

**FOR
AGENDA**

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May 19, 2004

To: Members of the Executive Board

From: The Secretary

Subject: **Turkmenistan—Staff Report for the 2004 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2004 Article IV consultation with Turkmenistan, which is tentatively scheduled for discussion on **Friday, June 4, 2004**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Turkmenistan indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. L. Hansen (ext. 37186) and Mr. Mered (ext. 38155) in MCD.

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TURKMENISTAN

Staff Report for the 2004 Article IV Consultation

Prepared by Staff Representatives for the 2004 Consultation with Turkmenistan

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May 18, 2004

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Executive Summary

The last Article IV consultation was concluded on November 1, 1999. It was not possible to conduct subsequent Article IV consultations with Turkmenistan because the authorities did not provide adequate macroeconomic data. The staff brought this issue to the attention of the Executive Board on September 18, 2001. Following a visit by the Executive Director for Turkmenistan in June 2003, the authorities agreed to a staff visit in September 2003, and, subsequently, to an Article IV consultation mission in March 2004.

Official data on macroeconomic developments since the last Article IV consultation indicate that Turkmenistan has managed to recover from the severe external shocks it experienced in 1997–98. This recovery has been driven by significantly increased receipts from gas and oil exports since 1999. As a result, the external current account has registered sizable surpluses in recent years allowing the authorities to build up international reserves and repay a large portion of their external debt. On the domestic side, real GDP growth has been impressive (although alternative staff estimates suggest lower real output growth) and inflation has declined markedly. However, macroeconomic policies have been inconsistent in recent years, as the tight demand management policies in 2001–02 were loosened again in 2003 to accommodate the large wage and pension increases granted early in that year.

Despite the improved economic environment, only marginal measures have been taken in the area of **structural reform**, and Turkmenistan's **foreign exchange and trade regimes** remain closed with extensive restrictions on both current and capital account transactions.

Turkmenistan has now normalized relations with the Fund and the mission received good cooperation from the authorities. On the economic front, discussions focused on the need for consistency in implementing macroeconomic policies, strengthening the macroeconomic policy-making framework, and accelerating market-oriented structural reforms.

Prospects for the medium-term are largely determined by Turkmenistan's ability to gain and maintain access to international markets for its key export products, gas and oil. Considerable uncertainties remain concerning pipelines necessary to achieve the country's full export potential. Additional new investments, including from foreign sources, are likely to be needed to fulfill export contracts.

The staff also stressed that the current environment was ideal for the introduction of wide-ranging market-oriented reforms. In place of current policies of universal subsidies and nonmarket prices, the authorities were urged to liberalize the trade and foreign exchange regimes, including unification of exchange rates, implement market-based pricing policies, and create a more conducive business environment. While recognizing the general need for market-oriented reforms, the authorities envisage a very slow pace of reform, with the state continuing to play a dominant role in the economy of Turkmenistan.

Turkmenistan: Basic Data, 1998-2003

Social and demographic indicators						
Area	488,000 sq. km.					
Total population (mid-year; 2003)	6.3 million					
Urban population (mid-year; 2003)	45 percent					
Life expectancy at birth (2002)	65 years					
Infant mortality (2002)	69 per 1,000 live births					
Population below national poverty line (based on minimum wage; 1998)	58 percent					
Absolute poverty (below US\$2.15 per capita per day; 1998)	7 percent					
Public expenditure on health (share of GDP; 2003)	5.8 percent					
Public expenditure on education (share of GDP; 2003)	2.8 percent					
	1998	1999	2000	2001	2002	2003
Economic indicators						
Nominal GDP (in billions of manat)	13,995	20,056	25,648	35,119	46,699	57,356
Real GDP (percentage change)	6.7	16.5	18.6	20.4	19.8	16.9
GDP per capita (in US\$; official exchange rate)	539	742	919	1,197	1,513	1,751
GDP per capita (in US\$; indicative exchange rate) 1/	479	379	415	460	586	695
PPP GDP per capita (in US\$; official real GDP) 2/	2,469	2,867	3,415	4,139	4,962	5,805
PPP GDP per capita (in US\$; staff estimates of real GDP) 2/	...	...	...	3,983	4,308	4,643
Population (millions; official)	5.0	5.2	5.4	5.6	5.9	6.3
Population (millions; UN estimates)	4.5	4.6	4.6	4.7	4.8	4.9
Nominal exchange rate (manats per US\$)						
Official (eop)	5,200	5,200	5,200	5,200	5,200	5,200 3/
Curb market (eop)	12,100	15,000	21,000	21,400	21,500	22,800 3/
Real effective exchange rate index (1997=100)	125	190	209	228	243	236
Consumer prices (percentage change; 12 months)						
End-of-period	19.8	20.1	7.4	11.7	7.8	2.7 4/
Period average	16.8	23.5	8.0	11.6	8.8	4.7 5/
Average wages (in thousands of manat per month)						
Nominal wage; period average	271	331	597	878	950	1,750
Real wage; period average (percentage change) 6/	25.3	-1.2	67.0	31.8	-0.6	74.4
Government finances (in percent of GDP)						
State budget revenues	22.0	19.4	23.5	22.3	17.7	18.7
State budget expenditures	24.6	19.4	23.9	21.7	17.5	20.1
State budget balance (- deficit)	-2.6	0.0	-0.3	0.6	0.2	-1.4
State Funds and other extrabudgetary balance (- deficit)	-22.0	-12.7	-2.4	4.6	5.7	3.1
Public sector borrowing requirement	24.6	12.7	2.8	-5.2	-5.8	-1.7
Money and credit (end-of-period; percentage change)						
Domestic credit to the economy	76.3	26.9	24.4	7.7	-2.9	-0.6
Reserve money	111.7	18.9	81.2	27.0	-19.7	74.9
Currency in circulation	154.9	-3.0	50.4	17.9	-2.1	93.4
Domestic broad money	69.8	20.4	67.1	17.5	-2.5	57.8
Broad money (including foreign currency deposits)	83.3	21.8	94.6	16.7	1.5	40.9
Velocity (GDP/end-of-period broad money)	6.3	7.9	5.2	6.1	7.9	6.9
CBT refinance interest rate; end-of-period (percent)	30	27	20	12	12	10
External sector (in millions of US\$; unless otherwise specified) 7/						
Exports (goods)	614	1,164	2,508	2,623	2,862	3,468
Imports (goods)	-1,137	-1,374	-1,742	-2,108	-1,832	-2,502
Current account balance (- deficit)	-935	-571	412	115	583	508
In percent of GDP	-34.7	-14.8	8.4	1.7	6.5	4.6
Gross official reserves (end-of-period)	1,379	1,555	1,808	2,055	2,346	2,673
In months of imports of goods and non-factor services	9.0	9.1	9.2	9.1	11.8	10.0
External debt (end-of-period)	1,842	2,026	2,184	1,865	1,660	1,519
In percent of GDP	68.4	52.5	44.3	27.6	18.5	13.8
External debt service	300	392	394	499	442	431
In percent of exports of goods and non-factor services	35.3	28.5	14.2	17.4	14.3	11.6

Sources: Data provided by the Turkmen authorities; and Fund staff estimates.

1/ The indicative exchange rate is defined as the average of the official and curb market rates.

2/ World Bank staff estimates based on official real GDP growth rates and UN population estimates.

These estimates are lower when Fund staff's alternative estimates of real GDP growth are used.

3/ End-March 2004.

4/ End-March 2004 compared to end-March 2003.

5/ 12-month average to March 2004 compared to 12-month average to March 2003.

6/ Nominal wages deflated by the CPI index.

7/ Based on the official exchange rate.

I. INTRODUCTION AND BACKGROUND

1. **A mission visited Ashgabat during March 3–16, 2004 to conduct the 2004 Article IV consultation discussions.**¹ The mission² met with President Niyazov, Deputy Chairmen of the Cabinet of Ministers Messrs. Aidogdiyev and Gurbanmuradov, Mr. Kakalyev, Minister of Economy and Finance (MOEF), Mrs. Mukhammedova, Acting Chairman of the Central Bank of Turkmenistan (CBT), Mr. Bairamov, Director of the National Institute for Statistics and Information (NISI), Mr. Geoklenov, Chairman of the Vnesheconombank, and other senior officials.
2. **The last Article IV consultation was concluded on November 1, 1999 (SUR/99/127).** At that time, the Turkmen economy had been adversely affected by a number of external shocks, including nonpayment for gas exports. On that occasion, Executive Directors stressed the urgent need for fiscal consolidation, the development of market based monetary policy instruments, and the speedy implementation of structural reforms. They urged the authorities not to intensify exchange and trade restrictions but instead to reunify exchange rates allowing for a real depreciation. To facilitate a comprehensive analysis of fiscal policy, Directors also recommended that the authorities incorporate all extra-budgetary funds in the fiscal accounts and stressed the need for transparent reporting of revenue and expenditure data. Finally, Executive Directors urged the authorities to reduce government intervention in the financial sector and to provide full autonomy to the central bank together with full control over the country's foreign exchange reserves.
3. **It was not possible to conduct subsequent Article IV consultations with Turkmenistan because the authorities did not provide adequate macroeconomic data.** The staff brought this issue to the attention of the Executive Board on September 18, 2001 (EBS/01/129). On that occasion, Directors urged the authorities to furnish all the items as specified in Article VIII, section 5(a) of the Articles of Agreement and other core statistical indicators before December 13, 2001. When the authorities were finally able to comply with these obligations in June 2002, a number of adverse political events made it difficult for the government to agree to host an Article IV consultation mission.³ Data were also not provided

¹ Relations with the Fund are described in Appendix I and those with the World Bank and the EBRD in Appendix II and III, respectively. Statistical Issues are discussed in Appendix IV.

² The staff team comprised Messrs. Hansen (head) and Mered, and Ms. ten Berge (all MCD), Mr. Feridhanusetyawan (PDR), Mr. Storozhuk (IBRD), and Mrs. John (Assistant—MCD). Mr. Zhukov, the office manager of the IMF office in Ashgabat, assisted the mission. Mr. Berengaut (MCD) joined the mission for a few days, and Mr. Zürbrügg, the Executive Director for Turkmenistan, also participated in the meetings.

³ In September 2002, a financial scandal at the CBT led to the dismissal and arrest of the Chairman. To date the government has not appointed a chairman of the central bank, which is now headed by an acting chairman. There was also an assassination attempt on the President in November 2002.

to the staff on a continuous basis. In June 2003, the Executive Director for Turkmenistan visited Ashgabat, which paved the way for a staff visit during September 8–11, 2003. Following this visit, the authorities forwarded a limited amount of updated macroeconomic data to the staff and, subsequently, agreed to host an Article IV consultation mission in March 2004 during which the authorities provided all the requested data.

4. **President Niyazov was voted President-for-life by the Parliament in December 1999 and reconfirmed in August 2002.** After the November 2002 assassination attempt, the government tightened control over public life. There has been mounting diplomatic pressure from the OSCE, the EU, and the United States against Turkmenistan's record on human rights. Meanwhile, beginning in 1999, after the resumption of gas exports to Russia and Ukraine, Turkmenistan's relations with these countries have improved.⁴ Long-term gas purchase agreements have been signed with Gasprom of Russia in April 2003 and a similar agreement is expected to be signed by Ukraine in 2004, to replace the current five-year contract expiring in 2006. Gasprom has also ensured the transport of Turkmen gas by signing bilateral agreements with the transit states, Uzbekistan and Kazakhstan.

5. **Turkmenistan lags well behind most of the other CIS countries in terms of economic reform, with economic management relying heavily on state intervention.** Accordingly, production targets are set in all areas; investment is essentially state driven; price controls are widespread; external trade is strictly controlled, and there is a 4 to 1 spread between the official and the curb market exchange rates. In addition, there are significant quasi-fiscal expenditures related to untargeted energy and food subsidies.

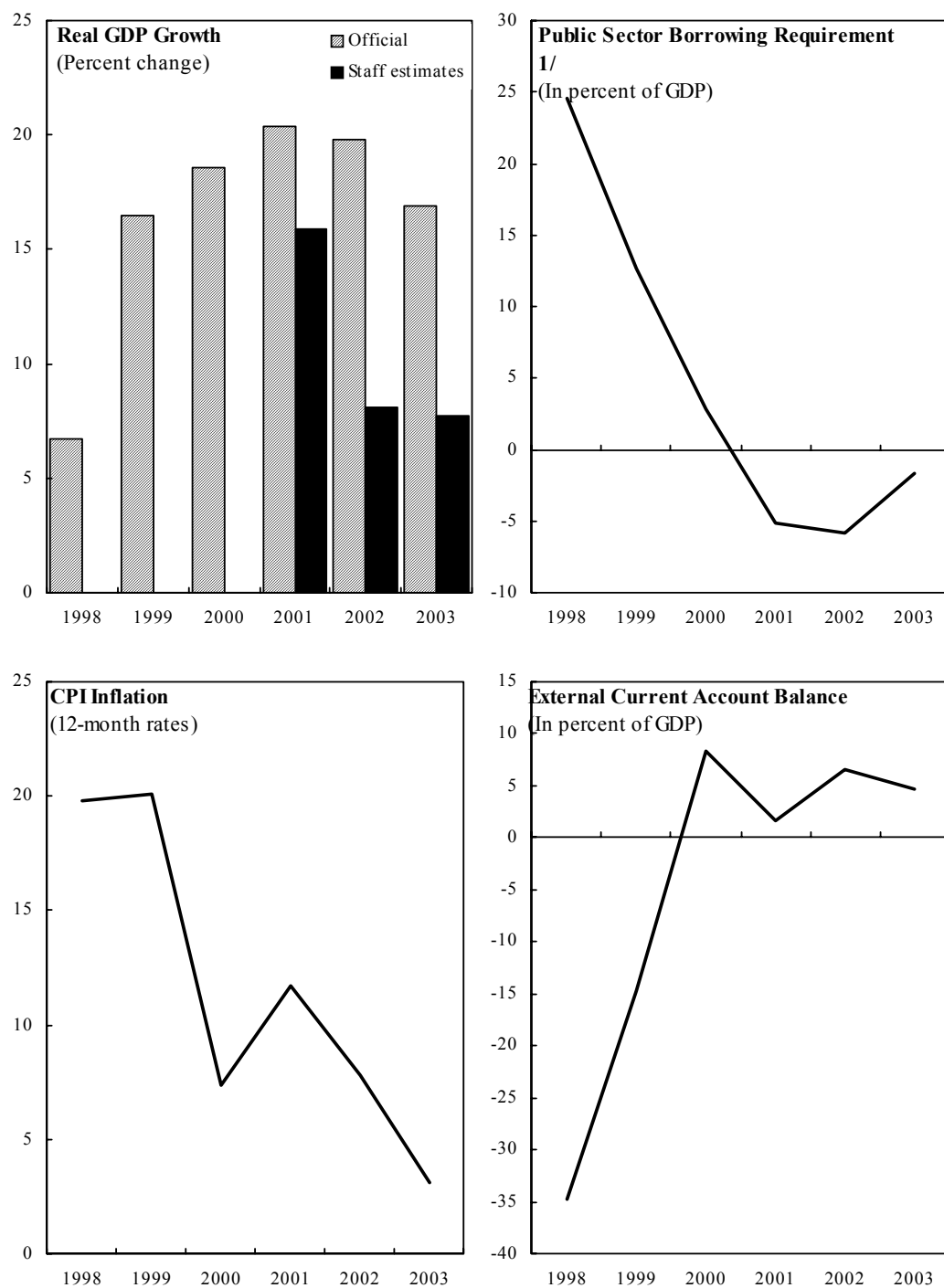
6. **Although Turkmenistan continues to avail itself of the transitional arrangements under Article XIV, it maintains a number of exchange restrictions and multiple currency practices subject to Fund approval (Appendix I).** The authorities have cooperated in providing the staff with information relevant to the exchange system, and confirmed that there had been no significant change to that system since the last Article IV consultation.

