

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

DRAFT

STRATEGY FOR TURKMENISTAN

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EXECUTIVE SUMMARY

Over the years the Bank has been concerned with Turkmenistan's failure to make progress towards multi-party democracy, pluralism and a market-based economy in keeping with Article 1 of the Agreement Establishing the Bank. Recent progress in the political and economic spheres, triggered by the change in leadership in December 2006, provides an opportunity for deeper engagement, though several challenges remain.

Since the new administration took office there have been political and economic changes taking place in the country, aimed at reversing social and economic policies of the previous regime and ending the country's international isolation. A new Constitution recognises the principle of separation of powers and the legislature has been strengthened. Wider access to the internet is permitted. However, much remains to be done in the area of democratic competition and accountability, strengthening the rule of law and guaranteeing protection of human rights and media freedom.

In the economic sphere, the Turkmen government has taken initial steps in a reform process designed to foster private sector development, with the aim to increase the private sector share of non-oil and gas GDP to 70 per cent by 2020. Following the recent unification of the exchange rate, the government has introduced a new foreign investment law, lifted the ban on international banking operations of commercial banks and started to liberalise a small number of controlled prices. These are positive steps. However, much more remains to be done to establish the basis for market-oriented economic development. Since the adoption of the last country strategy Turkmenistan has experienced double-digit economic growth supported by very high world commodity prices. The global financial crisis has had virtually no direct impact on financial institutions, as the banking system is dominated by state owned banks that are not integrated in the global financial system. Both foreign direct investment and the economy as a whole are focused on the hydrocarbon sector.

In its Strategy, the Bank will work together with private sector investors, the Turkmen authorities and other IFIs and donors to address the following key transition challenges:

- Diversification of the economic base is the key challenge, with 85 per cent of exports originating from the oil and gas sector.
- Competitiveness of the private sector is low by international standards due to hindrances in business entry and exit and there are generally poor standards of transparency and corporate governance.
- The business environment remains difficult and the playing field for private and state-owned businesses is not level; it is critical to further strengthen the legal and regulatory framework for markets.
- Financial sector development is at an early stage; it is necessary to increase financial depth and reduce state interference and control in order to facilitate the introduction of private sector banks and non-bank financial institutions and increased competition.
- Promoting sustainable development and the introduction of international best practice of the private oil and gas sector.
- Modernisation of infrastructure, which constrains private sector development and operates under below-cost prices and non-transparent practices. Commercialisation and energy efficiency improvements are necessary to ensure long-term sustainability.

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. The focus in all its operations will be on finding private sector oriented solutions and extending market discipline where possible. In working with the state

institutions, the Bank will establish clear criteria for its involvement that are consistent with its mandate to further entrepreneurship, competition and commercial practices. The Strategy outlines a **calibrated strategic approach** that will allow the Bank to increase its engagement with Turkmenistan on the basis of concrete implementation of sector-specific reforms designed to promote the further development of a market economy.

The objectives over the Strategy period will include the following, with certain areas of activity to be phased in as progress in meeting sector conditions is documented:

- **Development of private sector micro, small, medium-sized and large businesses**, in particular through enhanced access to commercially-based finance for MSMEs and direct funding.
- **Strengthening of financial institutions** including the establishment of new bank for private sector development, adequate provision of trade finance and MSME credit lines. The Bank should continue to engage in policy dialogue and to pursue its 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. This will also improve the opportunities of addressing the reluctance to introduce a market-oriented interest rate system for SME/CLs.
- **Improvement of business environment for the private sector** in particular in the banking and 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 commercial sectors of the economy particularly in its highly inefficient manufacturing and infrastructure sectors.
- **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.

An important dimension of the Bank's activities in the current Strategy period will be proactive **policy dialogue** with the authorities, donors and NGOs on the need for acceleration of reforms and importance of enhanced political and economic openness. As a part of the strategy exercise, the Bank conducted several missions and active discussion with local and international NGOs, most of whom suggested EBRD's more active engagement in Turkmenistan. In that connection, the Bank will continue to closely monitor progress in these domains against a set of reform benchmarks.

In the political sphere:

- 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.

In the economic sphere:

- 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 stabilisation fund and other operating foreign exchange funds. Improving accountability and efficiency in the provision of public services by steps towards fiscal decentralisation.

The Bank will actively and continually monitor developments against these benchmarks and report to the Board of Directors on an annual basis on progress/regress. This will further enable the Bank's management and shareholders to calibrate the appropriate strategic response to changes in the situation on the ground. In view of the proposed strategic approach and operational content, Turkmenistan should be a full beneficiary of the ETC Initiative, with the benefit of optimising the development of the private sector and required institutions, including the provision of Technical Assistance from the EBRD and, hopefully, other bilateral donors. In that context it is proposed, following Board adoption of this Strategy, to ask donors in the ETC Assembly of Contributors to consider including Turkmenistan as a recipient of ETC Fund resources for technical assistance.

The Bank will continue to ensure that all EBRD operations in Turkmenistan meet sound banking principles, have transition impact, are additional and are subject to the Bank's Environmental and Social Policy and incorporate, where appropriate, Environmental and Social Action Plans. The Bank will continue and enhance its cooperation with other IFIs and international organisations through co-financing and policy dialogue, and will seek to mobilise donor grant financing from other multilateral and bilateral donors.

LIST OF ABBREVIATIONS

AAP	Annual Action Programme
ADB	Asian Development Bank
AML	Anti-money Laundering
BAS	Business Advisory Services
CAC	Central Asia Centre
CAREC	Central Asia Regional Economic Cooperation Programme
CAS	Country Assistance Strategy
CBT	Central Bank of Turkmenistan
CDM	Clean Development Mechanism
CFT	Combating the Financing of Terrorism
CIS	Commonwealth of Independent States
CL	Credit Line
CNPC	China National Petroleum Corporation
DLF	Direct Lending Facility
DIF	Direct Investment Facility
DFID	UK Department for International Development
EC	European Commission
EH	Europa House
EIB	European Investment Bank
EITI	Extractive Industries Transparency Initiative
EREC	Economic Reform to Enhance Competitiveness
ESCAP	United Nations Economic and Social Commission for Asia and the Pacific
ETC	Early Transition Country
EU	European Union
EUR or €	Euro
FCO	British Foreign & Commonwealth Office
FDI	Foreign Direct Investment
FERF	Foreign Exchange Reserve Fund
FI	Financial Institutions
FX	Foreign Exchange
GDP	Gross Domestic Product
ICRC	International Committee of the Red Cross
IFC	International Finance Corporation
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOC	International Oil Companies
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IsDB	Islamic Development Bank
ISO	International Organization for Standardization
JBIC	Japanese Bank for International Cooperation
JICA	Japan International Cooperation Agency
JV	Joint Venture
MDG	Millennium Development Goal
MEI	Municipal and Environmental Infrastructure
MSME	Micro, Small and Medium Enterprise
NEAP	National Environmental Action Plan
NGO	Non-Government Organization
OCE	Office of Chief Economist
OCEEA	Office of the Co-ordinator of OSCE Economic and Environmental Activities

ODIHR	Office for Democratic Institutions and Human Rights
OECD	Organisation for Economic Co-operation and Development
OSCE	Organisation for Security and Cooperation in Europe
PSA	Production Sharing Agreement
PSP	Private Sector Participation
RO	Resident Office
SE	Sustainable Energy
SECO	Secrétariat d'Etat à l'économie (Government of Switzerland)
SME	Small and Medium Sized Enterprise
TACIS	Technical Assistance to the Commonwealth of Independent States
TAM	Turn Around Management
TC	Technical Cooperation
TFP	Trade Facilitation Programme
TRACECA	Transport Corridor Europe-Caucasus-Asia
UNCITRAL	United Nations Commission on International Trade Law
UNDAF	United Nations Development Assistance Programme
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNICEF	United Nations Children's Fund
US\$	United States Dollar
USAID	United States Agency for International Development
WB	World Bank
WRAP	Worldwide Responsible Accredited Production (textile sector)
WTO	World Trade Organization

1. THE BANK'S PORTFOLIO

1.1 Overview of the Bank's activities to date

The Bank's operations in Turkmenistan commenced in 1994. In the initial years the Bank's portfolio grew steadily with investments in infrastructure, textiles, oil and gas and a sovereign guaranteed SME credit line. However, since 2000 the country strategy restricted new operations to the private sector which should not have links or make contributions to the Foreign Exchange Reserve Fund (FERF) under the baseline scenario.

The Bank has signed 8 projects for a total commitment of EUR 107.5 million (excluding regional funds and TFP), the majority of which were signed before 2000 prior to the introduction of the scenario approach. Since that time the core of the Bank's approach in Turkmenistan has been support for the private sector, and dialogue with the government and civil society on ways to improve the investment climate for private entrepreneurs.

In the first few years of operations the Bank's investment focused on investment in the public sector including a majority state owned textiles plant and a port development project. More recently, the Bank concentrated on developing private sector projects without much success throughout the Niyazov era. Since 2008, however, since the introduction of key economic and political reforms by President Berdymukhamedov the bank's operational and transition prospects have improved considerably, along with the relationship with a government now committed ambitious targets for private sector development.

Table 1. Turkmenistan: Overview of the Bank's Activities to Date (30 September 2009)

Investment	Total Project costs EUR million	EBRD Finance EUR million	Current Portfolio EUR million	Operating Assets EUR million	%EBRD finance
Export-oriented Credit Line	5.9	5.9	0.0	0.0	100%
Gap Turkmen	63.6	23.9	9.0	9.0	38%
Gap Turkmen 2	11.6	3.4	0.0	0.0	29%
Gap Turkmen 3	7.3	7.3	0.0	0.0	100%
Turkmenbashi Port Development	32.2	20.5	6.5	6.5	64%
Dragon Oil	355.8	41.1	0.0	0.0	12%
DIF - TMS Wool Scouring	1.6	0.6	0.6	0.6	38%
DIF - TMS Wool Scouring II	1.2	0.5	0.2	0.2	42%
Regional Funds	11.0	4.3	1.1	0.5	54%
MTS	30.0	9.2	9.2	0.0	31%
Aureos Central Asia Fund LLC	0.0	0.1	0.1	0.0	0%
	531.2	116.8	26.7	16.8	22%

During the latest strategy period, adopted in July 2006, the Bank has continued to focus on attempts to directly support to the beleaguered private sector and policy dialogue to improve the investment climate and to build consensus for budgetary and economic reforms. Initially attempts to attract foreign strategic sponsors, to develop a commercial SME Credit line and micro-finance programmes and to expand the trade facilitation programme were not realised due to very difficult business environment and unwillingness of the authorities.

A DIF project with small foreign investor turned out to be unsuccessful mainly due to complicated export procedure. The sovereign guaranteed SME credit line was discontinued in 2005 and attempts to establish non-sovereign credit line experienced lengthy negotiations.

Since the death of President Niyazov in December 2006, however, a series of reforms have altered the business climate significantly. President Berdymukhammedov's goal to expand the role of the private sector to 70% of non oil and gas GDP by 2020 has led to an improved relationship with EBRD and a collaborative engagement with government agencies. With the unification of the exchange rate in May 2008 there are new opportunities to support the expanding private sector.

The country strategy update approved in May 2008 allowed (i) engagement with state owned banks as partners for SME credit lines, and (ii) Direct Lending Facility (DLF) to support emerging SMEs in Turkmenistan. New SME credit lines are under discussion with two local banks. The new credit lines will also offer the opportunity to provide technical assistance support for cautious but important reforms in the banking sector by improving operational standards of banks. There is a growing project pipeline involving the Bank's direct loans or equity under the DIF / DLF facilities.

Operating assets in Turkmenistan are now EUR 17.5 million, excluding regional venture funds, following a major reduction as a result of the pre-payment of EUR 23 million by Dragon Oil in 2006 and the settlement of 3 puts to the shareholders of GAP Turkmen for a total of US\$ 6 million.

1.2 Transition Impact and Lessons Learned

1.2.1 Transition Impact

Private Sector Development

There has been a convergence of the government's policies and the Bank's strategic orientations. EBRD's engagement with the Government of Turkmenistan at the cabinet and ministerial level has improved over time and in April 2008 the Government announced the 2020 private sector development goal. In order to respond to these positive changes the Direct Lending Facility (DLF) was extended to Turkmenistan in September 2008. Benefiting from the availability of new project financing tools (both debt and equity) there has been a growing project pipeline despite remaining significant obstacles to business growth and investment. At the same time, a strong growth in export revenues from oil and gas led to growing foreign exchange reserves over the last strategy period 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.

Although many of our projects are at an early stage, it is already becoming clear that the government is determined to encourage the emerging private sector in order that it will be an engine for growth. OCE is working with the Institute for Strategic Planning and Economic Development, which is responsible for private sector development strategies.

Since the change in Presidency of Turkmenistan, and in particular since the unification of the exchange rate in May 2008 EBRD support for capacity building in the private sector is starting to produce tangible results. Development of capacities at every level, especially among entrepreneurs is an important component in the development of the burgeoning Turkmen private sector. The TAM programme conducted its first enterprise screenings in September 2008 and from these has selected first five enterprises for the TAM Turkmenistan programme and these are under way. In particular the TAM programme has enabled local companies to address specific issues such as introducing management information systems, marketing and branding. The consultancy sector is small but growing and feasibility study for a Turkmen BAS programme is also ongoing.

Strengthening the Financial Sector

Transition impact on the financial sector has been severely restricted by the dominance of state owned banks and state directed lending. The Bank had problems disbursing its USD 7.5 million Sovereign guaranteed SME credit line due to the difficult investment climate and the facility was closed in 2005. However with a TC support for credit officers and further training, the first tranche of the credit was disbursed to 113 projects.

With the unification of the exchange rate and the country strategy update of May 2008 there are new opportunities for transition impact via support to the private sector. As currency conversions are no longer severely restricted under the new foreign exchange regime, the Bank is preparing to establish new SME credit lines with Senagat Bank and Turkmenbashi Bank.

Restrictions on correspondent accounts and swift transactions imposed on state owned and commercial banks by the CBT were lifted in October 2008. Since then only Senagat Bank has restarted its participation in the Trade Facilitation Programme. To support such steps, basic training on trade finance and expansion of TFP operations are also under consideration. Three TFP transaction through Senagat Bank have been completed since October 2008.

Financing Critical Infrastructure

Transport is the only infrastructural sub-sector in which the Bank was active in Turkmenistan. An envisaged road sector project in 2001 had to be cancelled as agreement could not be reached with the authorities to implement an increase in fuel prices that had been agreed upon. The 1997 Turkmenbashi Port development project was to help start institutional reforms covering the regulation and operations of the port. Despite some TC support, the project was initially delayed due to lack of capacity in the port authorities particularly in dealing with international open tender procedures. The port is now among the most modern facilities on the Caspian Sea, however its full commercialization has not yet taken place. TC funded activities have supported the elaboration of a new Maritime Law during 2002 which has yet to be adopted.

Policy Dialogue

Engagement with the Government of Turkmenistan at the cabinet and ministerial level has improved since the announcement of the Government's 2020 private sector development goal in April 2008. President Berdymukhammedov has referred publicly to EBRD as a "trusted partner" in attaining the countries private sector development goals.

Since last year the Bank has focused on addressing specific issues: a) a value chain study in the agribusiness sector with the Institute for Strategic Planning and Economic development. b) Assistance in drafting the new law on support to SMEs, with many EBRD recommendations being accepted. c) barriers to growth and good governance identified by our clients and raised with the government and the Union of Entrepreneurs such as the law against the export of foodstuffs, repealed in October 2008. However, engagement on reforms in the FI sector remain extremely challenging, and the government has made it clear that other critical issues such as land reform and commercialisation of state owned enterprises are not on the agenda.

1.2.2 Lessons Learned

Private Sector Development

Since 2000 the Bank's investment strategy has been excluded from investments in majority state owned enterprises. The Bank has invested in Gap Turkmen, a private cotton textile factory, which

was the first joint stock company in the country. The introduction of ISO 9001 and WRAP standards and transfer of knowledge, did not however produce broader transition impact beyond the factory gates. This was beyond the influence of the project itself and depended entirely on changes to the policy and practices of the state in Turkmenistan. A lesson learned, particularly for any future investment in state owned commercial enterprises is that the government must be encouraged and incentivised to use technically and commercially successful projects as examples and models for the rest of the sector.

A similar lesson can be learned in the natural resources sector. The Bank had significant success in the sector through its investment in Dragon Oil. The deal, approved in 1999, was based on a Production-Sharing Agreement (PSA), and has performed well. The company met production targets and successfully introduced new technical and management know-how combined with new standards for business conduct. Despite the good demonstration effect, the Bank has been unable to help to achieve further reform and to create a favourable investment climate in the sector. The creation of a stabilisation fund in October 2008 will lead to a more transparent utilisation of natural resource revenues and the allocation of proceeds for future generations, but the role of the Dragon Oil PSA in this is difficult to quantify.

