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TURKMENISTAN - FINAL REPORT

**NIS INSTITUTIONAL BASED SERVICES UNDER THE
ENERGY EFFICIENCY AND MARKET REFORM PROJECT
CONTRACT NO CCN-Q-00-93-00152-00**

DELIVERY ORDER No 17

**CENTRAL ASIAN REPUBLICS
REGIONAL ENERGY SECTOR INITIATIVE**

Final Report

Prepared for

U S Agency for International Development
Bureau for Europe and NIS
Office of Environment, Energy and Urban Development
Oil and Gas Division

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Appendix A, Reference	Report on Rule-Making for the Petroleum Law of Turkmenistan
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Appendix D, Reference	Report on Identification and Procurement of Selected Reference Materials for Counterpart Organizations in Turkmenistan
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EXECUTIVE SUMMARY

Hydrocarbon rich Turkmenistan has struggled with a variety of obstacles to tap into international markets for distribution and sale of one of the country's few profitable commodities. Some of the obstacles are matters of fate and difficult, at best, to overcome. Turkmenistan's location is far from hard currency markets and surrounded by competitor nations also rich in hydrocarbons. Others of the obstacles are within the power of the small nation to eliminate. Beginning in 1996, Turkmenistan embarked upon legal and regulatory reform to rid itself of its stifling legacy of Soviet style legislation and petroleum industry institutions. A new Petroleum Law was adopted and became effective in March 1997. The concept of an industry-efficient "one stop shop" was built into the structure of the new Law, and a new agency — the Competent Body — was created outside of the old guard institutions to implement the Law's terms. For the past 18 months, USAID advisors have counseled the new institution, together with the remaining old guard institutions, on aspects of implementing the reforms contemplated by the Law, and aspects of further refinement in the petroleum sector in general. Rules and regulations supporting the new Law have been drafted and are undergoing a review process of debate and deliberation. Accounting standards conforming to international standards are being drafted and promise to provide petroleum sector institutions with the kind of financial accountability used worldwide to exact operating and investment disciplines from entrepreneurial ventures. A process of analyzing and selecting national strategic options has begun and should result in Turkmenistan making the best and wisest choice of future roads to travel. Much work remains, however. The highly fragmented structure of the governmental oil companies is inefficient and ineffective. The petroleum sector must again be reorganized into a viable and competitive entity. The new Competent Body must be developed into a truly functioning regulatory body capable of coping with an international oil industry possessing technologies unlike anything heretofore seen within Turkmen boundaries. Accounting standards must become fixtures of workday practice. The nation's strategic options must be sorted through, selected, and executed with a vision of better days ahead for the country.

CHAPTER 1

INTRODUCTION

INTRODUCTION

During most of its existence as a member Republic of the Soviet Union, Turkmenistan played but a service role for other Soviet Republics. The only two commodities that the Soviets had developed in Turkmenistan — natural gas and cotton — depended upon Moscow and other sister republics for their market. Turkmen gas was not, except via the Russian pipeline system, connected to hard currency markets. When the Soviet Union broke apart in 1991, Turkmenistan was thrust into independence without having in place a robust or broad-based economy. In hardball fashion, Russia limited Turkmen access to the Russian pipeline system for sales only to other breakaway republics, most of which were unable to pay hard currency. As Turkmenistan's production fell from more than 80 billion cubic meters (bcm) annually to less than 10bcm, the infrastructure of the state petroleum industry began to crumble in step. Without the necessary capital available for reviving the industry, the country had to look to foreign investment to provide the development requisite to getting the petroleum sector, and hence the economy, out of the doldrums. Unfortunately, the legal and regulatory structure of the petroleum sector was as badly outdated and as doddering as the sectors' infrastructure, and the shadow of its burdensome and prescriptive edicts and processes added to the gloomy investment environment.

USAID's work in Turkmenistan's petroleum sector has appropriately, therefore, focused primarily on legal and regulatory reform and institutional development. Specifically, this delivery order and the implementing Memorandum of Understanding between USAID and the Government of Turkmenistan was targeted toward four tasks: (A) Legal and Regulatory Reform, (B) Institutional Development, (C) Seminars/Workshops/Study Tours/Training, and, (D) Advisory Services/Coordination and Management of Subtasks A-C. A description of each of the tasks is provided below, along with the results seen, list of deliverables and a description of other work products produced as part of the delivery order.