II. RECENT ECONOMIC DEVELOPMENTS

7. **Official data on macroeconomic developments since the last Article IV consultation indicate that Turkmenistan has managed to recover from the severe external shocks it experienced in 1997–98 (SM/99/258).** This recovery has been driven by significantly increased receipts from gas and oil exports since 1999. As a result, the external current account has registered sizable surpluses in recent years allowing the authorities to build up international reserves and repay a large portion of their external debt. On the domestic side, real GDP growth has been impressive and inflation has declined markedly (Figure 1 and Table 1). However, as discussed below, macroeconomic policies have been

⁴ Disagreements remain with the Russian Duma over the issue of dual citizenships of Turkmen citizens of Russian descent.

Figure 1. Turkmenistan: Macroeconomic Indicators, 1998 - 2003



Sources: Data provided by the Turkmen authorities; and Fund staff estimates.

1/ Estimated based on monetary and balance of payments data.

inconsistent in recent years, as the tight demand management policies in 2001–02 were loosened again in 2003.

8. **Official data indicate that economic growth has been very high with the rate of inflation declining since the last Article IV consultation.** Real GDP grew by 18 percent on average during the five year period ending in 2003. The authorities' data indicate consistent growth across all sectors of the economy, including agriculture, trade, and services. Year-over-year inflation, as measured by the official CPI, declined from 20 percent at end-1999 to less than 3 percent at end-March 2004. A review of the sectoral contributions to real GDP growth during the five year period ending in 2003 revealed a number of inconsistencies which may have led to an overestimation of overall output growth. While official historical data are used in the staff report, the analysis is supplemented with alternative GDP staff estimates. After adjusting for the apparent overestimation, the mission estimated average real GDP growth for the period 2001–03 at 10½ percent compared to 19 percent according to official statistics.⁵

9. **The latest available data on poverty indicators is based on the 1998 Turkmenistan Living Standards Survey carried out by the government, with World Bank assistance.** The Survey indicates that 58 percent of the population in 1998 lived below the poverty line (the official minimum wage). When using the criterion of US\$2.15 (Purchasing Power Parity) per day and taking into account all forms of income, the study estimates that income poverty in 1998 was then only about 7 percent.⁶ For 1998, the study also estimates a Gini coefficient of 41 percent which, while relatively high, compares well with other CIS economies.

10. **Monetary aggregates grew sharply until 2000, but the consequent build-up of inflationary pressures and a widening of the gap between the official and parallel exchange rates led the authorities to tighten monetary policy in subsequent years** (Box 2, Figure 2 and Tables 2 and 3). Monetary expansion in the earlier years was mostly carried out in the form of large directed credits to banks for on-lending to state enterprises; such lending has been significantly curtailed in recent years.

⁵ Box 1 discusses the staff's alternative estimates for GDP; also, the supplementary Statistical Appendix provides further details on official data and the staff's estimates.

⁶ Based on a sample of household budgets, the NISI concluded that only 0.7 percent of the population was below the PPP criterion in 2000 and that this figure approached zero in 2001.

Box 1. Turkmenistan: Alternative Measures of GDP

The mission has constructed alternative GDP estimates for 2001–03, which adjust for some of the inconsistencies in the official data.

The estimates use official real value added growth rates and deflators for gas, oil, electricity, and light industries, as well as for construction, agriculture, transport, and communication. For the other sectors, alternative estimates have been made. For most services such as health care, education, public administration, finance and banking, real value added growth rates were estimated based on the official sectoral employment statistics.

To allow for the likely growth of the unobserved economy in recent years, the real growth rates derived from employment growth statistics were augmented for all service sectors—by 3 percentage points in 2001, 4 percentage points in 2002, and 5 percentage points in 2003.

For trade and catering as well as for the remaining services for which no consistent employment statistics were available, real value added was assumed to have grown by 10 percent annually in 2001–03. The real value added growth in “Other industries” is assumed to have been 20 percent in 2001–03. While lower than the officially reported numbers, these assumed growth rates would still be among the highest in the CIS.

The sectoral weights for real value added and GDP calculations are based on the previous year’s nominal GDP. For the nominal GDP estimates, instead of the official sectoral deflators for 2001–03, which also show erratic fluctuations, the official period-average consumer price index was used for sectors where real growth rates were revised.

Gross Domestic Product

(Percent changes from previous year)

	2001	2002	2003
Real GDP			
Official	20.4	19.8	16.9
Staff	15.9	8.1	7.7
Industry			
Official	19.4	13.0	18.5
Staff	19.4	5.1	7.6
O/w: Other industries 1/			
Official	19.9	64.8	55.4
Staff	19.9	20.0	20.0
Trade and catering			
Official	32.0	43.9	28.1
Staff	10.0	10.0	10.0
Other services			
Official	25.0	49.2	26.4
Staff	3.3	8.6	8.6

(in billions of manat)

Memorandum items:

Nominal GDP

Official	35,119	46,699	57,356
Staff	33,623	38,611	43,775

Source: National Institute of Statistics and Information; and Fund staff estimates.

1/ Total industry less gas and oil extraction, electricity, and light industry (but includes cotton processing).

Box 2: Turkmenistan: Monetary Developments 1998-2003						
	1998 Dec.	1999 Dec.	2000 Dec.	2001 Dec.	2002 Dec.	2003 Dec.
(Percent change from the previous period)						
Broad Money	83.3	21.8	94.6	16.7	1.5	40.9
Reserve Money	111.7	18.9	81.2	27.0	-19.7	74.9
(Percent change in relation to reserve money stock at the end of the previous period)						
Net Foreign Assets	228.6	70.6	113.9	62.6	56.0	92.1
Net Domestic Assets (less other deposits)	-116.8	-51.6	-32.7	-35.6	-75.7	-17.3
of which : Credit to government	19.8	7.0	-13.2	-4.7	2.5	28.3
Credit to banks	84.1	0.3	140.4	70.7	17.1	33.6
Source: Central Bank of Turkmenistan; and Fund staff estimates.						

11. **In 2003, monetary aggregates again expanded rapidly as the government borrowed heavily from the CBT to finance the large wage and pension increases granted in early 2003.** In addition, the continued increase in net foreign assets was less than fully sterilized by the CBT. While reserve money grew by 75 percent in 2003, it appears that much of the wage and pension increases were held in cash. Currency in circulation increased by over 90 percent leading to a significant fall in the money multiplier, and broad money growth was limited to 41 percent. The monetary expansion, which was particularly pronounced in the second half of the year, has not yet been reflected in price increases⁷ but has, as explained below, led to further depreciation of the curb market exchange rate.

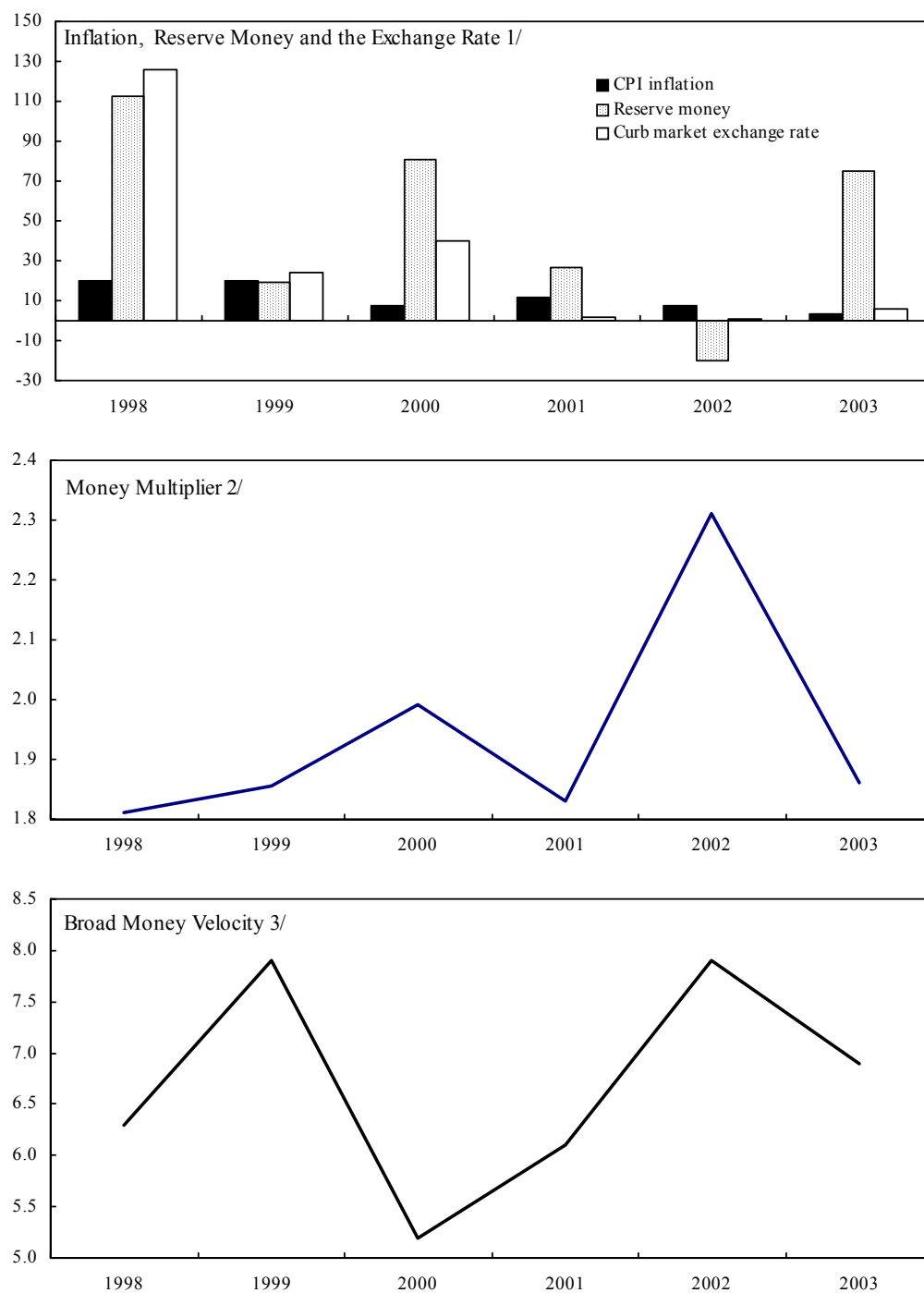
12. **The tight monetary environment during 2001 and 2002 helped the curb market exchange rate to stabilize and to even appreciate against the dollar in the early months of 2003** (Figures 3a and 3b). However, reflecting the loose monetary policy in the second half of 2003, the curb market exchange rate depreciated by 24 percent over the 12-month to end-March 2004.⁸ The official exchange rate has been kept constant since 1998.

13. **According to fiscal data on the State budget, the tightening of fiscal policy over the period 1998–2002 was interrupted in 2003 when large wage and pension increases resulted in an increased deficit** (Table 4). This deficit, which would have been much higher if the budget had not run up large wage and pension arrears, was mostly financed by

⁷ Because a large number of the prices included in the official CPI are subject to price controls, the monetary expansion may not be fully reflected in the official inflation figures.

⁸ Staff will continue to keep developments in the curb market under review.

