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Private Sector Assessment for Mongolia

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 30 June 2008)

Currency Unit -		Mongolian Togrog (MNT)
MNT 1.00	=	\$0.00084
\$1.00	=	MNT 1158

ABBREVIATIONS

ADB	-	Asian Development Bank
BIC	-	Business Investment Council
BOM	-	Bank of Mongolia
BOT	-	Build Operate Transfer
BT	-	Build Transfer
CEB	-	Central Europe and Baltic
CES	-	Central Electricity System
CGA	-	Customs General Administration
CIS	-	Commonwealth of Independent States
CHP	-	Combined Heat and Power Plant
CRC	-	Communications Regulatory Commission
CSP	-	Country Strategy and Program
EBRD	-	European Bank for Reconstruction and Development
ERA	-	Energy Regulatory Authority
ESDP	-	Education Sector Development Program
EU	-	European Union
FDI	-	Foreign Direct Investment
FGP	-	Family Group Practice
FIFTA	-	Foreign Investment and Foreign Trade Agency
FRC	-	Financial Regulatory Committee
GDNT	-	General Department of National Taxation
GDP	-	Gross Domestic Product
GoM	-	Government of Mongolia
GTZ	-	German Agency for Technical Cooperation
HIF	-	Health Insurance Fund
HOB	-	Heat Only Boiler
HSDP	-	Health Sector Development Program
IAS	-	International Accounting Standards
ICT	-	Information and Communications Technology
ICTA	-	Information and Communication Technologies Authority
ICNC	-	Information and Communication Network Company
IFC	-	International Finance Corporation
IFI	-	International Financial Institution
IMF	-	International Monetary Fund
IPO	-	Initial Public Offering
ISP	-	Internet Service Providers
KfW	-	Kreditanstalt für Wiederaufbau
KOICA	-	Korea International Cooperation Agency
JICA	-	Japan International Cooperation Agency
JSC	-	Joint Stock Company
JV	-	Joint Venture
MCAA	-	Mongolian Civil Aviation Authority

MCC	-	Millennium Challenge Corporation (U. S.)
MNCCI	-	Mongolian Chamber of Commerce and Industry
MCUD	-	Ministry of Construction and Urban Development
MDG	-	Millennium Development Goals
MIAT	-	Mongolian Airlines
MIT	-	Ministry of Industry and Trade
MNE	-	Ministry of Nature and Environment
MoFA	-	Ministry of Food and Agriculture
MoF	-	Ministry of Finance
MoUB	-	Municipality of Ulaanbaatar
MRTT	-	Ministry of Road, Transport, and Tourism
MSE	-	Mongolian Stock Exchange
MT	-	Mongol Telecom
NBFI	-	Nonbank Financial Institution
NSO	-	National Statistics Office
OSNAAG	-	Housing and Public Service Company
PPP	-	Public Private Partnership
PRC	-	The People's Republic of China
PSD	-	Private Sector Development
PUSO	-	Public Urban Services Organization
Russia	-	Russian Federation
SCHCD	-	Securities Clearing House and Central Depository
SLC	-	Savings and Loan Cooperative
SME	-	Small and Medium Enterprise
Soe	-	State-Owned Enterprise
SPC	-	State Property Committee
SPIA	-	State Professional Inspection Agency
TA	-	Technical Assistance
TDB	-	Trade and Development Bank
UB	-	Ulaanbaatar
UBDHC	-	Ulaanbaatar District Heating Company
UNDP	-	United Nations Development Programme
UNICEF	-	United Nations Children's Fund
UNIDO	-	United Nations Industrial Development Organization
USAID	-	United States Agency for International Development
USAG	-	A Water And Sewerage Company
USIP1	-	Ulaanbaatar Services Improvement Project
USIP2	-	Second Ulaanbaatar Services Improvement Project
USUG	-	Ulaanbaatar Water and Sewerage Authority
VAT	-	Value-Added Tax
VSAT	-	Very Small Aperture Terminal
WHO	-	World Health Organization
WTO	-	World Trade Organization

GLOSSARY

<i>aimag</i>	Province: highest sub-national administrative unit
<i>soum</i>	District: administrative level below aimag
<i>bagh</i>	<i>Smallest administrative unit</i>
	<i>dzud Severe winter and early spring conditions, usually preceded by summer droughts</i>

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MONGOLIA PRIVATE SECTOR ASSESSMENT 2008

EXECUTIVE SUMMARY

The findings of this Private Sector Assessment (PSA) constitute an input into the overall Asian Development Bank (ADB) Country Strategy and Program (CSP) for Mongolia between 2009 and 2013. The previous assessment was done in 2004 and provided the overall economic background and institutional context for the PSD strategy. The current assessment also evaluates the general situation while further enriching it with an in-depth analysis of sector by sector issues. The mining sector is only partially alluded to in this assessment as a number of detailed reviews and analysis have been undertaken recently by other International Financial Institutions¹. Moreover, the scale and policy complexity of the sector places it outside the scope of this assessment².

The 2008 PSA updates the business environment and investment climate for the private sector in Mongolia; identifies the strengths, weaknesses and constraints of Private Sector Development (PSD); considers directions for change and possible approaches to strengthening PSD; and suggests possible recommendations for ADB actions over the medium-term, including non-sovereign operations in Mongolia.

The assessment is based on the review of previous studies, interviews with selected stakeholders in the government, industry and NGO's, and a rapid sample firm survey.

The past five years has seen significantly improved economic performance for Mongolia. Gross Domestic Product (GDP) growth since 2004 averaged 9 percent, and GDP per capita reached US\$1,288 in 2007, almost double of the 2004 level. The agricultural sector is on a path of recovery after the devastating winters of 2001 and 2002, posting growth measured in double digits since 2004. After experiencing serious decline in 2004 and 2005 (due to the termination of favorable export quota regime for Mongolian textiles), manufacturing output is on the increase, mainly supported by robust foodstuff production and remarkable growth in basic metal output. Construction and real estate sectors are booming, but their contribution to GDP and share of employment are still not significant. The mining sector remains the biggest contributor to GDP at 27.5 percent (2007), but its growth has slowed down due to the ongoing minerals policy uncertainty. The services sector is a continued success story; it constitutes the largest part of the Mongolian economy posting double-digit annual growth in the trade, transport, financial intermediation and communications subsectors.

Inflationary pressures emerged in 2007 and continued to intensify despite the tightening of monetary policy. Monetary expansion has been significant, spurred by growth in foreign reserves and domestic credit. Budgetary performance has been exemplary with overall surplus being registered for the past 3 consecutive years, a situation bolstered by the boom in global commodity prices. Foreign direct investments have increased with the majority of inflows going into the mining sector.

¹ See the World Bank's recent Country Economic Memorandum for example.

² However the report briefly covers the subject of mining services; which has the potential of becoming a significant cluster of services to the mining industry.

In the meanwhile, Mongolia's global ranking in terms of economic freedom, ease of doing business, competitiveness, corruption and governance presents a mixed picture. The *World Bank's Doing Business 2008* survey ranked the country 52nd out of 178, and identified 'getting credit', 'paying taxes', 'trading across borders' and 'closing business' as the areas in need of most attention. While Mongolia's overall reform progress was ranked very high in the *European Bank for Reconstruction and Development Transition (EBRD) Report for 2007*, scores for infrastructure, securities market and railway transport are in fact quite low. In terms of the *Global Competitiveness Index* used by the World Economic Forum rankings, Mongolia has slipped to the 101th place among 131 countries; its standing in 2006 was 92nd out of 121. Labor freedom and freedom from corruption indicators for the country remain below global average, although Mongolia's overall *Index of Economic Freedom (Heritage Foundation)* is higher than both global and Asia-Pacific regional average. The *Worldwide Governance Indicators* ranking by the World Bank indicates that while its regulatory quality is improving, Mongolia has regressed in other areas since 1996: notably in the areas of control of corruption, rule of law, government effectiveness, and voice and accountability.³

The private sector dominates the Mongolian economy but its contribution to GDP has marked a decline and likely to contract further in light of the increasing state control of major mineral deposits-- prompted by rising sentiments of resource nationalism. Trade, construction, communications and financial intermediation sectors are seeing strong growth in the number of enterprises. However, diversification into manufacturing is still elusive and private sector employment growth remains stagnant. The economy is still dependent on the exports of a few commodities, and vulnerability of the agriculture sector to weather shocks and phyto-sanitary constraints is high.

The private sector in Mongolia continues to face formidable challenges to growth and development. Being land-locked with under-developed links to external markets --imposes high transportation costs and lengthy transit time that limit exporters' options; while corruption, cost of finance and tax issues are the most frequently cited internal constraints.

With the expansion of domestic credit to households and private enterprises, access to finance is somewhat improving; however for small and medium enterprises (SMEs) the access issue remains. Loan rates are still high compared to other countries, and while they have declined for the past few years, with mounting inflationary pressures and increasing competition for funds between financial intermediaries, the process is likely to reverse. Capital markets remain thin and under-developed with the insurance sector still at a nascent stage of development and there's a visible absence of institutional investors.

The number of local Initial Public Offerings (IPO) is increasing and trading on the Mongolian Stock Exchange (MSE) has intensified recently with more private enterprises turning to the exchange to raise capital. While this is a positive development, weaknesses in the current regulatory framework and supervision capacities, as well as the generally low standards of corporate governance among domestic companies, give rise to concerns over the possibility of financial sector upheavals similar to the recent Savings and Loans Cooperative (SLC) crisis.

The tax reforms implemented in 2007 seem to have had an overwhelmingly positive reception; the tax base has widened and signs of possible consolidation of private enterprises have emerged. However, it is still early to evaluate the full impact of the reforms and the lack of improvements in the tax compliance rate indicates that issues persist with tax administration.

³ In part due to the frequent change in governments.

The rapid enterprise survey conducted in May 2008 within the framework of this assessment has identified some new trends in the range of private sector development constraints. While survey results should be treated with caution due to the small sample size and limited geographical scope of the firms covered (compared to the *World Bank Investment Climate Assessment of 2004*), some interesting findings have emerged. Notably, private sector concerns over *macro-economic instability* are growing and *shortage of worker skills* is taking precedence over tax issues. However *corruption*, the legal framework affecting the business sector (such as *conflict resolution*, *access to land*), the *licensing regime* and *economic policy uncertainty* remain on the top of the list.

A review of the sectors indicates that private sector investment remains negligible in the **power and water supply sectors**. Under-pricing of tariffs, regulatory inefficiencies and the poor state of the physical infrastructure, coupled with significant start-up and operational costs, inhibit private sector participation--limiting it to repairs and maintenance contracts financed by the state. While there are a few privatization success stories in the electricity transmission area, setbacks are more common.

In the **railway sector**, the continued natural monopoly of the Ulaanbaatar Railway company (UBTZ) remains a binding constraint for any potential private entrant. Although basic legal conditions for private railway operations have been established, implementation mechanisms are still not clear, and strong resistance from the UBTZ continues for entry into its facilities. Again, deteriorating physical infrastructure and correspondent capacity constraints of the existing north-south line, as well as an unsustainable structure of current passenger and freight tariffs are factors that reduce economic returns for any private operator. However, opportunities are emerging for investing in and operating new railway lines (and spurs) in the mineral-rich South Gobi region.

A few existing private operators in the **civil aviation sector** continue to face rising fuel costs, small domestic market, highly seasonal air travel demand and limited access to international markets. While the authorities' implied state policy is to be supportive of private sector growth in the sector, continued MIAT monopoly in the most lucrative international routes and its cross-subsidy of domestic flights from international revenues, do not provide for an even playing field.

Unclear regulatory environment, low economic returns for Build-Operate-Transfer (BOT) schemes, high funding needs, and the lack of skilled engineering and labor workforce continue to limit local private investment in the **road construction sector**. Most projects remain budget or external partner-financed and the execution of contracted works is often poor as companies dependent on costly imports, lack capabilities to invest in new technologies and equipment.

The **Information and Communication Technology (ICT) sector**, while being a success story in terms of private investment and enterprise growth, is still being regulated by a policy not conducive to greater competition. Sector growth continues to be inhibited by limited backbone infrastructure, shortage of skilled labor and inadequate capacities to promote and regulate ICT development, including the regulatory environment for new *e-products*.

The **logistics sector** in Mongolia has a strong potential for growth in light of the country's strategic location, but infrastructure bottlenecks, capital issues and lack of integration with neighboring systems need to be addressed. Better external coordination in terms of transit and trade agreements with neighboring countries, streamlined customs policies and increased efforts at improving multi-modal infrastructure nodal points are necessary to support sector growth.

The **agribusiness sector** which is largely private, remains plagued by supply chain inefficiencies, vulnerability to climatic and phyto-sanitary constraints, and weak marketing capabilities in overseas markets.

Cashmere producers face significant capital constraints exacerbated by unfair trade practices by Chinese traders who are supported by low-cost domestic loans. The government continues to face a dilemma of choosing between cashmere producers' or herders' economic interests, and political pressures often lead to actions that increase market distortions rather than diminish them (for example, the very recent parliament resolution to maintain cashmere prices through direct purchase of raw cashmere and interest subsidy to processors).

While *meat* exports are on the rise after several years of phyto-sanitary restrictions imposed by recipient countries, inadequate slaughtering and packing practices, low value-added of export products, as well as transportation issues continue to hamper growth.

The *leather* industry is in a continued state of decline, and issues of raw material quality, processing costs and environmental pollution are significant. The once-thriving industry does not receive much attention and support from the government now; although the abundance of raw materials and growing world-wide leather consumption should be strong incentives for efforts to revive the sector.

Niche market potential exists for *natural and health products* capitalizing on the untouched ecology of Mongolia. *Seabuckthorn*, wild berries and a few animal origin products might have good marketing opportunities in the growing global health market. Again, capital and capacity constraints, vulnerability to climatic conditions and limited access to overseas buyers continue to emasculate private sector initiatives in this area.

Pristine environment, nomadic culture and lifestyle and a reputation of a unique adventure destination for Mongolia are the factors that provide for a positive development outlook for the **tourism sector**. Again, issues remain with availability of air and train connections, domestic infrastructure access and quality, workforce qualifications, product innovation, and service quality. While private operators continue to step up their efforts to tackle these issues, the absence of a coordinated and effective government support policy remains a major constraint to growth and development.

The **financial sector** remains dominated by the banking sector. Banks face fierce competition for deposits, and the under-developed inter-bank market coupled with currently limited access to international capital exacerbate the mismatch between supply of funds and longer term demand needs.

Under-developed regulatory framework for bankruptcy, foreclosure and collateral, as well as the absence of institutional investors continue to limit banks' options for risk transfer through money, foreign exchange and capital market instruments.

Non-bank financial intermediaries similarly have limited access to funds due to their inability to meet international standards of accounting, auditing, management, corporate governance and transparency. The regulatory environment for financial leasing, factoring, and management of mutual funds (and unit trusts) are incomplete; and supervision and monitoring capacities are inadequate.

Recent revival of the Mongolian Stock Exchange IPO and trading activities constitutes a positive development for the sector, but current regulatory weaknesses give rise to concerns of

possible systemic failures that may undermine public confidence, wipe out individual and enterprise savings, and constrain the extant limited access to funding.

