



BASIC FACTS:

Capital: Ashgabat
Area: 488,100 square kilometers
Population: 4.8 million (1999)
Currency: Manat
Exchange Rates: \$1 = 5,297.22 (May 2001)
GNP: \$3.2 billion (1999)
GDP Growth: 7.0% (1998); 16% (1999); 7.8% (1999-03)
GNP per capita: \$660 (1999)
Inflation: 19.5% (1999)

EXECUTIVE SUMMARY

Turkmenistan is a new, constantly changing market in which the investor or businessman must be flexible, persistent, and patient in order to succeed. It is a country of important, untapped natural resources, where the opportunities for investment and business are varied and numerous. However, the risks inherent in doing business in the former Soviet Union require that potential investors and businessmen proceed cautiously.

The Government of Turkmenistan (GOTX) has not yet implemented a program of far-reaching economic and political reform, although it has taken limited steps in some areas. While small-scale trading and service operations have largely been privatized, the government is still grappling with how to privatize medium- and large-scale enterprises. The government continues to play an interventionist role in the economy, and the problems inherent in a command economy continue to frustrate western companies. All decisions are made at the highest levels of government. Political considerations exert and influence on economic decisions. While some of the regulatory and legal foundations of a market economy have been developed, their implementation is flawed and inconsistent. Business infrastructure and know-how are improving, but still lag behind that of many other countries of the former Soviet Union.

Throughout the Soviet period, Turkmenistan's economy was based on exploitation of its natural gas, oil, and cotton. Today, the GOTX is focusing its attention on expanding export markets for its natural resources and increasing the value-added of its exports. The GOTX has placed a priority on investment in the oil and gas and textile industries, transportation and communication networks, and processing facilities. In addition, the GOTX has invested in infrastructure improvements designed to attract foreign businesses to invest in Turkmenistan.

ECONOMIC OUTLOOK

Turkmenistan was initially less negatively affected by the breakup of the former Soviet Union than other Republics because of its reliance on oil and gas exports. But the inability of several former Soviet republics to pay for their gas imports eventually led to serious external arrears and declining gas output. In 1994, export volumes declined sharply due to interruptions in deliveries of gas to Ukraine and Georgia, and with a worsening of the payments situation, gas exports were suspended completely in March of 1997. Although agreement was reached with Ukraine to export 20 bcm of gas in 1999, 60% of the payment will be made in equipment and other goods. Difficulties with this arrangement have already begun to appear.

Turkmenistan authorities are giving high priority to relieving their dependence on other former Soviet Republics as export destinations for their natural gas. A new spur pipeline to Iran was opened in December of 1997 with annual capacity to transport 8 – 10 billion cubic meters (bcm) of gas annually. Turkmenistan hopes to export 4 bcm of gas to Iran through this pipeline in 1999. In February of 1999 President Niyazov announced an ambitious project to build a Trans-Caspian Pipeline (TCP) that would have the capacity to export from 16 bcm to 30 bcm of gas annually to Turkey, and ultimately, to Europe, but this project has yet to be realized.

Recent economic developments have highlighted the economy's vulnerability to external shocks. Merchandise exports fell from \$1.7 billion in 1996, to \$523 million in 1998, because of the dual effect of deep declines in exports of natural gas and cotton fiber. Turkmenistan's export destinations swung markedly away from Russia and Ukraine in 1998 because of the payment difficulties those countries were experiencing. Imports also contracted markedly, although not enough to prevent a burgeoning trade deficit. This, combined with a deterioration in the services account associated with payments to foreign companies for construction services, caused an implosion of the current account in the balance-of-payments, from a small surplus in 1996 to a \$600 million deficit in 1997. The financial crisis in Russia in 1998 contributed to further deterioration in the current account deficit, to an estimated \$650 million.

Foreign debt rose from zero in 1992 to the equivalent of 74% of GDP in 1997. By 1998 a severe liquidity crisis had emerged. The reaction of Government authorities has been to restrict currency convertibility and try to maintain an artificially strong official foreign exchange rate. The black market rate in the first quarter of 1999 was three times the official rate.

State-sector wages were doubled in 1998, while pensions were increased by between 50% and 100%. The cumulative effect has been that inflation, although reduced to 20% by 1998, may be accelerating.

