

CHAPTER III

THE TRANSITION FROM ECONOMIC SOCIALISM TO ECONOMIC LIBERALISM

Turkmenistan won its independence almost deliberately when Uni Soviet Social Republic (USSR)'s power collapse. As a part of USSR, the impact of the collapse also infected to Turkmenistan and other Commonwealth of Independent States of Russian, namely Kazakhstan, Uzbekistan, Tajikistan and Azerbaijan. They were poorly prepared for unexpected and sudden independence both economically and politically.

As a new independence state, Turkmenistan government faced a several problems inside the state. As a consequence of having independence from USSR's collapse, at that time, they had a weak government, they had lack of state system to determine the problems and the mentality during USSR also still influence the current government. Thus, they needed a strong role of government to bring them surpass the crises that they had.

A. Economic Socialist During Saparmurat Niyazov's Regime

The Supreme Soviet declared Turkmenistan independent and appointed Saparmurat Niyazov as the country's first president on October 27, 1991. After reaching independence Turkmenistan was confronted with numerous problems. Most importantly the natural gas deliveries to former Soviet Republics had to be discontinued step by step due to payment difficulties on the buyer side. The consequences for Turkmenistan were

income source and led to a negative growth of the gross domestic product. The lack of foreign currency resulting from the drastically reduce natural gas exports. Termination of the planned economy and market-led consumer prices led to hyper-inflation and put the newly introduced national currency under massive pressure.⁴⁵

On June 21, 1992, he was elected as the country's first popularly elected president, and he was the only candidate. A year later, he declared himself as "Turkmenbasy," or "Leader of all Turkmen." He ruled Turkmenistan from 1985, when he became head of the Communist Party of the Turkmen SSR, until his death in 2006.⁴⁶

He promoted a policy of strict neutrality in foreign affairs and the full independence of Turkmenistan was recognised by a United Nation General Assembly resolution "The permanent neutrality of Turkmenistan" on December 12, 1995. As a result in 2005, Turkmenistan would downgrade its links with the Commonwealth of Independent States (CIS) becoming only an associate member under article 8 of the CIS charter, as such it would not participate in any of the military structures of the CIS.

Approximately 90% of Turkmen population follows the Islamic religion. During the USSR era, public worship was not allowed because secularisation was their ideology. In the course to revitalizing Islam, the Turkmen government has erected numerous new mosques all over the country. All religious facilities are under strict observation by the

⁴⁵ Heiko Schmid, Joachim Langbein, *Turkmenistan-Nation Building and Economic Development Since Independent*. retrieved on Mei 9. 2013 at <http://www2.geog.uni->

government and its become important factor in forming a cultural identity and in building the nation. "Ruhmana" is a book written by President Niyazov that focuses on spiritual words of wisdom and quotes from Al-Quran and serves as an important means of references in the process of building a national identity.⁴⁷

In USSR era, Turkmenistan's economic policies still differ very little from those of the Former Soviet Union. While the Central Asian countries in general retained relatively more state control over the economy compared to the other CIS countries, the extent of the Presidential control in Turkmenistan is no doubt the largest in the post-Soviet space. In what follows we discuss the key elements of Turkmen economic policies along with their implications for the observed growth patterns. Turkmenistan retained wage controls, price regulations and the system of state procurement from the Soviet period. The Turkmen population is provided with free gas, water, salt and energy with very generous usage limits and a highly subsidized pricing beyond those. All wages in the republic are effectively pegged to the centrally fixed wages in the State sector through the system of excess wage taxes.⁴⁸ In principle, private firms are free to set wages at will.

Turkmenistan economy retains many of the legacies of the Soviet-type command economy. Nominal wages and prices are tightly controlled

⁴⁷ Heiko Schmid, Joachim Langbein, *Turkmenistan-Nation Building and Economic Development Since Independent*, retrieved on April 23, 2013 at <http://www2.geog.uni-heidelberg.de/anthropo/mitarbeiter/schmid/pdf/turkmenistan.pdf>

⁴⁸ Alexandre Repkine, *Turkmenistan Economic Autocracy and the Recent Growth Performance*, retrieved on April 24, 2013 at http://psychologie.dev.czu.cz/stred-asie/html/CD/stredni_asie/Turkmenistan_final.pdf

by the government. Investment in key sectors of the economy is provided by the State. All major economic decisions are only taken at the final approval by President Niyazov.