The insurance market is still at a nascent level of development, and further efforts at product diversification and promotion, as well improvements in the legal framework, are necessary.

The **construction and real estate sector** has been booming over the recent few years bolstered by domestic credit expansion and growth in consumer purchasing power. Still, growth is mainly confined to the Ulaanbaatar area, where infrastructure bottlenecks and declining access to usable land are increasingly limiting development efforts. Lack of workforce and dependence on imported construction materials continue to increase costs for developers, while outdated building codes and inadequate quality standard enforcement lead to proliferation of sub-quality buildings, a major concern for authorities as Ulaanbaatar is located in an earthquake-prone zone.

The **food and beverage sector**, while seeing a few positive developments in product innovation and output growth, is still affected by inefficiencies in supply chain from raw material to processor, lack of adequate support systems-- such as fodder production, well water maintenance, veterinary health surveillance, low level of technical expertise, and absence of affordable domestically-produced packaging services. The country remains dependent on imports for most types of food products.

At a national level, shortage of skilled workforce has become a key impediment for private sector development, and the **education sector** is yet to meet the demands of the market. Curricula need to be updated and better aligned with labor market needs and the shortage of experienced teachers and modern facilities and equipment continue to affect the quality of teaching. These are problems for all levels (primary, secondary, tertiary, vocational and technical) of educational institutions alike. Private educational institutions often fail to meet existing quality standards as they have limited access to quality facilities and to sufficient funding for necessary investments. Start-up and operational costs are high for technical and vocational tracks, and shortages of qualified teachers further exacerbate the situation.

In the **healthcare sector**, there is a lack of an integrated legal framework for the privatization of the medical services and private medical insurance provision. The existing private operators do not have the ability to attract the higher end patients currently going overseas, although some private (and foreign) entities are entering the market --underscoring the emerging trend for a dual hospital system in which public facilities are used by the poor, and private facilities by the affluent. Structural inefficiencies remain in the Family Group Practice (FGP) financing and operating model, and the mentality of preferring hospitals to family medicine persists among the population. So far, no systematic review has been carried out to determine what will be required to build an effective public- private-partnership in the health sector and to define the role of the state and the Health Insurance Fund in the operations of the private sector.

Despite the numerous constraints and barriers, the Mongolian private sector has continued on a path of growth and development, a process which to a significant extent has been supported by external partner actions and programs. Multilateral and bilateral partners have been instrumental in promoting the private sector since the mid-1990s. Some have worked directly with enterprises, while most have influenced private sector development by working through government agencies, banks or private associations as intermediaries. The forms of actions have also varied: ranging from sector investments (infrastructure, finance, etc)

to sector policy reforms and technical assistance to strengthen institutional capacities for reform and implementation (tax, customs, competition, mining policies). External partners have just about covered all the levels that affect the start-up, growth and performance of private enterprises; now the bigger challenge would be to synergize these efforts for better impact of their PSD programs on the overall investment climate and Private Public Partnerships (PPP). Also, a special role can be seen for the International Financial Institutions (IFI), who can lend directly to the private sector, as capital needs have become larger with the growth of the economy. While most external partner actions have been motivated by their own analytical and research findings that underpin their respective private sector strategies⁴, more attention should now be directed towards coordination and alignment with government development policies and programs--an opportunity that is now offered by the formation of the new government..

Until very recently, the Government of Mongolia had no specific policy to promote private sector development⁵, and gaps still remain between policies and the institutional framework. The PSD strategy adopted in January, 2008, which is linked to the National Development Strategy (NDS) for 2021, is the first positive step towards a better coordinated and comprehensive support for the private sector in Mongolia and it could form the basis for external partners to coalesce around. The strategy defines particular targets (like increasing private sector participation, promoting industrial growth, etc) which, while in the right direction, would certainly pose a challenge with the growing trend of public sector expansion and the increase of state participation in mining. Other parts of the strategy include increasing labor productivity and flexibility (through skills and technology policy for the private sector); improving the business environment and investment climate and competitiveness of the private sector (by promoting macro-stability, financial market development, incubation centers, branding, improved financial and accounting practices); promoting PSD in the regions (by encouraging agro industries, tourism, mining services); and building all types of PPP's (by improving the legal environment, arbitration, infrastructure, logistics, and consultation mechanisms--including those with external partners).

The (previous) Ministry of Industry and Trade⁶ was emerging as the focal ministry to influence policies on the private sector. However a larger number of agencies affect policy outcomes; and coordination is still unwieldy, compounded by changes in governments. The public-private institutional arrangements for consultations and resolution of issues as found in other countries are many, and mostly *ad hoc*. The newly founded *Business Investment Council* (and its secretariat) established by the authorities in early 2008, and supported by the EBRD, offers an institutional way forward. With this new structure, the BIC could become the focal point for all the key players (government agencies, business associations, and the external partners) to table issues for resolution and their follow up, including the further development of the PSD strategy itself.

Since 1991, Mongolia has received 676.54 million USD in ADB assistance for 35 projects in a number of sectors. The Asian Development Bank (ADB) has provided financial and technical assistance for agriculture, education, energy, finance, health, industry,

⁴ The external partners with larger financial roles prepare longer term strategic programs (e.g. ADB's CPS, World Bank's CAS/CPS—2008-2012, Japan's Country Assistance Program 2004-2008, EBRD's Country Strategy prepared in 2006; EU's Strategy paper for 2007-2013 and USAID's Strategic Plan 2004-2008).

⁵ The lack of policy clarity over the past four years was also due to institutional constraints imposed by three coalition governments that were formed. The executive branch also lost its policy leadership, bequeathing a substantial role in this area to a divided parliament.

⁶ Under the new government that was recently formed after the June 2008 elections, the Ministry of Industry and trade was dismantled. Part of its portfolio was hived off to the Ministry of Food and Agriculture (on SME policies) and the new Ministry of Mining and Energy.

telecommunications, transport, and urban development sectors. The approach in the current Country Strategy and Program is to help the government implement major elements of its development strategy, accelerate private sector-led growth, and reduce disparities in rural and urban development.

ADB has actively assisted Mongolia in strengthening the financial sector. The Financial Regulation and Governance Program approved in 2005 aims to reduce borrowing costs, strengthen governance in banks and enhance the role of non-bank financial institutions. Khan Bank and Trade and Development Bank have so far been the recipients of direct assistance in form of equity and loan financing. With increased activity on the stock exchange, active ADB assistance in formulating a comprehensive industry regulatory framework, developing and enforcing standards for enterprise listing and de-listing, public disclosure, as well as enterprise level assistance in improving corporate governance, would go a long way in promoting the growing development of capital markets and increased firm access to both domestic and overseas funding. Direct support of insurance companies through equity and loan products as well as investment (either on a stand-alone basis or in a partnership with other IFIs) into soon-to-emerge private equity funds, could be considered, however a number of factors remain that make such investments risky and costly.

The Customs Modernization and Roads Development Projects are important measures to improve the business environment and linkages to external markets, which is particularly beneficial for private enterprise development. Further attention could be placed in improving efficiency in energy generation and transmission systems, as well as support to private investors and operators in new power generation facilities.

The Agriculture Sector Development Project is expected to utilize a more integrated approach to rural development and economic growth, with special focus on the Western region of Mongolia, where the Regional Altai Western Corridor Project will link road networks to those in Russia and China. Although agro-enterprises (engaged in cultivation and manufacturing of vegetable origin health products, as well as livestock herding) have longer gestation periods and slower payback terms, supporting their growth can help alleviate rural poverty and unemployment; build-up enterprises from the grassroots and help diversify the export base. In this regard, the cluster development approach found in many emerging economies is particularly suitable for the agribusiness sector, with integrated supply chains involving raw material sourcing, support services, packaging, testing, storage and logistics. Support for the modernization and integration of logistics and cargo terminal services augmented by efficiently-run air cargo operations is also a necessary step towards stronger integration of the Mongolian economy into the global trade networks.

ADB's support in improving cadastral mapping, land registration and building codes has been especially valuable for the urban development in Mongolia. The Urban Development Sector Project, approved in 2006, seeks to improve the living conditions and quality of life of the urban population, especially in the ger areas, by upgrading basic urban services, urban roads, and *in-situ* facilities. At the enterprise level, direct lending to enterprises expanding into environmentally-friendly and energy-saving construction technologies, and materials manufacturing (cement, pre-fabricated concrete, expanded polystyrene blocks and panels, etc) will further support the development of the sector.

The Third Education Development Project that aims to improve the quality and relevance of primary, secondary and vocational education is expected to be especially beneficial for private sector growth which is facing severe skills shortages. ADB's experience and operational expertise in the technical and vocational education training (TVET) sector will be particularly

valuable in addressing the worsening skills mismatch in the Mongolian labor market. For this to be successful, improvements are needed in TVET organization and management, in fostering better links between government, TVET institutions and employers; and in developing appropriate qualification standards and implementation mechanisms. Opportunities to support private sector initiatives through competition-based education funds could be explored.

ADB has been instrumental in decentralizing the Mongolian health system and encouraging the shift from hospital-based care to primary health care clinics. While significant hurdles remain, the Third Health Sector Development Project will further improve primary health services. For PPP's in health, one measure would be technical assistance to improve the availability and quality of private health insurance products and services.

Although the mining sector has not been covered by this assessment, significant potential exists for ADB's financial involvement. This could happen in partnership with other external partners and investors. Participation in project financing of mine area infrastructure projects (including road and railway spurs, highways, urban settlements and power generation facilities) with selected support to mine investments, would help capture greater regional economic development benefits. In a similar vein, support to SME's in mining services would create many spin-offs.

While Mongolia has performed remarkably well in the recent past, policy challenges loom large in the horizon. Mongolia will nevertheless be impacted by the present global financial crisis and commodity price declines. For the private sector which has done extremely well despite a range of constraints, redoubling efforts to reduce remaining barriers would be of paramount importance.

I. INTRODUCTION

1. Since Mongolia's transition into the market economy in 1992, its recent economic performance has never been better. The previous PSA (2004) was done at a time when Mongolia began a new era of structural change prompted by rising commodity prices. After a series of setbacks in the agricultural sector, GDP growth reached 9 percent in 2004 and by 2007 per capita income had reached \$1288, doubling over the course of 3 years. The mining and the services sector growth, coupled with the recovery of the agricultural sector, have been at the heart of a new growth trajectory.

2. There are down side risks however. The economy is dependent on the production and exports of a few commodities especially copper and gold. It is also vulnerable to commodity price fluctuations and natural disasters. This calls for prudent macro-economic management of commodity booms and shocks on the one hand, and increased structural reforms over the medium term to diversify the economic base.

3. The above background provides the context for the 2008 Mongolia PSA. Longer- term diversification of the economy depends on improving the business environment and investment climate further for the private sector and putting in place the human capital base for sustained growth.

4. This PSA was undertaken though a review of previous studies, interviews with selected stakeholders in government, industry and NGO's, was also complemented by a rapid firm survey.

5. As noted in the figure below, the PSA begins with the macro- economic context for private sector development. It then delves into the structure and performance of the private sector. The next two Chapters focus on the challenges and constraints facing the private sector. Chapter 4 details these constrains including opportunities from the perspective of twelve broad sectors. Chapter 5 then reviews actions thus far undertaken by external partners and the professed policy actions by the government to address the constraints and promote private sector development in general. The PSA concludes with potential ADB actions in the next 4 years in Chapter 6.



II. MACROECONOMIC ENVIRONMENT AND THE PRIVATE SECTOR

A. Gross Domestic Product, Growth, Employment

6. The last five years has seen significantly improved economic performance across all sectors. This chapter reviews the macroeconomic context for private sector development in Mongolia. The Mongolian economy has grown by 7-10 percent in the recent years, 2004 produced the highest growth at 10.6 percent followed by 9.9 percent in 2007. The agricultural sector is on a continuous recovery path following the devastating *dzuds* of 2001 and 2002, with output expanding at an average annual rate of almost 10 percent between 2002 and 2005. In 2007, the sector grew by over 15 percent --primarily driven by increase in livestock herds.⁷

7. The secondary sector, which includes mining, manufacturing, construction and utilities, has also performed reasonably well. Between 2001 and 2004, the mining sector had been the main growth driver with registered increases of 34 percent and 11 percent respectively, during 2001-2004 and 2005. For the past two years, however, increased manufacturing output (mostly in the form of basic metals production)⁸ and the construction boom were the main contributors to growth. In 2007, the manufacturing sector posted an increase of 32 percent, and construction grew by 22 percent. The mining sector's growth however was at 1.7 percent. The slowing down of mining sector growth is attributable to the adoption of the Windfall Profits Tax, proposed changes to the Law on Minerals, and continued uncertainty about the investment agreement on the Oyu Tolgoi project.

8. The tertiary sector continues to be the largest sector of the economy with the most consistent performance, averaging 8 percent growth annually during 2001-2004, reaching 12 percent in 2005, 6.7 percent in 2006 and 10.5 percent in 2007. Within the sector itself, trade, transport & communication, and financial intermediation have shown the fastest growth. The sector's relative share in the overall GDP since 2004, has contracted by 9 percent to the current 36.6 due to the overall increase of the share of mining.

Table 1.1: Annual change in Gross Domestic Product, by sectors (%)

	2004	2005	2006	2007
GDP	10.6	7.3	8.6	9.9
Agriculture, hunting and forestry	15.8	10.7	7.5	15.8
Mining & quarrying	31.1	10.6	6.3	1.7
Manufacturing	-3.7	-19.5	13.4	32.3
Construction	-6.6	15.6	5.1	22.4
Wholesale & retail trade	-4.9	2.5	15.3	15.4
Hotels & restaurants	11.7	16.7	9.9	1.2
Transport, storage & communications	8.1	22.5	12.1	18.6
Financial intermediation	18.9	14.3	-3.2	13.7

Source: NSO, 2007 Statistical Yearbook

⁷ As of December 2007 the livestock census counted 40.2 million heads of animals, a 30 percent increase compared to 2005, (NSO, 2007 Statistical Yearbook).

⁸ Basic metal output grew by 24.3% to over 165 billion MNT in 2007 from less than 48 billion MNT in 2004 (at 2005 constant prices). In contrast, total industrial output growth from 2004-07 was 21 percent, reaching 520.7 billion MNT in 2007 (at 2005 constant prices). (NSO, 2007 Statistical Yearbook 2007.)

9. The boom in copper and gold prices, Mongolia's two main mineral exports, has enabled the mining sector to become the most important contributor to GDP. In 2007, mining accounted for 27.5 percent of GDP (a 10 percent increase from 2004, but a 2.5 percent drop from 2006), 64 percent of total exports and 36.3 percent of total government revenues.⁹ Although the share of mining activity in GDP between 2001 and 2007 almost tripled, growth at constant prices registered less than 2 percent, underscoring the fact that the 'expansion of the sector has primarily emanated from the price effect'.¹⁰

10. In terms of regional economic activity, Ulaanbaatar city's contribution to GDP has declined from 76 percent in 2004 to 71 percent in 2007 (since a few other regions have shown increased economic activity of late, see below). The structure of GDP in Ulaanbaatar and elsewhere (with a few exceptions) has remained the same, with agriculture predominant in the rural areas and services dominating in the capital city. The exceptions are Orkhon aimag where the Erdenet copper mine is located, Umnugovi and Sukhbaatar aimags where the secondary sector has overtaken agriculture with new mines coming online or existing ones increasing output. Still, in terms of registered enterprises, Ulaanbaatar had 69% of the total business registrations.