The Bank made another operation in TMS Wool Scouring under the DIF in 2003, for scouring and packing local wool for export. Refinancing measures became necessary in 2005 to cover cost overruns and shortfall of working capital. Currently, the assets are administered by the Bank's Corporate Recovery Unit. Investing in a commercial enterprise with the government's involvement requires regular dialogue to ensure that the interests of the shareholders remain aligned in the future. DIF sponsors should demonstrate a successful track record of launching other businesses. The financial standing of the sponsor should be appraised and verified with care with respect to cash contributions of the partners to cover respective cash costs.

Strengthening the Financial Sector

The Bank had problems disbursing its sovereign guaranteed USD 7.5 million SME credit line due to the difficult investment climate. With a TC support to Central Credit Advisors (CCA) and further training, the first tranche of the credit was disbursed to 113 projects before the line was cancelled. With the unification of the exchange rate and the country strategy update of May 2008, based on the lesson learned, the Bank is preparing to establish new SME credit lines with some of initial partner banks. Independent consultants help ensure bank independence in credit policies and facilitate sound lending decisions.

Three banks were included in the TFP programme, but only one has been actively participating, Senagat Bank. Donor supported training programs were applied to trade finance and credit analysis in 2004/05, as well as banking governance and marketing in 2007. A lesson learned from the EU-financed Banking Sector training initiative is that the Bank should undertake both investment related and stand-alone TC operations in order to help develop the banking sector in low transition economies.

The Bank has been present in the country through regional private equity funds: the AIG Silk Road, NIS Restructuring, First NIS Regional, New Europe East Investment Fund and Baring Vostok Private Equity funds, as well as Centras International and Clean Globe Oil Spill in 2007. In the case of Burren Energy, which was at the time a London based oil and gas company with substantial assets in Turkmenistan, the fund managers added significant value to the company by restructuring it and reorienting its strategies. However, Turkmenistan still requires a complete reform of its creditor rights protection and substantial transition reforms before a viable private equity sector will develop in the country.

Financing Critical Infrastructure

Bank achieved some limited success in helping the Borrower to review and introduce some sort of cost based tariffs. The commercialization of the Port has not yet taken place but the Government is working with international donors and organisations to bring goods and passenger transit and customs procedures in line with the best international practices (OSCE, UNDP). However, the ministry still operates vessels while performing a regulatory function. The new Maritime Law, drafted with the assistance of the EBRD consultants in 2002 has yet to be adopted. Significant reform, especially enhancing management capacity at all levels is required if the port is not to lose out to strong competition from its commercially governed peers in Aktau (Kazakhstan), Baku (Azerbaijan), Mahachkala and Astrakhan (Russia).

Following the introduction of the scenario approach in the 2000 strategy further investments in the sector which may have enhanced and deepened transition impact were not possible. Investments in transport infrastructure in future should ensure sustained engagement with the Turkmen authorities and where possible be complementary to the long term reform agenda of the government.

1.3 Portfolio Ratio

As at early June 2009, the private/state sector portfolio ratio stood at 57/43. The repayment of the public sector projects, the change in the regime followed by the reforms and the planned focused expansion of the private sector portfolio are likely to result in the growth of the private sector share in the overall portfolio in the next 2-3 years.

1.4 Financial Performance of Existing Portfolio

The active portfolio consists of the two repaying projects, state-owned Turkmenbashi Port Development Project and FDI Gap Turkmen. Loan to the Turkmenbashi Port is performing well albeit short repayment delays occasionally. The delays are associated with the cumbersome process of coordinating state approvals for each repayment. The final repayment of the outstanding USD 10.9 million is planned for January 2013. The Bank is gradually exiting from its investment of USD 13.9 million in equity of Gap Turkmen. Due to the crisis in the cotton sector worldwide the Bank is working with the company to address the current challenges. All the projects, except regional investment funds, have been disbursed.

2. OPERATIONAL ENVIRONMENT

2.1 General Reform Environment

The main trigger of recent progress in the political and economic spheres was the change in leadership following the death of President Niyazov in December 2006.

The key political changes can be summarised as follows:

Constitutional reform: Turkmenistan adopted a new version of the Constitution in September 2008, which accords supremacy of international treaties over national legislation and the principle of separation of powers between the executive, legislative and judiciary now embedded in the text of the new basic law. Importantly the new Constitution provides for the protection of the rights of entrepreneurs. Efforts are being made to bring Turkmen legislation into line with its international treaty obligations, including in the area of the rule of law and protection of human rights. Nevertheless, Turkmenistan remains a one-party state and is still lacking in genuine political pluralism.

Political accountability/elections: The legislature has been strengthened by eliminating the People's Council and restoring the functions of a regular one-chamber parliament. On 14 December 2008 the first post-Niyazov parliamentary elections were held with 125 deputies elected (to replace 65 deputies of the old parliament). Although it fell well short of international standards for democratic elections, the December election had several candidates contesting each parliamentary seat.

Human rights and media freedom: A welcome recent sign was the release of the long-term political prisoner Mukhametkuly Aymuradov. However, much remains to be done in the field of human rights and respect for the rule of law. In particular, specialised human rights organisations demand the release of all political prisoners, free access by the ICRC to places of detention, lifting of the restrictions on foreign travel and freedom for the media and civil society groups.

Openness and transparency: Although the government continues to exercise full control over the media, wider access to the internet is now permitted and the Government has significantly increased international cooperation on a bilateral basis with all relevant multilateral bodies. In April 2009 the European Parliament approved an Interim Trade Agreement between the European Commission and Turkmenistan. The ratification of the agreement has been delayed for over ten years because of the lack of progress on human rights.

In the economic sphere, Turkmenistan has made significant transition improvements in 2008. However the country's overall transition indicator level is still below the ETC average. Since the adoption of the last country strategy Turkmenistan has made progress in kick-starting some fundamental structural reforms. The intention of the Turkmen government to increase the non-oil and gas private sector share to 70 per cent of GDP (currently approx. 40 per cent based on Government figures) constitutes a pronounced shift in policy stance towards the private sector. While some notable progress on economic reforms has been achieved, the Turkmen economy – in particular large manufacturing and the financial sector – continues to be dominated by government ownership.

The Government has made progress in several structural reform areas:

Exchange rate liberalisation: The unification of the national currency, the Manat, took place on 1 May 2008. The authorities have now lifted any FX quantity restrictions for private individuals or businesses.

Budget reform: The authorities have started to make some progress in reforming the budgetary process and its transparency with the support of the European Union. An important tangible step was the closure of several extra-budgetary accounts and the establishment of a stabilisation fund under the supervision of the Ministry of Finance. From October 2008 onwards the foreign exchange revenues are being transferred into this stabilisation fund that was set up to counterbalance the effect of the global financial crises and conduct long term investments. While the government continues to investigate similar funds abroad (namely Kazakhstan, Russia and Norway), specific investment rules and governing principles for the Turkmen stabilisation fund have not been made public nor the overall amount of foreign exchange earnings channelled through this new stabilisation fund as opposed to other foreign exchange reserve holdings.

Banking sector: The Central Bank of Turkmenistan (CBT) lifted a ban on international banking operations of commercial banks which are now able to open correspondent accounts with foreign banks and conduct SWIFT transactions. The banking sector needs to be more market-oriented with regards to interest rates, deposit-taking and lending activities. The sector cannot develop if it continues to over-rely on government subsidised lending schemes. This will result in credit rationing, limited availability of credit to SMEs, erosion of banking capital and will slow the development of the banking sector and stunt the growth of the private sector .

Foreign direct investment: A new investment law, effective since 18th March 2008, improves on these amendments and entails provisions for the repatriation of profits, exemptions for many duties and fees for foreign entrepreneurs, quick issuing of multi-entry visas, and compensation provisions in case of expropriation and drops the requirement of joint ventures with Turkmen enterprises. Foreigners are also allowed to rent land on a long-term basis. The unification of the dual exchange rate in May 2008 gave an additional incentive for foreign investments into non-hydrocarbon industries such as agribusiness and textiles and the unlimited FX access also encourages the development and growth of local export and importing businesses. Facilitation of entry of foreign investment into the non-hydrocarbon sectors remains an important transition challenge.

Legal Environment: Limited legal reform and transition has taken place over the last two years. Key sectors of Turkmenistan's commercial laws continue to fall well below internationally accepted standards, as is reflected by the results for Turkmenistan of the series of assessments of legal transition undertaken by EBRD in its countries of operation. However, certain monetary reform has taken place in the last year. Turkmenistan also adopted a new law on foreign investment last year to improve the foreign investment environment in the country and, more recently and with the help of experts from the IMF, a new law to combat money laundering and terrorism financing. A law on SME support was adopted on 22 August 2009. EBRD was consulted during the drafting phase and most recommendations have been included.

Nevertheless, much of Turkmenistan's commercial law was enacted in the 1990s and has remained un-amended and unreformed since first coming into force. The present legal framework does little to foster investment, and comprehensive reform is required in order to encourage and facilitate private sector participation. Extensive progress is also required at the institutional level. The courts and institutions which implement and administer the law are not independent of the government and remain subject to political influence. Turkmenistan faces serious challenges in developing both its commercial laws and legal infrastructure to internationally accepted standards.

2.2 Macroeconomic Environment

The Turkmen Economy has been growing strongly in the last few years, with double digit GDP growth up to 2007, mainly on the back of increasing hydro-carbon prices and negotiated off-take volumes. While, the current account surplus increased sharply up to 2007 it has moderated slightly in 2008 to 18.8% of GDP. Exports receipts increased by 20 per cent in 2008 while domestic demand for imports of goods and service also picked up thanks to easier access to foreign exchange. FDI inflows continue to mainly reflect investments in offshore oil production in the Caspian Sea. Turkmenistan successfully negotiated further significant increases in off-take prices and volumes for 2009 onwards and has for the first time linked these agreements to interest-free loans from off-takers to finance hydrocarbon infrastructure. The favourable external conditions also resulted in a further increase in international reserves. The disruption of gas exports to Russia due to a pipeline blast in April will have a negative impact on foreign exchange earnings and overall growth for 2009, the degree depending on the length of the disruption and the details of a new agreement between the two countries expected before the end of the year.

Exchange rate unification was completed on 1 May 2008 at the rate of 14,250 Manat per US dollar, a level broadly consistent with the country's strong external position and the currency redenomination took place in January 2009. The unified exchange rate enabled a revaluation of assets and liabilities and potentially freed up equity in the commercial banking sector. The ability to open foreign correspondent accounts abroad and increased access to foreign exchange led to an increase in trade finance operations. Overall financial intermediation remains very low with virtually all banks in government ownership. The government has started to strengthen bank supervision by moving to International Financial Reporting Standards (IFRS) and improving payment infrastructure via software upgrades and the promotion of plastic cards. Total credit grew strongly since the last strategy period up to 2007, mainly reflecting increased directed lending to the cotton sector. The latest government initiative in 2009 to increase financing to SMEs with subsidised interest rates of 5 per cent will potentially increase credit growth further in 2009.

The state budget for 2008 showed a surplus of 11.3 per cent of GDP – against an objective of 4.6, reflecting increasing hydrocarbon revenues and lower than budgeted expenditures. Efforts to streamline tax and customs procedures have positively contributed to raise revenue collection efficiency. Containing inflation within single digits is likely to remain difficult for the central bank as adjustments of regulated prices to market levels and rising international food prices continue to push up general prices.

2.3 Environmental Issues

Turkmenistan's climate and its fragile, arid ecosystems and limited water resources make the country vulnerable to environmental damage. High water intake rate for irrigation by the cotton industry, along with low efficiency of irrigation systems, take their toll on the already limited water resources in Turkmenistan. Construction of the artificial lake in the Karakum desert, which would collect waste and drainage water from all 5 regions in Turkmenistan, raises serious concerns as scientists and international organisations fear that the lake would pollute massive areas of land with salt, chemicals and fertilisers from the irrigation runoff and that, due to the arid climate in Turkmenistan and the high evaporation rates, the lake would aggravate water shortage problems.

Irregular supplies and quality of drinking water, especially in rural areas, are a cause of water-borne diseases. Chemical pollution caused by use of defoliating agents in the cotton fields causes environmental health problems.

Depletion of the sturgeon population in the Caspian Sea, mainly due to the illegal poaching for subsistence and sale by the coastal communities, is a serious regional and international concern. Obsolete offshore oil production platforms in the Turkmen sector of the Caspian Sea increase the risk of oil spill and marine pollution.

Management of natural reserves, which are home to a number of the Red Book of Protected Species, is a concern as protected areas are often used by local communities for collection of medicinal herbs and cattle grazing.

Turkmenistan's National Environmental Action Plan (NEAP) aims to addressing these issues by implementing the following activities (1) improving legal and institutional arrangements for better environmental management, (2) protecting ground and surface water, (3) preserving rare and endangered species of flora and fauna, (4) enhancing public environmental awareness, and (5) reversing land degradation and the desertification process. However, the implementation of NEAP is hindered due to the shortage of available resources and currently no information is available on the progress and status of actions within the NEAP.

2.4 Social and Labour Issues

After the new social welfare code was adopted in July 2007, the government reviewed pension and public sector wages and linked them to average earnings. After initial increases, in particular for teachers, in July 2008 the government announced a further wage increase of 10 per cent in 2009. These measures nevertheless do not fully compensate for the scale of recent price increases for key items. A combination of food price inflation, the (welcome) liberalisation of petrol prices that led to an eightfold increase in petrol prices, and the subsequent twenty-fold increase in transport prices, have all put pressure on household budgets and leave in particular the lower part of the income distribution vulnerable. This is especially true for those living outside the capital.

After years of underinvestment in the regions, the government has started a new regional development initiative, although its scale and focus is still unclear. Both the quality and quantity of services provided by the health and the education sectors in the regions seriously lag behind those that are available in the capital. In 2007, the President introduced a number of positive educational reforms intended to increase the number of years of compulsory secondary education and ensure that tertiary education was in accordance with CIS standards.

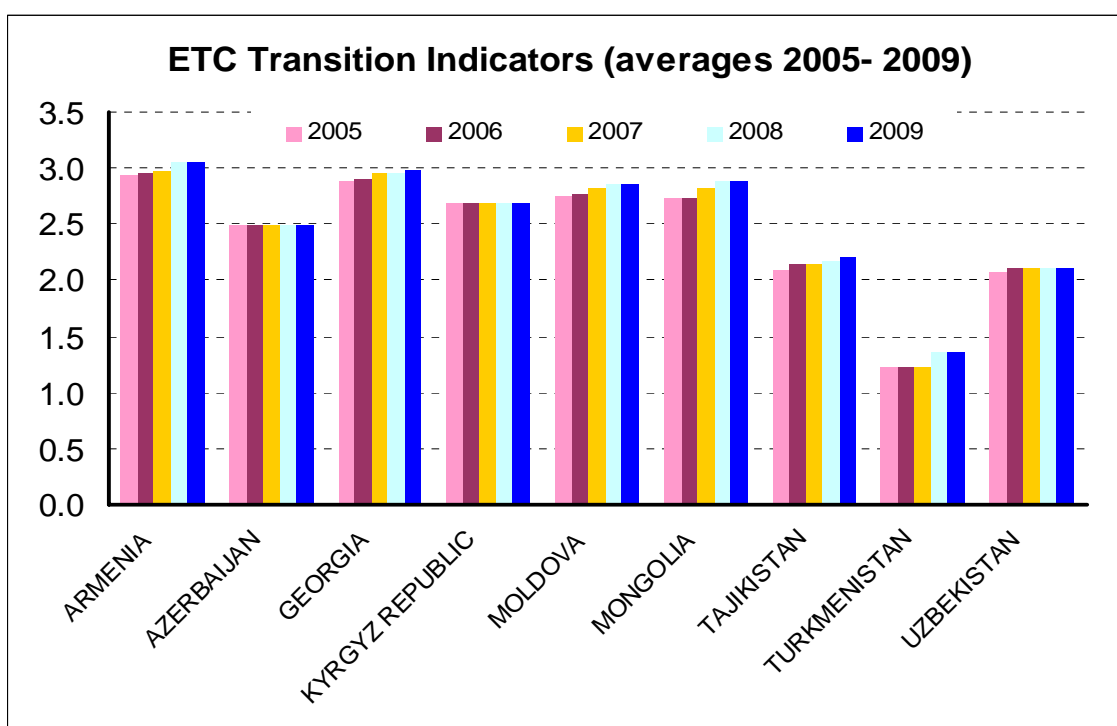
A new Labour Code has been approved in 2009, which updates the existing labour law that dates from 1993. The Code expands the rights of employees', including part-time workers. It also limit the use of short-term contracts in the public sector that have, in the past, led to increased side payments to ensure job security. The law also includes provisions for longer annual leave.