The initial decontrol of prices resulted in a 90% increase in retail prices in 1991, followed by a megasurge of 800% in 1992.⁴⁹ Contraction in output occurred mainly in industrial output while growth in the agricultural and transportation sectors, the latter particularly due to increased government investment, lessened the rate of decline in the overall economy. Enlarged subsidies, increased wages and family allowances, and the reinstatement of some price controls were used to offset the impact of rising prices and the potential for social unrest, particularly in light of the eruption of violence in Tajikistan and other former SSRs.

In order to alleviate the problem related to the transformation process, the Turkmen government subsidized staple foods and rent. Energy and water supply for private households became free of charge in 1993. The Process of privatising the government ruled economy was set in motion but in a rather timid manner. Key industries such as natural gas and crude oil but also the agricultural sector. Namely the production of wheat and cotton to this day remain under government to remain in control of the transformation process and to save the national economy from being exposed to market forces in an unprotected manner. While at the same time introducing an active economic policy aimed at re-designing the mono-

⁴⁹ Nations Encyclopedia, *Turkmenistan-Economy*, retrieved on April 28, 2013 at <http://www.nationsencyclopedia.com/Economy/Turkmenistan-Economy.html>

structured economy.⁵⁰ The main goal was to diversify the industrial production and to substitute imported staple foods and consumer goods.

In November 1993 Turkmenistan dropped out of the ruble-based monetary union and introduced its own currency, the Turkmeni manat. In the same month, Russia, on whose Gazprom pipelines Turkmenistan relied to take its natural gas to market, cut Turkmeni access to the hard currency markets of Western Europe, diverting its competitor's gas instead to the cash-strapped markets of the Ukraine and the ex-SSRs of the Transcaucasus. The result was one of the worst bouts of hyperinflation experienced by one of the newly independent states. The manat, introduced at two to a dollar, was at 125 to the dollar before the end of 1994, with unofficial rates often three times as high.⁵¹

The Turkmen Government maintains the system of price controls through the Commercial Exchange (COMEX) established in 1994. The official purpose of the Exchange is to facilitate provision of goods to the economy by matching buyers and sellers, to regulate import and export transactions, to regulate prices in exports and imports contracts and to regulate costs of investment contracts. By law, every transaction in excess of USD 5700 at the official exchange rate must be conducted through COMEX, with the Government officers deciding on the fairness of the contract price, both for external and domestic transactions, including barter. COMEX thus acts as an insurance instrument against sudden movements in

⁵⁰ Heiko Schmid, Joachim Langbein, *Turkmenistan-Nation Building and Economic Development Since Independent*, retrieved on Mei 9, 2013 at <http://www2.geog.uni-heidelberg.de/anthropo/mitarbeiter/schmid/pdf/turkmenistan.pdf>

⁵¹ Nations Encyclopedia, *Turkmenistan-Economy*, retrieved on April 28, 2013 at

supply and demand, contributing to the price stability or at least managed inflation.⁵²

In November 1995, with inflation at over 1000% for the year and the Turkmeni government threatening to cut off gas to its late paying customers, an agreement was reached with Russia for the creation of a joint stock company Turkman RosGaz (TRAO), 51% Turkmen, 44% Gazprom, and 5% Itera International Energy Corp. (U.S.), whereby Gazprom would purchase and transport all the gas that Turkmenistan could sell to the Ukraine and the Transcaucasus countries.⁵³ This did not solve Turkmenistan's basic problem of getting hard currency export earnings to back its currency. Azerbaijan, Kazakhstan, and the Ukraine had all run up substantial gas debts.

The Government announced ambitious privatization plans for 1996 and 1997. Each Ministry is expected to provide a list of 15 percent of the bodies reporting to it which should be privatized. This should lead to a further 800 privatized companies, according to the head of the Department of State Property and Privatization. Plans for mass privatization and a voucher system are being developed for larger units, over 330 employees.⁵⁴ Only the service sector has been completely privatized, however, constantly changing regulations and tax laws have held back entrepreneurial

⁵² Alexandre Repkine, *Turkmenistan Economic Autocracy and the Recent Growth Performance*, retrieved on April 24, 2013 at http://psychologie.dev.czu.cz/stred-aside/html/CD/stredni_asie/Turkmenistan_final.pdf

⁵³ Nations Encyclopedia, *Turkmenistan-Economy*, retrieved on April 28, 2013 at <http://www.nationsencyclopedia.com/Asia-and-Oceania/Turkmenistan-ECONOMY.html>

⁵⁴ Mehrdad Haghayeghi, Ph.D, *Accession to the WTO: The Case of Turkmenistan*, retrieved on April 28, 2013 at

expansion. The Government did not formulate an industrial privatization plan until late 1992, and the plan called for privatizing only 10% of plants. It allowed creation of 6,000 small businesses beginning in 1992, but postponed auction sales of midsized industrial establishments and large enterprises.⁵⁵ The Government has no plans to privatize the energy sectors of the economy or the cotton industry, although it is actively seeking foreign investment to develop these resources.

