will be on a cost-share basis with the Turkmen authorities. EBRD will maintain its close coordination with the World Bank on key policy dialogue initiatives over the new strategy period.

ADB and IDB

The Asian Development Bank's strategic priorities for Turkmenistan focus on transport and energy infrastructure to enhance regional connectivity as well as policy and capacity-building advisory services for clean energy and financial sector development. The CAREC agenda is among the driving forces for ADB operations in Turkmenistan. The Islamic Development Bank's activities in the country include financing rail infrastructure and the purchase of two large capacity oil tankers as well as fostering cooperation to improve the water supply. EBRD shall cooperate closely with ADB and IDB to promote transition in the transport infrastructure sector.

Other IFIs and donors

Reform regarding public sector transparency is another key area where the Bank will continue cooperating with international organisations though policy dialogue. Publication of investment rules and governing principles of the stabilisation fund and other operating foreign exchange funds, as well as improving accountability and efficiency in the provision of public services by steps towards fiscal decentralisation are key areas where the EU and UNDP are currently providing advice. One major milestone in this direction would be for Turkmenistan to become compliant with the Extractive Industries Transparency Initiative (EITI), which could open the door for EBRD investments in the oil and gas sector in the future. However, Turkmenistan's civil society would have to develop significantly before the country would be able to join EITI, as domestic CSOs play a crucial oversight role in the Initiative.

4.3 Cooperation with the European Union

The Bank's cooperation with the EU is multifaceted. The Bank shall keep monitoring the work of the EU to promote stability, democracy and respect for human rights as these directly affect the investment climate, and will be expanding cooperation on key policy dialogue challenges regarding private sector development and other key sectors requiring reform, such as banking, transport and infrastructure.

The Bank receives substantial EU technical assistance support for project implementation and will maintain its close coordination with the EU over the new country strategy period to ensure availability of funds fostering reform in agreed selected economic segments.

ANNEX 1 – POLITICAL ASSESSMENT

Over the years the Bank has been concerned with Turkmenistan's progress towards multi-party democracy, pluralism and market economics in keeping with Article 1 of the Agreement Establishing the Bank. In March 2010 the Bank adopted a calibrated strategic approach for Turkmenistan, which allowed matching operational responses to changes in the economic, business and political environment of the country. Overall, the progress with reforms during the past strategy period has been slow. Some progress has been made on three of the four economic benchmarks but no substantial progress was registered on the three political benchmarks of the country strategy, although some positive steps were noted.

On the political side, the Bank remains concerned about the progress Turkmenistan made toward the application of principles of multi-party democracy and pluralism during the previous Strategy period. Political power is concentrated in the presidency and is not sufficiently balanced by the legislature or judiciary. The last presidential election, held on 12 February 2012, was not monitored by the OSCE/ODIHR as their needs assessment mission concluded that the electoral framework of the country does not meet international standards for a competitive election. Although the first alternative political party was launched in August 2012, its introduction, while formally breaking the one-party system, has yet to contribute to increasing genuine political pluralism in Turkmenistan.

Freedom of the media remains a serious concern and the country's overall human rights record is poor, despite the adoption of relevant legislation. The implementation of the country's commitments under international treaties on civil and political rights – including the prohibition of torture, freedom of the media, and freedom of movement – needs to be significantly improved.

Free Election and Representative Government

Free, fair and competitive elections

While the electoral framework of Turkmenistan contains important basic principles, embedded in the Constitution and the laws, related to the conduct of elections, such as the universal, direct and equal right to elect by secret ballot, a number of crucial aspects of the electoral process are not adequately regulated.[2]

Despite substantial changes in the legislation, the election laws continue to contain shortcomings, including provisions creating a risk of inconsistent application of the legislation, undermining the principle of proportionality, maintaining lengthy residency requirements for candidates both for the Mejlis (parliamentary) and presidential elections, lacking mechanisms for ensuring political plurality in election commissions and guaranteeing the transparency of the electoral process.[3]

Turkmenistan has yet to hold an election which is recognised as being compliant with international standards. The last presidential election, held on 12 February 2012, was

[2] OSCE/ODIHR, Turkmenistan, Assessment of the Electoral Legislation, Warsaw, 23 July 2012, p.2.
[3] OSCE/ODIHR, Turkmenistan, Assessment of the Electoral Legislation, Warsaw, 23 July 2012, p.4.

not monitored by the OSCE/ODIHR. The OSCE/ODIHR Needs Assessment Mission (NAM) report of 3 January 2012 justified the decision not to deploy an observation mission as follows: “Given that fundamental freedoms continue to be limited, that the current situation limits choice between competing political alternatives, and that progress still remains to be made in bringing the legal framework in line with the OSCE commitments for democratic elections, the OSCE/ODIHR NAM does not consider that the deployment of an election observation mission, even of a limited nature, would add value at this point in time”[4].

A new presidential election law was adopted in 2011. While certain provisions of the law brought the legislation closer to international standards, some crucial shortcomings remain, including undue restrictions on the right to stand as a candidate, defamation provisions that limit the freedom of expression and the lack of due process guarantees in the complaints and appeals framework to ensure effective legal redress.[5]

A unified Electoral Code was adopted by Parliament in May 2013. A UNDP consultant was involved in advising the authorities in drafting the Electoral Code. The current legal framework requires further improvement but amending the legislation alone is not sufficient to bring the electoral process in line with the OSCE commitments and other international standards. This also requires political will to effectively implement the law and to develop a pluralistic environment that underpins genuine electoral processes.

Separation of powers and effective checks and balances

The principle of separation of powers between the executive, legislative, and judiciary is embedded in the Constitution. However, in practice political power is concentrated in the presidency and is not adequately balanced by the legislature or judiciary.

Following Turkmenistan’s independence in 1991, former President Saparmurat Niyazov was declared ‘president-for-life’ in 1999. After his death in 2006, a presidential election took place in 2007. Gurbanguly Berdymuhamedov won the election with 89 per cent of the vote and was re-elected for another five years in office in 2012 with 97 per cent of the votes, on a turnout of 96 per cent.

The current 125 members of the Mejlis (parliament) were elected in December 2013.The parliament has yet to become a body capable of balancing the strong executive branch of power.

Ineffective functioning of the justice system is caused by the lack of independence of the judiciary as the responsibility to appoint and promote judges rests with the President. There are numerous reports about widespread corruption in the judiciary.

[4] Turkmenistan, Presidential Election 12 February 2012, OSCE/ODIHR Needs Assessment Report, 7-9 December 2011, Warsaw, 3 January 2012, p.3.
[5] Turkmenistan, Presidential Election 12 February 2012, OSCE/ODIHR Needs Assessment Report, 7-9 December 2011, Warsaw, 3 January 2012, p.1.

Effective power to govern of elected officials

All key decision-making is concentrated in the presidency. The president is elected in a direct national election, although the country has yet to have an election in conformity with the OSCE commitments and other international standards. The last presidential polls were not monitored by the OSCE/ODIHR due to the lack of an environment conducive to competitive elections. Members of parliament, who are also elected through periodic elections with universal suffrage, have limited power to govern. There are no other un-elected sources of political influence and decision-making in the country.