Figure 2. Turkmenistan: Monetary Indicators, Inflation, and the Exchange Rate, 1998-2003



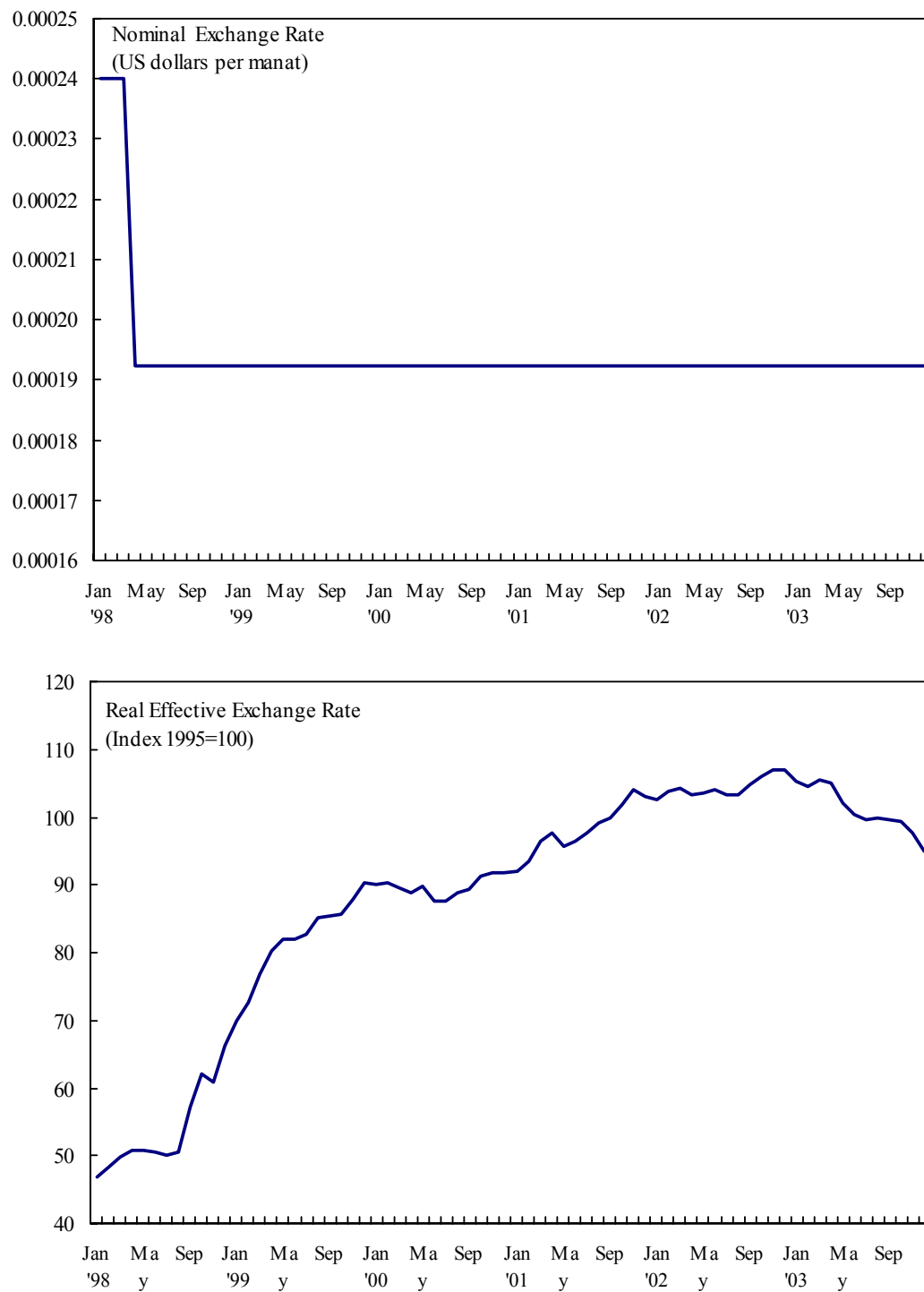
Sources: Central Bank of Turkmenistan; and Fund staff estimates.

1/ 12-month rates.

2/ End of period ratios.

3/ Calculated as a ratio of annual GDP and end-of-period broad money.

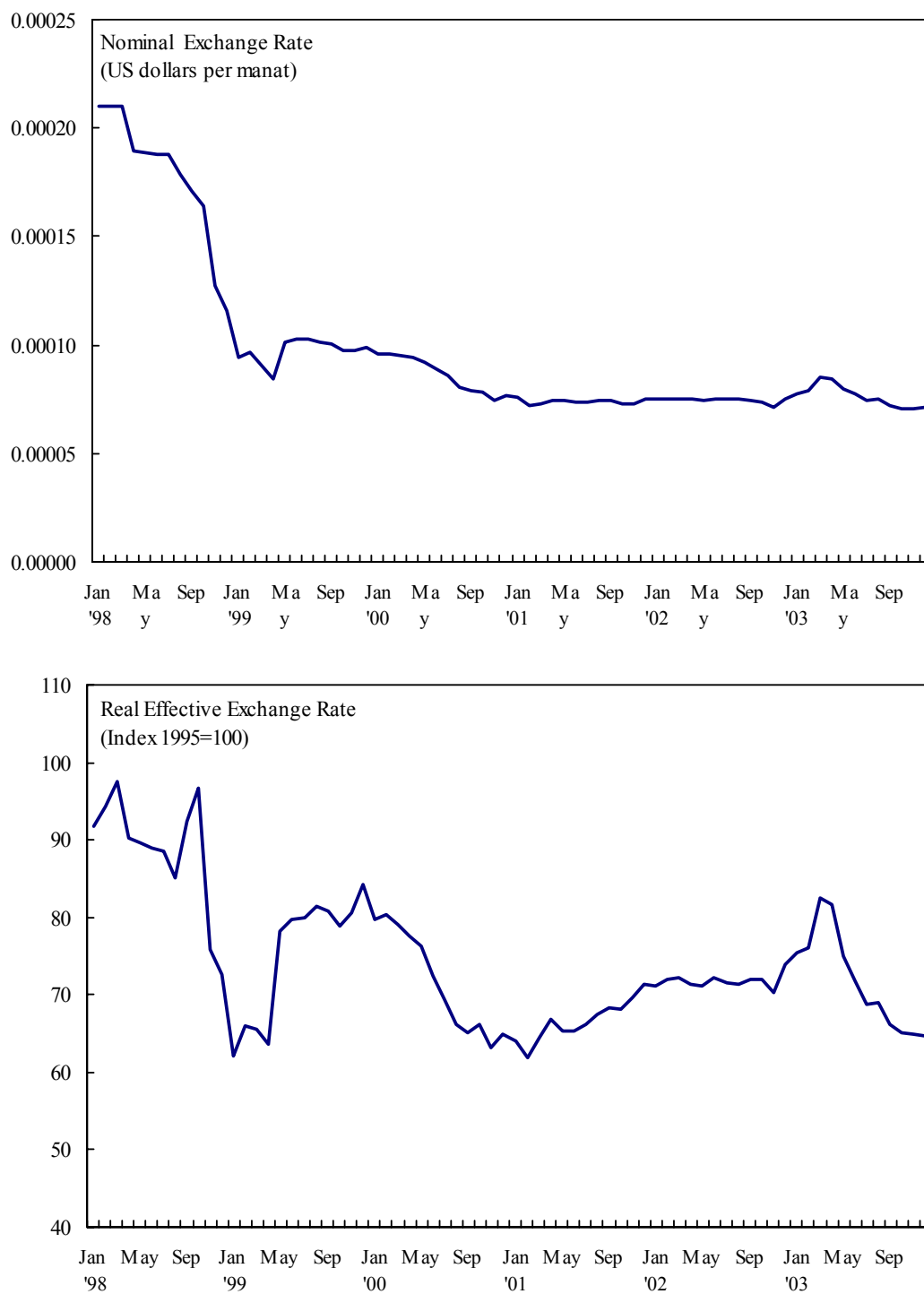
Figure 3a. Turkmenistan: Nominal and Effective Exchange Rates, 1998-2003 1/
(Official Rate)



Source: Information Notice System.

1/ Based on the official exchange rate. An upward movement indicates appreciation.

Figure 3b. Turkmenistan: Nominal and Effective Exchange Rates, 1998-2003 1/
(Indicative Rate)



Source: Information Notice System.

1/ The indicative exchange rate is an average of the official and curb market exchange rates. An upward movement indicates appreciation.

non-interest bearing advances from the central bank.⁹ The state budget, however, excludes the operations of the state funds and the self-financing ministries, which constitute some 75–80 percent of central government operations.¹⁰ Because of the lack of data on extra-budgetary operations, staff has developed a methodology to assess the Public Sector Borrowing Requirement (PSBR). Official monetary and balance of payments data are used to estimate the PSBR indicator from below the line. Based on staff estimates, the PSBR has declined progressively from 25 percent of GDP in 1998 to a surplus of about 6 percent of GDP by 2002 (Tables 1 and 5). However, in line with the expansionary fiscal policy in that year, the PSBR surplus narrowed to about 2 percent of GDP in 2003.

14. Revenues of the State budget do not fully reflect the significant increases of hydrocarbon exports since 1999. During the five-year period ending in 2003, tax revenues hardly increased in relation to GDP, reaching about 19 percent of GDP. The increase in exemptions as the authorities offered tax incentives to the non-oil sector and the shortening of the list of excisable goods contributed to this outcome. Except for 2000, when there was a significant one-off boost in revenues, the tax revenue ratio actually declined in both 2001 and 2002, as collections from excises, the profit tax, and VAT declined. In 2003, the revenue ratio improved somewhat as collections from income and payroll taxes increased on account of the wage and pension adjustments.

15. There has been a significant improvement in the balance of payments since 1998, according to official data (Table 6). The current account deficit in 1998, which reached US\$935 million (35 percent of GDP), turned into surpluses in recent years. This turnaround reflects the resumption of gas exports to Ukraine and Russia beginning in 1999. Receipts from gas exports have increased progressively over the years, reaching US\$1.9 billion by 2003. Similarly, exports of oil and oil products have increased four-fold to about US\$1 billion. On the import side, capital goods continued to increase with their value more than doubling from 1998 to 2003.¹¹ Much of these imports are associated with public sector projects and the development of the energy sector. However, growth in imports of food and consumer goods was very limited; this indicates the continued suppression of import demand and the rationing of foreign exchange. Both the service and investment income accounts have continued to register deficits over the years while net transfers have been positive.

⁹ During the mission, the authorities denied that there were wage and pension arrears. However, in a Cabinet of Ministers meeting in early April, the President revealed that there were significant arrears and ordered the Minister of Economy and Finance to eliminate the arrears within two weeks.

¹⁰ Extrabudgetary operations are discussed in Box 3. There are five major state funds: the Oil and Gas Fund, the Transportation and Communications Fund, the Agricultural Development Fund, the Government Investment Fund, and the Foreign Exchange Reserve Fund (FERF).

¹¹ About half of the payment for gas exports is delivered in kind with significant amounts of imports coming in as capital goods.

Box 3. Turkmenistan: Extrabudgetary Operations, 2000–03

The staff discussed the need to include the quasi-fiscal activities carried out through the “State Funds” and “Complexes” into the State Budget to enhance transparency and strengthen the budget system. Such extrabudgetary operations involve a vast mobilization of resources as can be seen from the table below. However, only a portion of these operations have a quasi-fiscal, as opposed to a commercial, nature. The quasi-fiscal activities include the provisioning of highly subsidized goods and services (such as energy, water, food stuffs and agricultural inputs). These subsidies are financed through taxation of gas, oil and cotton export receipts, mandatory profit transfers, and foreign borrowing that is government guaranteed.

Available data, however, do not permit a distinction between the commercial operations and quasi-fiscal activities, between regular revenues and transfers versus borrowed resources (financing), and between actual versus contingent liabilities. These issues need to be addressed before a useful, comprehensive analysis of the extrabudgetary funds can be undertaken.

	2000	2001	2002	2003
		(Billion manat)		
Extrabudgetary Expenditures 1/	22,708	35,413	36,126	40,543
<i>In percent of GDP</i>	89	101	77	71
O/w: Oil and Gas complex 2/	10,430	16,972	18,116	19,473
Energy complex	1,503	1,756	1,027	1,350
Agricultural complex 3/	3,486	7,196	8,605	10,009
Transport, communication and construction complex 4/	2,859	4,184	3,129	3,006
Consumer and social complex	1,730	2,152	2,197	3,350
Bank and insurance organizations	0	1,195	1,688	1,691
Other complexes	1,956	947	0	0
Governmental Fund for Investments	606	831	1,019	1,202
State Fund for Health Care Development	98	106	138	171
Other State Funds 5/	41	74	207	291
		(Share in total; percent)		
Classification of Extrabudgetary Revenues 6/	...	100	100	100
Own Resources	...	81	95	90
Borrowed Resources	...	19	5	10
<i>Memorandum Items:</i>		(Billion manat)		
State Budget Expenditures 7/	6,121	7,605	8,166	11,522
O/w: Social Sector	4,315	5,759	6,043	8,715
o.w. Subsidies for energy, water, and food items 8/	448	498	387	750
O/w: Centralized capital investment	290	382	482	604
Foreign Exchange Reserve Fund (FERF) Assets, eop	8,989	10,482	12,090	13,413

Sources: Turkmen authorities; and Fund staff estimates.

1/ Allocations in the annual budgets; defined such that expenditures equal revenues (including borrowed resources) for each Fund and Complex.

2/ Includes the State Fund for Oil and Gas.

3/ Includes the Agricultural Development Fund.

4/ Includes the Transport and Communications Fund.

5/ Includes State Fund for Education Development, State Fund for Ashgabat City Development, and State Fund for Golden Age Development.

6/ As reported by the MOEF.

7/ Actual outcome.

8/ This would not include implicit subsidization of housing services to certain employees of the various line-ministries, provided through large housing construction projects within each Complex.

16. **The current account deficits of the earlier years were largely financed with public sector medium- and long-term borrowing.** There was also a net increase in external arrears in 1998. Since 1998, medium- and long-term borrowing has declined sharply, amortization payments have increased significantly, and substantial amounts of external arrears have either been reduced or rescheduled.¹² Meanwhile, gross international reserves reached US\$2.7 billion by end-2003 (about 10 months of imports of goods and non-factor services), up by more than \$1 billion from 5 years ago.

17. **The authorities provided the staff with new aggregated data on external debt, both outstanding and overdue, which show a significant reduction since 1998.** Total outstanding external debt fell from 68 percent of GDP (with GDP valued at the official exchange rate) in 1998 to about 14 percent of GDP by end-2003.¹³ Similarly, debt service as a ratio of exports of goods and non-factor services has been reduced from 35 percent in 1998 to less than 12 percent in 2003. On the other hand, the authorities' information indicates that the stock of Turkmenistan's claims in the form of payment arrears and rescheduled debt resulting from gas deliveries to the CIS countries reached US\$1.2 billion at end-2003. About 70 percent of these claims are on Georgia and Ukraine, although about 45 percent of Ukraine's gas debt has been rescheduled.¹⁴

18. **Despite the improved economic environment, Turkmenistan's foreign exchange and trade regimes remain closed and extensive restrictions exist on both current and capital account transactions.** Almost all imports and exports require authorization by the State Commodity Exchange (Box 4), and access to foreign exchange for imports is limited.