11. Private sector contribution to GDP measured at current prices has contracted from 75 percent in 2001 to less than 70 percent in 2007. Again, the price-effect based expansion of the mining sector, which is dominated by the state-owned Erdenet copper mine, is the main factor for decreased private share in GDP, coupled with an almost four-fold increase in domestic investment by the state budget.¹¹ In light of the current policy of acquiring state ownership in strategic mineral deposits, the private sector share in GDP is likely to decline further.

12. Agriculture, industry and services remain predominantly private, with financial intermediation showing the biggest increase of private participation (measured by contribution to GDP) from 30 percent in 2001 to 90 percent in 2007. Enterprises engaged in wholesale and retail trade continue to dominate the private sector. Out of the more than 32 thousand economically active entities in 2007, 35.6 percent are in the trade sector. Enterprises providing financial and real estate services make up the second largest component with 11 percent out of total (the number of firms has increased by almost 130 percent since 2004). The number of construction firms has shown the fastest growth between 2004 and 2007. The situation is similar with hospitality and transportation enterprises which have grown at healthy rates but are still few in absolute numbers.

⁹ IMF, Mongolia: Selected Issues and Statistical Appendix, Country Report No. 08/201, July 2008

¹⁰ World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, July 2007, p.5

¹¹ Domestic investment financed from the state budget, increased to 230 billion MNT in 2007 from 58 billion MNT in 2004. (NSO, 2007 Statistical Yearbook)

Table 1.2: Composition of the Mongolian Private Sector

Active enterprises, by sector		Number in 2004	Share (%) in 2004	Number in 2007	Share (%) in 2007
Agriculture, livestock, forestry and fishing		1304	5.14%	1577	4.91%
Industry	Mining and quarrying	172	0.68%	312	0.97%
	Construction	687	2.71%	1233	3.84%
	Manufacturing	1454	5.73%	2167	6.75%
Services	Whole sale and retail trade	10146	40.01%	11429	35.60%
	Hospitality	817	3.22%	1366	4.25%
	Transport	525	2.07%	896	2.79%
	Financial, real estate and business	1905	7.51%	3553	11.07%

Source: NSO, 2007 Statistical Yearbook

13. Agriculture's share of employment has dropped by over 10 percent since 2001, whereas that of the services sector has grown by over 8 percent. Share of employment by manufacturing firms has contracted by 2 percent, and those of construction and mining increased by 3.4 and 1.9 percent respectively.

Table 1.3: Employment by Sectors

Share of employment (%)		2001	2004	2007
Agriculture, livestock, forestry and fishing		48.3	40.2	37.7
Industry	Mining and quarrying	2.4	3.5	4.3
	Construction	2.5	4.1	5.9
	Manufacturing	6.7	6	4.7
Services	Whole sale and retail trade	10.8	14.1	15.8
	Hospitality	2.0	3	3.9
	Transport	4.2	4.4	4.3
	Financial, real estate and business	1.7	2.9	3.1

Source: NSO, 2007 Statistical Yearbook

14. In 2007, the total workforce grew by 14,200 persons, and more than 7.5 thousand were civil servant staff increases. The unemployment rate dropped to 2.8 in 2007 from 3.6 in 2004, with a total workforce increase of 73.6 thousand persons over the 3 years.¹² Between 2004 and 2007, the manufacturing sector shed the highest number of jobs (9.4 thousand), and trade, construction and mining sectors have seen the largest gains at 28.5, 20.8 and 10.6 thousand jobs, respectively (NSO, 2007).

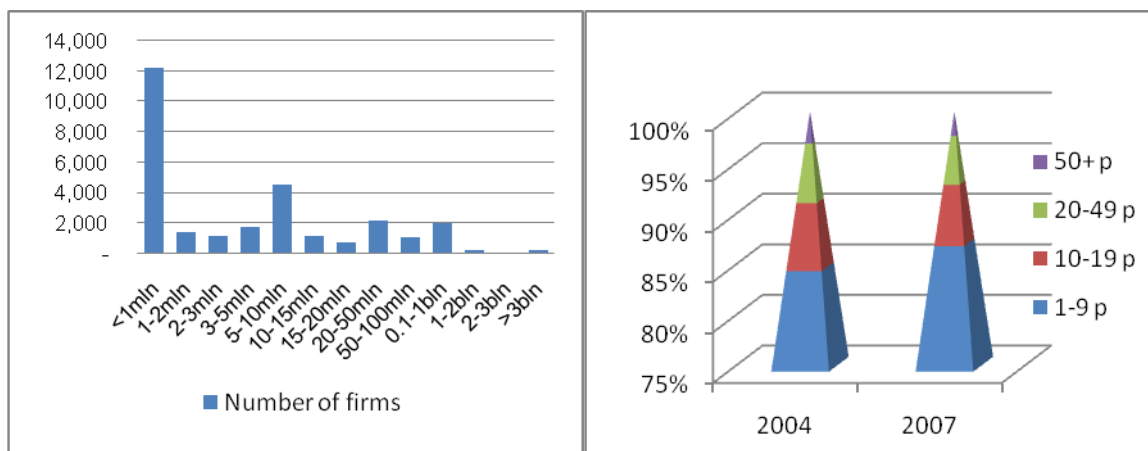
15. The majority of Mongolian enterprises remain small both in terms of revenues and employment. According to the 2007 4th quarter Tax office data, 87% of the registered (30 thousand) taxpayers have annual sales revenues of less than 50 million tugrug, and less than 1 percent reported revenues over 3 billion MNT. Although these numbers may be due to under-reporting, still it is evident that the private sector is dominated by small and medium enterprises as defined in the new SME Law that was adopted in July 2007.¹³ In terms of employment, close to 90 percent of total enterprises reported having 1 to 9 employees, and only 2.4 percent

¹² Still, it is believed that considerable "hidden unemployment" and underemployment exist in the labor market. (World Bank, Country Economic Memorandum, 2007, pp. 6-7.)

¹³ The law defines small and medium enterprises as those having less than 199 full-time and contracted personnel and up to 1.5 billion tugrug in sales.

employ more than 50 workers. The National Statistical Office data does not provide a further breakdown of the “50+ workers” category.

**Figure 1.1a,b: Size Distribution of Mongolian Enterprises
(by revenues in MNT and number of workers employed)**



Source: GDNT, 2008, NSO, 2007

B. Fiscal and Monetary Developments

16. Inflation pressures are growing. Although annual inflation rates decreased from 11% in 2004 to 6% in 2006, they jumped again to 9% in 2007. At the end of 2007, inflation reached 15.1 percent (month on month), the highest level in a decade. The increase was fueled by public sector wage increases, rapid monetary growth and upward changes in the price of some imported commodities. Inflation continued to accelerate in 2008, driven by high world prices for food staples and oil, despite tightening of monetary policy by BOM in the second half of 2007. In March 2008, ‘headline’ consumer price inflation reached 21.5 percent and 35.9 percent for food consumer price inflation, both being the highest in the South-East Asian region.¹⁴ According to the latest Asia Foundation survey, inflation is now one of the major concerns for the population, as the ‘fraction of respondents reporting that inflation is a major problem soared to 30%, from less than 5% two years ago’.¹⁵

17. Budgetary performance has been exemplary during 2005-2007, underscored by the boom in global commodity prices and successful fiscal consolidation efforts, and supported by considerable foreign assistance. An overall surplus equal to 2.2 to 3.3 percent of GDP was achieved over the last 3 consecutive years. Revenue performance was better than budgeted across the board, equaling 37 percent of GDP during 2005-2006 and exceeding 40 percent in 2007. The growth was spurred by higher windfall profit taxes, Boroo Gold and Tsairt Minerals starting to pay taxes based on changes in stability agreements; higher royalty revenues; and overall increase in corporate taxes due to tax reforms.¹⁶ Budget expenditures in 2007 however increased by over 40 percent compared to 2006 spurred by significant growth in salaries, current transfers and domestic investments.

¹⁴ World Bank data and staff estimates, 2008.

¹⁵ Asia Foundation, “Mongolia Corruption Benchmarking Survey 2006-2008,” USAID/The Asia Foundation, p.2.

¹⁶ Ministry of Finance Mongolia, “Mongolia: Macroeconomic situation,” Ministry of Finance, 2008.

Table 1.4: Consolidated Budget Revenues and Expenditures

	2004	2005	2006	2007	2008 (plan)
TOTAL REVENUES AND GRANTS	713 113.6	837 858.3	1 360 409.8	1 851 189.8	2 403 699.2
CURRENT REVENUES	706 292.8	832 584.7	1354 098.0	1 843 669.4	2 386 961.0
TAX REVENUES	583 119.0	692 206.5	1128 140.6	1 500 720.3	1 995 588.0
Income tax	144 132.2	178 539.2	476 833.0	647 842.4	799 549.6
Corporate income tax	98 613.9	120 552.6	222 338.7	219 132.4	351 734.6
Personal income tax	45 518.3	57 986.6	76 973.6	75 010.0	84 509.9
Windfall profit tax	-	-	177 520.7	353 700.0	363 305.1
NON-TAX REVENUES	123 173.8	140 378.2	225 957.4	342 949.1	391 373.0
CAPITAL REVENUES	769.0	982.9	1 626.6	2 512.7	1 238.2
GRANTS AND TRANSFERS	6 051.8	4 290.7	4 685.2	5 007.7	15 500.0
TOTAL EXPENDITURES AND NET LENDING	752 486.4	764 597.1	1237 008.0	1 749 168.4	2 568 625.7
CURRENT EXPENDITURES	538 699.2	600 288.8	982 349.6	1 361 462.7	1 968 173.2
Wages and salaries	128 844.9	142 749.0	196 608.5	292 458.8	566 217.4
Purchase of goods and services	227 356.2	243 970.6	495 879.7	371 066.9	453 524.9
Subsidies and transfers	160 428.6	192 886.3	271 779.7	679 616.8	927 022.6
CAPITAL EXPENDITURES	104 886.8	89 818.1	175 671.5	286 980.0	482 317.5
NET LENDING	108 900.4	74 490.3	78 986.9	100 725.7	118 134.9

Source: NSO, 2007 Statistical Yearbook

18. Monetary aggregates have been growing rapidly. Reserve money grew by 16.8 percent in 2005, 37.7 percent in 2006 and over 39 percent in 2007, driven by a large increase in net foreign assets of the Bank of Mongolia (BoM). With strong domestic demand and a cut in reserve requirements¹⁷, broad money grew by 57 percent in 2007 (and 30 percent on average annually between 2004 and 2006), while credit to the private sector increased by 75 percent.¹⁸ Monetary conditions have added to inflation pressures, prompting the International Monetary Fund to issue recommendations to further tighten the monetary policy so “that growth in reserve money should be slowed to about 12 percent in 2008”.¹⁹ The BoM raised the interest rates on its 7-day Central Bank Bills (CBBs) to 10.25 percent in September, 2008.²⁰

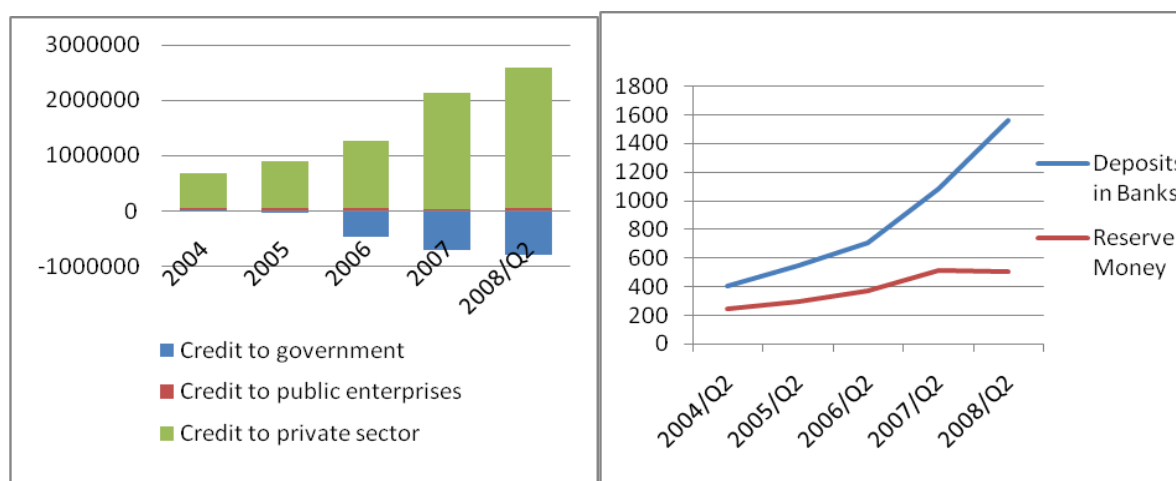
19. Private sector credit is growing; however concerns about credit structure and sustainability remain. Private sector loans have been the largest source of credit expansion, growing at about 60 percent on average annually during 2002-2007 and by 75 percent in 2007. This credit boom reflects improved confidence in banking services (evidenced by deposit growth) as well as a more competitive banking sector.

¹⁷ The previous 14 percent reserve requirement policy was discontinued since March, 2007. (The current requirement is 5.5 percent, Bank of Mongolia.)

¹⁸ IMF, Mongolia: 2008 Article IV Consultation, Country Report No.08/200, July 2008.

¹⁹ IMF, Mongolia: 2008 Article IV Consultation, Country Report No.08/200, July 2008, p.9

²⁰ As a result of tightening measures, growth of M1 slowed down to 25 percent in the first half of 2008, and that of M2 declined to 27 percent in the same period. (“Monetary Policy Implementation: The First Half of 2008”, Mongolbank, online report, <http://www.mongolbank.mn/web/guest/publication/mreview?id=r08-1.2>)

Figure 1.2: Private Sector Credit Growth

Source: Bank of Mongolia, 2008

20. Loan interest rates have been declining, but growing inflationary pressures may reverse the process. MNT lending rates have more than halved since 2001, and interest rate spreads in domestic currency in 2007 equaled one third of those in 2001. Still, real interest rates in MNT are high comparing to loan rates in neighboring countries.²¹ High deposit rates due to competition for funds, high reserve requirements, significant overhead costs and loan loss provisions to cover credit risks (as a result of credit expansion) have been compounded by factors such as inadequate credit recourse to remedies through liquidation or bankruptcy. With increasing rates of inflation in 2008, bank loan rates started growing again.