Civil Society, Media and Participation

Scale and independence of civil society

The atmosphere prevailing in the country makes it extremely difficult for independent non-governmental organisations (NGOs) to operate. The law requires all NGOs to register with the Ministry of Justice. Unregistered NGO activity is punishable by fine, short-term detention, and confiscation of property. Only a few of the registered NGOs have been recognised by international organisations as being independent. There are no international human rights NGOs with a permanent presence in the country and this severely restricts their ability to investigate the government's human rights policies and practices.

Independent pluralistic media that operates without censorship

The first law on media was adopted in December 2012, confirming that the state guarantees the freedom of the media. The law also declared the inadmissibility of censorship and interference into activities of the media.

However, in practice media freedom remains a serious concern. The government finances and controls almost all print media. There are significant restrictions on the importation of foreign newspapers. The government controls radio and local television, but satellite dishes providing access to foreign television broadcast are widespread throughout the country.

Defamation remains a criminal offence and journalists exercise self-censorship due to fear of government reprisal. The government prohibits reporting of opposition political views or criticism of the president. Although there was some improvement in this area, Internet access remains restricted. The government continues to monitor citizens' Internet activity.

Multiple channels of civic and political participation

There are very few registered civil society organisations in Turkmenistan and they have limited access points to participate in the political decision-making process. Government decision-making process is centralised and concentrated in the presidency with the entire process lacking transparency and accountability.

It is essential to begin the process of introducing a freedom of information law to enable public information to be accessed easily and freely by the public in accordance with international standards.

Freedom to form political parties and existence of organised opposition

For a long time Turkmenistan remained the only country in the post-Soviet area which had one political party. This has changed in August 2012 when the first alternative party – the Party of Industrialists and Entrepreneurs – was created. But so far its introduction, albeit technically breaking the one-party system, has not contributed to increasing political pluralism in Turkmenistan.

Until real political reforms are achieved, it will be difficult to create a competitive environment necessary for a multi-party system to develop. The new party system was tested for the first time in parliamentary elections held on 15 December 2013. The OSCE/ODIHR did not deploy a proper observation mission but sent a group of 15 experts to assess the compliance of the election with international standards. The mission issued a report on 4 March 2014 concluding that "the absence of political pluralism and an insufficient separation of powers between different branches of government, as well as the lack of respect for fundamental freedoms, contributed to elections that need to be significantly improved to live up to OSCE commitments and other international obligations for genuine and democratic elections."

A new law on political parties was adopted in January 2012. The passage of the law was acknowledged and appreciated by the international community. The OSCE/ODIHR published detailed comments on the law, containing its analysis and recommendations for improvement.[6]

Rule of Law and Access to Justice

Supremacy of the law

The right to a fair trial and freedom from arbitrary arrest and detention are enshrined in the Constitution and criminal code but is not maintained in practice. There are no clear restrictions in place on circumstances under which elected authorities can rule by decree or suspend constitutional rights and guarantees. Presidential decrees *de facto* have the force of law and there is no effective mechanism for oversight of the constitutionality of the decrees.

Independence of the judiciary

The independence of the judiciary is enshrined in the laws but in practice the judiciary is not independent from the executive branch of power. The country's judiciary is subordinate to the president. There is no legislative review of the president's judicial appointments. The president has sole authority to appoint and dismiss judges. These judges remain dependent on the president throughout their tenure.

[6] OSCE/ODIHR, Comments on the Law of Turkmenistan on Political Parties, Warsaw, 30 July 2012.

The UN Committee against Torture concluded that "the State party should take measures to establish and ensure the independence and impartiality of the judiciary in the performance of duties in conformity with international standards, notably the Basic Principles on the Independence of the Judiciary".[7] There is no mechanism providing for independent judicial monitoring or auditing of the authorities. The judiciary is known as being corrupt and inefficient.

Government and citizens equally subject to the law

Equality before the law is guaranteed in principle but not maintained in practice. There are no effective mechanisms for preventing abuse of authority. The law does not provide for an independent audit of assets of public officials.

Effective policies and institutions to prevent corruption

Corruption and general lack of transparency remains a significant problem in Turkmenistan. According to the 2013 Transparency International's Corruption Perceptions Index, Turkmenistan is ranked 168 out of 177 states surveyed[8]. While the law provides criminal liability for official corruption, the government does not implement the law effectively, resulting in officials often engaged in corrupt practices with impunity.

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

The fundamental freedoms of speech, religion, conscience, movement, association and assembly are recognised in the Constitution and the laws but are severely restricted in practice. There have been some positive developments in a few individual cases, but the country's overall human rights record remains poor and more progress is needed. Property rights lack legal protection due to inefficiency of the judicial system.

An area of serious concern is freedom of movement. It was reported that the Turkmen authorities arbitrarily interfere with residents' right to leave and return to Turkmenistan through an informal and arbitrary system of travel bans. According to the reports, a so-called "blacklist" of names of people banned from leaving the country is still in place.[9] This restricts the exit and entry into the country for the individuals on the list under state surveillance. There are also restrictions on the freedom of movement inside the country as Turkmenistan maintains the system of

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[7] UN Economic and Social Council, Committee on Economic, Social and Cultural Rights 47th Session, Geneva, 14 November – 2 December 2011, Concluding Observations – Turkmenistan (E/C.12/TKM/CO/1,), paragraph 10.

[8] Transparency International, Corruption Perceptions Index (CPI), 5 December 2013, http://cpi.transparency.org/cpi2013.

[9] United Nations, Human Rights Council, Summary prepared by the Office of the High Commissioner for Human Rights in accordance with paragraph 5 of the annex to Human Rights Council resolution 16/21, Geneva, 30 January 2013, p.5.

mandatory registration at the place of residence, which is a prerequisite for residence, employment, acquisition of real estate, and access to health services.

Only one UN Special Rapporteur has been allowed to visit the country, despite their frequent requests to do so.[10] In 2008 the Special Rapporteur on freedom of religion or belief visited Turkmenistan and noted that a high level of tolerance and a climate of religious harmony prevailed at the societal level. She also stated that individuals and religious communities remained under close scrutiny and faced difficulties when manifesting their freedom of religion or belief.[11]

In a positive move, in April 2012 a group of ICRC delegates were granted access to a prison under the jurisdiction of the Ministry of Internal Affairs, building on their first visit to a medical institution in 2011.[12] However, the ICRC has not been granted full access to all prisons. There is no independent national system in place that allows regular monitoring and inspection of all places of detention.

An inter-agency commission was established in 2007 with the aim of implementing the country's international commitments in the area of human rights. The government also implemented a joint EU/UNDP/OHCHR (Office of the High Commissioner for Human Rights) project "Strengthening the capacity of Turkmenistan to promote and protect human rights". As a result of the project, the government improved its interaction with the treaty bodies through enhancing the knowledge of officials representing Turkmenistan in monitoring committees. With the involvement of international consultants, the work is currently under way in Turkmenistan to prepare the first draft of the National Human Rights Action Plan.

