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**TURKMENISTAN:
FROM COMMUNISM TO NATIONALISM
BY GRADUAL ECONOMIC REFORM**

By

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FROM COMMUNISM TO NATIONALISM BY GRADUAL ECONOMIC REFORM

Among all the former centrally planned economies, Turkmenistan is regularly ranked last by transition indicators measuring speed of reform or degree of economic liberalization. As far as the local leadership was concerned, however, the primary goal was not economic liberalism but economic independence, and by this criterion the transition (from Communism to Nationalism) was smooth and rapid. Nationhood was embodied in the leader, Saparmurat Niyazov, who, after the metamorphosis from First Secretary of the Turkmen Soviet Republic to President of Turkmenistan, assumed the name “Turkmenbashi” - leader of the Turkmen.

This paper analyses the evolution of the economic system and Turkmenistan’s economic development since independence in 1991, but that can only be understood in the context of the primary foreign policy goal of positive neutrality and of the domestic political reality of an omnipotent leader. From the start, Turkmenistan viewed the Commonwealth of Independent States as a consultative grouping and nothing more.¹ It has remained outside all projected regional trade arrangements within the former USSR, and the only regional trade grouping of which it is a member is the Economic Cooperation Organization, which has been economically ineffectual, but the relations with Iran, Turkey and Pakistan provide a counterweight to Russia’s still powerful influence. Turkmenistan and war-torn Tajikistan are the only Soviet successor states not to have even initiated negotiations with the World Trade Organization and, although it is a member of the International Monetary Fund and World Bank, actual operations of these institutions have been minimal in Turkmenistan.² Turkmenistan has a positive attitude to the United Nations, which imposes no constraints on domestic policy-making and is viewed as the guarantor of the country’s neutrality.³

The political system is characterised by a strong presidency, with centralised decision-making and supported by a pervasive personality cult and security services. The President, who is also Prime Minister and chairs the only political party, controls selection to the “Khalk

¹ Turkmenistan refuses even to supply statistical data to CIS agencies. It has carefully avoided siding with the Eurasian Union or the GUUAM group which each contain five of the twelve non-Baltic Soviet successor states. In 1999 Turkmenistan withdrew from the CIS visa-free zone. President Niyazov declined to attend the 2000 CIS summit.

² Turkmenistan has not sought financial support from the IMF, but maintains a dialogue through Article IV consultations. The IMF and World Bank have provided technical assistance. World Bank loans approved between 1994 and 1997 were frozen between 1997 and 1999 due to misprocurement, and in 2000 new loans were frozen until specific transparency and collateral issues were resolved. A November 2000 IMF mission was denied access to information needed for an Article IV consultation.

³ The UN General Assembly formally recognized Turkmenistan’s neutrality in a resolution of 12 December 1995 (Freitag-Wirringhaus, 1998).

Maslakhty” (People’s Council), which has sole power to alter the Constitution and which in December 1999 unanimously extended the President’s term of office without limit. The legislature (“Majlis”) and judiciary, as well as specialised bodies, including the Central Bank, are subordinate to the President’s authority, and major decisions at all levels of government have to be cleared by the President’s office. Although the President has declared his support for eventual transition to democracy and a multi-party system, for the immediate future political stability is considered an essential precondition for economic growth.

Social security ranks highly among the government’s professed goals. The universal benefits from the Soviet era such as pensions at 57 for women and 62 for men have been supplemented by free provision of gas, electricity, water and salt for residential use. The drive to self-sufficiency in food is partly justified in terms of securing food quality for all. The social programs, as well as the import substituting industrialisation projects and public investment which drive economic growth, are essentially funded out of revenues from the major exports, natural gas and oil and cotton.

At independence Turkmenistan was estimated to benefit by a 50% improvement in its terms of trade after switching from Soviet to world prices (Tarr, 1994). Buoyed by the anticipated windfall gain from the natural resource exports, Turkmenistan embarked on an economic program reminiscent of that adopted by many new independent states of the 1950s and 1960s. Distorted prices and the lack of publicly available detailed data impede precise analysis, but the symptoms of misallocated resources, artificial exchange rate and financial repression are clearly evident and were associated with a disappointing economic growth performance during the 1990s and increasing concerns about the sustainability of the economic system in the 2000s.

