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Turkmenistan

Diversifying The Turkmen Economy

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TMT 1: US\$ 0.35

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ABBREVIATIONS AND ACRONYMS

ANS	Adjusted Net Savings
CAGR	Compound Annual Growth Rate
CBT	Central Bank of Turkmenistan
CIS	Commonwealth of Independent States
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FERF	Foreign Exchange Reserve Fund
GDP	Gross Domestic Product
GNS	Gross National Savings
ICT	Information and Communication Technologies
IMF	International Monetary Fund
MoF	Ministry of Finance
NPSD	National Program for Socioeconomic Development, 2011-2030
OECD	Organization for Economic Co-operation and Development
PISA	Program for International Student Assessment
PPP	Public Private Partnerships
RDP	Rural Development Program
SF	Stabilization Fund
SWF	Sovereign Wealth Fund
SME	Small and Medium-sized Enterprise
SOE	State Owned Enterprise
SSCT	State Statistics Committee of Turkmenistan
SDBT	State Development Bank of Turkmenistan
TAPI	Turkmenistan-Afghanistan-Pakistan-India
VET	Vocational Education and Training
WDI	World Development Indicators

Vice President	Laura Tuck
Country Director	Saroj Kumar Jha
Practice Director	Satu Kahkonen
Country Manager	Agata Pawlowska
Practice Manager	Ivailo Izvorski
Task Team Leaders	Gohar Gyulumyan and Donato De Rosa

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Executive Summary

The abundance of natural resources combined with high commodity prices for much of the last two decades has helped Turkmenistan reach upper middle-income status. The economy has grown fourfold in real terms and poverty outcomes are likely to have improved substantially. The question is whether this progress is sustainable, or just a windfall gain. In other words, what will it take to consolidate the gains achieved so far and achieve the long term objectives of a high-income, diversified economy able to create productive and well-paying jobs?

Turkmenistan prospered by integrating more into the world economy and the instrument of this integration has been hydrocarbons, the resource that the country has in the greatest abundance. Turkmenistan discovered its largest natural gas deposits (Yolotan) in the early 1990s, after the breakup of the Soviet Union, before transitioning to a market-based economy and commencing structural reforms. Over time this has led to the economy's reliance on extractive industries, which account for almost half of GDP and nearly 90 percent of exports, resulting in the most concentrated export basket in Central Asia. This is not surprising since countries typically export the items that are derived from their most abundant assets. Indeed, estimates of subsoil capital - the present value of the stream of annual resource rents that countries generate from production and exports of oil, gas, and mineral reserves - demonstrate Turkmenistan's richness.

Turkmenistan is working on completing its transition as it advances through upper middle income to high income. To a large extent, natural resource abundance thwarted the incentives for structural reforms and delayed first generation economic reforms, including trade/price liberalization, enterprise privatization and creation of institutions for the regulation of markets. Implementation of first generation economic and structural reforms began mainly after 2007. The public sector plays a dominant role in the economy, with centralized decision making.

Economic diversification is a key strategic priority. As part of diversification efforts and reduction of dependence on oil and gas revenues, the Government of Turkmenistan has embarked on a number of structural reforms. These aim to sustain a high level of government investment to diversify the economy, increase competitiveness, create new businesses and jobs, and expand domestic demand. Investment in infrastructure, particularly in more provincial and remote areas, is a key priority, as demonstrated by one of the highest rates of Gross Fixed Capital Formation in the world. Key priorities are also the improvement of monetary and credit policy and strengthening of the banking system.

Turkmenistan has a vertically centralized governance structure. Top-down decision-making characterizes the way the public administration operates. Most decisions are taken at the highest political level and implementation falls into various Ministries and agencies. Uneven coordination among the various agencies, capacity constraints in parts of the public administration and limited consultation with outside stakeholders may lead to fragmented regulation and sub-optimal quality of service delivery. In this context, the private sector has hardly evolved in a natural pathway and the relationship between the State and private enterprises is tightly controlled.

Accelerated and sustainable development will combine active diversification policies with policies to strengthen the country's asset base of natural resources, built capital and institutions. It may seem easier to target specific sectors or firms, with subsidies or other forms of preferential treatment, because focusing resources on the final objective (diversification of production or exports) is perceived as a quick win. cursory observation of global experience, however, shows that direct government intervention can only succeed if industrial policy is aligned with the comparative advantages of the economy and if the

mechanisms put in place to dispense government support are well designed and governed. Following the example of economies worldwide, the attention of policy and public financial resources could focus on leveraging natural resource revenues to diversify the country's asset base - the physical and human capital, and institutions that ensure macroeconomic stability, provide public services and regulate private enterprise. This development strategy offers better chances to achieve durable results, but requires a sustained effort on many fronts and over several years.

Reflecting its extraordinary resource abundance, Turkmenistan's asset portfolio is weighed toward "hard" endowments (natural resources and physical capital) while human capital and institutions are in need of improvement. Turkmenistan is richly endowed with natural resources, especially hydrocarbon wealth (it ranks 10th in the world in subsoil capital per capita). Thanks to massive investment in physical infrastructure, Turkmenistan has also built sizeable physical assets. Investments in "softer" assets - human capital and institutional upgrading - remain relatively low priorities. The Human Development Index (HDI), a composite statistic of life expectancy, education, and income, shows that, despite the spectacular increase in income per capita in recent years, health and education lag most comparators. Policies need to be put in place to improve the quantity and, more importantly, the quality of education. At the same time, rules to manage resource rents, provide public services, and ensure a level playing field for entrepreneurs and innovators need to be made more robust. For instance, Turkmenistan does not have transparent rules for defining limits of resource utilization from the Stabilization Fund or for the utilization of resource revenues for programs with higher public returns on investments. As for the regulation of private economic activity, there are no clear guidelines to ensure that procedures are duly followed when designing and implementing regulations, while Turkmenistan does not have a legal and institutional framework for competition.

In order to rebalance the country's asset portfolio, authorities can make specific policy choices to strengthen human capital, ensure a more level playing field for business, improve public service provision and manage resource rents. Key policy options in each of these areas are as follows:

Strengthening human capital

- Identify the optimal pace of increase in public investment spending in health and education, taking into account the current level of development and absorptive capacity of the country.
- Identify appropriate education policies to increase the quality of education and tailor the supply of education to the economy's development needs.
- Consider taking part in international benchmarking exercises, such as the OECD PISA assessment, to identify strengths and weaknesses of its education outcomes.

Regulating enterprise

- Consider a model of private sector development that allows greater decision-making autonomy to private entrepreneurs, for instance regarding production and location decisions. This should apply to both new firms and privatized enterprises.
- Devise regulatory management practices and procedures (regulatory impact assessment, consultation mechanisms, etc.) that can help improve the quality of regulations.
- Establish a competition framework that ensures a level playing field for enterprises, private and state-owned, domestic and foreign. The process could involve: (i) development and enactment of appropriate competition legislation (ii) identification of an institutional set up for a competition agency (sector-based, instrument-based or hybrid) that is appropriate within the current legal and

administrative framework, (iii) identification of the degree of independence and reporting requirements that guarantee effectiveness of competition enforcement in the current context.

Enhancing the quality of public service provision

- Enhance coordination mechanisms within government to ensure effective policy formulation, implementation and monitoring.
- Enhance the control system to increase the efficiency and effectiveness of public expenditure.
- Identify normative changes that would help increase the quantity and quality of service delivery, including, in due course, with the involvement of private partners in PPP arrangements.
- Develop a long term public investment strategy and introduce a public investment appraisal system.

Managing resource rents

- Introduce prudent fiscal rules and regulations to improve management of the Stabilization Fund to positively impact the quality of fiscal policy in the current setting of multiple fiscal institutions.
- Enhance the capacity of Ministry of Finance and Central Bank staff by developing skills on fiscal sustainability analysis and macroeconomic modeling.
- Use monetary policy instruments for effective smoothening of economic cycles.
- Reassess the fixed exchange rate arrangement.

Introduction

1. **Turkmenistan has become an upper middle-income economy driven by hydrocarbon exports.** The strong growth performance, sustained over a decade, helped to lift the country from a low income to an upper middle-income status. GDP per capita rose from US\$970 in 2002 to nearly US\$7,000 in 2013. Living standards of the population have improved, accompanied by massive investment in physical capital. Growth has been driven by natural gas exports, which amount to over 90 percent of exports, with the extractive sector (including refineries) accounting for nearly half of GDP.

2. **Sustained growth, continued improvement in living standards, an increased role for the private sector and economic diversification have become strategic government priorities for 2030.** In May 2010, the Government of Turkmenistan adopted its National Program for Socio-Economic Development of Turkmenistan for 2011-2030 (NPSD). Specific objectives include: a) increasing the private sector's role in the economy by expanding its share in the non-hydrocarbon economy to at least 70 percent; b) reaching a high-income status for the country by 2025; c) ensuring sustainable regional development by achieving universal access to drinking water in all communities by 2030; and d) closing the development gap between rural and urban areas and ensuring inclusive development throughout the country. The program envisages diversification of the economy and increased competition, and recognizes the importance of further market and institutional reforms. The program also includes privatization of small and medium enterprises (SMEs).

3. **A number of medium-term strategies support the implementation of long-term priorities.** This strategic vision is supported by the medium-term objectives of the Rural Development Strategy, SME Development Strategy and the President's program for Turkmenistan's Socioeconomic Development for the period of 2012-2016. These documents reflect the government's priorities of economic diversification, gradual increase of the private sector's role in the economy and ensuring sustainable development with environmental and social considerations. They also aim to further strengthen the base for the formation of a growing, diversified, highly competitive, and technologically strong economy. Both the energy and transport sectors are high-priority areas in which large-scale public investments are envisaged over the program period. According to the program, GDP is projected to see robust growth in 2012–2016, with industry expected to account for 55 percent of GDP by 2016, followed by services (22 percent), construction (14 percent), and agriculture (9 percent).

4. **Improvements in the investment climate and business environment are seen as fundamental factors for ensuring dynamic economic development.** The NPSD emphasizes the need to promote investments in the country from all sources, both domestic and foreign. In this respect the government's strategic documents include the priorities of creating an enabling environment for the transformation of private savings into real investment, developing an investment infrastructure, channeling investments into high return areas, drawing on multiplicative effect of investments, training specialists in investment management, improving the legal and organizational framework for investment facilitation, creating a network of investment information bureaus in the country and abroad, and encouraging investment activity by SMEs.

5. **The government also aims to create a stable, credible and well regulated financial and banking sector.** The NPSD suggests modernization of the financial and banking sector to offer high quality services and facilitate the growth of the non-hydrocarbon private sector. In addition, it anticipates increasing the role of the banking sector in the economy, improving its credibility in a competitive environment, upgrading the skills of banking sector personnel, as well as improving the financial literacy of the population. The country's main strategic document also envisages gradual development of an

effective foreign exchange market and transition to full liberalization of the exchange rate and convertibility of the national currency. These priorities are also stipulated in the Banking Sector Development Strategy for 2011-2030 and in the State Securities Market development for 2012-2016.

6. **This discussion note aims at supporting the government's strategic priorities.** It provides an umbrella framework for World Bank engagement in Turkmenistan. Companion discussion notes have been presented in the areas of privatization, investment climate, access to finance and trade. Based on global experience, this note identifies priorities to sustain Turkmenistan's modernization efforts, improvement in living standards and the successful diversification of the economy. It is argued that a precondition for success is the development of a balanced portfolio of national assets. This includes the country's resource endowments, an adequate base of physical and human capital and, most importantly, sound institutions for macroeconomic management, for the provision of public services and for the regulation of private economic activity. Only a balanced portfolio of national assets will guarantee the success of government policy in the long run, including the successful diversification of the economic base. The note has the following structure. First is an overview of recent economic developments, including the evolution of the country's economic structure and foreign trade. Next is an assessment of Turkmenistan's current asset portfolio of natural resources, physical capital, human capital and institutions. International experience is used to provide insights on how to better manage natural resources, improve physical and human capital, and strengthen the Government's ability to manage macroeconomic volatility, provide public services and regulate enterprise. A final section concludes with issues for discussion in the current context. This discussion note is informed by the policy priorities stipulated in the government's main strategy documents. More detailed analysis could be conducted when sectoral strategies and specific policy instruments deployed by the government to achieve its development objectives are made available.

Economic Performance

7. **Natural resource revenues served Turkmenistan well.** The strong growth performance, sustained over a decade, helped to lift the country from a low income to an upper middle-income status. GDP per capita rose from US\$970 in 2002 to nearly US\$7,000 in 2013 and the average wage in the economy grew by a factor of 7 between 2000 and 2011. The pace of wage increase was even higher in the construction and transport sectors. In the absence of other direct measurements of welfare, the average wage dynamic may be used to assess the overall positive social impact of natural resource revenues on the country's prosperity. Proceeds from hydrocarbon exports helped to build large foreign exchange reserves and create a comfortable fiscal buffer. Also, provision of key utilities (electricity, natural gas, and water) free of charge to the entire population since 2006, administrative control of prices for key foodstuffs, and subsidized prices for a number of goods and services with a large share in the consumption basket have had a large positive impact on the country's social situation. Official statistics indicate that social transfers are significant source of income (20 percent) for the lower quintile of population and account above 8 percent of income for the upper quintile.

Figure 1: Turkmenistan –one of the fastest growing economies of the world, 2012
(Annual change, in percent)

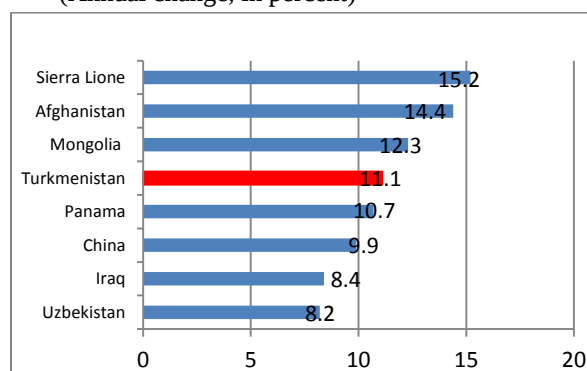
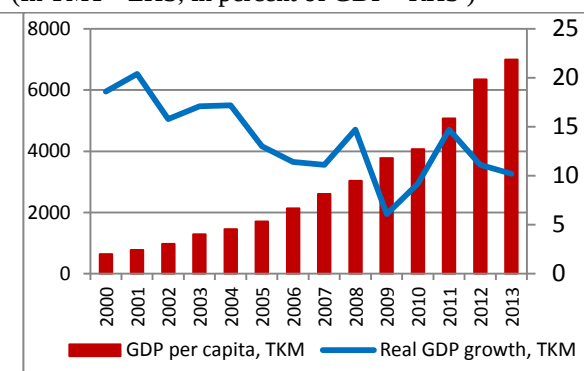


Figure 2: Average annual growth at double-digit and an eight-fold increase in GDP per capita, 2000-13
(In TMT - LHS, in percent of GDP - RHS)



Source: WDI

8. **The global crisis revealed the economy's vulnerability to a single-product centered and a single-market oriented growth model.** Before 2009 the main destination of the Turkmen hydrocarbon exports was Europe through Russia. But the crisis led to a decline of hydrocarbon prices and a drop in energy demand in Europe. As a result, natural gas exports from Turkmenistan collapsed during the last nine months of 2009, leading to a 30 percent decline in hydrocarbon output. Although growth was sustained at 6.1 percent, it was extensively supported by the expansion of public expenditures at the cost of significant depletion of the accumulated hard currency reserves. The crisis recovery strategy pursued by the authorities was centered on the redirection of trade to new markets for the most traded product, natural gas, in order to offset losses incurred in traditional markets. Construction of new pipelines to China and Iran in late 2009 helped to diversify the geography of gas supply and return the economy to double-digit growth. The eastward expansion of hydrocarbon exports will become even more significant after the completion of two on-going projects - the second pipeline to China, which is anticipated to become operational in 2017, and the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline set to enter into operation starting 2018. It is projected that these two large projects will increase Turkmenistan's natural gas export and triple current extraction capacity to 250 billion cubic meters by 2030.

Table 1: Turkmenistan, Selected Economic Indicators, 2008-2014

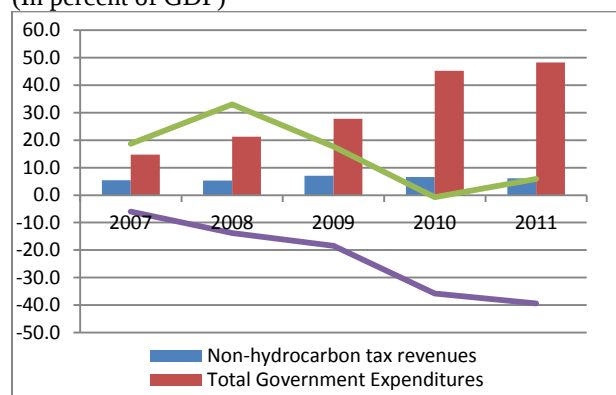
	2008	2009	2010	2011	2012	2013e	2014f
National Accounts							
GDP growth (percent change)	14.7	6.1	9.2	14.7	11.1	10.2	10.4
Non-hydrocarbon GDP growth	18.6	14.9	8.7	13.1	1.6		
Gross Fixed Investment (percent of GDP)	31.7	47.5	45.3	46.2	47.2	48.6	47.7
Public	18.4	31.8	30.3	33.6	36.7	39.3	39.1
Non-government	12.9	15.7	15	12.6	10.5	9.3	8.6
Money and Prices							
Consumer price inflation (% change, year-end)	8.9	0.1	4.8	5.6	7.8	7.5	6.5
Nominal exchange rate (Manats per dollar)	2.3	2.85	2.85	2.85	2.85	2.85	2.85
Fiscal (State Budget)							
	(in percent of GDP unless indicated otherwise)						
Revenues	20.4	20.4	15.8	15.1	21.0	20.6	17
Expenditures	10.9	17.6	13.8	12.2	14.7	18.9	15
Current	8.8	13.5	9.4	8.2	8.1	7.9	8.1
Capital	2.1	4.1	4.4	6.9	6.6	8.9	6.9
Overall Fiscal Balance	9.5	2.8	2.0	2.9	6.4	1.8	2.0
External Accounts							
	(current US dollars, millions unless indicated otherwise)						
Merchandise exports	11,786	8,946	9,660	16,719	19,884	21,656	24,139
Merchandise imports	5,363	8,071	7,428	10,447	13,357	14,615	15,673
Current account balance	6,423	-2,982	-2,349	583	15	97	1,787
in percent of GDP	29.9	-14.8	-10.6	2.0	0.0	0.2	3.8
Foreign Direct Investment, net (in percent of GDP)	11.9	14.2	12.0	8.9	7.6	7.3	13

Source: Government of Turkmenistan

9. **Structural imbalances, measured by the level of non-hydrocarbon fiscal and current account deficits, have increased over time.** The non-hydrocarbon primary fiscal deficit substantially widened from 6 percent of GDP in 2007 to almost 45 percent in 2011 (Figure 3). Similarly, the overall positive current account balance hides an expanding non-hydrocarbon current account deficit, which reached 40 percent of GDP in 2012 (Figure 4). A simple fiscal rule requires saving one-third of hydrocarbon revenues in the Foreign Exchange Reserve Fund (FERF). But the government needs to enhance its institutional capacity to ensure efficiency and sustainability of public spending funded from hydrocarbon revenues (see section on institutions to manage volatility).

Figure 3: The non-hydrocarbon fiscal imbalance widened over 2009-11

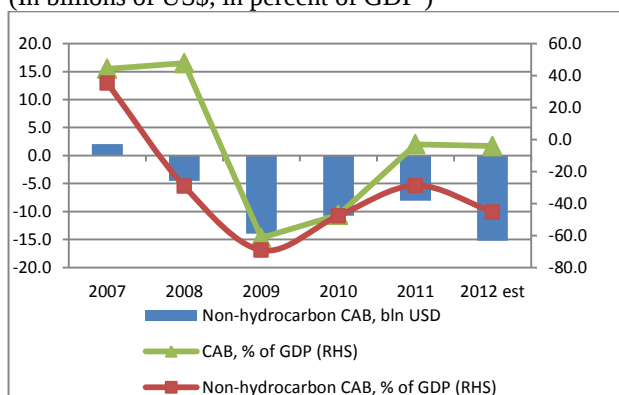
(In percent of GDP)



Source: Government of Turkmenistan

Figure 4: The non-hydrocarbon current account balance remains unsustainably high, 2007-12

(In billions of US\$, in percent of GDP)



Economic Structure

10. **The hydrocarbon sector has been a major source of growth and export earnings.** Throughout the last decade exports grew tenfold in dollar terms, helping the economy to expand by more than 4 times in real terms between 2002 and 2012, with average annual growth of 11 percent. Both growth and exports remained concentrated in the extractive sectors and were driven by a combination of favorable external environment (high prices for hydrocarbons) and increasing extraction capacity. By the end of 2013, the hydrocarbon sector contributed about 35 of GDP, nearly 90 percent of total exports, increased its contribution to the foreign exchange earnings by 2.6 times and ensured 85 percent of budget revenues, while providing employment to about 2 percent of the labor force.