19. **Similarly, there have been only marginal measures taken in the area of structural reform since the last Article IV consultation.** While the government generally recognizes the need to introduce market oriented reforms, a gradual pace of reform is envisaged in the government's national strategy¹⁵ with the state continuing to play a dominant role in the Turkmen economy.

¹² These are mostly loans from commercial banks to finance cotton production.

¹³ The debt-to-GDP ratio declines less markedly from 77 percent to 35 percent when GDP is valued at an indicative exchange rate, defined as the average of the official and curb market rates, which may be closer to a market clearing rate than the official rate (although no information is available on the volume of transactions in the curb market).

¹⁴ Details of Turkmenistan's claims on CIS countries are shown in the supplementary Statistical Appendix.

¹⁵ "The Strategy of Economic, Political and Cultural Development of Turkmenistan Until 2020."

Box 4. Turkmenistan: Trade Policies

The State Commodity Exchange (Comex) continues to play a dominant role in regulating exports and imports as all contracts of international trade transactions have to be registered at Comex to receive approval. Comex may not approve a contract if in its view the contract price of any transaction is not accurate. Export contracts of gas, however, are managed separately by the relevant ministries. The exports of some strategic commodities, including gas, oil and oil products, electricity and cotton, require approval by the Cabinet of Ministers. Domestic transactions between state and private enterprises that have a value in excess of 30 million manat must also be registered at Comex. Registration requirements do not apply to domestic transactions between state agencies and between private enterprises.

There have not been any significant changes in terms of criteria to regulate export and import contracts since the last Article IV consultation. All contracts should not be over- or under-priced, and exported goods should not be items in short supply in domestic markets. Some products, such as food commodities, are prohibited from being exported. Comex also discourages imports when locally produced goods are available. All trade, including barter transactions, must take place through the trading sessions at Comex, which are conducted three times a week. Comex charges a commission of 0.4 percent on all transactions, which is paid by the buyer and the seller in equal proportions.

While all international trade transactions are subject to government approval, there is no explicit license required for imports. Custom duties (ranging from 10–100 percent) are applied on 94 commodities, while shuttle trade in the amount of up to US\$ 500 is exempted from these duties. Above this amount, a uniform custom duty of 5 percent is applied. There are excise taxes for imported alcoholic beverages, tobacco and tobacco products, and cars, and the excise tax rates are higher than those applied for domestic products. Export licenses are not required as all exports have to be registered and approved by the state. There is generally no tariff for exports, except some custom duties applied on shuttle trade.

All exports are subject to repatriation requirements, and export proceeds of public sector enterprises are subject to a 50 percent surrender requirement to the CBT at the official exchange rate. Private enterprises are not subject to the surrender requirement, while the requirement for joint-venture enterprises is 10 percent. Export proceeds from cotton fiber are exempted from the surrender requirement. Gas exports are subject to a 25 percent surrender requirement to the CBT, in addition to the 50 percent foreign exchange tax on cash receipts, which is paid to the Foreign Exchange Reserve Fund.

20. **In the fiscal area, however, the authorities have made some headway in streamlining the tax system.** Taxes such as the excess wage tax, the fuel tax on foreigners, and the transfer tax were abolished and a number of local nuisance taxes have also been repealed.¹⁶ More importantly, tax offsets for state enterprises and other public sector agencies

¹⁶ A detailed update of the tax system is included in the supplementary Statistical Appendix.

no longer apply¹⁷ and the government is making a strong effort to increase the collection of tax arrears. In the management of public expenditures, the treasury system has been consolidated to include the budgetary operations of the central and local governments. A two-tier pension system was introduced since 1998: a PAYE system and a cumulative system where funds are reinvested and pensioners are paid according to their contributions. The system is currently self financing and solvent, and the social security taxes have been reduced from 30 percent to 20 percent. On the downside, however, tax privileges and exemptions have become more widespread as the government's attempts to stimulate the nonhydrocarbon industries through tax incentives have intensified. In addition, the gas and oil sectors continue to carry a heavy tax burden through the export surrender requirements, the overvalued exchange rate, and formal taxes.¹⁸

21. **Little has changed in the banking sector in the past five years.** However, the CBT Credit Committee was abolished and no longer approves commercial bank loans.¹⁹ Instead, CBT on-site and off-site inspections of banks have increased and prudential requirements are strictly applied.²⁰ As there have been further bank merger operations since 1999, the banking system now comprises 12 commercial banks and the CBT. Six of the largest banks are fully state owned, three are joint-stock commercial banks with majority state ownership, two are subsidiary branches of the Bank of Iran and the Bank of Pakistan, respectively, and one is a Turkish bank with a 50 percent Turkmen government interest. The CBT has also introduced a bank deposit insurance scheme, the regulations of which will be incorporated in a new central bank law.

22. **The privatization process which started as early as 1993 has stalled.** The government is slowing down the privatization process and is now keen to lease or rent state property instead. There are no plans to privatize enterprises in the hydrocarbon, transport, communication, and construction industries. However, almost all small stores and retail outlets are now privatized. The government has also started several textile producing enterprises with foreign partners. Overall, given burdensome licensing requirements, limited access to inputs, which are largely distributed by the state, as well as trade, foreign exchange

¹⁷ Tax offsets have continued despite the MOEF's order to limit their application in 1999 but have now become increasingly restricted.

¹⁸ The effective tax rate on the gas and oil sector is estimated at 45 percent of total sales in 2003 (valued at the official exchange rate).

¹⁹ A CBT order issued in March 1999 required the review and clearance of all commercial bank loans to state enterprises, enterprises with state participation, farmers associations, and consumer associations.

²⁰ Commercial banks generally comply with prudential regulations and ratios set by the CBT, however, the risk-weighted capital adequacy ratio does not accurately portray the situation. Many loans have a zero risk weight and loans to agriculture have a 20 percent risk weight.

and domestic cash restrictions, the environment for private sector development remains very unfavorable.

III. POLICY DISCUSSIONS

23. **The key topic of the discussions was how to normalize relations between Turkmenistan and the IMF.** The authorities' willingness to renew their cooperation with the Fund was confirmed by the President when he met with the mission. He emphasized that Turkmenistan had no secrets and invited the mission to visit whatever it wanted. Another sign of the President's wish to normalize relations with the Fund was his announcement during the mission's stay of the appointment of a new Governor for the Fund to replace the former Chairman of the Central Bank of Turkmenistan who had been dismissed in September 2002 but had remained on the books as Governor for the Fund.²¹ The mission explained in detail the authorities' obligations under the Articles of Agreement to provide the Fund with the information needed to discharge its surveillance obligations.

24. **The mission received good cooperation from the authorities and obtained all the data needed to prepare the staff report for the 2004 Article IV consultation.**

Nevertheless, a cumbersome system requiring clearance from high level officials for releasing data and arranging follow-up meetings remains in place. Also, the quality of the data leaves much to be desired in many areas. While the technical staff in most institutions is well qualified and, on the whole, follow internationally accepted methods, their output is subject to political interference. Also, it is clear that they have suffered from being cut off from interaction with international organizations and are in need of technical assistance in many areas.

25. **On economic issues, the discussions focused on ways to improve transparency and efficiency in policy formulation and implementation.** The mission stressed that the current favorable environment is conducive for introducing wide-ranging market-oriented reforms so as to encourage foreign direct investment in the nonhydrocarbon sector and reduce Turkmenistan's vulnerability to the current narrow market for gas exports. However, the prospects for major economic reforms are rather dim. The President made it quite clear that the path he had followed since he rejected the Fund's advice to liberalize the economy in the early 1990s was the right one. He emphasized that the state sector would have to remain a predominant force in the economy to deal with the challenge of developing the nonhydrocarbon sector.

A. Macroeconomic Policies and Prospects for 2004

26. **The authorities agreed with the mission that the macroeconomic policies pursued in 2003 had been too loose and that a tightening was needed for 2004.** In particular, a tightening of fiscal policy would be required following the large-scale

²¹ However, the new Governor for the Fund, the Minister of Economy and Finance, was dismissed in late April, again giving rise to issues with respect to the representation of Turkmenistan in the Fund.

borrowing by the government from the CBT to finance wage and pension increases in 2003. It was expected that the state budget would realize a surplus of over one percent of GDP in 2004 as revenue collections are improved and expenditure cuts on non-priority items are effected. A serious effort would be made to repay the full amount borrowed from the CBT in the previous year. The recent order by the President to pay the wage and pension arrears may, however, derail the intended fiscal tightening.

27. **The fiscal tightening would be essential to help the CBT bring liquidity under control.** The mission pointed out that the CBT would need to continue to strictly limit the extension of directed credits. In addition, it should quickly develop market-based monetary policy instruments, such as deposit auctions and/or issuance of CBT notes or bonds with competitive interest rates. To signal the tightening of its policy stance, the CBT should consider an increase in its refinance rate. CBT officials said that they were exploring different options for tightening monetary policy, including some of those recommended by the mission, but no firm conclusions had been reached on the policies to follow.

28. **Based on the policy recommendations made by the mission, the macroeconomic outlook for 2004 was discussed with the authorities.** They broadly agreed with the mission's projections for 2004, except with respect to economic growth. The mission expects real GDP growth of 7½ percent compared with 17½ percent forecast by the authorities. Consumer price inflation is expected to pick up moderately to about 4½ percent. Some reduction is expected in the external current account surplus (to about 2½ percent of GDP), mainly because of a pick-up in imports. A further reduction in debt is likely, while international reserves are expected to remain at a level corresponding to about 10 months of imports of goods and non-factor services.

B. Strengthening the Macroeconomic Policy-Making Framework

29. **In view of the rather inconsistent macroeconomic policies of the past few years, the mission recommended a number of reforms to strengthen the macroeconomic policy-making framework.** In particular, certain key measures are needed to strengthen the budget system and to make it more transparent. First, a clear distinction needs to be made between the commercial activities and the government functions of the complexes and the extrabudgetary funds; the latter activities could then be brought into a consolidated budget under the full control of the Ministry of Economy and Finance. Only then can the budget be a useful tool for macroeconomic policy. Second, the mission commended the authorities for the recent reform measures taken such as abolishing tax offsets and rationalizing the tax system; however, remaining issues are the streamlining of the exemption system and the realignment of the taxation of the energy and cotton sectors with international standards. The authorities recognized the need for these reforms and stated that they would consider the mission's recommendations.

30. **With respect to the monetary policy framework, the mission suggested that the CBT should be granted greater autonomy to conduct monetary policy.** Thus, the CBT should be relieved of its obligations to provide directed subsidized credits, and it should be given the freedom to hold and manage the international reserves of the country. At the same time, the CBT would need to quickly develop market based monetary policy instruments.

While the mission commended the CBT for its efforts to strengthen banking supervision, it recommended a careful review of the recently introduced deposit insurance scheme noting that such schemes, if poorly designed, can lead to problems of moral hazard and financial distress. The central bank officials agreed with the mission and were ready to examine their policy options and make specific recommendations to the government.

31. **The mission stressed that the strengthening of the budget and monetary policy-making capacity should be accompanied by a liberalization of the foreign exchange market, including a unification of exchange rates, with the value of the manat allowed to be freely determined.** Interventions by the CBT could then be limited to smoothing out short term fluctuations of the exchange rate. With international reserves at an all-time high, the risk of instability in the foreign exchange market is limited, provided that the CBT has the ability to utilize the international reserves of the country for intervention purposes, if needed. This will not be the case, however, unless the rules and regulations of the Foreign Exchange Reserve Fund (FERF) are modified.²² The authorities responded that, in line with the national program, there are no plans to unify the exchange rates over the coming year or two as the current official exchange rate of the manat is considered beneficial for much needed capital goods imports.

32. **The mission recommended that the FERF should be phased out and its assets be sold to the CBT.** The counterpart of the reserves could then be placed in a reserve account at the CBT in the form of a saving and stabilization fund. Such a fund should have clear regulations regarding the use and management of its resources and be subject to regular external audits. The mission also suggested that in the interim the FERF could be established as a legal entity, separate from the CBT and the government budget, but with spending from the FERF clearly reflected in the budget and approved according to normal budgetary procedures. The authorities, while understanding the economic arguments for the change, stated that determining the structure of the FERF would be a political decision taken at the highest level.

C. Structural Reforms

33. **Against the background of the current policies of universal subsidies and nonmarket prices, the mission proposed a number of structural reform measures.** The mission expressed the view that current policies were not only inefficient, but also unsustainable. Key areas of reform that should be initiated as soon as possible would include price liberalization and improvement of the business climate for agriculture and other sectors of the economy, together with liberalization of the trade and foreign exchange regimes.

²² The FERF, which derives its resources from the foreign exchange taxes on gas and oil exports, is under the direct control of the President, and there are no explicit rules and regulations governing the use of its resources. The assets of the FERF, which are a close approximation of the international investment position of Turkmenistan, are administered by the CBT, but controlled by the President.

34. Further price liberalization would contribute significantly to enhancing economic efficiency by giving proper signals to market participants and reducing waste.

In this context, the mission pointed out the economic costs and efficiency losses of the current untargeted social security system. It was noted that the provision of a number of goods and services for free or at very low subsidized prices is expensive for the budget and encourages overuse and waste.²³ The mission urged the authorities to reconsider the decision to maintain such a system until 2020 and to phase it out as soon as politically feasible, replacing it with a properly targeted social security system aimed at helping the most vulnerable segments of the population. While recognizing the costs involved, the authorities said that the decision to retain this system is of a political nature and is unlikely to be reversed.

