

Investment Climate in Turkmenistan: Problems and Risks

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Abstract

In the 1990s Central Asian republics experienced enormous economic problems because their economies were heavily dependent on Russia and could not function separately. The collapse of the Soviet Union meant also the collapse of the Central Asian economic systems. The Leaders of former Soviet republics decided to carry out rapid economic and political reforms. They adopted economic policies which were known as “shock therapy”. Shock therapy caused the emergence of many socio-economic problems, as well as the growth of unemployment and inflation. It also increased social inequality and the gap between rich and poor. With regards to Turkmenistan, its transition from a centrally planned economy to a free market economy was a very slow process and the central government continued to play strong directive and protective roles in the economy. Much of the economy has not been exposed to market disciplines and remained under the firm control of central government.

At first glance Turkmenistan seems a very attractive country for investors. It has immense amount of natural resources, especially oil and natural gas. Each year scientists discover large deposits of natural gas and oil in Turkmenistan. It is the fourth - largest producer of natural gas in the world. But, if one examines the country’s current socio-economic and political situation in details, he/she would discover that it is becoming increasingly an “investor unfriendly” country. Turkmenistan is regarded as one of the most oppressive countries in the world. The country has a long tradition of dictatorial rule which is a main obstacle to any kind of economic and political reforms. Turkmenistan has a largely state-run economy and the country’s economy is still based on the system of state ownership. Government still controls the vast majority of lucrative businesses and industrial assets. The economy of Turkmenistan is still characterized by state control of investment.

Keywords: corruption, economic reforms, foreign investment, investment climate

Introduction

Present article analyses the problems that Turkmenistan encountered during the transition period to market economy as well as the investment risks in this country. By highlighting a number of severe socio-economic problems, this article serves as a recommendation for policy makers who want to make Turkmenistan a more attractive country for investors.

The major impeding factor for the creation of business friendly environment is the authoritarian regime, which is against any kind of substantial changes and reforms. Turkmenistan formed part of the Russian and Soviet Empire for a long time and therefore, the country has no traditions of democracy, multiparty politics, pluralism and the rule of law. After the collapse of Soviet Union there was a hope that the transition to democracy would be quick. But in reality nothing has changed and the former communist leader Saparmurat Niyazov has established a Soviet style authoritarian regime in Turkmenistan. (Kareem Al Bassam, 2003, pp. 1-18) In order to describe the investment climate in Turkmenistan and analyze investment risks, it is extremely important to understand the transitions that have taken place in Turkmenistan after the breakdown of the Soviet Union.

Analysis of the Problems during Transition to Market Economy

Central Asia is a strategically important region because it is located at the crossroads of ancient civilizations, on the main historical routes between Europe and Asia. Turkmen people benefitted from this strategic location and for centuries maintained trade and commercial links with Asian and European countries. In the late 18th and early 19th centuries, almost

all the trade routes that connected Europe with Central Asia passed through Turkmen lands. Thanks to this strategic location Turkmenistan made some progress and Turkmen people benefitted from international trade and commerce. In the 19th century the Russian empire annexed Turkmenistan and the country was drawn into the economic system of Russia. Tsarist Colonial policy was harsh and was based on the exploitation of local people. During Russian colonial rule Turkmenistan remained a relatively backward agricultural country. The basis of Turkmen economic life was an economy consisting of land cultivation and cattle-breeding, as well as handicraft production, hunting, and fishing. During Soviet times Turkmenistan was transformed into an industrial republic and it became part of centrally planned Soviet economy. Turkmenistan developed its industrial base and the main sectors of its industry, including oil and gas production, petroleum refining, and machine building, hence experienced rapid development. However, the country still had a relatively high level of poverty and it was one of the least developed republics in USSR. Turkmenistan and other Central Asian republics were the poorest Soviet republics and these republics had the largest proportion of households living below the poverty line. Country’s economy was heavily depended on other Soviet republics and could not function independently. All republics became interdependent during Soviet times and formed part of the economic system that was directed from Moscow. Indigenous capacity for economic management was limited because everything was controlled and regulated from the centre. (Pomfret R., 2006, pp. 2-21)