11. **Hydrocarbons and construction have come to dominate the Turkmen economy, while services account for only one quarter of value added.** Between 2004 and 2013 the Turkmen economy expanded threefold owing to the strong contribution of industry and construction. As a result, the sectoral structure of the economy has substantially changed, leading to a reallocation of resources from agriculture and services to industry and construction. The latter became the most dynamic sector, expanding its share in the total economy from 6 percent in 2007 to about 17 percent in 2013. Together, construction and industry accounted for about two thirds of the Turkmen economy in 2013, up from 44 percent in 2007. Meanwhile the contribution of agriculture and services declined by half and 30 percent, respectively. The observed industrialization of the economy from 38 percent in 2007 to nearly 50 percent in 2013 was driven by the doubling of natural gas extraction during the same period. In total, hydrocarbons secured 80 percent of total industrial production in 2013 compared with 52 percent in 2007. The extractive sector's dominance was accompanied by the diminishing importance of food and light industries from a 42 percent share in industrial output in 2007 down to 15 percent in 2013.

Figure 5: Change in sectoral structure from agriculture and services to industry and construction, 2007-13

(In percent)

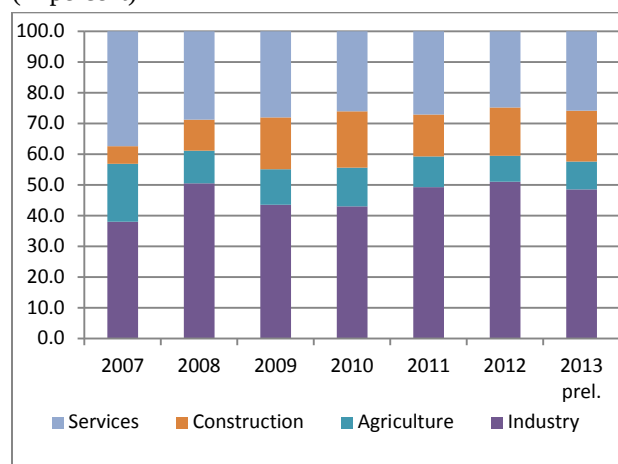
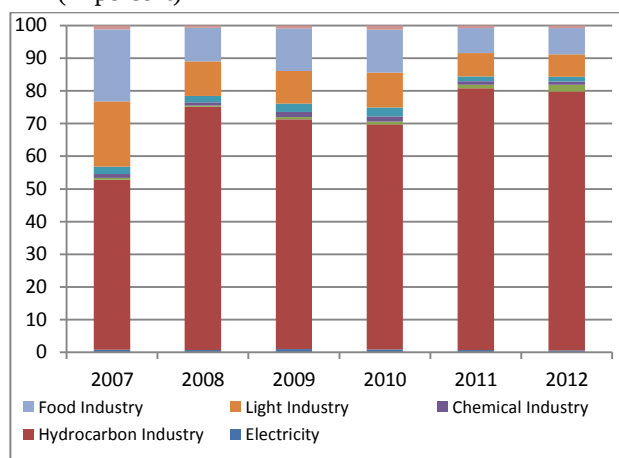


Figure 6: Industry is dominated by hydrocarbons, industrial sector structure, 2007-13

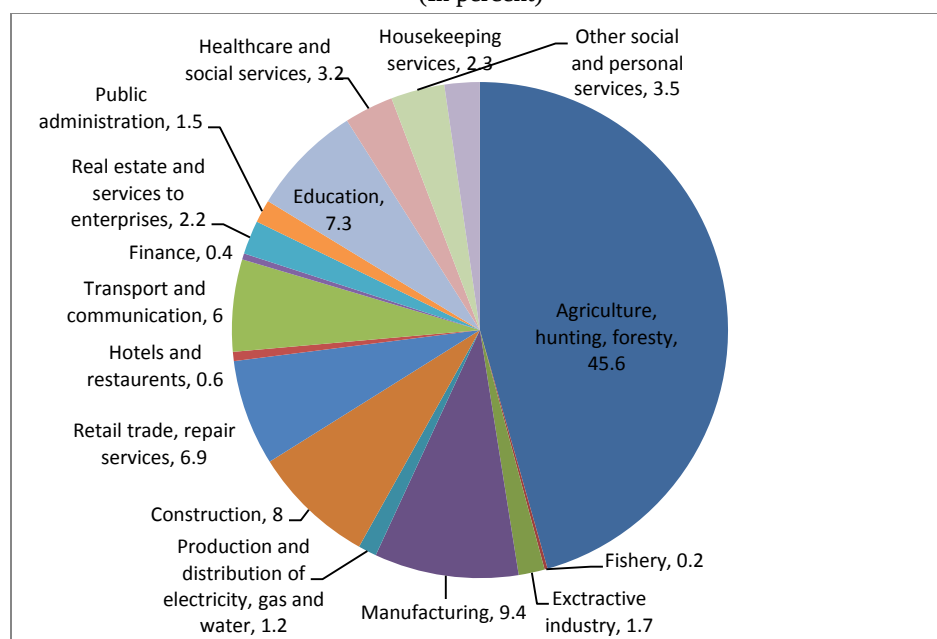
(In percent)



Source: Government of Turkmenistan

12. **Almost half of employment is in agriculture, with the expanding sectors contributing little to job creation.** Despite the notable structural change in the sectoral composition of the economy over the last decade, the sectoral structure of employment remained almost unchanged. Almost half of employment is in the primary sector, about nine percent in manufacturing and less than two percent in extractive industries. Services sectors are still under-represented and are likely to be the main source of new job creation in the years ahead.

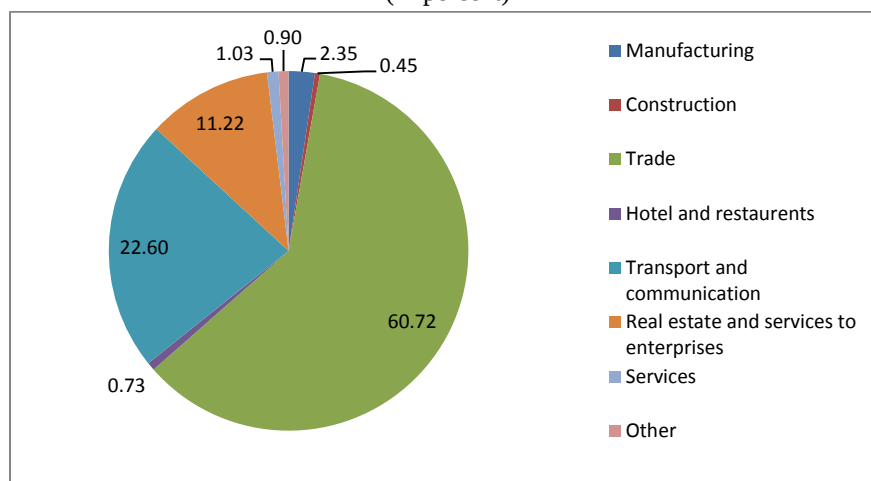
Figure 7: The bulk of employment is in agriculture, Share of employment in economic activities, 2012
(In percent)



Source: State Committee for Statistics of Turkmenistan, 2013

13. **The number of privately owned enterprises and individual entrepreneurs has increased significantly in recent years.** Recent government policies have led to an increase in the number of legal entities registered in Turkmenistan, from 19,268 in 2011 to 19,792 in 2012, with construction and manufacturing showing more dynamism in new firm creation. The total number of employed in individual entrepreneurship has increased by 14 percent in 2010-2011. Employment in manufacturing has slightly declined whereas it has been rising in other sectors. Most of the employed among 78,517 people in individual entrepreneurship are engaged in the trade and transport/communications sectors (Figure 8).

Figure 8: Individual entrepreneurs are mostly in retail and transport/communication, Individual entrepreneurs by sector, 2011
(In percent)



Source: State Committee for Statistics of Turkmenistan, 2013

Foreign Trade

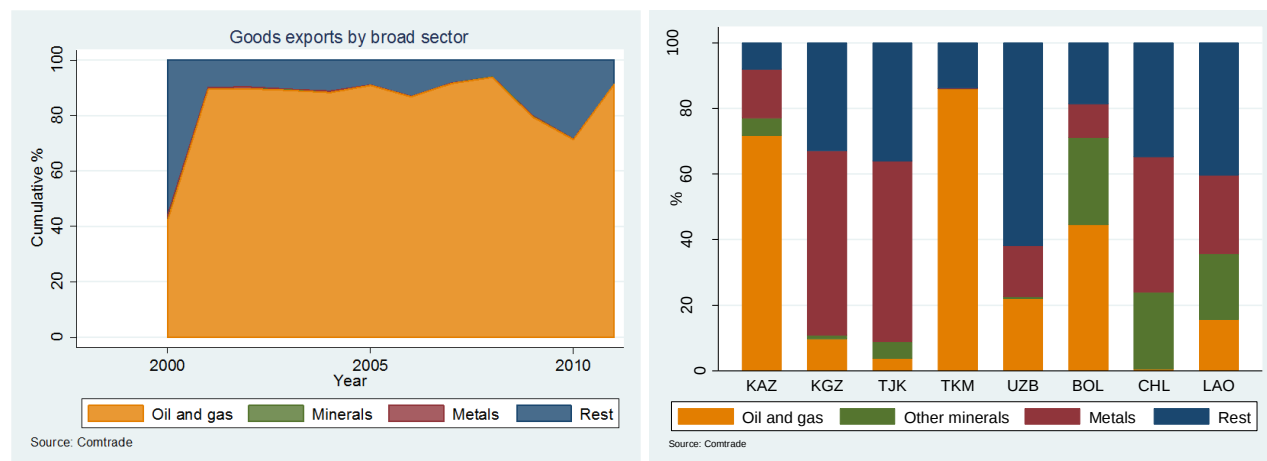
14. **Turkmenistan is one of the most open economies in Central Asia, mainly because of exports.** Exports have grown over 24 percent per annum over the last decade, with even faster growth (26 percent CAGR) since 2006; while imports grew at a 22 percent CAGR over the decade and 24 percent CAGR since 2006. As a result, the trade turnover increased by 2.6 times between 2007 and 2013, of which exports by 2.1 and imports by 3.6 times. Turkmenistan has run a strong trade surplus, rising steadily through the early 2000s to reach a peak of 38 percent of GDP in 2006 – it stood at 29 percent in 2012. The export share of GDP (48 percent in 2013) and trade share of GDP (90 percent) are among highest in the region. This is driven mainly by a high export share of GDP – Turkmenistan’s import share of GDP (41 percent in 2013) has actually declined significantly from its levels in the late 1990s and early 2000s.¹

15. **The export base is highly concentrated and dominated by hydrocarbons.** Turkmenistan’s exports are the most concentrated of any country in the region, with more than 90 percent of exports in 2012 in oil and gas (Figure 9). This ratio has held broadly steady over the decade, with the only exceptions of 2009 and 2010. According to the Herfindahl-Hirschman Index, the concentration of Turkmenistan’s exports has declined somewhat from previous years. Looking only at non-mineral exports, Turkmenistan remains relatively concentrated although it has increased the diversity of the non-mineral export basket – mostly cotton - and is now more diversified than Tajikistan, Chile, and Laos. Furthermore, Turkmenistan has one of the narrowest set of products. There are a few emerging products in the chemical industry, such as polypropylene, technical iodine sulfur and sulfuric acid, which have

¹ Data in this section may not provide an exhaustive picture of Turkmenistan’s trade since they are based on mirror statistics from the UNCOMTRADE database.

also contributed to the country's export basket since 2009-12. Nevertheless in 2012, Turkmenistan exported only 132 HS 6-digit products (of a total potential of more than 5,000), with relatively little growth over the decade (only 20 more products were introduced).

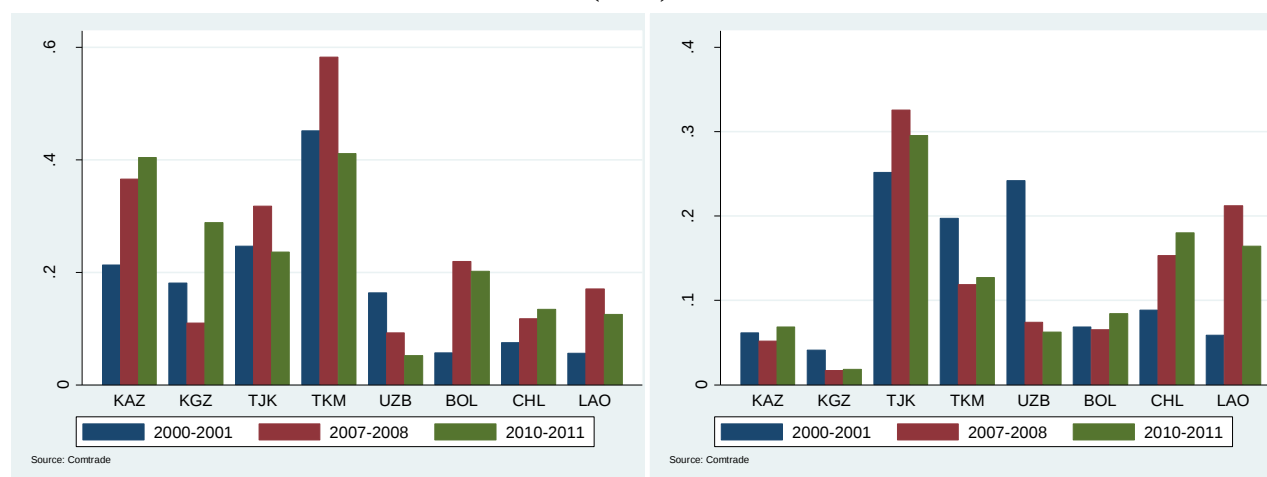
Figure 9: Turkmenistan's export basket is among the least diversified in the region
(In percent)



Herfindahl-Hirschman Index - All Exports

Herfindahl-Hirschman Index - Non-mineral exports

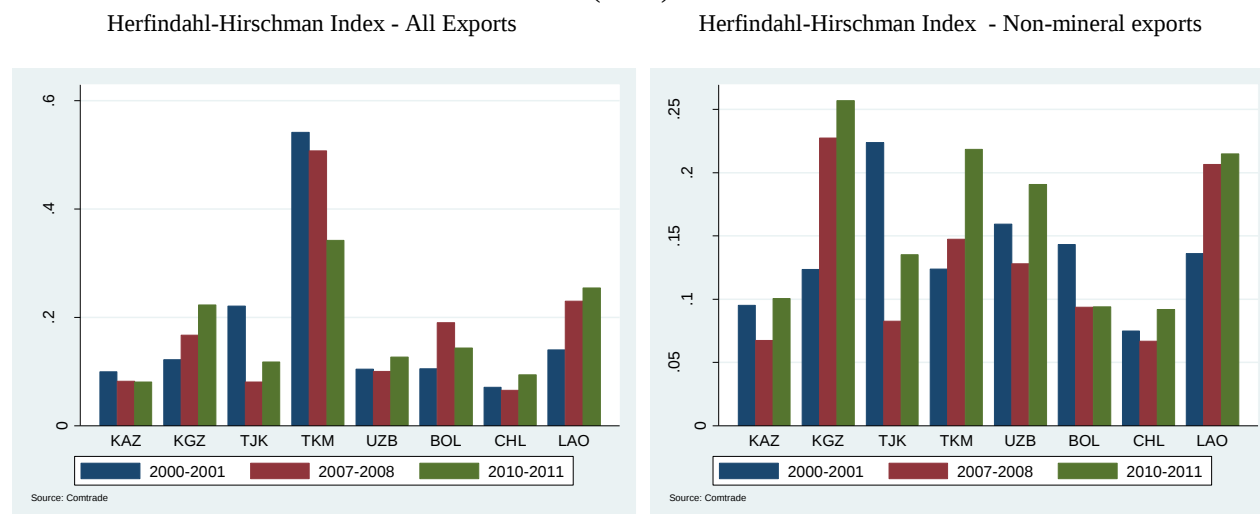
(Index)



Source: UNCOMTRADE

16. **Market reach is also relatively limited, with exporters selling to 50 markets in 2011, the same number as in 2000-01.** The number of destination markets is very limited both for all products and for non-minerals (Figure 10 and Table 2). Markets have shifted from Ukraine to China and Turkey (for natural gas and oil) and from the US and the EU to Turkey for non-minerals (mainly cotton). Non-minerals exports are almost equally concentrated in the top 10 markets (the top 10 share has grown from 61.7 percent to 88.4 percent over the decade). The most important export market for non-minerals is Turkey, which has grown substantially in share over the decade; with Russia second most important (18.8 percent, an increase from earlier in the decade). Non-minerals exports to the EU fell sharply as a share of the total over the decade; a similar pattern holds with the US, which accounted for 12 percent of non-minerals exports at the beginning of the decade.

Figure 10: Export destination markets are also not diversified
(Index)



Source: UNCOMTRADE

17. **China is by far the most important export market, followed by Turkey and Russia, with exports mostly concentrated in natural gas.** Between 2007 and 2012 Turkmenistan's trade turnover with China has increased by almost 20 times, dominated by natural gas exports to China. Exports are also significant to Turkey and Russia, but in these markets Turkmenistan runs a large trade deficit with imports amounting to four times exports. Exports (and imports) are very limited with India and Pakistan.

18. **Growth of non-mineral exports to China has been significant** (23 percent per annum) but total exports as of 2011 were only US\$40m. Almost 100 percent of exports to China are in minerals, while imports are more diversified. New export items, such as downstream petroleum products, polypropylene, and licorice root extract, as well as leather, wool and cotton yarn emerged in recent years. Exports of technical iodine and sulfur started in 2012. The structure of imports from China is diverse and consists of industrial goods, vehicles, furniture, clothes, shoes and fabrics. Tea is a prevalent import item in the food category. Outside natural gas, no single product accounts for more than US\$20m in exports. Vegetables and cotton, along with some chemicals account for virtually all other exports.

19. **Turkmenistan's exports to Russia are its most diversified.** They include plastics, textiles and minerals, among other smaller exports. Plastics in particular have grown strongly over the decade. Imports are also highly diversified, with the largest volumes in metals, machinery, and transport, but also substantial wood, vegetables, food, and chemicals. A number of new exports to Russia have emerged in Turkmenistan's export basket, but most of these are extremely small scale. The significant exports remain oil and petroleum products, lint cotton, cotton yarn, terry fabrics, bed sheets, textiles, wool, vegetables, grapes, melons, water melons, licorice root extract, polypropylene (the latter did not exist in the export basket a decade ago).

20. **Exports to Turkey are highly concentrated in textiles and minerals** with virtually nothing outside these categories. The most important exports to Turkey have remained broadly the same over the decade – mainly textiles, cotton and woven fabrics, along with some petroleum products, though there is a tendency of exporting new products such as polypropylene, unprocessed skins of large and small ruminants and bed sheets. Imports are much more diversified, with substantial volumes across almost all categories. Metals and machinery, in particular, have grown in importance over the decade.