While most recent work has proceeded at a relatively rapid pace, early efforts to provide technical assistance were frustrated by confusion within the Government of Turkmenistan concerning how to fit the new agency called for by the Petroleum Law into the existing oil and gas institutional structure. Ultimately, an entirely new agency, the Competent Body for the Use of Hydrocarbon Resources at the President of Turkmenistan [hereinafter, the "Competent Body"], was established apart from the old Ministry of Oil and Gas Industry and

Natural Resources Even then, it was to be several more months before the Competent Body could accept any assistance Indeed, Hagler Bailly was asked by USAID not to initiate any contact with governmental officials until after the execution of a Memorandum of Understanding — something which occurred on October 17, 1997 While Hagler Bailly then thought that it was free to begin substantive technical assistance, the Competent Body itself put off accepting any consultation until the preparation and agreement to an Implementation Plan — another eight-week delay Once agreement was reached on an Implementation Plan, the Competent Body accepted the Hagler Bailly recommendation to create a rule-making committee with membership drawn from a variety of agencies within the oil and gas sector and other agencies concerned with environmental matters At the same time, the Competent Body saw value in using a similar model of committee development for, among other things, a national strategy, and accounting and reporting standards Hagler Bailly's Resident Advisor was specifically named for membership on the committee drafting rules and regulations, and consulting assistance of Hagler Bailly was requested for the other two committees mentioned above The work of all three committees is progressing but remains incomplete at the time of closeout of Delivery Order 17, and the writing of this report

The impact of the Task work has been very important and substantial as will be detailed under each Task discussion below There remains much to be done, however, as the economy of Turkmenistan continues to implode A January story on emerging market indicators from the Economist¹ magazine cited Turkmenistan as having the only emerging economy for which Economist publishers would forecast a negative growth in gross domestic product for 1998 Now, two thirds of the way through the year, the global optimism of that report has not prevented a number of other economies from dropping to negative growth figures, but Turkmenistan continues the dubious honor of leading the charge into the economic depths A very recent article from the London Financial Times cites Turkmenistan as the "basket case" among national economies and predicts that 1998 will end with Turkmenistan's economy having shrunk by a whopping 25% — three times more negative than next worst Albanian economy which is predicted to drop by 8%² The overall external debt of the country now stands at 74% of gross domestic product³ Foreign direct investment continued to decline in 1997 probably due in part to continuing concern that the country still is in what can, at best, be characterized as the early stages of the reform process In short, the importance of USAID technical assistance to put in place legal, regulatory and institutional reforms and sweep away the obstacles to investment simply cannot be underestimated

¹The Economist, *Emerging-Market Indicators*, January 17, 1998

²Financial Times, August 5, 1998

³Due mostly to loans to the Agricultural sector

CHAPTER 2

TASK A: LEGAL AND REGULATORY REFORM

TASK TO PROMOTE LEGAL AND REGULATORY REFORM

The primary objective of this task was to assist with the institutional and regulatory reforms necessary to attract private investment to the petroleum sector by establishing a regulatory system consistent with international standards and practices. Task activities undertaken included reviewing and assessing the current legal, policy, institutional, and regulatory framework for hydrocarbon field developments, recommending a rule-making procedure and structure, reviewing and assessing existing Petroleum Regulations from other producing countries, reviewing existing materials related to international regulatory institutions, appointment by the President of Turkmenistan to participate as a named member to the Permanent Expert Group (PEG) for development and approval of "Uniform Rules for Development of Oil and Gas Deposits of Turkmenistan", drafting of an initial set of regulations — divided into thirteen (13) chapters — to complement the Petroleum Law of the country¹, participating in debate within the PEG regarding the substance of and necessity for each of the drafted rules, discussion of draft rules with industry representatives, and revising the initial and successive drafts of the Petroleum Regulations following debate and compromise by the Permanent Expert Group, submission of a complete set of rules to the Competent Body for its consideration, to industry for its comments, and to the Expert Council for its preliminary consideration and deliberation. The industry comments which have been solicited will be considered and desirable changes made before a preliminary-final draft of the rules is submitted to the Expert Council² for its final debate and deliberation.

The Petroleum Law was signed by the President of Turkmenistan on December 30, 1996, but became effective only upon its publication in March, 1997.

