

**The Private Pocket of the President
(Berdymukhamedov):
Oil, Gas and the Law**

CRUDE ACCOUNTABILITY

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This report was prepared by Crude Accountability through its general support fund.

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Foreword

In the 1990s, a popular bumper sticker read, “Silence is Complicity.” Today, nowhere in the world is that more true than in the west’s relationship with the government of Turkmenistan. Turkmenistan is among the most corrupt and opaque regimes in the world, ranking at the bottom of virtually every rating on human rights, transparency, corruption and democracy. However, western governments, corporations and international financial institutions—particularly in Europe—insist that the country’s governance is becoming more democratic, that the country’s economic indicators are improving, and that Turkmenistan is becoming a country in which western institutions can safely invest.

However, the story from inside the country is quite different.

The report you are holding in your hands is the result of unique research done by our colleagues working in Turkmenistan. It tells the story of one of the world’s most corrupt and opaque regimes, and, specifically, how that regime is robbing its own people blind with the acquiescence of western governments, international institutions and corporations.

The report focuses on the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan, a government body whose activity is as difficult to grasp as its name is clumsy to pronounce.

Essentially, during his presidency, through the Agency, President Berdymukhamedov has managed to consolidate all authority, decision-making, management, and, most importantly, oil and gas revenue in the hands of one person—himself. Displaying untethered cynicism, he has created special laws endowing the Agency with virtually unlimited license to use these monies however it wants. And, as the Agency is under his direct authority, he has essentially given himself unlimited access to the country’s oil and gas coffers.

Twenty percent of the Agency’s revenues go into the State budget. The other 80 percent disappear into the murky, shadow economy that President Berdymukhamedov has built through a legal, but highly unethical, system of law that he created under the noses of western officials, but which has never been analyzed, until now.

Every oil and gas agreement, every transportation deal, every investment made by foreign investors into the hydrocarbon sector contributes to the strengthening of this shadow economy, which sinks the average Turkmen citizen further into poverty and further away from a democratic society. Not only do foreign investments disappear into this black hole,

but those investments are then not subject to environmental, administrative, or financial monitoring in compliance with Turkmen national legislation or western standards.

If the west, including the European Union, the United States, major oil and gas corporations and the international financial institutions which finance them, is serious about supporting reform in Turkmenistan, gaining a firm understanding of the role of the Agency, is a critical step in addressing such reform. Some western organizations demand transparency, require accountability, and claim to do business only under circumstances that jibe with western standards. But, unless those institutions understand who and what they are doing business with, their proclamations will remain hollow.

The recommendations at the end of the report serve as a guide to investors, government officials, NGOs and others on how to engage with Turkmenistan. We encourage you to read them carefully, to share them with colleagues, and to insist on transparency on the part of the Turkmenistan government before investing in the country's oil and gas sector.

President Berdymukhamedov has, in the four years he has been President of Turkmenistan, created a stronger cult of personality, a more active secret police service, and a bolder international persona than that of President Niyazov before him. But, most egregious is the creation of a kleptocracy, which will use western investment to further control and isolate his people. We invite you to join us in condemning this system, and in working to break it down.



Kate Watters
Executive Director, Crude Accountability
October 2011

Introduction

Setting aside the specific reasons they took place, the revolutionary events in the Near East had one thing in common. The authoritarian and totalitarian regimes of these countries had essentially privatized a part of the state budget as well as revenues from the countries' basic financial flows.

These corrupt systems, at the head of which stood heads of state and their close circles, including family members, enabled them to put together a fortune worth billions. Furthermore, social politics, the dismal employment situation, and the potential for social and political growth for the majority of the population were not only limited, but nonexistent.

The source of what happened in Tunisia, Egypt and Libya, and which threatens to happen in several other countries, started several decades ago. At that time the authorities, and more precisely the leadership of these countries, did not pass up the temptation to take complete personal control of the finances of the country, completely ignoring the principle of separating power from their own personal control, including in the financial sector. Everything quickly devolved into a situation where the leaders fully merged their own personal pockets with that of the state. As a result, libertarianism and corruption completely destroyed all chances of developing a state and society—they considered any development to be a political failure and a consequence of a payment from the state budget, which they had already thought of as their own personal funds for many years. The authorities, with the help of repression and state ideology, tried to hold on to the status quo, and they were successful for quite a long time. But, as a result, we have that which occurred in Egypt, Tunisia and Libya.

Turkmenistan has come to our attention precisely because President Berdymukhamedov is now creating the foundation for future shocks to the state and society. Right now he is creating mechanisms for sole and uncontrollable access to the country's finances and to their administration, as well as the mechanisms to keep them from the people of his country. But, he is not factoring in the inevitable consequences of societal development and, like any dictator, thinks that he will be able to avoid overthrow, prison and exile.

Under the previous President Niyazov, the authorities of Turkmenistan were able to organize various corrupt schemes, which enabled them to accumulate large sums in various quasi-state accounts, and which were managed solely by the head of state. Furthermore, we are talking about colossal sums that were based on the sale of the main export commodity—natural gas. Society at large and the bodies of representative power (parliament) were excluded from any means of influence on decision-making about the allocation of this money.

But, if, during the time of Niyazov, the authorities of Turkmenistan continued to exploit the extractive and transport infrastructure that remained from the Soviet period and they were not required to deal with major investors; now, the situation is changing fundamentally. The main problem under Niyazov was “how and where to sell gas.” For Berdymukhamedov, the basic problem has become “how to extract gas.”

Currently there is not enough capacity in the country. There is a lack of financial and technological expertise and a shortage of qualified specialists to develop new fields; and the era of exploiting Soviet technological reserves is coming to an end. Something new is emerging—an era of attracting investment and determining the conditions of work for investors.

And, if earlier, under Niyazov, gas revenues were simply beyond the control of society and often, with no system, wasted on various mega-projects and on the cult of personality of Niyazov, Berdymukhamedov has now decided to create a unified and, within his system, logical, controllable activity for investors and revenue return from hydrocarbons. He is essentially appropriating this money for exactly the same kind of uncontrolled embezzlement.

The Agency—“The Hydrocarbon God”

On the Internet and in the Turkmen press one can find numerous references to the activity of the State Agency for the Management and Use of Hydrocarbon Resources under the President of Turkmenistan (further—the Agency). But, there is practically no information about it readily available.

Some of the answers to questions about the Agency can be found in the Law of Turkmenistan “On Hydrocarbon Resources,” which is briefly explained in one of the sections of this report. And there, the reader him/herself can evaluate the breadth of the authority that has been given to the Agency and which completely corresponds to its name.

But, neither in this law, nor in other sources, including the Internet, is there information about what the Agency itself represents, what its structure is, who is among its leadership and management bodies. There is no information about which documents and priorities provide the basis for the Agency to expend the largest part of its revenues from the sale of hydrocarbons, and what, precisely, is the authority of the Agency, according to the Law of Turkmenistan “On Hydrocarbon Resources.”

The text of this report presents an analysis of the legislation of Turkmenistan, which provides the basis for regulation and operation of the country’s oil and gas sector, and offers commentary on specific legislative echelons that strengthen the existing corrupt schemes and the direct withholding of revenues from the population. These methods require the authorities to confirm that their activity takes place within “the boundaries of the law,” and it is an absolute truth that the appropriation by the authorities, and more precisely,

personally by President Berdymukhamedov, of a large portion of the gas revenues has been raised to the level of law.

We aim to demonstrate this, and invite the reader to bear witness to the fact that this situation creates the foundation for a future revolution. For, theft and uncontrolled waste of monies belonging to the entire population, even if raised to the level of law, will continue to be an irritant to society. That theft will serve as the ideological basis and one of the key incentives for social protest in the future. The entire logic of the process of social development, which the authorities of Turkmenistan are ignoring, speaks to the fact that these actions will lead to revolution. This is what happened in Tunisia, Egypt and Libya.

All the documents used are readily available, if they are not mentioned separately. The links in the report are to official documents, which were published in the Turkmen press, on the Internet, and on State or pro-government sites. All of the links were live in August 2011.

If it is necessary to connect directly with the Agency, we provide its coordinates:

State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan
Address: 744036, Turkmenistan, Ashgabad, Archabil Shaely, 56
Tel: +993 (12) 40-38-01
Fax: +993 (12) 40-38-31
http://www.oilgas.gov.tm/_gosagenstvo.html

The State Agency for the Management and Use of Hydrocarbon Resources

The first time the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan was mentioned publicly was on March 12, 2007, with the publication of President Berdymukhamedov’s Resolution on the Establishment of that Agency. The decree confirmed the status, structure and staff description of the executive direction, and composition of the Board of the above mentioned agency,¹ but the documents themselves were not published in the mass media—only information about the establishment of the institution. The Resolution also stated: “The Ministry of the Oil and Gas Industry and Mineral Resources of Turkmenistan is required to provide in duly prescribed order the newly constituted state agency the authority and documentation of the previously abolished Competent Body for the Use of Hydrocarbon Resources under the President of Turkmenistan in the course of a week.”²

Background

To grasp the history of this issue it is necessary to draw on information about the predecessor of the Agency—the “Competent Body,” as it was called, under the President of Turkmenistan. At first the competency of that body was established through the Law of Turkmenistan “On Hydrocarbon Resources” from December 30, 1996³ in Article 1. Its competency was established like this:

“Competent Body”—a state body, which has been given authority by the Cabinet of Ministers (government) of Turkmenistan to distribute licenses and to conclude agreements with contractors.⁴

That is, initially, “the Competent Body” was a structure under the auspices of the government (Cabinet of Ministers), to which was delegated certain permitted functions to distribute licenses and conclude agreements on the development of hydrocarbon resources. According to the law from 1996, the Competent Body acted strictly under the orders and instructions of the Cabinet of Minister (Article 5, The Authority of the Competent Body):

Article 5. The Authority of the Competent Body

The Competent Body in the area of use of hydrocarbon resources and carrying out petroleum operations:

- By order of the Cabinet of Ministers (the government) of Turkmenistan sets the only regulations for the development of fields of hydrocarbon resources, in

¹ Newspaper, “Neutral Turkmenistan,” No. 62, March 12, 2007 and <http://www.turkmenistan.ru/ru/node/18572>

² Newspaper, “Neutral Turkmenistan,” No. 62, March 12, 2007 and <http://www.turkmenistan.ru/ru/node/18572>

³ Gazette of the Medzhlis of Turkmenistan, 1996, No. 4, Article 90.