1. Initial Conditions and Economic Strategy

At independence Turkmenistan was one of the smaller and poorer Soviet republics, with an economy dominated by cotton and energy (Pomfret 1999a). The Karakum Canal, begun in 1954, allowed an increase in the total sown area from 368,000 hectares in 1950 to over 1.3 million hectares in 1990, when over half of the arable land was devoted to cotton. In the 1980s, agriculture’s share of GDP fell as natural gas came to dominate the economy; proven recoverable natural gas reserves are the fourth largest in the world. Turkmenistan is also an oil producer, although output was declining in the years before independence. In the early 1990s, Turkmenistan’s newly nationalistic leadership blamed the USSR for not having

invested in oil and for creating the cotton monoculture. The industrial sector was very small, apart from two oil refineries and the cotton gins. The transport and pipeline network was adequate for connecting Turkmenistan to other parts of the USSR, but did not provide links to other countries nor was there a dense internal network.

In 1992-3 Turkmenistan moved cautiously through the early stages of nation building and replacing the planned economy. Turkmenistan, still using the ruble, had to follow Russia's January 1992 price liberalization, but many price controls were retained and the President decided very early on that gas, electricity and water should be free to households. Housing was not privatized, and housing costs were kept low. The national currency, the manat, was introduced in November 1993, apparently as a planned step towards economic independence rather than as a first step in establishing monetary control (Table 1). Annual inflation remained around 1000% in 1995 and 1996, when it was falling in other transition economies. The currency depreciated rapidly.

The first stage of privatization was completed in 1994-6 when 1698 enterprises were privatized, 27% by auction and 73% by sale to employees. After some attempts to convert former all-Union enterprises into joint stock companies, the second stage of larger scale privatization was put on hold. By November 2000 a total of 2053, overwhelmingly small, entities had been privatized of which 1942 were in consumer services and retail trade. Although the liberalization has been gradual, retail trade, cafes and so forth now operate in a market-setting with unregulated prices, although not a single one of the privatized enterprises has gone bankrupt.

The ongoing inflation mattered little, because outside the petty trading of the bazaar relative prices did not determine resource allocation. The state retained control over the gas and oil sectors. Foreign firms were brought in for their expertise, but in production-sharing arrangements which left the state in control. The two main crops, cotton and wheat, remain subject to state orders at prices well below world prices, which provides substantial earnings to the government from cotton exports (Pastor and van Rooden, 2000). Key inputs such as water and fertilizer are subsidized, but because access to them is tied to fulfilment of state orders, farmers are constrained in their choice of output mix. During the 1990s the state pushed for self-sufficiency in wheat, which appears to have been achieved, although yields in both major crops are low.

Public finances in Turkmenistan are extremely non-transparent, with a large proportion not recorded in the state budget but passing through a number of funds, some of which are directly controlled by the President. Nevertheless, the ultimate sources of state

revenue are the rents from gas, oil, and cotton exports. These have been spent on social security, including the water and other subsidies, and on public investment projects. Among the initial projects were a new presidential palace and capital city airport. Starting in 1995 the government financed development of a modern textile industry processing domestic cotton and silk.

Tracking Turkmenistan's output performance is complicated by poor data, but again the general pattern is clear. According to IMF figures, real GDP dropped steadily during the first half of the 1990s and in 1996 stood at 58.4% of its 1991 level, and then real GDP fell by a quarter in 1997 (Table 2).⁴ The big decline in 1997 reflected falling cotton prices and a poor cotton harvest, with cotton export earnings down to \$84 million from \$791 million in 1995 and \$332 million in 1996, and the cessation of gas exports in March 1997, which left annual export earnings from gas at \$70 million, compared to around a billion dollars in the two previous years (and \$1454 million in 1994).

The problems with gas exports arise from the inherited pipeline network, which only led to Soviet markets. After independence, Turkmenistan remained dependent on these markets even though several countries fell behind in payments. Turkmenistan's export data record the contract value of gas exports, whether paid for or not, while arrears enter into the balance of payments as increased foreign assets. In March 1997 Turkmenistan cut off gas supplies to its main debtor, Ukraine. After protracted negotiations with Russia and other gas importers over debt rescheduling and future payment arrangements, large-scale gas exports were only resumed in January 1999 (Sagers, 1999).

