

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

MANAGEMENT of Economic Reforms

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ECONOMIC REFORMS



UNITED NATIONS

New York, 1995

ST/ESCAP/1575



ESCAP attaches high priority to dissemination of information and exchange of experience on policy reforms in the economies in transition. Some of the recent publications by the secretariat intended to serve this objective are **Macroeconomic Reform Policies in the Disadvantaged Economies in Transition (ST/ESCAP/1416)** and **Macroeconomic Reforms in the Economies in Transition (Development Papers No. 18)**. The present volume is one more addition to the series.

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A. STAGES OF REFORMS

It has been 15 years since China started to reform its economic structure in 1979. The 15 years can be divided into four stages:

1. January 1979 – October 1984. During the stage, the reform was focused on the rural areas. With the widespread introduction of the household contract system of responsibility linked to production, several hundred million farmers were the first in China to have autonomy in production and management and establish non-agricultural businesses in towns and villages. In the meantime, the state raised several times the purchasing prices for farm and sideline products. Farmers' enthusiasm for production was brought into full play and the rural economy grew rapidly, creating a favourable foundation for nationwide reform. During this period of time, pilot reforms were conducted in cities and efforts were made to set up special economic zones geared to open foreign trade and investment.

2. October 1984 – September 1988. During this stage, the focus of China's economic reform shifted from rural areas to cities, marking the beginning of the nationwide reform. In cities, efforts were made to reform enterprise system, market system, the system for macro-economic regulation and control, and the social security system. With a view to opening up to the outside world, China opened gradually 14 coastal cities. During this period of time, China's economy developed at a fast speed, with the gross national product (GNP) rising at an annual rate of about 10 per cent. Unfortunately, China's economy became overheated in 1988. This tipped the balance between supply and demand, and inflation rate reached 18.4 per cent.

3. September 1988 – December 1991. During this stage, China moved to rectify the overheated economy and curb excessively high demand. Efforts were made to increase supply, improve distribution system order and raise interest rate. This had effectively cooled down the overheated economy and brought the inflation rate down to about 3 per cent.

* Prepared by Wu Honguang, Division Chief, Department of Policy and Legislation, State Commission for Restructuring the Economic Systems of China.

4. January 1992 – present. During this stage, China speeded up reform and reconstruction steps and opened wider to the outside world. Meanwhile, China established the goal of developing socialist market economy.

B. IMPACT OF REFORMS

Reform over the last 15 years has brought about enormous and profound changes to the Chinese society. Major ones include the following:

First, the change in ownership structure. Before the reform, public ownership was predominant and China's industry and commerce composed mainly of state-owned enterprises. Today, China has developed a new pattern in which public ownership plays the major role while other enterprises such as those owned by the collectives, individuals, joint ventures with foreigners and solely foreign-owned enterprises coexist and compete with one another. Of China's total industrial output value, 50 per cent is contributed by state-owned industrial enterprises, 38 per cent by collectively owned ones, and 12 per cent by individually owned, private and foreign-funded ones; of the total volume of retail sales, 41 per cent is contributed by state-owned commercial enterprises, 28 per cent by collectively owned ones, 31 per cent by individually owned and other private ones. The rapid growth of non-state-owned enterprises has given a new stimulus to the development of China's national economy.

Second, the change in state-owned enterprises. Before the reform, the state-owned enterprises were basically dependent on the government. State departments concerned were in direct charge of their production plans, supply of raw and processed materials and the marketing of their products. Now, in accordance with the principle of separating enterprise management from government administration, and ownership from management, the Chinese government delegated, step by step, more decision-making power to enterprises, thus making them nearly independent economic entities. Ninety per cent of the enterprises have introduced different forms of contract responsibility system. Enterprises with good performance were encouraged to take over under contract or absorb others with poor performance. Recent years saw efforts made to make enterprises participate in market competition and change their operational mechanism. In order to find out an effective way for the formation of public ownership, efforts are being made to experiment with varied forms of shareholding system. By the end of October 1994 there were over 10000 shareholding enterprises in the country, with more than 200 listed in the stock exchange in Shenzhen and Shanghai.

Third, progressive development of market system. Before the reform, consumer goods market was almost the only form of market in China. At present, while developing energetically various types of consumer goods markets, China makes active efforts to develop and cultivate various forms of production markets, including the capital goods market, long and short-term financial capital market, foreign exchange market, real estate market, labour market, technology market and economic information market. Through price reform China has decontrolled prices for the bulk of commodities. Market regulation is playing an increasingly larger role in pricing. By the end of 1993, less than 20 per cent of the total volume of farm products were priced by the state, while 10 per cent of the total volume of sales of industrial consumer goods and 30 per cent of that of intermediate goods were priced by the state.

Fourth, there has been a change in the instruments of control from mainly direct administrative control to mainly indirect regulation and control through comprehensive employment of economic and legal means. The state mandatory plans have been reduced greatly. Before 1979, upwards of 95 per cent of the industrial output value was produced according to state mandatory plans. Today, mandatory production plans issued by the State Planning Commission have been reduced to 5 per cent. The variety of intermediate goods subject to unified state allocation has been reduced from 256 before the reform to some 10 at present. With deepened reform of the planning, investment, monetary and financial systems, tax rate, exchange rate and the amount of money supply has become an important means for macroeconomic regulation and control.

Fifth, all-round development of rural economy through reform. The widespread introduction of the household contract system of responsibility linked to production as the main form in the rural areas and the gradual formation of a double-tiered management system characterized by unified and separate management has given full play to enthusiasm of these farmers. Chinese farmers have to set up numerous township enterprises, which, in the last decade or so, have created job opportunities for close to 100 million rural surplus labourers. Farmers work in these enterprises without leaving the countryside and the rural industry grows by leaps and bounds. At present, rural industrial output value makes up 37 per cent of the total industrial output value in China.

Sixth, greater openness. China's opening up pattern today is characterized by opening at different levels and in diverse forms, with areas open to foreign investment and trade extending from special economic zones to coastal areas, areas along the Yangtze River, border areas and inland areas. By the end of 1993 there were 174,000 foreign-funded enterprises registered in China. They introduced tens of thousands

of advanced equipment and technology. Their contracted investment reached close to US\$100 billion, with US\$ 63.9 billion actually made. China is reforming its import and export trade system in accordance with international market practices and GATT rules and regulations. The proportion of import and export trade value in GNP shot up from 10 per cent in 1978 to over 35 per cent at present.

Seventh, the change in perception. Benefits gained during the reform over the past 15 years have deepened the perception of the Chinese people that China can hardly develop without reform. It is commonly understood now that reform and opening up constitute the inevitable road to prosperity and people's affluence and happiness. The principle of efficiency first and the importance of market competition have been accepted by the broad masses of the Chinese people. Gradually establishing a socialist market economic system has become the goal of struggle to be attained by the whole nation.

In a nut shell, reform over the past 15 years has brought about widely acknowledged historic change to the outlook of China. The 15 years are a period in which China's economy developed at the fastest rate and the foundation of the people's lives improved impressively. Between 1978 and 1993 China's GNP had grown at an annual average rate of 9 per cent, and the per-capita income of urban and rural people, allowing for price increases, registered in annual rise of 6 per cent. The market is brisk, the supply of commodities is ample and the quality of people's life improved substantially.

C. CHARACTERISTICS OF CHINA'S STRUCTURAL REFORMS

Major characteristics of China's structural reform over the last 15 years are as the follows:

First, economic reconstruction as the focus of the reform. China's reform must always focus on economic reconstruction and further emancipation and development of the productive forces must be taken as the primary task. It is widely accepted that only by effecting a fundamental change of the economic system fostering the productive forces and only by introducing a socialist market economic system full of vitality, fresh progress in promoting development of the society can be made.

Second, market orientation. China's economic reform has from the very beginning been market oriented. The reform makes it possible for the market to play an increasingly larger role in regulation in urban and rural areas as well as in various economic sectors. In 1992 China

announced its goal to build up a socialist market economic system. The "Decision of the CPC Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure" was adopted by the Third Plenary Session of the 14th Central Committee of the Chinese Communist Party in 1993.

Third, proper handling of relations between stability, reform and development. Political and social stability is viewed as the prerequisite for reform. Social unrest and political instability will make it hard for various reforms to be conducted effectively. Economic development is the primary goal of the reform. Only through reform, which is the means, the productive forces could be further liberated and various economic undertakings could be rapidly developed. To sum up, stability is the prerequisite, development is the goal and reform is the means.

Fourth, gradually and boldly deepening the reform in the light of China's actual conditions. China is a developing country with more than 1.1 billion people. With uneven economic development, China has a weak foundation for market economy. In the absence of a ready and successful example to emulate, China's reform can only be conducted by relying on its own efforts and confirming assessment of experience. This is why China adopts progressive reforms instead of the "shock" therapy.