Given its strong natural resource base, Turkmenistan has excellent long-term development potential. However, economic reform has lagged, and recent developments have highlighted the nation's vulnerability to external shocks. Although authorities are attempting to diversify the export base by finding new markets for natural gas, the nation's economic vulnerability should also be reduced by accelerating the pace of economic reform. The immediate challenges are to adopt an effective macroeconomic stabilization program, consolidate the budget, and give the

central bank the independence it needs to conduct a restrained monetary policy. Over the medium term, Turkmenistan will also need to initiate comprehensive structural reform, fully liberalize prices, privatize non-strategic medium-and large-scale enterprises, and encourage competition.

BUSINESS AND INVESTMENT CLIMATE

Turkmenistan officially welcomes foreign investment in all areas. Since the March 1997 passage of a new law on hydrocarbon resources, the government has been actively courting large energy multinationals to participate in the development of Turkmenistan's oil and gas reserves through production sharing agreements and as minority joint venture partners. Yet it is still the case that, because the economy is still largely state-owned and controlled, most economic decisions continue to be made at the highest levels of government. The regulatory and legal foundations of a market economy are rudimentary, and discretionary official authority tends to prevail over the rule-of-law. These issues are gradually being resolved as the Government and the population become more familiar with the international norms of the world marketplace.

Turkmenistan is now announcing international tenders for competitive bids on government projects. Previously, trade contracts were granted for purely political reasons, with little regard for feasibility, economic viability, or the ability of the winning company to do the job. Despite the new policy, competition remains an alien concept to many government officials. Large-scale contracts are still signed at the presidential level and usually require a company's CEO to travel to Ashgabat to close the deal. Almost all companies investing in Turkmenistan form a joint venture with a local company. Practically all joint ventures include a government partner. Arbitrary re-negotiation of signed contracts remains a problem.

A new law concerning hydrocarbon resources, adopted in March of 1997, is intended to create better transparency in the regulation of foreign investors in the oil and gas sector. This law provides a detailed legal framework for conducting oil and gas business in Turkmenistan. Three types of licenses can be issued on the basis of tender results or direct negotiations: the exploration license, the extraction license and the single exploration and extraction license. Two types of agreements can be signed for oil production: the production sharing agreement and the joint venture agreement. A few foreign companies have already begun operations by signing production sharing agreements in the oil and gas sector before the new hydrocarbon resources law was adopted, and the government expects more foreign oil and gas companies to be attracted by this improved regulatory framework in the near future. However, investors in oil and gas still have to contend with the absence of export routes.

The State Agency for Foreign Investment monitors all foreign investment. It reviews and clears all investment proposals and foreign currency credits proposed by Government ministries. The Investment Agency tends to give preference to the Government's "priority" projects. The Investment Agency operates in cooperation with the Turkmen State Bank for Foreign Economic Affairs, the key institution for foreign businessmen and investors.

On October 25, 1993 a bilateral trade agreement, which provides reciprocal most favored nation (MFN) status, went into effect between Turkmenistan and the United States. Discussions concerning a U.S.-Turkmenistan bilateral investment treaty are ongoing. The United States Government has also proposed a bilateral tax treaty, which would provide U.S. businesses relief from double taxation of income. In September 1993, President Niyazov signed a law on the protection of intellectual property rights, and in December 1998 the Mejlis (Parliament) adopted a new Civil Code that addressed copyright regulations, although enforcement of these decrees remains untested. The U.S.-Turkmenistan trade agreement also contains commitments on protection of intellectual property.

Foreign companies can benefit from a number of exemptions and tax holidays established for specific circumstances. Foreign companies, their branches or representative offices, and foreign individuals registered and engaged in production and/or commercial activity in Turkmenistan, are subject to a value added tax (20 percent), a profit tax (25 percent), a property tax (1 percent) as well as excise taxes for certain imported goods and products. A VAT is levied on turnover including export operations, sales of all kinds of goods and services produced by the enterprise and/or acquired elsewhere, internal sale within the enterprise, barter, and free-of-charge transfer of goods and/or sales of collateral to other legal entities. There are a number of activities defined by the Law on the VAT under which VAT is not charged. The Law on Profit Tax offers some tax relief to foreign companies provided that at least 30 percent of the authorized capital of an enterprise is in hard currency. This enterprise can then enjoy a profit tax exemption for the period of repayment of initial capital investments. Also, foreign companies functioning in free economic zones are exempt from profit tax for three years, and agriculture investment projects are also provided a profit tax holiday. Investors in the oil and gas sector must pay a 25 percent profit tax plus a negotiable royalty sum.