A solution to Turkmenistan's problems with gas and oil exports must include construction of new pipelines to reduce dependence on the Russian network and the destinations to which this leads. The problem, however, lies in organising pipeline construction to new markets. A small gas pipeline to Iran became operational in December 1997,⁵ but more substantial projects through Iran are stymied by the non-participation of US companies. Negotiations in 1997 with Unocal of California to construct a pipeline through Afghanistan to the energy markets of South Asia collapsed, but this route is still on Turkmenistan's agenda, assuming the Taliban government became a more acceptable counterpart for the major energy companies and their governments. The longer route through

⁴ Several international agencies stopped publishing GDP estimates in the mid-1990s. The European Bank for Reconstruction and Development reported a 26% decline in Turkmenistan's real GDP in *Transition Report 1999* (p.277), but six months later in the May 2000 *Transition Update* (p.83) the decline was revised to 11.3%.

⁵ The 200 kilometre long Korpedeke-Kurt-Kui gas pipeline, built by an Iranian company, has a projected annual capacity of eight billion cubic metres, although it only carried five billion in 1999 (*Times of Central Asia*, 28 November 2000)

Azerbaijan to the Turkish port of Ceyhan is currently considered the most likely, but it is geographically difficult and runs through unstable areas so that despite western governments' political preference it is economically questionable. Construction has yet to begin on any of these projects.

The economic crisis in spring 1997 fostered recognition that Turkmenistan's initial economic strategy was not sustainable. The thousand days economic program announced in April 1997 acknowledged the need for policy reform, even though subsequent performance fell far short of the targeted 60% increase in GDP by 2000. A more fully worked out strategy was published in December 1999 as the President's program for the socio-economic development of Turkmenistan up to 2010.

2. The Development Strategy, 1995-2000

During the second half of the 1990s Turkmenistan pursued a statist development strategy in which growth was led by construction of infrastructure and monuments and by import-substituting industrialization. The process was directed and implemented by the government, with the private sector playing a passive role, more or less restricted to contract work by foreign firms. The financial sector remained heavily repressed, doing little more than allocate government-directed credits. Export earnings were subject to surrender requirements and foreign exchange controls were universal and restrictive after December 1998, when the official exchange rate started to become increasingly artificial.

The agricultural sector has absorbed most of the increase in the rapidly growing labour force, and by the late 1980s employed about half of the economically active population. Turkmenistan appeared to take the lead in Central Asia in reforming land tenure with the 1997 decree on land privatization. The state and collective farms were divided into individual plots, leased out to farmers who could obtain ownership rights subject to satisfactory output performance. In practice, however, farmers remain subject to severe restrictions because to obtain a lease they need to enter into a contract to fulfil specified state orders. Government control over essential inputs, notably water and fertilizer, locks farmers into such arrangements, which are administered by the single bank dealing with farmers (the Dayhan Bank).

Low state prices for the major crops, even allowing for subsidized inputs, provide little incentive for farmers. The limited information on rural living standards, and casual observation, suggest that rural households are significantly poorer than urban households and

that public services, such as water supply, have been declining more in rural areas. There appears to be little incentive for farmers to experiment with new methods to increase yields and they are discouraged from shifting their output mix beyond cotton or wheat. The agricultural stagnation augurs poorly for the first decade of the twenty-first century, during which population is expected to increase from 5.3 to 8.6 million. Agriculture is expected to absorb much of the increased labour force, maintain food self-sufficiency and double raw cotton production.

The development strategy in 1995-9 centred on maintaining a high investment to GDP ratio: 34% in 1995, and 45%, 49%, 51% and 49% over the remaining years in the decade. The investment has been directed to three types of projects: unproductive, infrastructure, and industrial.

The most striking construction works are in the national capital, with its grand statues and new public buildings. These are financed off-budget through funds whose details are not publicly available. Some of these projects were intended to be productive, such as the row of theme hotels south of the capital constructed in the mid-1990s for a flood of business people and tourists who never came.