Fifth, integrating domestic reform and opening to the outside world. Since the 1980s China has created favourable conditions and laid material foundation for opening wider to the outside world through reforms in rural and urban areas and economic development. Foreign capital, sophisticated technology and advanced managerial expertise have been introduced through opening to the outside world. This gives the enterprises a shot in the arm in participating in international market competition and, at the same time, energetically promotes reform and economic development. Facts show that areas that have made significant progress in introducing a new economic system and are having faster development of economy are areas that opened their door to the outside world earlier than others and have since done a good job in integration reform and opening up.

D. TASK OF CHINA'S FUTURE REFORM

To cope with the need of developing socialist structural reform and to consolidate achievements made during the past 15-year reform, actions are needed in the following areas:

First, rationalization of property right relations.

Enterprises are the major part of market economic activities. Future reform of the state-owned enterprises, must start with rationalization of property right relations of the state assets. The property right of state-owned enterprises must be defined through appraisal of the fixed assets and the circulating funds; and the state assets management and operational functions must be separated on the principle of separating enterprise management from government administration. On this basis, the efforts will have to be made to set up strict state property right management and operational systems, and conduct fundamental reform of enterprise organization. State-owned enterprises may become companies with the status of legal person such as solely state-invested company, limited-liability company or shareholding company. Efforts should also be made to establish an elimination system for enterprises on the basis of market competition and promote reorganization of enterprises.

Second, development of markets for production factors and intermediate goods.

After 15 years of reform it has been realized that the establishment of market system involves more than commodity markets. What is more important is to establish markets for production factors and intermediate goods without which there can be no optimal allocation of resources. Therefore, in future reform, this aspect should be given more prominent attention. In coordination with the reform property right, markets for labour, finance, physical capital and technology market, have to be adequately developed. This will require speeding up and establishment of appropriate legal systems.

Third, establishing a macro-regulation and control system characterized by indirect regulation and control.

Macro-regulation and control under the conditions of market economy should be indirect regulation and control, through which overall economy is balanced and overall economic structure optimized. Such macro-regulation and control should be achieved mainly through employment of economic instruments, supported by the legal and administrative machinery. In accordance with this need, the reform of future macro-regulation and control system should address the following:

- Rationalizing relations between the three basic economic activities of planning, financing and banking, and defining their respective responsibility in a well-coordinated and mutually reinforcing relationship.
- Further reforming the fiscal levy system, and introducing a new taxation system under which taxation and government administration are separated, tax is collected fairly, tax base is expanded, tax regulations are simplified, tax system is

standardized, and management of tax collection is beefed up and the jurisdictions of central and local governments are clearly defined.

- Deepening the financial reform and establishing an autonomous and efficient central bank which exercises indirect control supply of money and credit and on demand for capital.

Fourth, reforming the administrative structure.

To cope with the change from the planning to market economic system, the government functions must be changed substantially. To put it in a concrete way, there has to be a greater change from the past government practice of direct participation in business decisions and allocating resources through administrative means to one of formulating laws, maintaining the economic order and guaranteeing fair market competition, while ensuring fair income distribution. For this purpose, resolute measures must be taken to reform the government institutions with a view to establishing a streamlined, efficient and clean system operating strictly according to the law.

Special efforts must be made to strengthen legal framework. No time should be lost to enact the Commerce Law, the Company Law, the Finance Law, the Securities Law and the Market Trade Law. In addition, problems should be ironed out to pave the way for smooth implementation of the law and effect China's judicial administration system.

ECONOMIC REFORMS IN MONGOLIA: SOME LESSONS*

Mongolia is entering the fifth year of economic reform. As an underdeveloped, landlocked country inadequately integrated into the world transportation network with its high vulnerability to natural calamities, Mongolia experiences added difficulties in its transition to the market economy.

A. ECONOMIC CRISIS

The centrally planned model and irrelevance of the market mechanism to that system resulted in distortions in resource allocation and marginalization of the private sector. Binding the country's external trade with the CMEA countries exacerbated the systematic inefficiencies of the centrally planned model and rendered economic structure inflexible and almost totally dependent on CMEA for technology and the export market.

The gradual breakdown of the CMEA structure since the late 1980s, and the introduction of common commercial practices in trade since 1991 mean that Mongolia faces a serious economic crisis. The country's foreign exchange reserves have declined to a precariously low level, import of essential raw materials and input has dwindled, export prospects were dim, a number of enterprises were on the verge of collapse, and the budgetary situation was grim.

The severe economic collapse has been caused primarily by the abrupt deterioration in economic relations with the former USSR, but there were also several contributing factors, including the end of Soviet financing, deterioration in terms of trade, collapse in the volume of trade, shortage of spare parts and other transitional hardships. A sharp decline in real income and economic activities were caused by the political and economic changes, which constitute a movement towards a democratic

* Prepared by Gonchigiin Gongor, Acting Head of International Organization Department, Ministry of External Relations of Mongolia.

and free society. The decline started in Mongolia in 1990, but was accelerated in 1991 and 1992 as the old system was dismantled. The decline in real incomes has been estimated at 40 per cent to 50 per cent of GDP. Apart from periods of wartime destruction, there have been no documented examples of countries which have experienced such a sharp decline in real income. The budget deficit was balanced by money creation. The value of the Tugrik on the parallel market depreciated. The State maintained fixed prices for most essential commodities. Consequently, in combination with rapid money growth, the decline in goods supply due to low import and production resulted in severe shortages.

To provide families with adequate amounts of essential products the Government temporarily introduced ration coupons for basic food-stuffs. The Government managed to maintain minimal level of consumption and production through the import of essential products. As a result, however, foreign exchange reserves fell, creditors began demanding advance payments and deposits in order to maintain credit lines, and the stock of petroleum declined to two weeks consumption.

B. REFORMS

Since October 1990 the role of central planning has been sharply reduced, and the country has embarked on a wide-ranging economic reform programme, including the privatization of state-owned assets, monetary and fiscal reform, price liberalization and restructuring of state-labour relationship. The Government was faced with the task of stabilizing the economy with an acceptable social cost. Reforms, aiming at economic liberalization and the introduction of market-oriented systems, were necessary to continue economic restructuring and to lay a strong foundation for economic growth.

In order to stabilize the economy, the Government adopted measures to immediately cut the budget deficit. In accordance with the economic reform programme agreed to with the IMF, the remaining deficit was balanced by foreign assistance and a small domestic bond issue. The Government introduced an import surcharge, sales tax on domestic goods, an excise tax on tobacco and other products, and raised the excise tax on liquor and gold jewelry. Expenditure on consumer and producer subsidies, wages, health care, investment, and education were carefully monitored and reduced.

In order to provide a legal background for budget sources a package of tax laws covering all aspects of taxation was adopted. Due to

financial constraints, investment from the state budget was firstly channeled to projects of primary importance for the development of economic infrastructure.

Early in 1991, the Government reduced by 60 per cent the number of items entitled to state fixed price. Actually, prices and tariffs for goods, labour and services have, in general, been liberalized. But energy and petroleum prices, house rents and telephone subscriptions and some other prices remained under state control.

The Mongolbank introduced policies to ensure that domestic money and credit creation be conducive to low inflation and stable financial markets. There was a tightened monetary and credit policy. The interest rates of credit granted to commercial banks have been repeatedly raised and were maintained at 18-25 per cent in 1993. Considering the rate of tugrik devaluation, a minimum interest rate for private savings has been raised to 80 per cent depending on saving terms. The obligatory reserve deposit of the Commercial banks to be kept at the Central Bank (Mongolbank) has been repeatedly raised and a strict limit was fixed for net credits to be granted to Commercial banks. A bank clearing system of accounting has been introduced. Some progress was observed in the settlement and reduction of unpaid debts granted to Commercial banks, and in the settlement of debt related issues among state controlled entities.

From July 1993 the Mongolian national currency – the tugrik has become convertible on the domestic market. Measures have been adopted to increase the currency resource through the state's purchase of, and keeping at the Central Bank, a certain portion of export income gained by economic entities and through the suspension of commercial loans from foreign countries at the government request.

Centralization in foreign trade activities was considerably reduced, general export licensing was abolished. The Government fixed an import tariff at 15 per cent. The multiple tariff schedule under consideration would have differential rates on goods and convert Mongolia's tariff system to the Harmonized System, thus introducing general and MFN tariff rates.