Political inclusiveness for women, ethnic and other minorities

While there are provisions in various pieces of legislation regulating the issue of violence against, and protection of, women, there is no specific law addressing this area. The definition of discrimination against women in the Constitution refers only to civil rights. The authorities have been encouraged to include the principle of equality of women with respect to all rights.[13] They've been also urged to revise the Labour Code to eliminate the negative stereotypes against women that restrict their participation, particularly in the employment sector.[14]

[10] In fact, one of the recommendations of the civil society organisations during the latest round of Universal Periodic Review in 2013 was for Turkmenistan to extend a standing invitation to the UN Special Procedures, with ten UN monitors waiting to be invited, including the Special Rapporteur on Human Rights Defenders, Special Rapporteur on Freedom of Expression and Special Rapporteur on Freedom of Peaceful Assembly and Association.

[11] Report of the Special Rapporteur on freedom of religion or belief, Asma Jahangir, A/HRC/10/8/Add.4, para.52.

[12] ICRC International Committee of the Red Cross, Turkmenistan: ICRC visits prison, 13-04-2012 News Release.

[13] United Nations, Human Rights Council, Compilation prepared by the Office of the High Commissioner for Human Rights in accordance with paragraph 5 of the annex to Human Rights Council resolution 16/21, Geneva, 8 February 2013, p.7.

[14] United Nations, Human Rights Council, Compilation prepared by the Office of the High Commissioner for Human Rights in accordance with paragraph 5 of the annex to Human Rights Council resolution 16/21, Geneva, 8 February 2013, p.7.

Women serve in a few prominent government positions and are represented in the 125-member Mejlis (parliament), including the Mejlis speaker.

Freedom from harassment, intimidation and torture

The treaty body of the Convention against Torture and Other Cruel, Inhuman and Degrading Treatment or Punishment reported an amendment in August 2012 of the Criminal Code to incorporate the definition of torture which is in line with Article 1 of the Convention. However, the welcome change of the law did not eradicate the continued practice of torture.

There are numerous and consistent allegations about the widespread practice of torture and ill-treatment of detainees. According to information presented for the 2013 Universal Periodic Review (UPR), persons deprived of their liberty are tortured, ill-treated and threatened by public officers at the moment of apprehension and during pre-trial detention to extract confessions and as an additional punishment after the confession.[15]

[15] United Nations, Human Rights Council, Summary prepared by the Office of the High Commissioner for Human Rights in accordance with paragraph 5 of the annex to Human Rights Council resolution 16/21, Geneva, 30 January 2013.

ANNEX 2 – ASSESSMENT OF TRANSITION CHALLENGES

The table and the supporting text below provide an overall assessment of transition challenges by sector, based on the Transition Report 2013. There are two separate scores for each sector, rating market structures and market-supporting institutions.

Sectors	Market structure	Market-supporting institutions
Corporate sectors		
Agribusiness	Large	Large
Manufacturing and Services	Large	Large
Real estate	Large	Large
Private equity	Large	Large
Telecommunications	Large	Large
Energy		
Natural resources	Large	Large
Sustainable energy	Large	Large
Power	Large	Large
Infrastructure		
Water and wastewater	Large	Large
Urban transport	Large	Large
Roads	Large	Large
Railways	Large	Large
Financial institutions		
Banking	Large	Large
Insurance and financial services	Large	Large
MSME	Large	Large
Capital markets	Large	Large

Agribusiness

Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) build on recent progress in adopting a more cost-reflective prices on basic food and privatising agribusiness companies, and accelerate the liberalisation and privatisation of the sector.

The agricultural sector, which accounts for over 12 per cent of Turkmenistan’s GDP in 2010, continues to be characterised by high government intervention, subsidies and price controls. Price controls continue to exist for both input and farm gate prices, in particular, grain and cotton production. Agricultural output has been growing rapidly in recent years and in 2010, Turkmenistan became a grain exporter for the first time. Since the new government took office in February 2007 the country has started a slow transition reform process with significant legislative and economic changes including the unification of the exchange rate and new foreign investment legislation, and a limited number of price liberalisations that in principle are all beneficial for commodity traders as well as agri-processors. More recently, the government has increased the price of bread and flour but prices are still effectively controlled. A number of agribusiness companies have also been privatised. Private land ownership is limited and recent reforms have only allowed for improvements in the land leasing system including leases by foreign companies. Lending to agriculture is dominated by subsidised loans extended under various government programmes via commercial banks. Irrigation and infrastructure are in need for sizeable investments. Food processing is also in a nascent and fragmented stage and needs a lot of investments. Modern retail is at an early stage of development, in particular outside the capital.

Manufacturing and Services
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) accelerate privatisation and restructuring of state-owned enterprises to create space for new entry and development of private enterprises; and (ii) further improve overall business environment including simplifying the tax regime.

Transition in Manufacturing and Services is just beginning to take place with the unification of the foreign exchange rate, which has significantly improved price signalling and the functioning of markets. The private sector, however, remains small and the sector is still dominated by state-owned companies. The Government has so far focused on improving the business environment to facilitate the development of SMEs including privatisation plans. Among positive developments is an adoption of the new law on SMEs in August 2009 that reduced registration requirements and other administrative burdens on the SMEs. In May 2010 the government adopted the National Programme for Socio-Economic Development of Turkmenistan for 2011-30, which prioritises private sector development and recognises the importance of increased competition and further market and institutional reforms. For the first time, this explicitly includes the privatisation of SMEs. Although the prohibition of prepayment for imports by legal corporate entities has been lifted, significant barriers to businesses remain to promote new entry and growth of small and medium-sized private enterprises such as the arbitrary application of tax rules.

Real estate
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) ensuring the protection of property rights and predictability of the institutional environment; (ii) increasing supply of modern commercial property across sub-segments and introducing modern financing methods; and (iii) introducing modern construction techniques and technologies, including energy efficiency.

The real estate sector is at very early stages of development and there is widespread state intervention in the market. Property development financed by gas exports is driven by the state. Many standard market products and financing methods are not available. The legal framework for property development is poorly developed. In 2008, the Government approved a new constitution that highlights the protection of private property rights, but the legal system does not enforce contracts and property rights effectively. Gaps in terms of the development of modern primary and secondary legislation supporting the sustainability of real estate (energy efficiency, impact on environment) are still large. Public awareness of the sustainability issues is also low.

Private equity
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) broadening companies' access to PE financing, including by launching PE/VC initiatives; and (ii) improving corporate governance, accounting and business practices of corporate companies; and (iii) reducing state interference in the business activities of corporate companies.

A commercial private equity sector is yet to develop and to date the country has attracted almost no interest of international private equity funds. There are no country dedicated fund managers, and only one regional fund manager has been identified to include Turkmenistan in its portfolios scope. There is currently no private equity capital active and capital available for investment remains negligible at 0.002% of GDP. Conformity with OECD's Corporate Governance Principles requires improvement. A challenging business environment, limited investment opportunities and poor exit prospects restrict development of the sector.

Telecommunication
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) privatising the fixed line and mobile incumbents; (ii) liberalising the market, establishing an independent regulator and adopting modern regulatory framework; and (iii) further developing the telecommunications infrastructure (broadband internet in regional areas).