Table 2: Export destination

	2000-2001	2007-2008		2011-2012	CAGR (2001-02 to 2011-12)
	% of total	% of total	% of total	Average (000s US\$)	
TOTAL Top 10 (1)	86.0	88.0	94.9	8,759,760	14.5
China	0.1	0.5	72.4	6,683,278	118.7
Italy	3.2	3.6	4.9	452,031	17.8
Ukraine	71.9	71.0	4.7	429,678	-11.5
Turkey	3.1	5.4	3.8	348,110	15.4
Afghanistan	0.0	0.2	3.7	345,399	
Russian Federation	1.7	1.2	1.8	163,172	13.9
Kazakhstan	3.4	2.5	1.3	122,826	4.3
United Kingdom	0.1	0.7	0.8	74,048	35.9
Germany	0.3	0.4	0.8	72,449	24.9
United States	2.1	2.6	0.7	68,770	3.1
TOTAL Regional growth poles	5.0	7.2	78.0	7,205,683	45.8
China	0.1	0.5	72.4	6,683,278	118.7
Turkey	3.1	5.4	3.8	348,110	15.4
Russian Federation	1.7	1.2	1.8	163,172	13.9
India	0.1	0.1	0.1	11,123	18.8
TOTAL EU28 (2)	9.4	11.3	8.3	768,376	12.2
Italy	3.2	3.6	4.9	452,031	17.8
United Kingdom	0.1	0.7	0.8	74,048	35.9
Germany	0.3	0.4	0.8	72,449	24.9
TOTAL REST (3)	85.7	81.5	13.6	1,259,902	-4.0
United States	2.1	2.6	0.7	68,770	3.1
Japan	0.0	0.0	0.0	351	-1.6
TOTAL, WORLD	100.0	100.0	100.0	9,233,961	13.5

Source: UNCOMTRADE

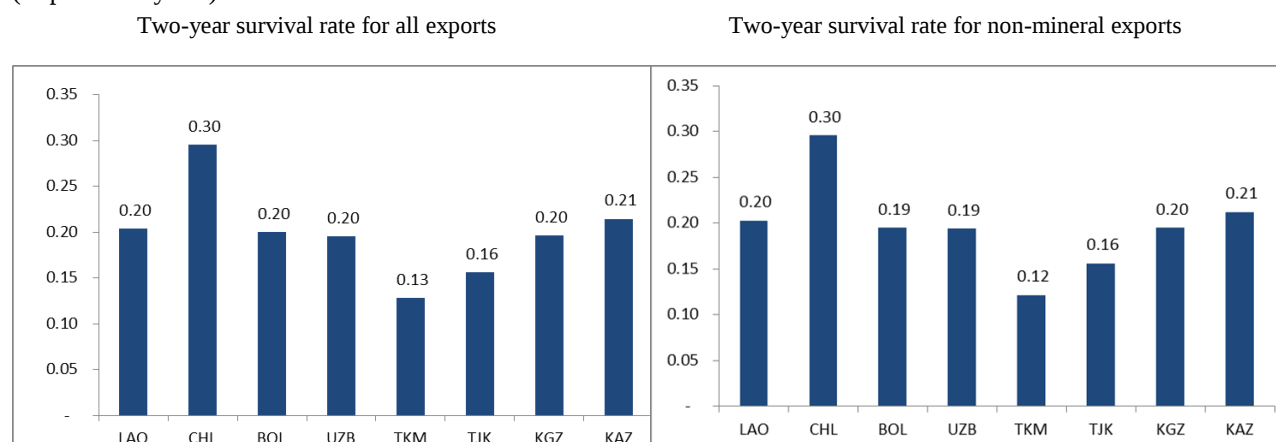
Notes: 1. These countries can appear again among the regional growth poles, the EU28, or the rest of the world. 2. Only countries with a share of exports in 2011-2012 greater than 1% are shown individually. 3. Excludes countries among regional growth poles and the EU28. The USA and Japan are shown individually even though other countries could have a larger share.

21. **Turkmenistan has low levels of regional trade with major fluctuations of export partners in recent years - away from Kazakhstan and toward Uzbekistan and Tajikistan.** Exports to the region have grown 11 percent per annum (in nominal US\$ terms) over the decade, but more than 30 percent per annum since 2005. Imports have grown 40 percent per annum over this period. Non-minerals trade with the region has grown even faster than minerals trade but remains at an extremely low level. Turkmenistan runs a significant trade deficit in the region for non-minerals. Although compared with 2007 the trade turnover in 2012 with Kazakhstan grew by 3.2 times, with Uzbekistan by 7.9 times, with Tajikistan by 3.8 times and with Kirgызstan - by 12 percent, regional exports amounted to only US\$276m in 2010, or only 1.6 percent of total exports. Similarly regional imports (US\$185m in 2010) accounted for just 1.8

percent of total imports. Exports to Kazakhstan in recent years have collapsed with only minor volumes (less than US\$3m each) in minerals, plastics, and transport. The reported structure of exports to Kazakhstan has been stable and consisted of vegetables, fruits, and gourds, oil and petroleum products, polypropylene, cement, bed sheets, and textiles, while imports collapsed as Turkmenistan substituted the wheat flour import from Kazakhstan by its domestic production. Trade with Tajikistan and Uzbekistan has been growing rapidly with the majority of exports in non-minerals products (minerals exports ranged from less than 15 percent of the total regional exports to a high of 26 percent in 2009). Trade with Uzbekistan might be expanded by the enforcement of a free trade agreement which is currently under discussion between the two governments. Export to Tajikistan includes oil, petroleum products, bitumen, vegetable oil, and, since 2012, also wheat and wheat flour. Imports are dominated by vegetables, fruits and aluminum and insulated wire.

22. **Turkmenistan's exports have a low probability of survival, but with substantial variation by export market.** The probability of an export relationship surviving after 2 years is only 16 percent (Figure 11). By year 5, it drops to 5 percent. The picture for non-mineral exports looks even worse, with the two-year survival rate at 12 percent and the five-year rate at 4 percent. There are, however, variations by export partner. Survival rates with Turkey are the highest (46 percent after two years), while survival rates to South Asia are low (17 percent to India and 13 percent to Pakistan). Within the region, the probability of export survival is highest with Uzbekistan (33 percent) and lowest with Kyrgyzstan (11 percent). Higher survival rates may be explained by integration in global value chains, where relationships among export and import partners tend to be longer term. Turkmenistan may be integrated across the cotton-textile-apparel value chain, particularly with Russia and Turkey, where two-way trade exists across most stages. Trade has grown strongly in the fabric and yarn stage of the value chain (as well as cotton).

Figure 11: The probability of export survival is low
(In probability 0-1)



Source: UNCOMTRADE

Turkmenistan's Asset Portfolio

23. **Assets can be classified into three categories: natural resources, built capital, and national institutions.** Natural resources—in the form of minerals, arable land, and forests—are largely endowed, but technological progress and better management can radically alter their economic value. Built capital consists of both physical and human capital, in the form of adequate infrastructure and a healthy and skilled labor force. This again can be measured for any country, though with more difficulty and less precision than natural resources. Finally, the most poorly measured and possibly the most important asset a country has are national institutions—the regulations and mechanisms that a country has put in place to manage resource rents, deliver public services such as roads, security, health care, and education.

24. **A country's asset base determines success or failure in the long run.** Based on the last two decades of experience in Eurasia, and more than two centuries in other parts of the world, governments can create the conditions for building a balanced portfolio of national assets—natural resources, built capital, and institutions. The United States and the United Kingdom increased their per capita incomes tenfold since 1870, and have diversified exports. Australia and Canada's economies have also grown as quickly, but their exports remain specialized. Through import substitution and industrial policies, Argentina and Brazil have diversified more, but have struggled to sustain economic growth. In 1910 Canada and Argentina's per capita incomes were about 80 percent of U.S. levels. By 2010 Canada's per capita income was 85 percent that of the United States; Argentina's had fallen to 35 percent. Brazil's GDP has stagnated at about 20 percent relative to the United States for more than a century (Gill et al., 2014). These experiences, together with the more recent success of countries like Chile, Korea or Finland, show that a balanced asset base is the critical factor of success in the long run.

25. **Turkmenistan's asset portfolio is weighed toward “hard” endowments.** Turkmenistan is richly endowed with natural resources, especially hydrocarbon wealth. In Turkmenistan, natural wealth accounts for the bulk of total wealth per capita, which also includes produced capital and intangibles as defined in World Bank (2011). Wealth in middle-income countries as a group was almost US\$75,000—and less than a fifth was natural resources. In high-income economies, measured wealth in 2005 was close to US\$700,000 per capita, with natural resources a negligible fraction. In resource-rich Australia, Canada, Norway, and New Zealand, natural capital is 8-13 percent of overall wealth.

26. **In order to sustain growth and increase the likelihood of success of the Government's active diversification policies, the asset portfolio needs to be balanced toward the “softer” assets** that are essential ingredients of long run success. In recent years, thanks to massive investment in physical infrastructure, Turkmenistan has built sizeable physical assets. Large-scale public investment programs are primarily targeted to enhance the country's physical capital. Investments in human capital and institutional upgrading remain relatively low priorities. Investments into physical assets and infrastructure of the social sector prevail over public spending aimed at improving the quality of the labor force and the development of skills demanded by emerging sectors of the economy. Policies need to be put in place to improve the quantity and, more importantly the quality of education. At the same time, rules to manage resource rents, provide public services, and ensure a level playing field for entrepreneurs and innovators need to be made more robust.

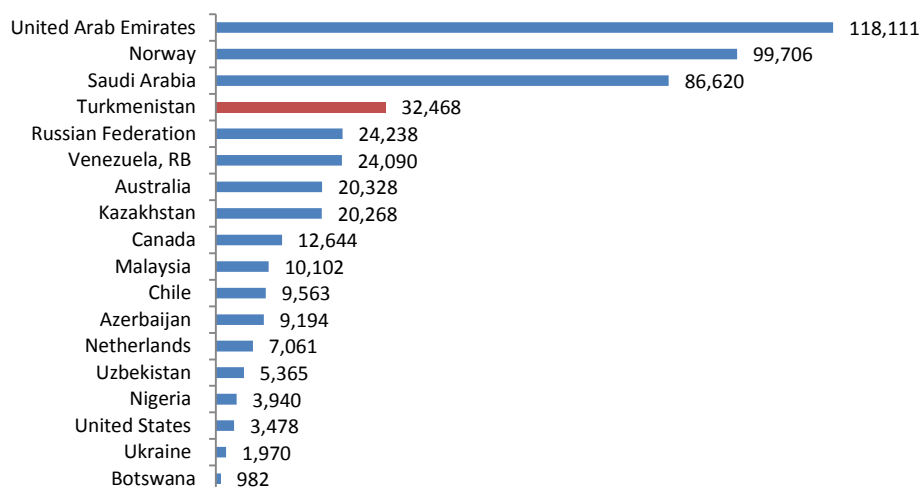
Natural Resources

27. **Natural capital, similarly to physical capital, is the present discounted value of the profit stream that such resources can generate far into the future.** Countries with similar initial quantities of land or subsoil assets may thus have different levels of estimated natural capital if they differ in how

productively they use their land or in how effectively they exploit their subsoil assets. The period over which resources generate profit depends on whether they are renewable or exhaustible. Reserves of subsoil assets such as oil, natural gas, and minerals are typically nonrenewable and exhaustible, whereas land, forests, and rivers can potentially last forever if managed well. The Changing Wealth of Nations (World Bank 2011) develops and applies a methodology that captures these dimensions, to compute comparable estimates of total natural capital or natural wealth for 150 countries for 2005 and in 2005 U.S. dollars. Each country's estimated total natural capital is then divided by its 2005 population to estimate per capita natural capital and its major components (subsoil capital and land capital) to permit comparisons across countries, regions, and income groups.

28. **Turkmenistan has the highest level of natural resources per capita in the CIS.** Turkmenistan ranks 12th in the world in natural capital per capita, ahead of Russia and Kazakhstan. It ranks even higher (10th) based on subsoil capital per capita (Figure 12). Natural capital per capita rose in Turkmenistan over 2000–10, driven by a combination of growth in the production of natural gas, the expansion in reserves, and, most importantly, higher world prices (Table 3). Subsoil capital now accounts for more than 90 percent of natural capital (Table 4). At present, after Russia, Iran and Qatar Turkmenistan has the fourth largest natural gas reserves in the world with an estimated 250-270 years of extraction horizon and owns the world's second-largest single deposit (Galkynish), which started operation in 2013. Turkmenistan could have high potential for discovering additional reserves of both oil and gas, if more risk capital and better technology can be deployed for more intensive exploration in more difficult terrain (IEA 2011).

Figure 12: Turkmenistan is one of the richest countries in the world in subsoil wealth, Subsoil Natural Resource Wealth per capita, 2005
(In constant 2005 US\$)



Source: The Changing Wealth of Nations, The World Bank

Table 3: Natural capital in Turkmenistan has grown substantially since 2000, driven by subsoil capital
(Indexes: 2005=100)

Country	Natural capital				Subsoil capital				
	2000	2005	2010	Growth 2000–10 (%)	2000	2005	2010	Growth 2000–10 (%)	Subsoil share in natural capital, 2010 (%)
Azerbaijan	43	100	195	353	33	100	211	545	92
Kazakhstan	57	100	147	158	43	100	153	259	91
Russia	82	100	104	27	56	100	109	53	84
Turkmenistan	62	100	84	36	54	100	80	36	91
Ukraine	124	100	101	-16	51	100	106	108	42
Uzbekistan	44	100	111	152	31	100	106	245	71

Source: Updated Estimates of all Eurasian Countries, Environment Dept., World Bank, 2013.

Table 4: Composition of natural capital in Turkmenistan and comparators

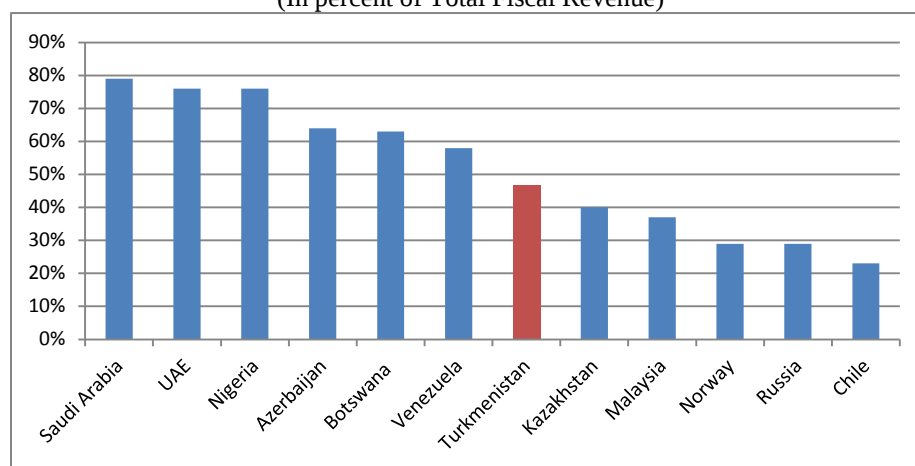
	Arable land, % of land area	Forest area, % of land area	Total natural resource rents, % of GDP	Natural wealth per capita, constant 2005 US\$	Proven oil reserves, billion barrels	Proven gas reserves, trillion cubic meters
United Arab Emirates	0.7	3.8	23.2	120,989	97.8	6.1
Norway	2.8	32.2	16.7	110,162	6.9	2.1
Saudi Arabia	1.6	0.5	50.9	97,012	265.4	8.2
Australia	6.1	19.7	6.8	39,979	3.9	3.8
Turkmenistan	3.21	4.5	41.0	37,866	0.6	24.3
Canada	4.9	34.1	5.4	36,924	175.2	2.0
Russian Federation	7.5	49.4	30.1	31,317	88.2	44.6
Venezuela, RB	3.0	53.6	32.1	30,567	296.5	5.5
Kazakhstan	8.4	1.2	42.8	23,916	30.0	1.9
Chile	2.0	21.6	14.4	18,870	-	-
United States	18.1	33.1	1.4	13,822	30.9	8.5
Netherlands	30.2	10.8	1.7	13,193	-	1.1
Malaysia	5.5	63.4	13.8	12,750	5.9	2.4
Azerbaijan	22.4	11.3	52.0	11,684	7.0	1.3
Uzbekistan	10.3	7.7	63.7	7,652	0.6	1.6
Ukraine	56.1	16.6	7.7	6,899	-	0.9
Nigeria	37.5	11.5	35.8	6,042	37.2	5.1
Botswana	0.4	20.8	3.5	5,420	-	-

Source: World Bank; Statistical Review of World Energy, British Petroleum.

Notes: a) Arable land includes land defined by the FAO as land under temporary crops (double-cropped areas are counted once), temporary meadows for mowing or for pasture, land under market or kitchen gardens, and land temporarily fallow. Land abandoned as a result of shifting cultivation is excluded. Average over 2000-11; b) Forest area is land under natural or planted stands of trees of at least 5 meters in situ, whether productive or not, and excludes tree stands in agricultural production systems (for example, in fruit plantations and agroforestry systems) and trees in urban parks and gardens. Average for years 2000, 2005, 2010 and 2011; c) Total natural resources rents are the sum of oil rents, natural gas rents, coal rents (hard and soft), mineral rents, and forest rents. Average over 2000-11; d) Natural wealth is sum of Crop, Pasture Land, Timber, Non Timber Forest, Protected Areas, Oil, Natural Gas, Coal, and Minerals; e) Proven oil and gas reserves taken to be those quantities that geological and engineering information indicates with reasonable certainty can be recovered in the future from known reservoirs under existing economic and operating conditions.

29. **In addition to being resource *abundant*, Turkmenistan is heavily *dependent* on its natural resources.** Extractives account for almost half of GDP, over 90 percent of total exports and 47 percent of fiscal revenue, much more than in resource-rich OECD countries (Figure 13). This dependence may result in excessive volatility of export receipts and government revenue, adding to overall economic volatility, hurting savings, investment, and economic output, straining government finances, and increasing uncertainty for households and firms.

Figure 13: Government revenues are heavily dependent on resource exports, 2006-10
(In percent of Total Fiscal Revenue)



Source: IMF (2012)

30. **Turkmenistan needs to become more efficient in converting its natural resource revenues into built capital.** Annual data for Turkmenistan are not available, but information for a few years shows a significantly negative adjusted net savings (ANS), lower than negative 50 percent (see Box 1). Turkmenistan should increase its GNS steeply to get close to a zero ANS and avoid continuing reductions in total economic endowments. One reason is high energy subsidies. In 2011 these subsidies in Turkmenistan amounted to 31 percent of GDP. Another reason, based on the experience of other countries, is that while ever bigger amounts are being saved in stabilization funds, a sizable fraction is likely to be invested abroad in long-term funds to transfer wealth to future generations, mainly through foreign investments. While this helps keep currencies from appreciating too much, it does not build capital at home. The central issue for governments is to secure a reasonably large share of resource rents as revenue while providing reasonable incentives to private firms to continue investing.

Box 1: Adjusted Net Savings

High national savings typically finance high investment in a sustained manner. Whether total GNS are adequate depends on whether they exceed the depreciation of physical capital and the depletion of nonrenewable resources. Only in such a case does investment from these savings avoid a reduction in total economic endowment of natural, human, and physical capital. This is the concept of adjusted net savings (ANS). When ANS is zero, the total endowment can potentially be kept unchanged provided all such savings are invested in the domestic economy; when ANS is negative, the total endowment is likely to fall; when ANS is positive, the total endowment can potentially grow if all savings are invested. Total savings thus make possible any changes in total endowment, but this is not an either/ or scenario. How much of the savings is invested determines the impact on endowment. Some countries have negative ANS, and countries with higher resource rents relative to gross national income (GNI) have more negative ANS.

Resource-rich countries save more than others but at a declining rate, suggesting that the greater the abundance the more difficult it is to increase savings (Atkinson and Hamilton 2003). The resource mismanagement is manifested in government consumption and public wages in particular. The same study finds that countries with high-quality

institutions transform resource-wealth into additional savings more easily than others. These patterns are consistent with the evidence elsewhere. Eurasian countries face some of the same public spending pressures as other resource-rich countries. First, greater resource revenue can create a deficit bias and reduce public savings. Second, these spending pressures show themselves through, for example, energy subsidies, unproductive public sector jobs, and higher public sector wages. Most energy subsidies are not only inefficient but also regressive in countries where the poor do not own a car or use much electricity, public sector employment has climbed, and public salaries have risen faster than inflation (in most of these countries). Third, pay increases for government employees given during a boom are almost impossible to reverse. More generally, spending that leads to increases in consumption is hard to reverse, because habits are formed and political resistance is high. By contrast, fluctuations in investment are easier to manage. Fourth, international capital markets turn suddenly generous when countries become newly resource-rich and when resource prices are high, often resulting in excessive external borrowing for consumption or investments with low return (Mansoorian 1991; Manzano and Rigobon 2007).