The privatization programme has been implemented in two phases. All small enterprises engaged in trade and services as well as independent units of large enterprises which qualified for the "Small Privatization" programme have been privatized by means of investment coupons. According to the Privatization Law, citizens of Mongolia were provided with investment coupons which enable them to purchase shares. Each person was entitled to one pink coupon for the "Small Privatization" and to one blue coupon for the "Large Privatization". The pink coupons

could be transferred, sold or purchased through brokers' agencies or be traded directly between the holders and buyers. The blue coupons were not transferable. The pink coupons could be used as an investment instrument once only. Thereafter, they were no longer marketable. The coupons did not earn interest. The secondary market did not deal in coupons. If the coupons were not used within a fixed period they could be returned to the Government and the charges levied for their acquisition refunded.

The enterprises privatized through the distribution of investment coupons have been converted mainly to shareholder companies, whose operations were governed by the Law on Economic Entities. Management and control of such companies were carried out by the General Assembly, the Board of Directors, the Supervisory Board and the Executive Director. Powers and functions of these bodies were stipulated in the Law on Economic Entities and more definite authority and objectives could be included in the Articles of Incorporation of the company. According to the Law, the General Assembly elected and dismissed Directors and members of the Supervisory Board. Shareholders were entitled to a dividend and had one vote per share in the General Assembly. The managerial structure of companies varied depending on the type and size of the company. In small and private companies, Directors and shareholders were usually the same. Companies did not make any special payment to State authorities, except for those related to their operations as an economic entity, which, for example, were taxes, duties and charges for services, as provided in the respective laws and regulations. A person holding coupons could become a shareholder either of a small private company under the "Small Privatization" scheme, or of a public company under the "Large Privatization" scheme by purchasing shares of that company. Such person acquired all the rights conferred by law on a shareholder, including managerial involvement. Shares of these companies were traded in the stock markets run by the Stock Exchange and could be purchased by national or foreign currencies, or other assets.

More than 90 per cent of livestock were now privatized. Agricultural cooperatives, state and fodder farms operated as stock companies with the former members of such cooperatives and farms holding shares acquired through their investment coupons.

Until the end of 1990, the State Bank of Mongolia was the only banking institution and exercised all banking functions. With adoption of the Banking Law in 1991 a two-tier banking system, which permitted the establishment of commercial banks, has been introduced. At present, there were sixteen commercial banks operating as public companies. Shareholders of these banks were both state enterprises and economic entities in the private sector. In some banks share of the private sector in

the capital of the bank was predominant. The period for privatization of the commercial banks has not been determined. However, further privatization of state enterprises would simultaneously lead to the gradual privatization of commercial banks.

At present, 80 per cent of properties entitled to privatization have been covered by the privatization process, over 90 per cent of trade, food and utility service entities, and about 90 per cent of livestock have been transferred to private ownership. The state controlled sector encompasses some 4 per cent of agriculture, 60 per cent of industry, 14 per cent of services and about 90 per cent of foreign trade.

The foreign investment law adopted in 1991 was revised in 1993. Foreign investment was permitted in all sectors with the exclusion of activities related to the production of drugs and other similar controlled substances. The law permitted full profit repatriation, provided for guarantee against expropriation, and limited tax rates. The taxation established a set of incentives for foreign investment in sectors such as mining, industry and infrastructure with, for example, a tax relief during a 5- to 10-year-period depending on the share of their production to be exported. For the purposes of the Law, more than 50 per cent of the capital of the foreign investment enterprises have to belong to foreign investors without any stipulation as to origin. Thus, Mongolia accorded to foreign investors both MFN and national treatment.

The anti-monopoly Law and Law on fair competition have also been adopted. In Mongolia monopolies were not permitted except for the sectors of communications and transportation. Other laws, required for economic reforms have been also adopted.

As a result of these macroeconomic measures living conditions of the population, specially of vulnerable group of people became much harder. The Government took some measures within the limits of its revenues to alleviate the situation. By the end of 1993 a granted minimum level of living standard has been fixed and necessary measures were adopted to ensure that level. A fund aimed at supporting and helping poor people was created. Enterprises, firms, cooperatives started to take poor people under their patronage, offering different kinds of benefits. The Government adopted some measures to increase the wages of those working in state agencies as well as allowances. However, because of the limited availability of resources the Government was unable to take any significant steps that would fully ensure the social security of the vulnerable group of the population.

At that difficult period of time the credit and assistance from Japan, United States of America, other donor countries and international organizations constituted important contribution to overcoming the difficulties. Such assistance amounted to US\$ 948 million for the period of 1991-1993.

These credits and assistance were largely spent to finance the import of most essential items. In the years to come it would be channeled to economic branches of priority importance and projects which would in a short time recover the investment. The credit obtained at the Government request would be offered to economic entities selected on basis of competition whatever their property ownership form on the condition that they accepted the term whereby they would pay back the credits. This practice was introduced in 1993. Several quite large projects on infrastructure development were launched in 1993.

C. CURRENT ECONOMIC SITUATION

The Government of Mongolia continues its major structural reforms despite transitional hardships. As for 1994, indicators of the first nine months suggest positive development. GDP in 1994 was estimated to have grown by 2.5 per cent, the first positive growth in 5 years. The inflation rate seemed to be under control; in the first 8 months the rate of inflation fell to 4.5 per cent. Industrial output during the first eight months increased by 4.4 per cent, a growth which has been witnessed for the first time in the last four years.

Although the plot of land under cultivation in 1994 was smaller than in 1993, the harvest volume was estimated to have been the same as in 1993. Approximately 8.5 million young livestock were produced in 1994, which was 930,000 more than in 1993. Though export exceeded import for the first six months in 1994, overall export value for 1994 was anticipated to be equal to total import. Role of the private sector in the country's economy was growing significantly.

However, the economic situation remained very fragile. Decline in production in many areas continued. Growth has been accomplished by the contribution of a few industrial enterprises such as the copper processing and enriching plant in Erdenet, the metallurgical plant in Darhan and the opening of gold mines. Out of more than 70 varieties of manufactured goods, the output of 60 has dropped, and 40 per cent of 4,671 industrial enterprises did not conduct manufacturing in 1994. The fuel and power sectors were in a very difficult condition. The living standard of the population was going down, poverty was spreading and the unemployment rate was growing. The domestic financial reserves were in a critical situation. External debt (excluding CMEA debt) was anticipated to grow from about US\$ 375.0 million in 1994 to US\$ 630.0 million by 1997. Resulting debt service was expected to be about US\$50.0 million by 1995. Substantial amount of short- and long-term debts were owed to former CMEA members, mainly to Russia.

D. SOME LESSONS

The most critical issues awaiting immediate intervention were continuing subsidies to the large inefficient state enterprises. This was first lesson why the industrial stagnation was not being curbed. There was an urgent need to commence reforms in public enterprises, which eventually would release funds for private sector development. Future economic growth would greatly depend on how successfully the private sector could grow. The state-run enterprises were financially weak and indebted to each other. Consequently, they were even unable to buy raw materials, spare parts, machinery and equipment, neither from the local nor from the foreign market.

The second lesson was that countries in transition must pay great attention to fiscal policy. The short-term measures such as a reduction of all government expenditures by 10 per cent in the second half of 1994, new taxes on imported automobiles, an extension of the sale tax to hotels and restaurant should be helpful in the government's efforts to achieve its fiscal goals for 1994. But a number of long-term structural issues in fiscal policy remain on the agenda. These include the need to broaden the tax base, strengthen tax administration, reform central and local fiscal relations and further streamline current expenditures.

There were several issues of concern in monetary and banking policies. First, interest rate remained high despite slowdown in inflation. Real interest rate has risen sharply over the last year. The high interest rate not only prevented revival of the industry but also weakened financially the major producers.

Another serious issue in the banking sector was the persistence of direct lending, under which commercial banks were instructed to grant loans at preferential rate to borrowers designated by the Government.

To increase the state budget revenue and to ensure economical and optimal realization of the budget it was essential to adopt the structural reorganization of all state-financed organizations.

The privatization programme worked for Mongolian conditions, but its implementation was not well organized and supervised by the Government. The next lesson was the need of the strict control over and determined actions on the implementation of such programme.

The other lesson was the effective management and coordination of the foreign aid resources. Rapid growth in the number of donors and greater diversity in aid programmes have made the task of coordinating aid resources much more complex. The development of required

technical specializations and institutional capacity has not kept pace with growing complexities of the aid programmes. Improved aid condition, and donor cooperation in this respect was very important for facilitating early disbursements, especially of project aid, and to ensure that projects would be designed in line with national implementation capacities.

The last, but very important lesson was the need for improving managerial skill at all level. Experience and ability in management were essential, particularly, for the countries in transition.

