World Bank Group - Turkmenistan Partnership

Program Snapshot

April 2015

WORLD BANK GROUP

RECENT ECONOMIC AND SECTORAL DEVELOPMENTS

Growth and External Performance

The Turkmen economy expanded by 10.3 percent in 2014 and sustained this strong growth performance largely on account of the non-resource sectors. Turkmenistan had another year of double-digit growth despite the global oil price decline. Growth in the non-extractive sectors (13 percent) outpaced the hydrocarbon sector's expansion and became the main driver of the overall economic dynamism in 2014.

Public investments and exports also made a stronger contribution to growth during the first half of 2014 by expanding at 8.2 and 8.3 percent, respectively, but both experienced a significant slowdown during the second half and ended in moderate outcomes, 6 and 5 percent, respectively, for the year as a whole. In addition to the import-substituting branches of the domestic economy (the production of beverages, cereals, dairy products, and processed foods), traditional sectors such as textiles and cotton fabrics grew by about 18–20 percent. The non-hydrocarbon mineral sector and some subsectors of the manufacturing industries, namely the production of construction materials and fish processing, also grew at higher rates. Overall growth in the agriculture sector was positive, aided by the good vegetable harvest. Together with the further expansion of the emerging services sectors (telecom, banking) all of the non-tradable sectors aided the high growth performance of the economy.

Capital investments from all sources of financing grew by 6 percent in 2014. This growth was supported by especially strong investment in social infrastructure—a 15 percent increase compared to the same period of 2013. Investment in physical infrastructure facilitated the further expansion of the exportable sector (especially natural gas). Although growth in foreign direct investments remained modest in 2014, increasing only by 3 percent, this is an improvement compared to the 0.1 percent growth in 2013. Large projects include intensive investments in the transnational transit corridor, including the Black Sea and Caspian Sea connection, a Middle-East–Iran–Commonwealth of Independent States (CIS) route by means of a new railroad connecting Iran with Kazakhstan through Turkmenistan.[1] However, in order for the Government's objectives to be achieved, investments in infrastructure projects will need to be complemented by policies to develop logistics and trade facilitation services.

The outcome of developments in 2014 and different dynamics during the first and second halves of the year demonstrate the sensitivity of the Turkmen economy to external factors. Turkmenistan remains significantly dependent on external demand for its hydrocarbon resources and on their price in the global market. In addition to the global shock associated with hydrocarbon price decline, the potential spillover effects of Russia's recession on the Central Asia region pose risks and challenges for Turkmenistan. The medium-term outlook for the country is being adjusted to take into account these circumstances, and global oil prices are projected to remain low until 2019.

Although growth projections for 2015–16 still remain around 7–8 percent, they are sensitive to further developments in Russia and the CIS region as well as to oil prices and their spillover effect on the natural gas price. Turkmenistan's exposure to remittances is low, but exposure to investments from and trade with Russia is significant. Despite the recent trade expansion to China and Iran, about 18 percent (10 billion cubic meters [bn cm]) of Turkmen natural gas was imported by Russia. Recently, however, Gasprom/Russia announced a roughly 60 percent cut in the imported natural gas volume which, if not substituted by a commensurate increase of exports to China, will imply a net loss of export revenues for Turkmenistan. Thus, the country will be adversely affected by the trade channel and potential slowdown of foreign investments, which was largely directed at the country's extractive sectors until recently. However, compared with

[1] A new rail transport corridor connecting Kazakhstan and Iran through Turkmenistan was inaugurated in November 2014. This railway will help develop social infrastructure in the desert areas, the Caspian region, and the Northern Territory. Improvement works are currently under way on the interstate highways connecting the city of Turkmenbashi with Ashgabat, Mary, Turkmenabat, and Farab, as well as on the Ashgabat-Dashoguz direction, which will facilitate the increased traffic of transit cargo through Turkmenistan. The total length of highways under reconstruction and construction is 1,700 kilometers.

other countries in the region, the possible implications of the current external shock on Turkmenistan are estimated to be moderate—around a 3–4 percentage point slowdown of growth and a 16 percent reduction in current revenues, which can be substituted by the large fiscal buffer accumulated through savings from hydrocarbon revenues.

The low level of inflation contributed to the overall positive macroeconomic performance. Compared with end-2013, cumulative inflation during 2014 was only 4.2 percent. It was relatively mute, as inflationary pressures stemming from the expansionary fiscal policy during the second half of 2013 eased in 2014. In spite of price increases for utilities and transport services, inflation remained in low single digits, helped by declining international food prices and the high import content of fiscal spending.