There is no easy way to counter these spending pressures, but three options may be considered. First, governments should increase the transparency for all revenue collection and all public spending and make spending agencies accountable to parliament and the public. Second, they should establish a centralized system of financial control and authority, backed up by a strong public financial management system, including an information system that provides real-time information on spending. Third, they should adopt countercyclical fiscal policies, supported by a short-term stabilization fund.

Source: Gill et al. (2014)

Spotlight 1 – Converting resource rents into revenues: international experience

Governments must seek to maximize the net present value of fiscal revenue from resources so that they can use it for the benefit of their citizens. Eurasian countries—as countries elsewhere—use a mix of tax instruments to affect the size and timing of revenue flows from resources. Bonus payments on signature, discovery, and production (single or staged lump-sum payments) advance the timing of revenue flows. Sliding-scale royalties on gross revenue are often a part of fiscal systems in resource-endowed countries because they secure early revenue, though they may not be very responsive to profitability. Corporate income tax is typically a core component of such arrangements because it ensures that the normal return to equity is taxed at company level. In addition, a tax instrument like the “Brown Tax” is based on a base of net cash flow and tries to target resource rents. The combination of instruments used, rates, and administration determine how much of the resource rents are converted into resource revenue. The larger the share of resource rents extracted by the government without undermining buoyant private investment in resources, the more efficient the conversion usually is. The share of the tax take in total rents is a measure of that efficiency, though combining it with an assessment of the efficiency of the resource tax regime is also important.

The tax take of three oil exporters in Eurasia (Azerbaijan, Kazakhstan and the Russian Federation) is far lower than in most comparators in the Middle East. Azerbaijan and Kazakhstan, which depended heavily on FDI for exploration and extraction, may have offered a larger share to investors for at least two reasons. First, they were relatively new independent countries and thus required to pay a higher risk-premium to investors than Middle Eastern countries with a longer hydrocarbons track record for FDI. Second, contracts and oil fields in Eurasia are quite new, with most of the oil produced in the early years going toward the investors’ cost rather than profit under the PSAs, making the potential base for extracting revenue smaller than the total rents generated. Part of the rent probably dissipated in two other ways. The State-owned resource companies needed some of the rent to finance their operating costs, which may have been higher than elsewhere because of various inefficiencies. Also, State-owned resource companies were selling energy at subsidized prices.

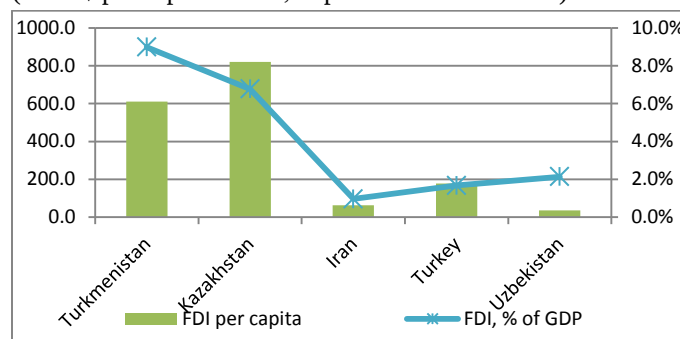
Source: Gill et al. (2014).

Physical Capital

31. **Turkmenistan has been building physical assets at a very fast pace, driven by public investment in the extractive industry.** Besides being one of the fastest growing economies, Turkmenistan’s investment rates in the last 5 years, at about 47-48 percent of GDP, have been among the highest in the world. Proceeds from hydrocarbon exports facilitated large-scale, especially public investments in physical infrastructure. The sources of funding have been mainly public, accompanied by one of the highest shares of foreign investment in the economy, largely in extractive sectors (Figure 14). Total investment in 2012 amounted to 48.4 billion Manats (17 billion US\$), of which 77.6 percent from public sources, 15.6 percent from foreign sources and only 6.8 percent from private investors. Investments in physical capital have been increasing at a much faster pace than those directed to social sectors (Figure 15). In 2012, investments in health and education amounted to only 2.9 and 3.1 percent, respectively, of total investment. Industry, mainly hydrocarbons, is the largest recipient of public (46.1 percent of the total in 2012) and foreign funding (85.2 percent of the total in 2012). The majority of private investment (37.3 percent of the total in 2012) has been directed to transport, while agriculture, and trade and services received 11.7 and 11.9 percent of total investment (Figures 16).

Figure 14: Turkmenistan has one of the highest FDI inflows in the region, 2012

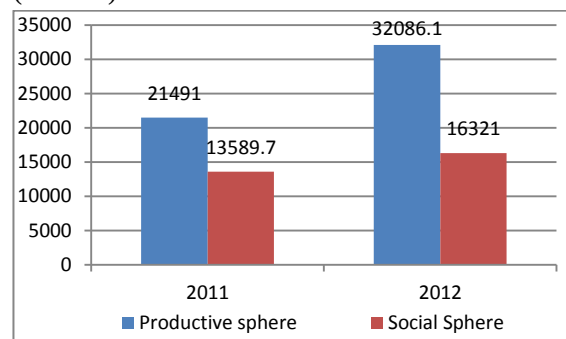
(in US\$ per capita – LHS, in percent of GDP- RHS)



Source: WDI

Figure 15: A large share of investments is allocated for physical infrastructure

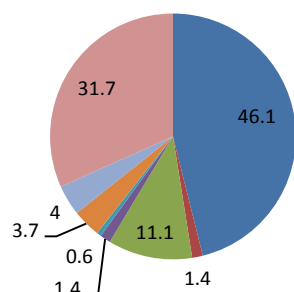
(In TMT)



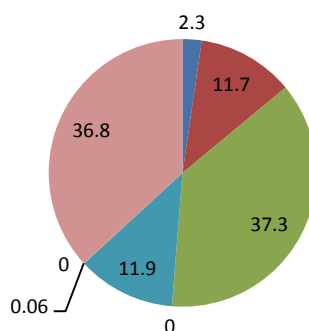
Source: Government of Turkmenistan

Figure 16: Industry (hydrocarbons) attracts the majority of public and foreign investment

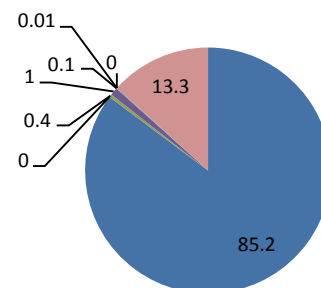
Public Investments by Sectors of Economy, 2012, % of total



Private Investments by Sectors of Economy, 2012, % of total



Foreign Investments by Sectors of Economy, 2012, % of total



■ Industry
 ■ Transport
 ■ Trade and Services
 ■ Education
 ■ Agriculture
 ■ Communications
 ■ Health
 ■ Other

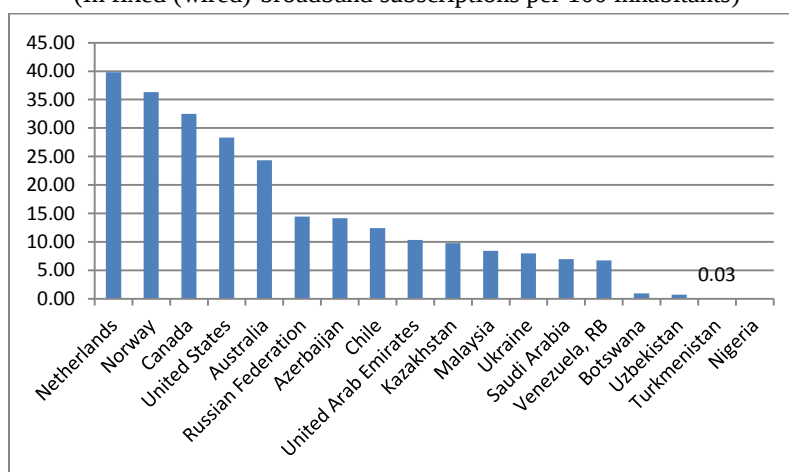
Source: Government of Turkmenistan

32. Investments in transport infrastructure need to be complemented by the development of services to facilitate trade. Expansion of the domestic and regional transport network is a cornerstone of the diversification agenda. The current transport and communication network is designed mostly to serve the demand of the extractive sector though the government approved large infrastructure projects aimed at facilitating increased volume of tourism, trade and transit flows. The 13,000 Km North-South and East-West highway is under construction to improve connectivity within the country. The North-South and East-West railroads are under construction. The Turkmen government set an ambitious objective to make the country an intensive transnational transit corridor, including the Black Sea and Caspian Sea connection, Middle-East - Iran and CIS route through a new railroad connecting Iran with Kazakhstan through Turkmenistan. Improvement works are currently underway on the interstate highways connecting Turkmenbashi with Ashgabat, Mary, Turkmenabat and Farab, as well as on the Ashgabat – Dashoguz direction, which will facilitate increased traffic of transit cargo through Turkmenistan. The total length of highways under reconstruction and construction is 1.700 km. 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.

33. **Penetration of ICT is at very low levels and this may hamper business growth going forward.** Telecom penetration in Turkmenistan is at extremely low levels, as shown by the fact that in 2012 there were only 7 internet connections per 100 people and only 3 fixed broadband internet subscribers per 10,000 people, very far from more advanced countries, including in the Eurasian region (Figure 17).² Although mobile connections are increasingly common, they are typically underused for data services, largely because of limited broadband availability and high prices. Inadequate ICT infrastructure will become an increasingly binding constraint for the development of a competitive business sector, since ICT is crucial for efficient communication with customers, suppliers and government authorities and is an especially crucial component of trade in business services, notably business process outsourcing. ICT makes it possible for companies and households to bridge distance and division, leapfrogging challenges in physical infrastructure.

Figure 17: ICT penetration is among the lowest in the world, 2012
(In fixed (wired)-broadband subscriptions per 100 inhabitants)



Source: International Telecommunication Union

² According to official sources, ICT penetration has dramatically increased since 2012. By 2014 the number of Internet users is reported to have increased to 21 connections per 100 people due to reduction of user charges, improvement of provided services and opening of alternative access points (internet cafes). The number of broadband LTE and 3G users has also increased. 15 people per 10,000 inhabitants are subscribers of fixed broadband internet lines. Since December 2012, internet penetration in Turkmenistan has increased also due to the provision of fixed broadband internet services to public and private enterprises, universities and secondary educational institutions.

Spotlight 2 – Physical capital in Eurasia

The Eurasian countries began the transition with a quantity of physical capital in line with the Soviet Union's level of development and its status as a superpower. Eurasia's high investment in physical infrastructure in the 1970s and early 1980s fell sharply with the advent of perestroika in the mid-1980s and the transition's early years. But infrastructure was allocated inefficiently across a vast territory, and other physical capital was spread less than optimally across sectors under the command system. The reasons are well known: the breakup of production arrangements within the Soviet Union and with the countries of Eastern Europe, along with the much-reduced role of military buildup and the privatization of State-owned enterprises.

Eurasia maintained investment at about 23 percent of GDP a year on average after the transition began, far below the 28 percent that East Asia invested. Eurasia's rate is lower than the 25 percent calculated as the average that several fast-growing countries maintained for several decades. Meanwhile, inadequate maintenance and repairs of the extensive transport networks that Eurasia inherited from the Soviet Union led to steep drops in infrastructure quality. Infrastructure established in cold climates proved too expensive to maintain and was allowed to degrade. Communal infrastructure similarly suffered, as artificially low prices and heavy State subsidies led to persistent underinvestment and less-frequent maintenance. Infrastructure, which did not figure much as an obstacle for doing business in the 1990s, is now one of the greatest obstacles for most countries.

Recent World Bank studies that use the perpetual inventory method with a fixed depreciation suggest that Eurasia's stock of produced capital—machinery, equipment, and urban land—was in line with its per capita GDP in the mid-2000s. Per capita physical capital was substantially lower in the mid-2000s than at the start of the transition. The quantity of physical capital would be even lower if the inefficiencies in public investment are taken into account. Recent estimates correcting for the efficiency of investment indeed suggest that Eurasia's capital stock is much lower than investment numbers imply. One study constructs a new public capital series that explicitly takes into account the efficiency of public investment by using the Public Investment Management Index. While efficiency-adjusted capital stocks throughout the world are lower than stocks estimated from cumulative investment, Eurasia stands out. In Eurasia, the stock of public capital is less than half of what cumulative investment spending suggests, due to the poor quality of investment itself.

Source: Gill et al. (2014).

Human Capital

34. Human capital is a vital asset for economic growth and to discover and exploit opportunities in all sectors of the economy. It is the ultimate source of innovation and productivity and one of the key mechanisms for transferring wealth across generations. Its pace of growth depends on the quantity and quality of education (in the classroom and on-the-job training), on the quality of health care, and on the broader social environment. Education and training institutions play a key role in enhancing the productivity of capital by supplying well-trained graduates and developing innovative ideas that improve existing technologies. Workers whose skills are aligned more closely with the demands of firms are typically more productive and contribute more to the country's economic growth. In addition, they tend to command higher wages and enjoy lower levels of unemployment. By contrast, workers whose skills are misaligned with employers' needs are likely to be unemployed, underemployed, or paid less than others.

35. **The quality of Turkmenistan’s human capital, its health and education, lags behind most comparators.** The Human Development Index (HDI), a composite statistic of life expectancy, education, and income, shows that, despite the spectacular increase in income per capita experienced in recent years, improvements of health and education outcomes should be a key priority of public policy (Table 5). The people of Turkmenistan have lower life expectancy than most neighbors, let alone the populations of more developed resource rich countries around the world. At 9.9 years, average years of schooling are quite high for Turkmenistan’s income level, a legacy of the Soviet system of universal education. Although there are no comparable data, such as the OECD PISA assessments, the quality of education, its alignment to the present and future needs of the economy, may be an issue. The Turkmen authorities prioritized the education sector by making important policy decisions, such as the adoption in March, 2013 of the Turkmenistan President’s Decree on the “Improvement of the Education System in Turkmenistan” and a President’s Resolution approving the “Concept of Transition to 12-year General Secondary Education in Turkmenistan”. These changes are enshrined in a new Education law, adopted on May 4, 2013, and effective from the 2013-14 academic year.

Table 5: The quality of human capital lags behind comparators, 2011 and 2012

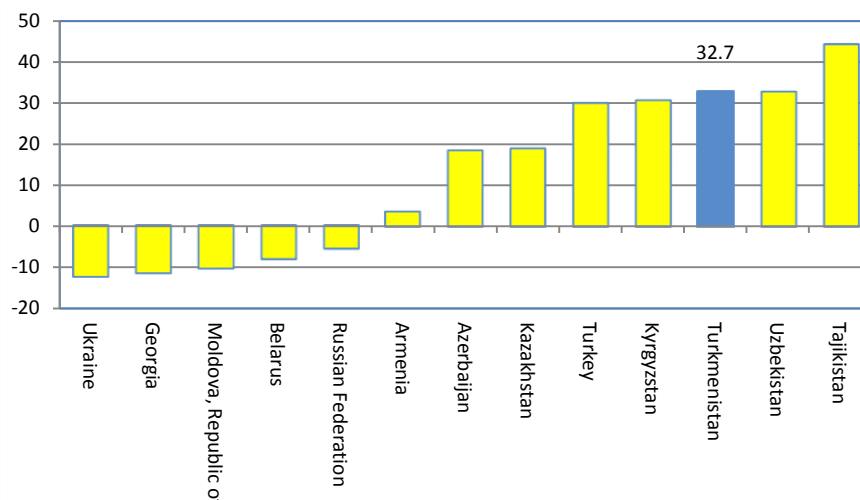
Country	HDI Value, 2012	Life expectancy at birth, 2011	Average Years of Schooling, 2000-2011	GDP per capita, PPP (constant 2005 international US\$), 2012
Norway	0.96	81.3	12.50	47,547
Australia	0.94	81.8	11.97	35,669
United States	0.94	78.6	12.51	43,063
Netherlands	0.92	81.2	11.23	36,599
Canada	0.91	80.9	11.63	35,936
Chile	0.82	79.0	9.40	15,848
United Arab Emirates ^a	0.82	76.7	8.56	37,392
Russian Federation	0.79	69.0	9.76	15,177
Saudi Arabia ^a	0.78	74.1	7.39	21,678
Malaysia	0.77	74.3	9.09	14,775
Kazakhstan	0.75	68.9	10.21	11,973
Venezuela, RB	0.75	74.3	6.89	11,613
Ukraine	0.74	70.8	11.13	6,394
Azerbaijan	0.73	70.7	11.20	9,156
Turkmenistan	0.70	65.0	9.90	9,121
Uzbekistan	0.65	68.3	10.00	3,095
Botswana	0.63	53.0	8.46	14,639
Nigeria	0.47	51.9	5.00	2,294

Source: World Bank, UNDP 2013, Barro and Lee. Notes: HDI = Human Development Index; PPP = purchasing power parity. ^a GDP per capita 2011

36. **Investment in human capital is crucial in light of the sharp increase in the working age population that will occur in the next two decades.** Current employment rates of 55 percent and a labor force participation rate of 61 percent for the 15-64 year old population are low by international standards. Improvements in the quality of the labor force will become even more pressing going forward. With the working age population projected to increase by one-third in 2030 investment in human capital is critical to allow the next generation of Turkmen citizens to find jobs (Arias et al., 2014 and Figure 18) . Together

with reforms aimed at increasing labor demand, such as improvements in the business climate and investment in physical infrastructure, the quality and employability of labor will crucially depend on policy choices and investments aimed at improving education and health. There are three key growth-enhancing effects of human capital. First, it contributes to economic efficiency. Second, it provides the labor resources on which growth depends. Third, it can reduce social inequalities and, potentially, make growth more sustainable.

Figure 18: The working age population is going to increase by one-third in 2030, change in the size of working population (15 years and older), 2010-30
(In percent)



Source: Arias et al. (2014)

37. **Science and technology policy could further improve the contribution of human capital to economic growth and diversification.** The recent adoption, in March 2014, of the *Law of Turkmenistan on the State Policy of Science and Technology* could contribute, among others, to the development of an innovative economy, support innovation in education, as well as to promote private participation in scientific activities. The State, through the Cabinet of Ministers, will be the main executor of science and technology policies and projects, but little is said on the links to education and entrepreneurship.

38. **Public expenditure in health and education is quite low by international standards.** Most governments around the world spend about 5-10 percent of GDP on health and education. Countries that spend more public resources tend to achieve better health and education outcomes. This positive relationship holds even when adjusting for the effects of GDP per capita. Turkmenistan spends around 5-6 percent of GDP on social sectors, of which 3-4 percent on education, 1 percent on healthcare and 1 percent on social protection (Table 6). The number of schools has remained quite stable despite the fact that the number of pupils has increased at all levels. For instance, there were 891 pre-school establishments with 123,300 children in attendance in 2000, while in 2012 there were 871 establishments and 190,200 children. The reduction of establishments took place in rural areas, but the number of children there increased. Despite the declining number of education institutions, 166 new pre-school institutions with 25,035 pupil capacity and 134 new schools with 60,964 pupil capacity have become operational since 2008. Also, some of the new establishments offer larger spaces and allow for economies of scale. The number of secondary schools decreased from 1,922 in 2000 to 1,741 in 2012, as did the number of pupils, from 1,017,100 to 900,400 in the same period. The number of secondary professional schools and higher education schools increased somewhat in the same period, but so did the number of students, by almost the double in some cases (State Committee for Statistics, 2013).

Table 6: Public expenditure in social sectors is low by international standards, 2008-13

	2008	2009	2010	2011	2012	2013
Total social sector exp, in mln TMT	2,680.8	3,438.1	4,243.0	5,601.4	5,397.6	7,168.6
Education	1,361.5	1,721.3	2,128.9	2,849.9	3,569.6	4,820.6
Healthcare	468.4	639.4	672.4	894.9	996.7	1,207.6
Social Protection	850.9	1,077.4	1,441.7	1,856.6	831.3	1,140.4
Total Social sector exp, in % of GDP	5.4	6.0	6.6	6.7	5.4	6.4
Education	2.8	3.0	3.3	3.4	3.6	4.3
Healthcare	0.9	1.1	1.0	1.1	1.0	1.1
Social Protection	1.7	1.9	2.2	2.2	0.8	1.0
GDP, mln TMT	49,470.0	57,611.0	64,362.0	83,315.0	100,218.0	111,713.0

Source: Government of Turkmenistan

Spotlight 3 – Education in Eurasia

In Eurasian countries, persistently high and rising education attainment rates—education quantity—are not accompanied by high-quality education outcomes. Resource-rich or resource-poor, the countries of Eurasia outside Russia have functional literacy rates detrimental to long-term development. Poor education quality translates into inadequate skills, and firms are increasingly concerned about the skills of job seekers. Exacerbating the low education quality and perceived skills mismatches are low health indicators that, despite some recent improvements, remain little changed from their level four decades ago. Starting with an already high level in the late 1980s, most resource-rich countries further increased the average number of years of schooling. Russia stands out for better education attainment—quantity of schooling—at all levels but more strikingly at the tertiary level.