2.5 Key Transition Achievements and Challenges

The unification of the exchange rate constitutes the largest policy development and should encourage foreign direct investment into the non-hydrocarbon sector, thus helping Turkmenistan to begin diversifying its economy. While there has been some progress in banking reform, with the introduction of IFRS reporting standards for banks, further efforts are needed to increase access to finance and ease the entry of private commercial banks into the largely state controlled financial sector. The hydrocarbon infrastructure and other physical infrastructure are in high need of further investment. Therefore the key Transition Challenges in Turkmenistan for this strategy period are:

- Diversification of the economic base is the key challenge, with 85 per cent of exports originating from the oil and gas sector.
- Competitiveness of the private sector is low by international standards due to hindrances in business entry and exit and generally poor standards of transparency and corporate governance.
- The business environment remains difficult and the playing field for private and state-owned businesses is not level; it is critical to further strengthen the legal and regulatory framework for markets.

- Financial sector development is at an early stage; it is necessary to increase financial depth and reduce state interference and control in order to facilitate the introduction of private sector banks and non-bank financial institutions and increase competition.
- Promoting sustainable development and the introduction of international best practice of the private oil and gas sector.
- Modernisation of infrastructure, which constrains private sector development and operates under below-cost prices, non-transparent practices. Commercialisation and energy efficiency improvements are necessary to ensure long-term sustainability. To attract private investment into municipal and other infrastructure developments, improving accountability and efficiency in the provision of public services by steps towards fiscal decentralisation is key.



2.6 Access to Capital

The government is addressing the massive infrastructure investment requirements outside of the major cities since 2008 through the “Modern Rural Development Programme”. This is a major investment programme in health, education, municipal services and agricultural development. In the hydrocarbon sector, there remain substantial investment needs in all areas, in particular for pipeline construction and start the exploitation of the South Yolotan oil field which requires state of the art drilling and processing technology. Approximately USD 4 billion in concessionary lending has been made available via CNPC to exploit these newly proven resources, and an export pipeline through Turkmenistan, Uzbekistan and Tajikistan to China is also under construction. However the estimates of several oil majors of the size of investment needed to exploit the new gas-fields range from USD20bn to USD30bn. Turkmenistan has limited external sources of finance and mostly relies on internal financial sources, particularly through state funds.

IFIs are not very active in Turkmenistan. The authorities concluded no new lending projects with neither IMF, the World Bank, nor Asian Development Bank during the past five years. Bilateral aid programmes are also limited but have increased since the end of the Niyazov era (between US\$ 30-

40 million p.a.). The situation regarding sovereign loans remains ambiguous and this will need to be addressed, along with IFI partners if the Bank is to invest in infrastructure.

For private enterprises, access to formal-sector finance remains limited at less than 10 per cent of total lending. Domestically private enterprises can, in principle, borrow from banks, but their business objectives need to be in line with state objectives. The debt pricing policies of state owned commercial banks are closely monitored by the Central Bank which recommends maximum interest rates. These banks show very low debt to asset ratios which clearly demonstrate the lack of incentive to lend. The state directed lending scheme, providing cheap (5%) loans to private businesses, is restricted to certain sectors, and has tough qualification requirements (e.g. 120% collateral).

Despite some legislation on capital markets the securities market barely exists. The government issued treasury bills in the past but has not issued any since 1998. The country does not have access to international capital markets (no bond issuance). Foreign direct investment continues to play a role, but only limited sectors are able to attract foreign investors (i.e., hydrocarbon sectors).

3. STRATEGIC DIRECTIONS AND OPERATIONAL PRIORITIES

3.1 Bank's Priorities for the Strategy Period

In recognition of the progress achieved in structural reforms in Turkmenistan in the previous Strategy period a more flexible strategic approach will open up new operational and transition opportunities which the Bank can pursue in a careful and selective manner. The Bank's overriding priority during the Strategy period, will be to provide support for private sector development as a means to promote further moves toward political and economic transition.

An important dimension of the Bank's activities in the next Strategy period will be proactive policy dialogue with the authorities, donors and other stakeholders. The Bank will encourage the Turkmen Government to accomplish further political and economic reforms in keeping with Article 1 of the Agreement Establishing the Bank and to attain Strategy objectives. In view of the proposed strategic approach and operational content, Turkmenistan should be a full beneficiary of the ETC Initiative, with the benefit of optimizing of the development of the enterprise and private sector and required institutions, including the provision of Technical Assistance from the EBRD and donors.

The Bank is in a position to conduct a broader range of operations, recognising that the country has embarked, however carefully, on a process of economic and political reforms required by Article 1. If the authorities remain committed to the programme of economic liberalisation and reform further opportunities may open up for broadening EBRD's activities during the strategy period. The following types of projects in principle could be undertaken (though they have to be prioritised and selective) depending on the reality of the country's reform process. However, development of specific investment opportunities remains elusive.

- **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. The Bank should continue to engage in policy dialogue and to pursue its 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. This will also improve the opportunities of addressing the reluctance to introduce market-oriented interest rates system for SME/CLs.
- **Improvement of 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.
- **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.

An important dimension of the Bank's activities in the next Strategy period will be proactive **policy dialogue** with the authorities, donors and NGOs on the need for acceleration of reforms and importance of enhanced political and economic openness. In that connection, the Bank will continue to closely monitor progress in these domains against a set of reform benchmarks. As a part of the strategy exercise, the Bank conducted several missions and active discussions with local and international NGOs, most of whom suggested EBRD's more active engagement in Turkmenistan.

In the political sphere:

- 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.

In the economic sphere:

- 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 stabilisation fund and other operating foreign exchange funds. Improving accountability and efficiency in the provision of public services by steps towards fiscal decentralisation.

The Bank will actively and continually monitor developments against these benchmarks and report to the Board of Directors on an annual basis on progress/regress. This will further enable the Bank's management and shareholders to calibrate the appropriate strategic response to changes in the situation on the ground. In view of the proposed strategic approach and operational content, Turkmenistan should be a full beneficiary of the ETC Initiative, with the benefit of optimising of the development of the private sector and required institutions, including the provision of Technical Assistance from the EBRD and donors.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Private Sector Development

The Turkmen authorities' ambitious targets for private sector development face challenges at every level. Investments in the banking and corporate sector can only address this when combined with technical cooperation assignments to build institutional capacities and good corporate governance.

Micro, Small, Medium-Sized and Large enterprise development: The Bank's priorities will continue to be aimed at promotion of private sector activities, supporting local and foreign enterprises through investment and TC. Specifically providing improved access to finance for the MSME sector via credit lines with local banks, including selected state owned banks; through proposed privately owned MSME finance bank; directly via the DLF and DIF programmes and where possible in larger corporate deals. The Bank will also explore opportunities to support the development of a leasing sector.

Food processing, beverages, packaging and small scale manufacturing offer good prospects for growth. The Bank will encourage the government to improve the regulatory framework for telecoms in order to stimulate private investment and upon the provision of an appropriate framework and the availability of good investors, might consider financing telecoms and internet projects.

In addition to financing, the role of TAM and BAS in improving management skills and in developing a local consulting industry is key to addressing the human capacity improvements necessary to meet both government targets for private sector development and EBRD objectives.

Private Oil and Gas Companies: The oil and gas sector requires massive amounts of investment during the next strategy period with the government's stated aim of increasing production two-fold by 2015. The Bank has refrained its investments both public and private oil and gas companies since 2000 because a half of its revenues were accumulated in the Foreign Exchange reserve fund (FERF), an off-shore, off-budget account, which was created and controlled by late President Niyazov. As there have been certain reform efforts around FERF, including (i) new oil and gas revenues are now accumulated in the state stabilisation fund, and (ii) FERF is officially under Central Bank's management, the Bank may consider selective private oil and gas sector projects in cases where the Bank can maximise transition impact.

Criteria for engaging with private oil and gas companies

The Bank may consider selective private oil and gas sector projects with high transition impact and significant environmental gains as well as technology transfer such as gas flaring reduction projects and pipeline rehabilitation projects if, with regard to FERF and the newly-formed stabilisation fund, the principles of their institutional functioning and management are disclosed and well-understood. In this case, Bank will mainly focus on reputable foreign companies or joint ventures, with proper bidding process, transparent revenues and procurement arrangements, with international best practice in environment and those following EITI principles.

3.2.2 Privatisation

Supporting the government's stated aim to privatise certain non-core sectors, and enterprises peripheral to protected industries the Bank will seek to encourage and to the extent possible participate in the privatisation of relevant sector of economy. The rationale is to assist the government in its approach to an effective, transparent and economically beneficial privatisation policy to build confidence in the process and thus make it irreversible. If and where appropriate, donors' contributions may be sought to assist in the capacity building of the privatisation authority to conduct the privatisation process in an efficient, transparent and competitive manner.

Criteria for engaging with state-owned or public entities

Any engagement by the Bank, whether in the pre-privatisation process or in the actual privatisation of a state-owned enterprises, will require high corporate standards, transparent financial statements, adequacy of management and viable operations. Considering the rather slow progress of privatisation discussions and the cautious approach on the part of the authorities, the Bank will consider supporting exceptionally good projects which have a strong potential for success and a high transition impact. In addition, *ex ante* project-specific quantifiable targets and deadlines would be set including in the respect of competitive tendering and transparency of the process. Any project in the area must contain conventional agreement on accelerating the Bank's exit on terms strongly motivating compliance of government agencies with the criteria, should the agreed objectives not to be met.

3.2.3 Financial Institutions

Given the recent reforms in the sector and the growing collaboration between the Bank and the authorities EBRD's impact on the Turkmen financial sector has potential in the following areas:

Establishment of a new bank for private sector development: The Bank has been invited by the Turkmen authorities and Union of Entrepreneurs to invest in a private green-field MSME finance bank. If standard conditions and reassurances from the state on non-interference are met, EBRD is ready to support to establish such a model bank and to work closely on with the Turkmen authorities on the regulatory framework especially the independence of such a bank.

Expand the Trade Facilitation Programme: The Bank will seek to reactivate the Trade Facilitation Programme with selected private and state owned banks to promote intra-regional and international trade. Establishing relationships with foreign confirming banks will help to address the isolation of its banking sector and expose the sector to international best practice.

MSME credit lines with direct risk to the local banks: The immediate priority is to replace the cancelled sovereign guaranteed SME line with a new line directly to selected local private and state owned banks. Not only will this increase access to finance for entrepreneurs but will increase competition between selected banks and lead to the development of new products and the expansion to new banks. However, the reluctance to accept market interest rates for the recently proposed lines to two local banks is a worrying phenomenon. The Bank should continue to engage in policy dialogue and to pursue its 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.

Criteria for engaging with state-owned or public entities

In line with the Country Strategy Update 2008, the Bank will seek to use existing conduits of SME finance, including selected state owned banks which can demonstrate high standards of commercialisation, financial transparency, corporate governance, integrity and management's autonomy in carrying out their activities. The client enterprises of SME Credit lines and TFP will be privately owned.

3.2.4 Energy Efficiency and Renewable Energy

The key opportunity for sustainable energy investments is to improve resource efficiency in the Natural Resource sector; subject to the criteria for engaging with private oil and gas companies outlined above, the best prospects are likely to be in gas flaring reduction. The Bank will focus on utilisation of renewable energy with a specific and quantifiable contribution from each project to reducing the energy intensity of the economy. Private operators and preferably foreign strategic investors bringing state-of-the-art technology will be sought on a priority basis. Such projects will require an appropriate regulatory framework to foster long term investments on an economical basis; energy tariffs are currently not at a level to motivate energy efficiency investments. When there are appropriate price signals, and when the banking sector allows the more market-oriented mechanisms which are discussed in section 3.2.3, a very good market entry strategy in this area would be to work with local financial intermediaries on developing dedicated energy efficiency credit lines to enhance availability of financing for medium and small scale energy efficiency investments.

Criteria for engaging with state-owned or public entities

Should non-privately owned operators be involved, provided a proper regulatory framework and effective corporate governance arrangements are in place, a specific action plan will be agreed to facilitate wider sector participation in energy infrastructure on a transparent, adequately re-regulated and sustainable basis. Provided there is a proper regulatory framework and the tariff system is geared towards cost recovery, on a selective basis, the Bank may also engage in public energy generation, transmission and other utilities, especially those that have regional significance as long as the efforts of other IFI and international donors can be combined to achieve the above structural and transition targets in a specific and measurable manner.

3.2.5 Selective Important Regional Transport Infrastructure

Efficient transport infrastructure is essential to support economic development. During the previous regime, investment decisions were often arbitrary and all sector reform initiatives were stifled. As a result there is now an enormous need to upgrade the country's transport infrastructure, and to combine this with the introduction of institutional reforms which will increase the efficiency of transport services. However, the willingness of the government to introduce such reforms is as yet untested and so is the availability of sovereign guarantees. Areas for possible consideration are regional transport infrastructure, including ports, airports and air navigation.

As a first step towards re-engagement in the infrastructure sector, during this strategy period the Bank will focus on improvements in selective important regional transport infrastructure, which is a part of CAREC corridors, or other key regional transport infrastructure framework, with other IFIs or key bilateral donors, including key Caspian sea port infrastructure projects. These would require a strong transition rationale.

Criteria for engaging with state-owned or public entities

Most transport infrastructure in Turkmenistan is owned and operated by the state so a future Bank transport project will require close engagement with public entities. The essential pre-condition for this must be a clear commitment by the government that, in parallel with the implementation of the project itself, there will be a transition programme which will include the introduction of specific reform measures. The emphasis will be on introducing commercial principles into transport operations, including movement towards cost recovery. Investment in these sectors will be predicated upon effective policy dialogue on sector reform particularly focusing on: advancing the commercialization and eventual private sector role in these sectors; enabling independent market participants' access to the infrastructure; compliance with internationally accepted standards for addressing the Environmental Impact of new facilities.

A future Bank transport investment could in principle materialise in any regional transport sub-sector so long as the project has a sound rationale, as evidenced by a satisfactory economic rate of return. Priority will be given to projects which are integrated into international programmes such as CAREC transport corridors, the EU-TRACECA programme, and UN-ESCAP's Asian Highway Network.¹ Such projects are likely to offer opportunities for the Bank to co-finance with other IFIs and bilateral donors. When reviewing potential transport projects, the Bank will favour those which are likely to benefit the private sector, whether directly, for example, through sub-contracting arrangements, or by preparing for a future privatisation, or indirectly by removing transport bottlenecks which constrain the efficiency of the private sector. The Bank will also seek projects

¹ CAREC is a high-level co-ordinating body for key infrastructure projects in the region with the participation of Central Asian countries, Afghanistan, Azerbaijan, China, Mongolia and key IFIs. The CAREC projects are genuinely regionally important networks consensually selected by the participants, with strong "in principle" financial backing by countries and IFIs.

which generate revenue streams that can be used to support debt service, and those which promote environmentally sustainable development.

3.2.6 Strengthening Policy Dialogue

The Bank will strengthen policy dialogue with the government on legislative and market reforms designed to transform the challenging business environment. The Bank will focus on identifying regulatory bottle-necks and barriers to investment in the private sector and to recommend reforms to the relevant agencies. The Turkmen government has recently encouraged the Bank to cooperate in reforms to support the enterprise sector and a specific request has been received to assist in the development of secured transactions and insolvency procedures.

Further policy dialogue will continue to enhance the government's understanding of required reform in the financial institutions sector and the need to rapidly increase access to finance for the growing private sector through commercially priced lending based on sound banking principles. Technical cooperation in the form of advisory and capacity building assignment will play an important role here.

3.3 Areas for future consideration

3.3.1 Municipal and Environmental Infrastructure

Subject to substantial and consistent progress in all above sectors, as evidenced in the annual reporting to the Board, it may be proposed to extend the Bank's operational priorities supporting the reform and technical upgrade of the municipal infrastructure, such as water supply, solid waste management, district heating and urban transport infrastructure, whereas, at this stage, the municipal sector remains the least advanced and most difficult area of the infrastructure sector reform, as (i) municipalities do not have the right to borrow, (ii) cities have very limited fiscal autonomy and own budgetary resources, (iii) almost all communal services are financed by Central Government's budget allocation, and (iv) most services are still provided to the general public and companies with very low and heavily subsidized tariffs.

Criteria for engaging in MEI projects

Involvement with the municipal sector by its nature requires the Bank to engage with public entities – municipal, regional and central authorities as relevant – therefore the criteria allowing engagement in this sector would be particularly important. These could include the adherence by the relevant authorities to: (i) a full cost recovery principle, to be implemented as soon as possible subject only to affordability constraints; (ii) development of a sustainable regulatory framework; (iii) enhanced accountability and corporate governance of corporatised municipal utilities; (iv) improved accounting standards and transparency; (v) public consultation and enhanced involvement of local residents on project preparation and implementation; (vi) promotion, where realistic, of wider private sector participation through competitive tenders; and (vii) twinning arrangement, if applicable, with more advanced municipal utility entities.