Unlike the other Central Asian countries, Turkmenistan has made only very limited efforts to liberalise its telecoms market. The Ministry of Communications plays the role of both the regulator and policy maker and controls a number of state enterprises in the post and telecommunications sectors. The state-owned incumbent Turkmen Telecom is the primary provider of public telephone, email and Internet services. In 2000 it was granted a monopoly over data services, thus seriously stifling growth of the Internet sector. Even though Internet cafes began to open in Ashgabat in mid-2006, Internet access is still restricted and controlled. In the mobile segment, the state-owned Altyn Asyr, a subsidiary of Turkmen Telecom, competed with MTS Turkmenistan, owned by the Russian telecommunications group MTS. In December 2010 the authorities suspended the license of MTS Turkmenistan, thus leaving the state owned Altyn Asyr as the only active mobile operator in the country. In July 2012, MTS announced it had signed an agreement with the government which should allow it to resume operations in the country, although it will have to share part of its profits with the state owned incumbent. Altyn Asr was transformed into a private closed joint stock company in April 2013 without a publicly announced competitive tender.

Natural Resources
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) encourage private-sector participation in the upstream oil and gas sector; (ii) liberalise and promote competition in the downstream segment; (iii) ensure independence and proper functioning of the hydrocarbons regulatory authority; and (iv) increase transparency of revenue flows from extractive activities and increase transparency and accountability to the population with respect to the management of the country's resources' wealth.

Turkmenistan has substantial oil and gas reserves in both onshore and offshore fields. Many of the prime oil deposits are located in disputed areas of the Caspian Sea, and without an agreement among Iran, Azerbaijan, Russia and Turkmenistan on maritime borders, these fields will likely remain undeveloped. The downstream sector is dominated by the state via Turkmeneftegaz, while the upstream has some limited IOC participation (e.g. Monument Oil, ExxonMobil, Burren Energy, CNPC, Petronas, Dragon oil) but mostly off shore and in JVs/PSAs with the state-owned company Turkmenneft. Competition is limited, especially downstream, and the market is not liberalised. The complex regulatory framework and unfavourable business practices deter private investment. Investors have expressed concern over the government's power to unilaterally annul petroleum licenses.

In the past, most of the revenue from hydrocarbon exports has been accumulated in extra-budgetary funds, especially the Foreign Exchange Reserve Fund (FERF) which was controlled by the President. A stabilisation fund established in October 2008 and managed by the Ministry of Finance accumulates the state budget surpluses to channel the revenues into long-term investments such as infrastructure, but this only partially addresses long-lasting concerns about the opaque and non-transparent management of the country's resources' wealth.

Sustainable Energy
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) introduce cost reflective tariffs for end consumers; (ii) develop legal and institutional framework for supporting sustainable energy; and (iii) support institutional development and project deployment for climate change.

The country continues to be very energy intensive. A SE supportive legal framework is missing and institutions are weak or non-existent. The Government heavily subsidises domestic and commercial end-users of gas, electricity and other energy products. Tariffs are therefore significantly below cost recovery levels and do not include environmental costs. Therefore price signals do not provide incentives to use energy efficiently and to invest in RES projects. No energy efficiency law, policies or agencies have been established. There are no specific laws, policies or economic incentives for RE development and hardly any project activity has been recorded. The UNFCC and Kyoto protocol have been ratified, but no climate policies or CDM project activities are in place. Remaining challenges include increasing fuel and energy tariffs, to provide incentives for a more efficient use of energy, and to make renewable energy more competitive. The creation of a basic legal and institutional framework to enable RE projects and the introduction of economic incentives, as appropriate, are also key challenges ahead.

Power
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) corporatise and unbundle the state-owned entity; (ii) establish an independent regulator; and (iii) start liberalisation of the sector.

The energy sector remains vertically integrated state owned and is not operated on commercial principles. Energy assets are formally excluded from the list of privatisations at least until 2020. Electricity supply disruptions remain frequent and the power generation and distribution networks need significant upgrading. Electricity tariffs need to be increased from extremely low levels to attract investment and reduce excessive consumption. Remaining transition challenges are large and include basic sector reforms, the beginning of unbundling, commercialisation, introduction of competition, putting in place a mechanism framework to support exploitation of the untapped renewable energy resources in the country, and establishing a regulatory framework for the power market in order to attract investment and encourage improvements in the efficiency with which energy is generated, distributed and used.

Water and wastewater
Market structure: *Large*
Market institutions: *Large*

The transition challenges remain significant and are identified in the following areas: (i) establishment of companies with arms-length relationships with the central government; (ii) establishment of regulation (e.g. development of the modern tariff methodology); (iii) development of contractual arrangements between the owner/policy maker and the company; (iv) initiate increases of tariffs and collection rates; (v) corporate restructuring and further commercialisation (including restoration of physical supply, reduced water losses and increased water quality); and (vi) introduction of meters and meter-based billing.

Market-based reforms in infrastructure have not yet started practically. Water/wastewater assets and operations are owned and operated by the government while decentralisation remains a key challenge. Water/wastewater utilities are operated in a bureaucratic fashion with no or limited concerns for financial or operational efficiency. In fact, most water/wastewater services are provided for free, and supported by government subsidy with limited incentives for users to reduce water consumption. Governance and transparency are very poor (e.g. no public consultations take place for the construction of new local roads).

Urban Transport
Market structure: *Large*
Market institutions: *Large*

Given the early stage in transition, the medium-term transition challenges are limited to the creation of corporate institutions and functions with arms-length relationships from the central and regional governments. Other reforms should follow but are only expected in the medium-term.

Market-based reforms in urban transport remain at an early stage. Bus services were separated from the central administration but not fully autonomous. Utilities are operated in a bureaucratic fashion with no concern for financial or operational efficiency. Prices generally are set politically at below cost recovery levels. Some bus services are provided by the private sector in a more commercial fashion. Governance and transparency standards are generally low.

Roads
Market structure: *Large*
Market institutions: *Large*

The key challenges mainly relate to reform initiation with a priority targeted at establishment of (semi-autonomous) road agency and building technical and financial capacity to carry out road construction and maintenance in time and budget within set terms and conditions under contracts.

The road sector remains unreformed in all aspects (institutions, road user charges, private sector participation). Fuel prices/levies are by far the lowest in the Bank's countries of operations (and indeed amongst the lowest in the world). Key decisions on road construction are politically driven. Road quality in Ashgabat, the capital city, is relatively good but the available evidence suggests that outside the main towns the road conditions are significantly lower in quality. Some large contracts were awarded to foreign construction companies but most new construction is done by the state-owned construction company (without competition).

Railways
Market structure: *Large*
Market institutions: *Large*

There are significant transition challenges remaining in almost all areas, but the priority should be given to the following areas: (i) the establishment of arms-length relationship between the government and management; (ii) increasing financial transparency and sustainability; and (iii) improvements in governance and transparency. Increasing competition and private sector participation are remote targets for the country.

Although the railways are corporatised, operating and policy setting functions are *de facto* not separated. Core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. While freight tariffs are higher, passenger tariffs remain well below cost recovery levels.

