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Crisis in Turkmenistan
A test for China's policy in the region

Jakub Jakóbowski, Mariusz Marszewski

The currency crisis, caused by the collapse in gas prices, has turned into the most serious social and political crisis in the history of Turkmenistan. The government in Ashgabat has passed the burden of the economic problems onto the population, suspending the convertibility of the manat and dismantling the extensive social security system. The drastic reduction in the standard of living of Turkmenistan's population has undermined the stability of the regime. The depletion of Turkmenistan's foreign exchange reserves could bring an end to the monumental state investment programme which – together with the social security system – is the main source of the regime's legitimacy. The current dynamics of the crisis are fully dependent on China, the sole recipient of Turkmenistan's gas (receiving more than 90% of total gas exports) and Ashgabat's main creditor. The terms of the Chinese-Turkmen contracts (apparently linking gas prices with oil prices) is leading to a drain of Turkmen resources and reducing the inflow of foreign currency. China may be faced with the need to stabilise the economy of Turkmenistan. In the absence of any rescue actions, there is a considerable risk of the collapse of the Turkmen state. However, any greater involvement by China could mean a violation of the Chinese-Russian *modus vivendi* in the region. Moscow could take advantage of the crisis to rebuild its influence in Ashgabat, and include Turkmenistan within its own political integration projects within the region, resuming gas cooperation and offering military assistance to stabilise the regime.

The currency crisis in Turkmenistan is a direct result of the rapid fall of prices on the global markets for oil and gas since 2014. The average price of the gas exported to China, which receives more than 90% of Turkmenistan's gas exports, has fallen from around US$503 per tonne in 2014 to $266 in 2017. This has led to a drastic reduction in the amount of foreign currency coming into Turkmenistan, causing an imbalance in the current account and putting strong downward pressure on the Turkmen currency, the manat. Turkmenistan's current account deficit rose from around 5% of GDP in 2014 to 21% of GDP in 2016. In their attempts to maintain a fixed exchange rate against the US dollar, in January 2015 Turkmenistan's authorities introduced a small devaluation of the manat (from 2.9 to 3.5 per dollar), and in January 2016 they completely suspended the convertibility of the manat into dollars for citizens (as well as private companies). The option of buying dollars at the official rate is now only available to entities involved in priority projects, such as the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline, and the Asian Games in 2017[1].

[1] O. Auyezov, *Exclusive: Turkmenistan limits access to foreign currency as exports fall,* Reuters, 20.06.2016, https://uk.reuters.com/article/us-turkmenistan-economy-exclusive-idUKKCN100153

The lack of access to foreign currency among the population and the private sector has inflated the the black market rate for the US dollar, which rose from 6 to around 30 manats from 2016 to 2018.

Multidimensional dependence on China

One factor aggravating the crisis was the series of mistakes in Turkmenistan's energy policy, leading to a harmful dependence on the Chinese market. As a result of the conflict over gas prices with Iran (2016), followed by the limitation and then suspension of imports by the Russian Gazprom after 2009, China is now the only major customer for Turkmen gas. In 2017 it received around 94% of the volume of Turkmen gas exports, which represented around 90% of the total value of Turkmenistan's total exports (and the most important source of the country's foreign currency revenues). Although the details of the supply contracts to China are not known, the sharp decline in the average price since 2014 indicates a formula linking the price of gas with that of oil. According to Chinese data, imports from Turkmenistan rose in 2014-17, from 18 million tons to 24 million tons of gas (see Annex), while Turkmenistan's total revenue fell from US$9.4 billion to US$6.5 billion. The Chinese market does not compensate for the lost revenue from the Russian and Iranian markets, and the total export volume of gas from Turkmenistan declined in 2014-17 from 41.6 to 33.6 bcm[2].

Turkmenistan is also bound by credit agreements with Chinese banks, which since 2009 have provided financing for the development of gas deposits for the previously self-sufficient Turkmenistan. In 2009-11, the total value of these loans stood at US$8.1 billion; in 2013 further contracts of unknown value were signed. China is now Turkmenistan's largest creditor (the state's entire foreign debt is approximately US$9 billion[3]), and the repayment of the Chinese loans takes up at least US$1 billion annually[4]. Moreover, a part of the fixed repayment tranches denominated in US dollars is likely being repaid in gas in current prices, in the so-called credit-for-resources formula that China has also used in its dealings with Venezuela and Angola[5]. These contracts were concluded in times of high prices for oil and gas, and after those prices fell, the states bound by them were forced to supply more of their raw materials.

The current form of the cooperation with China is leading to a drain of local resources accompanied by a clearly reduced inflow of foreign currency which the country needs.

In Turkmenistan's case, this model has meant a further drain on local resources, with a clearly reduced inflow of foreign exchange[6].