⁴ This means agreements on the development of hydrocarbon resources.

- conjunction with the only standards of international practice for conducting petroleum operations;
- Leads work to prepare tenders, carried out in accordance with regulations based in legitimate law and other acts of the government of Turkmenistan, provides information about the timelines, conditions and process of its execution;
 - Develops a model agreement and presents it for review by legal entities and individuals, for the conditions and process of its execution;
 - Leads negotiations with applicants to obtain a license;
 - Provides licenses in accordance with existing law;
 - Signs the agreement;
 - Provides registration of the agreement during the course of 15 days from the day of signing;
 - Exercises control over the conduct of petroleum operations, in accordance with legislation covering its behavior, and also in accordance with the conditions of the agreement and license;
 - Stops and annuls activity of a license in accordance with existing law;
 - Under the order of the Cabinet of Ministers (the government) of Turkmenistan, and together with the contractor, leads negotiations and finalizes agreements with the appropriate bodies of other states on questions of construction and exploitation of pipelines and other transport structures for the transportation of extracted hydrocarbon resources on their territory, as well as questions of use of similar transport facilities that are in existence and being used in those countries;
 - Presents an annual report to the Cabinet of Ministers (the Government) of Turkmenistan on the course of the implementation of the agreement;
 - Exercises other authority, given to it by the laws and acts of the President of Turkmenistan.
 - The Competent Body has the right to demand the presentation by the owner of the license and the contractor of the bank a guarantee or the guarantee of its parent company. Presentation of such guarantees can be a condition of receiving a license or the signing of an agreement.
 - The Competent Body is required to protect the national interests of Turkmenistan in carrying out its authority.

The extent to which the authority of the Competent Body was limited can be determined from Article 8, “Methods of Granting a License,” from the 1996 law:

Article 8. Methods of Granting a License

A license for exploration or extraction, whether a single license for exploration and extraction, is determined on the basis of a tender or direct negotiations conducted by the competent body and the candidate to receive a license.

The choice of method for determining licensing is the authority of Cabinet of Ministers (Government) of Turkmenistan.

But Article 4 of the Law “On Hydrocarbon Resources” from December 30, 1996 clearly gives priority to the Cabinet of Ministers in determining the basis of the policies of the state in this area:

Article 4. The Competence of the Cabinet of Ministers (Government) of Turkmenistan

The Cabinet of Ministers (Government) of Turkmenistan in the area of use of hydrocarbon resources and carrying out petroleum operations:

- Chooses the strategy for use, long term increase of productivity of hydrocarbon resources and the methods of their extraction;
- Sets priorities of the use of hydrocarbon resources as well as the rules for their protection;
- Establishes means for environmental protection, life and health of the population, guaranteeing healthy and safe labor conditions in the process of conducting petroleum operations;
- Organizes the carrying out of statistical reporting on hydrocarbon resources;
- Introduces limits on carrying out petroleum operations on specific areas in order to protect holy places, historical and cultural sites and other sites that have important significance for preserving and developing the traditional spirituality and culture of the Turkmen people;
- Implements any authority given to it by the laws and acts of the President of Turkmenistan.

On June 6, 1997, President Niyazov signed a document that regulated the activity of the Competent Body—the statute “On the Competent Body for the Use of Hydrocarbon Resources Under the President Turkmenistan.”⁵ The document begins with the authority of the Competent Body:

The Competent Body for the Use of Hydrocarbon Resources Under the President of Turkmenistan, further “the Competent Body,” is the body of state management, invested with exclusive authority to conduct negotiations, distribute licenses and conclude agreements, and also to have control over the process of fulfilling the terms of finalized agreements with the purpose of using the hydrocarbon resources of Turkmenistan.

The Competent Body, in its activities, is guided by the Law of Turkmenistan “On Hydrocarbon Resources,” the existing Statute, other normative acts that are directed toward securing rational and effective use of hydrocarbon resources and the protection of the natural wealth of Turkmenistan.

The President of Turkmenistan heads the Competent Body.

The Competent Body is the legal body having the stamp with the imprint of the state coat of arms of Turkmenistan and its appellation, as well as an account in the established banks of Turkmenistan.

Despite the fact that the Competent Body was empowered to sign all kinds of agreements, the receipt of money for the sale of oil and gas abroad did not come into its competence directly. In the reference to the Statute on its activity, financial guarantee of its activity exists as a result of other assignments:

⁵ Position “On the Competent Body for Use of Hydrocarbon Resources Under the President of Turkmenistan,” http://energylaws-tm.sitecity.ru/ltxt_2302160238.phtml?p_ident=ltxt_2302160238.p_1604102034

In order to guarantee a high level of professionalism and quality of independent expertise, as well as to attract international experts, a fund for the financing of the Competent Body is being formed, the sources of which are assigned from bonuses and royalties of signed agreements as well as from payments received from them through organizations carrying out tenders and receiving licenses.

The number of assignments is determined by the level of necessary financing and based on the confirmation of the President of Turkmenistan.

But nowhere is there a reference stating that the Competent Body controls any financial flows.

On the contrary, before August 2005, a document existed regulating the sale abroad of hydrocarbon raw materials: "The procedure for signing and usage of agreements (contracts) for the sale of the production of the fuel and energy complex on the international market."⁶ That document indicates:

1. The current procedure is developed in accordance with the legislation of Turkmenistan and regulates the procedures for the sale in exchange markets of crude oil, oil products, natural gas, electro-energy and other products that are developed in the fuel-energy complex of Turkmenistan (in the future called production).

<...>

3. The seller of production from the fuel-energy complex of Turkmenistan is the State Trading Company, "Turkmenneftegaz."

But this order applies only to stock trading and does not have any relationship to the return of monies into the country's budget from resources sold within the confines of two-party agreements.

On August 22, 2005, the Law "On Amendments and Additions to the Law of Turkmenistan 'On Hydrocarbon Resources,'" removed from the text of the previous version of the law any mention of the Competent Body, and its competency in all areas was given to the Ministry of Oil and Gas Industry and Mineral Resources of Turkmenistan.⁷ **Also excluded from the Law "On Hydrocarbon Resources," was the provision giving those concerns the right to sign agreements on Production Sharing Agreements (PSAs) with foreign contractors.**

On September 2, 2005, President Niyazov, in a resolution, abolished the Competent Body, giving its authority to the Ministry of Oil and Gas Industry and Mineral Resources of

⁶ <http://www.turkmeneconomy.narod.ru/fuel-export-rules.html>

⁷ «Neutral Turkmenistan," No. 200, August 22, 2005.

Turkmenistan⁸... “with the goal of further improvement of the structures of the oil and gas complex.”⁹

That resolution removed the authority of the Competent Body “on the instructions of the Cabinet of Ministers to create the only regulations to handle hydrocarbon resource fields.”

These regulations were to develop the Ministry of Oil and Gas Industry and Mineral Resources of Turkmenistan, which would control the activity of the state companies “Turkmengaz” and “Turkmenneft,” in the extraction of hydrocarbon raw materials.¹⁰

But, already on the 30th of November of the same year, 2005, President Niyazov would hold a special session to reevaluate the state of the oil and gas industry, including corruption.¹¹

“Opening the meeting, Saparmurat Turkmenbashi (President Niyazov) underscored the importance of the question under discussion, “proposing in the agenda the imminent need to add a new level of quality to the central sector of the national economy and the need to improve its condition, which is the result of many years of depraved practices by leadership of the branch [energy sector]”... **“They are stealing everything, beginning with those who were entrusted to run the TEK (energy sector) in the early days of independence,” said Saparmurat Turkmenbashi,** underscoring the persistent and urgent need to conduct a full inventory of the situation, and, first and foremost, to review the structures of the entire complex and the principles of operation of its chain of command in order to exclude forever any possibility for abuse.”¹²

It is worth mentioning that in May 2005 an entire group of upper management of Turkmenistan’s oil and gas sector was fired. Criminal proceedings were held against them, including for serious embezzlement in the execution of contracts for the delivery of oil and gas abroad. Among them was the former Vice Premier of Turkmenistan (the deputy to the head of the government), Elly Gurbanmuradov, who was found guilty:

“In the period that E. Gurbanmuradov was working as the Deputy Chair of the Cabinet of Ministers of Turkmenistan, the general revenue in the State Fund for the Development of the Oil and Gas Industry and Mineral Resources of Turkmenistan from 2001-2003 and in the first half of 2004 from realized oil production was \$2,729,341,500 (US). Under examination, it became clear that in reports presented to the institute “Turkmenmillikhasabat,”¹³ and the Ministry of Economics and Finance of Turkmenistan, a sum of \$2,680,928,500(US) was indicated. In this way, E. Gurbanmuradov committed a crime, appropriating for his own interests, the difference of 48 million 413 US dollars.”¹⁴

⁸ “Neutral Turkmenistan,” No. 211, September 3, 2005.

