

Turkmenistan's Economic Prospects and Challenges

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Turkmenistan enjoyed a strong growth record for nearly a decade. Growth was estimated at around 10-12% annually since the early 2000s, when natural gas exports to the Russian Federation and Ukraine became the backbone of the economy (hydrocarbons, half of which are natural gas, typically account for approximately 90% of total exports). The export price of Turkmenistan's natural gas has converged to European levels since 2008. Other important exports are electricity and textile (mainly cotton) products. During 2003-2005, total exports rose by 15% a year on average. High export revenues have enabled the government to invest heavily in infrastructure and construction projects.

Yet, GDP contracted by an estimated 6% in 2009. A dispute with the Russian Federation in April 2009, due to its attempt to renegotiate the contract price for purchases of gas, resulted in the cessation of most (90%) Turkmen gas exports to the Russian Federation and brought gas production to a standstill. Although GDP contracted in 2009 as a result, government spending in various social sectors, the country's isolation from global markets and Iranian (and more recently, Chinese) investment in hydrocarbons are thought to have cushioned the contraction.

Government statistics seem difficult to reconcile with outside estimates. Although GDP is thought to have substantially contracted in 2009 due to the quasi-total interruption of gas exports to Russia, two government institutions reported that GDP grew – at different rates – in January-September 2009 (the rates were 10.8% and 6%, year-on-year). Similarly, the government reported that trade volumes year-on-year in January-September 2009 increased by 11% in general, and by 30% with Russia. However, given that most of overall Turkmen exports are made up of gas exports to Russia, these trade figures as well as the raise a number of questions about government statistics overall.

Growth should resume in 2010. The resumption of gas exports to the Russian Federation should enable the economy to grow by 9% in 2010, although volumes and prices are expected to be lower than agreed before the pricing dispute. The government has recently made overtures to other foreign investors in the energy sector. Gas exports to

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Iran are expected to increase, while China began its imports in late 2009. However, the Russian Federation is expected to remain the largest importer in 2010.

The budget posted a deficit in 2009 but state finances should improve in the near-term; the Stabilization Fund has played a major role. Sharp decreases in trade revenues (the interruption of gas exports to the Russian Federation but also lower duties as part of trade reforms) and large government spending appear to have caused a budget deficit of 2% of GDP in 2009. The Stabilization Fund, which has been accumulating reserves from fiscal revenues since October 2008, is thought to have financed a large portion of the expenditures. The budget is expected to recover slowly in the short-term, depending on the strength of gas exports to the Russian Federation, China and Iran.

Yet, the government predicts lower revenues and expenditures in 2010 and projects a small deficit (0.6% of GDP) in 2010 in its latest budget. The government plans to increase spending on government salaries, health, education, culture and construction in 2010, even though it announced decreases in revenues and expenditure relative to 2009. The apparent contradiction could be explained by the fact that expenditures are often financed with extra-budgetary funds. The Stabilization Fund is also expected to be a substantial source of finance in 2010.

Poverty and low living standards remain a reality. Although estimates are difficult to make, it is thought that a sizable portion (30%, according to some observers) of the population lives in poverty. The government has typically provided subsidies for housing, fuel and basic food items, and the fact that some public funds have recently been injected in social sectors seems to indicate a positive trend in public spending. Additionally, the government has implemented a rural development program (2008-2020) to increase the welfare of rural populations, notably by investing in water, electricity, gas, health and education facilities, and roads.

Almost half of the population relies on the rural sector for their livelihoods, with cotton and wheat making up the bulk of agricultural production. Agriculture is typically intensive and takes place in widely separated areas in a largely arid landscape.

Despite the external shocks, the current account remained in surplus in 2009. The current account has been in surplus since 2004 and was originally forecast to equal approximately 35% of GDP in 2009 and 2010. Despite the shutdown of gas exports to the Russian Federation, the current account was in surplus in 2009, at an estimated 13% of GDP. The surplus is expected to move in the direction of gas exports in 2010 and 2011, approximating an equivalent of 33.3% and 37.1% of GDP respectively.

Government overall trade performance reports are ambiguous. The government has announced that general trade volumes increased by 11% year-on-year in the first eight months of 2009 and that trade with the Russian Federation increased by 30% in the same period. Nevertheless, observers consider these figures implausible, especially in light of the interruption of natural gas exports to Russia in April. The exception of China, whose trade with Turkmenistan reportedly increased by 54% year-on-year in January-September 2009, could not possibly have made up for the loss in gas exports due to the small proportion of Chinese trade in Turkmenistan's overall trade. Yet, the official 2009 trade growth statistics were lower than those in 2008, which could still indicate an official recognition that trade was affected in 2009.

Inflation is expected to increase, although price levels are difficult to estimate. From an estimated 13% in 2008, consumer price inflation is thought to have dropped to 10% in 2009 due to reductions in non-oil commodity prices. Prices are expected to rise by 12% in 2010 and 14% in 2011 in light of increased investment in the domestic energy sector. However, making price level estimates is complicated since official statistics often leave out rural inflation. In addition, most household purchases are made at black market prices and many transactions in the commercial and industrial sectors take the form of barter.

The government has few monetary policy tools at its disposal given the rudimentary nature of the financial system. The national currency (the manat) was redenominated (5,000 old manat = 1 new manat) and made fully convertible in January 2009, following the reunification of the official and commercial exchange rates in 2008. In April 2009 the government reported that 80% of old bank notes had been exchanged. These reforms resulted in an exchange rate of manat2.85:US\$1, forecast to remain stable through 2010-2011. The government is expected to rely on these changes to exercise some measure of control over price levels.

Reforms are generally moving slowly, with a few exceptions. The pervasiveness of state presence in all aspects of the economy remains largely unchanged, although the president indicated his intention to enact reforms several times in the past several years. The state still controls the heavily domestic-focused banking system as well as the hydrocarbons and agriculture sectors. The business environment is largely restrictive, although small changes have recently been recorded that seem to have reduced investor wariness. Many observers consider that improvements in the business environment affecting the non-hydrocarbons sector are necessary to diversify the economy and attract outside investors. The forecast increase in the price of non-hydrocarbons in 2010 helps this reasoning make a convincing argument.

Observers expect some reforms to be implemented in the hydrocarbons sector in the near future, as the government is increasingly recognizing the need for foreign capital and expertise in the sector to overcome domestic shortcomings in these areas. Overtures made to additional foreign investors in 2009 seem to indicate that steps are being taken in this direction. Moreover, there have been some changes recently in the agriculture sector, aimed at increasing farmers' incentives by increasing output prices and providing unrestricted access to lines of credit. Some duties have also been lowered as part of trade liberalization reforms. The currency reforms are also a solid step in the direction of improving the business environment. Finally, the government has announced a goal of increasing the non-oil and gas share of the private sector in the economy from 40% to 70% of GDP by 2020, another demonstration of intent to make Turkmenistan more business-friendly.

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