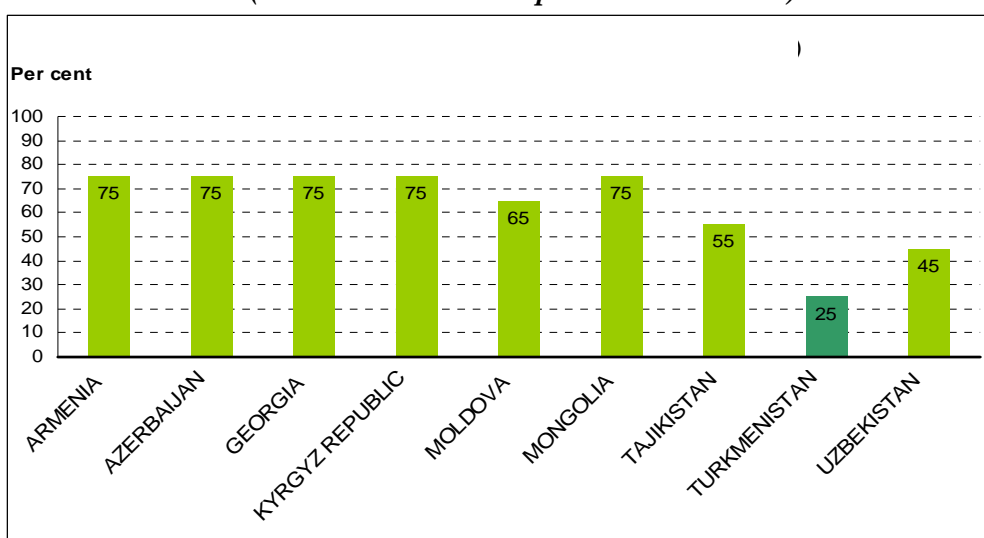
The compliance with such criteria can be expected to require considerable effort and time and progress in fiscal decentralisation and therefore the Bank is not likely to be able to proceed with any specific investment in these sectors until the later part of the new Country Strategy period.

4. EARLY TRANSITION COUNTRIES INITIATIVE

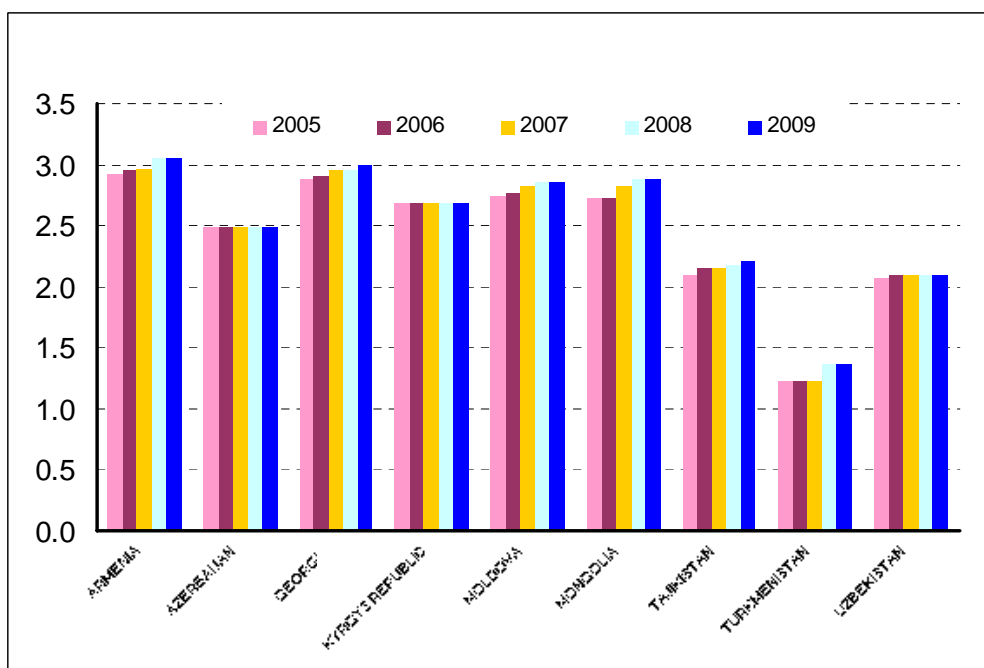
While Turkmenistan has made significant improvements in 2008 (namely the unification of the exchange rate, a new foreign investment law and a mobile telephone licence to a private operator) its overall transition indicator is still below the ETC average. As noted in section 2.5 Turkmenistan has still some way to go in the market enabling, first-stage reforms such as privatisation and price liberalisation. The most pressing transition challenge going forward will be to reform the financial sector that remains largely state controlled with a significant amount of directed lending.

The private sector share of GDP is also significantly below the ETC average, but the latest announcement by President Berdymukhammedov – to increase the non-oil and gas private sector share to 70 per cent of GDP (currently approx. 40%, or 25% if oil and gas is included) – shows that this has become a policy priority.

Private Sector Share in GDP (EBRD Transition Report Estimate 2009)



Transition Indicators (averages 2005 - 2009)



Under the ETCI, through the rapid and substantial increase in operations and associated technical assistance, the Bank is achieving significant transition impact and making a contribution to sustainable poverty alleviation. Given the very early stage of transition progress, recent reform developments and growing business opportunities, it is proposed that Turkmenistan should be a full beneficiary of the ETC Initiative upon approval of this strategy. This will incentivise and optimise the Bank's full deployment in smaller private transactions, at the higher risk spectrum of sound banking principles, and leverage EBRD's own-funded Technical Assistance to underpin the much required and needed policy dialogue and institutional building support for its projects.

Donor funding for TC is a key element of the success of the ETC Initiative. This has more than doubled over the pre-ETCI levels. The ETC Multi-Donor Fund has taken on a lead role, but with key bilateral donors also making larger contributions and now the "matching" funds of the EBRD Shareholder Special Fund. Turkmenistan's low transition indicators indicate that it is a good candidate for ETC Fund donor financing. In that context it is proposed, following Board adoption of this Strategy, to ask donors in the ETC Assembly of Contributors to consider including Turkmenistan as a recipient of ETC Fund resources for technical assistance.

5. OTHER IFIS AND MULTILATERAL ORGANISATIONS

The Bank will continue to closely co-ordinate with other IFIs active in Turkmenistan (The World Bank, IFC, ADB, IsDB and potentially EIB) to increase the leverage of Bank projects and policy dialogue. In response to progress in economic reforms in Turkmenistan, IFIs have stepped up their presence in the country, albeit limited in their scopes. UNDP takes responsibility for donor coordination and there is a good degree of information sharing and cooperation between donors and IFIs in Ashgabat. The activities of key IFIs/international organisations are summarised below.

- **International Monetary Fund (IMF):** Turkmenistan joined the IMF in 1992. There are no financial arrangements currently in place with the IMF. To-date the IMF has played an advisory role in Turkmenistan via regular Article IV Consultations and technical assistance. Since 2000, IMF has been cooperating with the authorities in improving the quality of national accounts and price statistics; adopting the AML/CFT law and establishing the necessary legal framework; promoting the monetary reform; and facilitating change in the exchange rate regulations. The IMF welcomed the progress Turkmenistan has recently made in economic reforms, particularly the successful exchange rate unification and the introduction of the new manat at the beginning of 2009, as well as measures to strengthen the banking system, and the establishment of the Stabilization Fund. In the near term, IMF will focus its assistance on further improving national accounts and price statistics and continuation of exchange rate, fiscal, and banking sector reforms.
- **World Bank Group:** Turkmenistan became a member of the World Bank in 1992. The World Bank Group has assisted the country in the areas of poverty reduction, private sector development, financial sector reforms and infrastructure development. The Country Assistance Strategy (CAS) for 2008-2012 is still under Turkmen government consideration. It is envisaged that the CAS focuses assistance in five main areas: (i) avian influenza, (ii) post-graduated specialists programme and opening of information research centres (iii) programme on improvement of financial payment systems; (iv) bank supervision; (v) sustainable development programme in transport sub-sector.
- **Asian Development Bank (ADB):** Turkmenistan became a member of the Asian Development Bank (ADB) in 2000. The latest Country Strategy was adopted in 2002. Within the framework of the summit of the Islamic Development Bank, ceremony of signing of the Memorandum between the Islamic Development Bank and the Asian Development Bank on the start of the functioning of joint infrastructural fund took place on 2 June 2009. As is known, Asian Development Bank is a regional intergovernmental bank on the long-term crediting of development projects in the Asia-Pacific Region. In line with the signed document, the banks on a par will finance the investment projects connected with the development of infrastructure in twelve Asian countries, including in Turkmenistan. Some 500 million US dollars are allocated for these purposes.
- **Islamic Development Bank (ISDB):** Turkmenistan has been a member of the ISDB since 1997. ISDB committed US\$ 74.3 million for 11 projects (37% concessional) including the construction of medical centres, the purchase of two oil tankers, the rehabilitation of a portion of the Mary-Tejen highway, a rural water supply project, and an optical fibre cable project for the state telecom company. ISDB held its annual meeting in Ashgabat in June.
- **United Nations Development Programme (UNDP):** The United Nations Development Programme (UNDP) has been in Turkmenistan since 1995. The UNDP Turkmenistan Country Programme for 2010-2015 will address four priority areas – 1) Strengthening Democratization and Rule of Law; 2) Strengthening Human Development to Achieve the MDGs; 3) Improving

Sustainable Development and Inclusive Growth; and 4) Promoting Peace and Security. UNDP focuses its strategy on (i) access to international good practices, and knowledge, skills and resources in the design of national development policies and strategies; and (ii) capacity strengthening and human resource development across a range of sectors to sustain impact at the system level. In response to reforms initiated in 2007, UNDP has specifically supported programmes on local governance, electoral reform, parliamentary development, human rights, economic development, microfinance, and expanding work on environment and climate change. In February 2009, UNDP and EBRD held a joint seminar on micro-finance.

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- **EU:** The Central Asia Indicative Programme 2007-2010 set out the key priority areas for EC assistance to the region, at regional as well as at country level. As this will expire in 2010, the EC is now beginning preparations for a new Indicative Programme to cover the years 2011-2013. Due to the differences in the EC aid cooperation for each of the Central Asia states, which derive from the political and socio –economic divergences, separate Indicative Programmes for each country will be produced. As such, a limited number of priority areas for assistance will be defined for each of the Central Asia countries, in order to guide planning and project identification, in a tailor –made approach and process was carried out for all Central Asia countries during 2009.

The list of potential priority areas foreseen under the Indicative programme 2011-2013 for cooperation assistance to Turkmenistan derives from the EC Regional Strategy for Assistance to Central Asia 2007 -2013 and it is intended to contribute to the implementation of the EU Political Strategy for Central Asia adopted by the European Council in June 2007. The objective of this exercise is to identify areas which have not been adequately covered by EC or other Donors' assistance in Turkmenistan but which represent key priority areas in need of financial assistance, especially in view of the development of the country, as well as areas for which follow-up assistance is required to previous programmes. This exercise is also supporting the strategic approach of enhancing the EC- Turkmenistan co-operation agenda.

- **Organisation for Security and Cooperation in Europe:** Activities of the OSCE Centre in Ashgabat are guided by its mandate and cover all three OSCE dimensions:

In the Politico-Military Dimension: The Centre works on addressing modern security threats and challenges. In the Human Dimension: Promoting respect and implementation of international human rights standards in the criminal justice system; supporting the legal reform and access to justice by citizens; assisting Turkmenistan in raising awareness about human rights. Economic and Environmental Dimension: Increasing capacity of the Government and other stakeholders in promoting trade, foreign investments, agribusiness development. An important element of the Centre activity from 2010 will constitute business and economics educational projects. Supporting mechanisms for combating corruption, money laundering and terrorist financing are also addressed.

Compliance with Article 1

Over the years the Bank has been seriously concerned with Turkmenistan's failure to make progress towards multi-party democracy, pluralism and market economics in keeping with Article 1 of the Agreement Establishing the Bank. Recent progress in the political and economic spheres, triggered by the change in leadership in December 2006, provides an opportunity for deeper engagement, though many challenges remain.

Since the leadership transition from former President Niyazov to the current administration under President Berdymukhamedov, political and economic changes have been taking place in the country, aimed at reversing social and economic policies of the previous regime and ending the country's international isolation.

A new version of the Constitution, as revised in September 2008, recognises the principle of separation of powers. The legislature has been strengthened by eliminating the Khalk Maslahaty (People's Council) and restoring functions of a regular one-chamber parliament. In December 2008 the first post-Niyazov parliamentary elections were held. Although it fell far short of international standards, the December election had several candidates contesting each parliamentary seat.

The Government continues to exercise full control over the media, permitting at the same time wider access to the Internet. There has been an improvement in legislation on human rights but the overall progress on the implementation of the adopted laws, the rule of law and respect for human rights remains a serious concern, as assessed by specialised human rights organisations.

Turkmenistan is making an effort to develop its relations with other countries and to increase its cooperation with international organisations, including those involved in the human dimension activities, such as the OSCE and the UN.

Political Accountability

The Bank's main concern during President Niyazov's period was lack of willingness on the part of Turkmenistan to genuinely implement its commitments towards political reform. The real change was completely stifled by the atmosphere of authoritarian rule with huge unchecked power concentrated in the hands of one person. The educational system has dramatically deteriorated and the country failed to introduce a minimum level of political pluralism. The lifetime presidency of Mr Niyazov perpetuated the imbalances and violated the basic right of the citizens of Turkmenistan to choose their leaders.

Following President Niyazov's death in 2006 the People's Council scheduled presidential elections for 11 February 2007 and, for the first time since independence, the election was contested by more than one candidate. In an election which did not meet international standards for free, fair and competitive election, the Acting President Gurbanguly Berdymukhamedov received 89 per cent of the vote.

The new leadership embarked on a new social and economic agenda, geared towards reversing the most egregious policies of the previous regime, with most notable changes made in the fields of social security, education and science.

In September 2008 Turkmenistan has revised the Constitution, which accords supremacy of international treaties over national legislation. The principle of separation of powers between the executive, legislative and judiciary is now embedded in the text of the new basic law.

The amended Constitution also provides for the protection of the rights of entrepreneurs. The private sector development was also given prominence in the President's announced plans to increase the private sector share of the GDP, outside of oil and gas, to 70 per cent by 2020.

Significant efforts are being made to bringing Turkmen legislation into line with its international treaty obligations. The legislature has been strengthened by eliminating the People's Council (the unprecedented supreme legislative body created by the former President) as a political body and restoring the functions of a regular one-chamber parliament (Mejlis). The revised Mejlis election law also incorporated some international standards such as granting the right to vote to detainees not yet convicted of a crime.

On 14 December 2008 the first post-Niyazov parliamentary elections were held with 125 deputies elected to replace 65 members of the old parliament. The new parliament convened its first session on 9 January 2009. Although it fell short of international standards, the December election had several candidates contesting each parliamentary seat. The candidates were nominated by the country's only political party – the Democratic Party of Turkmenistan - and the National Revival Movement Galkynysh as well as by the individual initiative groups of at least 200 citizens. The OSCE/ODIHR deployed a team of nine election experts to follow the proceedings and continue election-related dialogue with the authorities.

The Government has visibly increased international cooperation with relevant multilateral bodies. In August 2009 the United Nations has finalised a six-year Development Assistance Framework (UNDAF) for Turkmenistan, which includes as a first priority area strengthening democratisation and the Rule of Law. In April 2009 the European Parliament approved an Interim Agreement between the European Commission and Turkmenistan. The approval of the agreement has been delayed for many years because of the lack of progress on human rights. Within the established framework of human rights rounds, the second one of which took place in June 2009, the EU has a constructive dialogue with Turkmenistan on compliance of the country with international standards and improving the national legislation and practice of its implementation.

Notwithstanding these changes and future democratisation plans, Turkmenistan remains a one-party state which is lacking in genuine political pluralism. Continued absence of new political parties registering in Turkmenistan, controlled media and weak civil society contribute to the environment, which is not conducive to expressing dissenting views.

Rule of Law and Human Rights

There was an improvement in the human rights legislation and the Government's readiness to engage with the specialised international organisations, such as the UN and the OSCE, in the implementation of various human dimension initiatives, including in the area of monitoring and reporting international commitments, arising from international treaties, ratified by Turkmenistan.