⁹ “Neutral Turkmenistan,” No. 211, September 3, 2005.

¹⁰ <http://www.turkmenistan.ru/ru/node/17127>

¹¹ “Neutral Turkmenistan,” No. 306, December 1, 2005

¹² “Neutral Turkmenistan,” No. 306, December 1, 2005.

¹³ National Institute of State Statistics and Information

¹⁴ “Neutral Turkmenistan,” No. 121, May 21, 2005.

As a result, Elly Gurbanmuradov was condemned to 25 years and confiscation of property. Through this same case, Ilyas Charyev,¹⁵ the head of the company, “Turkmenneftegaz” (on the rank of Minister) was also condemned to 25 years. Later, Saparmamed Valiev was fired from the State Ministry—Chair of the State Company “Turkmenneft”—after being found guilty of corruption and given a long prison term.¹⁶

Through this process a special investigation was undertaken looking at the exit of monies from the country, which were received through the sale of oil and gas, in which special representatives of “Deutsche Bank” participated.

“We,” said Serdar (this is one of the public names for Saparmurat Niyazov), “need to create a new vertical management structure of economic organisms in the complex, and, in part, reassign a whole group of leading structures. **Thus, the Competent Body for the development of hydrocarbon resources will be subordinate not to the Cabinet of Ministers of the country, but directly to the President of Turkmenistan.** Leaders of all units of TEC (the energy sector) will be part of this structure. **The Fund for the Development of the Oil and Gas Sector** will operate in accordance with strict principles of agreement and reporting.”¹⁷

At the end of 2005, all authority for leadership of the industry moved from the Competent Body to the Ministry of Oil and Gas Industry and Mineral Resources of Turkmenistan. At the end of 2005, the company, “Turkmenneftegaz,” which had engaged in the operations of buying and selling oil, natural gas and processed hydrocarbons, was abolished.¹⁸ Simultaneously, the successor to the company for realizing contracts and agreements for the export of natural gas was the state company, “Turkmengaz,” and for export of oil products and liquid petroleum gas—the Turkmenbashi complex of oil processing factories merged together into a single state company, the Seidy oil processing factory.

However, all of the shifting that was taking place in the government and the reassigning of authority between various departments had as its goal not only bringing order to the oil and gas industry, but also removing from the political stage high level bureaucrats, with their political and economic ambitions, who had been able to gain significant political authority.

Nothing more is known about the long-term fate of the Competent Body, except that it stopped being a subject of legislation, even though it was under the personal authority of the President of Turkmenistan, Niyazov. President Berdymukhamedov’s Resolution on the Establishment of the State Agency for Management and Use of Hydrocarbon Resources Under the President of Turkmenistan, cites precisely the September 2, 2005 resolution of

¹⁵ <http://www.eurasianet.org/departments/insight/articles/pp062405.shtml>

¹⁶ <http://www.turkmenistan.ru/ru/node/17084>

¹⁷ “Neutral Turkmenistan,” No. 306, December 1, 2005.

¹⁸ “Neutral Turkmenistan,” December 20, 2005 and http://www.turkmenistan.ru/index.php?page_id=3&lang_id=ru&elem_id=7527&type=event

President Niyazov on the liquidation of the Competent Body, which suggests a certain continuity in the activity of these structures.¹⁹ But not in all of them.

And the issue is, again, who is the final beneficiary of resources for the sale of oil and gas? Until 2007, there was no clear or unambiguous indication of where the money should go in any legislative act in Turkmenistan, including into the country's budget. At various times "Turkmenneftegaz" was the recipient of monies for gas, for example, to Ukraine, in accordance with the agreement between the companies "Turkmenneftegaz" and "Naftogaz Ukrainy." However, only fifty percent of the payment in 2004 was in hard currency, and fifty percent was in various goods.²⁰ Therefore, the value of resources coming into the budget as a result of Ukrainian goods on the internal market is unknown.

Then, it seems that all subjects of foreign economic activity involved in the realization of oil and gas abroad were required to send all the proceeds from oil and gas to the **State Fund for the Development of the Oil and Gas Industry and Mineral Resources of Turkmenistan**. E. Gurbanmuradov was found guilty of violating that regulation in his supervision of the country's oil and gas sector. The same State fund, under the leadership of Gurbanmuradov, was found guilty of serious financial machinations with the participation of the Central Bank of Turkmenistan.²¹

An additional beneficiary (receiver and accumulating structure) of monies for the sale of hydrocarbon resources was called **The International Fund of Saparmurat Turkmenbashi**. Practically nothing is known about its activity, structure and the source of its revenue. All of the state bureaucrats who earlier ran the fund are now in prison, guilty of economic crimes. A special resolution of President Berdymukhamedov dissolved The International Fund of Saparmurat Turkmenbashi on June 22, 2007.²² This resolution was organized by a special commission, which was supposed to conduct an evaluation of the accounts and property of the fund and develop proposals about the future fate of its property. Nothing is known about the results of the work of the commission.

One can learn more about the dubious plans for the sale of Turkmen gas in the mid 2000s through the research of the organization, Global Witness: "It's a Gas. Funny Business in the Turkmen-Ukraine Gas Trade."²³

History of the Agency

When Gurbanguly Berdymukhamedov came to power on February 14, 2007, a restructuring of the entire state apparatus took place. A number of management bodies were either

¹⁹ "Neutral Turkmenistan," No. 62, March 12, 2007.

²⁰ <http://kommersant.ru/doc/570127>

²¹ "Neutral Turkmenistan," No. 130, June 1, 2005.

²² "Neutral Turkmenistan," No. 153, June 23, 2007.

²³ <http://www.globalwitness.org/library/its-gas-funny-business-turkmen-ukraine-gas-trade>

liquidated or changed, including in the oil and gas sector. Almost immediately, Berdymukhamedov began to take into his own hands all the governance structures of financial flows. By March 12, 2007 a resolution appeared about the creation of the Government Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan.

Regardless of the fact that the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan was established by President Berdymukhamedov on March 12, 2007, before the appearance in 2008 of the new Law “On Hydrocarbon Resources,” no documents regulating the activity of the Agency were published. So, the economic activity of the Agency was not visible.

According to data that make it possible to judge the structure, it should comprise: a concrete Resolution about the Agency, which regulates its internal organization; its subordination to other state structures; its staff (a staff list) and Board; and the activity and authority which should also be regulated by the Resolution on the Agency. However, this information is not accessible.

With the appearance in 2008 of a new version of the Law of Turkmenistan “On Hydrocarbon Resources,” and amendments to the law in 2011, the situation started to become clearer.

First and foremost, this involved the rights of ownership of hydrocarbon resources.²⁴

Ownership of hydrocarbon resources according to the 1996 law:

Article 3. Ownership of Hydrocarbon Resources

Hydrocarbon resources in their natural state in the subsoil or above the surface of the Territory of Turkmenistan are the exclusive property of Turkmenistan.

The authority to own, use and distribute hydrocarbon resources belongs to the Cabinet of Ministers (the Government) of Turkmenistan in accordance with the provisions of this law.

Ownership of hydrocarbon resources according to the 2011 law:

Article 4. The Right to Ownership of Hydrocarbon Resources

1. Hydrocarbon resources in their natural state in the subsoil of the territory of Turkmenistan are the exclusive property of Turkmenistan.
2. The authority to own, use and distribute Hydrocarbon resources belongs to the Cabinet of Ministers (the Government) of Turkmenistan.
3. Management of Hydrocarbon resources and their use is within the authority established in this law, belongs to the Agency.

²⁴ Article 1, point 30 describes “Hydrocarbon resources” in the following way: 30) hydrocarbon resources— crude oil and natural gas, as well as all processing or extraction together with their components.

Essentially the Law “On Hydrocarbon Resources,” gives the Agency exclusive authority, providing this body of the state authority a super-monopoly and essentially making it the owner and manager of all hydrocarbon reserves of Turkmenistan. And, as is apparent from the name of the Agency, its de facto leader is the President of Turkmenistan, Gurbanguly Berdymukhamedov.

The law solidifies the authority and responsibilities of the Agency.

In Article 1 of the Law, the very first point provides the legal understanding of the Agency:

- 1) The Agency—The State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan—is a legal body, which, in accordance with the current law and the decrees of the President of Turkmenistan, is delegated the authority for management and use of hydrocarbon resources.

And, beginning with Article 6 of the Law, the basis of the legal status of the Agency is formulated:

1. The Agency has the status of a legal body, is an independent subject of economic activity, has its own separate property and answers for its responsibilities to that property, and may, on its own authority, acquire and own non-property rights, carry responsibilities and be the plaintiff and defendant in a kaziet, arachi kaziet²⁵ and in an international court of law.
2. The Agency has the right to establish an enterprise (company), acquire private and public shares of other enterprises (companies) and to open their own offices and other branches on the territory of Turkmenistan and abroad.