MANAGEMENT OF ECONOMIC REFORMS IN TURKMENISTAN

A. PROGRAMME "10 YEARS OF STABILITY"*

The goals of programme "10 years of stability" and the mid-term programme of social and economic development of the country for 1994 – 1996 are: the fastest possible integration of the country in the world economy; ensuring self-sufficiency in food supplies; and restructuring of the economy. These are sought to be accomplished in the context of gradual shift towards market oriented economy, assisted by privatization, development of entrepreneurship, and encouragement to foreign investments. The mapped reforms are also aimed at strengthening national currency and raising the standard of living of the people.

Despite the problems of transitional period, the progress of transformation toward a market-oriented economy has been profound. Some specific measures that have been implemented to reorganize the system of state-run economy include creation of independent monetary and tax systems with a view to addressing matters of utmost importance such as financial stabilization, restraining inflationary pressures and improvement of pricing policy. Measures aimed at providing an effective system of social guarantees and protection have been put in place. Efforts are being exerted to secure more sustainable development of the basic sectors of the economy: industry, agriculture, construction and services.

The level of political stability maintained in the last three years facilitated stable progress in this direction. The economy of the country is becoming still more market-oriented and open for foreign partners and investors. The process of privatization of state property is under way and conditions for the development of private sector are being created. Market structures consistent with the process of reform are gradually taking shape. The entrepreneurial capacity of the population is rising, foreign capital is flowing in, the process of Turkmenistan's integration in the world community is gaining momentum.

* Prepared by H. Orazmuradov, the First Deputy Minister of Economy and Finance of Turkmenistan.

1. Targets

It is envisaged that sustainable economic development will be achieved within 10 years, with the volume of gross domestic product increasing threefold by 2002 as compared with 1992. If realized, this will substantially influence the process of strengthening of the national economic potential, and will create vast opportunities for the rise in the national standards of living and for implementation of projected social programmes.

The implementation of the programme requires that priority be given to the development of the basic sectors – oil, gas and energy industries and related processing enterprises. The development of these sectors is necessary not only to fully meet the demands of Turkmenistan for power resources, but also because they can provide for export of considerable quantities of such resources. The increase in the levels of oil and gas production will be ensured both by stabilization of extraction of oil and gas at existing fields and by exploiting and putting into operation of new hydrocarbon material deposits. Thus the level of gas production will rise to 120 billion cubic meters in 2002 and of oil production – up to 28 million tones, that respectively corresponds to two- and five-fold increase over the 1992 level.

In accordance with the plan for development of oil and gas industry in Turkmenistan to the year 2020, three gas pipelines are to be built. The first of them is due to start supplying up to 28 billion cubic meters of gas to the European markets via the Islamic Republic of Iran and Turkey by 1998. The second gas pipeline will provide gas from Turkmenistan to the neighboring Asian countries – Afghanistan and Pakistan. By 1998, this pipeline will be pumping annually around 20 billion cubic meters of gas. By 2002 it is projected to build the third gas pipeline from Turkmenistan to Japan via China with the capacity of 28 billion cubic meters per year.

It is also considered important for the country to build an oil pipeline from Turkmenistan to the Persian Gulf via the Islamic Republic of Iran by the year 2002, which will allow to supply of up to 14 million tonnes of crude oil per year. Timely construction of the above mentioned facilities will help to substantially raise the export earnings of the country.

A consortium for the purpose of construction of the oil and gas pipelines has been established. Bidding documents are being prepared for the contest of competitive foreign companies wishing to participate in an international consortium to build the gas pipeline from Turkmenistan to Europe via the Islamic Republic of Iran and Turkey.

In oil-refining industry it is planned not only to use the full capacity of two plants, but also to modernize them for the purpose of considerable improvement in the quality of petroleum refining.

In power industry the projected measures are aimed at the development of gas-utilizing enterprises and at the increase in export supplies of electric power through a new international power grid, linking Turkmenistan, the Islamic Republic of Iran, Afghanistan and Pakistan and, potentially, Transcaucasian States.

The next couple of years and the coming decade will give priority to the development of processing industries based on locally available raw materials: cotton, wool, silk, leather and astrakhan fur. Several projects are being successfully implemented, some of them with participation of foreign companies to build spinning, weaving, and finishing capacity to produce cotton yarn and ready-to-use fabric. This will help to meet local demand and create exportable surplus. It is planned to process 35-40 per cent of the national volume of cotton output.

Priority will be given to food industries, providing population with essential nutrients. Industries oriented mainly for export, such as fruit and vegetable cropping and wine-making, will be also developed. Along with relatively large-scale industrial projects growing importance is being attached to medium and small enterprises both under collective and private ownership.

The major shift in economic policy regarding agricultural sector has been reflected in the state programme "New village", designed to seek the solution to the problem of food supplies in the nearest future. The task is set to fully satisfy the needs of the country in food grain on the basis of national production and to improve the supplies of animal husbandry products to the population. The creation of national sugar industry will decrease the dependency of the economy on the import of this product from other countries.

In accordance with the programme "Grain" the production of 2.44 million tonnes of grain will be ensured by 1996 and it is estimated that the production of grain will rise to 2.5 million tonnes by 2003.

The volume of raw cotton yield will increase 1.5 times by 2002 and amount to 2 million tonnes. It is envisaged that the production of vegetables will actually double within the same period. The production of milk, cattle and poultry meat will approximately double by 1996 and is planned to almost triple during the period of 1992-2002.

Changes in ownership relations in agricultural sector and the implementation of agrarian reform form the basis of the "New village" programme. Formation of daihan-type (farm-type) farms along with state and cooperative farms will accelerate.

State support measures are envisaged for all forms of farming enterprises. Special attention will be given to the efficient management of land and water resources, priorities will be set for channelling the investments to drainage and irrigation; sources of investments and stages in introduction of innovative land and water management technologies will be defined.

Further augmentation of the economic potential of Turkmenistan seems impossible without comprehensive development of transport linkages and other infrastructures. In addition to existing transport network the construction of new railways is planned. Some of them will be of international importance and will contribute to the integration of Turkmenistan into the world economy. The railway line between Tedzhen and Sarakhs, linking Turkmenistan and the Islamic Republic of Iran, is scheduled to become operational in 1996. The airport complex in Ashgabad, functioning since the end 1994, will provide Turkmenistan with air transport linkages with many countries of the world.

New modern automatic telephone exchanges with a capacity of 207,000 connections and new 790 km. long cable connection lines will help to broaden the communications with the outside world. It is worth noting that communication lines and facilities to be constructed will fully comply with international standards.

The strategy of structural reforms in the economy and its sustainable development require goal-oriented government investment policy. The areas of priority in investment policy have been set forward in the programme and include: fuel and energy, agro-industrial and social complexes, transport and communications. Creation and functioning of the material and technical base of newly built industries and coherent development of all sectors will be the focus of the planned construction programmes.

Investments and inflow of capital of state-owned enterprises in priority complexes will be stimulated by preferential duties and credit. To encourage foreign investments, Turkmenistan has issued laws on foreign concessions, free economic zones, protection against confiscation, conditions for registration, reinvestment of profits, and repatriation of capital. Turkmenistan has also specified conditions and requirements for the access of foreign capital to securities market and its participation in privatization.

To implement the housing programme the government intends to use government investments. Additional measures have been designed to support individual housing projects, including the provision of land plots for construction purposes, granting opportunities for purchasing construction materials and access to credit.

The share of enterprises' own resources in financing of investment programmes and projects has been steadily rising and last year accounted for 66.6 per cent as compared to 54.7 per cent in 1993. In 1994 under contracts with foreign companies, projects and installations were completed for the total of 181.8 million US dollars. 79 foreign companies from 22 countries participated in the construction programme. They are engaged in building of industrial, social and cultural projects. The total amount of capital investments in the economy of Turkmenistan equalled US\$ 3 billion, from which US\$ 706 million were put into operation in 1994.

Starting from 1992 licenses for investment in the economy were given to 402 foreign companies which established 104 offices and 31 subsidiary companies with 100 per cent capital invested as well as 217 joint companies.

During the three years of national independence the inflow of foreign long-term and short-term credits amounted to 512 million US dollars. 70 per cent of them were investment credits. In these years Ashgabad airport complex, two cotton spinneries, four cotton cleaning plants and dozens other projects and installations in different sectors became operational.

In 1995, it is estimated that 68 industrial projects will be completed. These installations and facilities will, to a certain degree, ensure the restructuring of economy and the production of marketable goods.

2. Role of the private sector

A great amount of work has been done in the country to form legal base necessary for the creation of market environment. Laws on entrepreneurship, property, enterprises, privatization, incorporated companies, bankruptcy, pledges and a number of other legislative acts have been adopted, facilitating the development of competitive potential and economic initiative of enterprises.