Table 1.5. Interest Rates and Rate Spreads

Indicator	Year							
	2001	2002	2003	2004	2005	2006	2007	2008/3
Short term MNT loan rates (%)	41.4	33.4	31.5	30	28.3	24.5	19.9	20.8
Short term foreign currency loan rates (%)	22.2	19.8	19.6	17.9	14.8	15.5	14.2	13.8
Interest rate spread: domestic currency	17.4-39.0	11.4-27.4	9.5-25.5	9.6-24.0	9.1-22.3	5.1-16.94	0.6-12.34	1.6-18.4
Interest rate spread: foreign currency	9.0-21.2	7.8-18.6	7.6-17.	8.3-16.5	4-13.4	4.1-14.1	2.8-13	5.5-12.6
Inflation rate (%)	8	1.6	4.7	11	9.5	6	15.1	17.9

Source: Bank of Mongolia, 2008

C. External Sector Developments

21. The togrog exchange rate against U.S. dollar has been relatively stable until recently. Between 2000 and 2003, the central bank rate was MNT 1,108.9 to one U.S. dollar, in 2004-2007 it averaged at MNT 1,184.8. Overall, the togrog weakened against the U.S. dollar by 6.8 percent between 2000 and 2007. Although, since 2002, on a multilateral basis the dollar has fallen approximately 28 percent in nominal terms and about 25 percent in real terms²², this strong downward trend was not reflected in the MNT/US\$ exchange rate until 2008. As of

²¹ Mongolia: Sources of Growth, Country Economic Memorandum, World Bank, July 2007, p.182

²² The Anatomy of Dollar Depreciation, Giancarlo Corsetti, November 2007, www.voxeu.org

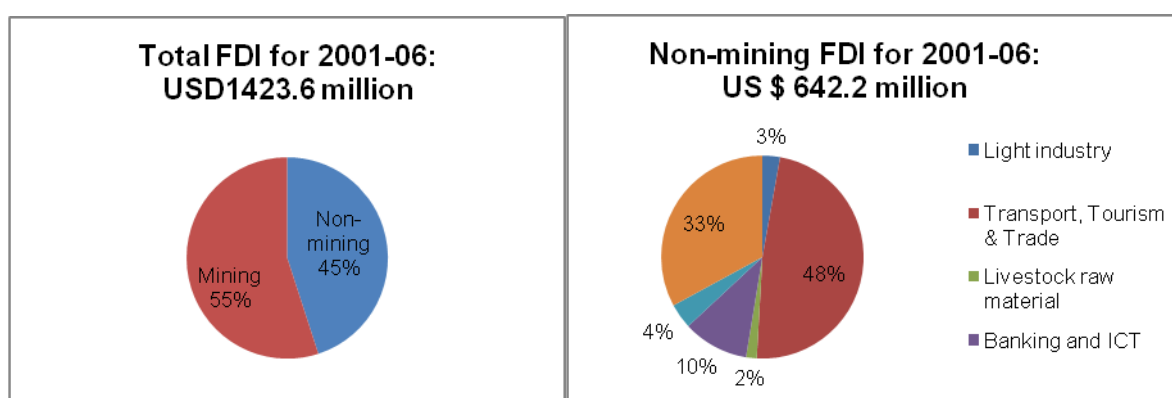
September 1, 2008, the exchange rate was 1,150.78 MNT to one U.S. dollar, showing a 1.62 percent strengthening of the togrog since beginning of 2008. The togrog depreciated by 7 percent vis-à-vis the Chinese yuan and 8 percent vis-à-vis the Russian ruble in 2007.²³ The Bank of Mongolia (BoM) the central bank, works to ensure the stability of the togrog and acts as the financial intermediary for the government. In 2008, BoM introduced MNT/USD swap arrangements to the inter-bank market to help commercial banks ensure their liquidity and financial stability. As of July 2008, six banks have been involved in the arrangements with the total value of trades reaching US\$ 59.4 million.²⁴

22. Minerals (mainly copper and gold) continue to be the main sources of export revenues. Gold exports dropped to 17.5 percent in 2006 from 31 percent of total exports in 2005, an outcome attributed by policy changes (gold exports in 2007 were 12.1 percent of total). Copper remains the major export commodity constituting 41.6 percent of exports in 2007. Mongolia's exports are concentrated: with 76 percent of its export earnings depending on four commodities – copper (41.6 percent), textiles (13.5 percent), gold (12.1 percent), and zinc concentrate (9 percent). Export revenues in 2007 increased by over 400 million USD (spurred by increase in copper and zinc prices as well as physical output) compared to 2006. Imports however grew by 631.7 million USD over the same period resulting in an overall trade deficit. In the absence of further export product diversification, the trade deficit will likely persist for the coming years.²⁵

23. Continued growth of Foreign Direct Investment (FDI) is contributing to economic growth and increased money supply. FDI inflows in 2005 were \$316.8 million, \$366.5 million in 2006 and \$499 million in 2007. Counterbalancing the trade deficit, growing FDI and foreign remittances in 2007 resulted in a balance of payments surplus, with net foreign reserves reaching \$972.4 million, equal to a 6-month import supply.

24. Between 2001 and 2006, 55 percent of total FDI went into the mining sector. In the non-mining sector, transport, tourism and trade sectors have been attracting the highest inflows of FDI. FDI classified as 'Other' now accounts for one third of total, and highlights the need for revising the current FDI classification to include 'newly emerging areas which, under the present system are not classified well so as to allow identification'.²⁶

Figure 1.3: Foreign Direct Investment by Sectors



Source: FIFTA, 2007

²³ IMF, Mongolia: 2008 Article IV Consultation, Country Report No.08/200, July 2008, p.6

²⁴ Mongolbank, "Monetary Policy Implementation: the First Half of 2008," online report, <http://www.mongolbank.mn/web/guest/publication/mreview?id=a-qr08-1.2>

²⁵ Ministry of Finance, "Mongolia: Macroeconomic situation," 2008.

²⁶ World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, July 2007, p.22

25. The origin of FDI has undergone some significant changes since the 1990s. China now accounts for over half of total FDI flowing into Mongolia, and Canada has emerged as the second dominant source, mostly in the mining sector.²⁷

Table 1.6: FDI Sources in 1990-1999 and 2001-2006 (% In Total)

China	24	China	53
Japan	11	Canada	17.7
Korea	9	Korea	6.1
USA	8	USA	3.6
Russia	8	Russia	2.2
China (Hong Kong)	5	Japan	1.9
Others	27	Others	15.5

Source: FIFTA, 2007

D. Impact of Tax Reforms

26. Previous tax policies led to adverse incentives. Prior to the tax reforms adopted in June 2006, taxes payable by a corporate entity were calculated at the rate of 15% on profits up to MNT 100 million, and at 30% (decreased from 40% in 2004) on levels above that. The laws allowed no loss-carry-forward, no investment credits and discriminated against domestic enterprises by providing tax holidays and exemptions mostly to foreign investors in certain sectors. Not all business expenses were allowed to be deducted from taxable income.

27. Labor taxes, in particular, social security taxes were high at 19% of employee salary, causing firms to evade taxes by keeping two sets of books. Firms resorted to a practice of hiring employees on short-term contract basis that allowed them to withhold benefits to which the personnel would be otherwise entitled to, and deterring any increases in employment remuneration.

28. The elements of the tax code discouraged investment and introduction of modern business practices, while encouraging tax avoidance by “staying small” or splitting companies to

²⁷ The GoM, through its policies, laws, and implementation thereof, has been fully supporting foreign direct investment (FDI) in all sectors and businesses allowed by law (prohibitions include manufacturing and distribution of narcotics, arms and weapons, and pornography). The first Foreign Investment Law was enacted in 1990 and further amended in 1998 and 2002. Mongolia does not discriminate for or against foreign investors; neither does it screen investments or investors, except in terms of the legality of the proposed activity. Foreign investors are entitled to freely remit their profits and dividends, to repatriate their own investments and capital in accordance with relevant laws and regulations, as well as to transfer their rights to other persons and entities. Minimum requirements for registered capital have been increased from US\$10,000 to US\$100,000 in August, 2008²⁷. Capital may be invested as cash or equivalent value in capital material (equipment, office stock, technology, etc). In both law and practice, foreigners may own 100% of any registered business without any legal, regulatory, or administrative requirement to involve a Mongolian entity as a joint venture partner, shareholder, or agent. The only exceptions are in land ownership, petroleum extraction, and strategic mineral deposits. According to the Law on Land, only individual Mongolian citizens can own real estate. No corporate entity of any type (either foreign or domestic) may own real estate. However, foreign individuals and Mongolian and foreign companies can own structures on the land and lease property for terms ranging from three (3) to ninety (90) years. Mongolian law also requires oil extraction firms to sign production sharing contracts with the government for both petroleum exploration and extraction. The 2006 amendments to the Law on Minerals have introduced the concept of strategically important deposits (or strategic mineral deposits). The amendments gave the GoM the right to obtain up to 50 percent equity share of any mine on such a deposit. Furthermore, the authority to determine what is or is not a strategic deposit was vested in the Parliament. In light of current developments on commodities and financial markets worldwide, the pressure is growing for the Parliamentarians to enact new amendments to the Minerals Law (which have been under heated debates for the past year) that will improve the investment environment in the mining sector.

appear small as well general tax evasion by under-reporting of profits. As a result, tax base in Mongolia remained small, with the top 100 enterprises contributing over 90 percent of the government's corporate tax revenues.²⁸ In addition, the tax code may have motivated firms and individual entrepreneurs to operate in the informal sector.

29. Tax reforms are a 'Step in the Right Direction'. The new corporate income tax code which became effective January 1, 2007 (except the new excise tax law, which went into effect in July, 2007), allows increased deductibility of legitimate business expenses. Moreover, loss-carry forward and investment credits are provided, while most of the special exemptions and tax holidays for certain sectors and types of firms had been removed, which creates a more fair business environment for domestic businesses, especially SMEs.

30. Although the reforms did not eliminate the two-tier tax structure, the tax threshold under this structure however has been increased substantially from MNT 100 million to 3 billion MNT (for the higher rates to apply). The new rates have been reduced from 15 and 30 percent to 10 and 25 percent respectively.²⁹ A flat 10 percent rate for personal income tax has been adopted whereas previously it had a three-tiered structure with 10, 20 and 30 percent rates and thresholds at MNT2.4 million, and 4.8 million respectively (of total annual salary). Value added tax (VAT) has been lowered from 15 percent to 10 percent. Social security contributions paid by employers have been reduced to 11 percent (down from 19% effective since 2008; employees however still have to contribute an additional 10%).

31. Tax revenues decreased slightly in 2007 due to tax reforms, but much less than anticipated. Corporate tax revenues in 2007 were at 219 billion MNT, showing a 3.2 billion MNT or 1.4 percent decrease, much less than the anticipated loss of 47 billion.³⁰ This favorable outcome was due to the widening of the tax base as well as overall growth in the economy. In 2007, over 8,000 income tax payers and 2,000 value-added tax payers were newly registered. It is also to be noted that the large taxpayers' (top 100 enterprises) share in total tax revenues has decreased to 74.5 percent in 2007 compared to 81.6 percent in 2006 and over 90 percent in 2004.³¹

32. Some anecdotal evidence suggests the process of enterprise consolidation is starting. Although the number of new limited liability company registrations maintained the same growth as in previous years, during 2005-2007 yearly additions to the business register have been increasing by approximately 1000 each year. The number of entities removed from the register in 2007 has more than doubled to almost 2,300 from less than 1000 in 2005 and 2006. As bankruptcy laws and procedures are still at a nascent level of development, the practice of corporate wind-up due to bankruptcy remains non-existent. Thus, it is difficult to draw a clear line between entities closed due to bankruptcy issues and those which were removed from the register for other reasons. Still, the strong increase does suggest a consolidation process going on, which at least in part, is probably due to the new tax regime.

33. Despite overall positive effects of tax reforms, tax compliance rate has not improved, indicating issues remain with tax administration. Tax compliance rate – the percentage of firms paying positive taxes – is a strong indicator for the efficiency of the taxation system both from

²⁸ Mongolia: Sources of Growth, Country Economic Memorandum, World Bank, July 2007, p.32

²⁹ The two-tier corporate tax system means that there are still two corporate tax brackets: 10% (for income less than MNT 3.0 bill) and 25% (above MNT 3.0 bill). The tax reforms reduced the thresholds but left the structure unchanged.

³⁰ Mongolia General Department of National Taxation,
http://www.mta.mn/component/option,com_easyfaq/task,view/id,39/Itemid,219/

³¹ Mongolia General Department of National Taxation 2007.

the tax code and tax administration perspectives. While the 2006/2007 tax reforms reduced the tax rates and thus were expected to lead to improved tax compliance, statistics show otherwise (see table below). The complexity of the tax code remains largely unchanged with the two-tier system still in place, and numerous studies by IFIs have shown that a range of problems exists in tax administration. The ICA report notes that “without reforms in tax administration to eliminate ... inconsistencies and lower the exposure of firms to arbitrary and predatory behavior on the part of tax inspectors, reforms in the tax code are unlikely to achieve their aim”.³²

Table 1.7: Mongolia’s Tax Base

	2004	2005	2006	2007
No. of tax statements filed	25,169	27,746	30,579	34,875
Compliance rate: % paying positive taxes	54.4	56.2	55.4	52.6
% reporting negative or zero net income	43.6	43.8	44.6	47.4

Source: GDNT

34. In summary, the macro-economic conditions in the past 5 years have largely been supportive of the private sector but policy challenges loom large. Building on the macro-economic foundations of fiscal consolidation and monetary stabilization that started in early 2001, structural policies have largely aided private sector investments. All sectors benefited from these fundamentals and the commodity price boom provided further impetus for private sector growth. The access to finance by firms and households were greatly facilitated by monetary policies; tax policies reduced taxes; and the togrog remained stable--encouraging foreign direct investments into all sectors. Still, policy challenges loom large in the horizon. Mongolia will nevertheless be impacted by the present global financial crisis and commodity price declines. For the private sector which has done remarkably well despite a range of constraints, redoubling efforts to reduce remaining barriers would be of paramount importance. The next two chapters address these issues.

III. GLOBAL RANKING OF MONGOLIA’S ECONOMIC COMPETITIVENESS

35. Mongolia’s global ranking in terms of economic freedom, ease of doing business, competitiveness, corruption and governance, presents a mixed picture. The World Bank’s Doing Business 2008 survey ranked Mongolia as 52nd out of 178 countries on the overall ease of doing business in the country.³³ While the country’s rank in 2006 was 61, it cannot be concluded that the situation is improving as the number of countries covered in the survey expanded from 155 in 2006 to 178 in the 2008 Report. Within ‘*getting credit*’, ‘*paying taxes*’, ‘*trading across borders*’ and ‘*closing a business*’ categories, Mongolia is performing worse than its peers in Asia and transition economies (in Europe and the CIS). Although it is ranked quite high on ‘*protecting investors*’ (19th in 2008) and ‘*enforcing contracts*’ (27th in 2008) the current state of legal framework, judicial system and corporate governance standards would make it hard to support such ratings.

³² World Bank, Mongolia: Promoting Investment and Job Creation, An Investment Climate Assessment and Trade Integration Study, November 2007, p. 51

³³ In the Doing Business 2009 survey released on September 10, 2008, Mongolia ranks 58th. As 6 countries were added to the survey (total of 184) it is more or less safe to assume that the situation has not changed dramatically since 2008 survey was released in 2007.