Under Turkmen law, individuals may own both agricultural land and real estate, but in practice, few do. There are only 100 private farmers. As part of the agricultural reform program, the Government of Turkmenistan has turned over to private farmers on a lease basis much of the country's arable land, promising to transfer title for parcels of land over to individuals who prove themselves to be good farmers. However, such individuals will not have the right to sell such land. Large state and collective farms still dominate Turkmenistan's agricultural and rural life which undermine farmers' motivation and incentives to perform. The Government maintains a state order system of agricultural procurement, which determines crop mix, distribution, and price⁵⁶. Loss making farms may be restructured into joint-stock companies or private farms. Opportunities for foreign companies will continue in supplying farm machinery and irrigation equipment, as well as dry land farming technology and seeds. The Turkmen Government has

for domestic consumption and export; yet it has to date been relatively reluctant to relinquish control of enterprises in this field.

Turkmenistan's industrial sector is overwhelmingly geared towards extraction of gas and the processing of cotton. The most important 45 firms in the industrial and transport sectors, such as national railways and state owned oil and gas monopoly, Turkmenneftezgaz, remain off limits for privatization. As such, industrial sector reform has been slow and in reality non-existent. However, the state controlled industrial sector has witnessed a shift from labour-intensive light industrial activities towards gas industry. Since 1995, the Turkmen government has been pursuing a policy of import-substitution to allow the domestic industries to grow and flourish. As such, the machine building, metallurgy, and food processing industries have somewhat benefited from this strategy.⁵⁷

Turkmenistan does not have a financial services sector as is generally recognized elsewhere in the world. The central bank of Turkmenistan known as the State Bank of Turkmenistan (SBT) constitutes the backbone of its financial sector. The SBT until 1997 was only responsible for printing money and extending credit at negative real interest rates on government's behalf. Beginning in 1997, SBT gained nominal autonomy from the Government in an attempt to reform its operations and stabilize the economy along the lines of the IMF program being implemented elsewhere in the region. President Niyazov, however,

head of SBT, Mr. Khudayberdy Orazov, was removed for merely advocating a mildly reformist plan to stabilize the economy.⁵⁸

Finance for the public sector has been largely made available through foreign creditors, as the Government is not in favour of foreign equity investment. The existing commercial banks are state controlled and lack the financial muscle to be of any substantial help in investment. Furthermore, banking supervision is very weak. The SBT has been following a lending policy that guarantees its loans to state owned enterprises. But as a result of growing inter enterprise arrears and chronic late payments on loans, Turkmenistan banks are insolvent by Western standards. Since 1998, the Government has been working to reduce the number of banks to address the issue.

Aggravating the situation, a below average cotton harvest extended poor economic conditions into 1996, as inflation raged on at about 992% for the year. GDP continued its post-independence slide, registering a decline in GDP of -8.2% in 1995 and -7.7% in 1996. Gross Domestic Product plunged further (-25.9%) in 1997 when Russia cut off access to its pipelines in a dispute over prices to be paid for Turkmeni gas. External debt, which had already increased 86.5% from \$401 million to \$750 million 1995 to 1996, jumped 136% to \$1.77 billion in 1997 as the government was forced to borrow to cover shortfalls in export payments. More promising were the effects of reforms in monetary and fiscal policy adopted in 1996 and 1997.⁵⁹

⁵⁸ Ibid

⁵⁹ Nations Encyclopedia, *Turkmenistan-Economy*, retrieved on April 28, 2013 at

Although not officially under an International Monetary Fund (IMF) program, the government voluntarily undertook to follow IMF recommendations about controlling credit expansion, reducing budget deficits, and liberalizing foreign exchange. From this point inflation began a steady retreat, falling to 84% in 1997, to about 20% in 1998 and 1999, to 14% in 2000, and to a reported 6% in 2001. However, internal evidence from the government's published figures suggest a resurgence of inflation in double digits in 2002. Another positive development in 1997 was the completion in December of the \$190 million, 24 mile Korpedzhe Kurt-Kui pipeline connecting Turkmenistan to the Irani gas pipeline system. In 2001, agreement was reached on a route whereby Turkmenistan gas could be delivered to Armenia through a still to be built Iran-Armenian pipeline. Work on the Armenian section, after delays, is scheduled to begin in 2003, though it is not clear if the scheme will be exempt from US sanctions on countries dealing with Iran. A more ambitious project is the Trans-Afghanistan pipeline, called the Central Asia Gas Pipeline (or Centgas) that would run 1440 km (900 mi) from the Daulet Abad gas field in Turkmenistan through Kandahar, Afghanistan and the end at Multan in Pakistan. The Centgas consortium was set up by Unacol in October 1997, but suspended in 22 August 1998 in the face of a lack of success in obtaining funding, continuing civil war in Afghanistan (and opposition in