The Expert Council includes the President of Turkmenistan, and the heads of various Ministries concerned with the issues of hydrocarbon development. It can be thought of as the "Board of Directors" of the regulatory agency, the Competent Body, created by the new Petroleum Law to control all facets of petroleum development within the bounds of Turkmenistan.

By the time advisors arrived to commence work under DO 17, the Government of Turkmenistan had already adopted a new Petroleum Law. The Law had been drafted, and largely ushered through the legislative process by the technical assistance of the European Union program, TACIS. Indeed, the new Law is very progressive and provides a rational basis for the adoption of an international set of rules and regulations and for the establishment of a rational regulatory commission capable of smooth administration of the nation's petroleum sector. The Competent Body was the agency created by the decree of the President in response to this Law.

By October 1997, the Competent Body had developed with the assistance of the Office of Major State Inspection of Turkmenistan a set of rules and regulations. Ostensibly developed to implement the new Law, the rules were reminiscent of the GOST standards developed and enforced under Soviet times. The rules were far from the set of rules and regulations "consistent with international standards" contemplated by the drafters of the new Law. By Letter of December 11, 1997, we advised the GOT not to adopt the old style regulations but rather to initiate a new rule-making effort to develop a truly revolutionary framework for the exploitation of their hydrocarbon resources. In January, 1998, the GOT moved in agreement with such advice by establishing the Permanent Expert Group (PEG) for the development of Uniform Rules for Development of Oil and Gas Deposits of Turkmenistan, and appointing Resident Advisor William James to the PEG. Under the chairmanship of Mr. Bayram Hasanov, First Deputy Head of the Office of Major State Inspection for Standards, Metrology, and Safety of Turkmenistan, the PEG quickly agreed upon an outline for the new set of rules and regulations, and set to the task of drafting, debating, and arriving at a compromise consistent with international practices and standards.

At the writing of this report, a complete set of thirteen chapters has undergone PEG debate and final revision. This final set of rules has been submitted under cover letter of the PEG Chairman, Mr. Hasanov, to the Competent Body for their consideration. It is anticipated that work could continue in the near future on the following further steps toward final development of such rules: receipt and consideration of industry comments to the preliminary-final set of rules, possible shepherding and advocacy of the set of rules before the Expert Council, explaining the merit and purpose of each section, and explaining the merit and content of industry comments to such preliminary-final draft, re-drafting or amendment of sections to the specification of the Expert Council, and development of a final-final set of rules for adoption, implementation and enforcement by the Competent Body.

Major Results

Major results of this task included the drafting of some 150 pages of rules and regulations in Russian and English, which regulations track relatively closely with international regulatory systems in other jurisdictions hosting major international petroleum firms. Further discussion of the work undertaken with respect to this subtask is contained in the report entitled "Report

on Rule-Making for the Petroleum Law of Turkmenistan ,” attached by reference hereto as Appendix A

Importantly, the newly drafted set of rules dramatically alters the old Soviet style of prescriptive regulations which micro-managed oil field operations, and which froze permissible equipment and technology at moments in time which were seldom changed or updated. The new rules, if adopted, will require the regulatory body, the Competent Body, to substantially professionalize its operation by becoming competent in the constantly improving technologies available to international firms. Decision making and permit and application processing would no longer be a simple matter of checking boxes and stamping “Approved” or “Denied” but rather would involve knowledgeable negotiation with Operators for a wide range of design specifications and permissible operating techniques.

Deliverables Required by the Delivery Order

The contractually required deliverables for this task include

- ▶ A report outlining the findings, recommendations, and a detailed action plan to develop the regulatory framework for hydrocarbon development

This deliverable was accomplished through the issuance of two reports, the first of which was completed on July 15, 1997. Such Report detailed the status of macroeconomic conditions in the nation, Turkmenistan’s upstream oil and gas structure, reforms then underway, current and past foreign donor activities, and a recommended USAID action plan. The second of these reports was completed on September 15, 1997, and detailed the then current oil and gas investment environment, and the ideal environment for attracting oil and gas investment. This latter report also recommended changes in laws and decrees, as well as regulations and drafts of new regulations, and process and institutional structure for foreign investment in oil and gas.