The inertia of Turkmenistan's economic model

So far, the strategy of Turkmenistan's government has been to pass the burden of the currency crisis onto the general public. Depriving its citizens and private business of the possibility to exchange the currency at the official rate, together with a steep rise in the black market rate, has significantly increased the cost of imported goods[7]. At the same time, the government in Ashgabat is continuing its policy of

[2] BP Statistical Review of World Energy, June 2018.

[3] Asian Development Bank Outlook (ADO) 2018.

[4] Authors' calculations, based on information about the conditions of loans obtained from news agency reports.

[5] Y. Chazan, *Angola's debt reliance on China may leave it short-changed,* "Financial Times", 13 June 2018, https://www.ft.com/content/fb9f8528-6f03-11e8-92d3-6c13e5c92914

[6] O. Auyezov, *Exclusive: Turkmenistan limits access to foreign currency as exports fall,* Reuters, 20 June 2016, https://uk.reuters.com/article/us-turkmenistan-economy-exclusive-idUKKCN100153

[7] However, the share of consumption in Turkmenistan's GDP is so low (11% of GDP) that a drop in the population's real disposable income need not necessarily lead to an economic recession. The primary driving force remains net exports and investments (29.9% and 49.1% respectively of GDP in 2015, UNCTAD).

spectacular public investments, which generate up to around 41% of the country's GDP. Along with the stimulation of the economy, these actions also legitimise the government and symbolically bind together the Turkmen nation, composed of conflicting tribes, and so they are seen as an essential element in maintaining the stability of the regime[8]. However, as Turkmenistan's economy is effectively a gas-based monoculture, every project of this type generates demand for significant imports of goods and services, thus expanding the current account deficit and exacerbating the currency crisis[9].

The social crisis is caused by rising inflation, mass firings of state employees, as well as food rationing. This is causing mass emigration in search of better living conditions.

Whether this policy can be continued will depend on the capacity of Turkmenistan's authorities to further defend the manat's official exchange rate to keep afloat the sectors of the economy dependent on it and to service the country's foreign debt (estimated at 30.2% of GDP in 2018). The amount of Turkmenistan's foreign exchange reserves is not officially published, but they are gradually depleting[10]. Although the official GDP growth amounted to 6.5% in 2017, reports from Turkmenistan since the end of 2017 indicate serious budgetary problems and the onset of an economic crisis.

The social crisis and the crisis of the state

One of the fundamental dimensions of the social crisis is linked with the repressive control of currency outflows by the Turkmen authorities. The ban on exchanging foreign currencies, the state capture of domestic savings denominated in US dollars, and the blockade on foreign currency transfers outside the country have led to problems for those social groups who interact with foreign countries: guest workers, businessmen, students and others. Limits and blockades have been introduced on ATM cards for withdrawals from Turkmen banks abroad. As trading in foreign currencies has been prohibited, the informal internal economic exchange based on dollars has been liquidated. Black market currency traders (often linked with the special services) are being repressed, along with small and medium-sized businesses.

The rapidly rising inflation rate, estimated by foreign economists at about 294%[11], is bringing about a deficit of basic (largely imported) consumer goods, including foodstuffs. This particularly affects the poorest social strata. The crisis has aggravated the negative trends in Turkmenistan's agriculture and animal breeding caused by structural problems, such as inadequate investment and the lack of qualified workers. The authorities have resorted to food rationing; its most extreme forms are to be found in the outermost regions. Until January 2016 the official exchange rate for the US dollar was 3.5 manat, while on the black market the figure was 7 manats. It then began to rise by leaps and bounds, reaching a record high of 30 manats in early June 2018, and at present fluctuating around 17 to 20 manats.

[8] For more on the formation of the tribal Turkmen nation and the role of monumental construction, see A L Edgar, Tribal Nation: The Making of Soviet Turkmenistan, Princeton 2004; J. Šír, *Cult of Personality in Monumental Art and Architecture: The Case of Post-Soviet Turkmenistan*, "Acta Slavica Iaponica" 2008, vol. 25, pp. 203-220.

[9] According to data from the Asia Development Bank, the gap in the current account turnover has so far been balanced out by the inflow of foreign direct investments, to the level of 12% of Turkmenistan's GDP of in 2016. The government has also sought to stimulate industries by substituting imports.

[10] After a visit to Ashgabat in November 2015, the IMF announced that the available reserves could cover imports for about 30 months; in 2017 the figure was only 20 months.

[11] This applies to the prices of imported goods sold outside the official Turkmen price-control regime (including foodstuffs). The estimates are based on the rise in the black-market rates of the manat to the US dollar from May 2017 to May 2018. The official inflation rate in Turkmenistan was 8% in 2017. *Turkmenistan's vicious cycle. State media distracts with giant bicycle get-togethers as the economy spins its wheels and the secret police represses,* https://eurasianet.org/s/turkmenistans-vicious-cycle

The reaction to the crisis has increased the pace of emigration for work abroad, mainly to Turkey (and also Azerbaijan, Russia, Ukraine, Cyprus, etc.). The largest numbers of emigrants come from the north and east of the country.