After the breakdown of the Soviet Union all Central Asian republics experienced enormous economic problems because their economies were heavily dependent on Russia and

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other Soviet republics. Central Asian republics did not have any experience in conducting economic affairs independently and therefore, there was a lack of enthusiasm to become independent. (Buyukakinci E., 2012, pp. 1-2) Leaders of these republics were former communists who were accustomed to receive orders from Moscow and did not have any idea how to govern their countries without the support from the centre. Central Asian republics were totally unprepared for independence and suffered serious disruption from the breakdown of USSR. The collapse of the Soviet Union also meant the collapse of the Central Asian economic systems. The transition from centrally planned to free market economy was not a smooth and gradual process. The Leaders of former Soviet republics decided to carry out reforms overnight because they were increasingly convinced that rapid transition toward market capitalism was needed. They adopted radical economic reforms which were known as “shock therapy”. Shock therapy failed in its goal of solving countries’ socio-economic problems and led to the increase of unemployment and inflation. (Murrell P., 1993, p. 111-137) It also increased social inequality and the gap between rich and poor. Central Asian republics adopted different strategies for transition to a market-based economy. With regards to Turkmenistan, its transition from a centrally planned economy to a free market economy was a very slow process and central government continued to play strong directive and protective roles in the economy. President Saparmurat Niyazov transformed Turkmenistan into one of the world’s most totalitarian and repressive states, retained absolute control over the country and minimized the economic change. Although Niyazov emphasized the importance of economic and political reforms and a need to move from central planning to a market economy, he did nothing to fulfill his promises. He declared himself “president for life” and showed little interest in reforming his country. Turkmenistan’s government only partially adopted market reforms and implemented them inconsistently. Much of the economy has not been exposed to market disciplines and remained under the firm control of central government.

Investment Climate in Turkmenistan

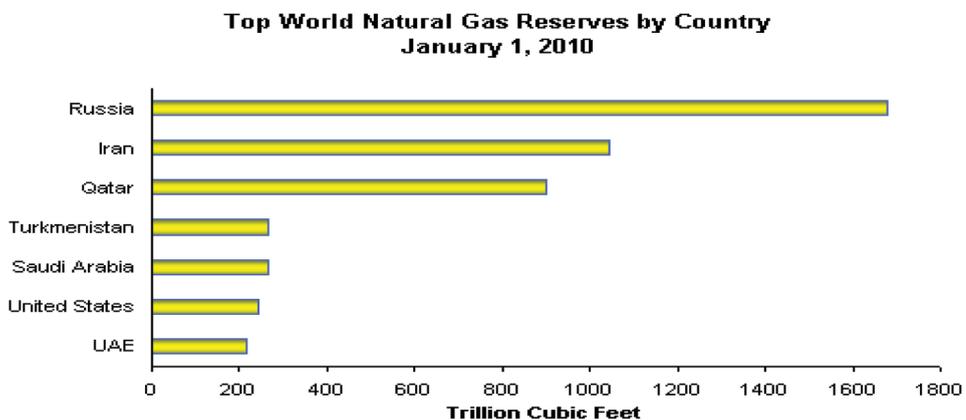
At first glance Turkmenistan seems a very attractive country for investors: the country has witnessed very rapid economic growth in recent years, mainly on the basis of exporting natural resources such as oil and gas abroad. The World Bank no longer classifies Turkmenistan as a “lower middle income country.” In July 2012 it has climbed into “upper middle

income countries” from the “lower middle income category”, which reflects the country’s recent robust economic growth. (Embassy of the United States, 2013) Turkmenistan has immense amount of natural resources. As it is illustrated in the diagram below the country has proven natural gas reserves of approximately 265 Trillion cubic feet. (Fig.1)