Article 10 of the Law “Methods of Giving Licenses” gives the Agency the right to determine the procedure for issuing licenses—on the basis of a tender or through negotiations. Earlier, in the 1996 Law, this right belonged to the Cabinet of Ministers (government) of Turkmenistan (Article 8, the 1996 Law).

1. Licensing can be provided on the basis of a tender or direct (non-exclusive) negotiations conducted by the Agency with contenders to receive a License.
2. The choice of method of provision of Licenses is that of the Agency.

Commercial Functions of the Agency

As was already mentioned, the Agency, as a legal body, has an entire list of commercial functions, including speaking as the exclusive representative of the state, including functioning as an intermediary in contacts between foreign investors and other state bodies of Turkmenistan.

Thus, Article 7, Point 5, “Basic functions and authority of the Agency,” determines that the Agency:

²⁵ Courts of various jurisdictions

5) signs Agreements and provides its registration to appropriate state management bodies in accordance with the legislation of Turkmenistan;

And also:

11) leads negotiations and closes agreements with appropriate bodies of other states on questions of construction and exploitation of pipelines and other transport facilities for the transportation of extracted hydrocarbon resources on their territories and also on questions of the use of similar transport facilities, that exist and are being used in those countries;

12) exercises confidential management of the assets and financial resources on the internal and external markets;

13) determines the procedure for receiving and using Hydrocarbon resources due to the Agency in accordance with the Agreement on the conduct of Petroleum operations;

14) disposes of revenues coming to the Agency, which it is liable for in accordance with the Agreement for conducting Petroleum operations;

15) exercises the management, administration, possession and dispersal of its property (assets) in any form on the internal and external markets;

Furthermore, the Agency can speak on behalf of Turkmenistan in the capacity of a plaintiff and defendant in legal instances, both inside Turkmenistan and outside its borders:

17) it can make a presentation in the Kaziet, arachi kaziet²⁶ and in international courts and arbitrage in the capacity of plaintiff or defendant in arguments arising from an Agreement, and carry the responsibility for property belonging to it;

In the law, the Agency is given special preferences for the commercial activity, which enables the Agency to essentially place under control the commercial activity of Contractors²⁷ and de-facto—international investors:

Article 28. The Right of the Agency to Acquire Hydrocarbon Resources

1. The Agency has a priority right to commercial acquisition of shares of Hydrocarbon resources of the Contractor at any time on a competitive market basis.

2. The Agency also has priority right to acquisition of shares of Hydrocarbon resources of the Contractor with the goal of satisfying the demands of the internal market, and on the condition that these demands were not fulfilled for the complete use of extracted Hydrocarbon resources. Furthermore, limited amounts of acquired Hydrocarbon resources, the procedure of evaluation, the form of payment and the hard currency used for payment are determined by the Agreement.

Another important aspect of the commercial activity of the Agency and its monopoly position, and in accordance with growing conflict of interest, is the following situation:

²⁶ Courts of various types

²⁷ Article 1, point 16) Contractor—a body (bodies) having licenses and having concluded with the agency and (or) a concern (corporation) an agreement in accordance with the current law.

The Agency gives out licenses for conducting all kinds of “petroleum operations,” controls all activity of the Contractor, including the volume of extracted resources, monitors any activity of the Contractor, including environmental violations. The Agency de facto blocks the monitoring of the Contractor by any other state bodies, including law enforcement, environmental protection and tax structures.

And this gives the Agency the broadest set of instruments for influence or coercion over the Contractor with the best possible conditions for the Agency’s economic relationship. This monopoly over the authority in various spheres creates the capacity for extremely high levels of corruption. Considering “confidentiality” of all aspects of these relationships, there are all the prerequisites for the appearance of all kinds of corrupt schemes. This includes what happened in the past, and the transfer of a part of the Agency’s commercial activity to “the state shadow economy.” This will be discussed in detail in one of the next sections of the report.

Furthermore, for the fully operational and effective continuation of all of these functions and authorities, the Agency must have an enormous staff of highly qualified workers and a multi-faceted structure, which must essentially double the functions and authority of other state bodies. But nothing is known about the existence of such a structure, although the Agency does, as a matter of fact, duplicate the functions and authority of other state bodies, de-facto blocking their authority and competence in the oil and gas sector.

Monitoring Functions of the Agency

The Agency has unprecedented monitoring functions over the activity of Contractors, as it states in the Law, “For Carrying out Petroleum Operations.”²⁸ Furthermore the competency of the Agency is such that it is able to block or substitute the activity of other state bodies. For example, Article 30 of the Law, Point 2 states that not one ministry can undertake verifications and inspections without previously informing and receiving approval from the Agency for such verifications.

Article 30. State Monitoring over Carrying out Petroleum Operations

3. Ministries and other bodies of state management, prior to conducting verifications and inspections in the areas of their competency for conducting state monitoring and

²⁸ Article 1, Point 11 of the Law “On Hydrocarbon Resources” defines “petroleum operations” as such: 11) Petroleum operations—all work for the exploration and extraction existing in accordance with the Agreement. “Exploration” is defined in this way: 21) Exploration—geological, geophysical and other work, including also drilling blast holes, core selection, strategic testing, drilling of wells, aero-cosmic photography, renting material and immaterial assets carried out with the goal of opening a hydrocarbon resource field in accordance with an Agreement. And “Extraction”—all forms of work to extract from the earth hydrocarbon resources through common methods or with artificial support to bring energy through the layers, storage, preparation, loading, warehousing, transportation, measuring, delivery and marketing of Hydrocarbon resources and other forms of activity, including renting material and immaterial assets in accordance with the Agreement.

supervision, in accordance with the legislation of Turkmenistan, must obtain written prior approval from the Agency to carry out such verifications and inspections.

In addition, Article 30, Point 1 obligates any state body of authority to keep confidential all the results of inspections and verifications,

<...> The Ministries and other bodies of state management are required to maintain confidentiality of any information, which they receive through monitoring and supervision.

Informing only the Agency:

4. Ministries and other bodies of state management send their conclusions, information, reports and other documents, prepared as a result of verification and inspection, to the Agency for review and to take measures in accordance with the existing Law, License and Agreement.

Even law enforcement bodies are required to inform the Agency about impending verifications ahead of time—Article 30, Point 5—and to send the verification results to the Agency, regardless of whether, as a rule, the results of the verification and inspection by the law enforcement structures are departmental secrets, investigative secrets or state secrets.

<...>

Law enforcement bodies inform the Agency about upcoming verifications. Information, conclusions, protocols and other documents of such verifications are sent to the Agency.

For its part, the Agency plays the role of higher arbiter, which has the exclusive right to review the results of verifications and inspections conducted by other ministries and departments, including law enforcement bodies (Article 30, Point 6):

6. The Agency informs ministries and state management and law enforcement bodies, which have sent their conclusions, information reports and other documents, about the results of their review.

In this way, the secrecy, the preliminary notification of upcoming verifications, the de facto possibility of the Agency to block investigations of violations by other state bodies and forwarding activities about violations to the courts paralyzes the objective control of state bodies over the activity of companies (Contractors) in conducting Petroleum operations.

Even on **questions of environmental protection**, in accordance with the Law “On Hydrocarbon Resources,” the primary competency is handed over to the Agency:

Article 43. Environmental Basis for Conduct of Petroleum Operations

1. Prior to commencement of petroleum operations, and, in instances of necessity, while they are ongoing, the Contractor presents to the Agency for agreement with special representative authorized bodies in the area of environmental protection and other state organs a plan for the conditions of environmental protection, safety and health of the

population, which the Contractor intends to apply in the implementation of its work plan.

2. The conclusions of specially empowered bodies in the area of environmental protection and other state bodies are presented, in written form, to the Agency, in the course of 30 calendar days from the day the plan is presented. In the absence of a determined time like for such conclusions, the Contractor may, with written permission of the Agency, begin to work on the appointed plan.

This essentially changes all the legal and obligatory procedures of environmental impact assessments (EIAs) for petroleum operations, and the direct participation of state environmental bodies has been excluded from these procedures.

All responsibility for environmental protection, in accordance with the Law “On Hydrocarbon Resources” is placed on the Contractor. Article 44 contains a list of the illegal activities, including disposal, spills, and flaring of incidental gas. This would not be an immediate concern if environmental monitoring in accordance with the law wasn’t also the responsibility of the Contractor. The fact that both responsibilities of environmental protection and monitoring of compliance are vested upon the Contractor discredits the environmental law of the country:

Article 45. Monitoring of the Natural Environment

1. In order to take all necessary measures for the prevention, elimination and decreasing any negative impact on the environment and ensuring ecological safety of conduct of Petroleum Operations including the Turkmen sector of the Caspian sea, a Contractor is obliged to conduct monitoring of the natural environment.

Before starting the conduct of Petroleum Operations and for the entire period of their conduct, a Contractor shall set up a monitoring system for obtaining comprehensive current information on changes occurring in the natural environment and on the nature of environmental impact of the Petroleum Operations.

2. Assessment by a Contractor of the impact on environment at each stage of Petroleum Operations shall stipulate ecological and industrial monitoring including:

- 1) background research on the environment prior to commencement of each of the Petroleum Operations including geophysical data, exploration drilling, production of hydrocarbons, as well as after the cessation of operations;
- 2) monitoring of sources of pollution;
- 3) monitoring the status of the environment;
- 4) monitoring of consequences of pollution of the environment as a result of accidents.