POLITICAL CLIMATE

Turkmenistan is a single party state governed by an authoritarian President, Saparmurad Niyazov. There is no Vice President or Prime Minister. A group of officials each holding the title of Deputy Chairman of the Cabinet of Ministers, each with responsibilities in a defined area, constitutes the next level of executive authority. According to the Constitution, the Chairman of the Mejlis (Parliament) assumes the presidency upon the death or permanent incapacitation of the President and then calls elections. The Halk Maslahaty (People's Council) is the highest representative body and is responsible for adopting constitutional amendments, treaties, and referenda. The Halk Maslahaty is chaired by the President and made up of Cabinet Ministers; regional, district, and city Hakims (governors and mayors); Parliamentary Deputies; People's Representatives, who are elected by one in each etrap (district); the Chairmen of the Supreme Court and the Economic Court; and the General Prosecutor. The Mejlis is the supreme legislative body, elected for a five-year term. However, its authority is limited; its decisions generally reflect the policies of the President.

President Niyazov, who has adopted the honorific surname "Turkmenbashi" ("head of the Turkmen"), is the former First Secretary of the Turkmen Communist Party. He was elected President in 1992 in a single-candidate election for a term of five years; a 1994

referendum resulted in the extension of his initial term to 2002; he recently extended his tenure to 2007. The National Democratic Party, the successor to the Communist Party, is currently the country's only political party and is led by President Niyazov.

SOURCES OF FINANCING

The banking system in Turkmenistan consists of the State Central Bank of Turkmenistan, three state banks and 17 commercial banks. Most of the commercial banks are small- and medium-sized. There are four banks with foreign capital including the Turkish-Turkmen bank "T.C. Ziraat Bankasi," the Russian-Turkmen bank "Rossiyskiy Credit," the Pakistani-Turkmen bank and an Iranian commercial bank "Saderat." All banks, including foreign banks, must be issued a license by the Central Bank of Turkmenistan, in order to operate. Five Turkmen commercial banks, a Turkish-Turkmen joint commercial bank, and Sberbank have licenses from the Central Bank enabling them to carry out foreign exchange operations.

The State Bank for Foreign Economic Affairs (Vnesheconombank) is the key institution for foreign businessmen and investors, as well as local exporters. It dominates import/export operations and is a member of the International Payment Cards Association. The Vnesheconombank has been authorized to sign an agreement with "Standard and Poors" agency concerning awarding Turkmenistan with the international sovereign credit rate.

Turkmenistan signed an OPIC agreement in 1993 that provides for loan guarantees, direct loans and investment insurance to U.S. companies. To date, there has been little U.S. investment utilizing these facilities in Turkmenistan. The U.S. Export-Import Bank provides short- and medium-term coverage for sovereign risk transactions. Ex-Im Bank requires an irrevocable letter of credit (ILC) or guarantee from the State Bank for Foreign Economic Affairs, Vnesheconombank, for short-term transactions. Many American companies in Turkmenistan have used Ex-Im Bank funds or guarantees to finance their projects.

Domestic enterprises are supposed to have access to credits from local commercial banks, but to date these banks have made few loans. The Central Asian-American Enterprise Fund and the European Bank for Reconstruction and Development have both opened credit lines for Turkmen private enterprises.

Turkmenistan is a member of the IMF and the fund has a permanent advisor stationed in Ashgabat. Turkmenistan is also a member of the World Bank and the EBRD, both of which have development projects in the country.