According to the statistical data Russia, Iran and Qatar are undisputed leaders in gas reserves. Turkmenistan is at the fourth place. Each year scientists discover large deposits of natural gas and oil in Turkmenistan. Turkmenistan is one of the largest gas producers in the world and at the same time has substantial oil resources. (International Business Publications USA, 2009, pp.20-28) Turkmenistan is also the world’s tenth largest producer of cotton. Although Turkmenistan has made significant economic progress thanks to its natural resources, the country is still not regarded as an attractive place for foreign investment. If one examines the country’s current socio-economic and political situation in details, he would discover that it is becoming increasingly an “investor unfriendly” country. Turkmenistan is regarded as one of the most oppressive countries in the world. Human rights violations and abuses are rampant. The country has a long tradition of dictatorial rule which is the main obstacle to any kind of economic and political reforms. Under the authoritarian rule of Saparmurat Niyazov the country demonstrated strong discrimination against foreign citizens. In 2003, Niyazov’s regime created a State Service for the Registration of Foreign Citizens in order to monitor and control foreign investors, whose activities were strictly regulated. Under Niyazov Turkmenistan followed a policy of isolation and the country was mostly closed to foreign business. Profits from the energy exports were not used for the alleviation of poverty. Government wasted financial resources for grandiose projects, while most of the population lived in poverty. (Freedom House, 2005)

Very little has changed after the establishment of Gurbanguly Berdimuhamedov’s regime in Turkmenistan. When he came to power there was a hope that country would embark on “a road of democratic transformation”. He implemented certain reforms in order to gain popularity in the country as well as abroad. One of the reforms he implemented was the renunciation of the personality cult. He also provided opportunities for new businesses to develop. Initially he had plans to carry out economic and political reforms and tried to attract as many investors as possible in the country. He made tentative moves to open up the country and began to organize forums and conferences for foreign investors. He was convinced that the country needed foreign capital for economic develop-

Figure 1: Top 2010 World National Natural Gas Reserves.
Source: Brian Westenhous (2011)



Source: Oil and Gas Journal

ment. The companies, that showed some interest in investing in Turkmenistan, were offered relatively transparent conditions in the form of investment agreements. According to these agreements the regime promised to protect investors and create business-friendly environment in the country. On the other hand, companies undertook an obligation to pay from 20 to 40 percent of their profit to the country's budget with appropriate taxes. These agreements offered protection to investors from local government's abuses. However, in a few years the appetites of local elites have grown to the extent that these agreements could not protect businesses from corruption and raids. Soon businessmen became convinced that the political system has not changed. (International Institute for Political Expertise, 2011, pp. 12-45)

According to the constitution of Turkmenistan the country is a democratic presidential republic and the power of government is divided into three branches – executive, legislative and judicial branches of power. Each branch is separate and independent from the others and has separate areas of responsibility. The constitution provides for rule of law, freedom of the press, democratic freedoms, respect for property rights and market economy principles, respect for political and civil rights. (Constitution of Turkmenistan, pp. 1-20) But the government does not respect these rights and corruption continues to be pervasive. In reality the whole political power is concentrated in the hands of one person, the president and the regime still is oppressive. Judiciary is not independent and is entirely controlled by the president. President appoints all judges without legislative review. Because of widespread corruption, investment attractiveness of Turkmenistan is extremely low. Government of Turkmenistan tried to improve the business climate in the country and adopted a number of laws on foreign investment such as law on foreign economic activities, law on hydrocarbon resources, law on foreign corporations, law on foreign investment, law on foreign concessions, etc. The Law on Foreign Investment is the main legal document which establishes the legal foundation for the business activities of foreign investors and defines the principles of investment. (USA International Business Publications, 2009, pp. 83-147) The law also provides for protection of foreign investors and aims at the attraction, as well as effective utilization of foreign investments in Turkmenistan. Although Turkmenistan has adopted a wide range of laws in order to improve investment climate, the laws have not been effectively implemented. (PricewaterhouseCoopers International Limited, 2011) Government is keen to attract foreign investors in the country, but its business regulations remain murky and the risks to investors are high. Turkmenistan is not an attractive place for foreign investment because of the tight state control of the economy, high administrative barriers for business activities, and slow pace of economic reform, inconsistent regulatory practices, and unfamiliarity with international business norms. To make matters worse, Gurbanguly Berdimuhamedov's regime plans to create a foreign investment oversight agency which will oversee and control foreign investment in the country. The establishment of this agency will create additional barriers for foreign companies seeking business and investment opportunities in Turkmenistan. (US Department of State, 2013) Any company that shows interest in conducting business activities in Turkmenistan will have to go through a thorough background check by this foreign investment oversight agency prior to being granted a special permit. The agency will have a right to oversee in