Table 2.1: Doing Business 2008

Item	Rank
Ease of doing business	52
Starting a business	62
Dealing with licenses	43
Employing workers	64
Registering property	18
Getting credit	68
Protecting investors	19
Paying taxes	90
Trading across borders	168
Enforcing contracts	27
Closing a business	115

Source: World Bank, 2008

36. Detailed analysis shows that while performing well in certain measures, Mongolia needs to initiate significant reforms in a number of areas if it wants to achieve its goals for private sector-led economic growth (see details in Chapter 5). In the *starting business category*, most of the country's indicators look quite respectable compared to other countries in transition: time needed, 20 days versus 48 in China, 50 in Vietnam and 33 in Russia; number of procedures, 8 on par with most Central and Eastern European countries; cost, 4.3 percent of per capita income, among the lowest in the country group. However, requirements for the minimal capital are quite high (96.3 percent of per capita income). The rating on *closing a business* on the other hand, shows that Mongolia lags behind the majority of countries included in the survey. In this category, the main problem is the time it takes 4 years – which is 4 times longer than what it would take, for example, in Lithuania.

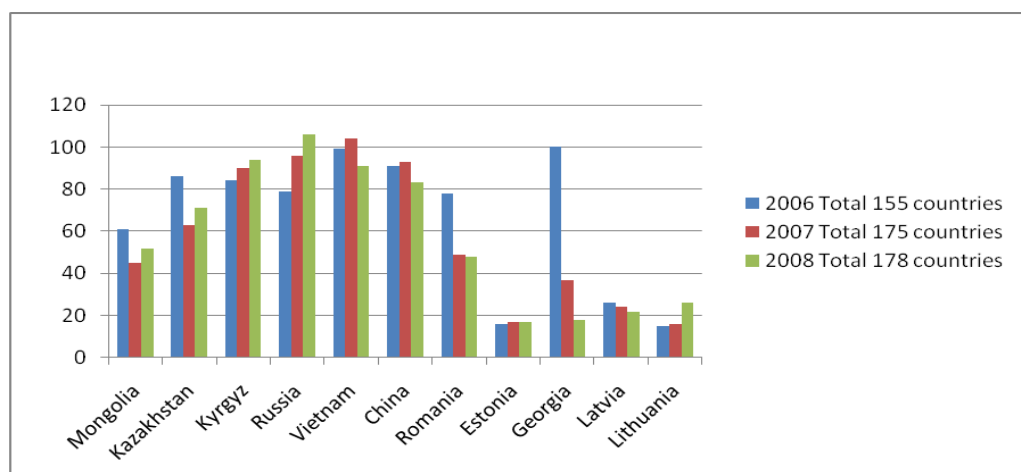
37. In the employing workers category, Mongolia's performance is somewhat uneven, with the *rigidity of hours index* being high (80 out of 100, meaning flexible work hours are not that common), non-wage labor costs are also substantial (21 percent of salary), but hiring and firing is relatively easy. The country's *getting credit* rank is lower than its overall position as it scored medium in the *strength of legal rights* and *depth of credit information* indices. Paying taxes is a category that illustrated deficiencies in tax administration, where payments per year are quite numerous (42 versus 9 in Kazakhstan, and 7 in Latvia), and time spent with tax inspector is lengthy (204 hours).

38. As mentioned above, Mongolia performs extremely poorly in the *trading across borders* category. Here, time and costs to import and export highlight the significant problems Mongolian companies face due to its land-locked position and deficiencies in trade and customs policies (time to export/import, 58/59 days; cost to export/import in \$ per container, \$1,807/\$3,197). In contrast, *registering property rank* for the country is high (18) underscoring the remarkable progress Mongolia has made in its reforms in the property registration system (5 procedures and 11 days to accomplish versus 8 procedures and 52 days in Kazakhstan).

39. Over a period of three years, the Doing Business Index (Fig 2.1) shows that the many countries have done better in their overall performance across a number of measures. It would be prudent for Mongolia to emulate some of the business environment reforms undertaken in these countries. Examples include Croatia, the runner-up for the top reformer position, which implemented reforms in property registration, company start-up, and credit information areas. Vietnam improved investor protection systems with new enterprise and securities laws, and eased access to credit by allowing usage of a wider range of assets as collateral. In Georgia,

amendments to its securities law closed loopholes that made possible for corporations to expropriate minority stakeholders, and disclosure requirements for company directors were strengthened with higher penalties for self-dealing.³⁴ The Baltic countries (Estonia, Latvia, and Lithuania) and Georgia offer models of doing business reform that Mongolia could further study for implementation.

Figure 2.1: Doing Business 2006-2008



Source: Doing Business, World Bank

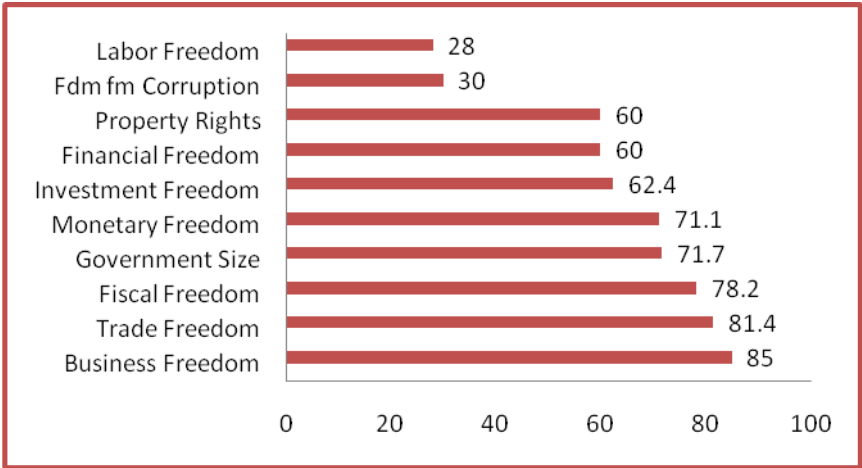
40. While the overall reform progress in Mongolia was ranked very high in the EBRD Transition Report for 2007, scores³⁵ for infrastructure, securities market and railway transport are in fact quite low. The 2007 EBRD transition report data ranked Mongolia the highest in the price liberalization and trade and foreign exchange system categories. Mongolia is on par with the Central Europe and Baltic (CEB) states and most South East European (SEE) countries in the trade category. Mongolia performed quite well in the large scale privatization area, ranking above average and better than most CIS and some SEE countries. The worst indicators for Mongolia were in the road sector, where Mongolia's ranking is similar to those of the poorest Central Asian countries. Overall infrastructure reforms, enterprise restructuring, securities markets and non-bank financial institutions development, and water sector reforms are areas which need further effort. Mongolia's score was '2' in these categories, lower than all CEB countries. Performance in the banking reform and interest rate liberalization, telecommunications and electric power was evaluated at '2.67', which is close to average among the 29 countries where EBRD is currently operating.

41. In terms of the Global Competitiveness Index used by the World Economic Forum rankings, Mongolia slipped to 101th place among 131 countries in 2007; its standing in 2006 was 92nd out of 121 countries. According to Heritage Foundation measures (2008), labor freedom and freedom from corruption indicators for the country remain below global average (at 28 and 30 out of 100), although Mongolia's *overall index of economic freedom* is higher than both the global and Asia-Pacific regional average (the country is ranked 62nd out of 162 worldwide and 10th out of 30 across the Asia-Pacific region).

³⁴ World Bank, Doing Business 2008: Comparing Regulations in 178 Economies, 2007.

³⁵ The score evaluates the results of ongoing reforms in transition economies and is given on a scale from 1 (little/no progress) to 4+ (high standards of advanced market economy).

Figure 2.2: Index of Economic Freedom

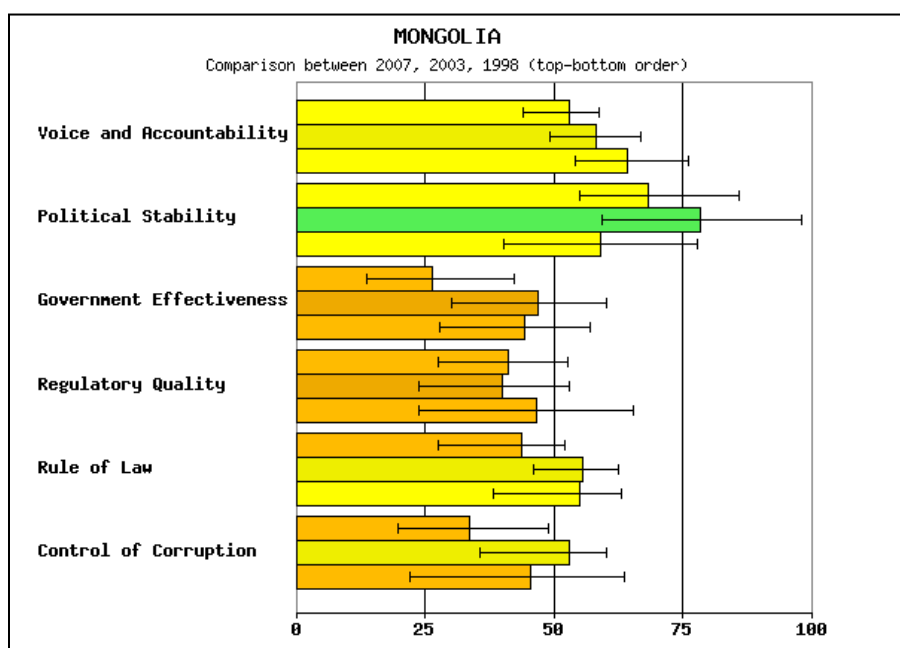


Source: Heritage Foundation, 2008

42. The Worldwide Governance Indicators ranking by the World Bank indicates that while its regulatory quality is improving, Mongolia has regressed in other areas since 1998: notably in the areas of control of corruption, rule of law, government effectiveness, and voice and accountability. This seems to coincide with Transparency International’s Corruption Perception Index, which placed Mongolia 99th out of 179 countries (99th out of 163; in 2006). The Asia Foundation’s 5th Corruption benchmarking survey for Mongolia found that corruption concerns remain strong and 85% of those surveyed think that corruption is common. The locus of corruption was to be found in dealings with *land, mining, customs, licensing, judiciary, police, and the health agencies*. Corruption ranked third behind unemployment and inflation in terms of priority concerns. Despite the passage of the Anti-Corruption Law, two-thirds of the respondents believe that the anti-corruption law has not been functioning well. However, attitudes are changing as household level bribe-paying continues to decline.³⁶

³⁶ Household level bribe-paying continues to decline in Mongolia: 19 percent in March 2008, 9 percent drop from September 2006. Fewer people report they would pay bribes: 27.6 percent, down from 45.7 percent in 2007 (Asia Foundation Survey, 2008).

Box 2.1: Worldwide Governance Indicators



43. In the Dolbear rankings for mining economies, Mongolia is 12th out of 25 countries; it lost 4 points since 2005 due to unfavorable tax regime and government uncertainty.³⁷ Although this assessment does not cover the mining sector, its importance for the country's economy underscores the significance of such ratings for analysis and assessment exercises. The Behre Dolbear & Company, a globally known provider of mining industry consulting and financial service, has been compiling a political risk assessment of countries of importance to the mining industry since 1999. The assessment looks at the political and economic system, corruption, social issues affecting the mining industry, bureaucracy in the licensing regime, stability of the currency, and the tax regime.

44. In summary, Mongolia's global rankings in terms of doing business and competitiveness, illustrate both the progress it has made over the 16 years of transition and the areas where the country continues to face numerous challenges. The indicators reviewed, have stagnated or regressed recently. In broad terms these relate to governance (policy and regulatory burden); institutional and legal weaknesses; and infrastructure and logistical bottlenecks. In the next Chapter, we deepen these cross-country rankings on challenges and constraints to private sector development by reviewing country specific surveys and studies.

IV. CHALLENGES AND CONSTRAINTS TO PRIVATE SECTOR DEVELOPMENT

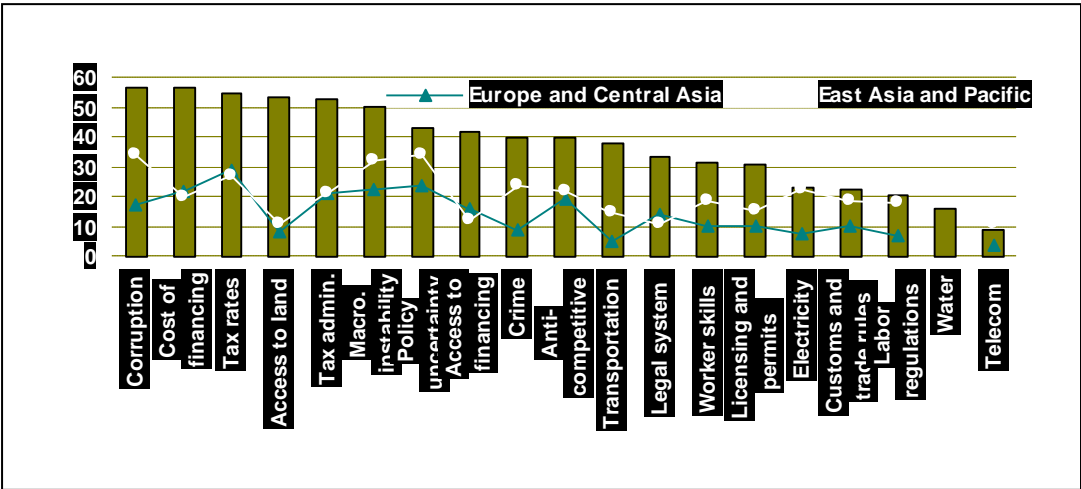
45. Although Mongolia has experienced robust growth in recent years, the economy remains undiversified and heavily dependent on a narrow range of mineral exports (especially copper, gold, and coal in the immediate future) and vulnerable to external and climatic shocks. This calls for prudent macro-economic management of commodity booms and shocks on the one hand, and increased structural reforms over the medium term to diversify the economic base. This

³⁷ The 2008 Ranking of Countries for Mining Investment "Where Not to Invest" Behre Dolbear & Company, Inc, online report, <http://www.dolbear.com/Publications/CountryRankings.pdf>

Chapter outlines the challenges and constraints facing the private sector in achieving the latter goal. Despite some positive policy actions in recent years, such as the tax reform of 2007, and the implementation of the anti-corruption law, much more needs to be done for the private sector to elevate its role and Mongolia’s global ranking (as noted in the previous Chapter).