35. Several measures would be needed to improve the business climate for agriculture and other parts of the nonhydrocarbon economy. Efficiency would be enhanced significantly in agriculture if the state order system were to be phased out.²⁴ This would allow farmers to receive world market prices for their products (converted at a market-clearing exchange rate for the manat), providing them with the necessary incentives to raise output and improve productivity. Such reforms, the mission noted, would make it possible to abolish the system of subsidized inputs for farmers and eliminate the need for cross-subsidies from the energy and other sectors of the economy, and thereby increase efficiency in these sectors as well. At the same time, the government would need to improve the environment for private and newly privatized enterprises. The mission suggested that the authorities should eliminate quickly bureaucratic obstacles to the establishment and operations of private business by improving governance in the public sector. Corporatization of state enterprises should also be given high priority in the government's reform agenda. Only by relieving state enterprises of their social and other subsidy functions (which should be transferred to the budget) and allowing them to operate on a commercial basis would it be possible for the government to set proper financial targets for their operations. Privatization should be considered as an option when politically feasible. The authorities took note of the mission's proposals but gave no indication that they had any plans to change their current policies in these areas.

36. Liberalization of the trade and exchange regimes would contribute to an improvement of the business climate and economic efficiency. The mission recommended an early removal of the current nontariff barriers (such as those established by the rules and regulations of the State Commodity Exchange) and quantitative restrictions on foreign trade. Instead, a low uniform import tariff system should be introduced and the current excise taxes

²³ Free gas, water, energy, and salt are provided universally, subject only to generous limits on usage, and heavily subsidized thereafter. Bread and a number of other food products are also subsidized.

²⁴ The two major crops, wheat and cotton, are grown and marketed under a state order system. While procurement prices are much lower than world prices, these are partially compensated by the provision of input subsidies to farmers.

on imports should be removed. It also suggested that if excise taxes are needed on certain products for budgetary reasons, they should be uniform for imports and domestically produced goods. The mission urged the authorities to remove the exchange restrictions and multiple currency practices as soon as possible, not only because such restrictions are inconsistent with the Articles of Agreement, but also because their removal would contribute significantly to improving economic efficiency. In this context, the mission also recommended that the export surrender requirement be abolished, which would pave the way for the establishment of a foreign exchange market if the commercial banks' foreign exchange window is reopened at the same time. Also in these areas, the authorities did not seem to have any plans to change current policies.

D. The Medium-Term Outlook

37. **Turkmenistan's ability to gain and maintain access to international markets for its key export products, gas and oil, will largely determine the prospects for the medium-term.** While the recent long-term contract for gas exports to Russia is encouraging, considerable uncertainties remain with respect to the pipeline capacity needed for fulfilling this and other export contracts already negotiated or envisaged. To achieve Turkmenistan's full export potential, significant new investments are needed that could only be achieved with a substantial element of foreign financial resources. If such investments are forthcoming and access to world markets is secured, the medium-term economic outlook for Turkmenistan is bright. In such a scenario, and even in a less optimistic scenario, the main challenge facing the Turkmen authorities is how to transform the riches from the hydrocarbon sector into the development of the employment-creating nonhydrocarbon segments of the economy.

38. **The mission discussed two medium-term balance of payments scenarios with the authorities** (Tables 7 and 8). The **baseline scenario** projects the volume of gas exports to grow conservatively from around 47 bcm in 2004 to 58 bcm by 2009, largely reflecting limited pipeline capacity. The **alternative scenario** projects gas exports to reach 84 bcm by 2009 as expected by the authorities. This scenario assumes the development of new pipeline capacity financed by an increase in capital goods imports and foreign direct investment. In both scenarios, the current account balance is expected to show healthy surpluses and external debt to be reduced significantly.²⁵ The authorities, while acknowledging the uncertainties of the scenarios, thought that the likely outcome would be that of the alternative optimistic scenario. However, both scenarios assume a continuation of current policies, which leave the Turkmen economy vulnerable to the narrow market for gas exports, and current policies would not be sustainable if the nonpayments for gas exports experienced a few years ago were to recur.

E. Statistical Issues

39. **Turkmenistan's macroeconomic statistics suffer from major weaknesses that complicate the conduct of surveillance.** These weaknesses are related to problems with

²⁵ As shown in Appendix V, there are no external debt sustainability issues.

source data, the application of proper statistical methodologies, and political interference in the processing and dissemination of data. The area of greatest concern is national accounts data, which in the mission's view overestimate significantly real GDP growth for the last few years. While the authorities disagreed with the mission's alternative GDP estimates, they admitted that there were problems with the data for 2002 and 2003 and that they would welcome technical assistance on this subject as soon as possible. The authorities also have yet to demonstrate that they will provide the Fund with timely macroeconomic data on a regular basis, as required under Article VIII, Section 5, of the Articles of Agreement.

F. Other Issues

40. **The mission commended the authorities for their conservative external borrowing policy and for reducing the external debt in recent years.** However, further strengthening of debt management would be desirable, and the mission encouraged the authorities to avail themselves of the Fund's technical assistance in the context of the public debt management project financed by a grant from the Swiss government.

41. **The authorities provided the mission with detailed information on Turkmenistan's framework to address anti-money laundering (AML) and to combat the financing of terrorism (CFT).** While the mechanisms to implement international AML and CFT standards appear to be in place, further strengthening of the relevant provisions is needed. For example, the ability of the CBT to monitor unusual financial activities needs to be enhanced.

42. **The mission also discussed with the authorities the issuance of a PIN and the publication of the staff report.** In principle, the authorities expressed their willingness to publish these documents, but they would take a final decision only once they had reviewed the staff report.

IV. STAFF APPRAISAL

43. Turkmenistan's decision to normalize relations with the IMF, as evidenced by the authorities' willingness to receive and cooperate with the Article IV consultation mission and by the appointment of a new Governor for the Fund, is a very welcome development. This is an important signal that Turkmenistan intends to share with the international community information on the immediate and long-term goals of the government and on the policies envisaged to achieve these goals. This renewed openness toward sharing information with the outside world, which would be enhanced by the issuance of a public information notice (PIN) and the publication of the staff report, could influence positively the attitude of foreign investors and help increase the flow of capital into the Turkmen economy.

44. Spurred by significantly increased receipts from gas and oil exports, the Turkmen economy has recovered strongly from the external shocks of 1997–98 that still affected the economy adversely at the time of the last Article IV consultation in 1999. Led by a significant recovery in the output of the hydrocarbon sector, strong overall real GDP growth has been registered in the last five years. The staff believes that official data overestimate real output growth significantly, especially since 2001. However, even after discounting for such

overestimation real economic growth remains impressive. At the same time, the rate of inflation has declined markedly and the external current account has registered sizable surpluses in recent years. This has enabled Turkmenistan to repay a large portion of its external debt and to build up further the international reserves of the country.

45. It is important that these economic gains be solidified in the period ahead. This will require a more consistent implementation of macroeconomic policies and an urgently needed strengthening of the macroeconomic policy-making framework, together with a speeding-up of market-oriented structural reforms.

46. For the near term, the staff recommends an immediate tightening of macroeconomic policies. A tightening of fiscal policy, either through expenditure restraint or revenue raising measures that would enable the budget to reduce its debt to the Central Bank of Turkmenistan (CBT), would help the CBT in its effort to bring liquidity under control and thus prevent a pick-up in inflation and/or a further depreciation of the curb market exchange rate. For its part, the CBT would need to continue to strictly limit the extension of directed credits and develop market-based monetary policy instruments with competitive interest rates. To signal the tightening of its policy stance, the staff urges the CBT to consider increasing its refinance rate.

47. The staff recommends a number of reforms to strengthen the macroeconomic policy-making framework. First, the budget system needs strengthening with the key aspect being to establish a clear distinction between the commercial activities and the government functions of extrabudgetary funds. The latter should be included in the budget, with such a consolidated budget being brought under the full responsibility of the Ministry of Economy and Finance. Only then will the budget be a useful tool for macroeconomic policy. Second, the CBT should be granted greater autonomy to conduct monetary policy, including by being relieved of its obligation to provide directed subsidized credits, and it should be given the freedom to hold and manage the international reserves of the country. Third, the strengthening of the budgetary and monetary policy framework should be accompanied by a liberalization of the foreign exchange market, including a unification of exchange rates, with the exchange rate for the manat being allowed to float. Finally, the staff recommends an early phasing out of the Foreign Exchange Reserve Fund (FERF). Different options could be considered, including that the control of the FERG in the interim could remain as at present provided that it be subjected to regular external audits.

48. The main challenge facing the Turkmen authorities for the medium-term is how to transform the expected large revenues from hydrocarbon exports into the development of the employment-creating nonhydrocarbon segments of the economy. The government's national long-term program "The Strategy of Economic, Political and Cultural Development of Turkmenistan Until 2020" addresses these issues. While this program recognizes the need to introduce market-oriented reforms, the authorities envisage a very gradual pace of reform with the state continuing to play a key role in economic life in Turkmenistan. In the staff's view, this is not the most efficient way to promote long run economic growth and maximize the welfare of the Turkmen population. However, if the government chooses to adhere to its current strategy, it is crucial that it be implemented in an efficient and transparent manner.

49. The current policies of universal subsidies and nonmarket prices, however, are not only inefficient but are also unsustainable, since they leave Turkmenistan vulnerable to the current narrow market for gas exports. In the staff's view, the current environment is ideal for beginning to introduce wide-ranging market-oriented reforms that would encourage the inflow of foreign direct investment needed to develop the nonhydrocarbon sectors of the economy. Key areas of reform that should be initiated as soon as possible include price liberalization and improvement of the business climate for agriculture and other sectors of the economy. Liberalization of the trade and foreign exchange regimes will be an important part of the efforts to improve the general business climate and create a level playing field for all participants in economic activity in Turkmenistan.

50. The staff commends the authorities for providing the broad-based statistical information to the Fund. Looking ahead, it is important that the government and the CBT continue to provide all the requested information on a regular and timely basis. The staff's analysis of the data and discussions with Turkmen experts have revealed a number of weaknesses in the official data that complicate the conduct of surveillance. The staff urges the authorities to devote the necessary efforts and resources to improving the statistical base, if necessary with the help of technical assistance from the Fund. At the same time, the staff urges the authorities not to interfere for political reasons in the processing and dissemination of data.

51. Turkmenistan maintains exchange restrictions and multiple currency practices subject to approval by the Fund under Article VIII, Sections 2(a) or 3, as described in Appendix I. In the absence of a clear timetable for their removal, the staff does not recommend their approval and urges their speedy elimination.

52. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Turkmenistan: Selected Economic and Financial Indicators, 1998-2003

	1998	1999	2000	2001	2002	2003	2004 staff proj.
(Annual percentage change; unless otherwise specified)							
National income							
GDP at current prices	26.0	43.3	27.9	36.9	33.0	22.8	12.9
GDP at constant prices 1/	6.7	16.5	18.6	20.4	19.8	16.9	7.5
Of which : natural gas sector	...	105.6	119.8	11.0	1.6	8.9	...
oil sector	...	-9.6	7.0	35.2	14.6	2.5	...
Implicit GDP deflator	18.1	23.1	7.8	13.7	11.0	5.0	5.0
Consumer price index (December-over-December)	19.8	20.1	7.4	11.7	7.8	2.7 6/	4.5
General government finance (State Budget)							
Total revenue	11.5	26.6	54.9	29.7	5.4	30.1	33.2
Total expenditure 2/	23.7	13.1	57.4	24.2	7.4	41.1	17.1
Money and credit 3/							
Net foreign assets	-159.7	-46.9	34.4	54.2	40.9	42.6	23.8
Net domestic assets	242.1	68.7	60.2	-37.6	-39.5	-1.7	-21.8
Domestic credit	205.6	93.5	69.9	-7.4	-32.6	-12.5	-21.8
Of which : credit to the economy	384.5	130.1	123.3	25.0	-8.6	-1.8	2.3
Broad money (end-of-period)	83.3	21.8	94.6	16.7	1.5	40.9	2.0
Foreign currency deposits as a ratio to broad money	29.7	30.5	40.3	39.9	42.3	35.3	35.3
Income velocity of broad money (end-of-period)	6.3	7.9	5.2	6.1	7.9	6.9	7.7
External sector (in US dollars)							
Exports (goods)	-20.7	89.6	115.4	4.6	9.1	21.2	8.2
Imports (goods)	13.2	20.8	26.8	21.1	-13.1	36.6	15.3
Real effective exchange rate index (1997=100)	125.0	190.2	209.0	228.3	243.0	235.5	...
(In percent of GDP; unless otherwise specified)							
Basic ratios							
Gross fixed investment	45.5	39.7	35.4	32.5	27.2	26.3	26.0
Gross domestic savings	8.6	22.3	44.0	34.9	35.0	31.1	29.1
Gross national savings	10.8	24.9	43.7	34.2	33.7	30.9	28.7
State Budget (- deficit)							
Revenue	22.0	19.4	23.5	22.3	17.7	18.7	22.1
Expenditure 2/	24.6	19.4	23.9	21.7	17.5	20.1	20.8
Overall fiscal deficit	-2.6	0.0	-0.3	0.6	0.2	-1.4	1.2
Consolidated government finance							
State budget balance	-2.6	0.0	-0.3	0.6	0.2	-1.4	1.2
State funds and extrabudgetary operations	-22.0	-12.7	-2.4	4.6	5.7	3.1	2.8
Public sector borrowing requirement	-24.6	-12.7	-2.8	5.2	5.8	1.7	4.1
Domestic financing	-2.7	-2.5	1.4	-0.5	-1.9	0.0	-3.0
External financing	27.3	15.2	1.3	-4.7	-4.0	-1.7	-1.1
External sector							
Current account (- deficit)	-34.7	-14.8	8.4	1.7	6.5	4.6	2.7
Foreign direct investment	2.3	3.2	2.7	2.5	3.1	2.0	1.8
External debt service ratio 4/	35.3	28.5	14.2	17.4	14.3	11.6	9.6
(In millions of U.S. dollars; unless otherwise specified)							
Gross official external reserves	1,379	1,555	1,808	2,055	2,346	2,673	2,923
-- in months of imports of goods and non-factor services	9.0	9.1	9.2	9.1	11.8	10.0	9.7
Nominal GDP (in manat billion)	13,995	20,056	25,648	35,119	46,699	57,356	64,741
Nominal GDP per capita (in US\$; official exchange rate)	539	742	919	1,197	1,513	1,751	...
Nominal GDP per capita (in US\$; indicative exchange rate) 5/	479	379	415	460	586	695	...
External debt outstanding	1,842	2,026	2,184	1,865	1,660	1,519	1,297
as a ratio to nominal GDP (US\$; official exchange rate)	68.4	52.5	44.3	27.6	18.5	13.8	10.4
as a ratio to nominal GDP (US\$; indicative exchange rate) 5/	76.9	102.8	98.1	71.9	47.7	34.7	...
Exchange rate (manats per US\$; end-of-period)							
Official	5,200	5,200	5,200	5,200	5,200	5,200	...
Curb market	12,100	15,000	21,000	21,400	21,500	22,800 7/	...
Population (millions; official estimates)	5.0	5.2	5.4	5.6	5.9	6.3	...