3. Conduct by a Contractor of the ecological and industrial monitoring of the natural environment should include observance over the following parameters:

- 1) Level of pollution of atmosphere, soil, surface waters, and bottom deposits using all the accepted indicators;
- 2) natural circulatory processes, hydro-meteorological indicators (water temperature, streams, speed and direction of wind, atmospheric precipitation, atmosphere pressure, air humidity).

6. While conducting the industrial monitoring a Contractor shall consider the results of the previous years' observations and use indicators of the existing stations located in the area of works (within the Contract Area and its surroundings) for the purpose of long-term observations.

And only Article 45, Point 4 refers to any kind of interference by the “authorized state body in the area of environmental protection”:

4. When necessary and on the demand of the authorized state authorities in the area of environmental protection, a Contractor must conduct additional research into the state of the natural environment.

Who determines this “necessity,” when government bodies are essentially unable to conduct ongoing monitoring of the activity of the Contractor, is not clear in the Law. But Article 45, Point 5 states the Contractor independently determines the type and method of observation in setting up the procedures:

5. The Contractor shall determine the types and methods of observation of the state of the environment requested by the authorized state authorities in the area of natural environment protection.

However, without independent environmental monitoring and independent monitoring of emissions into the air and soil and discharge into the sea, the results of monitoring carried out by the Contractor cannot be considered to be objective and in compliance with environmental protection and other Turkmen legislation.²⁹

Article 45, Point 7 also excludes the participation of state structures responsible for environmental protection in environmental monitoring and even in the evaluation of the results of monitoring carried out by the Contractor:

7. The Contractor is required to submit to the Agency the results of environmental and industrial monitoring.

And, according to the law, only the Agency has the legal authority to conduct environmental monitoring:

Article 7: Basic Functions and Authority of the Agency

7) executes control over measures taken by Contractors for the natural environment, public life and health protection, ensuring healthy and safe labor conditions in the conduct of Petroleum Operations;

But the agency does not have the necessary instruments for evaluating this kind of monitoring. Other regulatory norms, which would require the Contractor to be in constant

²⁹ This means the legislation in the areas of healthcare, insurance and administrative and criminal rights.

contact with the environmental protection departments, are not present in the law. Thus, environmental demands of the Agency are stated, but not enforceable!

The same situation exists with regard to Turkmenistan's international obligations with regard to international environmental protection conventions, especially the Aarhus Convention, which, in many instances, insists on not only state control, but also access by the public to environmentally important information.

In the conditions created by the Law "On Hydrocarbon Resources," the rights of the public are unenforceable. The conditions of secrecy and the sharp limitation on the number of state bodies, which are allowed to monitor the environment, as well as the de facto state ban on the activity of public organizations and the manifestation of any public initiatives, intensifies how Turkmenistan ignores its responsibilities within the framework of the Aarhus Convention^{30,31} and makes Turkmenistan's participation in the international legal regime simply profane.

However, the Law on "Commercial Secrets"³² states:

Article 8. Information, which is not a commercial secret

Information that cannot be considered a commercial secret includes:

<...>

Information about environmental pollution, <...> lack of compliance with labor protection regulations, <...> and about other violations of the legislation of Turkmenistan and the extent of the damage.

The Law "On Hydrocarbon Resources" demands confidentiality of any information received by the supervising bodies, including environmental:

<...>

Ministries and other state management bodies are required to keep confidential any information they receive while carrying out such monitoring or surveillance.³³

However, Article 23, Point 1 of the Law "On Hydrocarbon Resources," gives permission to essentially ignore other national legislation:

³⁰ Aarhus Convention—the Convention of the European Economic Commission of the UN "On Access to Information, Public Participation in Decision-making and Access to Justice on Issues Related to the Environment," <http://live.unece.org/env/pp/welcome.html>

³¹ The Aarhus Convention protects the rights of citizens to access to environmental information and participation in environmentally-significant decision-making and provides access to justice in instances when these rights have been violated. Turkmenistan signed on to the Aarhus Convention in 1999.

³² Gazette of the Medzhlis of Turkmenistan, 2000, № 3-4, Article 39.

³³ Article 30, Point 1, Law "On Hydrocarbon Resources."

1. Terms of the Contract related to protection of natural environment, mineral wealth, securing the safety and health of the population while conducting Petroleum Operations shall be agreed by the Agency and the relevant competent state bodies. The procedures and terms of such an agreement shall be determined by the Agency. The absence of an agreement on the Contract terms from the side of the indicated authorities within the established deadlines do not serve as the basis for refusal by the authorized bodies to register a Contract.

Word for word that article demands, without exception, that monitoring and regulating bodies lead in the establishment of an agreement and begin exploration and development of a field without taking into account the standards and demands of national legislation.

And Article 2, Point 2 **completely overrides** all other legislation of Turkmenistan, if it contradicts the Law “On Hydrocarbon Resources”:

Article 2 The Area of Application of the Current Law

3. In instances where rules are established by the legislation of Turkmenistan other than those stipulated by the current Law, provisions of the current Law shall apply.

For its part, the authority of the Agency to monitor and inspect is also unprecedented. Often its potential authority surpasses that of environmental protection bodies. For example, Article 7, “Basic Functions and Authority of the Agency,” Point 4, states:

4. The authorized officials of the Agency are entitled to free access to any area including the Contract Area, to any structure and transportation device used in relation to conducting Petroleum Operations.

Article 7, Point 3 clarifies the norms required for such authority:

Article 7. Basic functions and Authority of the Agency:

<...>

3. For the purpose of realization of its functions the Agency is entitled to:

3) conduct an examination of technical, financial and other documents relevant to Petroleum Operations, use excerpts and make copies of such documents;

4) provide instructions and introduce restrictions on the activity of the Contractor related to ensuring protection of environment, safety of health of personnel and population;

5) conduct technical, environmental and financial audits, analytical and other research, and collect information on the issue of compliance by the Contractor with the laws and other normative legal acts of Turkmenistan, terms of the License and the Contract;

6) exercise systematic control over compliance by the Contractor and the Operator with the current Law, License and the Contract;

Even financial-economic activity of the Contractor, by omission, if it is not stated otherwise, is in the purview of the Agency:

Article 49. Bookkeeping and Auditing

<...>

4. Audits of financial and economic activity of a Contractor shall be carried out by the Agency or other state bodies specifically authorized by the Cabinet of Ministers of Turkmenistan. The indicated bodies are entitled to use the services of independent auditors, including international experts.

But, in the case of auditing the tax transparency of the Contractor by the state tax bodies, the Agency plays the deciding role: only after notification of the Agency twenty (!) days prior to the audit, the tax authorities can begin to undertake an audit and inspection:

Article 49. Bookkeeping and Auditing

<...>

6. Monitoring compliance with the tax legislation of Turkmenistan shall be executed by the tax service authorities of Turkmenistan with consideration of the provisions of the current Law by preliminary notification of the Agency 20 days before such tax audit.

And even that law in fact has no legal authority, since the subjects, for which the distribution of the Law “On Hydrocarbon Resources” is intended, are excluded from the authority of the Tax Code:

Tax Code of Turkmenistan:

Article 3. Taxes on the Use of Mineral Wealth

Article 129. Taxpayers for the Use of Mineral Wealth

<...>

2. In accordance with the Law of Turkmenistan “On Hydrocarbon Resources,” contractors and subcontractors are not considered to be taxpayers for use of mineral wealth.

As is evident from the text of the law itself, the Agency de facto removes the activity of the Contractor from Turkmenistan’s legal arena, forbidding the state law enforcement, environmental and even tax bodies from conducting audits and monitoring the activity of the Contractor without special notification, essentially without the permission of the Agency. On the other hand, the Law reserves the Agency as practically the only state body with the authority to supervise the activity of foreign investors in Turkmenistan, where they operate in the context of the Contractor. However, in the absence of a large and qualified

staff, the Agency is simply not in the position to undertake such work. And it is clear that the dismissal of other bodies of state control and the provision to the Agency of absolute control over the activity of foreign investors creates all the pre-conditions for the operation of a “shadow state economy.”

Such a concentration of authority in the hands of one department, which is completely dependent on the President, carries very serious risks for foreign investors as well. Any subjective circumstances, including “political expediency,” can serve as a reason to pressure an investor, even leading to forcing it out of the country.

The scandal with the withdrawal from Turkmenistan of the Argentinean company, Bidas,³⁴ which had invested more than a billion dollars into the exploration of gas fields in Turkmenistan, and its project work in building the Turkmenistan-Afghanistan-Pakistan gas pipeline, is well known. But in 1995, President Niyazov figured that in order to realize a project as enormous as a Trans-Afghan pipeline, it was necessary to have more “authoritative” partners, behind whom stood powerful geopolitical players. As a result, Bidas was harshly pulled out of all of its investment projects in Turkmenistan and excluded from participating in the construction of the TransAfghan pipeline. Niyazov invited the American company Unocal to take Bidas’s place in the international consortium.³⁵ In addition, Bidas was not able to utilize any of the legal procedures of Turkmen legislation in its defense.

In Turkmenistan, the “verbal law” of the President carries much more weight than ordinary national legislation. And a body like the Agency combines within itself the permitting, supervisory and financial functions, creating a potential threat for investors. This is because in the instance of any conflict between the investor and the government, there would be only two options: either a corrupt, peaceful agreement, or the loss of investment and exit from the country. There could be no other conflict resolution in the legal field of Turkmenistan; the authority and functions of the Agency won’t allow it, and would even block it.