Banking
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) increasing role of privately-owned banks, through strengthening such banks and increasing bank privatisations; (ii) broadening access to finance and facilitating increased competition among banks; (iii) improving corporate governance and business practices in the sector; and (iv) facilitating improvements of the regulatory framework and its implementation effectiveness.

The banking sector is characterised by a very low level of intermediation and is largely dependent on the state and public resources. The regulatory framework remains highly underdeveloped, and the red tape and overregulation is holding back development of the sector. Risk management, legal transparency, corporate governance, accounting, and integrity standards remain far below the international best practise. The sector is very small, with assets to GDP at around 52 per cent. There are 11 banks, out of which only one is private; three are joint stock banks, one joint venture bank with foreign ownership and two foreign owned banks. The sector is highly concentrated: the six largest state-owned banks account for 90 per cent of the market. A large proportion of 'commercial' bank lending (around 53 per cent in 2012) remains directed to state-owned enterprises at rates that are below risk-adjusted market rates. Given limited bank capital and financing, there is little space for banks' further credit expansion to the private sector. Foreign currency lending has decreased, with two-thirds of total loans from commercial banks denominated in local currency in early 2012. A major recent reform is that international financial reporting standards (IFRS) were introduced in all banks in 2011. The new foreign exchange regulations law eliminates the requirement of prepayments for exports and imports and allows banks to conduct foreign exchange transactions with non-public customers without seeking prior approval from the central bank.

Insurance and other financial services
Market structure: *Large*
Market institutions*: Large*

Key challenges: Insurance sector: (i) increasing the role of privately-owned insurance companies; (ii) broadening access to non-life and life insurance products. Private pension sector: (i) facilitating establishment of necessary legal and regulatory framework. Leasing sector: (i) increasing the role of privately-owned leasing companies; (ii) broadening access to leasing.

Privately-owned non-bank financial institutions such as insurance companies and pension funds remain virtually non-existent. Foreign entry into the insurance sector is allowed only through minority joint ventures. Since the revocation of licenses of four private insurance companies in 2000, the state-owned insurance company—Turkmen Gosstrakh—has been enjoying a virtual monopoly position in the insurance market. Only non-life insurance is provided, and it has a very low penetration at 0.45 per cent of GDP (although this represents a slight increase from 0.25 per cent in the last review). The main challenges faced by the sector are weak corporate governance and lack of skills as well as and the availability of products in the market. Leasing sector exists but remains small.

Micro, Small and Medium-sized enterprises
Market structure: *Large*
Market institutions: *Large*

Key Challenges: (i) increasing the share of the private sector providing SME lending; (ii) diversifying the sources of finance available to SMEs such as leasing; (iii) improving management skills in the SME sector; and (iv) develop the legal and regulatory framework needed to support bank SME finance

Access to credit for MSMEs is very poor, and is not provided on a sustainable basis. The banking sector in Turkmenistan remains largely state-controlled, with private sector lending representing around 2.6 per cent of Turkmenistan's GDP in 2010. Bank lending to SMEs accounts for about 25 per cent of total bank lending. International financial institutions and NGOs aim at providing finance through the development of commercially based microfinance. Other sources of finance including leasing are almost non-existent. Management skills in the SME sector are below the standards of the rest of the transition region, which limits the potential growth of the private sector, a key government priority. In 2009, a new law was passed setting out the government policies to support the development of private sector SMEs, both through government funds and commercial bank lending with subsidised interest rates at 5 per cent. A law on micro-finance was adopted in April 2011. The legal and regulatory framework, including credit information systems, registration of immovable and movable property, and the enforcement of creditors rights is in the early stages of development.

Capital markets
Market structure: *Large*
Market institutions: *Large*

Key challenges: (i) facilitating increase in liquidity in local capital markets; (ii) improving the legal and regulatory framework governing capital markets.

Capital markets are highly underdeveloped. Securities market legislation is rudimentary and needs overall reform. In order to provide for the development of the securities market in Turkmenistan in November 2011 the President of Turkmenistan has approved the State programme and Action Plan for Securities Market Development of 2012-2016. At the moment the legal framework is being developed to support this initiative. The government is reportedly considering involvement of the World Bank in this initiative.

ANNEX 3 – LEGAL TRANSITION

This annex presents analytical comments on a series of legal topics directly relevant to the Bank's investment strategy for Turkmenistan. These comments are based on the assessments conducted by the Legal Transition and Knowledge Management Team in the Office of the General Counsel.

Supporting private sector development

Access to finance

The EBRD assessment work has shown that Turkmenistan is equipped with a legal framework for secured lending which can be improved in order to avoid some legal uncertainties and to better facilitate sound lending practices. Security rights on movable and immovable assets are governed by the Civil Code and the Law on Pledge. The Pledge law still has some features that can be seen impractical from a business perspective. For example, the law requires pledged assets to be specifically identified in the pledge agreement, together with the value and their location. The requirement to state the value of the collateral might be too burdening for the parties as not every collateral is easy to evaluate and the practical effect of such provision is questionable. The law does allow the pledging of commodities in circulation (stock) but limits its usage by stipulating that the pledgor is entitled to sell such property provided he pays the secured debt or that he replaces such property by assets of equal or greater value. While intended to protect the position of the creditor similar provisions are usually seen by business as too rigid since they place pledgor under unduly risk of unintentionally defaulting. This may make security over inventory impractical and, thus, of limited use. Formalities of creation of pledges are complex and slightly confusing as unclear provisions of various applicable laws and presidential decrees create problems in practice.

Apart from some welcome improvements of the secured transaction legislation the most desirable reform in the sector would be the introduction and development of a modern centralised register of pledges. In addition, the existing financial legal framework needs to be adapted to facilitate the development and operation of credit bureaus. The Central Bank recently expressed interest in receiving technical assistance for the development of the credit bureau but the policy dialogue undertaken by the Bank has not made much progress. One of the conditions for EBRD involvement is that these reform efforts are taking place together with a moderate, yet real effort to allow for market-based commercial practices (especially lending) in the country.

Corporate Governance

The principal legislation on corporate governance is contained in the Law on Enterprises of Turkmenistan and in the Civil Code, both issued in 2000 and in the Joint Stock Companies (JSC) Law of Turkmenistan, issued in 1999. Turkmenistan does not have a voluntary code of corporate governance.

According to the results of the latest EBRD's Corporate Governance Assessment, through which the quality of national corporate governance legislation was assessed, Turkmenistan was found to be in “low compliance” with the OECD Principles of Corporate Governance, showing a number of shortcomings especially on disclosure and transparency, and equitable treatment of shareholders. Among the major flaws highlighted by the assessment, were the weak disclosure and reporting requirements, the lack of protection for minority shareholders, the absence of specific regulation on related party transactions and the weak regulation of conflicts of interest.