TELECOMMUNICATIONS

The telecommunications equipment and service market in Turkmenistan is relatively small, but has been growing slowly in the past years. Among NIS countries Turkmenistan has the least developed communications services. The state-owned Turkmentelecom company is the primary provider of public telephone, e-mail and internet services for local organizations and companies. Most of the foreign

telecommunications companies that have established a presence in Turkmenistan have been successful due to "first come first win" contracts with the government. To date, the slow development of the Turkmen private sector and state control over most economic activities have been significant factors in the slow growth in telecommunications service sector. So far, German communications companies have been the main competitors for telecommunications equipment supply; however, in April 1994 a US company won a ten year exclusive contract for providing paging and cellular phone services.

Work on replacing out-of-date analog system equipment with modern digital communications system is currently underway as part of the general plan for modernization of the national communications network. Over the past several years, more than 20 digital telephone stations have been installed in Turkmenistan. This has increased the availability of telephone numbers by 100,000. Two German companies, Siemens and Alcatel, are carrying out the largest telephone network upgrading projects. A project to construct 708 kilometers of the Trans Asian-European fiber-optic communications line (TAE) within the boundaries of Turkmenistan was completed in 1997 by the Iranian National Telecommunications Company. The German company Siemens supplied most of the equipment for this project. Siemens has also supplied GSM equipment for about 5,000 phone numbers to Texas-based Barash Communication Technologies, Inc. The exclusive cellular and paging communications service provider is currently negotiating several additional contracts with the communications ministry. The government plans a gradual upgrade of the existing communications network by replacing it with a digital communications system, building new trunk communications lines, and developing new international communications channels.

In 1997 MCI signed a contract with the state Turkmentelecom company to provide access to the internet system and in 1998 this project was put into operation. It included setting up 15 digital channels, some of which have a capacity of 128 kilobytes per second and are used primarily for e-mail and Internet services. A direct telephone line connecting Turkmenistan with the US has been also established. Due to its high cost in relation to local incomes, there are not many Internet users currently in Turkmenistan. A direct digital communications via Russian satellite equipment "gorizont-53" with 30 channels was recently established between Ashgabat and Moscow. The next stage of this project is the expansion of the digital communications with Ukraine, Belarus, and the Baltic States via 120 channels of satellite communication.

The government has developed a draft strategy for socioeconomic transformations in Turkmenistan for 2000-2010 which was adopted at the Halk Maslahaty (people's council) meeting in December 1999. One of the components of this program deals with the development of the telecommunications sector and features numerous trade and investment projects. In considering these projects, US companies should take into account that long term financing arrangements and production sharing contracts are key issues for doing business in Turkmenistan. The government has said that it plans to use a long term credit line for USD 90 million from the Japanese fund for economic cooperation with foreign states (OECF) to invest in the telecommunications projects.

According to the law concerning communications, the Ministry of Communications licenses and regulates commercial activities in the area of telecommunications services. The Ministry does not impose restrictions on telecommunications services,

but encourages Turkmen and foreign companies to take into consideration the government's national program on the development of telecommunications sector.

Legal entities and individuals registered in Turkmenistan may apply for a license by submitting a package of documents to the ministry. The package includes a copy of the company foundation charter, a certificate for telecommunications equipment, a technical description of the project, and a feasibility study. The licensing commission under the Ministry will consider the application within a month and, if an approval is granted, will charge a licensing fee of USD 1,500.

The state committee on radio frequencies issues a one-year license for importing, selling, and using radioelectronic and high frequency equipment and devices. It provides radiotechnical tests of telecommunications equipment which must meet the established standards. The committee also determines a fixed location for the equipment, which cannot be changed without permission of the committee. Such items as video- and audio-equipment, microwave ovens, videocameras, videosenders, and satellite dishes are not under the category of the radioelectronic and high frequency equipment and devices.

INFORMATION TECHNOLOGY

Hardware and Software

The computer hardware and software market in Turkmenistan has been and is still underdeveloped. The market has grown very slowly and primarily due to the gradually increasing foreign business community. Domestic obstacles, such as widespread state intervention in the development of the private sector, low incomes, restrictions on hard currency convertibility, and limited license issuance have slowed the growth of the computer market.

