European Bank for Reconstruction and Development
One Exchange Square
London EC2A 2JN

25th February, 2010

Dear Members of the Board,

This is a letter in response to the publication of the EBRD's draft strategy for Turkmenistan which was released on 15th January 2010. We welcome this opportunity to submit our comments.

The Bank's Article 1 statement says that the EBRD will support those "countries committed to and applying the principles of multiparty democracy, pluralism and market economies." The EBRD thus plays an important role in helping a country such as Turkmenistan make this transition if its government shows such commitment. Turkmenistan is at a crucial point in its history: the death of first president Saparmurat Niyazov after years of despotic rule created a chance for genuine reform, both in the economy and in the development of human rights and democracy.

However, the hope that came with Gurbanguly Berdymukhamedov's election as Turkmen president in 2007 has now faded: there has been no movement towards the creation of a multiparty democracy, civil society is severely restricted, and the human rights situation is still dire, according to activists from both within the country (who have to operate covertly) and in exile. Many questions also remain over the management over the country's natural resource revenues.

The Turkmen government should certainly be encouraged in the reforms it has made. However, there is a danger that Turkmenistan is learning to 'play' the international community by making cosmetic changes which do not effect what is essentially the same system that Niyazov presided over. There is a risk that by funding even infrastructure projects, the EBRD may not bring about reform, and may only strengthen the current regime and make it more difficult for the country to achieve those principles contained in Article 1.

We therefore feel that the EBRD should continue its policy of not funding any project that may be beneficial to the state unless the Turkmen government first fulfils certain basic requirements regarding fiscal transparency and budget management. The point of greatest influence is now, before agreements on funding are made, when there is something for the Turkmen government to gain.

The Turkmen 'budget'

We would like to focus our comments regarding the draft strategy on the management of Turkmenistan's oil and gas revenues, which are crucial to Turkmenistan's future economic well-being. As we explained in our 2006 report *It's a Gas*,[1] none of the country's oil and gas money

[1] *It's a Gas*, Global Witness, April 2006. See http://tinyurl.com/7mrh7x

made its way to the budget, but was instead transferred to opaque off-budget funds. Under Niyazov, a staggering 75% of government spending took place off-budget.

Following Berdymukhamedov's election as president in 2007, certain statements were made that gave Turkmen citizens and international observers hope for reform: in August 2007, it was reported that the Turkmen government's accounts regarding how it spends budget funds would be published in Turkmen mass media for the first time and that an Audit Chamber had been set up on the order of Berdymukhammedov for preparing such reports.[2] This would have been a welcome step forward; under Niyazov, virtually no information pertaining to the budget was released.

Yet despite Berdymukhamedov's proclamation, nearly three years later information on the budget remains scant, and on government spending even more so, apart from a vague sector-by-sector breakdown. One source from an international financial institution reported to Global Witness in a private discussion that many extrabudgetary funds have been closed, with the result that some government spending has been brought onto the budget. The Turkmen government needs to present evidence to show that this has indeed been achieved. It should also – for the first time in its independent history – publish a proper budget so that the country's citizens can see what the money garnered from the country's oil and gas exports is being spent on.

Opacity and mismanagement in the Turkmen oil and gas sector

Under President Niyazov, as the draft strategy points out, resource revenues flowed to funds such as the Foreign Exchange Reserve Fund (FERF) which was controlled solely by Niyazov and used to bankroll his notorious personality cult. Both the FERF and the Oil & Gas Development Fund, which also accrued money from the sale of natural resources, were off-budget.

Global Witness estimated the money held in the FERF to be around US$3 billion in 2004/5, though rising gas prices may have meant that the fund held a much greater amount at the time of Niyazov's death. There is much concern regarding what happened to the FERF after Niyazov's death. Deutsche Bank (which holds accounts for the Turkmen state, including funds which make up the FERF) has refused to answer our questions, and the Turkmen government has remained silent. There is the possibility that some of this money simply disappeared.

Is oil and gas revenue management becoming more transparent in Turkmenistan?

On page 21, the draft strategy states, "As there have been certain reform efforts around FERF including (i) new oil and gas revenues are now accumulated in the state stabilisation fund, and (ii) the FERF is officially under Central Bank's management, the Bank may consider selective private oil and gas sector projects in cases where the Bank can maximise transition impact."

As noted above, the FERF was under the control of former president Niyazov, and as such posed a risk that revenues transferred to that fund may be used for personal ends and/or to strengthen the presidential personality cult. We would question the statement from the draft strategy that, "the FERF is [now] officially under Central Bank's management". Under Niyazov, the FERF was nominally under the jurisdiction of the Central Bank, but only Niyazov could authorise payments. The Central Bank chairman had no real control over the fund, and operated under the constant threat of the sack or even jail. In essence this made the FERF a *de facto* personal fund, and we have seen no evidence to suggest this is now otherwise under Berdymukhamedov.

The draft strategy goes on to say on page 36 that the newly-created stabilisation fund "would channel the country's oil and gas revenues into long-term investments such as infrastructure, partially addresses long-lasting concerns about the opaque and non-transparent management of the country's resources' wealth." However, it would be unwise to call the creation of the stabilisation fund a "reform effort" per se; without proper governance structures in place, the stabilisation fund

[2] Tass. 24 August 2007.

could easily become another FERF – an off-budget fund under the control of the president with its spending unaccountable to the Turkmen people. The fact that the fund is "managed by the Ministry of Finance" may mean nothing if the president is the sole signatory for payments from the fund, for example.

Using leverage to improve revenue management and budget transparency in Turkmenistan
The strategy states that private oil and gas projects may be considered, "if, with regard to FERF and the newly-formed stabilisation fund, the principles of their institutional functioning and management are disclosed and well-understood. In this case, Bank will mainly focus on reputable foreign companies or joint ventures, with proper bidding process, transparent revenues and procurement arrangements, with international best practice in environment and those following EITI principles."

While Global Witness welcomes such language, we feel that the EBRD needs to go further because of the unresolved issues regarding these funds, and the lack of any indication from the Turkmen government that more progress will be forthcoming. The Bank's Strategy for Turkmenistan from 2004 stated, "Critical for the operation of such a [stabilisation] fund… would be the proper accounting of all financial flows, as well as the requirement to disclose all operations to the public." We feel that the EBRD should adopt a similar principled stance in its current strategy and only consider funding projects (not just in the oil and gas sector) that may benefit and strengthen the current regime if the following requirements are fulfilled:

- The Stabilisation Fund and the FERF should be audited by an independent body and the results made available to the public. The regulations regarding the governance of these funds should be based on internationally agreed best practice procedures and should also be publicly available. The funds' operations should be disclosed.
- All other off-budget funds should be brought onto a properly drawn-up budget, which should be made available to the public. The Turkmen government should also release audited information regarding the off-budget funds it has closed.
- Transparent procedures for the allocation of oil and gas licences should be put in place, including a proper bidding process and the full disclosure of the ownership structures of those entities involved.
- All of the above conditions should be met before the EBRD agrees to fund other projects outside of Turkmenistan that could lead to revenues accruing in the FERF/Stabilisation Fund; for example, if Turkmenistan agrees to sell gas to be transported through the Southern Corridor Project or the Nabucco Pipeline.

If you have any questions, please do not hesitate to contact us.

Yours sincerely,

Gavin Hayman
Campaigns Director