46. A number of research papers and surveys have been undertaken in the past few years to identify the major constraints to private sector development in Mongolia. The more comprehensive studies were the World Bank’s 2004-2005 *Investment Climate and Trade Integration Survey (ICA)* and its 2007 *Sources of Growth* study. Other research, analysis and surveys include *Private Sector Assessment* (ADB, 2004), *Mongolia: A Survey on Business Enabling Environment* (GTZ, 2004), *Impact of the Mongolian Tax Regime on Country’s Competitiveness* (USAID, 2004), *Rural Development, Property Rights and Land Privatization: Issues for Success in Mongolia* (USAID, 2004), *Assessment of Corruption in Mongolia* (USAID, 2005), *Export Climate Survey, Mongolia* (GTZ, 2005), *Report on Regional Cooperation in Trade, Transport and Transit* (ADB, 2006), *Building Skills for New Economy* (World Bank, 2006), *Local Government’s Constraints to Rural Business Development* (USAID, 2006), *Judicial Sector Constraints to Private Sector Development* (USAID, 2006), *Landlockedness, Infrastructure and Trade: New Estimates for Central Asian Countries* (World Bank, 2006), and *Foreign Direct Investment in Mongolia: An Interactive Case Study* (USAID, 2007).

Box 3.1. World Bank ICA findings, 2006



Source: World Bank, 2007

47. Based on the ICA and other findings, constraints to private sector growth and development can be summarized into four categories:

1. Infrastructure and logistics

48. The Mongolian private sector faces a distinctive combination of physical constraints - a landlocked country, large internal distances, a widely dispersed population, and a severe climate. Just from the perspective of basic transport, heating, and communication costs, Mongolian firms are at a significant disadvantage compared with many of their peers in other countries.

49. Firms must deal with considerable logistical, infrastructural and institutional obstacles within Mongolia and beyond to get their goods to and from external markets. Transport options

are limited, costly and unreliable, and poor external coordination in customs and trade policies further exacerbates cost of business.

2. Policy and regulatory burden

50. Corruption and the lack of transparency and accountability in government-business interactions are at the root of many other impediments that Mongolian firms cite—problems with tax administration, customs, licensing and inspections, and access to land. “Rent seeking” behavior is common among tax inspectors and customs officials, licensing processes are opaque; and access to land, particularly in Ulaanbaatar, is becoming increasingly difficult.

51. Anti-competitive practices and state monopoly remain binding constraints for private sector participation and development in number of sectors, including energy, railways, civil aviation and public utilities (further details in Chapter 4).

52. Weaknesses in the current regulatory and legal framework hinder the development of a vibrant bank and non-bank financial sector, which in turn negatively impacts private sector’s access to and cost of funds. These include *inter alia* deficiencies in the bankruptcy law³⁸ and absence of laws on mortgage, collateral, and securitization.

3. Institutional weaknesses

53. Policy unpredictability is often named as a constraint to private enterprise growth, as the government’s limited efforts to consult with the private sector on policies that affect them, often results in decisions that further distort the markets. Macro-economic and fiscal policy decisions are increasingly regarded with apprehension by the private sector, as hopes are diminishing that the decision-makers will be able to effectively use the prudent lessons from other mineral- and resource-rich countries.

54. The legal framework for collateral registration, enforcing contracts, foreclosure, dispute resolution, debt recovery, and closing a business are ineffective or rudimentary. A structural problem exists whereby most laws introduced since the transition follow the Common Law approach of the United Kingdom and the United States while most of the judicial personnel have been trained according to the Continental Law approach of Europe and Russia. This conflicting approaches creates uncertainty of legal outcomes.³⁹

55. Issues of corporate governance and protection of minority shareholders are increasingly coming into light as these are prerequisites for any firm’s access to capital markets. The Corporate Governance Code came into effect in December 2007; compliance however is still

³⁸ Although bankruptcy is codified in Mongolia it is not effectively implemented as in other countries. The problem is mainly a lack of usable legislation. Between 1997 and 2006, there were 8 cases of bankruptcy but only 2 were handled by the courts. “Corporations that would be bankrupt typically just fail and dissolve. There is no way to attempt to rationally allocate remaining assets among creditors, shareholders or employees. There is no way to attempt to reorganize an insolvent company or take control away from the failed management team. Personal bankruptcy essentially consists of being declared insolvent by the court at the point of collection. There is no concept of creditors’ rights or any kind of debt restructuring for individual insolvency. This escalates the difficulty in personal lending and causes banks to ask for collateral of greater value in order to secure a loan.” (USAID Mongolia, “Judicial Sector Constraints to Private Sector Development, Mongolia” September 13, 2006, pp. 5-6).

³⁹ The Continental Law approach prohibits actions unless specifically permitted by law, whereas the Common Law approach is based on broader principles of fairness and precedent, and thus gives judges greater discretion to make rulings.

weak across firms of all sizes with an alarming trend-- where increase in controlling shares leads to proportionate decline in corporate decision-making transparency.⁴⁰

4. Skills and human resources

56. The education sector, and in particular the vocational and technical training system, needs a serious overhaul, as the skills mismatch in the labor market is rapidly becoming one of the more severe impediments for the private sector and longer term economic diversification.

57. The rapid enterprise survey conducted in May 2008 within the framework of this PSA has identified some new trends in the scope of private sector development constraints. The survey questionnaire was adapted from the one used in the World Bank Investment Climate Assessment of 2004-2005. Twenty seven firms based in Ulaanbaatar were selected, with representation from most economic sectors covered in this assessment.

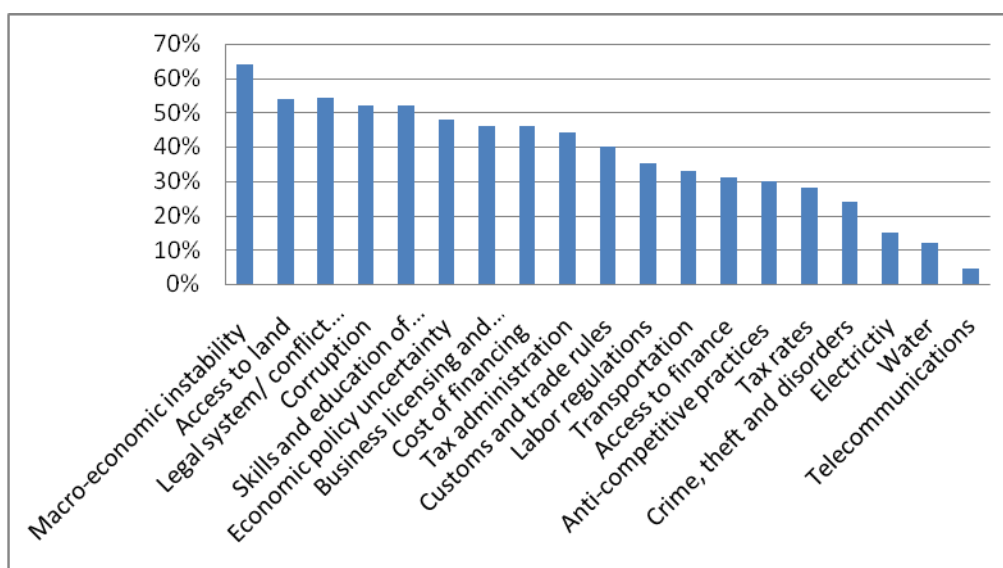
Box 3.2: Rapid Survey Respondent Detail

Firm Size (%)	%	Firm Activity (%)	%
Micro (< 10 emps)	8	Mining services	8
SME (10<=x<100 emps)	52	Tourism	4
Large (100+emps)	40	Health care	8
Market Orientation (%)		Food and Beverage	12
Exporter (>=10% sales)	8	Construction	12
Non-Exporter	92	Banking	8
Firm Ownership (%)		Telecom & IT	8
Company, Joint Stock	8	Infrastructure	8
Company, Limited Liability	84	Financial Services	12
Central State Enterprise	4	Education	12
Local State Enterprise	4	Agribusiness	8

58. While survey results should be treated with caution due to the small sample size and limited geographical dispersion of the firms, some interesting findings have emerged. These findings, while not fully representative, provide an indication of the emerging trends in the business environment and investment climate facing the private sector.

⁴⁰ The FRC has suspended 165 companies listed on the MSE for non-compliance to the Corporate Governance Code and violating minority shareholders' rights. However, the Commission lacks real powers to de-list the firms in question.

Figure 3.1: Percentage of Firms Having Cited a Particular Issue as a Major or Severe Constraint to Growth



59. It can be noted that the private sector's concerns over *macro-economic instability* are growing. Sixty four percent of firms surveyed cited it as a severe constraint to business development. Raging inflation and the correspondent tightening of monetary policies are reducing the economic returns for businesses and restrain their ability to take risks through expansion or forays into new business sectors. *Corruption*⁴¹ and the legal framework affecting the business sector--in particular, *conflict resolution*, *access to land*, and *licensing regime*⁴² -- remain on top of the list as found in the ICA. This is followed by *economic policy uncertainty*, the significance of which is ranked at the same level as the ICA findings. The private sector continues to feel dissatisfied with policies that affect them, especially from the perspective of adverse policy changes made without consultations. Tax reform (reduction in corporate and personal income taxes) implemented in 2007 seems to have made a positive impact: as tax administration has taken precedence over tax rates as an important issue. Firms cited such benefits as the ability to improve their employee remuneration, which in turn, improved their opportunities to hire and retain qualified personnel. Human resources are becoming an important constraint as the on-going rapid economic growth is starting to demand better skilled and highly qualified employees.⁴³

⁴¹ Corruption remains a major problem as reported by 20% of the population, and has become the number three social concern, after unemployment and inflation. However, household level experience with corruption has trended lower, with 19% of respondents reporting personal experience with corruption, down consistently from a high of 28% two years ago. The locus of corruption is perceived by households to be the land office, mining sector, customs, licensing/registries and judicial sector, in that order. (Asia Foundation/USAID, "Mongolia Corruption Benchmarking Survey 2006-2008", Mongol Messenger, May 7, 2008.)

⁴² In addition to licensing, the inspection regime is also complex and adds to the regulatory burden. Mongolia merged most of the regulatory inspections under one public authority, the State Specialized Inspection Agency (SSIA) in 2003. The Agency covers activities related to health, environmental and construction safety to others such as radiation inspection. Much needs to be done in improving the regulatory quality through skills, capacity and procedures of the Agency, and appeal and complain mechanisms from the public. (Jacobs & Associates, Capacity Building of State Specialized Inspection Agency, Final Report, 11 May 2007, Mongolia)

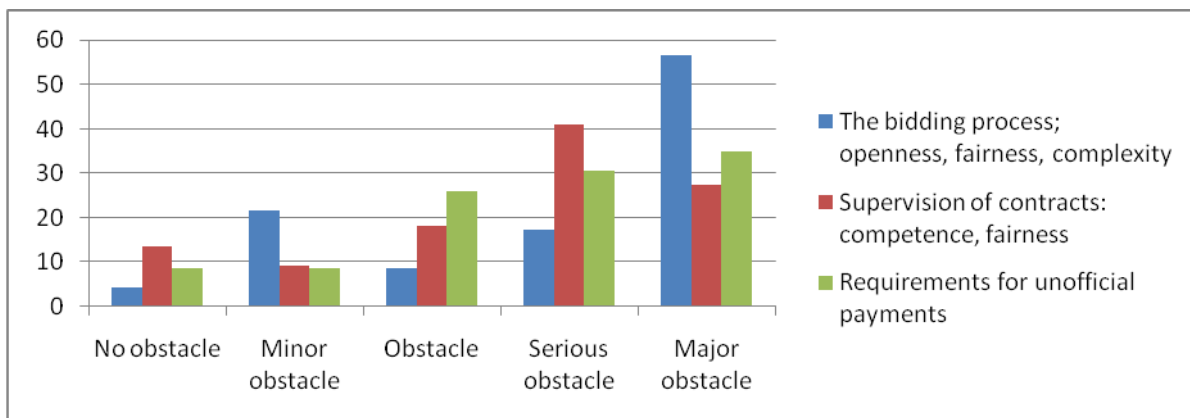
⁴³ A key challenge for Mongolia is the mismatch between the skills demanded by the employers and the supply of skills workers bring to the market. A large number of high skilled workers are employed below their qualifications. Large firms cite shortage of skilled workers. "A third of the firms report vacancies for professionals and nearly two-

Figure 3.2: Worker Skills and Education is Becoming a Major Impediment to Private Sector Development as Vacancies Remain Open Because...



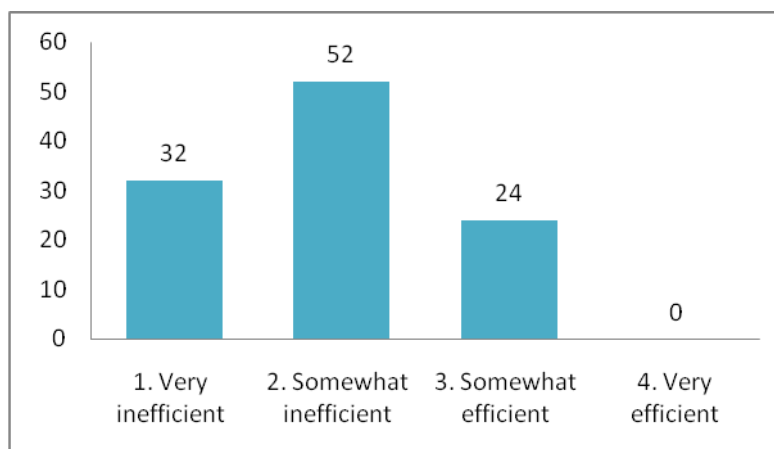
60. Survey findings further underscore the need for civil service reform and improvements in transparency and accountability of the executive and judicial branches of the government. Unofficial payments, questionable fairness of government bids and inadequate competence in supervising contracts continue to be significant obstacles for private operators. Respondents' satisfaction with the quality of services that the government delivers is quite low with the majority evaluating them as very or somewhat inefficient.

Figure 3.3: Doing Business with Government is Difficult



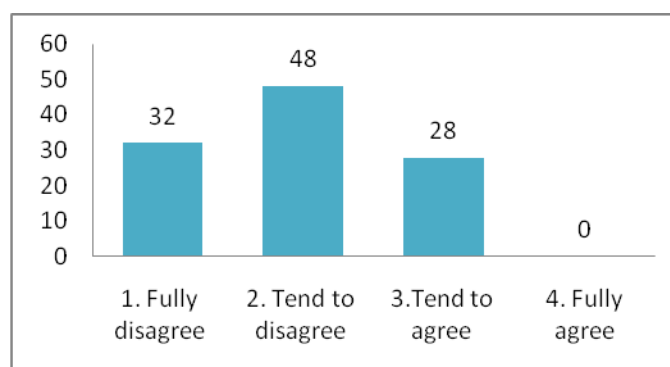
fifths report vacancies for educated workers. Employers—especially large firms—complain about shortage of certain types of skills such as practical knowledge (e.g. English), technical knowledge (e.g., computers), and managerial, marketing and behavioral skills (work ethics and ability to work in teams). It appears that Mongolia's education system continues to emphasize traditional academic subjects and memorization rather than the skills increasingly demanded by the market." (World Bank, Mongolia Sources of Growth: Country Economic Memorandum, July 26, 2007, p. 42). During the interviews conducted under the rapid survey, similar concerns were expressed by the firms, see figure 3.2.