Private sector will play substantial role in national economic development. The number of private commodity producers along with their share in the total volume of gross domestic product is rising.

There are approximately 24,000 small-scale enterprises and cooperatives currently operating in Turkmenistan. In 1994 the share of private sector in the total volume of gross domestic product accounted for 7 per cent while in 1993 it stood only at 3.5 per cent.

Of the total number of enterprises approximately two thirds are individual, family-owned enterprises, one fifth are incorporated companies and limited partnerships, and around 1.5 per cent are joint enterprises and subsidiaries or missions of foreign companies. Besides, more than 8,000 people are engaged in business activities without registering as juristic persons.

The privatization of state property in Turkmenistan is an integral part of the ongoing economic reform process and is being implemented in accordance with the law "On the Transfer of State Property and Privatization". The mechanism for implementation of this programme has been worked out taking into account international experience and with due consideration for specific features of the economy of Turkmenistan. Laws on enterprises, property, share holding, stock exchanges, and on foreign investments have been passed. Government agencies have been established for the purpose of implementing privatization. A special system of standards and methodology has been developed for application to different schemes of privatization.

As of 1 April 1995 about 1,300 installations (totally priced at 287.4 million manat) have been exempt from state property in Turkmenistan. The national budget gained 173.4 million manat as a result of privatization of establishments providing consumer services in trade and public catering sectors. Roughly 93 per cent of privatized projects have been bought by employees of these enterprises and the remainder has been sold by auction.

Along with the deepening of the process of privatization of state property, the economic reform programme provides for the creation of favorable conditions for the development of private entrepreneurship. These include development of the legal basis, staff training; provision of preferential government credit for highly efficient investment projects; involvement of international financial organizations to solve the problems of the development of private sector; and deregulation of economic activities. It is envisaged that by the end of 1996 the government sector will account only for one third of the total volume of gross domestic product.

For the purpose of stimulation of entrepreneurship development "The guidelines of government support of entrepreneurship in Turkmenistan" have been adopted. They will provide the basis for the programme of actions of the government and other government bodies and for prioritization of the entrepreneurship spheres. The issues relating to financial security, material and machinery supplies, support by the government and the training and retraining of personnel are dealt with in the document.

Intensive reform process is in progress in the agro-industrial sector. Land is being privatized, including those for the production of agricultural commodities. More and more entrepreneurs are involved in the development of new arable lands and in the production of agricultural commodities. Around 4,000 people have taken 81,000 hectares of arable lands, of which more than 30,000 hectares are already developed, including 20,000 hectares of grain-sown areas. At the same time the enterprises for providing supply and marketing services for agricultural production are being established. These measures will ensure a substantial rise in the volume of agricultural production.

In order to encourage investment by private sector, it is planned to allocate funds from the state budget. This will take the form of preferential government credit for the period of five years. In this process, the government intervention in economic activities will be kept at minimum. Provisions have been made to cater to the needs of training of personnel of enterprises in national educational institutions and abroad.

Favorable conditions have been created in the country for the operation of private companies with foreign capital participation. To this end, in various regions of Turkmenistan seven free economic zones have been formed to provide special regime of economic management, including preferential taxation, uncontrolled pricing and other preferences defined by the law.

Provisions have been made to continue the cooperation with international financial organizations in order to extend financial support and offer advisory services to private commodity producers. For example for this purpose European Bank for Reconstruction and Development, which has developed the programme of support for small and medium-sized businesses in Turkmenistan, has allocated credit resources for a total of US\$ 35 million.

3. Economic policy reforms

In the policy on prices, a consistent course for liberalization and their levelling with the world prices will be pursued. During the transitional period, government control will be maintained over prices of some consumer goods, industrial and technical products and strategic raw materials, because of the lack of competitive environment and monopolistic conditions.

It is envisaged that during the transitional period the practice of administratively set prices will be maintained only for certain types of products, consumer goods and services: fuel, electric power, flour, bread, meat, milk, oil and butter, children's food, rice, sugar, certain types of

public services and urban public transport. Provisions have been made to subsidize these types of products, goods and services from the state budget funds. The number of subsidized food products will be reduced in the future. The shift towards the establishment of comprehensive free price formation will be made gradually as the markets become more competitive in consequence of continuing privatization of property and development of entrepreneurship.

For the purpose of safeguarding the integrity of the fiscal policy of the country and creating conditions for effective functioning of the budgetary system the Treasury of Turkmenistan has been established. It is entrusted with the responsibility to control the process of implementation of the state budget and efficient management of government financial resources. To ensure the maximum inflow of financial resources into the state budget the taxation system of the economy is being modernized and simplified.

In Turkmenistan the existing system of taxation is rather simple and mostly corresponds to the requirements observed in the taxation systems of the market economies. It has been developed with due attention to changes in the national economy, which were taking place in the recent years, and economic reforms. The value added tax has become the major component of the taxation system (around one-half of the contributions to the budget). The tax rates are similar to the rates being used in other countries of the Commonwealth of Independent States (CIS).

The increased requirements of the government revenues will be met both by the widening of the tax base and by the introduction of new forms of direct and indirect taxation. The current legal structure of taxation of Turkmenistan is being improved and developed, as necessary, keeping the basic principle of neutrality of taxes in mind.

In the monetary sphere the reform of the banking system is in progress; laws on the Central Bank and commercial banks have been adopted. Currently there are roughly one and a half dozens incorporated commercial banks operating in Turkmenistan. Strong efforts are being made to strengthen the independent status of the Central Bank in the sphere of development and implementation of monetary policy.

Regarding the credit system the main efforts are aimed at broadening the use of market principles in distribution of credit resources. The credit policy pursued by the country is consistent with policies of structural reforms and ensuring financial stability.

An important element in the implementation of the monetary policy of the government is preferential credit for the priority sectors. Provisions have been made to introduce new methods of bank financing aimed at enlarging the scope of market mechanisms for distribution of credit resources.

A system of managing internal state debt incurred through state liabilities (treasury bills, bonds, etc.) is being developed. Intensive work has been done to create securities market, introduce the practice of deposits and mortgages in economic management and the circulation of bills of exchange. To finance the deficit in 1995 wider use of non-inflationary sources of financing, including selling of state securities, is proposed.

The economic reform programme provides for the establishment of comprehensive complex of financial institutions: exchanges, investment companies and trusts, insurance organizations etc. The relevant legal underpinnings have been developed and improved. Specifically, the law on securities and securities exchanges in Turkmenistan has been adopted and some changes in the laws on incorporated companies and insurance institutions have been made.

In 1995 it is planned to actually triple the volume of insurance services. The modalities for attracting foreign investments into insurance market of Turkmenistan are being developed. This will allow broadening the network of such services and introduce new forms of insurance.

4. Social policy

The transition to market economy has brought up a number of new problems in social sphere. One of the main problems is the protection of vulnerable sectors of the population: pensioners, people with disabilities and large families.

The programme "10 years of stability" provides for further improvement of current measures of social protection of the population. It is well known that beginning from 1993 the population of Turkmenistan was able to use water, gas and electric power supplies free of charge. Besides the above mentioned, in 1995 the population was still enjoying such privileges as free supplies of salt, 50 per cent compensation of the dwelling costs for single pensioners and low-income families, allowances for children in low-income families, rearing allowances for children and others. Only a few states can allow themselves to implement such measures in the current difficult conditions of transitional period.

Provisions have, therefore, been made to improve the system of social protection of the population and make it more target-oriented. To this end the system of declaration of revenues for certain groups of the population was introduced in the beginning of 1995.

As envisaged in the "10 years of stability" programme a substantial part of the state budget expenditures has been earmarked for the implementation of measures aimed at the social development and the improvement of the well-being of the population. More than 60 per cent of all expenditures have been earmarked for financing of social programmes and to support living standard of the population. The budget resources are used to refund the differential in purchasing and selling prices for such commodities as bread, flour and drugs. In addition, state funds are used to support low urban public transport rates and municipal services rates.

Plans have been made to reform the current system of payment of allowances for children; it is envisaged to periodically revise the minimum rate of social allowances depending on the rise of prices. Provisions have been made to implement an overall reform of the insurance system. On the basis of specific demographic situation in Turkmenistan labor market, employment and social guarantees schemes for women will be improved.

5. Foreign trade policy

In the next 10 years Turkmenistan will continue to focus on developing new trading relationship while maintaining traditional ties with the countries of CIS. A high priority is given to intensive development of integration, above all, with Turkey and with such neighboring countries as the Islamic Republic of Iran, Afghanistan and Pakistan. The main features of relations with these countries would include the following: rise in trade turnover, creation of joint ventures, access to credit facilities and provision of construction services. These ties will broaden in the coming years.