A large share of Eurasian secondary students completes vocational education programs. One of the Soviet legacies is a large number of vocational schools originally designed to supply trained workers to State-owned enterprises (Sondergaard and Murthi 2012). This produces narrow labor market skill sets, which limit a worker's ability to adapt to fast-changing labor market conditions and production technologies. Learning increasingly takes place after completion of secondary or tertiary education—whether during job searches, on the job, or as part of job-related formal training. In the United States, it is estimated that on-the-job training contributes around a fourth to a half of all human capital (Heckman, Lochner, and Taber 1998). Studies on countries in the Organisation for Economic Cooperation and Development (OECD) demonstrate that adult education and training sharply lift worker productivity. OECD (2004) shows that employee training affects wage growth of young or highly educated employees and that training employees allows them to attain and maintain the competencies required to bring productivity in line with market wages of older and low-educated workers.

Few Eurasian firms offer formal training programs to full-time employees, despite international evidence about the importance of post-formal education. While almost 70 percent of Czech firms and 60 percent of Polish firms offer formal training to their full-time employees, only about 45 percent of firms in Russia and Kazakhstan do. In Azerbaijan, Georgia, and the Kyrgyz Republic, less than 20 percent of firms do. Companies are voicing strong concerns that Eurasia's low-quality human capital is increasingly an obstacle to doing business. The Business Environment and Enterprise Performance Survey reveals that 36 percent of Eurasian firms consider worker education and skills a “major” or “very severe” constraint to firm growth in Eurasia. About half of surveyed firms in Kazakhstan and Russia identify inadequate education and skills as a major constraint to firm growth. Not surprisingly, innovating firms are even more concerned about the skills constraints. Management plays a key role in determining the success or failure of a firm. Bloom and Van Reenen (2007) show that management practices correlate strongly with labor productivity, sales growth, and return on capital employed. The authors collected management practice data from 732 medium-size firms in France, Germany, the United Kingdom, and the United States and found that measures of managerial practice correlated strongly with firm-level productivity, profitability, and survival rates.

Source: Gill et al. (2014)

Spotlight 4 - Investing in human capital: the case of Korea

In Korea, developing human capital has been key in the economic performance of the country. Education played a key role in Korea's transformation from one of the poorest countries in the world to a leading industrial nation by promoting the development of human resources and technological change.

Innovation and human resources development have been at the core of the policies of the Government of Korea and all national economic programs in the last few decades. Total spending on education – public and private – as a share of GDP in Korea, at 8.0 percent in 2009, is the second highest in the OECD, even before taking account of outlays for private after-school instruction. Moreover, the increase in spending – from 6.1 percent of GDP in 2000 – was the largest in the OECD area. Education spending rose from 16 percent of government expenditures in 2000 to 20 percent in 2008. Nevertheless, the private sector plays a large role, accounting for 40 percent of education spending, the second highest in the OECD area, reflecting its large share at the pre-primary and tertiary levels. Expenditure per student relative to GDP per capita in Korea was slightly above the OECD average in 2008 before including outlays for private, after-school instruction.

According to the OECD (2013), the annual public expenditure per student in Korea is below the OECD average. On average, Korea spent in 2010 US\$ 8 198 per student from primary to tertiary education, against the US\$ 9 313 of OECD countries. However, expenditure per student increased significantly between 2005 and 2010: for all levels of education, expenditure increased by 39 percent, more than doubling the average increase across OECD countries for levels below tertiary (17 percent) and more than quadrupling the average increase for tertiary education (8 percent). At the tertiary level, Korea has made a significant effort, increasing public expenditure on tertiary educational institutions by 104 percentage points between 2000 and 2010 against an average increase of 35 percentage points for OECD countries.

The education system includes nine years of compulsory free education (six years in primary school, followed by three years of middle school). Advancement rates approached 100 percent for middle school by 1980 and for high school by 2000 making Korea one of the few countries in which graduation from high school is almost universal. In 2011, 72.5 percent of high school graduates continued on to tertiary education, although this was down from 84 percent in 2008.

Source: OECD. 2013; Jones, R.S. 2013.

Institutions

39. **Institutions are a fundamental asset for long run economic development and are particularly important in resource abundant countries.** They comprise the rules and norms of behavior by which economies and societies operate, shaping the incentives of governments, individuals and firms. In resource abundant economies, institutions are what makes the difference between success and failure in the long run. Building a sound institutional framework will ensure that natural assets are exploited responsibly and productively and that governments, individuals and firms have an incentive to invest in physical and human assets. Stronger institutions will enhance the economy's growth potential and the ability to develop a comparative advantage in non-extractive sectors.

40. **Three government functions are essential:** (i) the package of fiscal, monetary and exchange rate policies that allow **managing the volatility** deriving from a concentrated export basket; (ii) the capacity of the public administration to effectively **deliver public services**, such as health, education and

infrastructure; (iii) and the ability to effectively **regulate private enterprise** guaranteeing a competitive environment across all sectors, where the most efficient firms can emerge and prosper, increasing overall productivity and generating sustainable employment. These institutions are especially necessary for countries that have to manage sizable resource rents, where weaknesses in accountability and corruption can become sources of instability (Gill et al., 2014).

41. **Turkmenistan has made limited progress in building the institutions for a market economy.** Inconsistent enforcement of laws and regulations are typical symptoms of weak governance, and Turkmenistan is far behind comparator countries in all elements of governance and transparency. The World Bank's Worldwide Governance Indicators (WGI) indicate that rule of law, corruption, regulatory quality and accountability remain problematic, ultimately undermining the effectiveness of government policy (Table 7). Although private ownership is enshrined in legislation, these weaknesses may translate into a major deterrent for firms to invest and innovate, including by constraining financial development.

Table 7: The quality of institutions lags in several dimensions, World Governance Indicators, 1996-2012
(Ratings, average)

	Average of Governance Indicators	Government Effectiveness	Control of Corruption	Political Stability and Absence of Violence	Regulatory Quality	Rule of Law	Voice and Accountability
Netherlands	1.71	1.89	2.15	1.11	1.79	1.75	1.58
Norway	1.71	1.92	2.12	1.29	1.39	1.91	1.60
Canada	1.62	1.87	2.04	1.01	1.59	1.73	1.50
Australia	1.59	1.75	1.98	0.98	1.63	1.75	1.45
United States	1.32	1.64	1.51	0.44	1.54	1.55	1.22
Chile	1.15	1.21	1.43	0.56	1.48	1.25	0.98
Botswana	0.70	0.54	0.89	0.97	0.61	0.61	0.58
United Arab Emirates	0.49	0.85	0.84	0.86	0.66	0.54	-0.81
Malaysia	0.36	1.06	0.27	0.20	0.53	0.50	-0.39
Saudi Arabia	-0.36	-0.20	-0.23	-0.29	0.03	0.16	-1.62
Ukraine	-0.58	-0.68	-0.92	-0.21	-0.53	-0.85	-0.27
Kazakhstan	-0.63	-0.60	-0.98	0.16	-0.40	-0.89	-1.06
Russian Federation	-0.73	-0.47	-0.93	-1.05	-0.33	-0.89	-0.70
Azerbaijan	-0.88	-0.80	-1.08	-0.79	-0.59	-0.88	-1.13
Venezuela, RB	-1.02	-0.98	-1.01	-1.12	-1.07	-1.33	-0.62
Nigeria	-1.14	-1.02	-1.11	-1.73	-0.89	-1.24	-0.84
Turkmenistan	-1.32	-1.47	-1.25	0.15	-1.99	-1.42	-1.94
Uzbekistan	-1.34	-1.00	-1.07	-1.16	-1.66	-1.27	-1.91

Source: World Bank

42. **Turkmenistan has a vertically centralized governance structure.** A strong presidential system results in top-down decision-making that characterizes the way the public administration operates. Most decisions are taken at the highest political level and implementation falls into the different Ministries and various agencies, with limited public participation. Turkmenistan is a civil law jurisdiction in which the

laws are hierarchically organized, being the Constitution of Turkmenistan the Supreme Law of the State. The hierarchy of laws is as follows:³

In terms of primary regulations:

- a. The *Constitution of Turkmenistan* was approved on 18 May 1992 and amended in 1995, 1999, 2003 and 2008. Norms and provisions secured in the Constitution have direct effect.
- b. *Constitutional laws*, which either amend and modify the Constitution or are established by the Constitution, such as laws regarding independence, fundamental principles of State organization, or on the permanent neutrality of Turkmenistan.
- c. *Codes*. Currently, laws in Turkmenistan are in the process of being codified.
- d. *Ordinary laws*, which constitute the bulk of regulation in Turkmenistan. Having a legacy from the Soviet legal system, economic activity is heavily regulated.

In addition to a number of subordinate or secondary regulation:

- e. *Decrees and acts of the President, Resolutions of the Mejlis (Parliament)*.
- f. *Resolutions and orders of the Cabinet of Ministers*.
- g. *Normative acts of the organs of State power and government*.
- h. *Resolutions of the hyakims (regional governors)*.
- i. *Decisions of local meetings (gengeshi)*.

43. **Executive power is with the President, the Cabinet of Ministers, Ministries and local government.** The President enacts Constitutional and other laws, and issues decrees, resolutions, and orders, which have mandatory force throughout the country. The Cabinet of Ministers is an executive and management body. The President chairs the Cabinet of Ministers. According to Article 75 of the Constitution, the highest-level executive authority is the Cabinet of Ministers, chosen and headed by the President. The Cabinet consists of the deputies of the Chairman of Ministries and the ministries. Among others, the Cabinet of Ministers is empowered to organize the enforcement of the laws of Turkmenistan, the legal acts of the President of Turkmenistan, and of the Mejlis of Turkmenistan; to develop proposals regarding key areas of internal and external policies of the State, as well as programs for the country's economic and social development, which are then submitted to the Mejlis for review and to ensure State management of economic and social development, organize management of State enterprises, organizations and institutions, and secure rational use and protection of natural resources.

Policy Coordination and Regulatory Quality

44. **In Turkmenistan as elsewhere, accountability, transparency and clear responsibilities of functions are essential to ensure policy coherence and coordination.** The role of the center of the government is essential to promote such coherence and coordination. Its function is to lead and steer the implementation of the national vision-based strategy and its policy and programming initiatives effectively, efficiently and coherently across the central administration and with sub-national authorities, as well as mobilize non-governmental actors from across society in support of the government's vision.

³ Based on Stalbovskiy, Oleg and Maria Stalbovskaya. 2006. Available at: www.nyulawglobal.org/globalex/turkmenistan.htm

Center of government institutions act as champions of reform and promote reform to generate and manage interdependencies across the administration. Some countries have gone through this process and some lessons can be drawn from those experiences.

Spotlight 5 - Policy coordination: Finland, Estonia and Poland

Finland has a strong track record in responding to difficult economic situations. The public administration has been critical to this success; both in supporting Finland's remarkable transformation from an economy specialized in traditional industries to a diversified and modern economy, and in helping the country navigate the Nordic economic crisis of the early 1990s. As a result, the Finnish citizenry today trusts the public administration as a key partner for economic development and service delivery, as well as the mechanism to realize many Finnish values of social solidarity and equality. Finland is a leader in identifying and placing high-level commitment behind horizontal, government-wide priorities. Since 1987, successive Finnish governments have focused on the modernization of government, with public management reforms receiving strong political support. Within the State administration, reforms have focused on increasing the productivity and efficiency of operations, and achieving greater coherence of cross-sectoral policy issues. They included a program on performance management, ministry and agency mergers, a Productivity Program, and e-government. Strong, independent ministries and agencies in the State administration and autonomous municipalities characterize the structure of the Finnish public administration. Finns traditionally trust the State level of government, but prefer that everyday functions (such as the delivery of basic services) be located at the local level. The Nordic model followed by Finland means that social benefits and public services are provided in a more comprehensive way than in other OECD countries. The Nordic experience has proven that social protection and economic development can work in tandem, in a mutually reinforcing way. High economic growth has been combined with a reduction in poverty and income inequality, coupled with close to full employment. A strong welfare State is compatible with strong economic growth. The Nordic countries have also shown that social protection can play a crucial role in economic development.

Since the restoration of independence in 1991, and prior to the global financial and economic crisis, Estonia enjoyed one of the most dynamic periods of economic growth among both transition and OECD countries. Critical to this success was Estonia's transformation from a centrally planned economy to a liberal market economy. The stewardship of the government has resulted in budget surpluses, a reasonable level of openness, and a high level of economic and political stability, an important factor for investors. As a result, the Estonian government, supported by the public administration, was a key orchestrator of economic development. Over the same 20-year period, Estonia has also developed, practically from scratch, all the functions and apparatus of a modern State, including a legal code, a civil service, and national and sub-national institutions that bear all the responsibilities and risks of independent statehood. Estonia operates a fragmented and decentralized public administration. However, as a small State, it is critical that the public administration work as one cohesive unit, rather than in separated silos. Estonia's public administration has shown its capacity for horizontal working at both the political and administrative levels. However, this ability to come together collectively shines more in times of crisis, or when a more immediate policy response is needed, than in "business-as-usual" activities. Estonia has an impressive ability to establish working groups for a variety of activities including pilot projects in the public administration, drafting policy reforms and legislation (e.g. the Employment Contract Law), processes and systems (e.g., sustainable development indicators), sub-national negotiations, and international initiatives. Often these are populated with a wide array of appropriate stakeholders, providing a more structured way to tap into individual personal or professional networks, both inside and outside of government. In addition, there also is solid co-operation and collaboration at the technical or administrative level, often based on or reinforced by informal networks and personal relationships. This is evidenced by the collaboration required for designing and implementing pilot projects and integrated (cross-sectoral) policy initiatives (e.g. the program and accrual budgeting initiative). But one reason that public administration reforms have not advanced in Estonia is that senior public servants have not been able to articulate a coherent and unified message about the need and direction for reform, and then communicate it to politicians. Given conflicting signals, politicians

have held off committing to public administration reforms. To gain support and buy-in at the political level, the public administration's senior leadership needs to communicate its own vision for reform.

In 1989, with the end of the communist regime, Poland undertook important reforms aimed at building a democratic State and a functioning market economy, such as the privatization of public sector economic activity, price liberalization, the reform of the banking system, administrative modernization and the recasting of the social welfare system, including in education and healthcare. Coordination is still evolving in Poland. The central government has made an important effort to consolidate and streamline national planning, laying the ground for enhanced co-ordination. From over 400 politically driven single-sector strategies at the beginning of the 2000s, the government has integrated its strategic direction within a single long-term vision ("Poland 2030"), a National Development Strategy and nine medium-term integrated strategies which address cross-cutting issues and form the basis for working across traditional ministerial lines. However, most medium-term integrated strategies have yet to be approved, and the center of the government structure still appears to be too siloed and neither integrated nor nimble enough to address fast-moving policy challenges effectively. Uneven co-ordination between center of the government institutions, and between these institutions and line ministries, hinders capacity to build cross-sector synergies and coherence to maximize the impact of decisions on results for citizens and reap fully the potential benefits of the new strategic framework. Intra- and inter-ministry co-ordination within the national government tends to be sporadic and ineffective. In addition, evidence-based policy analysis is not yet systematically informing important decision making by the government of Poland, and evidence-based policy advice is not always sought by decision makers, perhaps due to a perception that it takes too much time and effort to generate this evidence, or due to a lack of confidence in the quality of the evidence once it is produced, or that once produced the evidence will be ignored. However, the civil service as an institution has been enhanced significantly – the government now employs a relatively diverse, well-educated workforce. Many centers of excellence exist across the government and Poland's National Civil Service School's role in training civil servants is now recognized beyond the country's borders. For Poland, given the scope and scale of the reforms that are still required to implement strategic-State capability, an incremental approach likely constitutes the most prudent and realistic way to complete the reform implementation process.

Sources: OECD. 2010d; OECD 2011; OECD. 2013a;

45. **Turkmenistan does not have specific guidelines to ensure that procedures are duly followed when designing and implementing regulations.** Initial steps of an organized process of regulatory management exist: technical government officials prepare draft laws and regulations in the respective Ministry and then legal advisers review them in order to comply with consistency with other legal norms, constitutionality and coherence. In the case of primary regulation, e.g. laws, drafts are sent to the Cabinet of Ministers with an explanatory note providing the reasons and justification for intervention. The Cabinet of Ministers, which oversees the various policy sectors, reviews draft laws and it might require further changes and revisions in the draft from the respective Ministry, which has to prepare protocols in case of amending regulations or new proposals. In the case of subordinate regulations, draft regulations are not sent to Cabinet, but have to be registered by the Ministry of Justice, which also acts as a quality control filter in legal terms. Laws are finally approved by the Mejlis and enacted by the President.

Spotlight 6 - Regulatory management: Canada, France and Sweden

In Canada, the *Cabinet Directive on Streamlining Regulation* came into effect on April 2007. It replaced the *Government of Canada Regulatory Policy* (1999), and introduced several key improvements, including a more comprehensive management approach with specific requirements for the development, implementation, evaluation, and review of regulations. The *Directive* establishes that when regulating, the federal government will:

- Protect and advance the public interest in health, safety and security, the quality of the environment, and the social and economic well-being of Canadians, as expressed by Parliament in legislation;
- Promote a fair and competitive market economy that encourages entrepreneurship, investment, and innovation;
- Make decisions based on evidence and the best available knowledge and science in Canada and worldwide, while recognizing that the application of precaution may be necessary when there is an absence of full scientific certainty and a risk of serious or irreversible harm;
- Create accessible, understandable, and responsive regulation through inclusiveness, transparency, accountability, and public scrutiny;
- Advance the efficiency and effectiveness of regulation by ascertaining that the benefits of regulation justify the costs, by focusing human and financial resources where they can do the most good, and by demonstrating tangible results for Canadians; and
- Require timeliness, policy coherence, and minimal duplication throughout the regulatory process by consulting, co-ordinating, and co-operating across the federal government, with other governments in Canada and abroad, and with businesses and Canadians.

In France, the government's programme of work (PGT), which details the main orientations of the government, field by field, is set out every six months. This enables political will to be expressed and priorities adapted by checking that government policies are consistent. It includes the list of draft legislation that the government intends to submit to a vote in parliament, the list of draft ordinances and decrees proposed for introduction into the agenda of the Council of Ministers' meeting, and the list of matters that are to be subject of communication in the Council of Ministers (oral presentation by ministers of their actions within a field under their responsibility). The programme of work is therefore an instrument for organising legislative and regulatory activity, allowing forward planning and timely scheduling of business in the Council of State, the Council of Ministers, and the parliamentary agenda for the government's part. Since the programme of work is simply indicative, if necessary, it can be modified to take account of new requirements arising from current events. The themes included in the work programme are subject to proposals made by members of the government. These proposals are collected by the Secretariat General of Government (SGG), which puts them in a uniform format. They are all then submitted to arbitration by the Prime Minister. The government's programme of work is not made public, without necessarily being classified as confidential.

In Sweden, work flows from the government's political agenda, based on the coalition agreement at the start of each political term. The Prime Minister's Office (PMO) submits a list of upcoming bill proposals twice a year to the parliament. The annual Budget Bill also indicates the direction of reforms. It gives significant information about priorities, including new legislation for the coming years. The government

also informs the *Riksdag* annually about appointed Committees of Inquiry and their work (*kommittéberättelsen*, the Committee Report). These documents are available on the government's website.

Sources: Treasury Board of Canada Secretariat. 2007. Cabinet Directive on Streamlining Regulation, available at www.tbs-sct.gc.ca/ri-qr/directive/directive01-eng.asp; OECD. 2010a and OECD. 2010b.