Another, recent example of forcing an investor out of Turkmenistan is the instance with the Russian telecommunications company MTS.³⁶ In 2010, the authorities started to put secret pressure on the daughter company of MTS in Turkmenistan, demanding it increase royalties in favor of the Turkmen authorities. The Turkmen authorities later admitted this fact as a motive to create a conflict. But pressure on the company began long before the complaints became public. In the summer of 2010, cargo with MTS SIM cards for use in Turkmenistan was confiscated by Turkmen customs. Then, in December 2010 an “unexpected” accident occurred in the central computer hall at MTS and the most of the equipment was

³⁴ http://en.wikipedia.org/wiki/Bridas_Corporation

³⁵ See further, Ahmed Rashid, Taliban. *Islam, Oil and the New Great Game in Central Asia*.

³⁶ <http://www.company.mts.tm/eng/company/>

destroyed.³⁷ As a result, the Turkmen authorities annulled MTS's license,³⁸ and the company was forced to leave the country. In addition, the Turkmen authorities refused to even review the issue of compensation for the loss of business.^{39,40}

These are not isolated examples, but rather, fully characterize the utter contempt of the Turkmen authorities for their responsibilities within the bounds of joint agreements, and also their responsibilities within the bounds of national legislation in the area of protecting foreign investments. The role of the Agency in monitoring foreign investments, and, when necessary, putting pressure on them, is exclusive. In the hydrocarbon sector, the Agency has legally usurped this authority with help from the Law "On Hydrocarbon Resources," without even the need to manipulate other areas of legislation.

"Shadow State Economics"

The term "Shadow State Economics" is based in the notion that it is impossible to describe other examples of the economic model created in Turkmenistan. It is commonly known that the sale of hydrocarbon resources comprises the overwhelming part of the revenue coming into the country. It is not possible to find out more precise figures—all the data is fiercely hidden by the Turkmen authorities and the majority of the partner-buyers of hydrocarbons. Plus, the level of secrecy in past years is close to absolute. Yes, the Turkmen authorities talk about the volume of gas that has been sold and that is planned for sale. But the prices, for which it will be sold, neither net nor gross,⁴¹ are not publicized and are in fact secret. Similarly, there are no data about the sums that are coming into the country for sold hydrocarbons. As it is impossible to judge approximately the volume of sold oil through open net sources,⁴² it is impossible to judge the actual volume of gas sold abroad, and, especially the prices, for which that gas was sold.⁴³ Accordingly, it is difficult to determine the amount of hard currency coming into the country. In accordance with the Law "On Hydrocarbon Resources," the Agency holds the full calculations for all statistics on hydrocarbon resources:

Article 7: The Basic Functions and Authority of the Agency

1. The Agency carries out the following functions in the area of management and use of Hydrocarbon resources:

³⁷ <http://www.turkmenistan.ru/ru/articles/35467.html>

³⁸ <http://www.company.mts.tm/>

³⁹ <http://www.turkmenistan.ru/ru/articles/36102.html>

⁴⁰ <http://www.company.mts.tm/eng/company/>

⁴¹ This means transport costs for the delivery of gas.

⁴² A part of Turkmenistan's oil is extracted on the basis of Production Sharing Agreements, but this does not allow for adequate evaluation of the amount of extracted oil nor the number of shares of the investors, much less to determine the amount of money that is placed into the budget from the extraction of oil.

⁴³ Strangely enough, the most open company working in Turkmenistan is Russia's Gazprom, which, in recent times, has made its contracts with Turkmenistan transparent. But, the share of Gazprom's trade with Turkmenistan is constantly diminishing.

<...>

9) organizes statistical reporting for Hydrocarbon resources;

Accordingly, the Agency itself does not publicize any kind of statistical reporting and does not give this reporting to other state departments for publication. On the Agency's website,⁴⁴ there is no full information about this, and the Agency does not produce its own printed publications, except for advertising.

Thus, all data about the volume of all categories of reserves in Turkmenistan, the volume of extraction and the volume of export are in the hands of the Agency.

But most importantly—the Agency is the beneficiary of essentially all payments made by foreign investors for extracting hydrocarbon resources on the territory of Turkmenistan:

Article 51. Sources of Revenue and Tax Liability of the Agency

1. Sources of revenue for the Agency are:

1) royalties for extraction of Hydrocarbon resources, established as a percent of the relationship from the volume of extraction of Hydrocarbon resources or from the cost of carrying out the production and payment to the Contractor in financial form or in the form of a part of the extracted Hydrocarbon resources;

2) bonuses, paid in the form of one time payments in the signing of the Agreement, at the commercial discovery of a Field of industrial significance, for the achievement of an Agreement on the level of extraction of Hydrocarbon resources and in other cases stipulated by the Agreement;

3) income received by the Agency through the terms of the Production Sharing Agreement as a result of sharing production;

4) income received by the Agency through the terms of other forms of Agreements as the Contractor carries out Petroleum operations;

5) other income received by the Agency through other agreements, signed in accordance with the existing Law, as well as a result of its activity, including the management of the transfer and (or) nontransfer of property, including assets and financial means.

In addition, the Agency is also the owner of hydrocarbon resources and represents Turkmenistan according to the conditions of Production Sharing Agreements:

Article 7. The Basic Functions and Authority of the Agency

1. The Agency carries out the following basic functions in the area of management and use of Hydrocarbon resources:

⁴⁴ <http://www.oilgas.gov.tm/gosagenstvo.html>

<...>

13) determines the procedure for obtaining and use of Hydrocarbon resources due to the Agency in accordance with the Contract for conduct of Petroleum Operations;

This is particularly important because the majority of agreements with foreign investors have been formed specifically on the basis of the Production Sharing Agreement.⁴⁵

And now we have arrived at the most important point—the interaction between the Agency and the state. In the amendment to the Law “On Hydrocarbon Resources” in 2008, this was described in the following way:

Article 51. Sources of Revenue and Taxation for the Agency

<...>

2. The Agency transfers to the State budget of Turkmenistan **10 percent of the revenue** indicated in points 1-4 in the first part of this article.

In routine amendments in 2010, this article of the Law states:⁴⁶

Article 51. Sources of Revenue and Taxation of the Agency

<...>

2. The Agency transfers to the State budget of Turkmenistan **20 percent of the total revenue** indicated in points 1-4 in the first part of this article.

This means that the Agency transfers to the budget of the State of Turkmenistan only twenty percent of the sum of all revenues, which it receives for the sale of natural hydrocarbon raw materials!

Of course, it is very important that the Agency reserves for the budget a full twenty percent instead of ten percent of revenues of one of the richest hydrocarbon states in the world. The practice of “cutting off” and “sterilization” of surplus revenues from the sale of hydrocarbon raw materials is well known and is used in various countries to create various funds “for future generations,” “stabilization funds” in case of crises, etc. But, there is no mention of the existence of these additional structures and mechanisms in Turkmen legislation.

One could propose, for example, that a portion of the direct taxes goes into the state budget in the form of royalties from contractors for the use of mineral wealth. But, the Tax

⁴⁵ http://www.oilgas.gov.tm/_gosagenstvo.html

⁴⁶ http://www.turkmenistan.gov.tm/_ru/laws/?laws=01gf

Code of Turkmenistan excludes from its jurisdiction all subjects of the Law “On Hydrocarbon Resources:”⁴⁷

Tax Code of Turkmenistan:

Chapter 3. Taxes on the Use of Mineral Wealth

Article 129. Tax Payers for the Use of Mineral Wealth

<...>

3. Legal bodies and individuals who are contractors and subcontractors in accordance with the Law of Turkmenistan “On Hydrocarbon Resources” are not included among taxpayers for the use of mineral resources.

In this way, the Agency concentrated in its own hands all mechanisms of control and appropriation of revenues from the development and sale of hydrocarbons.

This is the fate of all other monies remaining at the command of the Agency after the payment of 20 percent to the state budget:

Article 51. Sources of Revenue and Taxation of the Agency

<...>

2. The Agency transfers to the State budget of Turkmenistan 20 percent of the total revenue indicated in points 1-4 in the first part of this article.

The part of the revenues of the Agency that remains after the payment of these transfers is not subject to taxation and is not the object of assessment for calculation of any required payments (collection and assessment), is not included in its gross revenue in the determination of taxable profits of the Agency, **and remains at the disposal of the Agency and is used by them independently in accordance with its decisions.**⁴⁸

This means that after the payment of twenty percent to the budget, the remaining resources remain at the total and uncontrollable disposal of the Agency, do not incur any taxes, and, in accordance with this standard of the Law, are not considered to be a profit of the Agency!