In response to the crisis, the government has introduced a range of reforms for the *de facto* discipline and preventive repression of the society.

The government has been blocking this to some extent by introducing an informal ban on trips abroad to citizens below 40 years of age, in an attempt to restrict the outflow of labour.

The economic crisis is leading to budgetary problems in Turkmenistan. 2017 saw the dismantling of the social security system, including the citizens' right to the free monthly consumption of specific amounts of water, gas, electricity and gasoline. The mass layoffs of government officials has proved particularly difficult for the public[12], along with delays of several months in paying salaries and the extension of unpaid extra work hours. Turkmenistan has also stopped repaying its debts to some foreign companies, mainly Turkish and Belarusian, which have been investing in the country's construction and energy markets.

Fearing a palace coup, President Gurbanguly Berdimuhamedov has reduced his travels abroad over the course of the last year to a minimum. At the same time he has been promoting his son Serdar Berdimuhamedov as his successor. Since the end of last year he has officially represented Turkmenistan at almost every diplomatic event abroad, serving formally as a deputy minister of foreign affairs, and *de facto* as the deputy head of the state.

[12] In Turkmenistan, as in other countries in Central Asia, civil servants make up a substantial percentage of people who have a steady job.

To counter the creeping descent into anarchy, the authorities have introduced a series of reforms which are tools for the *de facto* discipline and preventive repression of society. These include stronger restrictions on the dress code for women working in the public sector; a strict prohibition of bigamous marriage has been introduced (which has hit the political, business and religious elite – the majority of their representatives conduct additional informal relationships, in some cases sanctioned by religious beliefs), and alcohol prohibition has been introduced in selected regions. The persecution of people and groups who are distinguished by religiosity in Turkmenistan's secular society has been increased.

Conclusions

By shifting the burden of the crisis onto the general public, the Turkmen authorities have effectively violated the informal social contract, binding the government with society since 1995. According to it, while the political system of Turkmenistan was the most extreme variant of Central Asian authoritarianism, the people did receive important subsidies (water supplies, cheap food, energy resources) and social relief from the state. Social security was also a key element legitimising the government in Turkmenistan, along with the monumental construction programme and the state's neutral status (a guarantee that the society would not be involved in armed conflict). The removal of these social advantages has translated into a social crisis, weakening the regime's stability and its position in its relationship with Turkmen society.

As a result of the country's deep and multi-layered economic dependency on China, the course of the crisis in Turkmenistan has become heavily dependent on the actions of Beijing. Some of the underlying causes of the Turkmen crisis are largely independent of Beijing's policy, including the collapse of oil prices in 2014 and Ashgabat's conflicts with its other customers. However, the nature of the present economic dependency, as well as the current dynamics of the crisis, is a direct result of Beijing's long-term policy. The expansion of the gas-related infrastructure, based on Chinese loans, has burdened the Turkmen budget. Additionally, the loans are being partially repaid in kind (gas), and the price of gas supplies is linked with current global gas markets, which exacerbates Turkmenistan's balance of payments problems.

The deepening economic problems may lead to the implosion of state structures, and in the worst case to the collapse of Turkmenistan.

Beijing took advantage of its strong negotiating position, which in part resulted from Ashgabat's conflicts with its other partners, to transfer the long-term economic risk onto Turkmenistan. This has translated into the country's current socio-economic crisis.

Prospects

In the current situation, the most favourable scenario for the government of Turkmenistan is linked with the potential increase in global commodity prices. A small boost to the average price of gas supplied to China in 2017 has led to a reduction in the current account deficit to 11.5%. Another potential way to extend the life of the regime would be to acquire foreign loans to support the manat's official rate, which would temporarily help to stabilise the budget's situation and support the government's investments. However, if the economic crisis deepens further, that could lead to the implosion of state structures. In the most extreme scenario, this could lead to the collapse of the state of Turkmenistan and a resulting political vacuum which could be filled by radical groups of militants from neighbouring Afghanistan. In the latter's north-western districts, the structures of the Taliban and Islamic State movements have been strengthening among the Uzbek and Turkmen minorities for several years. Despite the vastly oppressive nature of the Turkmen regime, its structures would prove weak in a confrontation with an external enemy, and would display very low resistance to open political violence.