46. **Regulatory quality is key for Turkmenistan in its current transformation efforts.** Regulation is an essential function of government. Together with taxes and budget, regulation is intended to shape social and economic relations in any society. It is therefore essential to have adequate regulatory procedures that are transparent and participatory, in order to attain clear policy goals. Diversification of the economy and consolidation of a market economy can be successfully achieved only if there are adequate regulatory frameworks in all policy fields. Government should actively promote clear and proportionate rules to ensure macroeconomic stability and enforce a level playing field for the private sector. Several countries have taken the lead in reforming their regulatory processes, integrating the use of modern tools to ensure regulations are proportionate and attain their desired objectives (see Box 2).

Box 2: Why regulatory quality matters?

Having adequate procedures during the regulatory process to make it more predictable, transparent and participatory, and integrating tools that can help preparing and implementing regulations of quality are essential components for economic development, growth and social welfare. Regulatory quality refers to the capacity of the government to manage the regulatory flow and stock (preparing new regulations and reviewing existing ones) and ensure that regulations are cost-effective and efficient. To achieve these goals, governments have to engage in regulatory management and reform, and introduce adequate tools and policies to ensure that the administrative machinery carries on good regulatory principles.

47. **Consultation is fundamental to improve the quality of regulations.** While preparing new regulations or amending existing ones, some consultation takes place. Within the Turkmen central administration, consultation with other bodies is not uncommon, particularly when regulations are intended to implement government strategies and plans. In that particular case, the Ministry of Economy has some coordination roles, as it monitors the implementation of the Government programs and plans. Ministries have to report quarterly to the Ministry of Economy on the implementation progress. Some indicators also help institutions to measure progress.

48. **Engagement of stakeholders is more challenging, as consultations are rather focused and there are no open mechanisms for different groups to participate in the process.** However, Ministries reported that depending on the nature of the regulation, they are obliged to consult with stakeholders. The Ministry of Justice verifies that such a consultation has taken place and comments from stakeholders have been incorporated in the final draft. There are, however, no clear provisions or guidelines for consultation.

49. **Laws are published in the Official Gazette and Ministries and other institutions also promote their dissemination through official channels and at local levels.** There is an official website of the Government of Turkmenistan⁴ that publishes the laws enacted by the President, but this repository consists only of a list of laws issued by date. There are no search options that could help interested parties to find easily the laws.

⁴ Available at: <http://www.turkmenistan.gov.tm/?rub=12>

Spotlight 7 - Consultation in the regulatory process and publication of regulations: United States, Canada and Mexico

Consultation with stakeholders is a fundamental tool to ensure the quality of the regulation. Greater public involvement enhances legitimacy and is a pre-condition for effective governance. It helps establish public confidence, trust and credibility. Stakeholders and citizen engagement is an important part of improving the design of rules and promoting acceptance of and compliance with rules – reducing therefore enforcement costs. Several countries have improved consultation procedures and publish systematically regulatory decisions. In addition, making regulations public is essential to increase participation and to inform stakeholders so they can better comply with regulations.

The United States incorporated consultation procedures in the regulatory process in the 1948 Federal Act of Administrative Procedure. Thus, consultation is an essential part of the rule-making process, which is followed by executive and independent agencies of the federal government to implement primary legislation. Executive Orders by the U.S. President also establish principles and guidance for the rule-making process. In 2003, the e-Rule-making program was established to improve access and participation in the federal regulatory process. The e-Rule-making programme launched the www.regulations.gov website to enable citizens to search, view and comment on regulations issued by the U.S. government. On average, federal agencies and departments issue nearly 8,000 regulations per year. In the past, if members of the public were interested in commenting on a regulation, they would have to know the sponsoring agency, when it would be published, review it in a reading room, then struggle through a comment process specific to each agency. Today, the public can contribute to and retrieve rules and regulations that impact their lives conveniently, from anywhere. They find all regulations in a single online portal. While www.regulations.gov is a depository of all regulations prepared by the federal government, the rule-making docket (known as a “Docket Folder”) contains all of an agency’s relevant rule-making materials (e.g., Notice of Proposed Rule-Making, hearing notices, extensions of comment period, and final rule), supporting documents (e.g., economic and environmental analyses), studies and other references, all public comments, and other relevant documents. This approach follows the principle that, as a norm, government decisions should be based solely on the information set out in the publicly available record. This should include all comments submitted by citizens, affected entities, along with all other information the government relies upon and the response of the government to public comments.

In Canada there is a strong link between public consultation and public policy making. Consultation rounds start very early in the policy formulation phase. Departments use discussion papers, written submissions, informal discussions, *ad hoc* meetings, departmental Web sites to seek input and disseminate information, workshops, conferences, and seminars, using regional offices to collect and channel opinion, newsletters, consultative or on-going multi-stakeholder advisory committees. Especially performing is consultation on subordinate regulations. The Canadian Government puts particular emphasis in the preparation of a structured “consultation plan”, which, while it requires an upfront investment of time, budget and effort, allows to critically frame the boundaries of the consultation process and hence enhance the overall efficiency. The plan should precisely state the objectives of the process and include the issues under review, a public environment analysis, key participants, realistic timelines, and a mechanism for reporting consultation results. It should clearly describe the proposed consultative approach and “rules of engagement,” so that interested parties can decide whether or not to participate and, if so, how. The Government suggests that stakeholders can, where appropriate, be invited to provide input on the development of the consultation plan, including on how the consultation should be conducted and which consultative tools would be most appropriate. The Privy Council Office, the non-partisan advisory body to the Prime Minister and Cabinet, released the Government of Canada Regulatory Policy in 1999, formalizing requirements for consultation. Guidelines for Effective Regulatory Consultation are available through the Treasury Board. Other governmental agencies developed own tools.

In Mexico, the Federal Registry of Formalities and Services (*Registro Federal de Trámites y Servicios*) is the official, single on-line portal for all federal formalities and services, classified by institution and administrative unit. The Registry is provided for by law, which grants it legal status. Every formality and service is registered in the Federal Registry with the following information: name of the procedure, legal basis of the formality or service, situation in which the formality might be requested or the service offered, how the formality or service can be requested, forms to be filled in, data and information that has to be presented with the formality or service, response delay, fees to be charged and how they are established, validity of the licences, authorisations or permits that could be provided, criteria for resolution, administrative unit responsible of the formality and service, time schedule for citizens and businesses, and contact details. In Mexico, process re-engineering was used to improve business formalities. In June 1998, the UDE (the former Deregulation Unit at the Ministry of Trade and Industry which later on became the Federal Regulatory Improvement Commission, COFEMER) launched an ambitious communications project: an electronic one-stop shop based on the inventory of formalities supported by Internet search facilities. A user-friendly, online search tool was posted, permitting any person to retrieve a list of formalities needed to start up or operate a business. Once the inventory became the official federal registry, the list of formalities provided nearly 100 percent accuracy and legal security. The registry became in 2000 the Federal Registry of Formalities and Services, a unique tool to provide business and citizens with a full list of compulsory procedures. Through the Federal Registry, the COFEMER can ensure the regulatory improvement process, as businesses can identify problems or inaccuracies, in addition to assess their economic impact on business activities. The Federal Registry provides legal security, as institutions cannot apply a formality that is not registered in the Federal Registry or ask for obligations or requirements that are not listed in the online portal.

Sources: www.regulations.gov; www.gazette.gc.ca/consult/consult-eng.html; www.cofemer.gob.mx.

Managing Volatility

50. **Resource rich economies usually face a challenge of uncertainty and volatility associated with the price and/or demand fluctuations for the natural resource.** Given the importance of the extractive sector for such economies, volatility of resource flows may impact the country's broader macroeconomic parameters and lead to larger policy challenges, such as fluctuations in export performance, ups and downs of GDP growth, budget revenues, public spending/investment, employment, inflation and exchange rate behavior.

51. **To address these challenges and manage volatility, most resource-dependent countries introduce additional institutional arrangements and task them with specific functions.** In some countries these institutions are legally separate entities and autonomous units in the public administration structure (Alaska/USA, Alberta/Canada, Azerbaijan, and Kuwait). In other countries, for example in Norway or Timor Leste, they are divisions within the Ministry of Finance. The size of assets managed by stabilization funds varies from country to country. As of 2009, the largest fund in nominal US\$ terms was managed by Norway (US\$423 bn), as a percentage of GDP - by Tuvalu (365 percent of GDP) while the smallest funds - by Venezuela and Sudan (0.2 percent of GDP respectively). Kuwait was the first country establishing such an institution (Kuwait Investment Authority, KIA) in 1953 and then the General Reserve Fund (managed by KIA) in 1960. Since then the total number of stabilization funds around the world has grown to 52. The main objectives of most of these funds are of short term nature - smoothening government revenues and thus public spending. The international experience shows that in countries where there is a Stabilization Fund fiscal performance is more disciplined and fiscal policy implementation, measured by the non-primary balance, is smooth (Sugawara, 2014).

52. **Usually the designated institutions manage resource revenues separately from the regular budget.** But important considerations are whether: a) there are designed rules and regulations for operation for such institutions/funds; b) the execution reports of separated funds are integrated into the regular budget reports; c) they follow the established rules of accountability and internal/external oversight and d) there is a coordination mechanism at the policy level (macroeconomic, fiscal, monetary and exchange rate) and at the institutional level (Ministry of Finance, Ministry of Economy/Development, Stabilization Fund, and Central Bank).

Spotlight 8 - Stabilization Funds: international experience

Norway established Government Pension Fund Global in 1990 with US\$ 396.5 billion. The Government Pension Fund is a sovereign wealth fund (SWF) where the surplus wealth produced by Norwegian petroleum income is held. It is the largest pension fund in Europe and the second largest in the world. It is among the most transparent of the SWFs in its holdings and investments. The petroleum fund is investing parts of the large surplus generated by the Norwegian petroleum sector, generated mainly from taxes of companies. The purpose of the Government Pension Fund-Global is to facilitate government savings necessary to meet the rapid rise in public pension expenditures in the coming years, and to support a long-term management of petroleum revenues. The fund invests a large portion of assets in fixed income and equities. It currently does not invest in private equity.

Alaska (USA) established Alaska Permanent Fund 1976 with and initial capital of US\$734,000. It is a constitutionally established Fund, managed by a semi-independent corporation. At least 25 percent of proceeds come from minerals, such as oil and gas, sale or royalties are directed to the Fund. The Alaska Permanent Fund sets aside a certain share oil revenues to continue benefiting current and all future generations of Alaskans. Spending Fund income is up to the Legislature. The Fund grew to the sum of approximately US\$40 billion as of 2007.

Alberta (Canada) established the Investment Fund for Future Generations in 1976. This fund was created with several goals in mind, including diversification of economy, improving quality of life, and accumulating savings for "rainy days". The fund was originally designed for economic development, but now primarily it is a long-term savings and investment fund. The fund is invested in stocks, bonds, and real estate and alternative investments, with the aim of generating revenue for the Alberta province. Currently the Fund's capital is estimated about US\$ 17 bn.

Azerbaijan established the State Oil Fund of the Republic of Azerbaijan (SOFAZ) in 1999. Main responsibility of the Fund is to manage foreign currency and assets generated from oil and gas exploration and development. It has seven members of the Supervisory Board, represented by state bodies and civil society, who are appointed by the President. The Fund may be categorized as a savings fund for future generations. The Fund primarily invests in investment-grade securities such as government agency bonds, corporate bonds, and mortgage-backed securities.

Kazakhstan established the National Fund of the Republic of Kazakhstan in 2000 on the basis of resources originated from oil, natural gas and metallic minerals. The National Fund a stabilization fund that ensures economic stability of Kazakhstan against the price swings of oil, gas, and metals. The assets of the National Fund assets are monitored by the National Bank of the Republic of Kazakhstan. Currently the Fund's capital is estimated at about US\$ 38 billion.

Source: World Bank Staff

The Stabilization Fund, Fiscal Policy and Management

53. **Turkmenistan created a Stabilization Fund (SF) in 2008.** The SF's assets are held at the Central Bank as a separate sub-account of the Treasury Single Account and managed by the Government of Turkmenistan. The timing of creation of the SF coincided with the recent global crisis and the need to execute a fiscal stimulus package to support the domestic economy during the post-crisis period. To execute these programs a new institution, the State Development Bank of Turkmenistan (SDBT), was created in 2011 with a starting capital of US\$1 bn. As of the end 2013 the total credit to the economy through the SDBT amounted to TMT 11 bn (about US\$4 bn). The funds have been used not only to provide credit to public sector entities through domestic banks, but also to implement priority investment projects approved by the President and by the Cabinet of Ministers, and acquire domestic or external financial assets. Revenues generated from hydrocarbon exports have been channeled to non-hydrocarbon sectors through public investments and thus stimulated domestic sources of growth.

54. **By its mandate, the SDBT performs functions of both fiscal and monetary institutions.** It provides lending to the economy directly and through local commercial banks. There is a set reporting requirement to the government, Central Bank and Chamber of Control with monthly and quarterly periodicity. The interest rate charged by the State Development Bank for on-lending is approved by the government. Besides the ex-post reporting, it is also important to ensure full coordination with the Central Bank to ensure consistency of the State Development Bank's lending practices and interest rate application with monetary policy objectives.⁵

55. **A simple fiscal rule was introduced in 2008.** It stipulates accumulating the surplus of the State Budget in the Stabilization Fund at the end of each fiscal/calendar year after safeguarding the deficit financing need of the following year. The annual limit of utilization of the Stabilization Fund resources by the State Development Bank is approved by the President's decree and specific directions - by the Cabinet of Minister's decision.

56. **There is a shared responsibility between the Ministry of Finance and the State Development Bank for the execution of State Programs.** The Ministry of Finance, through the State Budget, is responsible for implementation of the Rural Development Plan (envisaging projects mainly of social nature) while the State Development Bank is tasked with implementation of the rest of public programs (mainly infrastructure, construction and economic development). However, there are different requirements for legislative approval and external oversight for the State Budget and for the Stabilization Fund. The State Budget and its annual execution report are subject to Parliament approval and external audit by the Chamber of Control. Allocations from the Stabilization Fund do not require approval by Medjlis and by the end of the fiscal year project implementation reports are not incorporated into the State Budget (Consolidated Budget) to be presented and discussed by the legislature. Although the Chamber of Control reviews and approves each investment project on a case by case basis, it is important to produce and present the full picture of fiscal accounts and public spending by the end of each reporting period regardless of the institutional setting of public expenditure execution agencies.

57. **Moving ahead, the authorities could introduce more objective criteria and set transparent rules for defining limits of resource utilization from the Stabilization Fund.** Also, the government may consider approving a long-term strategy for utilization of resource revenues for programs with higher public returns on investments. In addition, improved coordination between different fiscal institutions (Ministry of Finance and the State Bank for Development) for ensuring consistency and harmonization of public expenditure management practices and policy objectives would be essential. As the SDBT

⁵ This issue is discussed in the World Bank's discussion note on Access to Finance.

develops more capacity, it may consider introducing more robust methods for public investment appraisal to be able to screen and select from project proposals developed by line ministries.

The Foreign Exchange Reserve Fund, Stabilization Fund and Exchange Rate Policy

58. **Natural resource dependent countries are usually prone to the “Dutch Disease”, associated with exchange rate appreciation triggered by large foreign exchange inflows from exported natural resources.** The appreciated currency imposes an implicit tax on export of the non-resource tradable sector and impedes export expansion. At the same time, large foreign currency inflows elevate domestic demand through increased levels of public spending, which in turn leads to an increase in prices for domestic non-tradable goods and to the appreciation of the national currency. As a result, the country loses its competitiveness, resources shift from non-competitive tradable sectors to non-tradables, the economy becomes dominated by a few sectors and less diversified. It is, thus, very important for resource-dependent economies to draw attention not only on institutional arrangements for managing resource revenues and on setting transparent fiscal rules but also on the need to ensure a competitive exchange rate.

59. **Turkmenistan created a Foreign Exchange Reserve Fund (FERF) in 2007.** The FERF is managed by the Central Bank and has been created to guarantee full convertibility of the national currency.

60. **In May 2008 the Central Bank of Turkmenistan announced the unification of the exchange rate.** Before 2008 Turkmenistan experienced a dual exchange rate operation with a difference between the official and parallel exchange rates of about 4-5 times. The dual exchange rate practice resulted in an implicit tax on exports and an implicit subsidy on imports. Also, it hindered the banking sector's involvement in the foreign exchange market and trade financing operations. The unification had a positive net effect on the economy as the reform momentum was highly advantageous for Turkmenistan. First, the dominance of the hydrocarbon sector ensured revenues to the budget. Second, the country enjoyed a fiscal surplus, low public debt and comfortably high external reserves, which provided room to deal with external shocks. Also, the government already implemented large subsidy programs which helped to mitigate the negative implication of relative price changes on the welfare of certain groups of the population. Besides, the government decided to support public enterprises with input subsidies to maintain jobs and prevent possible disruptions caused by the higher cost of inputs.

61. **The exchange rate unification was followed by the redenomination of the Turkmen Manat in January 2009.** The currency was redenominated at TMT 1 per TMM 5000 and pegged to the US dollar at fixed TMT 2.85 per 1 US\$. Macroeconomic and social indicators of the post 2008 period show that the overall exchange rate unification and redenomination of the currency were managed successfully. The stable exchange rate increased confidence towards the national currency. The exchange rate unification also set the stage for the banking sector's development as it enabled the revaluation of assets and liabilities, and increased access to the foreign exchange market.

62. **The choice of a fixed exchange rate in 2009 was well justified in the background of the prior developments and applications of parallel exchange rates.** In addition to increased confidence, the stable currency encouraged savings and thus promoted formal financial intermediation though from a very low base. Between 2009 and 2013, the banking deposits denominated in Manats increased by more than 6 times while foreign currency deposits by less than 3 times. As a result, the ratio of domestic currency deposits to foreign currency deposits contracted from 1:3.1 to 1:1.4 during the last five years. Also, the stable currency was quite helpful in ensuring social stability during the recent liberalization of administratively controlled prices.

63. **Despite the above mentioned positive aspects, the fixed exchange rate seriously limits the space for monetary policy and does not facilitate export of non-resource sectors.** The exchange rate, fixed in January 2009 and not revisited since then, may pose obstacles for the Central Bank in its pursuit of low inflation. In addition, the cost of the fixed peg increases over time and leads to overvaluation of the national currency. Therefore it is advisable to introduce exchange rate flexibility, move away from the fixed US\$ peg and introduce a wider foreign exchange band or trading margins to manage the transition to a floating exchange rate smoothly.

Providing Public Services

64. **A key function of government is the provision of public services.** In Turkmenistan State intervention is dominant not only in social policies, such as health and education, but also in large infrastructure projects or the development of transport systems. The Government defines the pace and scope of the delivery. Private participation (local and foreign) is rather limited in most areas, as services and products are mostly offered by SOEs and other State entities.

65. **The Law on Investment Activities in Turkmenistan governs investment decisions.** Decisions on State investments are adopted expecting a high rate of return and on the basis of the following criteria: (i) forecasts for economic and social development; (ii) schemes of labor development and distribution; and, (iii) special scientific and technical feasibility studies. The Law foresees private participation in such investments, but in the move towards a market economy, the State plays a key role in guiding the way investments are channeled.

Priority Setting and Capacity

66. **Policy priorities are decided by the President and Cabinet of Ministers in line with the Government development programs.** The Government, mainly through decisions by the President and the Cabinet of Ministers, sets priorities for public services, with participation of local executive bodies and concerned public organizations. Priorities have to be in alignment with the main directions of the different Government development programs and monitoring of project execution has to be conducted by the responsible Ministry or institution, according to the mentioned Law.

67. **The Ministry of Finance is then in charge of allocating resources for such priorities.** The recent introduction of a new system of multi-year budget planning should facilitate monitoring resource allocation with the introduction of a results-based system. This is of core importance as the current magnitude of public investment spending accentuates the need for better control over the efficiency of spending. At the moment this is rather opaque, as a significant amount of government revenue and expenditure remains outside the main State budget, moving through extra-budgetary funds (ADB, 2014). According to official numbers (State Committee for Statistics, 2013), investments in Turkmenistan have increased from 1,814.4 Mio. Manats in 2000 to 48,407.1 Mio. Manats in 2012. In 2012, the following funding sources, in decreasing order of magnitude, were used: other, internal funds of enterprises and organizations, foreign investors, loans, centralized and local budget and population.