Sources: Turkmen authorities; and Fund staff estimates.

1/ According to official statistics for 1998-2003. Alternative estimates indicate lower real GDP growth rates in 2001-03.

2/ Includes centralized investment expenditures.

3/ In percent of beginning-of-the-period money stock.

4/ In percent of exports of goods and non-factor services; excludes rescheduled amounts.

5/ The indicative exchange rate is defined as the average of the official and curb market rates.

6/ End-March 2004 compared to end-March 2003.

7/ End-March 2004.

Table 2. Turkmenistan: Monetary Survey, 1998-2003
(In billions of manats; end of period stocks)

	1998	1999	2000	2001	2002	2003
Net foreign assets	-937	-1,920	-1,043	1,650	4,021	6,523
Net international reserves of the CBT (convertible)	-2,483	-2,509	-2,075	-2,009	-1,844	-825
Foreign Exchange Reserve Fund assets (FERF)	7,015	7,857	8,989	10,482	12,090	13,413
Net foreign assets of commercial banks (convertible)	-5,469	-7,268	-7,957	-6,823	-6,225	-6,064
Net domestic assets	3,032	4,472	6,008	4,142	1,856	1,756
Domestic credit	3,288	5,246	7,029	6,660	4,771	4,039
Net claims on Government	-6,864	-7,632	-8,996	-10,606	-11,995	-12,622
Central bank	-6,855	-7,616	-8,929	-10,539	-12,068	-12,671
Of which: Foreign Exchange Reserve Fund (net)	-7,015	-7,857	-8,989	-10,482	-12,090	-13,413
Commercial banks	-9	-16	-67	-67	73	49
Credit to the economy	10,152	12,878	16,025	17,266	16,766	16,662
State enterprises	9,927	12,650	15,499	16,628	15,918	15,527
Other private sector	225	228	526	638	848	1,135
Other items (net)	-256	-774	-1,021	-2,518	-2,915	-2,283
Broad money	2,095	2,552	4,965	5,792	5,877	8,280
Manat broad money	1,472	1,773	2,963	3,481	3,394	5,354
Currency outside banks	1,040	1,009	1,518	1,790	1,752	3,389
Manat deposits	432	764	1,445	1,691	1,642	1,965
Foreign currency deposits	623	779	2,002	2,311	2,483	2,926
Memorandum items:	(Percentage change; year-on-year)					
Broad money	83.3	21.8	94.6	16.7	1.5	40.9
Manat broad money	69.8	20.4	67.1	17.5	-2.5	57.8
Credit to the economy	76.3	26.9	24.4	7.7	-2.9	-0.6

Sources: Central Bank of Turkmenistan; and Fund staff estimates.

Table 3. Turkmenistan: Summary Accounts of the Monetary Authorities, 1998-2003
(In billions of manats; end of period stocks)

	1998	1999	2000	2001	2002	2003
Net foreign assets	4,532	5,348	6,914	8,473	10,246	12,588
Gross international reserves (CBT)	156	230	414	203	107	487
Foreign Exchange Reserve Fund assets (FERF)	7,015	7,857	8,989	10,482	12,090	13,413
Foreign liabilities (convertible)	-2,639	-2,739	-2,489	-2,212	-1,951	-1,312
Net domestic assets	-2,909	-3,776	-3,640	-3,851	-5,759	-6,085
Domestic credit (net)	-2,892	-3,505	-3,103	-2,236	-3,585	-4,016
Net claims on government	-6,855	-7,616	-8,929	-10,539	-12,068	-12,671
Budgetary support	160	241	60	-57	22	742
Foreign Exchange Reserve Fund (net)	-7,015	-7,857	-8,989	-10,482	-12,090	-13,413
Credit to State enterprises	2,939	3,084	2,869	3,585	3,225	2,542
Of which: in foreign currency	2,889	2,887	2,856	3,580	3,220	2,537
Claims on banks	1,024	1,027	2,957	4,718	5,258	6,113
Other items net	-17	-271	-537	-1,615	-2,174	-2,069
Reserve money	1,156	1,375	2,492	3,164	2,542	4,445
Currency issued	1,051	1,024	1,530	1,803	1,775	3,389
Bank deposits	105	351	962	1,361	767	1,056
Other deposits	467	197	782	1,458	1,945	2,058
Memorandum items:						
Net international reserves (in millions of US\$)	872	1,028	1,330	1,629	1,970	2,421
Gross international reserves (in millions of US\$)	1,379	1,555	1,808	2,055	2,346	2,673
Reserve money (percentage change)	111.7	18.9	81.2	27.0	-19.7	74.9

Sources: Central Bank of Turkmenistan; and Fund staff estimates.

Table 4. Turkmenistan: Government Operations, 1998-2003
(In billions of manat)

	1998	1999	2000	2001	2002	2003
State Budget						
Total Revenues	3,078	3,895	6,034	7,824	8,243	10,727
Tax revenue	2,604	3,436	5,909	7,783	8,243	10,727
Income tax	158	171	480	641	734	1,190
Profit tax	413	723	703	756	1,171	1,382
Property tax	52	88	102	207	201	206
Value added tax	715	1,023	1,745	2,243	2,422	3,033
Natural resource tax	43	67	374	813	1,157	1,253
Excises	221	181	770	252	323	259
Payroll tax	719	767	1,237	1,184	1,341	2,263
Other taxes and duties	283	416	498	1,687	894	1,141
Nontax revenue	474	459	125	41	0	...
Total expenditure	3,440	3,890	6,121	7,605	8,166	11,522
Current expenditure	3,242	3,688	5,831	7,223	7,684	10,918
Social services	2,410	2,473	4,315	5,759	6,043	8,715
Education	883	904	1,693	2,033	2,196	3,340
Health	489	478	839	1,016	1,100	1,617
Culture	96	101	157	188	215	291
Social security	509	586	1,167	1,931	1,836	2,489
Housing services	433	403	458	592	696	978
General services	339	417	847	965	1,048	1,507
National economy	431	557	446	481	536	690
Other expenditure	38	79	105	0	1	0
Interest	24	163	117	18	56	6
Centralized capital investment	198	202	290	382	482	604
Primary balance	-338	169	30	237	133	-789
Overall balance of State Budget	-362	5	-87	219	77	-795
Financing	362	-5	87	-219	-77	795
CBT	108	81	-181	-117	79	720
Other	254	-86	268	-102	-156	75
Balance of State Funds and other extra-budgetary operations	-3,085	-2,552	-625	1,609	2,647	1,761
Of which: Expenditures	...	...	22,708	35,413	36,126	40,543
Overall fiscal balance of consolidated government 1/	-3,447	-2,546	-712	1,828	2,725	966
Public Sector Borrowing Requirement 1/	3,447	2,546	712	-1,828	-2,725	-966
Domestic	-375	-496	369	-162	-877	-2
Domestic borrowing (net)	500	346	1,501	1,331	731	1,321
FERF balance (increase -)	-875	-842	-1,132	-1,493	-1,608	-1,323
External	3,822	3,042	343	-1,666	-1,848	-964
Public sector net external borrowing	3,801	3,930	2,786	236	-812	-933
Change in external arrears (net)	21	-888	-2,443	-1,902	-1,036	-31
Memorandum items:			(In percent of GDP)			
Overall balance of State Budget	-2.6	0.0	-0.3	0.6	0.2	-1.4
Public Sector Borrowing Requirement 1/	24.6	12.7	2.8	-5.2	-5.8	-1.7

Sources: Turkmen authorities; and Fund staff estimates.

1/ Includes calculations made by the staff to estimate the public sector's borrowing requirement (PSBR).

Table 5. Turkmenistan: Selected Fiscal Indicators, 1998-2003
(In percent of GDP)

	1998	1999	2000	2001	2002	2003
State Budget						
Total Revenues	22.0	19.4	23.5	22.3	17.7	18.7
Tax revenue	18.6	17.1	23.0	22.2	17.7	18.7
Of which: Income tax	1.1	0.9	1.9	1.8	1.6	2.1
Profit tax	3.0	3.6	2.7	2.2	2.5	2.4
Value added tax	5.1	5.1	6.8	6.4	5.2	5.3
Natural resource tax	0.3	0.3	1.5	2.3	2.5	2.2
Excises	1.6	0.9	3.0	0.7	0.7	0.5
Payroll tax	5.1	3.8	4.8	3.4	2.9	3.9
Non-tax revenue	3.4	2.3	0.5	0.1	0.0	0.0
Total expenditure	24.6	19.4	23.9	21.7	17.5	20.1
Social services	17.2	12.3	16.8	16.4	12.9	15.2
Of which: Education	6.3	4.5	6.6	5.8	4.7	5.8
Health	3.5	2.4	3.3	2.9	2.4	2.8
National economy	3.1	2.8	1.7	1.4	1.1	1.2
General services	2.4	2.1	3.3	2.7	2.2	2.6
Primary balance	-2.4	0.8	0.1	0.7	0.3	-1.4
Overall balance of State Budget	-2.6	0.0	-0.3	0.6	0.2	-1.4
Balance of State Funds and other extra-budgetary operations	-22.0	-12.7	-2.4	4.6	5.7	3.1
Of which: Expenditures	...	...	88.5	100.8	77.4	70.7
Overall fiscal balance of consolidated government 1/	-24.6	-12.7	-2.8	5.2	5.8	1.7
Public Sector Borrowing Requirement (Financing) 1/	24.6	12.7	2.8	-5.2	-5.8	-1.7
Domestic	-2.7	-2.5	1.4	-0.5	-1.9	0.0
Domestic borrowing (net)	3.6	1.7	5.9	3.8	1.6	2.3
FERF balance (increase -)	-6.3	-4.2	-4.4	-4.3	-3.4	-2.3
External	27.3	15.2	1.3	-4.7	-4.0	-1.7
Public sector net external borrowing	27.2	19.6	10.9	0.7	-1.7	-1.6
Change in external arrears (net)	0.2	-4.4	-9.5	-5.4	-2.2	-0.1

Sources: Turkmen authorities; and Fund staff estimates.

1/ Includes calculations made by the staff to estimate the public sector's borrowing requirement (PSBR).

Table 6. Turkmenistan: Balance of Payments, 1998-2003
(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003 (preliminary)				
						Q1	Q2	Q3	Q4	Year
Current account	-935	-571	412	115	583	345	-18	76	105	508
Goods	-523	-210	766	515	1,030	474	93	187	212	966
Exports, of which	614	1,164	2,508	2,623	2,862	974	759	808	927	3,468
Gas	72	389	1,244	1,501	1,643	565	399	412	510	1,887
Oil and oil products	264	365	773	699	797	269	259	269	255	1,053
Cotton	135	210	223	89	48	56	8	14	61	139
Imports	-1,137	-1,374	-1,742	-2,108	-1,832	-500	-666	-621	-715	-2,502
Consumer goods and Foods	-193	-234	-296	-358	-311	...	...	...	...	-522
Capital goods	-944	-1,140	-1,446	-1,750	-1,520	...	...	...	...	-1,980
Services	-471	-461	-342	-356	-332	-98	-107	-120	-111	-436
Exports	237	212	266	254	219	56	74	63	66	259
Imports	-708	-673	-609	-609	-551	-154	-180	-183	-177	-695
Factor income	33	-6	-177	-105	-122	-35	-17	-3	-18	-73
Credit	127	120	158	133	93	50	48	45	48	190
Debit	-94	-125	-336	-238	-216	-85	-65	-48	-65	-263
Current transfers (net)	27	105	166	61	8	4	12	12	22	50
Public	38	18	34	12	5	2	5	2	1	10
Private	-11	87	132	48	3	2	8	10	21	40
Capital and financial account	861	329	-203	-193	-509	-218	72	-115	41	-220
Capital account	20	1	12	13	11	3	3	3	3	11
Financial account	841	328	-215	-207	-521	-221	69	-118	38	-231
Net foreign direct investment	62	125	131	170	276	42	74	47	55	218
Portfolio investment	2	0	0	0	0	0	9	-9	0	0
Medium Long-term borrowing	540	758	494	166	78	27	8	31	42	109
Scheduled amortization	-238	-602	-511	-769	-613	-215	-116	-89	-181	-600
Trade credits (net)	56	-109	-257	259	-159	18	165	-67	118	233
Currency and deposits	73	-39	7	78	-74	-95	-63	-79	-71	-309
Arrears to Turkmenistan (net)	-120	-102	-406	-374	-159	-10	-12	35	11	25
Repayment of rescheduled debt	465	298	326	263	130	13	5	13	64	94
Errors and omissions	32	184	-122	-68	9	-72	40	81	-197	-148
Overall balance (-deficit)	-42	-58	88	-146	82	56	94	42	-51	140
Financing	42	58	-88	146	-82	-56	-94	-42	51	-140
Reserve assets (-)	-92	-176	-253	-247	-291	-152	-142	-29	-5	-328
Exceptional financing	134	234	166	393	208	96	48	-13	56	188
Change in arrears (net)	124	-69	-61	8	-40	0	-6	-23	-3	-31
Rescheduling of debt	10	303	226	384	248	96	54	10	59	218
Memorandum items:										
Current account as percent of GDP	-34.7	-14.8	8.4	1.7	6.5	...	...	...	...	4.6
Gross official external reserves (millions US\$)	1,379	1,555	1,808	2,055	2,346	2,497	2,639	2,668	2,673	2,673
In month of imports of goods and non-factor services	9.0	9.1	9.2	9.1	11.8	11.5	9.4	10.0	9.0	10.0
Exchange rate (Manat/US\$; end-of-period)										
Official	5,200	5,200	5,200	5,200	5,200	5,200	5,200	5,200	5,200	5,200
Curb market	12,100	15,000	21,000	21,400	21,500	18,400	20,600	22,600	22,700	22,700
External public debt (millions US\$)	1,842	2,026	2,184	1,865	1,660	...	...	...	...	1,519
In percent of GDP at official exchange rate	68.4	52.5	44.3	27.6	18.5	...	...	...	...	13.8
Debt service (millions US\$) 1/	300	392	394	499	442	138	74	82	137	431
In percent of exports of goods and non-factor services	35.3	28.5	14.2	17.4	14.3	13.4	8.9	9.4	13.8	11.6

Sources: Turkmen authorities; and Fund staff estimates.