Unlike many other countries there are no export and import customs tariffs in Turkmenistan. Along with these measures the government intends to further liberalize foreign economic activities and trim down the management by orders and decrees in the sphere of export and import operations. In particular, licensing of export of most of the goods produced in Turkmenistan will be abolished. Exporters will be able to freely export goods.

It is envisaged to gradually raise the share of technology, equipment and machinery in the structure of import. This measure is connected with accelerated development of consumer goods complex and more intensive down-stream processing of raw materials.

Foreign currency earnings will be mainly ensured by the export of gas, electric power and oil products. Barter trade with foreign countries will remain at the level required for the processing enterprises under

construction in Turkmenistan. Provisions have been made to broaden the export base of the country by means of attracting foreign investors in agro-industrial complex, oil processing and chemical industries.

The foreign economic activities will be further liberalized and it is envisaged to reduce the list of goods subject to quotas and licensing, excluding strategically important products (gas, oil products, electric power).

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Therefore the implementation of the programme "10 years of stability" will make it possible to lay down a solid foundation for a major improvement in the economic performance of the country and to enhance national well-being on the basis of own resources. The accomplishment of the planned goals will allow Turkmenistan to be effectively integrated into the world community to develop economic relations with many foreign countries. All prerequisites exist for Turkmenistan to become a dynamic and an efficiently functioning developing economy by 2002 with a high standard of living of its population.

B. PRIVATE SECTOR IN THE ECONOMY OF TURKMENISTAN*

Today Turkmenistan has entered a stage of crucial economic transformations, opting to be a member of the international community of states. The change of political and social system in Turkmenistan following the declaration of its independence created necessary conditions for establishing a market-based economy and provided prerequisites for bringing it up to international standard.

The international community in its turn lent its support to Turkmenistan in its efforts to transform the economy. This is reflected in the fact that international organizations and some highly developed countries have been providing various financial and technical assistance to Turkmenistan, and this assistance is substantial.

The European Bank for Reconstruction and Development, for example, provided US\$ 35 million in investment loans specifically to entrepreneurs; the American Business Support Fund and the Commission of the

* Prepared by A.B. Baidjaev, Director, Department of Support of the Private Business, the Cabinet of Ministers of Turkmenistan.

European Communities also provided funds for private sector development, particularly in the field of small and medium-scale businesses. Hundreds of young citizens of Turkmenistan annually study in the United States of America, Turkey, the Islamic Republic of Iran and European countries, and acquire knowledge and experience of a market economy.

In the course of structural transformations scheduled for 1995-2000, it will be necessary to eliminate distortions in the economy, better address the problems of reconciliation between supply of and demand for goods and services in the domestic market, and create conditions conducive to export growth with concurrent partial import substitution.

While establishing a socially-oriented market economy and new production relations, the Government has been seeking to boost the development of entrepreneurship. Deregulation and demonopolization in the public sector are under way. Small and medium-scale businesses have a role to play in this process, particularly in industries producing consumer goods. For this strategy, it is important to meet the challenges of effective and sustainable use of raw materials, turning them into a final product, which would ultimately help to make up for lack of consumer and investment resources.

The revival of private sector in Turkmenistan dates back to the period of 1987-1988 that witnessed the emergence of co-operatives and small-scale enterprises. Also, those were the years when a process of taking a lease of public property and land started to unfold in the country and when reorganization of production relations in agricultural sector began. In rural areas the system of self-financing and collective and individual tenancy started to evolve. However, all those economic innovations were intended to serve public sector, since in the overwhelming majority of cases fixed assets were instituted and owned by public enterprises and farms.

When Turkmenistan achieved its political independence the process of economic reforms accelerated due to the adoption of a number of legislative acts and regulatory instruments which provide a legal framework for market reforms. Among the first laws drafted and adopted by the Mejlis of Turkmenistan were the laws concerning property, enterprises, companies, entrepreneurs, privatization, mortgage, banking, bankruptcy, etc. Concurrently a package of laws and regulations have been adopted to promote greater openness of Turkmenistan's economy to foreign investment. Economic zones of free enterprise have been designated and institutionalized.

To give a boost to the development of entrepreneurship in the country, various statutory privileges have been granted to those who begin to break fresh economic ground which is unfamiliar to the country.

For example, entrepreneurs who wish to engage in agricultural production and processing activities are given from the moment of leasing a piece of land a 5-year exemption from profits tax and land-related payments and some other privileges. Tax privileges are provided to those entrepreneurs who participate in social programmes related to employment of people with disabilities, finance cultural and public-service facilities and provide funds for environmental management, health care, education and children's protection.

Measures taken by the Government have contributed to an accelerated development of private sector in the economy. By now the number of small-scale industries, firms and companies in the non-public sector has risen from a few hundred to 20,000. They include more than 14,000 individual and family enterprises, over 3 thousand partnerships and associations and more than 1 thousand cooperatives.

Furthermore, over 13,000 physical persons have been engaged in business activities. As of today the total number of able-bodied population employed in non-public sector, including those who combine jobs, (agricultural sector excluded) stands at more than 12 thousand people. In 1994 alone the value of goods and services they produced was put at 4 billion manat. They contributed 808.7 million manat to budget revenue in the form of taxes and other levies.

Contrary to a common view that all entrepreneurs are engaged in profiteering and reselling of goods, statistics show that over one third of entrepreneurial units have been active in the construction and maintenance of buildings and structures, one-fourth in commerce and public catering and one-fifth in production of consumer goods and other activities.

The year 1993 saw the beginning of the entrepreneurship development in agricultural sector. One of the crucial developments that gave impetus to an accelerated entrepreneurship development in agricultural sector was a decision taken by the Government to pass into private ownership of each daikhan household up to 50 ha of land and to allow them to take a lease of land almost without any limitation on its size. While for 4.3 million people the country has 49 million ha of the territory, agricultural land totals 17 million ha. Irrigated land accounts for 1.7 million ha. True enough, lack of water resources constrains the irrigation, thus only 10 per cent of cultivable land is used in agriculture. However, the Government of Turkmenistan has systematically been addressing the problems of water supply through construction and renovation of water reservoirs and irrigation systems in order to increase reliability of water supply and expand the area of irrigated lands, especially in subtropical zones and in the areas of ancient irrigation.

As of now over 80,000 ha of land has been privatized and more than 10,000 ha is let on long-term lease. The people of Turkmenistan favoured the introduction of private land ownership, being fully aware that only private owner could become the real land manager, capable of putting it to maximum possible use and preserving its fertility. Now the country is already witnessing the fact, that a daikhanin, having become a full-fledged owner of a piece of land, has been harvesting 1.5 to 2 times more than before from the plot of the same size.

Privatized and leased-out land has become the base for the development of farms. As of today their number reached 4,100. Usually each consists of 3 to 4 people. More often than not, it is a family farm. There has been the emergence of first farms specializing in processing of agricultural crops. At present they are in their developmental stage and in the process of setting up their production facilities. However, a favourable trend towards putting an end to state monopoly in rural areas is evident. Furthermore, the size of household plots given to each family has been increased which contributes to greater self-sufficiency of people and fuller saturation of the consumer market.

The Government of Turkmenistan have been counting on closer cooperation with foreign investors in the field of joint-ventures in all economic sectors, particularly in fuel and energy, agrobusiness and consumer goods industries. Emphasis has been placed on the provision of favourable climate for foreign entrepreneurs.

A major role in this process has been assigned to the establishment of free enterprise economic zones. Seven such zones with particularly favourable regime for foreign economic activities have been established in various parts of Turkmenistan. A special legislation guarantees the observance of rights and interests of economic entities in a zone of free enterprise. These zones provide for a special economic regime: preferential immigration and customs regime, favourable conditions for the land lease and the use of water, electricity and gas; tax privileges to attract foreign investment; free pricing; a right to freely remit (provided that all taxes are paid) earnings in foreign currency abroad; and an absolute right to remittance, transfer, mortgage and export of investments in freely convertible currency. As of today a number of foreign investors availed themselves of the opportunity to operate under free enterprise zone regime. The possibility of establishing a free trade zone in Ashgabad's International airport area and in the seaport in the city of Turkmenbashi is under examination.

"Open door" policy, being pursued by Turkmenistan, tends to attract into the country an increasing number of businesspeople from many states. As of now over 70 projects have been developed with

foreign participation. Foreign partners delivered sophisticated equipment, state-of-the-art machinery and helped their colleagues from Turkmenistan to increase the level of their technical and professional skills.