With this, the long-term fate of hydrocarbon monies is simply lost in the bowels of the Agency. There are no legislative standards that determine the rules of accumulation and dispersal; it is as if investment of these resources does not exist. There is no control over this money on the part of the parliament or society. The structure of the Agency and the composition of its official leadership and management bodies are also unknown, with the

⁴⁷ [http://www.turkmenistan.gov.tm/ ru/laws/?laws=01bn](http://www.turkmenistan.gov.tm/ru/laws/?laws=01bn)

⁴⁸ <http://www.turkmenistan.gov.tm/ ru/laws/?laws=01gf>

exception of the fact that the Agency is under the leadership of the President and, although he selects a formal director, he is its only real leader.⁴⁹

In October 2008, after the Law “On Hydrocarbon Resources” was passed and the role of the Agency in it was confirmed, President Berdymukhamedov stated at a government meeting that a Stabilization Fund would be created in Turkmenistan. He stated that the source of this Stabilization Fund would be the “leftovers from the profitable resources of the State budget and in the future, financial assets of the state would accumulate in it.”^{50,51}

It is worth mentioning that this particular statement of Berdymukhamedov specifically mentions the “profitable resources of the State budget,” that is, monies that are already in the budget; the shares of the Agency have no relationship to the afore-mentioned “Stabilization Fund.” Berdymukhamedov’s statement that “in the future, financial shares of the state will accumulate in it,” has also not been confirmed—there is no mention of it in the press, not one law was passed that would make the statement real, and not one normative document was signed.

How to Steal an (Oil or Gas) Field

If the reader thinks that the attempts by the authorities to further usurp the oil and gas reserves of Turkmenistan stop at that, then we offer yet another example.

On August 11, 2011 the Law of Turkmenistan on Amendments to the Law of Turkmenistan “On Hydrocarbon Resources” was published. Anticipating signing the Law on Amendments to the Law “On Hydrocarbon Resources,” President Berdymukhamedov stated, “This law is based on rational use and preservation of the natural wealth of the country for future generations.”⁵²

This is the text of the Law on Amendments to the Law “On Hydrocarbon Resources,” in full:⁵³

The Law of Turkmenistan

On Amendments to the Law of Turkmenistan “On Hydrocarbon Resources”

The seventh part of Article 64 of the Law of Turkmenistan “On Hydrocarbon Resources,” was adopted by the Medzhilis of Turkmenistan on August 20, 2008 (Vedemosti Medzhlisa Turkmenistana, 2008, No. 2, p. 40; 2010, No 1, p. 20), to be placed into the next edition:

⁴⁹ <http://www.turkmenistan.ru/ru/node/24658>

⁵⁰ “Neutral Turkmenistan,” No. 266, October 22, 2008.

⁵¹ <http://www.turkmenistan.ru/ru/node/24837>

⁵² Presentation on Turkmen Television channel, Altyn Asyr, August 11, 2011.

⁵³ <http://www.turkmenistan.gov.tm/ru/laws/?laws=01in>

7. The licensing of work for exploration and extraction of hydrocarbon resources, not regulated by the current Law, exists in accordance with the Law of Turkmenistan "On Licensing Different Kinds of Activity."

President of Turkmenistan Gurbanguly BERDYMUKHAMEDOV.

This is how Article 64, Point 7 appeared in the previous version of the Law (2008) "On Hydrocarbon Resources":

7. Licensing of different kinds of petroleum operations, not regulated by the current Law, exists in accordance with the Law of Turkmenistan, "On Licensing Different Kinds of Activity."

The 2011 amendment to the Law "On Hydrocarbon Resources" carries fundamental importance.

Earlier, in the 2008 Law "On Hydrocarbon Resources," this point allowed licenses to be given for certain kinds of "petroleum operations," and implied and stated only that at the time of its entry into force, the law could not take into account all kinds of work. Because technology and methods of exploration and extraction of hydrocarbons change constantly, the authorities decided that it did not make sense to make changes to the law each time a new technology was adopted. Therefore, this type of work has been placed under the jurisdiction of the Law "On Licensing Different Types of Activity."

But the last amendment to this point of the Law "On Hydrocarbon Resources" creates an enormous legal "hole" in all of the legislation of Turkmenistan because it introduces the possibility for the creation of a legal precedent, in which "exploration and extraction of hydrocarbon resources," may not fall under the function of the Law "On Hydrocarbon Resources."

What could this mean? That all requirements of the Law "On Hydrocarbon Resources" on legal, environmental, social, insurance, tax and all other articles could be void in the case, which is mentioned in the amendment to the Law "On Hydrocarbon Resources," if this precedent occurs outside the perimeters of the authority of the Law "On Hydrocarbon Resources."

By introducing this amendment, it is now possible to carry out "exploration and extraction of hydrocarbons" on the basis of a foreign investor obtaining a license and on the basis of a production sharing agreement, a favorite of the Turkmen authorities. In this way there is the real possibility, not only to avoid all the requirements of the Law "On Hydrocarbon Resources," but also to take "into the shadows" all the interaction with investors who are developing hydrocarbons. Agreements on the basis of PSAs have always been secret, or had necessarily secret articles, especially those that related to the division of profits and the payments to investors by the government or a substitute for the state entity.

This confidentiality is mentioned in a separate article of the Law:

Article 62. Confidentiality of Information

1. No party to the agreement have the right to publish, divulge or transfer to a third party any information that can be considered confidential and having a connection to Petroleum operations, without prior agreement from the other party to the agreement.
2. Confidential information can be given to legal advisors, accountants, other consultants, guarantors, creditors, subcontractors, companies transporting goods, under the condition of a prior written guarantee that these parties will not divulge information they receive.

Furthermore, removing hydrocarbon extraction from the authority of the Law “On Hydrocarbon Resources,” creates a legal vacuum in the area of payment for sold hydrocarbons. What sort of role the Agency would play is not entirely clear. It is clear that the Agency would give licenses for “exploration and extraction” of hydrocarbons, and that only the Agency would have the authority to conclude agreements on production sharing, etc. But this procedure is only in the legal arena of the Law “On Hydrocarbon Resources.” What would be outside of its scope can only be surmised.

But all of this does not remove the main question. Why was it necessary to amend the law? As a rule, such amendments, which **knowingly** weaken the regime of the law, serve only one or two goals, or both immediately:

- weakening or completely excluding the control of state bodies for the activity of a foreign investor

And

- creation of a nontransparent system of distribution of revenues from extraction and sale of hydrocarbon resources.

International experts who were consulted were not able to name any other reasons or a need to introduce such amendments to the legislation,⁵⁴ as was done in Turkmenistan.

Findings

1. President Berdymukhamedov created a structure in the form of the State Agency for the Management and use of Hydrocarbon Resources Under the President of Turkmenistan, which de facto usurps and completely controls and disposes of all Turkmenistan’s hydrocarbon resources—starting with holding the tender for investors to receive licenses and control of the activity of investors, and ending with the accumulation of all the monies from the sale of hydrocarbons abroad.

⁵⁴ On the adoption of changes to the Law of Turkmenistan “On Hydrocarbon Resources,” August 11, 2011.

2. President Berdymukhamedov strengthened his scheme for usurpation in the separate Law “On Hydrocarbon Resources,” which enables him to control on his own the revenues from the sale of hydrocarbons “on a legal basis.”
3. Out of the sum of all revenues, which exist now and will appear in the country in the future from the sale of hydrocarbon resources, and which the Agency accumulates, **only twenty percent go into the budget of Turkmenistan.** The other 80 percent remain at the disposal of the Agency and “are spent at its discretion”⁵⁵ according to the Law “On Hydrocarbon Resources.”⁵⁶ In addition, these assets of the Agency will not be taxed in the future.⁵⁷
4. There are no publicly accessible documents that succinctly and in accordance with the legislation of Turkmenistan describe the structure of the Agency, the composition of its leadership and management bodies, and the authority of the Agency with regard to management of monies, which are at the disposal of the Agency. Furthermore, the entire responsibility for management of the Agency remains exclusively under President Berdymukhamedov, which is clear from the full name of the Agency⁵⁸ and the source of its legitimacy—the ruling of the President.⁵⁹
5. In August 2011, President Berdymukhamedov signed a law,⁶⁰ which allowed for the possibility of removing the exploration and extraction of hydrocarbon resources out from under the authority of the Law “On Hydrocarbon Resources.” This created even more possibilities for him personally to usurp Turkmenistan’s hydrocarbon reserves.
6. The Agency is a self sustained legal body with the authority of independent economic and international economic activity.⁶¹ Without strong public monitoring, this fact opens the door to uncontrolled use of capital, including outside of the country, which is under the authority of the Agency.
7. The structure that has been created in the form of the Agency, and its authority encroaches on the competency of other ministries and departments, essentially paralyzing their work in monitoring the activity of foreign investors in Turkmenistan.

⁵⁵ Article 51, Point 2 of the Law “On Hydrocarbon Resources.”

⁵⁶ On the Adoption of Changes and Additions to the Law of Turkmenistan “On Hydrocarbon Resources,” March 12, 2010.

⁵⁷ Article 51, Point 2, Law “On Hydrocarbon Resources.”

⁵⁸ State Agency on the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan.

⁵⁹ Resolution of the President of Turkmenistan on the Formation of the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan,” “Neutral Turkmenistan,” No. 62, March 12, 2007.

⁶⁰ Law on the Introduction of Amendments to the Law “On Hydrocarbon Resources,” August 11, 2011.

⁶¹ Articles 6 and 51 of the Law “On Hydrocarbon Resources”

Conclusion

Just as in any other totalitarian state, the authorities in Turkmenistan are trying not only to keep all aspects of the state, economic and social life under their control, but they are also trying to encroach upon all aspects of these spheres in order to manage them as tightly as possible.

In this regard, Turkmenistan may become a classic example of the contemporary totalitarian dictatorship. On the one hand, it is an example of an anachronism like North Korea, deriving its totalitarian potential from the time of the Cold War and the blessings of Joseph Stalin or Mao Tse Tung. On the other hand, Turkmenistan could become completely respectable like the former regime of Hosni Mubarak in Egypt or the regime of the “soft dictator” Alexander Lukashenko in Belarus.