The deepening crisis may force China to take a decision to stabilise the economy of Turkmenistan. Currently it is China's biggest supplier of gas, responsible for 36% of imports, and 13% of Chinese gas consumption. Despite its large gas reserves and access to alternative sources (such as LNG), a sudden halt of supplies from Turkmenistan could negatively affect the Chinese economy. One possible scenario would be for Chinese banks to offer loans to stabilise the manat[13]. Beijing could also reduce the burden arising from the repayments by acquiring the Turkmen assets (the gas deposit infrastructure) which those repayments funded[14]. The most extreme scenario would be to present Turkmenistan with a reform plan linked to a stability package and the introduction of special economic zones managed by China. However, this scenario would represent a deep intrusion into Turkmenistan's internal affairs, and Beijing has shunned such open interventions aimed at stabilising those economies in Asia and around the world which are dependent on it.

The crisis in Turkmenistan is violating the *modus vivendi* of the Chinese-Russian cooperation functioning in Turkmenistan and Central Asia. This had been based on Moscow's acceptance of growing Chinese economic influence in return for concessions in the political and security fields.

[13] China is apparently providing such emergency loans to Pakistan, which is also struggling with its own currency crisis arising, in part, from the need to repay Chinese loans.

[14] This model has been carried out in the case of the deep-water port in Hambantota in Sri Lanka, among others.

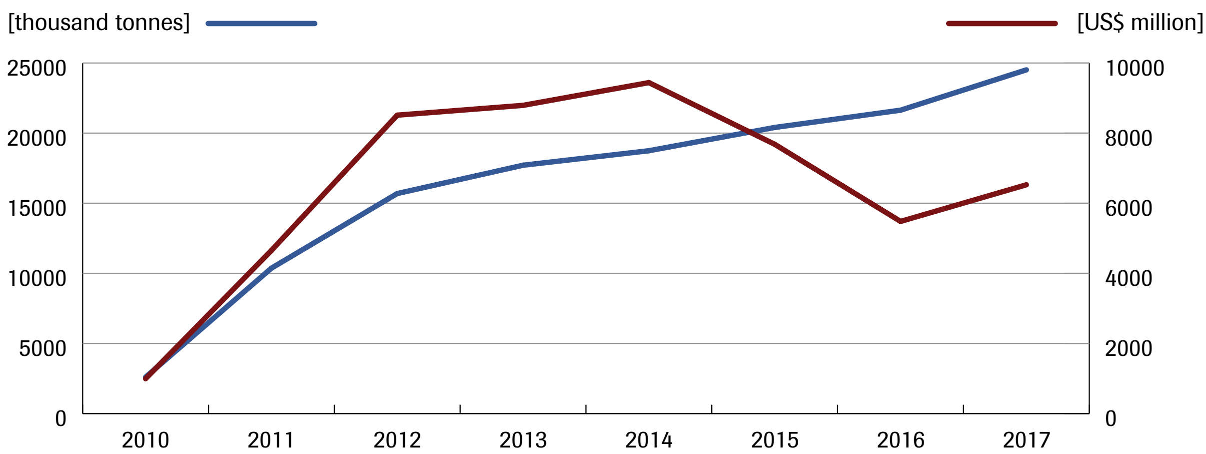
The economic destabilisation of states in the region as a result of their financial dependency on China[15] may create an opportunity for Moscow to get more intensively involved and strengthen its influence at China's expense. With regard to Turkmenistan, the Kremlin has adopted a 'wait and see' approach[16], so that if the crisis develops further, it will be able to dictate its terms to Ashgabat concerning the access to Russia-led political and economic forms for integrating the post-Soviet space. In an extreme situation, it could offer military assistance in order to stabilise the situation. Moscow may also potentially resume its gas cooperation with Turkmenistan, or lift its blockade of the transit of the latter's gas to Europe. The present terms and conditions for the provision of assistance from Moscow, to which the Turkmen government has not yet expressed its consent, assume official cooperation in the security sphere, the presence of groups of Russian observers and military advisers, as well as close cooperation between the departments of force and intelligence services of both states.

[15] While Turkmenistan is the most extreme case, similar symptoms of a balance of payments crisis in the region are also being displayed by Kyrgyzstan and Tajikistan; see J. Hurley, S. Morris, G. Portelance, *Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective*, "CGD Policy Paper" 121, March 2018.

[16] Moscow has been supporting Ashgabat to a limited extent from the end of 2016, resulting in a thaw in the bilateral relationship (President Putin paid an official visit to Ashgabat in 2017, among other moves).

ANNEX

Chinese imports of natural gas from Turkmenistan 2009–2017



Source: Chinese Customs

EDITORS: Adam Eberhardt, Krzysztof Strachota
Anna Łabuszewska, Katarzyna Kazimierska
TRANSLATION: Jim Todd
DTP: Bohdan Wędrychowski

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Centre for Eastern Studies
Koszykowa 6a, 00-564 Warsaw
phone: +48 | 22 | 525 80 00
e-mail: info@osw.waw.pl

Visit our website: **www.osw.waw.pl**