One of the important policy changes was the exchange rate devaluation in January 2015. A fixed exchange rate of the Turkmen manat was introduced in 2009 and has been maintained unchanged and pegged to U.S. dollar since then. However, relative price dynamics in Turkmenistan and its trading partners have led to real exchange rate appreciation throughout the years. These pressures have intensified especially since the second half of 2014, when external demand for Turkmen exports declined and exports proceeds fell. Against this background and the weakened Russian ruble and Kazakh tenge, the authorities devalued the Turkmen manat by 18 percent to support the national currency's external competitiveness and compensate for declining fiscal revenues from natural gas export. Despite the currency devaluation, Turkmenistan holds a strong international reserves position, and external buffers amount to more than 22 months of import coverage.

The current account balance turned positive in 2013 and remained in balance in 2014. During the first half of 2014, exports increased by 8.3 percent while imports grew by 9.3 percent, which was associated with the large import of investment goods. However, during the second half of the year, the growth rate for both imports and exports decelerated and led to modest outcomes for the year of 3.4 and 4.9 percent, respectively. The export-to-import ratio remains at 1.4:1. The hydrocarbon cluster continues to be the main driver of economic growth and the core engine of export performance in 2014, including to nontraditional markets such as China.

Fiscal Performance

The overall fiscal position strengthened further in 2014 and the fiscal balance remained in surplus. In the background of strong fiscal buffers, in 2014 the Government increased public spending by about 12 percent while revenues went up by only 8 percent. Compared with the approved budget, actual revenue collection was up by more than 21 percent, whereas the Government contained public expenditures at below the 96 percent level. Tax revenues remain dominated by proceeds from hydrocarbon exports. The growth pattern in public investments changed in 2014 in favor of a substantial increase (30 percent) for social sector infrastructure.

Average wages grew 10.1 percent, leading to a real increase in incomes in a relatively low inflationary environment. The Government maintains a large portfolio of social transfers and budget subsidies. Currently, all 17 subsidies have a universal character and are guaranteed until 2030, though the Government may revisit this decision and decide to move earlier to a more targeted public transfer policy. In the current context, it is especially relevant to reconsider energy subsidies that are among the largest in the world and that do not contribute to the efficient use of resources.

Medium-Term Outlook and Challenges

The medium-term outlook is still positive but dependent on developments in the external environment and the international price for Turkmen hydrocarbon products. The baseline growth projection has been adjusted to 7–8 percent for 2015–16, down from the 10–11 percent projected earlier. With the hydrocarbon sector accounting for about 35 percent of GDP, 90 percent of exports, and 80 percent of fiscal revenues, the decline in demand for Turkmenistan's hydrocarbon exports is the key risk to growth projections.[2]

[2] According to International Monetary Fund (IMF) estimates, the breakeven level of the oil price for Turkmenistan is US$51.9 per barrel of oil to maintain the fiscal position in balance and US$54 to keep the balance of payments in positive territory.

Natural gas export requires a specific time- and investment-intensive infrastructure, which makes it difficult to substitute lost markets with new destinations in a relatively short period of time. In this context, if Russia does not revisit its recent decisions to cut natural gas imports, Turkmenistan may face a challenge.

It is expected that in the medium term, inflation will stay at around 4–5 percent, down from 6 percent in 2013. It will be fuelled by a further liberalization of utility and transportation services in Turkmenistan, as well as by the inflationary pressures expected from the price transfer of imported foodstuffs.

The diversification of export routes to China diminished the risk of a spillover effect from the CIS and Eurozone crises. However, the projected slowdown of economic growth in China and the economic recession in Russia pose challenges to Turkmenistan. With the aim of further diversifying its trade partners, Turkmenistan is accelerating the construction of a new pipeline to supply gas to Pakistan and India through Afghanistan (the TAPI project), to start in 2017. There are a number of issues to be addressed, however, including security concerns, for the successful and sustainable operation of this important regional infrastructure project.

Even with the revised growth outlook, Turkmenistan may reach high-income country status within the next decade. However to sustain the growth momentum in the medium to long run, Turkmenistan will need to implement strong structural reforms and face several important challenges:

- The overreliance on hydrocarbons makes the country vulnerable to a drop in prices for these resources on the global market. Although Turkmenistan runs a fiscal surplus and has been able to build a comfortable fiscal buffer, the diversification of skills, human capital, and other assets, products, and services as well as trade partners is needed to address fiscal vulnerabilities. The diversification of development options will be necessary to sustain growth in the long term.

- The necessary steps for a successful diversification strategy involve the development of market institutions. The creation of an effective financial and banking sector will be required in order to promote the growth of the non-resource sectors of the economy and thus enhance Turkmenistan's competitiveness. In addition, investing in human capital and strengthening institutional capacities will be essential to facilitating private sector–led development.