Other Task Activities

Additional activities undertaken during this task include the following

- ▶ Officials from Turkmenistan were sent to the United States on a study tour to witness first hand the regulatory processes developed by the mature administrative agencies of several US States that have oil and gas production. Beginning with attendance at the semi-annual meeting of the Interstate Oil and Gas Compact Commission, the body providing oversight direction for state regulatory bodies, the group also visited a regulated oil field in New Mexico, a California regulated offshore platform near Long Beach, oil company and service company offices in Oklahoma, and in Houston, as well as the University of Houston Oil and Gas Institute. While most of the expenses

of this tour were incurred by another USAID contractor, AED, Hagler Bailly supported this activity by sending a Resident Advisor from the Ashgabat office and two staff members who were directly involved in the development of Turkmenistan's new rules and regulations

- ▶ Legal advice has been provided to the Competent Body to better enable it to handle interim regulatory matters concerning operators already working in country Oral advice has been given on a broad range of matters including customs taxation of imported oil field equipment, as well as issues concerning conservation, permitting, licensing, protocols, and management committees

Next Steps

Having legislation in place and rules and regulations on the books is one thing Effective implementation of these legal precepts is quite another Subsequent USAID assistance to Turkmenistan should include technical assistance for developing a fully operative administrative agency capable of dealing with international oil firms, their practices, technologies, while addressing the entire scope of problems that development of natural resources poses — environmental concerns, humanitarian concerns, and fiscal concerns Such a regulatory agency should ideally be separate from that agency principally concerned with the commercial aspects of managing the nation's hydrocarbon resources — something which today is merged in the Competent Body Further, such an oil and gas regulatory authority (OGRA) should be independent from the political processes at work within the Government of Turkmenistan Historically, independence from political processes has been achieved by appointment of regulatory commissioners for defined and staggered terms, with removal of commissioners available only for serious malfeasance in office Legislation providing for such an OGRA will need to be introduced in the Medjlis

CHAPTER 3

TASK B: INSTITUTIONAL DEVELOPMENT

TASK OF INSTITUTIONAL DEVELOPMENT

The primary objective of this task was to assist in the development of or improvement of with the organizational and institutional capabilities for attracting and handling foreign oil and gas investments. In short, governmental procedures had to be made more streamlined, transparent and investor friendly. Task activities undertaken included reviewing existing process and capabilities for handling foreign oil and gas investments, specifying and helping to implement the legal, structural and policy improvements which could be made to make foreign investment more likely, and more economically productive for the nation as a whole.

Major Results - Accounting and Reporting Subtask

One major result of this subtask was initiation of the development of a set of accounting and reporting standards for the oil and gas industry that are consistent with international standards. Working with the PEG created to develop "Uniform Principles, Methodologies and Forms For Accounting and Reporting For Petroleum Operations in Turkmenistan," Hagler Bailly, has undertaken the following activities:

- ▶ Collected accounting standards, instructions, and methodologies currently in use in the international practice and provided copies to the PEG members including International Accounting Standards (IAS), copies of 1998 Miller GAAP Guide, "Restatement and Analysis of Current Promulgated GAAP", "Accounting Standards" adopted by Kazakhstan's National Accounting Commission (in English and Russian), English version of the Letter No. 4/122 of January 21, 1997 of the National Accounting Commission of the Republic of Kazakhstan, "Concerning the Procedure for Transition to the General Charts of Account for Finance-Business Activity of Entities" and attachments (I) Supplement to the Letter, and (II) Instruction Concerning the Application of the General Chart of Accounts for Finance-Business Activities of Entities, Annual Reports, Security and Exchange Commission disclosures, and other information published for shareholders by international oil companies.
- ▶ Prepared a detailed Work Plan for the project.

- ▶ Developed a draft framework describing (1) the objective of preparing financial statements on the basis of IAS, (2) the purpose of financial statements, (3) the main principles of IAS, (4) the organizations, divisions, and subsidiaries that will be required to adopt to the new Accounting Principles, (5) the legal basis for adopting the new standards, and (6) other topics, issues or questions that will facilitate a general understanding of the new Accounting Principles that will be developed
- ▶ Identified and prepared a list of the specific Accounting Principles that will have to be developed and implemented to enable the relevant enterprises to prepare financial statements in accordance with IAS
- ▶ Through participation in PEG committee meetings, promoted a greater understanding of relevant IAS's and U S GAAP oil and gas Accounting Principles In addition, the Hagler Bailly expert has drafted Oil and Gas Accounting Policy Statements for (1) Acquisition of Mineral Rights, (2) Exploration Costs, and (3) Development Costs to better illustrate the relevant accounting principles and to provide examples of policies and procedures that the State Concerns will need to develop to successfully implement international standards
- ▶ Reviewed and commented on the Accounting Standards drafted by various PEG members, including AP-4 Balance Sheet and Main Financial Statement Disclosures, AP-7 Revenue, AP-8 Long Term Assets, Ap-5 Cash Flow Statement, and AP-10 Foreign Currency Transactions
- ▶ Discussed the decree on "Composition of Products Costs" with the PEG and prepared memorandum on reclassifications of "Products Costs" according to IAS
- ▶ Prepared a Table of Definitions of Terms used in Accounting Standards for communicating common accounting concepts
- ▶ Developed a draft of a proposed account coding structure and new Chart of Accounts based on IAS and distributed to the PEG for review and comments
- ▶ Developed model financial statements for preparation of Turkmengas Enterprise operating results based on IAS
- ▶ Prepared a memorandum with comments and proposal on how the "Kazakhstan Accounting Standards" could be used as the basis for developing Oil & Gas Accounting Standards for Turkmenistan