Legal reforms involved the adoption of the new version of the Constitution and a large number of other pieces of legislation. A newly-adopted criminal procedures code is supplemented by internationally-funded programmes for training judges, prosecutors and defence lawyers in new ways of approaching pre-trial detention and criminal procedure. A welcome sign was the release of the long-term political prisoner Mukhametkuly Aymuradov. By Presidential decree, a National Institute for Democracy and Human Rights was given mandate to ensure Turkmenistan's compliance with international obligations on human rights. The Director of the Institute was heading the Turkmen delegation at the UN Universal Periodic Review in December 2008.

Despite these positive changes, the situation with implementation of the adopted laws and with upholding the rule of law and respect for human rights remains a serious concern. In particular, as assessed by the specialised human rights organisations, the priority areas requiring urgent attention include the release of all political prisoners, free access of the International Committee of the Red Cross (ICRC) to places of detention, lifting the remaining restrictions on foreign travel, freedom for the media and free functioning of the civil society groups.

Lack of independence of the judiciary is a concern. According to the 2008 Corruption Perceptions Index of Transparency International, country has a severe corruption problem. There are reports on harassment and intimidation of human rights defenders. Turkmenistan has no domestic human rights NGOs and there are no international human rights NGOs with a continued permanent presence in the country.

In September 2008 the UN Special Rapporteur on Freedom of Religion made her first official visit to the country. The Rapporteur made a number of recommendations aimed at bringing the legislation and practice of its implementation into greater conformity with international standards in this area.

Although wider access to the Internet is now permitted, the Government continues to exercise full control over the media. The Turkmen Telecom remains the main provider of Internet services to the general population and the rates for dial-up access remain expensive for average citizens. Practically all print media is Government-financed and there are significant restrictions on importation of the foreign newspapers. Domestic journalists and foreign news correspondents engage in self-censorship due to fear of Government reprisals.

ANNEX 2

SELECTED ECONOMIC INDICATORS

Turkmenistan	2003	2004	2005	2006	2007	2008 <i>Estimate</i>	2009 <i>Projection</i>
Output and expenditure	<i>(Percentage change in real terms)</i>						
GDP ¹	17.1	14.7	13.0	11.4	11.6	10.5	6.0
Private consumption	na	na	na	na	na	na	na
Public consumption	na	na	na	na	na	na	na
Gross fixed capital formation	na	na	na	na	na	na	na
Exports of goods and services	4.0	11.2	28.3	44.9	27.4	29.3	na
Imports of goods and services	40.8	22.1	-6.4	34.8	47.8	41.9	na
Industrial gross output	13.5	16.4	8.5	na	na	na	na
Agricultural gross output	9.5	13.0	4.0	na	na	na	na
Employment	<i>(Percentage change)</i>						
Labour force (end-year)	3.0	3.0	na	na	na	na	na
Employment (end-year)	2.2	na	na	na	na	na	na
	<i>(In per cent of labour force)</i>						
Unemployment ²	29.8	30.2	na	na	na	na	na
Prices and wages	<i>(Percentage change)</i>						
Consumer prices (annual average)	5.6	5.9	10.7	10.5	8.6	12.0	5.5
Consumer prices (end-year)	3.1	9.0	10.4	7.1	8.6	8.9	6.0
Producer prices (annual average)	na	na	na	na	na	na	na
Producer prices (end-year)	na	na	na	na	na	na	na
Gross average monthly earnings in economy (annual average)	84.2	5.7	21.6	na	na	na	na
Government sector³	<i>(In per cent of GDP)</i>						
General government balance	-1.3	1.4	0.8	5.3	4.0	11.3	5.3
General government expenditure	19.4	18.9	19.7	14.9	13.4	12.3	na
General government debt	na	na	na	na	na	na	na
Monetary sector	<i>(Percentage change)</i>						
Broad money (M3, end-year)	33.4	13.6	5.6	10.7	96.4	-7.6	na
Domestic credit (end-year)	-0.6	3.6	-3.5	-6.7	31.0	52.2	na
	<i>(In per cent of GDP)</i>						
Broad money (M3, end-year)	13.2	12.3	10.2	9.2	15.0	7.7	na
Interest and exchange rates	<i>(In per cent per annum, end-year)</i>						
Refinance rate	10.0	5.0	na	na	na	na	na
Interbank market rate	6.9	4.6	na	na	na	na	na
Deposit rate (6-12 months) ⁴	15.4	11.3	na	na	na	na	na
Lending rate (6-12 months) ⁴	20.4	17.3	na	na	na	na	na
	<i>(Manats per US dollar)</i>						
Exchange rate (end-year) ⁵	10,390.0	10,540.0	10,870.0	10,690.0	10,690.0	14,250.0	na
Exchange rate (annual average)	10,033.5	10,375.0	11,015.2	10,881.9	10,690.0	13,041.5	na
External sector	<i>(In millions of US dollars)</i>						
Current account	305.0	82.2	876.9	3,347.2	4,036.0	3,560.0	5,300.0
Trade balance	886.0	705.5	1,997.1	4,597.8	5,334.0	6,423.0	7,900.0
Merchandise exports	3,465.0	3,853.9	4,944.1	7,155.5	9,114.0	11,786.0	14,500.0
Merchandise imports	2,579.0	3,148.4	2,947.0	2,557.7	3,780.0	5,363.0	6,600.0
Foreign direct investment, net	226.0	353.7	418.2	730.9	804.0	820.0	0.0
Gross reserves, excluding gold (end-year) ⁶	2,673.0	2,714.0	3,442.0	7,477.2	0.0	0.0	na
External debt stock	1,519.0	1,273.0	1,007.0	805.0	0.0	0.0	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	9.5	8.0	10.7	25.0	na	na	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service ⁷	11.6	9.6	5.7	3.9	na	na	na
Memorandum items	<i>(Denominations as indicated)</i>						
Population (end-year, million)	6.2	6.5	6.5	6.5	6.5	6.5	6.5
GDP (in billions of manats)	59,404.8	72,706.4	91,863.2	113,073.6	136,244.0	247,152.0	361,670.0
GDP per capita (in US dollars)	954.9	1,078.1	1,283.0	1,598.6	1,960.8	2,915.6	3,837
Share of industry in GDP (in per cent)	39.7	38.6	na	na	na	na	na
Share of agriculture in GDP (in per cent)	19.6	18.4	na	na	na	na	na
Current account/GDP (in per cent)	5.2	1.2	10.5	32.2	31.7	18.8	21.2
External debt - reserves (in US\$ million)	-1,154.0	-1,441.0	-2,435.0	-6,672.2	0.0	0.0	na
External debt/GDP (in per cent)	25.7	18.2	12.1	7.7	na	na	na
External debt/exports of goods and services (in per cent)	40.8	30.2	19.1	10.7	na	na	na

¹ Official statistics until 2004, but EBRD estimates thereafter.

² Officially registered unemployed.

³ Significant off-budget expenditures occur through extra-budgetary funds and lending.

⁴ Unweighted average deposit and lending rates for individuals (in local currency) of state commercial banks.

⁵ Before May 2008 Turkmenistan operated a dual exchange rate system. The series refers to a weighted average between the official exchange rate and the commercial rate (given as the black market rate). Weights are variable depending on official and shuttle trade.

⁶ Includes foreign exchange reserves of the central bank plus the foreign exchange reserve fund.

⁷ Excludes rescheduled amounts.

ANNEX 3 ASSESSMENT OF TRANSITION CHALLENGES

The table below provides an overall Assessment of Transition Challenges rating for 2009 and 2005. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform. The overall rating in 2009 is based on individual ratings for market structure and market-supporting institutions and policies (see methodology annex circulated separately). The 2005 overall rating is based on individual ratings for market structure, market-supporting institutions and market behaviour. Due to changes in the methodology, made necessary by the evolving meaning of transition and the lessons of the financial crisis, comparison between the two overall scores should be made with caution.

Turkmenistan	Overall 2009	Overall 2005
Corporate		
Agribusiness	Large	Large
General Industry	Large	Large
Property and Tourism	Large	Large
Telecom	Large	Large
Infrastructure		
MEI	Large	Large
Natural Resources	Large	Large
Power	Large	Large
Sustainable Energy	Large	Large
Transport	Large	Large
Financial Institutions		
Banking	Large	Large
Insurance and financial services	Large	Large
MSMEs	Large	Large
Private equity and capital markets	Large	Large

The next page provides a snapshot of the general institutional environment, which helps to set the context for the sector-by-sector assessments that follow. The general institutional environment comprises such country-wide factors as government effectiveness and regulatory quality, the rule of law, levels of corruption, democratic institutions and knowledge and innovation capacity. These factors are not specifically addressed in the sector assessments, however, they have been considered as part of the important institutional background against which the sector assessments have been made and ratings assigned. For each of the four categories in the general institutional environment we have used a combination of in-house expertise, EBRD surveys and external cross-country ratings to give a brief indication of the quality of the underlying institutional framework. The charts are drawn from the Worldwide Governance Indicators (Government Effectiveness, Regulatory Quality, Rule of Law), Transparency International (Corruption Perceptions), the Polity IV database (Democratic Institutions) and the World Bank (Knowledge Economy). The methodology annex explains how these are measured.

Assessment of Transition Challenges by Sector

(i) Corporate

Agribusiness

Market structure: Large

Institutions/policies: Large

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. Nevertheless most of agricultural commodities – in particular grain and cotton – still suffer from high government intervention, high implicit taxation, subsidies and price controls (both for input and farm gate prices). Private land ownership is limited and recent reforms have only allowed for improvements in the land leasing system. Lending to agriculture is dominated by directed credit through government controlled banks. Irrigation and infrastructure are in need for sizeable investments. Modern retail is at an early stage and not present outside the capital.

General Industry

Market structure: Large

Institutions/policies: Large

Transition in general industry 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 has focused on improving the business environment to facilitate the development of SMEs, but is yet to adopt concrete steps to ease enterprise entry and exit.

Property and Tourism

Market structure: Large

Institutions/policies: Large

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. Tradability of land is limited de jure.

Telecommunication

Market structure: Large

Institutions/policies: Large

Turkmenistan has made little move to liberalise its telecoms market. The regulator is the Ministry of Communications, which is also the policy maker and controls eight state

enterprises in the post and telecommunications sectors. The state-owned Turkmen Telecom has been the primary provider of public telephone, email and Internet services, and has also been operating a GSM mobile network with a private operator, Russian MTS since November 2005. Turkmen Telecom has a de facto monopoly over data services since 2000, which seriously stifling growth of the internet sector. On the positive side however internet cafes started to open again in Ashgabat in mid-2006 and internet speeds are gradually increasing. Mobile service provider MTS started offering data/internet connections in 2008 to all of its subscribers. Access to some internet sites is still restricted and controlled.

(ii) Energy and Infrastructure

Municipal and Environmental Infrastructure

Market structure: Large

Institutions/policies: Large

Market-based reforms in infrastructure remain at an early stage. Some units providing utility services (e.g. bus services) were separated from the administration but others (e.g. water) are part of the government structures and decentralisation remains a key challenge. Utilities are operated in a bureaucratic fashion with no concern for financial or operational efficiency. In fact, municipal utility services are either provided for free (e.g. water) or prices are set politically much below cost recovery levels (e.g. public bus service and district heating). Some bus services are provided by the private sector in a more commercial fashion. Governance and transparency are very poor (e.g. no public consultations take place for the construction of new local roads). While capital investments are mostly covered from the central budget, the immediate transition goal would be to achieve cost recovery of operational costs and operational, technical and financial performance improvements.

Natural Resources

Market structure: Large

Institutions/policies: Large

Turkmenistan has substantial oil and gas reserves in both onshore and offshore fields*. The country has two major refineries, Seidi (Chardzhou) and Turkmenbashi, while a third has been commissioned by Dragon Oil in 2007. Many of the prime oil deposits are located in disputed areas of the Caspian Sea, and without an agreement between Iran, Azerbaijan, Russia and Turkmenistan on maritime borders, these fields will likely remain undeveloped.

The downstream sector is dominated by the State, while the upstream has some IOC participation (CNPC, Petronas, Dragon oil) but mostly in JV/PSA with the state-owned company Turkmenneft, which was spun off from Turkmenneftegaz by Presidential decree in 2005. Competition is limited, especially downstream, and the market is not fully liberalised. Turkmenistan maintains a partial licensing regime for exports and imports (albeit somewhat loosened by now). The complex regulatory framework and unfavourable business practices deter investment. Investors have expressed concern over the government's power to unilaterally annul petroleum licenses. Since the arrival of President Berdymukhammedov, there have been some indications that a more IOC-friendly environment is bringing back foreign partners. In March 2007, the new government established a hydrocarbons regulatory authority separate from the central government.

* The first international audit of Turkmen reserves was conducted by DeGolyer & MacNaughton and Gaffney, Cline and Associates in 2006 and confirmed reserves at least twice the amount estimated thus far by BP.

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. The establishment of a stabilisation fund, managed by the Ministry of Finance, that would channel the country's oil and gas revenues into long-term investments such as infrastructure, partially addresses long-lasting concerns about the opaque and non-transparent management of the country's resources' wealth.

Power

Market structure: Large

Institutions/policies: Large

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.

Sustainable Energy

Market structure/outcomes: Large

Institutions/policies: Large

The country continues to be very energy intensive. A SE supportive legal framework is missing and institutions are weak or non-existent. Tariffs are significantly below costs 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 UNFCCC and Kyoto protocol have been ratified, but no climate policies or CDM project activities are in place. Remaining challenges include to increase 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.

Transport

Market structure: Large

Institutions/policies: Large

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.

The road sector remains largely unreformed in all aspects (institutions, road user charges, private sector participation). Fuel prices/levies are the lowest in the EBRD countries of operations. Key decisions on road construction are politically driven. Road quality is relatively good (at least in the capital city) by regional standards. Some large contracts were awarded to foreign construction companies but most new construction is done by the state-owned construction company (without competition). The authorities should initiate the reform process.

(iii) Financial Institutions

Banking

Market structure: Large

Institutions/policies: Large

The financial sector remains very small – private sector credit to GDP is about 1 per cent – and there is only one bank in majority ownership of a private investor. Competition is extremely limited as five large state-owned banks account for 95 per cent of the banking market. A large portion of ‘commercial’ bank lending remains directed to state-owned enterprises at below market interest rates. The depth of the banking system has been declining over the last five years, mainly due to the dual exchange rate system which limited the inflow of foreign funds. Red tape and overregulation also hold back the financial sector. The unification of the exchange rate regime in May 2008 ended distortions in the foreign exchange market and may boost the role of banks in the wider economy. Risk management, legal transparency, corporate governance, and integrity standards remain far below international best practise.

Insurance and financial services

Market structure: Large

Institutions/policies: Large

Privately-owned non-bank financial institutions such as insurance companies, pension funds, and private equity funds remain virtually absent. 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 monopoly position in the insurance market. Leasing and non-bank consumer finance market segments exist but remain fairly limited.

Micro, Small and Medium-sized enterprises

Market structure: Large

Institutions/policies: Large

Access to credit for MSMEs is very poor, and is not provided on a sustainable basis. International financial institutions and NGOs aim at providing finance through the development of commercially based microfinance. The government is currently drafting a law on micro-finance.

Private equity and capital markets

Market structure: Large

Institutions/policies: Large

Securities market legislation is rudimentary and in need of overall reform. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector.

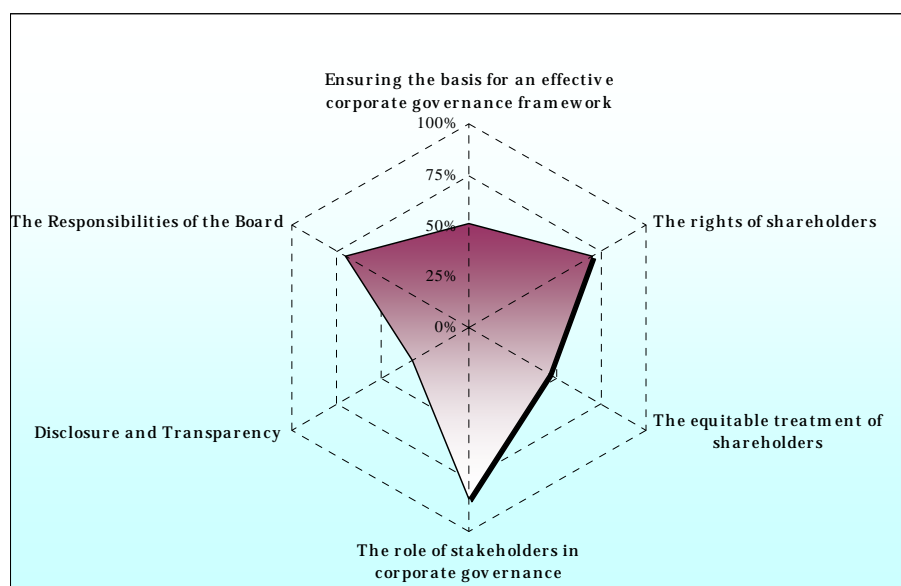
ANNEX 4 COMMERCIAL LAWS OF TURKMENISTAN

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Turkmenistan, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Company Law and Corporate Governance

The principal legislation on corporate governance in Turkmenistan is contained in the Enterprise Law of Turkmenistan, dated 15 June 2000 and the Joint Stock Companies (JSC) Law of Turkmenistan, dated 23 November 1999. The JSC Law provides the basic legal framework for the establishment, functioning, re-organisation and liquidation of joint stock companies and the rights and duties of shareholders. No voluntary national code of corporate governance good practice exists in Turkmenistan.