- The improvement of public financial management and governance practices is critical to ensuring the efficient utilization of hydrocarbon revenues. In addition to institutional reforms, it will be necessary to develop a strategic framework to guide public investment decisions and ensure the efficiency of capital investments. Staff capacity will also need to be improved to ensure that they are able to carry out the in-house appraisal, screening, and selection of priority public investment projects.

- A more equitable allocation of budget resources may require amendments to the current principles of public spending policy. The cost of the budget subsidies currently provided and the state aid programs may become too high and fiscally unsustainable over time. Thus the current practice of universally providing budget assistance to the entire population should be replaced with targeted social assistance programs only to those in need.

Turkmenistan will need a reliable and comprehensive set of statistics to inform its policy decisions. The introduction of international standards in statistics and the continuous improvement of the quality and reliability of the statistics it does produce will be required to better inform public policy decisions. The Turkmen authorities should take the necessary steps to make the existing statistics on the country's economic and social development readily available to the public. To facilitate this process, staff capacity will need to be improved and new methodologies introduced in line with international practice.

WORLD BANK PROGRAM IN TURKMENISTAN

Past Engagement (1995–2004)

At the request of the Government, the World Bank has prepared a number of studies and extended three loans to Turkmenistan (for details, see box below). The Bank has made efforts to help Turkmenistan with reforms in areas such as public resource management, through an Institution Building and Technical Assistance (IBTA) loan that closed on December 31, 2003; financial transparency, through Institutional Development Fund (IDF) grants on Public Procurement, International Accounting Standards, and External Debt Management; the public transport system, through an *Urban Transport Project*; the energy sector, through a sector review in 1999–2000; and the water and sanitation sector, through a *Water Supply and Sanitation Project*.

Recent Activities (2005–12)

Recent Bank activities in Turkmenistan included the World Bank trust fund to finance the *Statistical Capacity Building Project*, which closed on April 15, 2012, and the Civil Society Fund Program, which is now being transformed into a Global Partnership for Social Accountability Program. The *Avian Influenza Control and Human Pandemic Preparedness and Response Project* was another recent project that closed with a satisfactory rating on December 31, 2010. At the Government's request, the Bank also provided advice on a number of other issues, including but not limited to, national wealth funds, an Accounting and Auditing Report on the Observance of Standards and Codes (ROSC), the modernization of the Hydromet agency, an anti-money-laundering/combating the financing of terrorism (AML/CFT) legal framework together with the International Monetary Fund (IMF), transport and logistics issues, and international experience in the ports sector.

Current Partnership Program FY14–15

On July 25, 2013, the Interim Strategy Note (ISN) for Turkmenistan was discussed by the World Bank Board of Executive Directors. The ISN prepared jointly by the World Bank Group and the Government of Turkmenistan serves as a platform for the World Bank and International Finance Corporation (IFC) to cooperate with Turkmenistan in support of reforms in the country for the period from July 2013 through June 2015.

The purpose of the Interim Strategy, which does not involve lending, is to assist the Government in addressing selected priority issues related to the country's development goals. This will be accomplished through the provision of analytical and advisory services in the selected areas identified through extensive consultations with key stakeholders, including government ministries and agencies, private sector representatives, civil society organizations, and development partners.

The ISN consists of two components:

• ***first***, a Reimbursable Advisory Services (RAS) program, financed by the Government and focused on macroeconomic statistics, financial sector development, and private sector development. This program is arranged, managed, and supervised by the World Bank Group.

• ***second***, complementing the RAS program, a set of strategic analytical studies undertaken by the Bank and IFC on economic diversification, access to finance, the investment climate, privatization, and World Trade Organization (WTO) accession. These studies will be financed by the World Bank Group and implemented in line with standard internal procedures for analytical and advisory services.

Reimbursable Advisory Services Program

On September 30, 2014, the World Bank Group and the Ministry of Finance of Turkmenistan signed a Reimbursable Advisory Services (RAS) Agreement, which is a two-year program that is an integral part of the interim strategy for Turkmenistan.

The activities under the RAS agreement are financed by the Government of Turkmenistan and focus on areas proposed by the Turkmen authorities, namely, macroeconomic statistics, financial sector development, and private sector development. The entire program under the RAS is arranged, managed, delivered, and supervised by the World Bank Group in line with international best practices.

Results

Most ISN-RAS activities and outputs were delivered as planned and the results considered broadly satisfactory by both the Turkmen authorities and the World Bank Group. Overall, the level and quality of the authorities' engagement in RAS-funded tasks was higher and timelier than in the Bank-financed advisory studies, except for the RAS program's privatization component, where planned IFC support for individual privatization transactions did not materialize. Nonetheless, the Bank-funded advisory studies were important in facilitating an initial policy dialogue on structural issues, such as banking system reform and private sector development.