Hagler Bailly has also assisted the PEG on Reporting since March 1998. At the writing of this report, Hagler Bailly has carried out the following activities:

- ▶ Prepared a detailed "Work Plan for Development of Uniform Principles and Forms for Reporting Petroleum Operations in Turkmenistan"
- ▶ Prepared a framework for Uniform Reporting Principles and identifying contractual/statutory reporting requirements for the foreign companies. These will be used to explore the reporting relationships between the Management Committee and the Competent Body and the information requirements of the two bodies.
- ▶ Reviewed existing reports prepared by various entities operating in the oil and gas sector including foreign oil companies. This work is currently continuing. Roughly 50% of the reports have been translated into English. Most of the reports were found to be too detailed and short term oriented and lacked information as to the performance of oil and gas entities with respect to budgets and plans.
- ▶ Prepared a scheme (including draft forms) for reporting financial information by foreign oil companies working under PSAs. These forms were formally presented to the PEG along with an explanation of the fiscal terms in PSAs.
- ▶ Hagler Bailly has also prepared a "List of Technical Reports Normally Prepared for Upstream Oil and Gas Operations" for discussion with the Competent Body.

A more complete discussion of the work undertaken in furtherance of this Accounting and Reporting subtask is included in the report entitled "Final Report USAID's Technical Assistance for Developing Uniform Principles, Methodologies, and Forms for Accounting and Reporting for Petroleum Operations in Turkmenistan" and attached by reference hereto as Appendix B.

Major Results - National Strategy for the Petroleum Sector Subtask

The second major subtask under Institutional Development has been to provide assistance with the development of a national strategy for the petroleum sector. Again, working with one of the Presidential PEG's created in January 1998, specifically that for development of "The National Strategy for the Use of Hydrocarbon Resources of Turkmenistan," Hagler Bailly has provided guidance, analysis, and presentations to the Government of Turkmenistan to help structure the strategic planning process. As with the work on accounting and reporting standards, and with petroleum sector rules and regulations, work on this project is progressing but incomplete at the writing of this report. Completion of the National Strategy is now proceeding on a nine-step program.

- ▶ Development of a preliminary Mission Statement
- ▶ Analysis of the strengths and weaknesses of the Turkmenistan oil and gas sector
- ▶ Analysis of world oil and gas markets
- ▶ Analysis of existing oil and gas infrastructure in Turkmenistan
- ▶ Analysis of Turkmenistan's energy supply and demand profile through 2015
- ▶ Analysis and recommendations on the restructuring of Turkmenistan's oil and gas institutions
- ▶ Development of alternative strategies to achieve the goals of the Mission Statement
- ▶ Development of various scenarios to test alternative strategies
- ▶ Selecting the preferred strategy or combinations of strategies based on scenario analysis

Hagler Bailly has provided much of the input for this process to date on the development of a preliminary Mission Statement, an analysis of the strengths and weaknesses of the Turkmenistan oil and gas sector, and an analysis of world oil and gas markets. In addition, we have had many conversations with members of the PEG, individually and in groups, regarding the concepts involved in long range strategic planning. Nonetheless, this PEG has, in terms of activity level and work product, lagged behind other PEG's charged with assessing energy related issues. The technical assistance provided by Hagler Bailly to date has focused on dissemination of information and exposing the group members to the concepts and complexities of long range strategic planning. Development of alternate strategies, construction of various scenarios to test alternative strategies, and choosing the appropriate strategy or combination of strategies will prove to be the most complex and critical step in the process. A detailed description of the work accomplished under this subtask relating to the development of a national strategy for the petroleum sector is included in Appendix C, attached by reference hereto.