But the distinctive peculiarity of Turkmenistan revolves around its colossal natural energy resources and its small population. And this has opened up fantastic possibilities for post-Soviet modernization including its entry into the circle of wealthier countries.

However, the authorities have preferred to deny society all freedoms, gradually reducing political, economic, and social freedoms, dragging the country further and further away from development.

The degradation of education and science, the destruction of the opposition movement and any appearance of activity of civil society, including the press, the destruction of small and medium sized business, and the isolation of the country—all this was, and remains the reality of Turkmen existence. On the other hand, the authorities have propagated a state ideology, thoroughly intertwined with the cult of personality of the first and second presidents and with ersatz nationalism; the dominance of the secret police have paralyzed not only public and political life, but also given birth to enormous corruption and a racket within the secret police itself, which has suffocated economic life. And, on the other hand, the authorities have entirely usurped the enormous revenues from the country’s oil and gas sector and used that money in a completely unfettered manner to support the dictatorship and cyclopean projects of dubious economic and aesthetic expediency.

The hopes for some sort of modernization and potential for reform by the new President Berdymukhamedov, which were held by western politicians in 2006 and 2007, have dissipated like smoke. Berdymukhamedov deliberately walked away from systemic reforms, but very carefully built an entire system of state management under his own personal, and very specific, notion of what it was. He preserved and strengthened the repressive apparatus, brought into the government people what he picked himself, “allowed” his cult of personality (the cult of his own personality), and recreated the country’s economy according to his own tastes.

The history of the creation of the “hydrocarbon god” in the form of the Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan is a good example of this. And this history should be a cause for concern among those who believed and continue to believe that Berdymukhamedov has some sort of program or strategy for the modernization of the economy.

He has no program or strategy other than strengthening and preserving his own power. For that, he created two instruments—a personal monopoly on hydrocarbon money and a repressive apparatus, which holds the entire Turkmen society in fear and ideological absurdity. And, so that he can hold on to his personal power, Berdymukhamedov will never refuse either of his instruments. Therefore, all the expectations, hopes and demands to the Turkmen authorities regarding liberalizing the economy and democratizing public life remain without an answer. There is no cause or reason for Berdymukhamedov to begin to change anything. The Turkmen people are afraid, and all the democratic countries stand in line in front of Berdymukhamedov waiting for gas and forgetting about all of their principles, silently broadening his ambition.

But, this cannot go on forever. Sooner or later the Berdymukhamedov’s regime will collide with the problems that brought about the collapse of the regimes of Ben Ali, Mubarak and Khadafi. Everything is pointing in that direction, as was discussed in this report.

The authors of the report suggest that the reader consider which portion of the guilt for the future turmoil is the burden of the Turkmen regime, and which portion of the guilt is that of those who strengthened the regime and closed their eyes to the absolute violation of human rights and the total corruption in Turkmenistan. Through their actions and inaction, both the Turkmen authorities and their international partners are doing everything that could lead to a revolutionary scenario in Turkmenistan. The current Turkmen regime is incapable of evolution, and it has proved this. Whether there will be a “velvet” scenario, as in Tunisia, or a civil war like in Libya, only time, and the ability to learn from history, will tell.

The authors of the report believe it is their responsibility to propose recommendations for the key players involved in the “gas games” inside and around Turkmenistan. The authors remain hopeful that it is still possible to avoid major turmoil, human suffering and sacrifice.

Recommendations

For Foreign Governments and International Organizations

- Encourage the Turkmen authorities to be transparent with information about all oil and gas development revenues, including cover-ups of extra-budgetary funds. It is important that international governments understand that hiding these revenues can provide the foundation for corruption in state structures, as well as for transnational corruption. It is important for international partners of Turkmenistan

to understand that transparency of hydrocarbon monies is one of the foundations of political forecasting and political trust in regimes like Turkmenistan.

- Encourage the Turkmen authorities to move toward real democratic reform in political, public and economic life. Only a developed civil society, including mass media and NGOs, political parties and private business, is capable of effectively protecting public interests and shielding the country from radical turmoil.

Specifically for the bodies of the European Union: European Parliament and the European Commission; and for the US Government

- Conduct an objective evaluation of Turkmenistan as a state-partner, conforming to the minimum demands for state-partners. In order to do, that one must carry out additional analysis of Turkmenistan's legislation to determine how it conforms to the basic requirements and standards for observing human rights, democracy, environment, economic freedom, and the fight against corruption.
- Objectively evaluate the progress and regress of Turkmenistan's democratic and economic reforms, including its transparency and fight against corruption, as well as a measurement of the capacity of Turkmenistan's leadership to conduct real reforms in these areas.
- Strictly and fundamentally require that any economic and political cooperation with Turkmenistan be dependent on concrete and systematic reforms both on the level of legislation and on the level of implementation—with human rights, the development of democratic institutions, free enterprise, and the fight against corruption.

For the European Bank for Reconstruction and Development

- Precisely determine and firmly demand transparency of the activity of the Agency and other extra-budgetary funds as a requirement of further cooperation.
- As part of the annual review of the EBRD's country strategy for Turkmenistan, consider the Turkmen authorities' progress in growing away from a regime of secrecy about all hydrocarbon and other financial assets, including those of the Agency, the Stabilization Fund, and other extra-budgetary funds.
- Encourage the Turkmen authorities to guarantee parliamentary and public control over the return of monies from the extra-budgetary funds, including their expenditure.

- Encourage the authorities of Turkmenistan to move toward real reform in the management and use of hydrocarbon resources, especially toward the attainment of clear and transparent principles regarding the placement of hydrocarbon monies into the state budget, and their expenditure.

For the World Bank and International Finance Corporation

- While creating its lending and grant policies, take into consideration the existence in Turkmenistan of “shadow state economics” and take all measures to avoid supporting and strengthening, or providing international legitimacy to it.
- Bring attention to the fact that legislation in Turkmenistan is specially adapted to hide all violations of environmental and social standards, especially involving foreign investors. The legislation also creates the conditions for functional corruption on the state level with the possibility to grow to the international level.
- Take into account that the Turkmen legislation in the oil and gas sphere contradicts other areas of legislation, creating conflicts of interest and competency among various state bodies, and leaving many legal gaps in the regulation of the activity of foreign investors, primarily in the oil and gas sector.
- Encourage the authorities of Turkmenistan to create transparent legislation in line with international standards for regulating the oil and gas sector, regulations for foreign investment and equitable distribution of revenues from the sale of hydrocarbon resources.
- Encourage the authorities of Turkmenistan to remove the monopoly over the non-hydrocarbon economy—communications, agriculture, transport, banking services – and to create a real base for the development of a market economy.

For Foreign Private Investors

- Avoid any questionable and corruptly capacious propositions from the Turkmen authorities, as well as regulations established by Turkmen legislation that could facilitate the development of corruption, including international corruption.
- Propose to the government of Turkmenistan that it use a more transparent system with relation to finalizing contracts for the development of hydrocarbon resources and financial calculations with state bodies of Turkmenistan for extracted and sold hydrocarbons.

- Pay specific attention, when planning activities in Turkmenistan, to how they may impact social and environmental development in the country.
- Strictly observe the norms of international law, especially in the area of fighting corruption, environmental protection and human rights.

For International Nongovernmental Organizations

- Criticize human rights violations and the incentivizing of corruption not only by the government of Turkmenistan, but also by the governments of western countries, international financial institutions, natural resource transnational corporations and banks for lack of adherence to principles of human rights and sound environmental management.
- Actively seek information on oil and gas transactions by requesting that relevant documents be made publicly available by international investors, the international financial institutions, corporations and governments, including on environmental, economic, labor and other issues. Be prepared to utilize freedom of information laws in your country to obtain this information.
- Engage with corporations and investors working in Turkmenistan and provide them with information about the environmental, human rights, labor and social issues inside Turkmenistan.
- Hold international financial institutions, private banks, government departments and corporations to the same standards required in the west, particularly on human rights, labor and environmental issues.
- Cooperate with the media to share information and draw attention to important issues related to oil and gas transactions in Turkmenistan.

For the Government of Turkmenistan

- Provide complete transparency of activities of the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan, including the composition of its management and leadership bodies, as well as the mechanisms, priorities and goals for expenditures of the monetary resources that are at the disposal of the Agency.
- Engage in diversification of the power and competency of the Agency among constitutionally authorized bodies of state authority, in order to eliminate conflict of interests in the internal authority of the Agency, as well as in the interactions with other bodies of state authority.

- Provide complete transparency of the work of all extra-budgetary funds, including the financial assets of the State Agency for the Management and Use of Hydrocarbon Resources Under the President of Turkmenistan, the Stabilization Fund of Turkmenistan and any other financial institutions, as well as to provide transparency of their interactions with the state budget.
- Disclose relevant information and promote transparency about the interactions with all foreign investors, especially in the oil and gas sector, excluding from the category of state and commercial secrets the amounts of all costs and revenues of the earning and exploitation of oil and gas resources, as well as the amount of revenue from the sale of hydrocarbon resources in all schemes, including those based on Production Sharing Agreements.
- Allow parliamentary and public control over the income and expenditure of monies received through the sale of hydrocarbon resources, extracted on the territory of Turkmenistan and sold outside the country.

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