details business activities of any foreign company seeking business and investment opportunities in Turkmenistan. Any foreign company wishing to do business in Turkmenistan will have to provide detailed information about its activities to this agency. The agency will have overarching powers either to grant a permit to a foreign company to operate in Turkmenistan or to reject its request to do business in Turkmenistan. The agency will also have the authority to levy fines against companies that violate Turkmenistan's business regulations. The foreign investment oversight agency will not make Turkmenistan a more attractive country for investors, on the contrary, it will deteriorate business climate in the country. (Rejepova T., 2013) Turkmenistan is officially regarded as one of the most corrupt countries in the world. Transparency international ranked Turkmenistan 170 out of 174 countries in its Annual Corruption Perceptions index of 2012. According to the 2013 Heritage Foundation Index of Economic Freedom, which measures economic freedom of 185 countries based on trade freedom, business freedom, investment freedom, and property rights, Turkmenistan's economic freedom score is 42.6, making its economy the 169th freest in the 2013 Index. "Its score is 1.2 points lower than last year, with substantial declines in property rights and fiscal freedom." the index says. The government of Turkmenistan is not willing to implement reforms such as increasing business freedom and investment freedom and it does not take steps to increase economic freedom for the society. (Heritage Foundation, 2013) Foreign companies' success to do business in Turkmenistan often depends on its ability to have connections with government officials. Strong relationship with government is needed in order to enter the market and establish a business in the country. Government officials expect personal gain for allowing or helping foreign investors enter the local market. (US Department of State, 2013)

Despite some efforts to open up the country, Turkmenistan still remains one of the most closed economies in the world. The government has several tools at its disposal to discriminate against unwanted foreign companies: excessive tax examinations, license extension denial, and customs clearance and visa issuance obstacles. (Embassy of the United States, 2013). The country remains isolated and has limited contacts with other countries and international organizations. Turkmenistan is becoming a very authoritarian country which stubbornly opposes any kind of reforms and changes. Turkmenistan has a largely state-run economy and the country's economy is still based on the system of state ownership. All land is owned by the government and nobody can obtain long-term land use rights for "non-agricultural" purposes. Other ownership rights are also limited and the government does not respect property rights. Government still controls the vast majority of lucrative businesses and industrial assets. The economy of Turkmenistan is still characterized by state control of investment. The economy remains heavily dependent on energy sector and government has not implemented any substantial reforms to diversify its economy.

Turkmen economy is highly regulated by the state. The overall freedom to establish and run a business is very limited under the inefficient and non-transparent regulatory framework. State regulates the rules of large business and dictates businessmen "the rules of the game". (Small businesses are less regulated in comparison to large businesses). Nobody is allowed to conduct large business independently, because large business is something that is regulated by the state. Turkmen

economy can be classified as a centrally planned economy. Government regulates and controls the prices of 16 major grocery products. The market forces are not allowed to set the prices for these products. All major resources are in the hands of the government and there is little sovereignty for producers. (International Institute for Political Expertise, 2011)

Conclusion

Historical experience has shown that no country can remain in isolation for a long time. Turkmenistan has to open up its economy in order to create more employment opportunities for the people, achieve job growth and economic prosperity. Its government has to make serious efforts to create a business-friendly environment in the country. Investors need stable environment and prefer countries with stable political systems. Although Turkmenistan has legislation that prohibits and outlaws corruption, the laws are not respected and corruption remains a major problem for the country. Formally president and government officials are against corruption, but in reality they are involved very actively in corrupt practices. In order to improve business environment and make country more attractive to foreign investors, the government has to carry out anti-corruption reforms, as well as free market oriented economic reforms and rule of law reforms. The implementation of these reforms is crucial otherwise the country will not be able to take advantage of the opportunities that exist in the global economy. Furthermore, the government should make business regulations transparent and clear and should abolish high administrative barriers for business activities. Western companies will not make serious investments in Turkmenistan, unless the government will implement these reforms. The economic well-being of Turkmenistan depends on the government's willingness to reform the country and make it an attractive place for investors.

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