Deliverables Required by the Delivery Order

The contractually required deliverables for this task include

- ▶ A short concept paper for establishing a national oil and gas regulatory authority. Such paper is to address independence from political decision-making and rule-making, enforcement procedures, conservation and management of national resources, record-

keeping, permit and license issuance, fee collection, and establishment of oil and gas pipeline tariffs

This deliverable was accomplished through the preparation of the document entitled "Model Oil & Gas Regulatory Agency" dated May 1998, and delivered to and discussed with Turkmen officials during the seminar on Independent Administrative Agency Law

Other Task Activities

A number of books, software programs, reference materials, laws and regulations have been acquired during the course of this delivery order. See Appendix D, attached by reference hereto. Some of these materials have been translated and provided to our counterparts. It is anticipated that the remaining materials will be donated to the appropriate governmental agency or counterpart upon termination of Hagler Bailly's work in Turkmenistan.

Next Steps

As with the rule-making procedure described above in Legal and Regulatory Reform, work must continue on the development of accounting and reporting standards, and on the national strategic planning. Moreover, to properly implement the accounting and reporting standards there must be developed with the government a cadre of accountants competent at understanding and applying the new standards. Managers must learn how to better manage their agencies by becoming familiar with the benefits that such information provides them. Most importantly, the governmental oil sector must be re-structured into a viable national oil company — as competitive and bankable outside the country as within — and the managers of that company will need to learn the managerial disciplines of pursuing maximum efficiency from the information revealed by the new accounting and reporting systems. USAID should be prepared to assist with these additional developments.

Hagler Bailly has made significant contribution to the development of a market oriented national strategy by providing the PEG with strategic planning methodology and by identifying and elaborating on many of the important issues that the PEG should consider. Hagler Bailly should continue to interact with the PEG members and assist them as necessary until they have completed the present planning cycle. The process of strategic planning in the Turkmen oil and gas sector is of the highest importance and continued USAID support is recommended. For the long term, it is recommended that the Turkmen Government institutionalize the process of strategic planning by creating a Department within the Competent Body or the Ministry of Oil and Gas Industry. It is further recommended that USAID assist with the organizational development, the training of selected individuals who will staff such an organization, and provide the required resources including a long term advisor, if necessary.

CHAPTER 4

TASK C: SEMINARS/WORKSHOPS/STUDY TOURS/TRAINING

TASK OF PROVIDING SEMINARS/WORKSHOPS/STUDY TOURS/TRAINING

The primary objective of this task was to assist in the development of the skills necessary for Turkmenistan to actively, competently, and successfully participate in the global petroleum industry. Such industry today is a complex marketplace bringing together buyers and sellers each with tremendous wealth, power and knowledge. Many international oil firms have decades of experience in the marketplace while Turkmenistan has virtually none. Such disparate administrative and business skills can lead to poor business transactions — both from an international oil firm's point of view as well as that of the country. For implementation of this task, seminar topics were chosen which would begin to reduce this disparity.

Topics included the following:

- ▶ International Petroleum Economics
- ▶ Basics of Oil and Gas Accounting
- ▶ Independent Administrative Agency Law
- ▶ Strategic Planning
- ▶ International Petroleum Agreements
- ▶ A Study Tour of Alaskan oilfields, regulatory agencies, and oil spill response facilities to be held in early October [to be funded by AED, but planning is underway as a part of DO 17]

The number of participants ranged from 13 to 23, and included mostly mid-level managers coming from a diverse range of governmental agencies having direct or indirect interests in the petroleum sector. Participants generally evaluated the workshops as excellent. Separate reports have been prepared and submitted on each of the courses.