1/ Excluding rescheduled debt.

Table 7. Turkmenistan: Balance of Payments, Medium-Term, 2003-09 (Baseline Scenario)
(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009
	Prel	Projections					
Current account	508	341	182	142	128	107	94
Goods	966	869	714	660	662	660	670
Exports, of which	3,468	3,753	3,793	3,899	4,097	4,294	4,496
Gas	1,887	2,037	2,123	2,187	2,309	2,427	2,523
Oil and oil products	1,053	1,120	1,034	1,020	1,026	1,031	1,056
Cotton	139	146	143	146	148	150	152
Imports	-2,502	-2,884	-3,079	-3,239	-3,435	-3,634	-3,826
Consumer goods and Foods	-522	-606	-652	-691	-738	-787	-835
Capital goods	-1,980	-2,278	-2,427	-2,548	-2,697	-2,848	-2,992
Services	-436	-479	-502	-519	-536	-553	-568
Exports	259	269	271	275	282	288	295
Imports	-695	-748	-773	-793	-817	-841	-863
Factor income	-73	-100	-79	-49	-48	-51	-57
Credit	190	182	236	286	291	289	288
Debit	-263	-281	-315	-335	-339	-340	-346
Current transfers (net)	50	50	50	50	50	50	50
Public	10	10	10	10	10	10	10
Private	40	40	40	40	40	40	40
Capital and financial account	-220	-91	15	20	72	95	100
Capital account	11	11	11	11	11	11	11
Financial account	-231	-102	4	9	61	84	89
Net foreign direct investment	218	225	232	238	244	249	254
Portfolio investment	0	0	0	0	0	0	0
Medium Long-term borrowing	109	109	108	105	103	100	95
Scheduled amortization	-600	-331	-252	-248	-172	-134	-131
Trade credits (net)	233	-194	-174	-176	-205	-221	-219
Currency and deposits	-309	0	0	0	0	0	0
Arrears to Turkmenistan (net)	25	0	0	0	0	0	0
Repayment of rescheduled debt	94	90	90	90	90	90	90
Errors and omissions	-148	0	0	0	0	0	0
Overall balance (-deficit)	140	250	197	162	199	202	194
Financing	-140	-250	-197	-162	-199	-202	-194
Reserve assets (-)	-328	-250	-197	-162	-199	-202	-194
Exceptional financing	188	0	0	0	0	0	0
Change in arrears (net)	-31	0	0	0	0	0	0
Rescheduling of debt	218	0	0	0	0	0	0
Memorandum items:							
Real GDP growth (percent)	16.9	7.5	7.0	6.5	6.0	5.5	5.0
GDP deflator (percent change)	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Current account as percent of GDP	4.6	2.7	1.3	0.9	0.7	0.6	0.4
Gross official external reserves (millions US\$)	2,673	2,923	3,120	3,282	3,481	3,683	3,878
In month of imports of goods and non-factor services	10.0	9.7	9.7	9.8	9.8	9.9	9.9
Exchange rate (Manat/US\$; end-of-period)							
Official	5,200	5,200	5,200	5,200	5,200	5,200	5,200
Curb market	22,700	...	...	...	...	...	...
External public debt (millions US\$)	1,519	1,297	1,074	930	787	718	684
In percent of GDP at official exchange rate	13.8	10.4	7.7	5.9	4.5	3.7	3.2
Debt service (millions US\$) 1/	431	385	326	328	243	195	186
In percent of exports of goods and non-factor services	11.6	9.6	8.0	7.9	5.6	4.2	3.9

Sources: Turkmen authorities; and Fund staff estimates.

1/ Excluding rescheduled debt.

Table 8. Turkmenistan: Balance of Payments, Medium-Term, 2003-09 (Alternative Scenario)
(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009
	Prel	Projections					
Current account	508	341	182	142	473	527	647
Goods	966	869	714	660	1,030	1,113	1,242
Exports, of which	3,468	3,753	3,793	3,899	4,673	5,146	5,593
Gas	1,887	2,037	2,123	2,187	2,939	3,317	3,657
Oil and oil products	1,053	1,120	1,034	1,020	1,026	1,031	1,056
Cotton	139	146	143	146	148	150	152
Imports	-2,502	-2,884	-3,079	-3,239	-3,643	-4,033	-4,351
Consumer goods and Foods	-522	-606	-652	-691	-766	-836	-895
Capital goods	-1,980	-2,278	-2,427	-2,548	-2,877	-3,197	-3,456
Services	-436	-479	-502	-519	-541	-571	-592
Exports	259	269	271	275	302	317	331
Imports	-695	-748	-773	-793	-843	-888	-923
Factor income	-73	-100	-79	-49	-66	-65	-53
Credit	190	182	236	286	291	289	288
Debit	-263	-281	-315	-335	-357	-374	-391
Current transfers (net)	50	50	50	50	50	50	50
Public	10	10	10	10	10	10	10
Private	40	40	40	40	40	40	40
Capital and financial account	-220	-91	15	20	95	212	163
Capital account	11	11	11	11	11	11	11
Financial account	-231	-102	4	9	84	201	152
Net foreign direct investment	218	225	232	288	292	295	294
Portfolio investment	0	0	0	0	0	0	0
Other investment							
Medium Long-term borrowing	109	109	108	105	103	100	95
Scheduled amortization	-600	-331	-252	-248	-172	-134	-131
Trade credits (net)	233	-194	-174	-226	-230	-150	-196
Currency and deposits	-309	0	0	0	0	0	0
Arrears to Turkmenistan (net)	25	0	0	0	0	0	0
Repayment of rescheduled debt	94	90	90	90	90	90	90
Errors and omissions	-148	0	0	0	0	0	0
Overall balance (-deficit)	140	250	197	162	568	739	810
Financing	-140	-250	-197	-162	-568	-739	-810
Reserve assets (-)	-328	-250	-197	-162	-568	-739	-810
Exceptional financing	188	0	0	0	0	0	0
Change in arrears (net)	-31	0	0	0	0	0	0
Rescheduling of debt	218	0	0	0	0	0	0
Memorandum items:							
Real GDP growth (percent)	16.9	7.5	7.0	6.5	10.0	8.0	6.0
GDP deflator (percent change)	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Current account as percent of GDP	4.6	2.7	1.3	0.9	2.6	2.6	2.8
Gross official external reserves (millions US\$)	2,673	2,923	3,120	3,282	3,850	4,589	5,400
In month of imports of goods and non-factor services	10.0	9.7	9.7	9.8	10.3	11.2	12.3
Exchange rate (Manat/US\$, end-of-period)							
Official	5,200	5,200	5,200	5,200	5,200	5,200	5,200
Curb market	22,700	...	...	...	...	...	...
External public debt (millions US\$)	1,519	1,297	1,074	930	787	718	684
In percent of GDP at official exchange rate	13.8	10.4	7.7	5.9	4.4	3.5	3.0
Debt service (millions US\$) 1/	431	385	326	328	243	195	186
In percent of exports of goods and non-factor services	11.6	9.6	8.0	7.9	4.9	3.6	3.1

Sources: Turkmen authorities; and Fund staff estimates.

1/ Excluding rescheduled debt.

Turkmenistan—Relations with the Fund

(As of February 29, 2004)

1. Membership status:

Date of membership: September 22, 1992

Status: Article XIV

2. General resources account:	SDR Million	Percent of Quota
Quota	75.20	100
Fund holding of currency	75.20	100
Reserve position in the Fund	0.00	0.01

3. SDR department: None

4. Outstanding purchases and loans: None

5. Latest financial arrangements: None

6. Projected payments to the Fund: None

7. Exchange rate arrangements:

The currency of Turkmenistan, the manat, was introduced on November 1, 1993 at the official exchange rate of manat 2 per U.S. dollar. Since May 1996, the official rate has been determined in weekly foreign exchange auctions, which are, however, controlled by the CBT. The official rate, which gradually depreciated earlier, was held constant at manat 4,165 per U.S. dollar after May 1997, about 25 percent below the average exchange rate of commercial banks. On April 17, 1998, the official exchange rate was depreciated to manat 5,200 per U.S. dollar and unified with the commercial banks' exchange rate. On December 3, 1998, the commercial bank market was closed, leaving the heavily controlled foreign exchange auctions as the only official market for foreign exchange.

Although Turkmenistan avails itself of the transitional arrangements under Article XIV, it is known to maintain a number of exchange restrictions and multiple currency practices subject to approval by the Fund under Article VIII, Sections 2(a) or 3, including as follows: (i) the screening and limiting by the CBT and the Foreign Exchange Committee of applications for foreign exchange provided through the weekly CBT auction with respect to certain categories of current international transactions conducted by resident legal entities; (ii) the screening by the CBT of applications for foreign exchange by individuals with respect to medical, educational, and travel expenses; (iii) restricting the right to purchase foreign exchange for certain current international transactions; (iv) the requirement that foreign exchange sales to specialized stores of consumer goods and foods shall be subject to the condition that the commercial mark-ups over the contract price of goods will not exceed 30 percent; and (v) multiple currency practices, arising from the 50 percent foreign exchange tax

on gas exports and 30 percent on oil and petroleum-product exports, the proceeds of which are earmarked for the Foreign Exchange Reserve Fund (FERF).

8. Article IV consultation:

Turkmenistan is on a 12-month consultation cycle.

The last Article IV consultation with Turkmenistan was concluded on November 1, 1999.

9. IMF missions, staff visits, and technical assistance:

The following list summarizes technical and policy assistance provided by the Fund to Turkmenistan since December 1991.

EU2—Acquaintance mission	December 1991
EU2—Pre-membership economic review	February–March 1992
FAD—Public finance management and reform	March–April 1992
MAE—Modernization of banking operations	June 1992
INS—Seminar on macroeconomic and financial policies	July 1992
FAD—Budgetary procedures	November–December, 1992
MAE—CBT and financial system development	December 1992
EU2—Staff visit	March 1993
MAE—CBT development	May 1993
STA—Money and banking	May 1993
EU2—Staff visit	June 1993
STA—Multi topic	July 1993
FAD—Budget, treasury, and public expenditure	July 1993
EU2—Article IV consultation discussions	July–August 1993
INS—Financial programming seminar	September 1993
EU2—Program discussions	September 1993
MAE—Introduction of currency and CBT development	October 1993
EU2—Article IV and program discussions	October 1993
Managing Director's Visit	December 20–22, 1993
STA—Balance of payments statistics	January 1994
FAD—Establishment of a Treasury	January 1994
MAE—Resident Advisor acquaintance visit	January 1994
STA—Money and banking statistics	January–February 1994
EU2—Staff visit	February 1994
STA—Consumer prices	March 1994
MAE—Modernization of the Central Bank	May–June 1994
EU2—Staff visit	June 1994
STA—Consumer prices	September 1994
STA—Government finance statistics	September 1994
STA—Balance of payments statistics	November 1994
STA—Money and banking statistics	November 1994

EU2—Article IV consultation discussions	November 1994
FAD—Tax administration	January 1995
STA—National income accounts	February 1995
EU2—Staff visit	June 1995
FAD—Social safety net	September 1995
MAE—Monetary and exchange reforms	September 1995
EU2—Article IV consultation discussions	November 1995
STA—Money and banking statistics	November 1995
FAD—Inspection visit Treasury Advisor	December 1995
EU2—Staff visit	May 1996
FAD—Social Safety Net	May 1996
MAE—Foreign exchange and credit auctions	May 1996
EU2—Article IV consultation discussions	November 1996
FAD—Inspection visit Treasury Advisor	December 1996
MAE—Visit by Research Expert	December 1996
EU2—Article IV consultation discussions	February 1997
EU2—Staff visit	June 1997
FAD—Fiscal management	September 1997
EU2—Staff visit	September 1997
MAE—Multi-topic	October 1997
EU2—Visit Department Director	January 1998
EU2—Article IV consultation discussions	February 1998
STA—National accounts	March 1998
STA—Balance of Payments Statistics	November 1998
EU2—Staff Visit	November 1998
EU2—Staff Visit	March 1999
STA—National Accounts	April 1999
MAE—Multi-topic	April 1999
STA—Money and Banking Statistics	November 1999
STA—National Accounts	April 2000
EU2—Staff Visit	January 2002
EU2—Staff Visit	September 2003
MCD—Article IV consultation discussions	March 2004

10. Resident Representative:

Mr. Jon Craig succeeded Mr. Michael Blackwell as the Fund's third Resident Representative in October 1997, and he completed his assignment in September 1999. Currently there is no Resident Representative but the Fund maintains a locally-staffed office in Ashgabat.

11. Resident Advisors:

Mr. Sharma completed his three-year assignment as Resident Advisor at the Ministry of Economy and Finance in February 1997 and Mr. Robinson completed his one year assignment as Resident Advisor at the Ministry of Economy and Finance in June 1999. Mr. Brown succeeded Mr. Akrami (after a two-year assignment) as Resident Advisor to the Central Bank of Turkmenistan in January 1996, while Mr. Franson took up his assignment as Banking Supervision Advisor to the Central Bank of Turkmenistan in August 1998. Mr. Hafiz (who was stationed in Bishkek) completed a one-year assignment as Regional Advisor on Balance of Payments Statistics in July 1997.