Figure 3.4: Percentage of respondents describing government services delivery



61. Protection of property and entrepreneurs' rights, and confidence in the judicial system are key factors that ensure functioning of the economic system. However, the situation in this area is particularly worrisome as the majority of respondents felt insecure about the ability of the courts to protect their rights.⁴⁴ (Similar concerns were expressed during the consultative meeting with the private sector, organized as the part of the assessment.)

Figure 3.5: Percentage of Respondents Agreeing that the Courts will be able to Protect their Property and Business Rights



62. In summary, four categories of business and investment climate constraints that affect private enterprises have been identified in this Chapter. These range from policy and regulatory constraints, infrastructure and logistics bottlenecks on the one hand, to skills and human resources, and institutional and legal impediments on the other. These issues are examined

⁴⁴ While Mongolia has made a great deal of progress in building a legal system to support the market economy since 1992, many problems remain. Mongolia has a Continental Civil Law system compared to the Anglo/ American Common Law system. Lack of enforcement of contracts increases business uncertainty and costs. Judges are not accustomed to the relatively new Civil Code provisions and in mediating disputes. The tradition has been to decide on cases according to fixed legal standards. Lawyers are rarely involved in contract drafting. Many laws are new and changing. The economic principles underlying new commercial legislation need to be understood. "There is a general idea that if an individual or company takes the government to court, there will be a fair hearing on the merits, however if the suit is between two parties, there will be complications. Many people believe that influence and/or bribery are required in order to have your side prevail." (USAID/Mongolia, "Judicial Sector Constraints to Private Sector Development, Mongolia", September 13, 2006, p.3.). An Alternate Dispute Resolution system is being experimented through the Mongolia Chamber of Commerce and Industry.

further from the perspective of the private sector's engagement in the various sectors of the non-mining economy. Nine broad sectors are analyzed in detail in the next Chapter.

V. SECTOR PROFILES AND CONSTRAINTS

63. This chapter reviews the current situation of private sector involvement in various sectors of the Mongolian economy, highlighting sector-specific constraints that are faced by private enterprises, recent developments in the markets, the legal and regulatory framework affecting the sector, as well as opportunities for growth, investment and economic diversification. A wide range of sectors are reviewed. These include traditional sectors where Mongolia is thought to have competitive advantage--such as agribusiness, tourism, food and beverage. New areas where Mongolia can develop niche expertise are mining services, ICT services, and logistics services. Other sectors of private participation that would be more domestic oriented include financial services (banking and non-banking), infrastructure (energy, water supply, road construction and maintenance, civil aviation, and urban transport) construction, and real estate. In addition, the social sectors (education and healthcare) are also reviewed in terms of private participation.

A. Agro-business

64. Livestock-related products (primarily cashmere, skin and hides, and meat) accounted for a little over 10 percent of Mongolia's export revenues in 2007.⁴⁵ However, the livestock-dominated agriculture sector still accounts for about 38 percent of employment.⁴⁶ For rural households, livestock is an important source of income, jobs, food security, and wealth accumulation. This section gives an analysis of the main agriculture-based industries excluding the crop sector, namely cashmere, meat, and leather. A summary on other agriculture products with potential for future export and revenue growth is also provided.

5. Cashmere

65. With the long-awaited privatization of Gobi Corporation in 2007, the Mongolian cashmere processing sector is now fully private. Today, there are 53 domestic and joint-venture entities operating in the sector (down from 85 in 2006). Over half of the joint ventures include Chinese investment, and the rest have equity participation by investors from Japan, Italy, USA and Switzerland.

66. In 2007, raw and dehaired⁴⁷ cashmere constituted 9.2 percent of total exports.

⁴⁵ Total export revenues in 2007 were 1,949.2 million USD, NSO 2007 Statistical Yearbook.

⁴⁶ Including 20 percent of the national GDP. (NSO, 2007 Statistical Yearbook).

⁴⁷ The process of 'de-hairing' removes coarse, so called 'guard' hair with thicknesses exceeding 30 microns.

Table 4.1. Cashmere Output and Exports

Cashmere exports	2004	2005	2006	2007
Greasy cashmere, MT	47.4	381.3	1 675.7	1 510.5
Dehaired cashmere, MT	800	800	1 400	1 800
Cashmere tops, MT	12.7	13.9	13.0	15.5
Number of goats, thousand	12,238.0	13,267.4	15,451.7	18,347.8
Domestic cashmere output, thousand MT	3.2	3.7	4.0	4.9

Source: NSO 2007 Statistical Yearbook

67. The cashmere industry is widely regarded as a sector with the most revenue and export potential (after mining), but a number of internal and external constraints continue to hamper its growth. While Mongolia produces 25 to 30 percent of global raw cashmere, the country earns less than 5 percent of worldwide cashmere revenues. Several factors are at the root of this situation:

- (i) Fifty-three cashmere processing entities operate in Mongolia, and only 18 of them are spinning factories. Nationwide de-hairing and scouring capacity is much higher than total output.
- (ii) While design capabilities have been improving, most firms still face difficulties such as low productivity, high cost of funds and weak export marketing capabilities.
- (iii) Raw material procurement is cash-based and seasonal, increasing processors' financial burden as they have to seek high interest rate bank loans to obtain needed cash.
- (iv) Herders' dependence on cashmere income (and cash-flow) leads to favoring quantity over quality. Although domestic producers have started paying higher prices for better quality cashmere, still the premium offered does not seem to be a strong enough motivation for herders. In any case, cashmere quality improvement needs significant time and resources, as well as changes in breeding and culling practices. Lack of efficient support services, such as water supply, fodder production and veterinary services compound the problems.
- (v) Unfair trade practices by China are often cited by cashmere industry insiders as the main reason for domestic producers experiencing raw material shortages. Cash-rich Chinese traders offer high prices to herders regardless of quality, and there is extensive raw cashmere smuggling into China (some estimates run as high as 50 percent).⁴⁸
- (vi) Changes in the world garment industry⁴⁹ have made it more difficult for Mongolian garment producers to compete. Even Chinese producers backed by decades-long support from the government have been unable to successfully integrate into international distribution channels. A USAID analysis⁵⁰ recommended that Mongolia's cashmere industry should make an effort to forge alliances with major market players seeking to counterbalance Chinese producers rather than trying to develop an independent brand name. The current worldwide trend for further segmentation of the cashmere market with strong growth of affordable pure and blended cashmere garment sales co-existing with

⁴⁸ World Bank, Country Economic Memorandum, 2007, p.53.

⁴⁹ The changes include declining prices, acceleration of fashion cycles and shift of bargaining power to brand name holders. (See, "A Value Chain Analysis of the Mongolian Cashmere Industry." USAID/EPRC, 2005.)

⁵⁰ As above.

high-end luxury segment, might be to the advantage for the Mongolian cashmere industry, the report concluded.

68. The industry is taking certain actions to increase the worldwide recognition of Mongolian cashmere, participating in trade shows and organizing promotion events abroad. The Mongolian FiberMark Society, comprised of leading cashmere processors and garment producers of Mongolia and prominent cashmere companies from North America, the European Community and Japan, has been working to promote the Mongolian cashmere worldwide as well educating herders on cashmere quality and access to market issues.

69. Policymakers' actions have received mixed reception and the effectiveness of measures is uncertain. The Government of Mongolia, with WTO's blessing, is continuing the policy of levying 4,000 MNT export tax on greasy cashmere but this measure remains under strong criticism by domestic processors for not being effective. The Cashmere and Wool Association has warned that local manufacturers are in danger of going out of business if the export tax is not increased and their access to credit is not improved. International development agencies (notably, USAID) remain skeptical of such measures and recommend that the government should instead, focus on removing market distortions. In June 2008, the Parliament passed a resolution to provide interest subsidy to domestic processors who buy cashmere from herders at a certain price (30-32 thousand MNT per kilo for cashmere with less than 17 micron of fiber thickness). In addition, the Government has made allocations from state budget to purchase 1.5 thousand tonnes of cashmere directly from herders to boost prices which have gone down to 20-25 thousand MNT per kilo in 2008. The remarkable absence of large numbers of Chinese traders during the 2008 collection season (explained by restrictions on raw material imports imposed by the Chinese government for the Olympic year and less availability of low-cost credit for cashmere processors) seems to have contributed to falling prices. The impacts of the recent government intervention remain to be seen.

Box 4.1. China: Strong Government Support for Cluster Development (USAID/EPRC, 2005)

Since the 1970s, the Chinese government has granted substantial subsidies to the cashmere processing sector: low interest rate loans, tariff protection, no charges for worker welfare and housing, and export subsidies in the form of tax rebates (as a percentage of export sales). It also has a strict licensing system for traders and excludes all foreign traders.

China has been able to develop cashmere clusters of herders, processors, machinery and parts manufacturers, dye and other chemical input producers, as well as traders and service providers (repairs, shipping and transportation, etc.).

In April 2005, at the China International Cashmere Forum, the Chinese outlined their strategy for their cashmere industry: worldwide dominance by controlling the supply and pricing of raw cashmere and being the "factory to the world" for finished cashmere products either as contract producers or in alliances with international brand holders and more importantly, by either developing or buying brand names for themselves.

6. Meat

70. Approximately 30 private and joint-stock ventures operate in the meat processing and packing industry. Twenty eight industrial slaughterhouses nation-wide are licensed for meat exports, however only a few are equipped with modern equipment and are fully utilized. Industry

experts estimate that less than 10 percent of meat is industrially processed, with the remainder going through the hands of meat 'changers' (traders).

Table 4.2: Meat Output and Exports

Meat production, thousand MT	2004	2005	2006	2007
Total	195.2	183.9	170.7	188.5
Of which:				
<i>Beef</i>	53.8	45.3	44.2	46.6
<i>Mutton & goat meat</i>	96.2	93.4	88.4	107.0
<i>Pork</i>	0.2	0.2	0.2	0.6
Meat exports, thousand MT	8.4	7.8	11.7	10.9

Source: NSO 2007 Yearbook

71. The general low-quality of meat production coupled with a number of phyto-sanitary issues continue to restrict export opportunities for Mongolian meat, however external conditions seem to be improving somewhat. Mongolian meat exports are currently highly concentrated in one market--Russia, and at one very low value-added product category-- frozen carcasses of large animals. Today, only a few meat processing companies have obtained quotas to export meat and meat by-products to Russia. Although Russian agricultural authorities' policies aim to reduce the market share of imported meat in Russia, rising incomes in the Siberian region and shortages of locally-produced meat products fuel increased demand from Russian buyers. Contract terms and enforcement are somewhat improving, with buyers increasingly interested in 3-5 year contracts with "at sight letter of credit" conditions. In 2007, a few, more established meat exporters, such as Dornyn Govi LLC, had seen their products loaded in containers and shipped to Russia as fast as they were packed.

72. Animal health surveillance is still inadequate, and the lack of sufficient extension services (veterinary, fodder, water) needs to be addressed on an urgent basis. In 2007, only 60 percent of total livestock were immunized against common infectious diseases, 1.4 percent against severe infectious diseases and less than 2 percent underwent any type of laboratory diagnostics. The number of veterinary specialists in 2006 dropped by 10 percent compared to 2000⁵¹, while total capacity of wells and water reservoirs in 2006 decreased by 60 percent from 2000 levels.

73. The 2001 outbreak of the "Hoof and Mouth Disease" in Mongolia, which caused China and Russia to impose bans on Mongolian exports of all animal products, is an example of how outbreaks of livestock diseases damage productivity and restrict market opportunities. To minimize the risks, surveillance, diagnosis and disease mitigation mechanisms need to be strengthened with improved linkages between the present private veterinary services and public agencies.

74. Diversification of exports into specialty meats and higher value added products can provide significant growth opportunities. Interest in canned meat imports from Mongolia is growing stronger in Russia and South Korea. Initial agreements have been concluded with some local producers who have been able to invest into upgrading of canning lines, slaughterhouse and storage facilities. Once quality requirements of international buyers are met, expansion into canned segment of the meat market enables producers to stabilize production

⁵¹ One thousand eight hundred in 2006, compared to more than 2,000 in year 2000. (NSO, 2007 Statistical Yearbook.)

schedules as well as income streams. An assessment undertaken by World Bank⁵² concluded that while horsemeat for Japan and lamb for Arab countries are promising venues for exports, supply chain (transportation, *halal* certification systems, etc.) and local cultural issues (reluctance of Mongolian herders to slaughter young animals) continue to hamper the process. Experience of other countries that have developed extensive air cargo shipments for such products (Australia, New Zealand) offers a viable option for the Mongolian meat industry to explore.

75. Japanese and South Korean pet food markets are promising venues for Mongolian meat processors. The pet food market is estimated at about \$3 billion in those two countries and almost \$50 billion worldwide. Several companies have undertaken test exports of jerky dog treats and canned horse meat. One company, Eco Pet Foods LLC, has established a partnership with a Japanese pet food marketing company which has taken up 25 percent of the company's equity. Since 2006, the company has been exporting 5-10 tonnes of products annually. Although overseas interest in sourcing Mongolian meat by-products for pet food consumption is strong, a number of hurdles remain:

- (i) Costly transportation with lengthy transit time
- (ii) Trade regulations and lack of bilateral agreements recognizing Mongolian meat products
- (iii) Lack of affordable capital
- (iv) Lack of affordable domestically produced packaging material
- (v) Seasonal slaughtering patterns that prevent continuous supply
- (vi) Increasing prices of raw materials in Mongolia (one reason cited, is the increased competition from Chinese buyers)

76. Efficient government coordination and support is necessary to fully utilize growth opportunities. Better coordination in: trade and logistics with Mongolia's neighbors; laws and regulations; sector strategies and corresponding implementation plans; and policies for natural resource management, supplemented by prudent public investments in infrastructure, will help develop the supply chains and generate growth in the livestock and meat industry. Facilitation by the government and private sector associations to improve herders' and processors' access to marketing, export promotion and product quality information is critical to the success of companies.⁵³

77. Establishment of a new industrial park for growth industries, that would include high-value food and natural product exporters as well as international packaging companies equipped with suitable cold storage facilities, sanitary laboratories and with access to good infrastructure near Ulaanbaatar's airport, will certainly provide an environment conducive for growth.

7. Leather

78. Global leather industry prospects are bright, despite increasing environmental regulations and growth in synthetic fiber consumption. For Mongolia, successful utilization of its abundant raw materials depends on its ability to correct numerous deficiencies in the existing

⁵² World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, July 2007.

⁵³ One of the initiatives by external partners is the EPRC/USAID's *Routes to Market* program that works to bridge local producers to international buyers. The Chamber of Commerce and Industry provides information on international foodstuff and equipment fairs and exhibitions to encourage local companies to participate.

supply chain. Leather and leather products are among the most widely traded and universally used commodities in the world. Already, the total value of annual trade is estimated at:⁵⁴

- (i) one and half times the value of the meat trade;
- (ii) more than five times that of coffee; and
- (iii) more than eight times that of rice.