Insolvency

The relevant legislation can be found in the Law on Bankruptcy of 1 October 1993, as amended (the “Bankruptcy Law”). The Bankruptcy Law applies to the bankruptcy of natural and legal persons carrying out a commercial activity. There is very little publicly available data on bankruptcy proceedings in Turkmenistan. It is not clear whether bankruptcy proceedings are used. The EBRD Insolvency Sector Assessment completed in late 2009 concluded that Turkmenistan’s bankruptcy law on the books was of poor quality, as benchmarked against international standards of best practice. Particular deficiencies highlighted included vague financial criteria for the petitioning and opening of bankruptcy proceedings, absence of express notice requirements for creditors regarding the opening of such proceedings, inadequate moratorium provisions (e.g. stay/suspension of actions/proceedings against the debtor) following the declaration of bankruptcy and lack of clarity on the effect of bankruptcy on the positions of secured creditors and the absence of any provisions specifically permitting set off in bankruptcy. The assessment also highlighted the fundamental lack of statutory provisions in the Bankruptcy Law regarding the regulation and conduct of insolvency office holders.

Judicial Capacity / Contract Enforcement

All judges are appointed by the President for five year renewable terms. The President may also dismiss judges during their term of office, as well as decide on whether criminal charges can be brought against them. Thus, the executive dominates the judiciary, and judges are more akin to civil servants than representatives of a constitutionally independent branch of power. Correspondingly, in disputes in which a government agency is one of the parties, the courts have a pattern of resolving the disputes in the governments favour.

The extent to which the courts are actually used to resolve commercial or other disputes in Turkmenistan is not known, as court decisions, case files and most court data are not publically available, even to lawyers. Turkmenistan was the only country in the Commonwealth of Independent States in which it was not possible for EBRD to conduct its Judicial Decisions Assessment, which examined the quality of judgments in commercial matters in the region.

Priorities for reform are difficult to establish, given the closed nature of the justice sector in the country. Leaving to one side fundamental constitutional issues and concerns about judicial independence, two relatively simply measures would be recommended. First, providing public access to judicial decisions and court files, even if redacted, would be a substantial improvement and afford the business community the opportunity to consider the merits of using the court system. Secondly, amending the *Law on the Establishment of the Arbitrazh Court* to allow it to sit outside

Ashgabat, or allowing Velayat Courts to hear commercial matters, would make the courts more accessible to the business community outside the capital.

Promoting international integration / Fostering private sector participation in transport sector

Concessions/PPP

According to the recent EBRD 2012 PPP/Concession Assessment the Turkmenistan legislation was rated as being in “low compliance” with international standards and its application as in “low effectiveness”. No clear policy framework that would promote PPP in Turkmenistan has been identified. The Turkmenistan Law on Foreign Concessions adopted in 1993 remains the piece of special legislation that is somewhat relevant, to an extent only, to the Concession/PPP subject area in addition to the general contract law rules.

As could be seen from its title the law deals with concessions to foreign partners only and therefore discriminates against domestic investors. It covers limited sectors as it was initially designed to focus on natural resources; in fact, the law regulates royalty and associated arrangements for exploration and production as opposed to public works or services.

The law is too vague as far as the majority of the key elements of a modern concession law are concerned: definitions and scope, selection procedures, project agreement, security instruments and state support, dispute resolution. According to the law concession is defined merely as a permission by the state to a foreign partner to carry out a specific type of business activity. The Contracting Authority is not clearly defined either. Sectors that may be subject to concessions are not defined, and, as noted above, seem limited to natural resources only. The selection procedure is underdeveloped; although competitive selection is provided for no pre-qualification is required; there is no obligation to make public a notice on the project award. The law refers to the Cabinet of Ministers decisions regarding the award procedures, however no such document, except in the oil and gas sector, is publicly available even though certain rules are said to exist.

Disputes are settled in domestic courts; no arbitration, let alone international arbitration, is either expressly provided for, or prohibited.

Despite certain positive components, the law does not constitute a sufficiently solid legal basis for the development of PPPs in infrastructure or utility services in Turkmenistan. Concessions have been awarded in natural resources sector only.

Laying the foundation for future reforms / Renewable energy and energy efficiency

Renewable Energy

The free or almost free state supply of electricity to the country’s population discourages any private sector development. There is no policy or legal framework promoting renewable energy in Turkmenistan, which is a major obstacle to the development of the sector. President Gurbanguly Berdymukhamedov has recently stated that the utilisation of renewable energy, primarily solar and wind energy, is a priority for the development of the country's energy sector. In practice, however, more than a mere political statement would be needed for the investors to start looking for opportunities to utilise the country's renewable energy potential. Revision of the current energy subsidy regime and a more transparent regulatory regime reflective of international best practices would be a good place to start.

Energy Efficiency

Turkmenistan's potential for energy efficiency has not been reliably assessed. Similar to the renewable energy sector, there is no policy or legal framework regulating or promoting energy efficiency in the country. It is understood that the country's energy strategy is being developed at present, which, among its priorities, will envisage increase of fuel efficiency in power stations via modernisation of fuel systems, increase of municipal and industrial energy efficiency as well as improvement of residential energy efficiency.

Targeted and consistent efforts towards development of policy and legal energy efficiency measures and instruments in all sectors of the economy need to be undertaken, with a view to implementing international energy efficiency standards in Turkmenistan. It is understood that the government is working on an energy saving law but it is unclear if any international assistance is being received.

Certain international donors have started looking at introducing energy efficiency instruments and measures in some of the most energy intensive sectors in the country. Specifically, the United Nations Development Programme (UNDP) has started a project on improving energy efficiency in residential buildings until 2015. The project budget totals USD 46 million and in addition to the international participation, it is being co-financed by national partners such as the State Concern "Turkmengaz", the Administration of Ashgabat city and the Ministry of Construction of Turkmenistan.

ANNEX 4 – SMALL BUSINESS SUPPORT

The Bank supports economic transition through its Small Business Support operations which are aimed at achieving enterprise change in potentially viable micro, small and medium enterprises (MSMEs) and contributing to the development of a sustainable infrastructure of local business advisory services. The SBS operations comprise two complementary programmes, the Enterprise Growth Programme (EGP), formerly the TurnAround Management Programme, and Business Advisory Services (BAS).

Previous SBS experience in Turkmenistan

Since inception in 2008, €1.2 million of funding have been provided by donors for the implementation of **EGP in Turkmenistan**. The largest donors of EGP operations have been EBRD Shareholders Special Fund and Ireland. EGP has carried out 15 projects, 4 of which are still in progress. These projects were implemented across various industry sectors, with the top being manufacturing. To date, 7 projects have been evaluated upon completion as “highly successful”, while 4 were closed early with mutual agreement between the Banking Team and EGP. 89 per cent of assisted enterprises reported increases in turnover, 78 per cent reported increases in pre-tax profit, and 56 per cent reported increases in employment. 67 per cent of assisted enterprises reported productivity growth after the EGP project, and 56 per cent reported improvement in profit margin.

BAS in Turkmenistan was launched in 2011 with a total of €0.83 million of donor funding from the EBRD Shareholders Special Fund. To date, BAS has undertaken a total of 70 projects with local SMEs engaging 14 local and regional consultants. 30% of the beneficiary companies are located in rural areas and the majority of assisted enterprises have less than 50 employees. The industry spread is wide covering agribusiness, construction and wholesale and retail distribution. In addition, BAS has also undertaken a number of market development activities (MDAs) with the aim to improve the entrepreneurs’ business skills and develop local consultancy market.