The Government of Turkmenistan intends to improve the system of state support for entrepreneurship. Under the auspices of the Cabinet of Ministers of Turkmenistan there exists a Department on entrepreneurship development support. Here, every new business man can receive learned advice on any matter concerning the establishment of his or her business.

Also, the International Incorporated Bank for Reconstruction, Development and Support for entrepreneurship was established one year ago with only one quarter of the registered capital is state-owned. The Bank has been providing loans for business projects. The Government has been channelling investment loans to private sector through this Bank. Besides, in due course it is expected to set up an entrepreneurship development fund.

According to the projections, intended measures for private sector development will bring the share of non-public sector in overall gross domestic product by 1996 up to 33 per cent and the number of people employed in it up to 42 per cent of the total people employed.

The Government has been paying considerable attention to the stability of manat exchange rate. Since the introduction of the national currency the Government has been pursuing strict fiscal policy. The Government feels that the challenge of maintaining a stable exchange rate of manat could be met by solving the problems of the CIS partner's debt to Turkmenistan for energy resources supplied in 1993-1994. Presently the overall outstanding debt to the country exceeds US\$ 1.6 billion, and this has an adverse effect on its economy and the standard of living of its people.

The economic development of Turkmenistan depends to a great extent both on export capacity and the level of foreign currency earnings. A legal framework has been established in the country, which stimulates external economic relations and foreign direct investment.

At present there are over 200 enterprises with foreign participation in the country. Companies and organizations from 42 countries took part in their development. They include companies from the Russian Federation, Turkey, the Islamic Republic of Iran, the United States of America, Bulgaria, India, etc.

Foreign investors feel confident in the domestic market of Turkmenistan due to legal measures that were taken to ensure safety of the invested capital. The legislation of Turkmenistan guarantees the security of foreign investments against non-economic risks; investors

have been granted a number of substantial tax exemptions and privileges. They enjoy a guaranteed right of priority to use their earnings for the purchase of goods and products, including cotton fibre, petrochemicals, yarn, wool, carpets, to name but a few, as well as the right of unlicensed export out of Turkmenistan.

In order to facilitate foreign trade a state commodity exchange has been set up in Turkmenistan, which requires all enterprises of Turkmenistan, irrespective of their forms of ownership, to conduct all their foreign transactions only through the commodity exchange (except for contracts under intergovernmental agreements). The commodity exchange also has a right to evaluate the utility of barter deals which, once approved by the Cabinet of Ministers, are formalized; this is to protect the domestic market of Turkmenistan and legitimate interests of parties concerned. The commodity exchange sets ceilings on bid and asked prices. It is expected that the establishment of such exchange will attract honest and scrupulous businessmen and contribute to the revitalization of trade with the outside world.

The formation of the Ministry of foreign economic relations in Turkmenistan also contributes to greater contacts with business world. This Ministry promotes the strengthening of cooperation between Turkmenistan and foreign entrepreneurs and contributes to the protection of Turkmenistan's economy from undesirable effects related to lack of experience of the country's investors and entrepreneurs in international business.

The country has plans aimed at reforming proprietary relations. These plans do not encompass comprehensive privatization, although it was envisaged that almost all economic activities should be subject to privatization. Privatization is being carried out on a step-by-step basis. It was started with community-service facilities which were already privatized in 1994. Now, trade and public catering enterprises are being privatized. Construction industries and industries producing construction materials, are being prepared for massive privatization and later, light food processing and agricultural production support industries should be also privatized.

Since the beginning of the privatization process in Turkmenistan nearly 1,200 community-service facilities have been sold to private buyers for an amount of 115.2 million manat. Privatization of trade and public catering enterprises began in the second half of 1994, and nearly 100 units were sold.

In industry the process of incorporation and leasing-out of the industrial enterprises with subsequent buy-out provisions for medium-scale ones has begun.

Electric-power, oil and natural gas industries, railway and air transport, communications, most of medical, educational and cultural facilities will continue to be state-owned. But that does not mean that the development of other forms of ownership in these fields will be ruled out.

In agriculture and its related infrastructure, the process of changing production and management relations is gaining momentum. The country is witnessing the beginning of the reformation of collective and state farms and other agricultural enterprises through turning them into daikhan farm unions, farming companies and partnerships, cooperatives and other forms of farm management which ensure participation of proprietors and make them responsible for the results of their activities.

However, private sector development in Turkmenistan is faced with many problems. External factors that are beyond entrepreneur's control include general economic and financial situation in the country, problems related to manat convertibility and structural distortions in which result in a dependent economy. There are many problems the solution of which depends on the initiatives of entrepreneurs themselves and the adoption of a wide-range of legal provisions by legislative and executive bodies. However, in many respects overall socio-economic situation in which private sector can develop would faster become more favourable.

The following are the most important issues to be addressed by the Government:

- amending legislative acts and regulations governing entrepreneurial activities, and making them more specific based on the experience gained in the development of entrepreneurship both in the country and other economies in transition;
- development of infrastructure for meeting the needs of private sector, i.e. stock exchanges, investment and mortgage banks, adequate number of insurance and holding companies and information dissemination centres;
- provision of financial support for business infrastructure development by the Government;
- allocation of maximum possible financial, material and technical resources for entrepreneurship development in agricultural sector in order to give a boost to a quantitative and qualitative growth of peasant farms and small-scale enterprises providing services for them;
- addressing institutional aspects of economic reforms: assigning the task of privatization and entrepreneurship development to one government body. Such a government body with adequate powers would be capable of implementing full-scale economic reforms in a consistent and coordinated manner.

By and large, development of entrepreneurial sector could proceed stage-by-stage in the following directions:

Stage I (1995-1996)

- Privatization of state-owned community-service facilities, trade, small- and medium-scale industrial enterprises in accordance with the government programme on privatization.
- Initial stage of infrastructure development for entrepreneurial sector, which requires the formulation of a separate programme.
- Setting up of a state fund for entrepreneurship support, partially using proceeds from privatization of state-owned property, tax revenues (up to 5 per cent) received from business entities, returns on investment and commercial activities of the fund and other sources.

Stage II (1996-1997)

- Privatization, incorporation and deregulation of medium- and large-scale state enterprises in accordance with the Government programme.
- Further infrastructure development, establishment of information network, development of database on non-public sector of the economy.
- Development and implementation of a government programme on coordination of small- and medium-scale business development in Turkmenistan.
- Provision of government support for various investment funds that contribute to economic development in the most important directions; provision of soft loans for investment projects oriented to export and import substitution, etc.

Stage III (1998-2002)

- Development and implementation of individual programmes to meet the needs of non-public sector of the economy.
- Establishment of the system of public management of private sector development in the economy of Turkmenistan; coordination of its foreign economic activities at all stages of entrepreneurial development.

The point is that the state cannot be torn loose from the economy. However, the proposed programme of socio-economic transformation should change the share of private sector in the economy of Turkmenistan from almost zero-level up to 33 per cent of gross national product by 1996 and 57 per cent by 2002, while the share of those employed in non-public sector of the economy, including agricultural sector, should reach 75 per cent.

Public sector will play a leading and predominant role in natural monopoly industries (fuel and energy industry, railway and road transport, communications and mineral industry).

Non-public sector will embrace agro-industrial sector, light and local industries, services, i.e. all those areas of activities which do not require substantial initial investments and employment of a large number of people, and where small-scale production, trading and subcontracting relationships between business entities are the most effective.

It is the non-public sector that will be the most close to consumers, meeting daily needs of the people in terms of goods and services.

Turkmenistan seems to have an optimum strategy of transition to a market economy. First tactical steps have been taken in the direction of entrepreneurship development. However, further measures will be needed for the development of normal market relations and full-fledged monetary economy.

C. ADVANTAGES AND DISADVANTAGES OF ALTERNATIVE SCHEMES OF PRIVATIZATION IN TURKMENISTAN*

The state programme of privatization is based on the principle of consolidation of statehood as well as development of economic independence of individuals engaged in economic management. The main aim of privatization in Turkmenistan is, as emphasized in the programme, to form a class of proprietors who would facilitate building up of a socially-oriented market economy.

The legal basis for the programme of privatization is formed by the law of Turkmenistan "On Exemption of Property from State Ownership

* Prepared by N.B. Movlianov, Head of the Department on Privatization of State Property, subordinate to the Ministry of Economy and Finance of Turkmenistan.

and its Further Privatization", adopted on 19 February 1992 (as amended and supplemented by the Mexhliis of Turkmenistan on 1 October 1993).

The present legislation of Turkmenistan sets up different forms of privatization, including:

- lease of state property with the right of its subsequent sale to a leaseholder collective;
- buying out of state property by members of a work collective;
- conversion of state-owned enterprise into a joint-stock company;
- auctioning of state-owned property.