The government has tried to diversify external transport links and improve the domestic network. The national airport and pipeline to Iran have already been mentioned. In May 1996 a rail link was completed, the first line south from former Soviet Central Asia. In the late 1990s the government embarked on an ambitious road building program, connecting all the nation's major towns by divided highways and, in the case of the recently begun north-south highway from Dashoguz to Ashgabat, accompanied by a parallel rail link. Another rail project will connect Kerkishi directly to Turkmenistan's rail network rather than via Uzbekistan. The Caspian Sea port of Turkmenbashi (formerly Krasnovodsk) has been upgraded. All of these projects yield social benefits, but the railway to Iran, the Ashgabat airport and the new roads are all operating far below capacity.

The industrial investments have focused on a \$1.5 billion upgrade of the Turkmenbashi oil refinery and development of petrochemicals there, and the creation of a cotton textile industry. Petrochemicals and capital-intensive textiles do not fit well with the comparative advantage of a country in which average rural incomes in 1998 were around \$200 per year.⁶ Between 1995 and 2000 the share of cotton processed domestically rose from 3%

⁶ Based on the 1998 household survey conducted under World Bank auspices, in which the average rural household of six had an annual income of \$1200. The government's own figures report a nominal monthly wage of 330,700 manat in 1999, which is \$63 at the official exchange rate and between a third and a quarter of that at the curb rate.

to 35%. The mills are typically joint ventures with Turkish partners, using Italian equipment. Their operations are not transparent but the state appears to have financed most of the equipment purchased and provides cotton at below world prices; yet, despite generous treatment of depreciation, the mills are not making high profits. As well as displacing imports, the textile industry is supposed to generate exports, but in 1999 these amounted to \$21 million, mostly to Turkey, Russia and Iran, and less than half of the export earnings that could be generated by exporting a third of the cotton crop as fibre. The government's response to these problems was to use export credits from Japan and an EBRD loan to fund what is claimed to be the world's largest textile complex, the Turkmenbashi Jeans Factory, which is equipped with state of the art equipment.

Regardless of the social desirability of individual projects, the degree of centralization and lack of tendering suggest that resources may be extravagantly used. Much construction is based on simple cash contracts negotiated with a single firm. Some projects have been financed by directly assigning part of the cotton crop to a foreign contractor. Some large contractors have undertaken social projects without payment, in return for being granted a large construction deal or other privilege.⁷ In a non-transparent society much of the evidence is hearsay, but the projects are real and the payments are large. Most grandiose of all is the construction of a large lake in the Karakum Desert during the first half-decade of the 2000s as a drainage-cum-irrigation project, despite its huge cost and almost universal condemnation by external observers as unable to achieve the stated impact on agricultural output and as being an environmental disaster.

Table 3 provides the official statistics on the composition of investment. The large unaccounted for component is presumably the prestige and other unproductive projects. Of the remainder the capital-intensive oil and gas sector dominates. Another striking feature is the small and declining share (from 15% in 1994 to 2% in 1999) of the agricultural sector, where half the population works.

3. Outcomes

The first decade of Turkmenistan's existence saw the country sustain its political and economic independence, and the President consolidate his personal position. Economic independence is incomplete; the country still depends on the Russian-controlled pipeline

⁷ Wehner (2001, 128) describes the \$40 million heart clinic and \$27million kidney clinic built by Siemens primarily for the President's own use. Siemens had earlier arranged the President's heart bypass operation in Munich in 1997.

system for much of its gas exports, and oil and cotton exports are subject to large fluctuations in world prices. Self-sufficiency in grain and textiles has involved, possibly substantial, resource costs.

The living standards and social well-being of the population are harder to assess. As in other Soviet successor states real per capita GDP was lower at the end of the 1990s than at the beginning. In the comparative estimates of poverty rates by Milanovic (1998), Turkmenistan experienced a substantial increase in poverty after the dissolution of the USSR, but was not an extreme. Both of these results are based on dubious data. The World Bank's poverty assessment based on the 1998 LSMS survey is more cautious, concluding that poverty was not as serious in Turkmenistan as elsewhere in Central Asia, but a large segment of the population is living not much above the poverty line.⁸

The free provision of gas, water, electricity and salt to households, plus public housing at low cost, and other subsidized basic goods and services have undoubtedly protected poorer members of society. Such untargeted social assistance is, however, costly and may be regressive; richer households have more electric appliances and are most likely to have indoor toilets, benefiting more than poor households from free electricity and water.