Quality of corporate governance legislation – Turkmenistan (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2007 assessment

According to the results of EBRD’s 2007 Corporate Governance Sector Assessment* through which the quality of corporate governance legislation in force in November 2007 was assessed, Turkmenistan was assessed as being in “low compliance” with the OECD Principles of Corporate Governance, showing a number of substantial shortcomings especially on disclosure and transparency, and equitable treatment of shareholders (see chart above). 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

* For more information see: <http://www.ebrd.com/country/sector/law/corpgov/assess/index.htm>

specific regulation on related party transactions and the weak regulation of conflicts of interest.

At a broader level dialogue between the government and the private sector on corporate governance improvements, generally accepted as essential for the development of a sound and effective legal framework, is absent in Turkmenistan. Starting a constructive dialogue with the private sector and build up consensus for a constructive reform improving the legislation in line with international standards should be a priority action for the government.

Concessions

The Turkmenistan Law on Foreign Concessions, (“the FC Law”) of 1993 governs concessions to foreign persons in the country and permits concessions to be granted for any type of activity, including industrial or natural resources exploration, provided such concessions are not otherwise prohibited by law. Infrastructure projects like transport or municipal concessions are not expressly mentioned in the FC Law.

Pursuant to the FC Law, concessions are granted on a competitive basis for a period of 5 to 40 years. While the FC Law contains a basic set of rules on tender procedures, these rules are very limited and the scope of their application unclear, arguably leaving room for arbitrary decisions by the authorities from case-to-case. The FC Law provides that concession agreements may only take the form of Build Operate Transfer arrangements, thus limiting flexibility of arrangements between the parties.

Concession is defined as "a permission by the state to carry out a specific type of business activity". The Contracting Authority is not clearly defined and sectors that may be subject to concessions are not specified and the selection procedure is not sufficiently developed. The FC Law refers to the Cabinet of Ministers’ decisions on this account but no publicly available document, other than in the oil and gas sector, can be identified. Disputes are to be resolved by the courts of Turkmenistan and there is no provision for international arbitration.

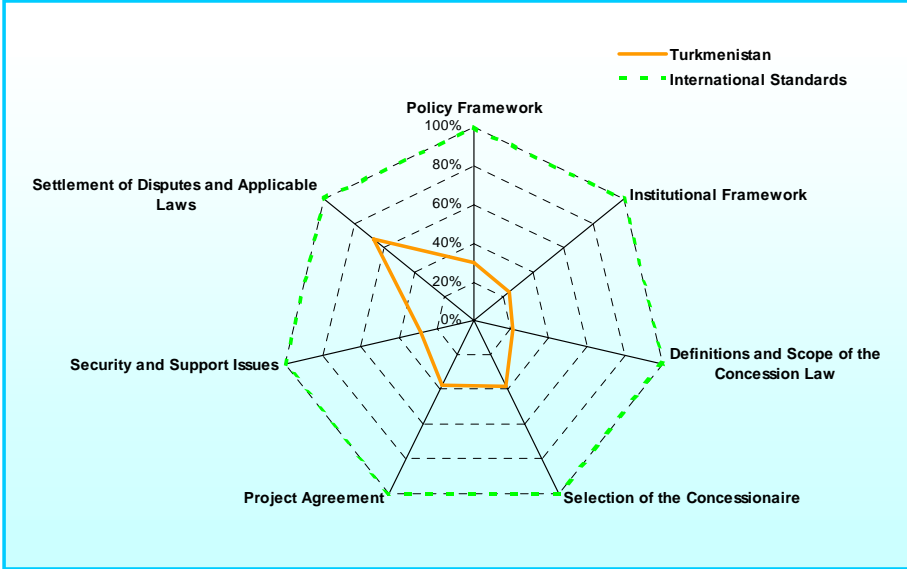
Notwithstanding these deficiencies, there are a number of positive elements. The FC Law declares that any amendments to the concession’s terms may only be exercised by mutual agreement and provides for compensation where the concession is terminated by the grantor. However, the rule is somewhat declarative and vague and does not provide for any mechanism for determining such compensation. Also worth mentioning as a positive feature is a general principle of government assistance in "achieving objectives" of concession agreements.

The FC Law, together with the recently enacted Hydrocarbon Resources Law, forms the basis for the government to grant concessions to several multinational energy companies to participate in the development of Turkmenistan's large oil and gas reserves through production sharing and joint venture agreements.

On balance, despite some positive components, the FC Law does not constitute a sufficiently solid legal basis for the development of Private Sector Participation (PSP) in infrastructure and utility services in Turkmenistan. There have been reports of plans to draft a new concessions act for Turkmenistan, but nothing of substance has appeared yet in this respect.

As can be seen from the graph below, the 2007/8 EBRD Assessment of Concessions Laws indicates that there is much room for improvement in all key elements of the regime of PSP in public infrastructure, works and services.

Quality of concession legislation – Turkmenistan (2007/8)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the ‘web’, the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2007/8

Insolvency

Bankruptcy and insolvency in Turkmenistan are governed by the Law on Bankruptcy of the Republic of Turkmenistan, 1993, as amended (the “Insolvency Law”). The Insolvency Law was assessed a 2006 EBRD Insolvency Sector Assessment and scored “very low compliance” when compared with international standards.

The Insolvency Law’s main deficiencies are to be found in the all-important substantive provisions of how insolvency proceedings are conducted, once they have been initiated. The weakest area is the regulation of treatment of estate assets. Specifically, there are no established duties of the debtor (its management, other connected parties) to deliver or make the assets available to the insolvency administrator or other ways to safeguard the assets. Nor are there any obligations established for the debtor to provide full information regarding the assets, liabilities or business affairs of the debtor, except for the latest financial statement. Further, the Insolvency Law merely states that the pre-bankruptcy transactions can be contested, failing to provide any clear criteria or detail of the elements of harmful transactions to be avoided or set aside. Treatment of secured creditors appears to be vague, with the Law providing for secured claims priority over other claims without describing the procedure or the person authorised to deal with the foreclosure of the collateral, This vagueness, coupled with other provisions on priority of claims and the insolvency administration procedure, makes the implementation of the provisions regarding secured creditors somewhat problematic.

It is generally accepted that a good insolvency law will facilitate, in a reasonable and balanced way, the re-organisation and rehabilitation of a debtor. Despite the range of available rehabilitation procedures that the Insolvency Law offers, the absence of drafting precision, and the lack of detail or comprehensiveness of procedures would likely make re-organisation

extremely difficult to implement. In addition, there is no interim form of stay of proceedings against a debtor between the initial filing of proceedings and their formal opening.

Overall, the Insolvency Law requires very little involvement by the general body of creditors and no supervision of the reorganisation plans or liquidation implementation. On the other hand many of the proceedings require strong involvement and continuous decision making by the court, which may considerably delay the insolvency proceedings. The Insolvency Law also seems to fall short in addressing terminal/liquidation proceedings. It is not clear from the Insolvency Law that, in cases where there are insufficient assets to cover the costs of liquidation, the estate would be properly wound up.

Another weakness of the Turkmenistan's insolvency regime is dire underdevelopment of the insolvency administrators' profession. There appear to be no clear rules on the qualification, education and experience that an insolvency administrator must hold before being appointed. Insolvency administrators are not subject to licensing or any type of supervision and there is no body responsible for their discipline. Similarly, there are no standards of professional or ethical conduct for the profession. Insolvency administrators are a very important link in efficient implementation of insolvency proceedings and lack of clear rules for the profession may lead to difficulties in maintaining a functional insolvency regime.

Secured Transactions

Security rights on movable and immovable assets in Turkmenistan are governed by the Civil Code of 1 December 1998 (arts 267-299, 325-329), enacted on 1 March 1999, and the Law on Pledge (Pledge Law) of 1 October 1993. The Pledge Law can only apply to the extent that it does not contradict the Civil Code. The Civil Code primarily covers security over immovable assets (mortgages), possessory pledge (i.e. when the debtor must transfer possession of the collateral to the creditor or a third party) and also the rules of enforcement. The Pledge Law provides more detailed provisions on non-possessory charges and envisages the establishment of a registration system through which non-possessory charges would be publicised. Despite attempts to create a modern system for secured transactions, the legal regime remains very limited in many respects. EBRD is not aware of recent attempts to modernise the legal framework, although the current developments of micro and SME lending (assisted by organisations such as the EBRD) may create momentum for such reform.

Current issues include the requirement that the collateral must be specifically identified in the charge agreement, together with its value and the location of the assets. When inventory is offered as collateral, changes in the composition is only allowed providing the assets' total value does not fall below the amount agreed in the charge agreement. This makes security over inventory impractical and, thus, of limited use.

Formalities of creation are complex and slightly confused. The law provides that the charge agreement must be in writing and subject to authentication and registration at a notary office. However, as implementing rules were lacking at first, notaries did not accept applications. A Presidential Decree issued in December 1997 introduced rules and fixed fees but these are considered to be prohibitively high. Furthermore, notarisation requires presentation of many documents and titles as well as the establishment of an inventory, and this is bound to make the process slow and subject to delays. After notarial authentication of the charge agreement, the agreement must be registered, depending on the type of charge. It was probably envisaged

that notaries could run a general registration system in parallel with specific asset-based registries. However, this system was never put in place.

Enforcement remains a challenging process for secured creditors. Enforcement can be initiated either by way of inscription of execution by public notary, or on the basis of court decision (judgement), followed by realisation by a court enforcement officer. In the first case, the chargeholder must submit the notarised charge agreement to a notary public who is authorised to execute an execution inscription on it, in order for realisation to proceed. A state duty of 2% of the claimed amount is charged for execution of the inscription of execution by a public notary. In the case of enforcement via court, the state charges a duty of 10% of secured debt. Whatever the chosen route, realisation may only be carried out by way of public auction at the State Commodity and Raw Materials Exchange of Turkmenistan. A remuneration of 5% of the recovered sum has to be paid to the enforcement officer. One of the problems faced in enforcement is the obstruction that the debtor could exercise - by challenging the inscription of execution executed by a public notary or even the judgement, in which case the court could decide to suspend the enforcement. This is common practice. On enforcement (whether or not the debtor is insolvent), the creditor will be satisfied after alimony claims and salary arrears, as well as tax claims. All this makes the recovery of the secured debt highly uncertain.

Turkmenistan has not followed the pace of reform that many neighbouring countries in central Asia have taken in the last decade, starting by Kazakhstan, the Kyrgyz Republic and also Russia. As a result, it is equipped with a very rudimentary legal framework for secured lending, which does not encourage sound banking practices.

Securities Markets

In Turkmenistan the basic legislation on the securities market is comprised of the Law on Securities and Stock Exchanges, dated 28 December 1993; the Regulation on Securities and Stock Exchanges, approved by the Presidential Decree No. 1576 dated 22 November 1993, which in turn underpin the Rules of Securities Issue and Registration, the Rules of Securities Transactions Conduct and Registration, and the Licensing Rules for Stock Exchange Activity at Securities Market, all approved by the Ministry of Economy and Finance on 24 December 1993.

The Law on Securities and Stock Exchanges sets uniform principles of securities issue and circulation, the general principles of stock exchanges and investment institutions operations and regulates the rights and obligations of securities market participants. The Regulation on Securities and Stock Exchanges was approved before the enactment of the Law on Securities and is practically identical to the Law on Securities. No amendments to securities and stock exchange legal framework have been made since established. The securities market regulator is the Ministry of Economy and Finance, which is competent for registration of securities, supervision on issuance and circulation of securities and regulation and supervision over the insurance activities. The Central Bank of Turkmenistan is competent for registration of securities issued by the commercial banks. There are no stock exchanges or collective investment schemes in the country and there is no active over-the-counter trading.

In 2007 EBRD benchmarked securities markets legislation in Turkmenistan against the “Objectives and Principles of Securities Regulation” published by IOSCO, finding the

national framework in “very low compliance” with international standards (see chart above).^{*} The assessment showed a framework in urgent need of reform in all elements examined, the only exception being “Accounting”, because of the 1996 Law “on Accounting in Turkmenistan”. In order to understand how securities market legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey asking practitioners in the region to comment on a hypothetical case study. The Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator.[†] Effectiveness of securities markets legislation is perceived as very low as the country lacks a functioning stock exchange and an IPO has yet to be launched. There is no disclosure practice based on prospectus and financial reporting is made in accordance with national standards, which are not compliant with international standards. The functions of the Ministry of Economy and Finance as securities markets regulator extends beyond mere supervision, with the Ministry empowered to enquire into the merits of an issue in certain cases. This form of control is too tight to allow a market to develop effectively.

Going forward, commencing constructive dialogue with the private sector and building up consensus for constructive reform, improving legislation in line with international standards, should be a priority action of the government.

Telecommunications

The Ministry of Communications (the ‘Ministry’) is the central authority in the communications sector in Turkmenistan, being regulator and operator, controlling eight State Enterprises in the post and communications sector. Law is made by the Cabinet of Ministers and the Deputy Chairman of the Cabinet of Ministers (Deputy Prime Minister) has overall responsibility for the sector. The President and the Cabinet of Ministers defines policy for the sector and the Ministry is tasked with its implementation. Under the 2000 Law on Communications, the Ministry provides proposals for the development of the sector and is the regulatory body that regulates the co-operation between operators. It also receives applications for, and issues, licences (under the “Law on Regulation of Licences”), carries out spectrum management (under “Law on Frequency Management”) and establishes tariffs caps for residential line rentals and local calls. The General Director of Turkmen Telecom reports to the Cabinet of Ministers, as does the Minister for Communications. Thus there is no real concept of separation of powers as understood under modern regulatory practices and political interference is inevitable under the vertical structure of Ministry, Regulator and State owned operator.

There is a tight system of control in the sector in Turkmenistan, right through from licence application to market operation. Each licence is for a fixed term of three years. There are currently understood to be 32 different types of licence in the sector, issued by the Ministry, though there appear to be efforts to revise the number of licences required to take account of new technologies and new services. There are no exclusive rights explicitly defined and where there is only one licence holder this is understood to be because no other operator has applied for a licence.

State-owned TurkmenTelecom runs fixed line services nationally, except in the capital, which is operated by another state company, Ashgabat City Network. Technically speaking anyone is supposedly allowed to offer Internet services provided they have a licence, but at present

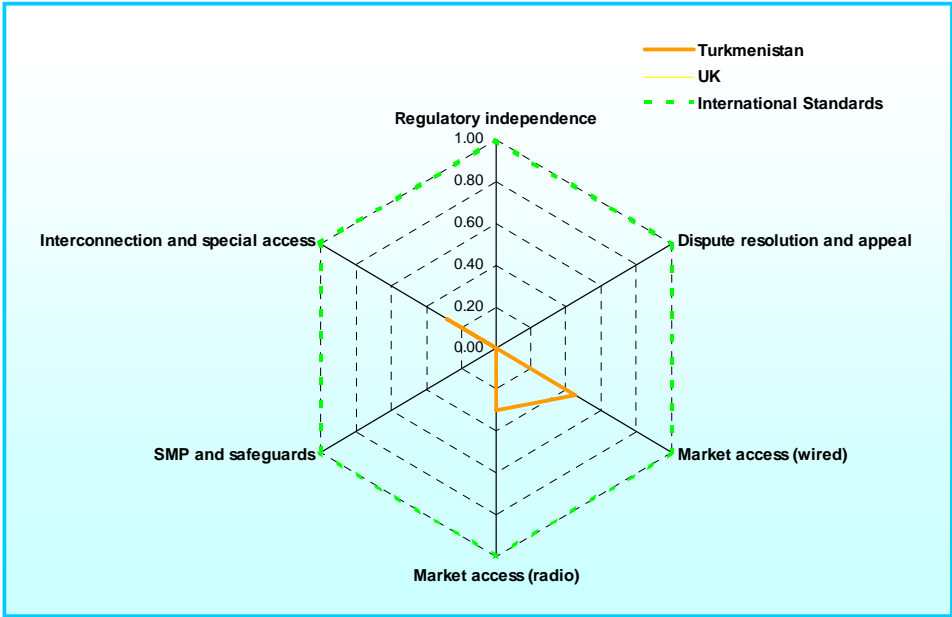
^{*} For more information see: <http://www.ebrd.com/country/sector/law/capital/assess/index.htm>

[†] For more information see: <http://www.ebrd.com/country/sector/law/capital/survey/index.htm>

there is only one licence holder, TurkmenTelecom. There are two mobile operators, Altyn Asyr (100% government controlled) is understood to have around 200,000 subscribers and MTS (100% privately owned) has just in excess of 1 million subscribers.