MSME and Consulting sector in Turkmenistan

The MSME sector and business environment

Economic growth in Turkmenistan has been among the fastest in the EBRD region and reached 14.7 and 11.1 per cent in 2011 and 2012 respectively. Turkmenistan is however characterised by large transition gaps across all sectors in what concerns market structure and market institutions. The authorities continue to express commitment to reform, and, in particular, to gradual privatisation and private sector development. One of the state goals is to increase the share of the private sector to 70 per cent of non-hydrocarbon GDP by 2020.

The business climate in Turkmenistan remains weak while progress in improving it cannot be measured using widely used surveys. The country does not participate either in the World Bank Doing Business survey or in the Business Environment and Enterprise Performance Survey. Barriers to entry for new business remain large although there has been some evidence that they had been reduced in 2011. The country scores poorly in the Transparency International’s Corruption Perception Index

(CPI) at the 168th position among 177 countries included in the 2013 ranking. In the World Bank's Worldwide Governance Indicators in 2011, Turkmenistan performed poorly in such areas as Control of Corruption, Government Effectiveness, Regulatory Quality and Rule of Law.

Some progress has been made to develop small and medium enterprises (SME) sector. An SME law was adopted in 2009 and later the President approved a state programme for 2011-2015 to support SMEs that also envisages state loans under preferential rates for these enterprises. Also, local SMEs can now have foreign currency accounts to conduct import/export operations without being required to have a license or permission from the cabinet of ministers. MSMEs however remain constrained by access to finance, excessive state interference and poor management skills.

MSMEs are in strong need of basic business skills including organisational planning, financial analysis and planning, human resources management, as well as marketing and sales. They lack opportunities for networking and experience sharing. Their access to information about good practices in business management is limited due to the inadequate business support services.

The consultancy market

The consultancy sector in Turkmenistan faces large transition challenges with regard to MSMEs. Unawareness about potential benefits from consultancy, lack of confidence in a consultancy project outcome make the demand among private MSME for advisory services relatively low. The number of professional consulting companies is very limited. They are not able to address the current needs of the market. There are companies that offer consulting services along with their main business activities. Some companies offer a broad range of services and, rather than concentrate on some core competences, provide services on demand only. The existing consulting companies lack solid skills of setting up and running a consulting business. However, there are experts trained through various donor programmes who have a potential and interest in engaging in consulting. They are still in need of technical skills to be able to engage into consulting activities. The consultancy industry is concentrated in the capital Ashgabat. The advisory services available on the market include audit, legal consulting, management consulting, and management information systems, but the market remains highly fragmented and weak and needs support to professionalise and consolidate the sector.

Infrastructure of SME support

The government voiced its commitment to further private sector development which was reflected in the National Programme for Socioeconomic Development 2011-2030. Principal objectives of the programme include diversification of economy by fostering private sector development of non-hydrocarbon sectors, promotion of gradual transition to market-based economy, and achievement of sustainable, inclusive economy. Although some progress has been made in support of SME sector some planned economy approaches are still used and do not provide for sustainable achievements even on enterprise level.

The Union of Industrialists and Entrepreneurs of Turkmenistan is a business intermediary organisation that is responsible for implementation of state policies related to support of entrepreneurship development in the country, promote interests and rights of the entrepreneurs. The Union lacks experience and resources to help them explore the full range of opportunities at local level and improve access of Turkmen small businesses to global markets. Chamber of Commerce and Industry of Turkmenistan communicates the interests of its members and organises of international exhibitions and conferences. The support these organisations currently provide to local MSMEs is limited due to the lack of relevant experience and necessary expertise. Both business intermediary organisations try to work with international partners through international agencies present in Turkmenistan to be able to broaden the scope of their activities, upgrade the quality of services they provide to SMEs, introduce international standards to the private sector and expand international cooperation.

Continuation of SBS in Turkmenistan

The Bank will continue to support SMEs through direct enterprise assistance under SBS operations in order to contribute to the development of a competitive and sustainable private sector in Turkmenistan. SBS operations will focus on activities in priority sectors such as agribusiness, retail and wholesale distribution and transport and logistics.

The Bank will facilitate client access to finance through EBRD and its partner financial institutions. Cross-cutting issues such as rural development, gender equality and energy efficiency will also be addressed.

Under **EGP** operations, the Bank plans to further support the transfer of management skills. EGP will be focusing on providing advice in the areas of organisation and management, business planning, sales and marketing, and product development. The Bank will also assist the enterprises improving their organisational and management skills and enhancing their exposure to international best practices. The Bank will attempt to focus in particular on agribusiness in rural areas, IT, natural resources, manufacturing and energy efficiency projects in support of the Bank's banking operations

Under **BAS** operations, the Bank plans to further enable MSMEs to access advisory services by facilitating projects with local consultants. A flexible grant scheme will be applied through annual updates of the Grant Guideline Matrix to prioritise interventions, ensure additionality and avoid duplication of efforts with international donors and governmental organisations. Higher grants are typically allocated for smaller enterprises, for enterprises located outside of major cities and for projects involving services where market demand is less mature.

At the market level, the Bank will promote international best practices in priority sectors through dissemination of successful showcases and trainings. The Bank will promote the use of business advisory services to stimulate demand and enhance the professionalism of the local consultancy sector. The Bank will seek to develop a sustainable MSME support infrastructure through the support and development of local consultants.

In addition, the Bank will implement the ETCI Accounting Improvement Programme with the objective of raising enterprise financial management and reporting practices and standards to support clients’ access to finance through EBRD and its partner banks, as well as other financial institutions.

ANNEX 5 – TECHNICAL COOPERATION

TC COMMITMENTS BY DONOR THROUGH EBRD, 2010-2013

Donor	TC Commitments (€)
Early Transition Countries Fund	1,872,474
EBRD Shareholder Special Fund	2,105,502
EU	48,000
Japan	220,000
Korea	249,650
United States of America	340,000
Grand Total	**4,835,626**

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2010-2013

Sector/Team		TC Commitments (€)
SME Development *	SBS	1,797,052
	Enterprise Support	425,519
Financial Institutions	Financial Institutions	2,396,155
Infrastructure	MEI	180,000
Sustainable Energy Initiative	E2C2	36,900
Grand Total		**4,835,626**

Note: Commitment values based on year end or period end data for each year.