68. **Better prioritization of expenditures and focus on results will strengthen the quality of public service provision.** Turkmenistan could follow the lead of advanced OECD countries and shift to performance-oriented public sectors that emphasize efficiency and accountability. This requires systems to monitor results—including enlisting private companies, academic institutions, and nongovernmental organizations to monitor indicators of public service delivery. The role of external performance audit will also become important in ascertaining that delivery units comply with their delivery obligations, on the basis of which they receive budget financing. This approach would require systematic reviews of public spending to identify the scope for service delivery improvements and to advance institutional reforms.

69. **Coordination and capacity within the public administration is crucial to ensure the effective provision of public services.** Strategic-State capacity refers to the extent to which the central government can (i) set and steer a national long-term strategy for the country, (ii) identify and address internal and external challenges to implementing this strategy correctly through enhanced evidence-based decision making and strategic foresight, (iii) improve efficiency in policy design and service delivery to meet these challenges, and (iv) mobilize actors and leverage resources across government and society to achieve integrated, coherent policy outcomes that address these challenges effectively. The strategic-State concept emphasizes leadership and stewardship from the center, integrity and transparency, the importance of networks and institutions both inside and outside government, the need to draw inspiration from sub-national initiatives and from citizens, and the importance of effective implementation of strategy in support of positive outcomes for a country's economy and society (OECD, 2013a).

70. **Capacity of the administration in Turkmenistan is uneven across ministries and service delivery can be fragmented.** The example of the current efforts to improve vocational training offers a case in point of the challenges still facing the administration (see Box 3). In response to high demand to attend vocational schools and training centers, the government has begun establishing a vocational training system. In doing so, it has faced challenges, mainly related to government capacity and coordination within the administration. The lessons from the current experience can be summarized as follows. First, coordination mechanisms among the different Ministries and institutions have to be explicitly promoted, as in many cases the top-down decision-making and the implementation process fall into the competences of different entities, which are not able to communicate and coordinate on their own and promptly. Second, human capacities also vary considerably across the administration, which in some cases does not have adequately trained staff to deal with the demand for services. Ministries and other government agencies need to build those capacities in a sustained manner over time because expertise to deal with specific and very technical implementation of Government programs is not always at hand within the administration. Third, social participation is limited, even if providing services entails meeting stakeholders' expectations and needs.

Box 3: Vocational training in Turkmenistan

Vocational training is an important priority of the Government of Turkmenistan, in particular to develop expertise and specialists for economic and social areas that are demanding a more qualified labor force. It is part of strategies to be promoted as part of Government programs in the medium and long term. In Turkmenistan, training is provided on both a full-time and part-time (evening classes) basis. There are 118 accredited initial vocational schools and training centers in 2000 and 129 in 2012, which come under the jurisdiction of the corresponding sectoral ministries and departments. The number of pupils in those establishments increased from 21,000 to 51,100 in the same period. As a rule, vocational schools receive no government funding, and training is provided on the basis of tuition fees paid by students or directly, for example, by enterprises, which order training courses from vocational schools. According to the Ministry of Education, the schools at this level provide training in 268 occupations. Secondary VET is provided in secondary schools of different types (colleges, secondary professional schools and others) and at certain higher education institutions that hold the relevant licenses. Training in secondary vocational schools is provided on a full-time basis. In 2010/11, there were 27 secondary vocational schools and 6,206 enrolled students (a 44.2 percent increase compared to 2000/01).

Traditionally, this policy area was in the hands of the State Committee on Labor and later on in the Ministry of Economy. A new Ministry of Labor and Social Welfare was set up in April 2011 to replace the old Ministry of Social Welfare, which is now in charge of this issue. The Ministry defines the main guidance at the policy level, and other institutions, mainly Ministry of Education, are in charge of implementation. Regulations to help implementation are put forward by the responsible implementer institution, but the Ministry of Labor participates with comments to any draft.

Through technical assistance of the European Union, the project on Improvement of the Quality and Relevance of Professional Education has helped to develop better coordination mechanisms. The purpose of the project was to

provide technical assistance and policy advice to various stakeholders in Turkmenistan to develop human resources and related policies through analyzing current and future skills needs in the selected economic sectors, developing new standards, curricula and training programs, creating a basis for vocational and educational training (VET) qualifications, establishing relevant quality procedures for the VET system and facilitating the development of policy options aimed at widening equal access to VET and lifelong learning. The Ministry of Education is the main stakeholder, and a steering committee has been set up that includes all the relevant stakeholders and representatives of other donors active in the field of education and training

Source: Corradini and Dergunova. 2012; State Committee for Statistics, 2013.

Improving Service Delivery

71. **Increased private participation could improve the quantity and quality of public service delivery.** Private participation in long-term projects that can improve service delivery is promoted by the Government of Turkmenistan, mainly through specific incentives, such as credit lines at very low rates (1 percent or even no interest at all). Even if this policy has had some success in attracting investors, an adequate framework for private participation in service delivery is not yet in place.

72. **Going forward one possible option, widely used at international level, is to establish public-private partnerships (PPPs) as an alternative to more traditional arrangements.** Although some laws acknowledge the cooperation between the public and the private sectors under concession agreements, PPPs do not have a legal basis in the country. International experience shows that different incentives, combined with an adequate legal framework, have to be in place in order to ensure sustainability of PPPs, as well as to maximize and improve the use of resources. In Turkmenistan, institutional arrangements and capacities within the administration are still inadequate for a PPP model to be viable. Skills and institutions to initiate and supervise PPPs have to be systematically developed.

Spotlight 9 - Private participation in service delivery: Indonesia and Korea

Several countries around the world have been confronted to the need to increase private participation in service delivery, not only for ideological reasons, but also in the pursuit of value for money, e.g. how to improve the use of resources. Public-private partnerships (PPPs), long term contractual agreements between a government and a private partner whereby the latter typically finances and delivers public services using a capital asset, have been used as a “third way” between public provision and full privatization, inducing cost minimization behavior by the private provider in charge of the provision while reducing potential market failures by limiting the market power conferred on the private provider via the regulation through the contract. PPPs are widely used around the world. In the United Kingdom, for instance, they account for 14 percent of public investment. Both developed and developing countries have opted for PPPs, and results are mixed. The introduction of PPPs also raised a series of political, economic and technical questions. Two concrete cases illustrate the use of PPPs and challenges faced: Indonesia and Korea.

In Indonesia, prior to 2001, decision-making was largely centralized. However since 2003 the country experienced a significant degree of decentralization following the passing of the 2003 Law on State Finance (Law 17/2003). In addition, the implementation of a legal and institutional framework that could serve as basis for a larger degree of private participation in the form of PPPs was actively promoted after the Asian crisis in the early and mid-2000s. The legal and institutional framework establishes a basis for the involvement of private participation in infrastructure construction, finance and management. The Master Plan for Acceleration and Expansion of Indonesia’s Economic Development, 2011-2025 (MP3EI) focuses primarily on increasing the connectivity in Indonesia through, among other things, the development of six corridors and various ports. In addition, the MP3EI seeks IDR 4 012 trillion (US\$ 440 billion) of investment, with IDR 1 786 trillion assigned to items such as highways, harbors and power plants. Through the significantly increased use of PPPs in toll roads, rail and power generation the government of Indonesia wants to significantly catch up in infrastructure development, creating the necessary foundation to maintain the high economic growth rates it needs as a frontline emerging market economy intent on joining the BRICS. Today, most PPPs in Indonesia are in the form of concessions. The Government of Indonesia passed a number of laws to improve the process and principles through which projects are awarded, becoming the legal framework for PPPs: Presidential Regulation 67/2005 introduced the use of competitive bidding, and Presidential Regulations 13/2010 and 56/2011 regulate what types of projects are considered as infrastructure, what the eligible contracting agencies are and the role of potential private participants. In addition, regulations set out the responsibilities of the Ministry of Finance (MoF) with respect to the granting of fiscal support and guarantees to specific projects in the procurement process. Some challenges persist in Indonesia in relation to PPPs, such as lack of coordination among institutions involved in the design, implementation and supervision of PPPs, the need to have a dedicated PPP Unit within the MoF, more transparency, predictability and convergence of the regulatory framework of PPPs and sectorial areas, better alignment of overall PPPs strategy with objectives and priorities of individual projects at the highest political level, better value-for-money assessments of the different projects (including not only a high rate of return, but also economy, risk, effectiveness and efficiency of the project), and strengthen the budgetary process to ensure integrity of the PPPs cycle.

Korea has 15-year experience in PPP programs, well-established institutional settings and a mature market. Following decades of rapid economic growth, the country found itself at the beginning of the 1990s with a serious shortage of infrastructure facilities, such as roads, railways, seaports, and airports. The government, judging there would be limits to its ability to fund the needed construction of infrastructure facilities, had come to feel the need to induce private sector participation in infrastructure investment as an alternative means of replenishing infrastructure. The Government of Korea (GoK)

initiated then various kinds of policies that could facilitate infrastructure financing through PPP approaches. Comprehensive and clear definition of the PPP procurement steps—to secure or enhance value for money—in the special law and regulations has been an essential element to improve consistency and efficiency and to reduce uncertainty in implementing PPP projects in the country. The Ministry of Strategy and Finance (MOSF) is responsible for managing PPP projects, and the Public and Private Infrastructure Investment Management Center (PIMAC) at the Korea Development Institute (KDI) supports MOSF different ways, prescribed in the PPP Law: (i) supporting MOSF in formulating the Basic Plan for PPP; (ii) supporting the competent authorities and ministries in the procurement process, such as assessment of feasibility and value for money for potential PPP projects, formulation of the request for proposal, designation of the concessionaire, and promoting foreign investment in PPP projects through consultation services and other related activities; and (iii) developing and operating capacity-building programs for public sector practitioners. In addition, PIMAC at KDI conducts policy research related to PPP programs and provides policy advice to MOSF and procuring ministries. The PPP Act and the Enforcement Decree, the principal components of the legal framework for PPPs, clearly define eligible infrastructure types, procurement types, procurement processes, the roles of the public and private parties, policy supports, etc. . The PPP Act lays out the PPP Basic Plan and PPP Implementation Guidelines, which together address, in detail, policy directions, procurement steps, and government support. The Basic Plan provides PPP policy directions, PPP project implementation procedures, financing and refinancing options, risk allocation mechanisms, payment schemes for government subsidies, and documentation instructions. PIMAC developed the PPP Implementation Guidelines to improve transparency and objectivity in PPP implementation. According to this framework, 46 types of infrastructure facilities in 15 sectors are currently eligible for PPP procurement. Among those, most active PPP projects involve transport facilities, such as roads, ports, and railways. Also, some PPP projects include social facilities, such as waste treatment facilities, educational facilities, military housing projects, and bachelor's resident projects. Continuous development of the act and related regulations demonstrates a strong commitment on the part of the government to strengthen the private sector's confidence in the PPP program and also shows that there are always challenges ahead: for instance, to address ex-post management of PPP projects, as some of them enter into the implementation phase and strict monitoring is needed to ensure adequate performance.

Sources: OECD. 2008; OECD. 2012; ADB. 2011.

73. **The Concessions Law has significant shortcomings to become a legal basis for PPPs.** While the Concessions Law contains a basic set of rules on tender procedures, these rules are very limited and the scope of their application unclear, arguably leaving room for arbitrary decisions by the authorities. The Concessions Law provides that concession agreements may only take the form of Build Operate Transfer arrangements, thus limiting flexibility between the parties. Under the Concessions Law the concession projects can be granted for exploration, development, extraction or operation of natural resources, as well as for any other economic activity in all sectors, provided that such activity is not prohibited by existing laws and does comply with established requirements of ecological, sanitary-hygienic, radiation, fire and explosive safety. The definition of concession implies that a PPP mechanism (if used in the country) can be applied to a broad range of sectors (i.e. not only to infrastructure sectors, such as transportation, waste, water, disposal, etc., but also to sectors, such as manufacturing and agriculture, that fall beyond the scope of traditional PPP arrangements).

74. **The legal framework for PPPs could be strengthened and extended beyond natural resources.** The concession relations in Turkmenistan are governed by the Law on Foreign Concessions 1993, under which an authorized body on State property is entitled to review tender applications, select the concessionaires and sign the concession agreements. According to an EBRD assessment (EBRD,

2012) of the Concessions Law in 2011, the Law is too vague as far as the majority of core areas are concerned and its scope of application needs serious improvements, e.g. concession is defined as “a permission of the State to carry out a specific type of business activity.” In addition, the Contracting Authority is not clearly defined, there is discrimination against domestic investors, and sectors that may be subject to concessions are not defined, and seem limited to natural resources. Finally, the selection procedure is not developed. Thus, Turkmenistan scored low for compliance in the assessment of its legal PPP framework (26 percent compliance rate), receiving the lowest marks in the EBRD region. The analysis of the local institutional framework revealed substantial gaps, from 50 to 67 percent, in all key indicators.

75. **An additional instrument used by the Government of Turkmenistan to support service delivery is the creation of the State Development Bank of Turkmenistan.** Established in September 2011, the Bank plays a decisive role in service delivery, as it is a key institution for financing government projects. The Bank helps implement projects to diversify the economy, financed either through own resources or through the Stabilization Fund. The breakdown of its lending is as follows: 30 percent to transport and communication systems, 25 percent to construction, 4 percent to agriculture, 4 percent to trade, 37 percent to other type of projects, such as social development projects (schools, hospitals, tourism, etc.).

76. **The State Development Bank offers preferential lending to government entities, such as ministries or SOEs, or private entrepreneurs through a tender process.** Projects have to be approved by the Cabinet of Ministers, and should be in alignment with government priorities established in the development programs. Once the request has been approved, the Ministry of Economy has to justify why the project requires financing. The State Development Bank monitors the use of the credit and the payment, but other institutions, such as tax authority or the Ministry of Economy, also participate in the reporting system that beneficiaries have to comply with.

Regulating Enterprise

77. **The government’s function in regulating private enterprise is essential to ensure the development of all sectors of the economy.** Apart from imposing additional costs, regulation can be manipulated with the objective of creating unfair competitive advantages for some firms (not necessarily the most productive) with welfare losses for the rest of the economy. In the long run, an economy where competition is restricted, by cumbersome or captured regulation or by other means, will be less productive because its firms will face reduced incentives to be efficient and adopt new technologies. The consequences may be particularly severe for economies that are far from the technological frontier, since the ability to adopt new technologies is essential to productivity growth and convergence to the levels of more developed economies (Acemoglu et al., 2006).

78. **The Government of Turkmenistan is committed to increase the share of private sector in GDP to 70 percent by 2020.** Several economic reforms are needed to achieve this goal. In particular, having adequate regulatory frameworks is key. Thus, Turkmenistan still requires improving regulatory processes to ensure that regulations are of quality and meet their intended policy objectives. Several international examples show the relevance of promoting regulatory quality for better economic performance.

Spotlight 10 - Promoting regulatory quality for economic growth: Australia and the United Kingdom

Some countries have actively used regulatory quality to trigger economic growth. Australia and the United Kingdom are successful examples where improving the quality of regulation has been sought to increase competition, make the economy more competitive and deliver better services.

In Australia regulatory reform has served the purpose to make the economy more competitive. The Productivity Commission (PC) is an independent research body that advises the Australian Government on a range of economic, social and environmental issues that affect the welfare of Australians. Its charter is to improve the productivity and economic performance of the economy, taking into account the interests of the community as a whole, considering environmental, regional, and social dimensions, not just the interests of particular industries or groups. An important function of the PC is modeling the economic costs and benefits of alternative policy options. It may make recommendations on any matter that it considers relevant, and it is up to the government to decide how to use the advice provided. The PC is unique among OECD members for its standing inquiry and policy advising work across a range of economic, social and environmental issues. The government directs the PC on what areas to study through the issuance of formal terms of reference, but the PC is independent in its analysis and findings. The processes of inquiry are public, allowing the opportunity for the participation of interested individuals and groups, and the inquiry reports must be tabled in Parliament within 25 sitting days of the government receiving the report. The PC cannot launch its own inquiries, although it can initiate supporting research and publish the results via Commission or staff research paper.

The United Kingdom has constantly reviewed its regulatory reform program, ensuring that it responds to the private sector needs and looking for more efficient ways to deliver services to the society. The UK Government understands which areas of regulation concern business most. Research by the Better Regulation Executive in 2006 estimated that just the administrative cost of regulation to UK businesses was some £13 billion a year. Since 2009, the Better Regulation Executive has compiled, and published at intervals, a Forward Program, which in March 2010 projected total costs across the whole economy of £9.9 billion a year from new regulation planned to be introduced by April 2011. Total benefits to society from this regulation were projected at £11.6 billion a year. The current work on regulatory delivery aims at creating a regulatory environment in which businesses have the confidence to invest and grow and citizens and communities are properly protected.

Sources: OECD. 2010c and National Audit Office. 2011.

79. **In Turkmenistan the development of a market economy and a private sector is still underway and regulation will play a crucial role in shaping a level playing field.** International experience shows that the regulatory conversion into a competitive market economy requires a combination of factors, including commitment at the highest political level and the creation of capacity within the public administration to manage regulatory frameworks. Countries in Eastern Europe, such as Poland and the Czech Republic, understood the relevance of having a sound regulatory system to accelerate the transition to a market economy and consolidate it over time.

Spotlight 11 - Regulatory transformation in former communist countries: Poland and the Czech Republic

In the case of countries that have experienced a reshuffle in their regulatory system after the fall of communism, such as Poland or the Czech Republic, regulatory governance has been key to promote economic activity and growth and to consolidate a market economy.

From 1989 to 1999, the Czech Republic largely completed the move from a central planning to an open market economy. By the year 2000, about 77 percent of GDP was produced by the private sector, compared to less than 5 percent in 1989. However, the reforms were uneven at the beginning. The Czech State embarked in fundamental changes to its role and in the establishment of new capacities and institutions, becoming an accountable implementer of public policy and an increasingly capable regulator and overseer of competitive markets. It was necessary to transfer State powers to democratic institutions and to create a free market through implementation of an economic reform program, liberalizing foreign trade and domestic prices (though price controls remained in some important markets), establishing currency convertibility, deregulation and rapid privatization. Later on, fast track harmonization with EU legislation supported the legal and regulatory transformation, and the Czech Government committed to enhance capacities to produce high quality regulations. For instance, it introduced the Governmental Legislative Rules, which established a well-structured mechanism for intergovernmental consultation on policies and legal drafts. Publication of an annual legal agenda enhanced public consultation mechanisms that were increasingly used across the administration. Located at the center of government and supported by two specialized departments, the well-respected Legislative Council improved the legal quality of texts. A modernization program launched in 1997 helped further promote good regulatory management practices.

Poland's transition proceeded on five strategic fronts: (1) establishing democracy through transfer of State powers to democratic institutions; (2) creating a free market through implementation of an economic reform program; (3) decentralizing the power to govern to municipalities, counties and regions; (4) striving to join the European Union, and (5) reforming the State and rebuilding its administrative and regulatory capacities. Among these fundamental areas, progress differed significantly, but two interconnected trends were visible. First, laws regulating the functioning of the economy and the foundation of civic society were adopted in the first half of the 1990s, whereas a new constitution and new penal codes along with many other significant laws were adopted in the second half of the decade. Second, progress was easier in re-establishing and creating private sector law than administrative law. A culmination of the reform of the State was the enactment of a Constitution in 1997. The new Constitution had two major effects on the legal order. First, it eliminated major inconsistencies in the sources of law by providing for an explicit catalogue of the different legal instruments. Second, it triggered a major review of existing laws and regulations to make them compatible with the new constitutional framework, replacing, redrafting or removing hundreds of statutes. In parallel with the constitutional reform and the restructuring of the public administration, Poland embarked on improving its regulatory policies through a better management system and new institutions. For instance, in September 2000, the Prime Minister articulated the regulatory reform policy stating that its aim is "to achieve sustainable development, to increase the competitiveness of the country and improve the quality and transparency of government" in a government order. The same order also established an inter-ministerial body, the Team for Legal Regulations Quality, as the advisory and consultative body, chaired by the Minister of Economy to drive the policy.

Source: OECD. 2001; OECD. 2002.