Tariffs are set by the operators themselves. However, before a licence is issued, the Ministry examines the tariff proposals, to see that certain tariffs are not exceeded. If a private operator wants to change retail tariffs or interconnection charges, they are understood to need to consult the Ministry. Tariff rebalancing has been discussed but not implemented.

Quality of telecommunications regulatory frameworks – Turkmenistan (2008)



Note: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications regulatory framework of the country approximates these standards.

Source: EBRD Telecommunications Regulatory Assessment, 2008

In a 2008 Communications Sector Assessment undertaken by EBRD, Turkmenistan was assessed as having “Low compliance” when measured against benchmarks of international best practice, scoring low in all categories assessed (see chart above).

Going forward significant legal, regulatory and institutional reform will be necessary in the sector for Turkmenistan to exploit the potential the sector has to benefit the economy and its citizens. The relative success of private operations in the mobile sector should encourage the government to grant a third mobile licence (to a private investor) and/or move the state-owned mobile operator towards privatisation or a strategic partnership. On both the fixed and wireless side, a firm strategy for the exploitation of broadband technology based on liberalisation should be developed and implemented without delay. Tariff rebalancing on the fixed side and general overhaul of the licensing regime is critical to opening up the sector to appropriate levels of investment and the government should make their implementation a priority.

ANNEX 5 ASSESSMENT OF INFRASTRUCTURE DEVELOPMENT

Transport Infrastructure

The transport sector in Turkmenistan is regulated and managed by separate line ministries which cover each transport sub-sector, including automobile transport, railways, aviation, and marine and river transport. Large investments in new construction and rehabilitation of the transport network and fleet modernization are provided by the state budget through the line ministries based on the procurement rules established in the Law of Tendering. The Government of Turkmenistan has developed and approved in 2008 the Country Development Strategy up to the year 2020 covering 15 sectors of the country's economy, out of which seven are in the infrastructure field. According to the Strategy, modernization of the transport operations and rehabilitation of the transport network and facilities should be fully completed during the period out of the funds provided from the state budget. Currently, the government is devoting huge financial resources for rehabilitation of the road and railway networks, including construction of new road and railway bridges over Amudarya River, modernization of the aviation fleet and railway rolling stock, as well as construction of new cargo and passenger terminals in several of the country's airports, and the port of Turkmenbashi.

The only part of the transport system where more or less commercially oriented principles have been introduced (in particular for foreign companies) is for those the facilities that play an important role on the regional level, such as new North-South railway link connecting Kazakhstan, Turkmenistan and Iran, which totals more than 900 km, and in the port of Turkmenbashi where modernization will promote the integration of Turkmenistan into the region by opening new trade routes to Russia, Kazakhstan and Azerbaijan. According to the Ministry of Economy and Development, there is a USD 1 billion investment program approved by the government for rehabilitation of infrastructure, mainly transport network, airport and sea port, of the City of Turkmenbashi, including a new seaside resort "Avaza" development. Information provided by the Ministry of Railways showed that the Government is ready to consider possibilities for external financing by the IFIs of the North-South railway project, taking account of the fact that the longest section of this railway - about 700km - lies within Turkmenistan, and considering also the project is due to be completed by the end of 2011. The ADB is currently discussing a possible financing of part of this project with the Government.

At the moment, very low domestic tariffs for services represents a key challenge in the sector that prevents its transition to commercial operations. Solutions to this problem will need to be worked out in coordination with other IFIs active in the sector, such as ADB and JICA, and will require institutional reforms which promote commercialization of transport operations. The scope for such reforms will be a key factor determining the selection of regional transport infrastructure projects suitable for Bank financing.

Municipal and Environmental Infrastructure

Development of the municipal and environmental infrastructure is included into the Country Development Strategy during 2008-2020 to be financed out of the state budget funds. There is sufficient amount of funds in the annual budget allocated for each administrative units of the country, in total five provinces, and all the funds managed through the province and city administrations. The new equipment modernization program suppose to replace all deteriorated equipment; for instance the City of Mary with the population of about 120 000

inhabitants only during this year received more than 70 units of new municipal service machinery for water supply utility, solid waste management and cleaning equipment. In addition to the communal service utilities, the administrations, in order to accomplish the Strategy in time, create new construction enterprises with all necessary facilities and assets through which the development program is to be implemented. For example, the Province of Mary, has established three new construction companies with the aim to rehabilitate the water supply infrastructure during the strategy period. The companies are equipped with the necessary machinery and have quite ambitious program to replace about 600km of water network a year all over the province, however lack of institutional capacity of the newly created companies prevents them to accomplish the targets in time and in a proper quality.

Institutional reforms and tariff restructuring towards cost recovery levels, at least for industrial entities, are unlikely to take place in a short-term prospective, based on the Decree of the former president valid until 2030. According to the water company management of Mary, out of three groups of consumers: individuals, budgetary organizations and industries, the only tariffs for the last group cover the cost recovery level and it is only 8% of the totals number of water users in the city. However even in this case, it is very difficult to calculate a real cost of unit produced as there are no meters installed, therefore the level of technical losses is very high.

It is one of the most challenging sectors for the Bank's involvement at this stage and a dialogue with the central government should be facilitated, to strengthen the institutional capacity of the municipal entities and the relevant governmental agencies responsible for the sector. This should lead to improvement of their financial and operational performance through introduction of new tariffs methodology and decentralization of management responsibilities, at least at the level of small pilot project.

Power and Energy

Ministry of Energy and Industry of Turkmenistan is a policy maker and regulator in the electricity sector responsible for generation, transmission and distribution of electric power in the country and its export abroad. In its turn, the state owned concern (group of companies) "TurkmenEnergo" manages financial and operational activities of the sector enterprises including the enterprises not directly involved in power production, such as construction and service companies in power sector, several cement production plants and even pulp and paper plant, in total there are 11 enterprises.

Increase of power generation and transmission capacity is one of the priority investment programs for the government. With this regard, there are three new thermal power stations are currently under construction, each 254MW in nominal capacity located nearby the capital Ashgabat, at the seaside resort Avaza and in Balkanabad Province for industrial development of the region in future. In addition, modernization and construction of high voltage transmission lines for 220kV and 500kV is going on around Ashgabat and the areas having potential access to neighbouring foreign markets. The foreign companies, mainly from Turkey and Iran, have also indicated their interest in investing in power sector on BOT basis (build-operate-transfer) for potential export of power to their countries and further. The arrangement require conclusion of concessional agreement between the state and the investor and the government has been considering the issue seriously. The existing electricity export markets for Turkmenistan are Iran, Turkey, Tajikistan and Afghanistan and negotiations for supply to Armenia are currently going on between the two states.

Another area of consideration by the state is development of alternative sources of energy, such as wind and solar power. There are a few pilot projects proposed by leading western companies on construction of solar power plant of up to 10MW nominal capacity in average and wind power plant on Caspian Sea shore. The necessary studies are going on and, taking into account huge natural gas reserves in the country, it is not yet clear if the concept on alternative energy will be accepted by the government or not.

The tariff policy could remain unchanged, due to the decree of the former president which establishes a maximum limit of up to 35kWh per person per month for free and the rest should be paid, however the price is much below the cost recovery level. There are currently two groups of electricity consumers with different tariffs: individual and others including budgetary organization and state and private enterprises and both tariffs are heavily subsidised by the state budget. The tariff policy is regulated and established by the Ministry of Finance and to be approved by the Cabinet of Ministers. Despite the fact that financial management is under tight control by the Ministry, the accounts of power generation, transmission and distribution enterprises are separated and they regularly prepare a balance of sold and purchased power in nominal prices in their financial reports, however there is no any transfer of real money takes place between the companies.

ANNEX 6 BANK COMMITMENTS AND NET PORTFOLIO

by Sector (as at 30 September 2009)

Sector Name	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO		
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
Financial Institutions	10	16.9	10.1	60	5.9	1	0.7	3
<i>Bank lending</i>	<i>1</i>	<i>5.9</i>	<i>5.9</i>	<i>100</i>	<i>5.9</i>	<i>0</i>	<i>0</i>	<i>0</i>
<i>Equity Funds</i>	<i>9</i>	<i>11</i>	<i>4.2</i>	<i>38</i>	<i>0</i>	<i>1</i>	<i>0.7</i>	<i>3</i>
Infrastructure	1	32.2	20.5	64	20.5	1	6.5	25
<i>Transport</i>	<i>1</i>	<i>32.2</i>	<i>20.5</i>	<i>64</i>	<i>20.5</i>	<i>1</i>	<i>6.5</i>	<i>25</i>
Energy	1	355.8	41.1	12	41.1	1	0.3	1
<i>Natural Resources</i>	<i>1</i>	<i>355.8</i>	<i>41.1</i>	<i>12</i>	<i>41.1</i>	<i>1</i>	<i>0.3</i>	<i>1</i>
Corporate	6	115.3	35.7	31	35.7	2	19	72
<i>Telecoms, Informatics & Media</i>	<i>1</i>	<i>30</i>	<i>9.2</i>	<i>31</i>	<i>0</i>	<i>1</i>	<i>9.2</i>	<i>35</i>
<i>General Industry</i>	<i>5</i>	<i>85.3</i>	<i>35.7</i>	<i>42</i>	<i>35.7</i>	<i>1</i>	<i>9.8</i>	<i>37</i>
Country Total	18	520.2	107.4	21	103.2	5	26.5	100

by Portfolio Class and Investment Type (as at 30 September 2009)

Class and Investment Type	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO		
	No. of Projects**	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
Private	18	488	96.2	19	82.7	4	20.1	75
Public	1	32.2	20.5	63	20.5	1	6.5	25
Country Total	19	520.2	116.7	22	103.2	5	26.5	100
Non-Sovereign	17	482.1	90.3	18	76.8	4	20.1	75
Sovereign	2	38.1	26.4	69	26.4	1	6.5	25
Country Total	19	520.2	116.7	22	103.2	5	26.5	100
Debt	9	476.8	98.3	20	87.3	3	16.2	61
Equity	10	43.4	19.9	45	15.9	2	10.4	39
Country Total	19	520.2	116.7	22	103.2	5	26.5	100

* One project has both debt and equity making it difficult to split the total project cost.

Project Pipeline (in EUR million) (as at 30 September 2009)*

	Number of Transactions	EBRD Finance (EUR M)	% of Grand Total (Number of Transactions)
Enterprise Sector			
<i>Agribusiness</i>	7	14.2	58%
<i>General Industry</i>	2	3	17%
<i>Total</i>	9	17.2	75%
Financial Institutions			
<i>Bank Debt</i>	2	3.4	17%
<i>Small Business Finance</i>	1	5.7	8%
<i>Total</i>	3	9.1	25%
Grand Total	12	17.6	100%

* Projects having passed concept review or equivalent approval stage plus exploratory projects as of the end of September 2009. This pipeline reflects only the current picture of the projects in process and does not purport to represent the entire set of projects which the bank will be working on over the next strategy period.

The TAM/BAS Programme supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises in the EBRD countries of operation

11.1. TAM/BAS in Turkmenistan

Previous TAM experience

TAM supports the introduction of international best practice in small and medium sized enterprises with the potential of becoming future leaders in their market through the introduction of international advisors from developed countries with 15-20 years of professional experience in the relevant sector. TAM projects typically last around 18 months. The Programme also carries out seminars and training activities promoting international best practices by disseminating successful case-studies to entrepreneurs.

TAM began operations in Turkmenistan in 2008 and has currently 5 ongoing projects and 1 completed market development activity. Two of the projects are in food manufacturing, one more in bottle manufacturing, one in miscellaneous manufacturing and one in the real estate sector. TAM is working with enterprises of varying size, but especially with medium-sized enterprises, many with a large turnover. The start of the TAM activity has been concentrated on urban areas, with 4 projects in the capital Ashgabat and one in Tejen. TAM has been screening additional enterprises to create a pipeline of candidates for future TAM projects, depending on donor funding.

As to date, TAM has secured €0.4 million in donor funding. The largest amount came from the the EBRD Special Shareholders Fund and the cost of €75 thousands for a project in Altyn Aylag were funded by Ireland.

Previous BAS experience

BAS acts as a facilitator for the use of local, private-sector consultants by MSMEs to obtain a diverse array of services. BAS works on the demand and the supply side. By assisting individual enterprises to engage with local consultants on narrowly-based, specific projects with a rapid payback, it stimulates demand and the understanding of the potential benefits of using external consultants. It also directly increases the supply and quality of local advisory services, through targeted market development activities. BAS supported projects typically last around four months.

BAS is not currently operating in Turkmenistan, however, depending on funding availability, BAS is planning to carry out a feasibility study in early 2010. This study will assess the feasibility and potential impact of BAS in Turkmenistan and determine whether the BAS model is applicable to Turkmenistan and, if so, how its implementation should be conducted using the experience of the BAS Program in other countries, to effectively assist the development of SMEs throughout the country.

Linkages with banking

To date, 2 TAM assisted companies in Georgia have attracted investments from the EBRD or EBRD related financial intermediaries mobilising a total project value of €15 million. Additional two companies are in the pipeline and might get investments in 2010.

11.2. MSME and Consulting sector in Turkmenistan

Shrinking MSME sector in a challenging environment

Turkmenistan is largely dependent on natural resources and the MSME sector is underdeveloped. Unfortunately, data is scarce so that it is impossible to further quantify the real situation. The rule of law is not well established, and government effectiveness and regulatory quality fall well below the average for transition countries. The judiciary is not independent as judges are appointed and removed by the president.

Corruption is difficult to measure and there are country specific research difficulties in Turkmenistan. However, expert assessments and the Transparency International Corruption Perceptions Index for 2008 suggest that corruption is a very serious problem. Turkmenistan ranks near the bottom of the CPI amongst 180 countries and is among the lowest ranked transition countries (together with Kyrgyz Republic and Uzbekistan).

Export-oriented business has benefited from the introduction of full convertibility of the local currency Manat. However, regional and international trade is hampered by the lack of facilitating trade agreements with Tajikistan and Uzbekistan. Difficulties businesses face in obtaining leasehold and freehold property rights are also an impediment to growth.

Access to credit for MSMEs is very poor. International financial institutions and NGOs aim at providing finance through the development of commercially based micro-finance, but programmes are mostly targeted at rural development and/or specific societal groups such as disabled persons or women. The government is currently drafting a law on micro-finance. The financial sector is dominated by 9 state-owned banks. Only 2 private banks operate in Turkmenistan, one of which is Turkish.

Strong need for TAM/BAS

MSMEs are in strong need of basic business skills including organisational planning, as well as advice on exports, imports, marketing and sales. Demand for consultancy services exists especially in MSMEs specialised in services, but the market is still in its infancy and the supply structure is not developed. Business support services are heavily reliant on international donors and mostly oriented towards large corporations and foreign investors.

The Small and Medium Enterprise Development Agency in Ashgabat, a joint-venture between the European Union and the Turkmen government, provides business support services and advice. However it is targeted at foreign companies interested in setting up their business in Turkmenistan. The donor community aims at imparting business knowledge, skills and information beyond the capital and strengthening MSME support institutions such as local associations and the private sector. Business consulting and trade advisory services are difficult to implement as restrictive business licensing requirements (including licensing renewal) negatively affect companies and lead to uneven growth in sales and productivity.

International donor programmes

Several international donors are present in Turkmenistan, however, few have programmes targeting MSME development. The UNDP's project "Business Opportunities for Rural Women" aims to increase self-employment opportunities for rural women in the Dashoguz and Mary provinces of Turkmenistan (mainly through business training and micro-grants).

Turkmenistan became a member of the ADB in August 2000 but, as of end-2008, it has yet to receive country programme funding as consultations are still ongoing on development priorities, and the ADB's potential role in programmes and projects.

The EU TACIS program, aimed at building a sustainable post-oil and gas economy, is winding down operations, and will cease its involvement in Turkmenistan in 2012. More broadly, the EU has a bilateral 2011-13 program looking at capacity building, SMEs and rural development.

Generally, Turkmenistan tends to be included in regional rather than specific national donor programmes, both because it ranks higher than regional peers in terms of average wealth and because of the government's uncertain commitment to international development assistance. However, the average per capita income is inflated by the country's natural resource wealth, and does not reflect the real situation of the majority of the population.