Turkmenistan—Relations With the World Bank Group²⁶

1. Turkmenistan signed the Articles of Agreement of the World Bank Group on September 22, 1992. It became member of MIGA in October 1993 and of the IFC in mid-1997. The Bank finalized the first Country Economic Memorandum in May 1994. The Bank also prepared an Energy Sector Review (FY94), a Health Sector Review (FY95), an Agrarian Sector Review (FY96), special needs assessments in rural water supply and sanitation and urban transport (FY97), a regional development study for the poorest region of the country (Daskhovuz)(FY98), a report on Improving the Management of Public Expenditures (FY99), and a Living Standards Assessment (FY01). The Bank has also provided substantive assistance and advice on privatization issues.
2. The first Country Assistance Strategy (CAS) for Turkmenistan was presented to the Board on May 27, 1997. In 1996, the Bank established a Liaison Office in Ashgabat to enhance communications with the government and to provide operational support. An Institution Building/Technical Assistance Loan (IBTA) in the amount of US\$25 million was approved on September 15, 1994 and became effective in July 1995. This loan was restructured in FY02 to focus on modernization of the Treasury, Tax and Social Assistance functions. It closed on December 31, 2003.
3. An Urban Transport Project (US\$34 million) and a Water Supply and Sanitation project (US\$30 million) were approved by the Board on May 27, 1997. The Urban Transport Project closed in January 2001 and the Water Supply Project closed in January 2003. As a consequence, the Bank does not currently have any loans under supervision in Turkmenistan.
4. The Bank has also approved three Institutional Development Fund (IDF) Grants for Public Procurement Reform (US\$160,000, signed in FY97), External Debt Management (US\$324,000, signed in FY99), and the Introduction of International Accounting Principles (\$237,900 signed in FY01). All three have closed.
5. The second Country Assistance Strategy (CAS) for Turkmenistan was presented to the Board in January, 2001. It indicated a number of basic conditions for new lending including: (i) resolution of the negative pledge clause violation; (ii) improvement in the performance of ongoing projects; and (iii) progress on key budget and debt management areas, including debt reporting and reform of the Foreign Exchange Reserve Fund (FERF). To date, these conditions have not been fulfilled and no new lending is envisaged in the near term.

²⁶Information provided by World Bank staff.

Turkmenistan: Relations with the EBRD²⁷

1. Turkmenistan became a member of the European Bank for Reconstruction and Development (EBRD) in 1992. The strategy approved by the Board on July 10, 2002 notes the limited progress made in Turkmenistan in enhancing multi-party democracy, pluralism, and market economics. As a result, until such time political and economic reforms are accelerated, the approved strategy requires limiting the EBRD's role to supporting a few private sector investments (baseline scenario).
2. EBRD operations in Turkmenistan started in 1994, since then the Bank was involved in 7 projects for a total commitment of Euro 134 million. As of March 2004, the Bank's total portfolio in Turkmenistan is Euro 97.9 million. Projects include the Gap Turkmen textile plant (Euro 37.7 million); the Dragon Oil Project (Euro 59.5 million); a credit line for small and medium sized enterprises (Euro 11.9 million); the Turkmenbashi Port development (Euro 23.8 million); and, a wool scouring facility (Euro 0.6 million). As of March 9, 2004 gross cumulative disbursements amounted to Euro 67.8 million.
3. In recent years the Bank has focused on private sector projects. In 2003, the Bank committed to a new wool scouring facility; it re-activated the credit line for small and medium sized enterprises; and, signed an agreement with the Vnesheconombank and a subsidiary of the National Bank of Pakistan as participatory banks in the Trade Facilitation Program.
4. A new two-year strategy will be considered by the Executive Board in mid-2004.

²⁷ Information provided by EBRD staff.

Turkmenistan—Statistical Issues

After a gap of more than three years, the authorities have provided the staff with the necessary data to conduct the Article IV consultation. While this is a welcome development, the quality and timeliness of macroeconomic data remain a major concern. The authorities would also need to continue providing updated data and information on a regular and timely basis.

Turkmenistan does not have a page in *International Financial Statistics (IFS)*.

The authorities have indicated to the staff that they are ready to reconsider introducing a page in *IFS*. The staff will re-submit to the authorities the proposed format for an *IFS* page for Turkmenistan showing the currently available range of statistics to be published, the data reporting format and instructions, and a request to nominate an *IFS* correspondent.

National accounts

5. GDP estimates are produced by the National Institute for Statistics and Information (NISI). Despite efforts in recent years to extend GDP coverage to the informal sector, the robustness and reliability of GDP estimates remain questionable. The mission's analysis of sectoral and the informal sector's contribution to growth reveals a number of inconsistencies that may have led to a significant overestimation of GDP growth, particularly for the period 2001–2003. Among the major weaknesses of national account statistics are: (a) the lack of detailed sectoral GDP accounts; (b) the unsatisfactory compilation of the financial transactions of the State Funds and self-financed ministries; and (c) the use of the overvalued official exchange rate (which is currently more than four times higher than the curb rate) to estimate the value-added of exports of goods and services. The most recent STA mission on national accounts dates back to April 2000.

6. The mission has constructed alternative real GDP estimates for 2001–2003 which adjust for some of the inconsistencies indicated above (Box 1).

Price indices

7. Consumer price inflation is measured by a chain-linked Laspeyres-type index. Data for the breakdown by major categories has been provided to the staff through December 2003. However, the staff has little information on the status of the other price statistics (e.g., producer prices, and import and export indices). There has not been a price statistics mission in recent years.

Government finance

8. The official budget continues to show expenditures by function and not on the basis of an economic classification. However, the staff has received expenditures based on economic classification through 2003. The budget covers the central government (state

budget) and includes aggregate data on the activities of the State Funds and self-financing ministries. However, only the state budget, which represents about 20–25 percent of government operations, is under the control of the treasury system and is subject to approval by the Ministry of Economy and Finance. With regard to the execution of the budget, the only information available is that related to the state budget. There has been no STA mission on government financial statistics in recent years.

Monetary accounts

9. Compilation of monetary accounts is based on a system originally developed with STA technical assistance and updated by EU2 missions to reflect changes in the banks' chart of accounts since its introduction in 1999. For the 2004 Article IV Consultation, the staff has received balance sheet information of the CBT and the commercial banks through December 2003 on a quarterly basis. While the data provided are adequate for the 2004 Article IV consultation, more detailed balance sheet information on a monthly basis would be needed. The most recent STA mission in money and banking statistics dates back to November 1999, and some technical advice was provided during the February 2002 EU2 visit. However, the authorities are likely to need further technical assistance from STA.

Balance of payments

10. Turkmenistan's balance of payments statistics are produced on a quarterly basis by the CBT, according to the methodology of the IMF's *Balance of Payments Manual*, 5th edition. Balance of payments data compilation has made good progress in recent years; in particular, the compilation of direct investment capital and income, and external debt statistics have been improved. The mission collected detailed BOP statistics, including external debt data, through December 2003. However, the most recent balance payments statistics reported to STA for publication dates back to the second quarter of 1998.

Turkmenistan: Core Statistical Indicators 1/
(As of April 30, 2004)

	Exchange Rates	External Public Debt/ Service	Inter-National Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Export/ Imports 3/	Current Account Balance	Overall Government Balance	GDP
Date of Latest Observation	Mar. 2004	Dec. 2003	Dec. 2003	Dec. 2003	Dec. 2003	Dec. 2003	Jan. 2004	Mar. 2004	Dec. 2003	Dec. 2003	Dec. 2003	2003
Date received	na	Mar. 2004	Mar. 2004	Mar. 2004	Mar. 2004	Mar. 2004	Mar. 2004	April 2004	Mar. 2004	Mar. 2004	Mar. 2004	March 2004
Frequency of Data	D	Q/M	M	M	M	M	M	M	Q	Q	M	-
Frequency of Reporting	W	Q	Q	Q	Q	Q	Q	M	Q	Q	Q	-
Source of Updating	A	A	A	A	A	A	A	B	A	A	C	B
Mode of Reporting	LO	LO/M	LO/M	LO/M	LO/M	LO/M	LO/M	LO/M	LO/M	LO/M	LO/M	LO
Confidential	-	-	-	-	-	-	-	-	-	-	-	-
Frequency of Publication	M	-	-	-	-	-	M	M	M	-	-	M

1/ While staff now have the data as indicated in the above matrix continued provisioning of data is necessary.

Explanation of abbreviations:

Frequency of data, reporting and publication: D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, OR-on request, CH-when changed, IR= Irregular.

Source of Updating: A-Central Bank of Turkmenistan, B- (NIS) Turkmenstatprognos, C-Ministry of Economy and Finance.

Mode of reporting: LO-by fax and e-mail through Liaison Office, M-Obtained during Missions.

Confidentiality: CON-confidential.

Turkmenistan: Debt Sustainability Analysis

The Debt Sustainability Analysis (DSA) shows that Turkmenistan's debt dynamics look favorable over the medium term.²⁸ The baseline scenario, which assumes a modest increase in gas exports due to limited pipeline capacity, demonstrates that the debt to GDP ratio is expected to decline from 10 percent in 2004 to 3 percent in 2009. The projections under the baseline scenario are more encouraging than they appear because the declining debt-to-GDP ratio is accompanied by a significant increases in foreign asset. The alternative scenario for the DSA under the assumption that all key variables are at their respective historical averages throughout the projection period shows that the debt to GDP ratio would decline even faster than that of the baseline. The baseline scenario looks less optimistic than the alternative mainly because of more realistic assumptions on real GDP and export growths. The only shock that would potentially alter the debt dynamics is of the current account. The results of the stress test shows that current account deficits of 15 percent of GDP for two years in a row (2005 and 2006) would increase the debt to GDP ratio to 39 percent in 2006 before declining to 33 percent in 2009. However, this dramatic turn-around is unlikely because large gas exports to Ukraine are expected to continue until 2006, while a larger and longer-term gas export contract with Russia has already been negotiated.

²⁸ The debt sustainability analysis is conducted based on 1998-2003 debt data provided by the authorities during the mission.

1/ Derived as $[-(g - g) + (-1+r)]/(1+g - g)$ times previous period debt stock, with r = nominal effective interest rate on external debt; g = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-(g - g) + (-1+r)]/(1+g - g)$ times previous period debt stock.
3/ For projection, include the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ The implied change in other key variables under this scenario is discussed in the text.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.



INTERNATIONAL MONETARY FUND

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International Monetary Fund
700 19th Street, NW
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IMF Concludes Article IV Consultation with Turkmenistan

On June [4], 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Turkmenistan.²⁹

Background

Since the last Article IV consultation in 1999, Turkmenistan has recovered from the severe external shocks it experienced in 1997–98. This recovery was driven by significantly increased receipts from gas and oil exports since 1999. As a result, the external current account has registered sizable surpluses in recent years allowing the authorities to build up international reserves and repay a large portion of the external debt. On the domestic side, output growth has been impressive and inflation has declined markedly. However, the tight demand management policies of 2001–02 were loosened in 2003 which could threaten macroeconomic stability unless quickly reversed.

Monetary aggregates grew sharply until 2000, but the consequent build-up of inflationary pressures and a widening of the gap between the official and parallel exchange rates led the authorities to tighten monetary policy in subsequent years. Monetary expansion in the earlier years was mostly carried out in the form of large directed credits to banks for on-lending to state enterprises; such lending has been significantly curtailed in recent years. However, in 2003, the government's borrowing from the central bank increased, resulting in renewed monetary expansion. The tight monetary environment during 2001 and 2002 helped the curb market exchange rate to stabilize. However, reflecting the loose monetary policy in the second half of 2003, the curb market exchange rate depreciated by 24 percent in the year to end-March 2004.

²⁹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June [4], 2004 Executive Board discussion based on the staff report.

On the fiscal side, the State budget deficit of about 2½ percent of GDP in 1998 was progressively reduced until 2002. However, the fiscal tightening was reversed in 2003 when the large wage and pension increases awarded early in the year resulted in a deficit of almost 1½ percent of GDP. The state budget, however, excludes the operations of the state funds and the self-financing ministries, which constitute some 75–80 percent of central government operations. Because of the lack of data on extra-budgetary operations, the staff has developed a methodology to assess the Public Sector Borrowing Requirement (PSBR), using official monetary and balance of payment data to estimate the PSBR from below the line. Based on staff estimates, the PSBR has declined progressively from 25 percent of GDP in 1998 to a surplus of about 6 percent of GDP by 2002. However, in line with expansionary fiscal developments, the PSBR surplus narrowed to about 2 percent of GDP in 2003.

There has been a significant improvement in the balance of payments since 1998, according to the official data. The current account deficit in 1998, which reached US\$935 million (35 percent of GDP), turned into surpluses in recent years. This turnaround reflects the resumption of gas exports to Ukraine and Russia beginning in 1999. Receipts from gas exports have increased progressively over the years, reaching US\$1.9 billion by 2003. Similarly, exports of oil and oil products have increased four-fold to about US\$1 billion. The current account deficits of the earlier years were largely financed with public sector medium- and long-term borrowing with government guarantees and an increase in external arrears. Since 1998, medium- and long-term borrowing has declined sharply, amortization payments have increased significantly, and substantial amounts of external arrears have been either reduced or rescheduled. Gross international reserves reached US\$2.7 billion by end 2003 (about 10 months of imports of goods and non-factor services), up by more than US\$1 billion from 5 years ago.

New data on external debt, both outstanding and overdue, show a significant reduction since 1998. Total outstanding external debt fell from 68 percent of GDP (with GDP valued at the official exchange rate) in 1998 to about 14 percent of GDP by end-2003. Similarly, debt service as a ratio of exports of goods and non-factor services has been reduced from 35 percent in 1998 to less than 12 percent in 2003. Turkmenistan's claims on other CIS countries on account of unpaid gas deliveries amounted to US\$1.2 billion at end-2003.

Despite the improved economic environment, Turkmenistan's foreign exchange and trade regimes remain closed and extensive restrictions exist on both current and capital account transactions. Similarly, there have been only marginal measures taken in the area of structural reform since the last Article IV consultation. While the government recognizes the need to introduce market-oriented reforms, a gradual pace of reform is envisaged in the national strategy with the state continuing to play a dominant role in the Turkmen economy.

Executive Board Assessment

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Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.