1. U.S. State Dept. Memorandum on negotiations with the unrecognized Taliban

regime), and, finally, US cruise missile attacks against al-Qaeda training camps.⁶⁰

In 1999 a turn around point in the economic development was reached and there has been a considerable economic growth since. Together with an increase in currency receipts. The inflation rate was stabilized and the debt service was intensified. Despite these positive developments the Turkmen gross domestic product clearly remains below the level of 1991, the year of Independence.⁶¹ The Turkmen economy continues to be dominated by the structures established during the Soviet period. This shows especially well when turning to the occupational structure and the distribution of the economic sectors. Still, nearly 50% of all persons employed are working in the agricultural sector, making it the largest employment sector. While at the same time it only produces approximately one fourth of the Gross domestic product (GDP). The share of employees in the industrial sector is much smaller, yet its contribution to the GDP has grown.⁶² In the near future, one can expect this sector to further expand since it is expected that the crude oil and natural gas exports will increase.

Yet reinforcing the economic development under government aegis required enormous public investment in the sectors of natural gas, crude oil and transportation. These infrastructure measures could only be financed in part by revenue generated by selling natural gas and cotton. For the larger part Turkmenistan is dependent on foreign loans. Until the year 2000 a

⁶⁰ Ibid

⁶¹ Heiko Schmid, Joachim Langbein, *Turkmenistan-Nation Building and Economic Development Since Independent*, retrieved on Mei 9, 2013 at <http://www2.geog.uni-erlangen.de/~schmid/lehre/2012/lehre/14/turkmenistan.pdf>

considerable debt of over 2.6 billion US dollars has accumulated, equivalent to more than 75% of the GDP⁶³. The missing natural gas exports between 1997 and 1998 led to a further intensification of the financial pressure. Under that impression the government was forced to discontinue subsidizing staple foods, which amounted to up to 70% of the national budget.

The economic structure of Turkmenistan is clearly dominated by the natural gas sector. More than 60% of the export revenue is accounted for by the export of natural gas. Taking the enormous natural gas deposits and the purposes for which the revenues of the natural gas are used into account, Turkmenistan can be considered a “gas republic” or a rentier state.⁶⁴ But Turkmenistan is heavily dependent on pipelines. This monopoly position has been to Gazprom’s advantage during price negotiations. Alternative export routes are hardly available for Turkmenistan, due to its continental location and high investment costs for opening up alternatives. The situation is further intensified by outstanding payments and the financial difficulties faced by the states which are supplied.

Despite these difficulties and problem the natural gas sector holds the crucial developmental potential for Turkmenistan and still guarantees most of the states revenues. Taking this into account it is not very surprising that the standard of living and the income situation in Turkmenistan are better than in the neighbouring states next to the share of natural gas exports, which have recently been increasing, this development

may be seen as a result of the government controlled investment policy. This

holds especially true for the crude oil and natural gas sector but also for the production sector and the chemical industry, in which the government has placed large investments. The agricultural sector has also profited from the intensified efforts to substitute imports today, over 80% of all staple foods are produced inside the country. In addition, Turkmenistan has been successful in the processing of agricultural product.⁶⁵

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B. Economic Liberalism During Saparmurat Niyazov's Regime

Turkmenistan's transition from a command economy to a free market economy was initially cushioned by its relatively low level of development, as well as by the central government's plans for a gradual reform over a 10 year period with the state continuing to play strong directive and protective roles in the economy. Saparmurat Niyazov lead economic liberalist system for a half from his regime. He changed it to economic liberalism because he wanted Turkmen's economy more developing.

He has made a frightful mess of his policy towards Russia and the West. He ruined the chances of obtaining a gas pipeline across the Caspian Sea to Western markets by his ham-fisted negotiating tactics. The representatives of the majors got totally fed up by him and put prudence before their pockets.