11.3. TAM/BAS continuation in Turkmenistan

Continuation of TAM

Interviewed stakeholders find strong evidence for TAM/BAS to expand operations in the 2009/2011 period. The Turkmen economy is still largely focussed on extractive industries, depending heavily on the income generated by exports of its natural resources. Unconfirmed data indicate that only 28% of the non-oil and gas economy is from the private sector, which leaves a large scope for TAM/BAS to support SME development.

TAM/BAS will attempt to focus in particular on infrastructure, IT, natural resources and energy efficiency projects. If trade agreements in the region and with the EU are reached, there is additional scope for the development of the cotton and textile sector and projects which support this.

Setting up of BAS

The general need for MSME advisory service is strong and for certain segments of the economy the demand already exists, but the consulting service supply is in the earliest stages of development and cannot meet that demand.

A consultancy training event undertaken by TAM/BAS in Ashgabat in 2009 demonstrated that there is a role for BAS to play in facilitating the development of a sustainable infrastructure of business advisory services. Subject to a successful feasibility study in 2010, BAS plans to initiate operations in Turkmenistan.

TAM focus on cross-cutting issues

In order to address cross-cutting issues that are pertinent to Turkmenistan's MSME sector's development, the TAM Programme will promote measures to increase energy efficiency in production and reduce environmental pollution. The viability of energy efficiency projects will however be dependant on whether the government takes action to reduce subsidies on energy inputs. TAM will also devote efforts to supporting women entrepreneurs and encouraging women's access to middle management and executive positions through targeted initiatives.

Contribution to policy dialogue

By thoroughly analysing the business environment and clearly identifying the challenges faced by the MSME sector, TAM/BAS further strengthens the EBRD's policy dialogue toolkit. Future challenges for the government (among others) identified as to foster the MSME sector through improving the educational system and human capital formation as well as supporting institutions, improving law enforcement reduce administrative corruption. As mentioned in cross-cutting issues, steps to reduce energy subsidies are also needed if energy efficiency is to become economically viable.

ANNEX 8

SUMMARY OF TC PROJECTS

A. Committed Projects to September 30 2009

Commitment Name	Euro Committed	Euro Disbursed	Approval Date	Status	Sector	Fund
Austrian Development Bank DIF/DLF Framework	250,000	0	28/09/2009	Committed	Varoious, Manufacturing	Austrian Development Bank
MSME Bank of Turkmenistan - Feasibility Study and Business Plan	148,225	0	11/09/2009	Committed	Finance, Business	US SME Finance Facility
Task 7 Review of Turkmenistan Agricultural Sector. Current situation and Potential Investment Opportunities	74,751	0	19/06/2009	Committed	Community/Social Services	Shareholder Special Fund
Credit Advisors Programme	400,000	0	22/05/2009	Committed	Finance, Business	Japan
DIF - SSF Allocation	60,000	27,909	21/04/2009	Disbursing	Manufacturing	Shareholder Special Fund
TAM - Toprak	75,000	7,319	17/04/2009	Committed	Manufacturing	Shareholder Special Fund
TAM - Market Development Activities	22,496	19,765	09/04/2009	Disbursing	Manufacturing	Shareholder Special Fund
TAM - AK TAM	75,000	23,153	18/03/2009	Committed	Manufacturing	Shareholder Special Fund
DLF - SSF Allocation for Turkmenistan	48,110	0	23/02/2009	Committed	Community/Social Services	Shareholder Special Fund
TAM - Hasar	75,000	28,805	22/12/2008	Committed	Manufacturing	Shareholder Special Fund
TAM - Bereketli	75,000	23,423	22/12/2008	Disbursing	Manufacturing	Shareholder Special Fund
Turkmenistan: Assistance with Business Plan for a new SME Bank	35,940	27,453	07/08/2008	Disbursing	Finance, Business	Switzerland
Turkmenistan: IFRS Restatement and Audit of Accounts	155,450	134,399	07/08/2008	Disbursing	Finance, Business	Switzerland
DIF - SSF Allocation for Turkmenistan	91,890	71,241	30/07/2008	Disbursing	Community/Social Services	Shareholder Special Fund
TAM - Aktyn Aylag	74,440	19,065	18/03/2008	Disbursing	Manufacturing	Ireland
Turkmenistan: Banking Sector Training Initiative	44,921	44,921	07/07/2006	Closed	Finance, Business	EU
Turkmenistan: Advance Trade Finance Training for Local Banks	14,531	14,531	28/06/2005	Closed	Finance, Business	Switzerland
TMS Wool Constructuion Supervisor 2	7,346	7,346	27/05/2005	Closed	Finance, Business	Italy
TMS Wool Swiss Legal Due Diligence	37,400	37,400	11/04/2005	Closed	Finance, Business	Switzerland
TMS Wool Turkmen Legal Due Diligence	6,050	6,050	11/04/2005	Closed	Finance, Business	Switzerland
Trade Facilitation Programme: Turkmenistan - Basic training for local banks	11,864	11,864	26/02/2004	Closed	Finance, Business	Switzerland
Turkmenistan - Local Credit Advisers new programme	52,636	52,636	20/10/2003	Closed	Finance, Business	Switzerland
TMS Wool Swiss Legal 3c	7,831	7,831	28/08/2003	Closed	Finance, Business	Switzerland

Commitment Name	Euro Committed	Euro Disbursed	Approval Date	Status	Sector	Fund
TMS Wool Swiss Legal 3 Additional	9,564	9,564	23/07/2003	Closed	Finance, Business	Switzerland
TMS Wool Construction Supervisor Assignment	49,990	49,990	27/05/2003	Closed	Finance, Business	Italy
TMS Wool - Local Legal Due Diligence	14,650	14,650	18/03/2003	Closed	Finance, Business	Switzerland
TMS Wool Swiss Legal Due Diligence	27,666	27,666	12/03/2003	Closed	Finance, Business	Switzerland
TMS Wool Scouring Additional Swiss Legal Due Diligence	2,033	2,033	21/03/2002	Closed	Finance, Business	Switzerland
Management Assistance to Turkmen Sea Administration	262,703	262,703	26/11/2001	Closed	Transport, Storage	EU
Turkmenistan Local Credit Advisors	39,546	39,546	11/10/2001	Closed	Finance, Business	Turkmenistan Financial Sector Fund
TMS Wool Swiss Legal Due Diligence	28,127	28,127	18/09/2001	Closed	Manufacturing	Switzerland
GAP Turkmen	36,610	36,610	19/09/2000	Closed	Manufacturing	Switzerland
Turkmenistan Credit Advisors Program: Extension	493,714	493,714	20/03/2000	Closed	Finance, Business	Japan
Institutional capacity building for oil spill preparedness	86,431	86,431	06/10/1999	Closed	Extractive Industries	Japan
Oil and gas field services sector development	392,074	392,074	04/08/1999	Closed	Extractive Industries	Japan
Management Assistance to Turkmen Sea Administration	651,326	651,326	02/11/1998	Closed	Transport, Storage	EU
Turkmenistan SME Credit Advisors Program	1,322,466	1,322,466	01/09/1998	Closed	Finance, Business	Japan
Turkmenbashi Port development project - project implementation unit	571,775	571,775	20/07/1998	Closed	Transport, Storage	EU
Development of Turkmen Sea Administration's financial Management Information System	402,090	402,090	05/12/1997	Closed	Transport, Storage	Japan
Commercialisation of Turkmenautoellari and assistance with project implementation	496,454	496,454	12/09/1997	Closed	Construction	EU
Consultancy services for detailed engineering design and procurement assistance for a dry cargo terminal	598,975	598,975	13/05/1997	Closed	Transport, Storage	EU
Digital overlay network	53,866	53,866	30/04/1997	Closed	Telecommunications	UK
Review of tax and foreign investment related legislation	13,233	13,233	21/01/1997	Closed	Community/Social Services	UK
Review of tax and foreign investment legislation	29,407	29,407	13/01/1997	Closed	Community/Social Services	TC Special Fund
Preparation of road improvement project	395,810	395,810	08/10/1996	Closed	Construction	EU
Digital overlay	183,307	183,307	18/03/1996	Closed	Telecommunications	USTDA
Feasibility study for Turkmenbashi port development	407,609	407,609	01/07/1995	Closed	Transport, Storage	USTDA

Commitment Name	Euro Committed	Euro Disbursed	Approval Date	Status	Sector	Fund
Export oriented line of credit - Central Bank and participating banks/Institutional Development	988,086	988,086	22/06/1995	Closed	Finance, Business	EU
Road rehabilitation study	53,050	53,050	08/06/1995	Closed	Construction	France
Administration and financing of road improvement	153,728	153,728	21/12/1994	Closed	Construction	EU
Business Advisory Services - export oriented line of credit	393,499	393,499	09/12/1994	Closed	Manufacturing	EU
Export-oriented line of credit - project preparation	45,868	45,868	16/09/1994	Closed	Finance, Business	Spain
Export oriented line of credit - institution building	196,000	196,000	01/08/1994	Closed	Finance, Business	Japan
Grain and inputs industry - feasibility study	98,524	98,524	01/04/1994	Closed	Manufacturing	Portugal
Bank Restructuring and SME Development	192,898	192,898	01/12/1993	Closed	Finance, Business	Japan
Gas Sector Development Strategy	111,574	111,574	01/10/1993	Closed	Energy	Taipei China
Gas Sector Development Strategy	74,569	74,569	27/08/1993	Closed	Energy	Turkey
Country Total Euro Amount:	10,721,102	9,442,331				
No of Commitments:	57					

C. Technical Cooperation Project Pipeline

Project Title	Project Description	Amount (€)	Assignments start	Status/Funding
Accountancy Training and Audit Programme	1. Accountancy training for CFOs 2. IFRS audit and 3. further training for the introduction of IFRS standards for up to 8 Turkmen enterprises.	200,000	January 2010	Early stage discussions with bilateral donors
Capacity Building in the FI Sector and Turkmen Central Bank	Training of Central Bank staff and PBs in risks management, corporate governance, efficient bank structure, efficient regulatory structure for the sector, strategy development for the sector, and may include a plan for a credit union in conjunction with LTP	300,000	Q2 2010	Dependent on SME Credit lines proceeding
Trade Facilitation Programme Training	Training of partner banks, existing and potential issuing banks in trade finance instruments supported by EBRD's Trade Facilitation Programme	200,000	Q1 2010	ETC Fund*
Feasibility Study for Turkmen BAS Programme	Market study and consulting skills audit of potential Turkmen BAS consultants. Business Plan for BAS Office	35,000	Q1 2010	Funding being sought from existing SSF allocation for TAM BAS
TAM Programme Turkmenistan	Continuation of TAM Programme support for 10 enterprises.	770,000	Q2 2010	Co-financing ETCF* and SSF
Legal Transition Programme for Turkmenistan	LTT assignment (to be decided but may be secured transactions, telecoms regulatory)	250,000	Q4 2010	Exploratory discussions ongoing with the central bank, telecoms and justice ministries. Funding from ETCF*/SSF

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* For eligibility of Turkmenistan for ETC Multi-donor Fund see section 5

ANNEX 9 BILATERAL ASSISTANCE

Germany

Germany and Turkmenistan have enjoyed extremely friendly relations, which have grown out of the longstanding links between Turkmenistan and the former German Democratic Republic (GDR). The development co-operation that currently exists with Turkmenistan began in 1991, following the country's political and economic transformation.

Deutsche Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation) or GTZ mainly operates on behalf on the Federal Ministry for Economic Cooperation and Development. GTZ activities are mostly focused on regional and bilateral projects and programs in Turkmenistan including: “Capacity Building and On-the-Ground Investments for Sustainable Land Management; “Sustainable Forestry Management in Turkmenistan”; Trans-boundary Water Management in Central Asia; “Supporting Legal and Judicial Reforms in Central Asia”; Advanced Training of Specialists for the Agrarian Sector in Central Asia; Supporting National Secretariat of CACILM; Preparation phase for the regional program supporting basic education in Central Asia Countries with focus on 3 countries: Kyrgyzstan, Tajikistan, Turkmenistan. In total GTZ has committed over € 4.5 million to projects in Turkmenistan.

Japan

The Japan International Cooperation Agency (JICA) has been operating in Turkmenistan since 1997. JICA provides support for policy and human resources development to assist in the process of transition to a market economy. Technical assistance totals €3.5 m, capital grants €4.6m. Grant assistance has been concentrated on the following projects:

- Medical re-equipment programme (1997, €4 mln);
- Sport equipment for the Turkmen State Olympic Committee (2001, €0.34 mln);
- Audiovisual equipment for the National Library of Turkmenistan (2004, €0.14 mln).

In December 1997, Japanese Bank for International Cooperation (JBIC) concluded a loan agreement in the amount of €33 mln for the Railway Transportation Modernization Project, which aimed to rehabilitate a diesel locomotive repair facility in the capital, Ashgabad. In 2005 JBIC provided three loans totalling € 344 mln for Turkmenistan Bank for Foreign Economic Affairs for the textile industry (a cotton processing plant project) and business related to natural gas projects. JBIC is currently discussing projects with the Turkmen government in the chemicals and transport sectors.

Switzerland:

Although not directly engaged in Turkmenistan, SECO, the Swiss donor agency agreed to finance a small IMF project following a request by the Turkmen Authorities in 2008. The programme focuses on strengthening Anti Money Laundering (AML) and Combating the Financing of Terrorism (CFT) procedures. The programme is aimed at reviewing the existing AML/CFT legal framework; assisting the authorities in the drafting of an AML/CFT law and training of the financial institutions who will be subject to the AML/CFT requirements. The programme will enhance the supervisory institutional framework, particularly the CBT and its banking supervision department, by strengthening the monitoring and inspection skills of its staff.

USA

Cumulative U.S. aid budgeted for Turkmenistan in FY1992-FY2007 was \$285.6 million, making it by far the largest bilateral donor to Turkmenistan. Turkmenistan's lack of progress in economic and political reforms under its late president was cited by successive US Administrations as a reason why only limited U.S. aid was provided (compared with other Central Asian states). Budgeted aid for FY2008 was \$7.2 million, estimated aid for FY2009 was \$8.9 million, and the Administration requested \$16.65 million for FY2010 .

The U.S. Agency for International Development (USAID) plays a lead role in providing bilateral development assistance to Turkmenistan. The program emphasizes one major theme: sustainable, private sector-led economic growth and more effective and accountable governance. Total USAID assistance to Turkmenistan from 1992 through 2009 was about \$80 million in programs that help improve social services, expand access to information, and increase the development of market and agriculture.

Economic Reform to Enhance Competitiveness Program (EREC Programme) is a regional project implemented in Turkmenistan since 2008. The project assists with strategic planning for economic growth and development of competitive private sector and builds institutional capacity for oversight for public spending; supports implementation of the Certified International Professional Accountant program, which is based on International Financial Reporting Standards, and builds local capacity to meet the technical and professional standards of the accounting profession; helps the banking sector expand the use of International Financial Reporting Standards; facilitates integration of international accounting program into curricula of the country's higher educational institutions.

Junior Achievement Programme (2009-2011) increases access to economics and business education for young people through student-oriented activities, contests and alumni networking.

Phase Two of the Regional Energy Markets Assistance Program (REMAP-II) will work to create an institutionalized, rules-based, liquid and competitive electricity trading regime among Central Asian countries. REMAP-II will provide technical assistance to strengthen the operations of the Regional Transmission System Operator (CDC Energia), develop and implement mechanisms for establishing the economic value of water-regulating services related to flood control and irrigation in support of hydroelectricity generation investment, and support increased and more reliable supply of electricity available for export to South Asia.

USAID also supports the development of civil society at the community level through training, technical assistance, and access to legal information. Specialists from various sectors also receive training in the United States in their areas of expertise.

Of the 70 current Peace Corps volunteers in Turkmenistan half are involved in the TEFL program and the remainder are working with the Health Ministry on Health Education issues.

United Kingdom

UK's technical assistance in Turkmenistan is focused on the following areas: democracy building; civil society and the rule of law.

Currently the UK DFID has no activities in Turkmenistan. However, Bilateral Project Programmes devolve funds from the FCO in London to the Ashgabat Embassy and gives the capacity to respond locally to opportunities to support activities directly connected with the UK's international priorities.

The Human Rights and Democracy programme is part of the Strategic Programme Fund (SPF). By focussing one strand wholly on Human Rights and Democracy, the FCO expects to bring a more strategic and effective approach to its Human Rights project work. The Embassy also implements a media development programme along with the BBC and national print journalist training their Turkmen counterparts.

The cooperation between the UK FCO has launched a new programme to promote a move to Low Carbon, High Growth global economy. The UK government is also working with the Turkmen authorities on draft energy efficiency legislation.