4. Sustainability

The President views the economic achievements of the 1990s as a springboard for greater progress by 2010. The Economic Program released in December 1999 provided a detailed and ambitious agenda for the years up to 2010. Growth in GDP will be 18% per annum over the decade, led by a 330% increase in gas exports, a 270% increase in oil exports and a doubling of cotton exports. Real GDP per capita is projected to be three and a half times its 2000 level by 2010.

How sustainable is Turkmenistan's economic progress? The biggest warning sign is the external debt situation which deteriorated in 1997-8, after which data ceased to be available.⁹ As of September 2000 Turkmenistan had external assets of \$1.3 billion in arrears owed by Ukraine, Georgia, Armenia, Azerbaijan, Iran, Kazakhstan, Uzbekistan and Itera (a Russian-owned US-registered gas distribution company), which the government was trying to

⁸ The LSMS data are not in the public domain so independent assessment of the result is not possible, and comments on the survey's findings are based on reports in World Bank and IMF publications.

⁹ Even when data were released there is doubt about its comprehensiveness, because ministries or other agencies contracted foreign debts without central coordination.

sell at a discount rather than waiting for eventual settlement.¹⁰ External debt is generally assumed to exceed the nominal value of assets. The seriousness of the problem in 2000 was reflected in failure for the first time to meet payment deadlines on construction projects and other expenditures.

A second, more opaque, danger signal is the end of a surplus in the state budget in 2000, and a projected deficit in 2001 equal to 3.5% of GDP. This measure is opaque because a large part of state transactions are through off-budget funds whose contents are secret. Clearly in most years the consolidated state budget required some financing by money creation, because the inflation rate has been substantial. Inflationary pressures are inadequately reflected in the official consumer price index figures. A better guide is the value of the currency in foreign exchange markets, where it started at two manats to the dollar in November 1993 and was trading at around 20,000 per dollar seven years later.

The foreign exchange regime is a deeper symptom of economic problems. The depreciation of the manat in the mid-1990s reflected the hyperinflation, but by 1997-8 the worst was over and, when the currency was pegged at 5200 per dollar in April 1998, this was close to the market rate. Since then, however, the government has maintained the official rate despite strong excess demand for foreign currency. In December 1998, surrender rates for foreign currency earnings were raised and access to foreign currency at the official exchange rate tightly controlled. The parallel exchange rate fell precipitously to over three times the official rate by mid 1999 and to four times the official rate by late 2000. The substantial black market premium has rapidly introduced many counter-productive practices into the economy as people seek ways to benefit from the spread rather than pursuing directly productive activities.

The lack of financial reform is also a symptom of economic malaise. Although two-tier banking was quickly introduced after independence, the financial system is still in many respects the old monobank system, with the central bank's functions not clearly separated from those of the state banks which control most of the deposits. All of these entities act as agents of the government's directed credit policies. The main quasi-independent bank is the Vneshekonombank which has a monopoly over foreign economic transactions and which operates on its own account as a separate arm of government reporting to the President, rather than to the Central Bank or to the Ministry of Economics and Finance. There is no

¹⁰ In November 2000 the Turkmenistan government announced plans to sell \$115 million in debt owed by Azerbaijan and Kazakhstan because "it had not seen any effort by these countries to pay their debts" (*Times of Central Asia*, 30 November 2000) – presumably not a statement likely to encourage high bids. Azerbaijan's \$59 million principal is for gas deliveries from 1993-4, which was restructured in 1995 but on which there were no payments in 1998 or 1999. Kazakhstan owes \$56 million for electricity.

entrepreneurial commercial banking using loan analysts to identify the best borrower at a market-driven interest rate.