In 1991 Turkmenistan was the least computerized country among the newly independent states. As a result, the Turkmen population is to a large degree computer illiterate. There are no schools teaching computer programming, but there are a few short-term computer courses providing computer education to the population. There are no computer hardware manufacturers in Turkmenistan. Computer equipment is imported and distributed by Turkmen and Turkish dealers who buy hardware and software in Russia, UAE, Turkey, China, and some European countries. The state entities that dominate the Turkmen economy have not been the main buyers of computers. The GOTX has not put its priorities on data processing and transferring system development. Turkmen state banks, the national civil aviation company, telecommunications entities, and some government offices have installed such brand name computers as IBM, Compaq, and Hewlett Packard. The Turkmen private and foreign business communities have been the main driving force in the development of information technology market in Turkmenistan.

There are about 15 small- and medium sized computer assembly, sales and service firms in Turkmenistan. Among those licensed are individuals or groups of computer fans who were skilled enough to provide qualified but simple service to the market. 10 to 12 computer firms have existed in the market since 1993-94 and have developed stable sales and provided services. The Turkmen market is small; out of an estimated

five million population only a handful of Turkmen use computers. Turkmenistan is primarily a wire communication market; wireless systems are almost not used here. An exception might be those few foreign businesses and diplomatic missions represented in Turkmenistan.

Pentium II (Celeron) and Pentium III are the most popular PC processors and are purchased mainly for office use and playing games. Internet browsing is not yet a popular activity. To make their business reasonably profitable, the majority of local distributors import computer parts, assemble personal computers, and sell them at low prices to be able to meet local market purchasing capacity.

There are no more customs tariffs and excise taxes levied on imported computer equipment. Individuals bringing personal computers into Turkmenistan must declare their PCs at the customs to be able to take them out of Turkmenistan at a later date. The GOTX used to charge a 10 percent tax for the resale of computers, but this was abolished as of March 1, 2000.

Turkmenistan has a pirate software market; although the new civil code addresses copyright issues, there is not yet an authorized body to protect intellectual property rights for imported goods and services. The current procedure for IPR protection involves the following steps: the IPR owner should register the intellectual property product with the patent agency and then submit an official letter to the state customs requesting that it take appropriate measures to protect the owner's IP products from piracy. If someone imports goods without the property right owner's permit for sale in Turkmenistan, customs gives a ten day notification period to the importer to obtain a license from the owner.

Because of high prices for licensed software, Turkmen PC users who constitute more than 50 percent of PC buyers prefer to buy non-licensed software. Among individuals purchasing PCs, 99 percent buy non-licensed software. The Turkmen software market is dominated by windows 98, office 97, page-maker, Coreldraw, and Photoshop programs. English and Russian software versions are widely used but a Turkmen language version has become a necessity since the GOTX introduced the Turkmen language as the official state language.

Internet

The Internet first officially appeared in Turkmenistan in 1997, when the government of Turkmenistan signed a contract with MCI for the construction and development of data transmission and Internet services. At the end of 1996, USAID provided a grant to one of the Turkmen firms to provide Internet services to a local ecology related non-government organization. This significantly promoted the Internet services and educated the first wave of internet users.

The future of the Internet in Turkmenistan looks rather bleak with the state holding a monopoly as the sole legal Internet service provider. Internet development in Turkmenistan hit its lowest level after the national company Turkmentelecom became a monopoly. Domestic ISPs learned that their Internet licenses would be withdrawn due to nonconformity to their obligations. The ISPs had invested heavily in equipment and established steady and mutually profitable relationships with local clientele. All clients transferred to Turkmentelecom.

Currently, Turkmentelecom provides Internet access to more than 1,000 users. However, this figure is an official estimate that does not consider a large number of non-official internet users that access the internet either by tapping into Turkmentelecom's servers illegally or using other users' log-in names. Local computer analysts estimate the actual number of users as high as 2,500-3,000.

Internet usage is almost completely limited to Ashgabat, Turkmenistan's capital, and Turkmenbashi, an important sea-port city where a number of western energy companies are located. The rest of the country is virtually uncovered, although Turkmentelecom has branches in all five regional centers.

The majority of Internet users are corporate clients and foreign companies located in Ashgabat. The younger generation of Turkmen, mainly students and those who have studied in the west, represent an important user-group as well. This user segment is supported by a few Internet cafes operating in Ashgabat. A relatively low-cost connection enables the users to gain valuable experience with the world wide web. Nevertheless, the majority of the country's adult population does not have a clear concept of the Internet and its use.