Niyazov was then obliged to do a deal in April with the one country across which Turkmen gas can be exported to market, Russia. This is now coming into force, 2004 being the first year of the agreement's operation. Under the deal, Turkmenistan will provide Russia with up to six billion cubic metres of gas in 2004, with six billion to seven billion cubic metres in 2005, with up to 10 billion cubic metres in 2006 and with 60 billion to 70 billion in 2007. Russia will be paying US\$44 per 1,000 cubic metres. In 2004-2006, half the price will be paid in hard currency and half in equipment for Turkmenistan's gas industry. Niyazov expressed doubt that

exports that is planned.⁶⁸ Gazprom was ready to increase the capacity of the pipeline section between the Turkmen and Russian borders.

But a new prospect is opening up, to export to China via a new pipeline, built with the help of Chinese finance. The problem is that the route lies across Afghanistan, which is not exactly the ideal venue for a pipeline. It is not difficult to see the possibilities for theft or sabotage. Unless conditions improve remarkably in Afghanistan the project is likely to remain a non-starter.

Turkmenistan plans to produce 74 billion cubic metres (bcm) of gas in 2004, of which 58 bcm will be exported, deputy prime minister, Yolly Gurbanmuradov, said at a government meeting, Interfax News Agency reported. An increase in exports will be possible due to new gas pipelines of 120 kilometres in length. The country's main customers will be Ukraine (36 billion cubic metres), the Itera group (10 billion) and Gazprom (5 billion), he said. Turkmenistan also plans to produce 15 million tonnes of crude, up from the 10 million tonnes planned this year. Turkmenistan will produce 11 million tonnes itself. The country plans to produce 67.6 billion cubic metres of gas in 2003, up 26% year on year, and 13.5m tonnes of crude, up 50%. Turkmenistan produced 47.2 billion cubic metres of gas in January until October 2003, up 8% year on year, and 8.145m tonnes of crude, up 10%.

The foreign trade surplus in Turkmenistan totalled US\$722.5m in the first nine months of 2003, up 28% year on year, Interfax News Agency reported, citing figures released from the national statistics and information

⁶⁸ International Industrial Information Ltd., *Turkmenistan*, retrieved on May 15, 2013 at

agency. The nine month foreign trade grew 18.9% year on year to US\$4.419bn. Turkmenistan traded with 81 countries. The former Soviet republic exported 20.4% more goods for US\$2.571bn in the first three quarters and exported 17% more products for US\$1.849bn. Turkmenistan increased its economy 22.7% year on year to 64.47 trillion mantas in the first 10 months, the national statistics institute told Interfax. Industrial output was 21.4% higher to 24.19 trillion mantas.

About the textile industry in Turkmenistan, the Turkey-based group Norsel International Ltd recently finalised a US\$3.5m overhaul of a cotton spinning mill in Turkmenabad, a source at the Turkmen Textiles Ministry said in a statement, Interfax News Agency reported. The revamping subsidised by the Turkmen government, involved the putting in place of Japanese winding machines and fine-tuning of existing production lines, increasing capacity almost 10-fold to 1,500 tonnes of cotton yarn per year, the source explained.

Active in the former Soviet republic in over a decade, Norsel has participated in the construction of the Saparmurat Niyazov textile mill (1997) and cotton spinning mills in Bakharden (1995) and Khalach (2002). Recently, the Turkish group opened a new textile mill near the Turkmen capital, Ashgabat. The textiles ministry has said it will open about another 10 new industrial facilities before December 31st, 2003. Turkmenistan's cotton industry represents about 25% of the value of all industrial fixed

Turkmenistan's irrigation infrastructure and water-use policies have not responded efficiently to this need. Irrigation now depends mainly on the decrepit Garagum Canal, which carries water across Turkmenistan from the Amu Darya. The Dostluk dam, opened at Serakhs on the Iranian border in 2005, has increased available irrigation water and improved efficiency. Plans call for a similar dam on the Atrek River west of Ashgabat. Private farmers grow most of Turkmenistan's fruits and vegetables (chiefly tomatoes, watermelons, grapes, and onions), but all production phases of the main cash crops, such as grain and cotton, remain under state control. In 2006, grain crop failures led to steadily increasing bread lines and reinstatement of a ration system in most regions. At the root of those failures was a culture of falsifying output figures together with poor administration of the sector.

Turkmenistan's economic performance remained stable during 2006. According to IMF, an annual real GDP growth was 11.5%. With rapid growth of gas and oil industry during 2006, the country's agricultural sector witnessed shortfalls in cotton crop production over the period 2000 until 2006. Inflation declined from 10.5% in 2005 to 8.2% in 2006. This was achieved due to the Government's prompt measures in introducing a freeze in wage growth, cuts in pension payments and price control.⁶⁹