Major Results

Seminars and workshops have included

International Petroleum Economics The first course was conducted on February 17 and 18, 1998, by Dr Bhamy Shenoy Discussed under this broad topic were the concepts of time value of money, return on investment, financial analysis of investments including the impact of royalties, taxes, and production sharing arrangements The forces which set prices in international petroleum transactions and the impact of transportation costs on the producing country were highlighted Illustrative examples explored, among other things, refinery investment, pipeline costs, and different product values

Basics of Oil and Gas Accounting The second seminar was held on March 9 and 10, 1998, by Mr Dag Lillegraven The discussions focused on the creation and purpose of accounting data, and the usefulness of such data to managers, investors or creditors, and others who may be indirectly interested in such information for purposes such as taxation or economic pulse measures Issues specific to oil and gas accounting were explored in detail including 'full cost' versus 'successful efforts' accounting, the acquisition and conveyances of mineral rights, exploration and production costs, petroleum reserves, capitalization and amortization of exploration and development costs, and joint ventures

Independent Administrative Agency Law The third workshop was held on July 15 and 16, 1998, by C John Sanders, Esquire Sessions explored the nature and creation of such agencies, their importance and purpose within the framework of 'three-branch' governmental systems, together with their practices and procedures Finally, a Model Oil & Gas Regulatory Agency was presented and discussed

Strategic Planning Working in concert with the PEG on "The National Strategy for the Use of Hydrocarbon Resources of Turkmenistan" created in January, 1998, by the President of Turkmenistan to advise the Expert Council of the Competent Body, Dr Bhamy Shenoy conducted this fourth workshop on August 4-5, 1998 While planned as an active, two-way discussion or brainstorming session using actual data, the resulting charrette turned out more to have been a classroom lecture session on strategic planning where Turkmen officials, though attentive, had precious little information readily at hand One topic discussed which is of considerable timeliness and relevance to Turkmenistan is the rehabilitation and upgrading of the Turkmenbashi Refinery — a three staged, nearly one billion-dollar project, the economics of which Dr Shenoy helped the participants to analyze The workshop also exposed the need for the restructuring of Turkmenistan's oil and gas sector

International Petroleum Agreements The fifth and final seminar of this Delivery Order was held on August 26-27, 1998, with Resident Advisor William James and Short-Term Advisor R Patrick Grammar, both oil and gas attorneys, instructing The course analyzed the parties' motivations, the drafting, negotiation and implementation of various contractual arrangements for the development of oil and gas resources, and will particularly highlighted the concepts of Production Sharing Agreements in use by Turkmenistan A Microsoft Excel

Model was prepared for course discussion on the economic analysis of various agreement terms and negotiable parameters

Environmental, Safety and Regulatory Study Tour A study tour is being planned by Hagler Bailly, to be funded in large part by USAID contractor AED, which will permit an early October focus on Alaskan oil fields and which will have five main goals (1) First hand look at the co-existence of oil field operations and rigorous environmental protections in the ultra-sensitive tundra of Alaska's North Slope, (2) Inspection of safety features and practices of offshore oil platforms in the icy waters of Cook Inlet, and a collateral visit to the world class on-shore fertilizer plant demonstrating the manufacture of modern products from hydrocarbon resources, (3) Office visits to Alaskan and federal administrative agencies regulating the oil and gas industry in that State and in Washington, DC, (4) Site visit and tour of the oil spill response facilities of the operator of the TransAlaska Pipeline System, Alyeska, at the TAPS terminus in Valdez, (5) Site visit to the oil spill response training facilities of Chevron Oil Company in San Ramon, CA, to see the kind of training techniques, and equipment necessary to train and maintain a rapid response to an oil spill

Deliverables Required by the Delivery Order

The contractually specified deliverables for this task are the manuals on four of the five seminars/workshops¹ which manuals have been prepared in both English and in Russian

Next Steps

Much work remains to bring the administrative and business skills of Turkmen officials up to parity with those exercised by international oil firms. Subsequent USAID technical assistance in Turkmenistan should continue to provide seminar, workshop, and study tour assistance

Dr. Shenoy prepared a long range planning model, spread sheets, reports on world oil market and world gas market, and documents for discussion

CHAPTER 5

TASK D: ADVISORY SERVICES/COORDINATION AND MANAGEMENT

TASK OF PROVIDING ADVISORY SERVICES/COORDINATION AND MANAGEMENT OF TASKS A-C

The objective of this task was to provide advisory services to the Government of Turkmenistan by providing resident advisors with petroleum industry backgrounds who could provide advice on specific issues pertaining to technical, economic/financial and legal matters relating to the oil and gas sector. In furtherance of this task, two Resident Advisors were provided to Turkmenistan and have spent most of the past 16 months working in Ashgabat where they have gained the confidence of, and built credibility with, the various institutions and officials of the Turkmen Government.