At the present time Turkmenistan is going through the first stage of privatization as it is defined by the programme. This stage of privatization is meant for three years and aims at privatization of establishments and facilities providing popular consumer services, public catering and trade, different enterprises producing consumer goods and construction materials, those processing agricultural products, as well as privatization of motor transport, uncompleted construction projects and of projects being built with participation of foreign investors.

The implementation of the programme of privatization began in the end of 1993 with privatization of state-owned establishments providing public consumer services. It was enhanced by the enactment signed by the President of Turkmenistan, dated 13 May 1994 and entitled "Measures designed to exempt from state ownership and to privatize trade and public catering facilities in Turkmenistan".

By 1 May 1995 a total of 1,329 establishments (roughly priced at 414.1 million manats) had been exempt from state-owned property. The number included 1,188 facilities providing consumer services, with estimated value of 115.5 million manats, and 141 enterprises providing public catering and trade worth 298.6 million manats.

Small enterprises employing up to 100 workers were privatized in two main ways, as suggested by the programme of privatization: either by sale to employees or by putting them up at auction.

It should be noted that 96.5 per cent, a total of 1,146 establishments in the sphere of consumer services was privatized by way of sale, with only 3.5 per cent (42 facilities) sold by auction. This could be explained by relatively low prices quoted for majority of establishments providing consumer services which made it possible for members of work collectives to acquire as private property. Thus, average price for a single bought out enterprise amounted to 41,000 manats, whereas average price for an enterprise sold by auction was 1,621,000 manats.

In the sphere of public catering and trade, a total of 141 establishments privatized only 60 (43 per cent) were privatized by sale to employees, while 81 were auctioned. The average price of a single establishment privatized by sale was estimated 440,000 manats, with the price for an enterprise at an auction stood at 3,360,000 manats. Comparatively slow pace of privatization in this sphere of economy could, in our opinion, be explained to a large extent by higher prices of establishments.

Analysis of the process of privatization shows that both buying out of state property by members of the work collectives and auctioning of the enterprises are quite acceptable as forms of privatization with each depending on particular circumstances. The pace of privatization is generally afflicted by the lack of funds necessary for the population to take up establishments. This will particularly affect the pace of privatization at its second stage beginning from 1996, when the privatization of major industrial enterprises, construction projects, transport and other large enterprises is envisaged.

At the same time it is not the pace of privatization that is of utmost importance but the prospects of successful functioning of privatized enterprises. In this connection it is worth mentioning that the operation of facilities bought through an auction appears more effective. The high cost of establishments put up at auction serves as a guarantee that its participants have thoroughly considered the possibilities and options and are decisively determined to turn them into preferable ventures. Worker collectives and their leaders, in contrast, are mostly inclined to view privatization as merely an administrative procedure or as a sheer change of sign-board meant to decrease state control over their activities.

Regarding the operation of the privatized enterprises, both in the sphere of consumer services and in the sphere of public catering and trade, it is worth mentioning that most of these establishments require substantial capital investments to replace used-up machinery and to renovate industrial premises and workshops. They also face problems in obtaining raw materials, tools and other materials. Therefore new proprietors need governmental assistance. That can be provided either in the form of establishing a special fund for privatization by accumulating receipts from the sales of state-owned property or in the form of providing credit to the new proprietors on favorable terms, or granting them tax privileges, or preferential allocation of material and other resources.

Only a few steps have been taken to privatize state-owned property by means of its conversion into joint-stock companies of open type, as this form of privatization is obviously more elaborate than sale or auctioning.

It also implies building up of investment funds and creation of securities market and stock exchanges. Preparations are under way in these respects.

Privatization in the form of lease of an enterprise with subsequent sale of is acceptable as well, though it takes longer for worker's collectives to accumulate funds first to buy out and then to modernize the facility.

In late 1991 the Kyrgyzstan embarked on a course of transforming the economy which was predominantly based on centralized planning and administrative control over allocation of resources into a market-oriented economy. First steps in the process of reforms were related to step-by-step price liberalization, establishment of a two-tiered banking system, adoption of foreign investment code and privatization of state property.

In May 1993 national currency was introduced so that the republic could pursue an independent policy of financial stabilization. At the same time, with the support of IMF a programme of stabilization and restructuring was launched. The programme provided for further price liberalization, phase-out of government orders for agricultural and industrial products, and expansion of privatization process.

In June 1994 a 3-year memorandum was signed between IMF and Kyrgyzstan, which provided a basis for an integrated action programme of the Government of the Kyrgyzstan to ensure economic restructuring during 1994-1997 period. So far this is the main instrument for managing economic reforms in Kyrgyzstan.

The results of the activities undertaken under the programme in 1994 and in early 1995 suggest a considerable success in macroeconomic stabilization, particularly in reduction of high inflation rate and lowering of interest rates, the trends towards output decline and further unemployment still persisted. The following are the highlights of some major policy reforms and results.

1. Finance policy

For the purpose of stabilizing financial situation, as far back as early 1994 subsidization of the unprofitable enterprises from budgetary sources was stopped and tax privileges for certain enterprises were withdrawn. In addition, administrative staff reduction (by 14 per cent in 1994) at all levels was initiated. The Treasury and tax police were instituted with a view to strengthening control over public finances. Furthermore, banking system reforms were initiated.

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2. Demonopolization and privatization

In 1994 demonopolization and partial privatization of grain-producing industry got under way, that will continue this year. A number of major wholesalers in the field of material and technical supply were also demonopolized. In transport three state-owned holding companies were liquidated.

In an effort to implement industrial restructuring the economy embarked on a special programme on reorganization or liquidation of unprofitable enterprises.

A programme on deregulation and privatization of state property continues to be implemented. Since the second quarter of 1994 there has been a regular sale of the government's share of stock of incorporated enterprises through voucher and money auctions. As of 1 March of this year 5,285 public enterprises have been privatized, which accounts for nearly 53 per cent of all enterprises to be privatized.

3. Price liberalization

In line with the programme, measures have been taken to fully liberalize the prices. Thus, the number of monopolistic enterprises which are subject to price control has been reduced to 5. Since the 1st of July there has been increase in charges for gas, electricity, heating and trunk-calls for population (an increase of 1.4, 2, 3 and 2, and 5 times respectively). Starting from the second part of 1995 it is intended to implement the second stage of the increase in charges for the above-mentioned services.

4. Liberalization of foreign economic activities

In the context of further liberalization of foreign economic activities there has been further reduction in the number of items which are subject to license for export and import (export duties are imposed only on 4 items). In addition, intergovernmental deliveries on a clearing basis are held to a minimum, (in 1995 clearing is to be used with Uzbekistan only).

5. Social issues

Measures are being carried out to provide better social protection for the people, especially for low-income sections of society (minimum wage and pension rates have been raised from 45 to 68 som; monthly grants are given to low-income families and citizens).

6. Legal aspects

A number of measures aimed at improving regulatory framework for deepening of the reforms have been implemented. These include revision of the labour code, preparation of a draft revenue code, and a revised version of the land code. Drafting of laws concerning companies, private property, entrepreneurship and social insurance is near completion.

7. Privatization

By and large, compared to other countries of CIS, Kyrgyzstan was successful at the first stage of the reforms in terms of such indicators as the share of non-public sector and privatization of large- and small-scale enterprises. State property fund is embarking on mastering new methodology of selling companies to strategic investors.

8. An assessment

Despite the achievements in macroeconomic stabilization, by and large the situation in real sector of the economy remains difficult, and there is little progress in overcoming economic slump.

More than 100 large- and medium-scale enterprises stand idle. Major causes of idleness are either lack of funds or lack of final markets.

The country completed the first stage of reforms (if such relative division is possible) more or less successfully, and this was acknowledged by foreign experts. However, the second stage of economic reforms beginning in 1995 will be more difficult. Fundamental improvements are required to ensure a production pattern that increasingly suits market requirements, achieves higher efficiency and creates greater competition among producers.

So far the economy has been unable to develop an effective system of financial intermediation that would stimulate production. But that would be difficult without a greater success in curbing inflation.

As for foreign economic activities, the country should review the policy with regard to promoting export-oriented industries and fostering the upgrading of machinery and technology. It is necessary to review the medium-term policy in this regard, as well as the policy of effective foreign investment, since these are very important for the revitalization of the production.

As regards the objectives for the current year, the programme calls for intensification of economic reforms in the strategic areas, such as stabilization of finance and credit system; accelerated demonopolization and privatization of public sector; reorganization or liquidation of major unprofitable enterprises; further price liberalization; improvement of legislative framework; and provision of increased social protection to low-income groups of the population.