The Privatization Program⁶

80. **Privatization in Turkmenistan has been an on-going process since the days of independence and has taken new momentum in today's Government programs.** The private sector, without the fuel and energy sector, has accounted for almost 40 percent of GDP on average in recent years, and the plan is to increase this figure to 70 percent and reduce the country's reliance on oil and gas production. Privatization of SOEs, particularly SMEs, is envisaged up to 2020, as part of a strategy to increase the role of the private sector in the economy. The privatization program includes three stages. The first stage will be implemented in 2013/14 and focuses on the privatization of textile, catering, and construction companies. The second stage is to be implemented in 2014/15 and should focus on industrial enterprises. The third stage is to be implemented between 2015/16 focusing on the privatization of enterprises in the communications and transport sectors, as well as converting large SOEs to joint-stock-companies. The privatization of SOEs has resulted in 2,123 enterprises that have been denationalized between January 1st, 1994 and January 1st, 2012. 598 enterprises have been auctioned or sold in a commercial competition, 18 have been awarded by target sale, 1,507 have been sold in other forms, and 34 have become a joint-stock company. The biggest number of entities privatized is in the following sectors: non-production types of consumer services to the population (1,294), trade and organizing public catering (718) and industry (57) (State Committee for Statistics, 2013).

81. **A number of legal changes have been introduced to govern the privatization process.** The draft Law of Turkmenistan "On de-nationalization and privatization of State property" was submitted for consideration of the Cabinet of Ministers of Turkmenistan. Based on the Resolution №11906 of the President of Turkmenistan dated November 18, 2012 the State program on securities market development for the period of 2012-2016 has been approved.

82. **A regulatory framework has also been introduced to promote private participation in the economy.**⁷ Much, however, remains to be done, as SOEs have pre-eminence in the economy and private sector development is controlled by the State. For instance, Law No. 198-IV about the Union of Industrialists and Entrepreneurs of Turkmenistan, from May 21, 2011, "defines the legal, organizational and economic basis for the activity of the Union of industrialists and entrepreneurs of Turkmenistan and aims at increasing its role in entrepreneurship development".⁸

Institutional and Regulatory Constraints

83. **The private sector has hardly evolved in a natural pathway and the relationship between the State and entrepreneurs is heavily regulated.** According to the Law of Turkmenistan on Entrepreneurial Activity in Turkmenistan, State bodies might organize their relationships with entrepreneurs using different tools and incentives, such as tax and finance credit policy, including establishment of tax rates and interest rates for State credits, tax privileges, prices and rules of pricing, special grants and subsidies, economic sanctions; State property and system of reserve, licenses, concessions, leasing; external economic and currency policy; State orders and scientific-technical and social State and regional programs. The Law does not provide further guidance on how these tools and

⁶ Privatization is treated in greater detail in a dedicated World Bank Discussion Note,

⁷ For instance, the Law of Turkmenistan on Investment Activities in Turkmenistan, the Law of Turkmenistan on Entrepreneurial Activity in Turkmenistan, the Law of Turkmenistan on Free Economic Zones, the Law of Turkmenistan on Licensing on Certain Type of Activities, etc.

⁸ The Law also defines the main characteristics of the union of industrialists and entrepreneurs of Turkmenistan. The Union is the public organization pooling industrialists and entrepreneurs, carrying out business activity on the basis of a privately-owned pattern of ownership. Its role is to express and protect the rights and legitimate interests of its members to help entrepreneurship development in Turkmenistan. In addition, it sets its main purposes: 1) assistance to development of the economy and market relations; 2) formation of entrepreneurial infrastructure for private sector development; 3) creation of economic sectors and raising the level of employment and entrepreneurial activity of the population.

incentives are to be used, but other laws pick up on the subject, for instance, on concessions or licenses. The Law also provides for dispute resolution mechanisms and ways to terminate economic activity.

84. **To encourage the establishment of new businesses, the authorities have simplified the registration and accounting systems required for small enterprises.** Other measures related to taxation and access to credit have been introduced to create a more favorable environment for SMEs and to stimulate their development. Entrepreneurial activity can only be undertaken once State registration is conducted. Registration is done at the Government State Registration on Legal Entities and Investment Projects of the Ministry of Economy. Once registration is completed, businesses have to comply with different licenses, according to the Law of Turkmenistan of Licensing of Specific Activities from 2008. The Law integrates a comprehensive list of activities that require issuing a license, as well as the procedures to be followed for both the applicant and the State body in charge of the license.

85. **A legal framework of State support to SMEs has been established.** This includes the Presidential Order on Improving the Licensing Procedures in Turkmenistan and the Law “On State support to small and medium size enterprises”, which was adopted on August 15, 2009. In addition, the Government adopted “The State Program to support small and medium enterprises in Turkmenistan for 2011-2015”. This program envisages improving access to credit and the quality, stability and transparency of legislation, developing the financial sector, eliminating bureaucratic barriers, as well as other measures. At the moment, the State ministries and departments offer only limited support to private enterprises and the only measures are the ones related to taxation and access to credit. The role of the government is limited to assisting the management of State-owned enterprises, which are the responsibility of the corresponding ministries. Support to entrepreneurs from local authorities is also limited, and regional development agencies need to be set up to promote the establishment of SMEs outside the capital.

86. **The Government has also established a State Commission for the support of SMEs,** composed of government agencies and private sector representatives, coordinated by the Ministry of Economy. The State Commission has regular meetings, has defined a particular policy agenda and it helps channeling suggestions and concerns from different stakeholders. It prepares a Performance Report that is submitted to the Cabinet of Ministers.

Box 4: Main objectives of the State Program to support SMEs in Turkmenistan for 2011-2015

The main objectives of The State Program to support SMEs in Turkmenistan for 2011-2015 are:

- Establish strong legal foundations for entrepreneurship and State support. A series of legal challenges still persist in the development and consolidation of SMEs, such as State registration, starting banking operations, getting permits for different activities, certification of products, leasing of industrial and commercial activities, inspections by different bodies. Several proposals to amend existing laws or introducing new ones will be required to ensure legal changes that support SMEs development.
- Use of modern financial instruments, widespread entrepreneurship and development of financial and credit methods. Banking services need to be provided to SMEs, particularly preferential credit on a long-term basis, as well as insurance for property. Lending capacities have to be created to support productive capacities and new products.
- Dissemination of experience aimed at creating favorable conditions for SMEs, organizations and institutions related to the State. The State needs to create capacities and infrastructure for SMEs, which could include the implementation of joint projects and transfer of State ownership. This also includes the privatization of certain enterprises, particularly SMEs, to private individuals or legal entities.

- Train highly qualified specialists to implement public policies related to the development of SMEs. In addition, offering them the possibility to have access to data and information systems to improve their performance. This objective also includes the set-up of information centers in different cities of Turkmenistan to offer consulting services to SMEs on their development and growth opportunities.
- Provide opportunities for employment by enterprise activity to the general population. This also includes the promotion of entrepreneurship among the Turkmen population and in particular linked to creating skills in the educational cycle.
- Facilitate the implementation of regional and interregional markets of products (works, services) produced by SMEs. Entrepreneurial activity should aim at producing competitive products locally, primarily for the internal market, and then expanding externally.

The expected results of the program are, among others, the increase in the number of SMEs in Turkmenistan, creation of jobs due to SMEs, economic competitiveness and create an entrepreneurial culture among the Turkmen population.

87. **Labor market regulations are not particularly cumbersome**, according to the Institute for the Study of Labor's Employment Protection Legislation Index (Muravyev 2010). The Labor Code of Turkmenistan (last amended in July 2009), the Social Welfare code, and a number of regulations approved by presidential resolutions govern labor issues. The Government of Turkmenistan continues to employ 24.4 percent and the private sector 45.4 percent of the labor force while most of the rest are employed by organizations with a mixed ownership. . One major problem for businesses is the lack of highly qualified workers and most vacancies posted at employment offices are low-skilled jobs. A major problem for foreign companies is the restrictive visa regime that has contributed to hinder the creation of an attractive foreign investment climate.

88. **Non-regulatory barriers to trade are high in Turkmenistan.** A variety of means are used to discourage trade and protect domestic industries. Turkmenistan does not apply tariffs per se on imported goods. However, in practice the Government of Turkmenistan levies customs duties and higher excise taxes on imports, which are significant barriers to trade. Under Presidential Resolution # 9925 dated July 27, 2008, there is a customs duty on the import of 49 types of merchandise. Average rates range from 5 percent to 100 percent. Importers also pay small administrative fees to the Customs Service. The slow and bureaucratic customs procedures seriously inhibit trade. When the basis of the consignment is a contract but not a paid invoice, Turkmenistan requires that export and import contracts be registered at the State Commodity and Raw Materials Exchange (SCRME), the only exchange in the country.

Competition Policy

89. **Market competition is crucial for achieving higher productivity and living standards by allowing the efficient reallocation of resources among firms.** It also signals acceptance of new entrants and clear rules of the game for newcomers. By stifling innovation in existing firms and entry of new firms, however, anticompetitive behavior unchecked by clear rules reduces firm efficiency (Nicoletti and Scarpetta 2003; Conway et al. 2007). Competitive markets for labor, capital, and other inputs provide signals to entrepreneurs about the profitability of different economic activities. This process may be driven by incumbent firms or by new entrants. Both have an opportunity to expand and grow as a result of improved processes, introduction of new products, and marketing or organizational innovations.

90. **Competition is necessary to let the market pick the best firms.** Corporate activity in Turkmenistan is likely to be dominated by less productive incumbents, many of which are owned partially

or wholly by the public sector, or are likely to have strong links with the political establishment. Observing the experience of neighboring countries, these firms are bound to have privileged access to natural resources, markets, credit, and licenses. More efficient enterprises, especially small and medium firms and start-ups, cannot compete with public sector entities and incumbent firms on an equal footing, with the result that the best firms do not emerge, inefficient firms remain dominant and overall productivity suffers.

91. **The role of competition authorities is essential** to prevent horizontal and vertical agreements among firms, control mergers transactions that would limit competition, and undertake advocacy efforts that promote the demand for competitive outcomes. Competition advocacy, in particular, refers to those activities conducted by a competition agency related to the promotion of a competitive environment by means of non-enforcement mechanisms, mainly through its relationship with other governmental entities and by increasing public awareness of the benefits of competition.

92. **Turkmenistan is the only country in the former Soviet Union that does not have a competition authority.** As a member of the Commonwealth of Independent States (CIS), Turkmenistan became a party to the inter-governmental Treaty on the Implementation of a Coordinated Competition Policy, which was signed on December 24, 1993, in Ashgabat (see Box 5). In October 1993, Resolution No. 1532 established a Committee for the purpose of protecting enterprises and other entities from the impact of monopolistic practices. The increasing dominance of the State in major sectors of the Turkmen economy severely undermined the effort of creating an appropriate institutional framework. The Committee was abolished by the Presidential Resolution 2057 of January 11th, 1995. Meanwhile, most Eurasian countries had adopted modern competition laws, such that by 1999 all but two (Belarus and Turkmenistan) had enacted modern competition frameworks, with regulatory bodies in charge of enforcing legislation. Across the region, however, implementation efforts have remained weak and uneven, partly because of limited institutional capacity, resource constraints, and a lack of relevant information, but mainly because of the inability of young competition agencies to resist anticompetitive and distortive policies aimed at favoring businesses that are directly or indirectly connected to political parties or to the legislative or executive branches. The enactment and early implementation of competition law was often stopped or overruled by distortive government interventions and biased court decisions.

Box 5: Competition Policy in the former Soviet Union – the Interstate Council for Antimonopoly Policy

The legal basis for the prevention, reduction, elimination of monopolistic conduct and unfair competition in the organization of former Soviet Republics is contained in the Treaty on the Implementation of a Coordinated Antimonopoly Policy, which was signed on December 24, 1993, in Turkmenistan, Ashkhabad. The treaty outlines the main principles of coordination and cooperation on competition policy matters. Significantly, the treaty created the Interstate Council for Antimonopoly Policy (ICAP). Meetings of the ICAP allow its participants to regularly exchange views on recent tendencies in antimonopoly law, views on the general economic situation in their countries, and information about the most interesting cases of antimonopoly enforcement practice in order to develop common approaches to the harmonization of competition law and its implementation in the CIS. A revised edition of the international agreement has been signed in Moscow on January 25th, 2000.

93. **Turkmen legislation contains only few fragmented references to antimonopoly practices and unfair competition.** Despite efforts to set up a new legal framework in the early years of its independence, Turkmenistan has never enacted specific provisions to regulate market dominance, mergers or anticompetitive agreements. No industry is specifically restricted in regards to monopolistic activity. Determining the legal foundations for the prevention and elimination of monopolistic activity would require the introduction of a modern legal and institutional competition regime.

94. **Monopolistic activities and unfair competition are generally prohibited but not specified by the legislation of Turkmenistan.** The most relevant provisions are contained in:

- Articles 80 and 780, Civil Code of Turkmenistan (2000);
- Article 9, Law on Commerce (2002) preventing the creation of monopolies in the consumer's market;
- Article 16, Law on Foreign Investments (2008) regulating aspects of unfair competition;
- Article 3, Law on Licensing of Certain Types of Activity (2008);
- Article 45, Law on Communications which represents the legal basis for activity of telecommunications operators (2010);
- Article 11, Law on Tourism (2010);
- Article 245, Criminal Code of Turkmenistan (2010) setting up the grounds for liability with reference to monopolistic activities and other anticompetitive conducts restricting competition.

95. **The legal and institutional framework for competition is still poor.** Considerable development is needed before it becomes an instrument to enhance market access for new competitors, protect markets from restrictive business practices, and foster economic efficiency and consumer welfare. No governmental body is in charge of supervising and enforcing the prevention of anticompetitive practices. The establishment of a well-functioning enforcement mechanism would require the development of competition legislation, adequate funding to ensure the proper functioning of a competition authority, as well as appropriate administrative rules and procedures to protect its independence.

96. **There is no optimal design for a competition framework in Turkmenistan given the variety of approaches that a jurisdiction can decide to adopt.** Specific factors such as legal and administrative traditions, degree of economic development, and political conditions always play an important role in the institutional setup. When designing a competition authority, the following can be taken into account:

- **Functions, powers, and competencies.** The Authority might have specific tasks as regulator in some sectors (sector based model) or foster the concentration of specific skills for a particular instrument, such as cartels (instrument based model). A hybrid structure is also possible.
- **Independence vs. Influence.** In order to be able to freely conduct its activities, a competition authority should enjoy the highest degree of independence from the Executive and be separate from the ministerial administrative structure. Whereas Government's involvement is normal for activities falling under the general mandate of the Authority, the issue of independence might become crucial when a specific case is being handled or an advocacy activity is undertaken. The way these potential "conflicts" are resolved depends on strategic choices. The most relevant statutory rules governing the Authority, such as the procedure to establish and to approve the budget and to appoint (and remove) the Head should be determined accordingly.

Whither Diversification? Options for Turkmenistan

97. **The Government of Turkmenistan has taken a proactive stance in creating a diversified economy, where the private sector plays an increasingly important role.** Strategic priorities are enshrined in a long term development strategy for 2030 and in a number of medium term plans to guide implementation of the strategy. The ultimate objectives are to improve development outcomes: increase the well-being of the population, sustain a high economic growth rate, and gradually increase the role of the private sector as a driver of economic diversification.

98. **Government programs are targeting a number of priority sectors to diversify the economy.** Whereas it is possible for the Government to put in place the conditions for specific sectors to develop and make production and exports more diversified, a crucial lesson from international experience is that policies to directly diversify export compositions or production profiles are rarely successful on their own. Successful diversification can be achieved if governments create the conditions for building a balanced portfolio of national assets - natural resources, built capital, and institutions. With a strategy to diversify assets rather than production, Turkmenistan's economy and exports might well become more concentrated in the short term. But if done right, the economy will become more productive and better able to create jobs. Over time, a balanced asset portfolio will also yield a more diversified economy, but one that is sustainable and not dependent on artificial government support. As underlying assets strengthen, Turkmenistan can also begin to participate in global value chains and take advantage of intra-industry trade, capitalizing on the inherent advantages of specialization.

99. **Stabilization, education, and competition are the priorities for the next decade.** Turkmenistan needs better economic institutions to ensure stable public finances and dampen volatility, improved education and infrastructure to make workers more productive, and stronger competition regimes to encourage private enterprise and entrepreneurship. In order to manage the volatile revenues associated with the exploitation of natural resources, good rules need to be in place to manage the revenues from natural resources over booms and busts and reduce the volatility of government spending. Turkmenistan can use revenues from natural resource exports to invest more in education, health, and infrastructure, while the quality of education needs to improve to keep pace with a growing economy. Rules for private enterprise have to be made better with public institutions that enforce them consistently and impartially.

100. **This note proposes concrete ways to strengthen Turkmenistan's portfolio of national assets.** A number of issues for consideration by the Government of Turkmenistan are put forward. They suggest ways to achieve a better balance among natural resources, built capital (physical and human) and three essential functions of government, namely managing volatility, providing public services and regulating enterprise. A number of observations and policy options, grouped by area, are proposed below. Availability of more detailed information on sectoral programs and specific policy instruments to achieve the Government's strategic objectives would allow more tailored analysis and recommendations. World Bank staff stands ready to assist the Government of Turkmenistan in designing and assessing the effectiveness of specific policy instruments.

101. **Suggested policy options for diversifying Turkmenistan's national assets, grouped by area, are summarized in the table below.**

Table 8: Summary of policy options

Observation	Policy options	Level of priority	Time frame for implementation
Building human capital is a pre-requisite for sustainable development	The government may deem necessary to identify the optimal pace of increase in public investment spending in health and education, taking into account the current level of development and absorptive capacity of the country. Authorities may wish to identify appropriate education policies to increase the quality of education and tailor the supply of education to the economy's development needs. Turkmenistan may consider taking part in international benchmarking exercises, such as the OECD PISA assessment, to identify strengths and weaknesses of its education outcomes.	High priority	Ongoing Short-medium and long term (1-10 years)
Building institutions to regulate private enterprise is essential for a market economy	The authorities may wish to consider a model of private sector development that allows greater decision-making autonomy to private entrepreneurs, for instance regarding production and location decisions. This should apply to both new firms and privatized enterprises. The authorities may wish to devise regulatory management practices and procedures (regulatory impact assessment, consultation mechanisms, etc.) that can help improve the quality of regulations. The authorities may wish to establish a competition framework that ensures a level playing field for enterprises, private and state owned, domestic and foreign. Although the establishment of a competition authority will be necessary in due course, the authorities should refrain from creating a government agency devoid of real clout. The process could be gradual and involve: (i) development and enactment of appropriate competition legislation (ii) identification of an institutional set up for the competition agency (sector-based, instrument-based or hybrid) that is appropriate within the current legal and administrative framework, (iii) identification of the degree of independence and reporting requirements that guarantee effectiveness of competition enforcement in the current context.	High priority	Medium to long term (1-7 years)
Building efficient institutions for the provision of public services is a key determinant for long term sustainable development	To ensure effective policy formulation, implementation and monitoring, the Turkmen government may consider enhancing coordination mechanisms. The government may consider enhancing the control system to increase the efficiency and effectiveness of public expenditure. The government may wish to identify normative changes that would help increase the quantity and quality of service	Medium priority	Medium term (1-3 years)

	delivery, including with the involvement of private partners in PPP arrangements,.		
Building physical capital is essential to close the infrastructure gap and facilitating the country's development	The Turkmen authorities may consider developing a long term public investment strategy and introducing a public investment appraisal system.	Medium priority	Short to medium term (1-5 years)
Building institutions to manage macroeconomic volatility is key for macroeconomic stability	The government may wish to introduce prudent fiscal rules and regulations to improve management of the Stabilization Fund. This will positively impact the quality of fiscal policy in the current setting of multiple fiscal institutions. The capacity of Ministry of Finance and Central Bank staff could be enhanced by developing skills on fiscal sustainability analysis and macroeconomic modeling. The authorities may consider using monetary policy instruments for effective smoothening of economic cycles. The Government may also wish reconsider the fixed exchange rate arrangement and introduce flexibility.	Medium priority	Medium to long term (2 to 7 years)
Sustainable natural resource management is important for the efficient transfer of wealth to future generations	The authorities are invited to consider: (i) making an assessment and establishing a viable rate of natural resource extraction; (ii) establishing rules for domestic and foreign investors to help improve the efficiency of extraction to transform resource rents into revenues for the Government, (iii) attaining positive adjusted net savings by converting resource revenues into efficient investment in physical and human capital and (iv) the pros and cons of establishing a Sovereign Wealth Fund (SWF) as an effective tool to transfer the country's wealth across generations.	Medium priority	Medium to long term (2 to 7 years)

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