* This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils)

ANNEX 6 – SELECTED ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012	2013 *Estimate*
Output and expenditure			*(Percentage change in real terms)*				
GDP	11.1	14.7	6.1	9.2	14.7	11.1	10.2
Private consumption	na	na	na	na	na	na	na
Public consumption	-4.0	14.2	26.6	2.5	14.4	6.3	na
Gross public fixed capital formation	68.4	221.7	125.4	20.8	65.2	15.0	na
Exports of goods and services	7.3	-7.4	-28.5	7.9	18.1	5.1	na
Imports of goods and services	36.6	250.9	80.4	-3.6	29.5	10.7	na
Industrial gross output	32.9	152.4	-2.5	0.7	na	na	na
Labour Market[1]			*(Percentage change)*				
Gross average monthly earnings in economy (annual average)	1.2	19.2	12.1	2.3	11.8	11.2	na
Real LCU wage growth	-4.7	4.1	15.2	-1.8	6.2	6.4	na
Unemployment rate (end-year)	na	na	na	na	na	na	na
Prices			*(Percentage change)*				
Consumer prices (annual average)	6.3	14.5	-2.7	4.5	5.3	5.3	6.6
Consumer prices (end-year)	8.6	8.9	0.1	4.8	5.6	7.8	5.5
Fiscal Indicators			*(In per cent of GDP)*				
General government balance	3.9	10.0	7.0	2.0	3.6	6.4	0.2
General government revenues	17.3	20.9	20.4	16.1	18.3	21.0	16.5
General government expenditure	13.4	10.9	13.4	14.1	14.6	14.7	16.3
Monetary and financial sectors			*(Percentage change)*				
Broad money (M2, end-year)	72.2	-17.8	10.9	43.4	36.3	35.6	29.3
Credit to the private sector (end-year)	19.9	41.4	72.1	72.6	30.3	49.0	na
Non-performing loans ratio	0.4	0.1	0.1	0.1	na	na	na
Interest and exchange rates [2]			*(in per cent per annum, end-year)*				
Deposit rate	4.1	2.8	2.5	2.5	3.0	na	na
Lending rate	8.4	7.6	4.7	5.4	5.6	na	na
CBT Refinancing rate	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Exchange rate (end-year)	10,690.0	14,250.0	2.85	2.85	2.85	2.85	2.85
Exchange rate (annual average)	10,690.0	13,041.5	2.85	2.85	2.85	2.85	2.85
External sector			*(In per cent of GDP)*				
Current account	15.5	16.5	-14.7	-10.6	2.0	0.04	-3.3
Trade balance	20.5	29.9	4.3	10.1	21.5	18.6	13.2
Merchandise exports	35.1	54.8	44.3	43.6	57.2	56.5	49.2
Merchandise imports	14.6	24.9	39.9	33.5	35.7	38.0	36.0
Foreign direct investment, net	2.8	4.0	6.3	20.6	11.6	8.9	7.5
Gross reserves, excluding gold (end-year)	na	na	na	na	na	na	na
External debt stock	2.4	2.8	2.4	10.6	10.0	18.1	20.6
Public external debt	2.4	2.8	2.4	10.6	10.0	18.1	20.6
Private external debt	0.0	0.0	0.0	0.0	0.0	0.0	na
Gross reserves, excluding gold (end-year)	na	na	na	na	na	na	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	5,186.0	5,269.0	5,353.3	5,439.0	5,526.0	5,614.4	5,704.2
GDP (in billions of manat)	27.0	49.5	57.6	63.1	83.3	100.2	115.6
GDP per capita (in US dollars)	5,006.1	4,083.6	3,776.0	4,072.1	5,290.11	6,263.2	7.112.0
Share of industry in GDP (in per cent)	38.1	53.7	53.5	48.0	48.4	na	na
Share of agriculture in GDP (in per cent)	19.1	12.3	12.3	14.6	14.6	na	na
FDI (In million of US dollars), net	730.9	856.4	1,276.9	4,552.8	3,398.7	3,116.8	3,061.0
External debt - reserves (in US$ million)	-12,548.1	-16,058.0	-18,417.5	-16,378.3	na	na	na
External debt/exports of goods and services (in per cent)	6.5	4.9	5.1	22.7	16.8	30.9	40.6
Broad money (M2, end-year in per cent of GDP)	47.0	21.1	20.0	26.3	27.1	30.6	34.3

[1] Figures do not include emigrant workers abroad.

[2] Weighted average rate overall maturities from IMF Country Report

ANNEX 7 – GENDER EQUALITY

Labour force participation

According to the World Bank data, in 2010, 46 per cent of females aged 15 years and older participated in the labour force as compared to 76 per cent for males in the same age category.

According to UNESCO data, youth and adult literacy rates are high for both men and women. For example, in 2010, 99.7 per cent of males and 99.5 per cent of females were literate in Turkmenistan. There were no significant gender gaps reported in primary and secondary school enrolment either. However, data shows gender segregation in education. For example, according to the UNDP Turkmenistan, while females constituted 58.2 per cent of the total number of students attending secondary vocational schools in the 2010/11 academic years, much higher proportion of women compared to men were involved in such areas as healthcare, education and economics while men dominated other areas, such as transport, law, industry, construction and agriculture.[16]

While occupational employment statistics disaggregated by sex are not available for Turkmenistan for the last decade, data from the early 2000s indicates that women employees are concentrated mainly in agriculture, social sciences and arts, while men are involved in construction, transport, communications and extractive and processing industries.[17] Gender differences in the choice of education may thus be contributing to the occupational segregation in the labour market in Turkmenistan.

The length of the fully paid maternity leave in Turkmenistan is 112 calendar days. A woman is also entitled to an unpaid leave until the child is three years old.

Entrepreneurship, access to finance

According to the World Bank's Global Financial Inclusion index (Findex), in 2011 not a single man and as low as 0.8 per cent of women aged 15 years or older surveyed had an account at a formal financial institution.[18] 1.1 per cent of females and 0.6 per cent of males took a loan from a financial institution in the past year in Turkmenistan. The data would indicate that females tend to have slightly better access to formal financing in Turkmenistan. However, according to the same source, 23.9 per cent of the surveyed females borrowed money from family and friends in the past year as compared to 28.2 per cent for males, and 36.4 per cent of females took loan compared to 42.4 per cent of males in the same category. Whilst not conclusive, the figures could be attributed to the development of some micro lending in the country which would appear to better benefit women, and to the fact that men are increasingly using other sources of finance, other than formal finance.

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[16] Overview of the MDG Progress in Turkmenistan, http://www.undptkm.org/

[17] International Labour Organisation (ILO), '*Work and Family Relations in Turkmenistan*', publication date unknown

[18] A bank, credit union, cooperative, post office, microfinance institution, etc. Findex surveys approximately 1,000 people using randomly selected, nationally representative samples

According to the 2008 UNDP report '*Turkmenistan: Gender Differences in Business'* surveying 572 heads of small businesses in Turkmenistan, there is also a strong sexual division of labour observed between different business sectors. For example, female-headed enterprises are concentrated mainly in such areas such as consumer services, education and science, while male-headed businesses tend to be operating in the area of industry, agriculture and construction. The research also found that businesses run by women are more often closed down than businesses owned by men. The main reason for the closure is the shortage of the capital.

Turkmenistan's legislation provides women and men with equal rights with respect to inheritance and property ownership. However, according to OECD's Social Institutions and Gender Index (SIGI), it appears that women may be facing obstacles in exercising their legal rights in Turkmenistan. In 2006, the UN Convention on the Elimination of all Forms of Discrimination against Women (CEDAW) raised concerns about the growing number of women leasing state land, which may be an indication of the unequal distribution of the land between men and women during the de-collectivisation process in 1990s. However, there are no statistics on the share of land allotted to women and men.