The New Country Engagement Note FY16–17

Currently, the World Bank Group and Turkmenistan are in the process of preparing a new Country Engagement Note (CEN) for the period covering FY2016–17. The CEN will continue to focus on the sectors identified under the Interim Strategy Note (ISN) for the period of FY14–15 and may include follow-up activities in the areas of current engagement as well as potential additional activities in several new areas such as: (i) support to competitive industries; (ii) financial sector modernization; (iii) improved skills in support of innovation; (iv) support for competitive agriculture; (v) climate change/water resource management; and (vi) the connectivity agenda (information and communications technology [ICT] and transport).

In early April 2015, the CEN team, comprised of representatives of several of the World Bank's Global Practices, will hold consultations with government partners, development partners, the private sector and civil society organizations, and other stakeholders to identify specific activities for inclusion in the engagement note for FY16–17.

International Finance Corporation

Turkmenistan became a member of IFC, the private sector arm of the World Bank Group, in 1997. Since then, IFC has worked with the Government on a number of activities. As part of the ISN, IFC is joining the efforts of the World Bank to assist the Government and may explore potential opportunities for support to small and medium-sized enterprises, either through a financial intermediary or through direct investments in private enterprises.

Multilateral Investment Guarantee Agency

The Multilateral Investment Guarantee Agency's (MIGA) portfolio in Turkmenistan consists of one project, issued to a Turkish investor in support of the country's manufacturing sector to expand and modernize a soft drink bottling facility in Ashgabat. In 2012, MIGA issued an additional guarantee to the same investor.

A MIGA team visited Ashgabat in March 2015 for an evaluation mission and also researched opportunities to expand its operations in Turkmenistan.

SUMMARY OF PROJECTS IN TURKMENISTAN

Loans to Turkmenistan

- Institution Building and Technical Assistance Loan (IBTA) (IBRD, US$24.9 million) *(2003)*
- Urban Transport Project Loan (IBRD, US$34.2 million) *(2001)*
- Water Supply and Sanitation project Loan (IBRD, US$30.3 million) *(2004)*

Analytic and Advisory Services

Public Sector Management

- Public Expenditure Review *(1998)*
- Comments on Draft Tax Code *(2000)*

Social Sector

- Living Standards Survey *(2000)*
- Dashoguz: Regional Development Priorities *(1998)*
- Rationalizing the Health Sector *(1997)*
- Water Supply and Sanitation: Needs Assessment *(1995)*

Rural Development

- Agricultural Sector Review *(1997)*
- Farm Survey *(2000)*

Energy and Infrastructure

- Energy Sector Study *(1995)*
- Energy Export Prospects *(2000)*
- Energy Taxation *(2000)*

Banking and Accounting

- Introduction of International Accounting Standards Grant *(2004)*
- Advice on Modernizing the Payment systems *(2008)*
- Accounting and Auditing Module of the Reports of Standards and Codes (A&A ROSC) *(2010)*

For more projects, please visit:

www.worldbank.org/tm

Turkmenistan: Turkmenistan Coca-Cola Bottlers
Project ID: 11662

Fiscal year: 2012
Guarantee holder: Coca-Cola Icecek A.S.
Investor country: Turkey
Gross exposure: US$8.7 million

About the project:

On June 25, 2012, MIGA issued a guarantee of US$8.7 million to cover an investment by Coca-Cola Icecek A.S. (CCI) of Turkey in Turkmenistan Coca-Cola Bottlers (TCCB). The coverage is for a period of up to seven years against the risks of expropriation, transfer restriction, and war and civil disturbance.

The project consists of the continued expansion and modernization of a soft drink bottling facility in the city of Ashgabat. TCCB bottles, distributes, and sells soft drink products throughout the country.

Results achieved:
MIGA has supported this project since 1999. Since then, TCCB has continued to grow and meet rising local demand by installing three additional production lines. TCCB has widened its reach by increasing its distribution and warehousing network.

TCCB's expansion and modernization contribute to the strengthening of local businesses through the procurement of raw materials. Eighty percent of plastic preforms are sourced from a local supplier, and TCCB procures pallets and propane from the local market. The project's investment in human capital has continued to grow—from 185 jobs in 1999 to approximately 360 jobs in 2011, with wages and benefits 10 percent higher than the country-wide standards; additional staff is also expected to be added. Workers also benefit from the substantial transfer of technical and managerial expertise. There is anticipated employment growth among local suppliers of goods and services as TCCB's production increases.

The project is aligned with MIGA's strategic priority of supporting South-South investments.