Both of these symptoms reflect that Turkmenistan is far from a market-driven economy, with the two key prices in such an economy (exchange and interest rates) having no economic function in the country. More fundamentally, the economy remains tightly controlled through a single person, which often leads to non-decision and makes real coordination difficult. Such a system is likely to have the stultifying negative consequences of the centrally planned economy without achieving the degree of organization that allowed the planned economies to survive so long. Turkmenistan has a relatively simple production structure, so the disorganization may be limited on that side, but it is unlikely that the present system could supply the range of goods and services appropriate to the more diversified economy envisioned by 2010.

The recidivist influences are reflected in the official suspicion of the private sector, which is only really permitted in petty retailing. This too is likely to stifle economic dynamism. Yet there are signs of entrepreneurship in the shuttle trade, believed to be equal in value to 10-20% of official trade in 1999 and 2000,¹¹ and in Ashgabat's huge outdoor Sunday market. Beyond that, however, private activity is quickly discouraged by excessive red tape and a widely held belief that any successful business will be heavily taxed or nationalized.

5. Conclusions

Turkmenistan's economic performance during the first decade after independence is interesting because it is an extreme case. The government has given a low priority to economic reform, while emphasizing the country's neutrality and minimizing internal political change. The country's abundant resource endowment provided favourable initial conditions for pursuing this agenda. Nevertheless, in 1997 the unreformed economy suffered a deep decline and, although it has enjoyed some recovery since 1999, the overall performance of GDP since independence is one of the worst among all transition economies.¹² Although the government had achieved its external and internal political goals, the economic strategy appeared to be unsustainable.

¹¹ The shuttle trade, involving small traders flying, especially to Istanbul, quickly developed specializations. Carpet sellers and clothing buyers trade their baggage rights on outward and return flights, and appear to have quasi formal arrangements with customs officials.

¹² Especially striking is the comparison in Table 2 with Tajikistan, which was torn by civil war until 1997.

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Table 1: Inflation in Turkmenistan, 1992-9
(annual increase in the consumer price index)

	1992	1993	1994	1995	1996	1997	1998	1999
Turkmenistan	493	3102	1748	1005	982	84	17	24

Source: EBRD *Transition Update*, May 2000, p.83.

Table 2: Real GDP, Central Asian countries and CIS average, 1991-7
(index, 1991 = 100)

	1991	1992	1993	1994	1995	1996	1997
Kazakhstan	100	94.7	86.0	75.2	69.0	69.3	70.7
Kyrgyz Rep.	100	86.1	72.8	58.2	55.0	58.9	62.8
Tajikistan	100	71.0	63.2	51.3	44.9	42.9	43.8
Turkmenistan	100	94.7	85.0	68.9	63.2	58.4	43.8
Uzbekistan	100	89.0	86.9	83.3	82.5	83.8	85.6
CIS average	100	78.8	69.8	59.1	55.6	55.4	56.1

Source: IMF staff estimates, reported in Mercer-Blackman and Unigovskaya (2000, 4).

Table 3: Sectoral Composition of Investment, Turkmenistan 1992-9
(in billion manat, current prices)

	1992	1993	1994	1995	1996	1997	1998	1999
Oil & Gas (incl. Refinery & Pipeline)			1.9	22.3	486	1390	3242	3838
Light Industry			4.0	23.8	386	404	269	756
Electricity			0.2	6.3	39	231	238	44
Agriculture			3.1	15.6	144	142	798	171
Transport & Communications			0.6	7.9	960	412	378	643
Total	0.1	2.3	21.5	143	3112	4297	6367	7955

Source: Government of Turkmenistan figures.

ABSTRACT

Turkmenistan's economic performance during the first decade after independence is interesting because it is an extreme case, regularly ranking last among all the former centrally planned economies by transition indicators measuring speed of reform or degree of economic liberalization. This paper analyses the evolution of the economic system and Turkmenistan's economic development since 1991. The country's abundant resource endowment provided favourable initial conditions for pursuing an agenda that gave a low priority to economic reform, while emphasizing the country's neutrality and minimizing internal political change. Nevertheless, in 1997 the unreformed economy suffered a deep decline and, although it has enjoyed some recovery since 1999, the overall performance of GDP since independence is one of the worst among all transition economies. Although the government had achieved its external and internal political goals, the economic strategy appeared to be unsustainable.