Major Results

The major impacts of this project are the results described above for beginning development of a new set of rules and regulations for the petroleum sector, beginning development of a new set of generally accepted accounting principles for that sector, and commencement upon a new planning process to end with strategic goals and pathways for the petroleum sector. It is indicative of the degree to which the two Resident Advisors have labored in this regard that the President of Turkmenistan specifically named one of them to the Permanent Expert Group for the development and approval of Uniform Rules for Development of Oil and Gas Deposits of Turkmenistan while the second of the Resident Advisors has been trusted with access to the highest level of the strategic planning process for the nation's single largest economic factor, petroleum.

Deliverables Required by the Delivery Order

Reports have been prepared by the two Resident Advisor's, William R. James and Krishna C. Gupta, which reports are attached by reference hereto as Appendixes E and F. Such Resident Advisor reports are the only deliverables required by this mostly legatine task.

Other Task Activities

Several additional activities were undertaken as part of this task.

- ▶ Numerous agreements, documents, or informal inquiries were responded to, or reviewed on short notice by resident advisors and usually oral consultation and advice were then provided to Turkmen officials regarding US or international legal or commercial customs and practices. Examples of such documents or inquiries upon which comment or advice was sought include (A) a Protocol between the Competent Body and Exxon Turkmenistan for a feasibility study for the construction of a gas pipeline from Turkmenistan, through China to Japan, (B) a joint activity agreement between the Competent Body and Petronas Petroleum for the provision of certain services collateral to its conduct of petroleum operations, (C) Draft Bidding Procedures for the provision of oil field services and equipment, (D) Tender terms for the procurement of Oil & Gas Auditing Services, (E) the nature and effect of 'Take or Pay' provisions in international oil and gas agreements, (F) draft regulations on the purpose and functions of Management Committees envisioned under the terms of the model Production Sharing Agreement being used by the Competent Body, and, (G) Procedures for the issuance of licenses for the conduct of petroleum operations.

CHAPTER 6

FUTURE AND SUMMARY

FUTURE

While much was accomplished by the work under DO 17, the country is far behind other NIS emerging economies due to the deliberate policy of the President to move slowly on reforms USAID should continue to encourage progress toward the goals of DO 17 in legal and regulatory reform and in institutional reform. The following specific projects and technical assistance should be viewed in furtherance of such progress: (A) The national oil and gas industry must be restructured to emphasize efficiency, competence and competitiveness in the upstream sector, with separate commercial and regulatory units acting independently, (B) The general level of understanding of principles of a market economy and the conduct of business within such an economy must be raised, (C) The development of accounting principles generally accepted in the international oil and gas industry should be seen to adoption and implementation, and, (D) A coherent National Strategy must be thoughtfully developed to provide a roadmap for Turkmenistan's aimless and drifting policies.

SUMMARY

This delivery order achieved major results in each of the four task areas. The Legal and Regulatory Reform and Institutional Development components, in particular, have resulted in an increased awareness of the need for reforms in the petroleum sector. This momentum appears sustainable. The Permanent Expert Groups are functioning, albeit at varying levels of activity, and serve as important platforms to effect change. Importantly, the Competent Body appears willing to promote or undertake change when the result is an increased possibility of attracting foreign investment to the petroleum sector.

More specifically, the Legal and Regulatory Reform Task has helped to facilitate one of the first internationally consistent efforts undertaken in Turkmenistan. The Petroleum Regulations project is likely to result in the actual adoption and implementation of rules which may prove to be the standard for countries in the region. Additionally, continuing activities related to this task might facilitate the gradual transformation of the Competent Body or successor agency into a truly independent regulatory body complete with rule making authority.

The Institutional Development Task has focused on accounting reform and technical assistance in developing a national strategy for the petroleum sector. Although we are unable to report a major breakthrough on either front at the closeout of DO 17 and the writing of this report, the fact that dialogue continues within the respective Permanent Expert Groups is encouraging. Continuing technical assistance, combined with subtle advocacy, should lead to progress on both projects.

Finally, the Training Task has resulted in a number of achievements. Seminars, workshops and the regulatory study tour have been platforms for meaningful dialogue on a diverse range of topics. In addition to facilitating the transfer of technical expertise, they have also served as a forum for ideological discussions.

Overall, this delivery order contributed significantly to the process of reform in Turkmenistan's petroleum sector. Additionally, it has set the stage for implementation of future reform initiatives under the Energy IQC.