79. Formal trade is calculated at over US\$ 85 billion a year and according to analysts, the market is far from being saturated. Developing countries supply 45 percent of the buyer-driven world leather trade. China and Italy are the leading producing and exporting nations in the world with exports worth US\$ 19 billion and US\$ 13 billion respectively. India, with an output of US\$ 4 billion and exports of US\$ 2.4 billion, is placed third.⁵⁵

80. Mongolia has abundant raw materials and once had a thriving leather industry. In the 1980s, Mongolia's vertically integrated, large-scale leather processing complexes used to produce 5.1 million skins, 1,000 MT of shoe sole leather, approximately 240,000 items of various leather garments, 4.1 million pairs of shoes, and 180,000 pure coats per year, constituting 6.5 percent of total industrial output.⁵⁶ With the transition to the market economy, large state-owned enterprises collapsed, and today the majority of enterprises are small-scale, privately owned factories. Total combined output was just 0.3 percent of gross industrial production in 2007. Table 4.3 illustrates the stagnating domestic production and exports of leather products.

Table 4.3: Leather Output and Exports

	2004	2005	2006	2007
Leather industry output, million MNT	4,096.9	608.0	8,055.8	7,384.0
Raw and processed leather exports, million USD	52.6	56.5	56.9	42.2

Source: NSO, 2007 Yearbook

81. Domestic leather processors are plagued by low capacity utilization, capital constraints, limited access to international markets and short supply of good quality raw materials. Recent overall industry capacity utilization is less than half of that in 1989, and in some bigger factories it has fallen below 10 percent.⁵⁷ Ninety-nine percent of raw and processed leather is exported to China, as the quality and finishing is not satisfactory for most other markets. The quality of domestically processed leather is so inadequate that it does not even meet requirements of local garment producers-- let alone international buyers. In 2004, 3.8 million pieces of wet blue processed skin were imported from South Korea.⁵⁸ Poor skinning techniques employed by slaughterhouses and high prevalence of tick and other insect bites on animal hides make it problematic to produce high-quality semi-finished and finished products.

82. Capital, technology and environmental issues in the leather sector need to be urgently addressed. One of the biggest cost items for leather manufacturers is chemicals used in processing. While worldwide leather industry average spending on chemicals is 10-18 percent

⁵⁴ FAO, 2007.

⁵⁵ "Leather, India Brand Equity Foundation", World Economic Forum papers, Davos, 2006.

⁵⁶ "Confronting the Challenges for the Development of the Leather Processing Industry of Mongolia", Ministry of Industry and Trade presentation to the Economic Research Institute for Northeast Asia, 2006.

⁵⁷ "Confronting the Challenges for the Development of the Leather Processing Industry of Mongolia", Ministry of Industry and Trade presentation to the Economic Research Institute for Northeast Asia, 2006.

⁵⁸ NSO, 2007 Statistical Yearbook.

of processing costs, in Mongolia it reaches 25 percent.⁵⁹ Full dependence on imports coupled with costly transportation, places additional financial burden on processors and limits their options to improve product quality through wider selection of higher-quality chemicals.

83. Environmental pollution from leather processing factories is a major concern. Worldwide, 80-90 percent of leather processing factories use chromium (III) for the suppuration of skins. In addition, organic solvents, phenols and mineral salts are used in leather processing. To confront the situation, China has put restrictions on imports of raw hides by using its tax policy and started encouraging imports of wet blue processed skins.

84. Due to the wide geographical dispersion of Mongolian leather processors, many factories are not connected to the centralized waste water treatment center. The center itself, founded in 1972, has not undergone any modernization since its establishment, and the quality of treatment is inferior.

85. Sector development policies need to address a multitude of problems to effectively support the revival and growth of the leather industry in Mongolia. The global leather sector is becoming increasingly integrated and to gain access to new markets, the Mongolian leather industry must also integrate itself — to the extent possible — at the national, sub-regional and regional levels. The following competitive factors need to be addressed: (i) physical infrastructure and services, (ii) attractiveness to foreign investment, (iii) technological development, productivity and workmanship, (iv) facilities for skills development, (v) securing working capital or low-cost capital, (vi) effective environmental controls, (vii) marketing information and expertise.

86. The main challenges to achieving integration include the absence of mechanisms for in-country geographical collaboration in the sector, limited contacts between firms and support institutions, and low international visibility of the Mongolian leather industry. With challenges of this scale, only a combined effort by all stakeholders — the leather business, government, trade support institutions and international organizations — will bring about the necessary solutions.

Box 4.2: India Government Regulation & Support for the Leather Industry (IBEF⁶⁰, 2006)

The Government of India has various initiatives to make its leather industry more competitive. Key policy initiatives include:

- Free import of raw hides & skins, semi-finished and finished leather.
- Concessional duty on imported machinery and chemicals.
- Free export of raw hides & skins, semi-finished and finished leather and leather products.
- Policies to facilitate modernization: In June 2005 the government initiated a US\$ 64 million 'modernizing scheme' called the 'Integrated Leather Development Program', whereby all leather tanning and product units will be eligible for modernization assistance. The support will be up to 30 per cent of project cost for SMEs and 20 per cent for large entities, subject to a ceiling of US\$ 110 thousand per unit.
- Setting up of leather parks with centralized infrastructure, including waste water treatment plant: An outlay of US\$ 24.5 million for setting up five leather parks.
- Establishment of 'design centers' at individual manufacturing units, to facilitate improvement in design capabilities: Under this scheme, 25 per cent of the project cost is provided to the

⁵⁹ "Confronting the Challenges for the Development of the Leather Processing Industry of Mongolia", Ministry of Industry and Trade presentation to the Economic Research Institute for Northeast Asia, 2006.

⁶⁰ "Leather, India Brand Equity Foundation", World Economic Forum papers, Davos, 2006.

entities under the market access initiative scheme of the Ministry of Commerce and Industry.
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8. Other products

87. The global market for natural foods, food supplements and beauty products provides growth opportunities to Mongolian businesses. Mongolia's large and relatively pristine geographic area with attendant resources of eco-products, makes the country well-placed to respond to the rapidly growing world market for health-related foods. Mare's milk concentrate, black goat extract, fungus tea, wild berry preservatives, seabuckthorn juice and oil have been identified as potential niche entrants into the health food and supplement markets. Several private companies are extending efforts in this area, Beneduct, Mon-enzyme and UFC being the examples. Again, limited availability of raw materials and packaging, capacity constraints, weak international promotion, and low access to affordable credit are impeding their growth. A number of international and bilateral partners are supporting the developments in this area (ADB, Netherlands, SDC, USAID, GTZ etc).⁶¹

B. Food and Beverage

88. Mongolia is dependent on imports for most of its food needs. Cereal cultivation has dropped sharply in recent years, however growth is evident in horticultural output.⁶² The domestic vodka and beer market is vibrant and beverage production is being diversified. Food retail markets are developing rapidly, but issues persist with logistics, food safety and inspection.

89. Food and Beverage output in 2007 constituted 30 percent of total manufacturing output, showing a 50 percent increase over 2004 levels.⁶³ The highest growth items were alcohol, beer and beverage, while production of breads and biscuits declined. Food imports in 2007 were \$266.4 million with volumes almost doubling since 2005; reflecting underlying income growth.

90. The dairy sector is showing signs of revival, but significant structural constraints remain. Mongolia used to be self-sufficient in milk production during the planned economy period, when close to 70 million liters of milk (20 percent of total milk output) were industrially processed. The system of state-operated dairy farms collapsed in the beginning of the transition period, and processed milk output dropped to less than 2 million liters in 2002. In 2007, 9.2 million liters of milk were processed domestically, and annual imports of milk and dairy products have been 50 million liters on average. Almost 70 percent of milk consumed in urban areas is imported.

91. Domestic processors face numerous problems in procuring 1) sufficient quantities of quality raw milk from widely dispersed small scale milk producers (post-harvest losses are estimated at one-third of total production⁶⁴); 2) reasonably priced and good quality packaging, as the domestic packaging industry remains virtually non-existent; and 3) affordable credit to modernize equipment and finance working capital needs. With no integration and clustering in the sector's value chain, producers have no control over the quality of raw milk purchased from individual producers. Primary treatment and collection infrastructure are woefully inadequate and livestock support services—such as fodder production and veterinary surveillance—are

⁶¹ For example, ADB: Agriculture Sector Development Project; PSOM (Program for Cooperation with Emerging Markets – Netherlands); USAID's Routes to Market program that finances mare's milk farm in Tuv aimag; SDC's support for seabuckthorn cultivation activities in Western Mongolia.

⁶² Cereal production in 2007 declined by almost 20 percent compared to 2004, whereas vegetable output grew by 43-55 percent over the same period. (NSO, Statistical Yearbook, 2007.)

⁶³ Measured at 2005 constant prices. (NSO, 2007 Yearbook.)

⁶⁴ "Mongolia: Small Milk Producers – the Key to Dairy Industry Survival", Ministry of Food and Agriculture, 2007

insufficient. Inspection of dairy products sold in urban markets has found about 40 percent being contaminated with brucellosis and pathogenic bacteria and 36.7 percent contained traces of flour, water and baking soda.⁶⁵ Thus, major producers had to resort to business models based on reconstituting imported full-cream milk powder, marketed as ‘fresh’ milk.

92. The government, supported by external partners, has been implementing a number of interventions in the dairy sector and initial results are promising.⁶⁶ The Mongolia-Japan-FAO/UN Special Program for Food Security project ran from October 2004 to September 2007. The Dairy Sector Revival Strategy devised by the National Dairy Task Force incorporates a sector-wide food chain approach to be implemented under 1) Milk Production Enhancement, 2) Milk Marketing Enhancement, and 3) Capacity Building and Training programs. These are made operational through six investment packages or dairy modules covering each link in the cow-to-consumer dairy chain and involve both public and private sector partners. With government-backed support services in herd breeding, personnel training, retailing and promotion, the activities are bringing promising results. By mid-2007 sixteen dairy modules were in operation with the government sharing the investment risks by contributing know-how and equipment. Private sector investment amounted to \$1.3 million in equipment and facilities. The amount of processed milk has increased more than three-fold, and the two major producers, currently specialized in reconstituted milk, are expected to invest upwards of \$100 million in the modules in the coming years.

93. The domestic beer market is flourishing, and producers are ramping up capacities to keep up with the growing demand. MCS Group and APU JSV are the main competitors in the beer and beverage market, with a number of smaller breweries and bottlers sharing the rest. Per capita consumption of beer in Mongolia is 9 liters, which is significantly lower than that in Europe⁶⁷ signaling strong potential for further market growth. MCS Group has partnered with Asia-Pacific Brewery Co., Ltd of Singapore and the new \$20 million brewery with a capacity of 12 million liters of Tiger/Heineken brand beer came online in 2007. In 2008, the company obtained approval for a \$30 million loan (partly convertible) from the International Finance Corporation (IFC), and some of the funds will be used to upgrade its soft drink production facilities.⁶⁸ Currently, APU is in negotiations with EBRD for equity investment to set-up a new 50-million liter brewery, the decision is slated for end of 2008. There are over 170 vodka factories nation-wide and cases of sub-quality vodka poisoning in December 2007 have intensified calls for tighter quality and licensing regulation of the market. The domestic vodka market is saturated, and major producers (notably, APU) are increasingly looking into opportunities to enter international markets. APU has opened a new spirit distillery in 2008, and currently is investing substantially to upgrade its vodka bottle design and acquire Chinggis trademark rights in Europe, Asia and Australia.⁶⁹

94. Recent years have seen the introduction of a range of new products in the processed and frozen food sector, indicating efforts by the private sector at product diversification despite a number of challenges. The variety of domestically-produced frozen foods in supermarkets has increased, ranging from dumplings to fish fillets.⁷⁰ With growing disposable urban incomes, the

⁶⁵ UNDP, Second National Report on Implementation of MDGs in Mongolia, 2007.

⁶⁶ “Mongolia: Small Milk Producers – the Key to Dairy Industry Survival”, Ministry of Food and Agriculture, 2007

⁶⁷ Per capita beer consumption in Austria is 108 liters, Poland – 75, Germany – 115, and Italy (the lowest) – 29 liters. Online statistics.

⁶⁸ Also, the EBRD made its first syndicated loan in Mongolia with a \$13 million credit to MCS Coca-Cola LLC, to help expand its production in July 2008. EBRD website: <http://www.ebrd.com/new/pressrel/2008/080708.htm>

⁶⁹ Interview with Mr. Batsaikhan, Chairman of APU JSV, May 2008.

⁷⁰ No statistical information is available on frozen and processed foodstuff.

market in processed and frozen foods is set to develop further (its limited size, however, is unlikely to attract significant foreign investment).

95. Lack of affordable, domestically-produced packaging, inefficiencies in the raw material supply chain, coupled with unstable prices, as well as access and cost of finance issues are the main factors limiting the expansion of the processed and frozen foods industry. While hygiene and sanitary oversight standards need to be strengthened to ensure product quality, excessive bureaucracy in license issuance and rent-seeking practices of health inspectors are often cited by producers as serious constraints to growth.

C. Finance

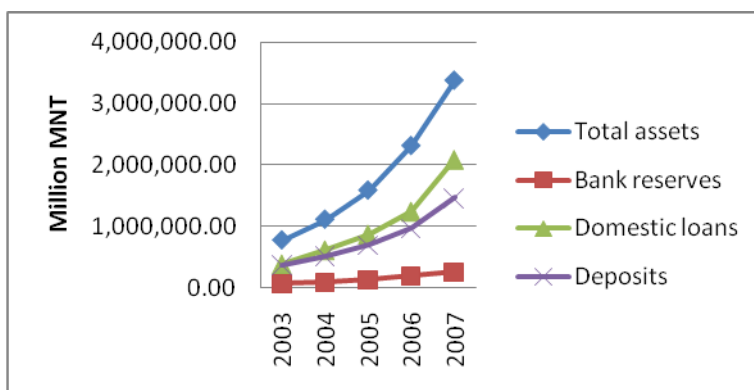
96. Mongolia's financial system consists of 16 commercial banks and 369 nonbank financial institutions, including 182 licensed Savings and Loan Cooperatives (SLCs), 15 insurance companies, and 35 securities companies. The sector continues to be dominated by banks. Capital markets are thin and underdeveloped, and the insurance sector is just emerging. The SLCs crisis in 2006 has severely damaged public confidence in non-bank financial institutions and underscored existing deficiencies in the legal and regulatory framework. The recent revival of IPO's and trading activity on the Mongolian Stock Exchange (MSE) raises hopes for the emergence of a vibrant financial segment. However, significant concerns remain regarding potential systemic problems if necessary initiatives to strengthen the regulatory foundations of the financial sector (especially in the non-banking sector) are not undertaken in time.

9. Banking Sector

97. The banking sector continues its rapid growth. Banking sector indicators have improved considerably over the past several years. Total bank assets reached 3.38 trillion MNT in 2007, constituting 96 percent of total financial sector assets and 74.3 percent of GDP.⁷¹ Since 2002, loans and deposits have risen by 56 and 47 percent respectively on average. This indicates rapid growth of the sector and at the same time, underscoring the increasing gaps in funding demand and supply needs. In 2007 alone, total credit increased by 75 percent⁷², a growth largely spurred by construction related loans, the share of which more than doubled since 2003. Overall the sector Non-Performing Loan (NPL) ratio has until recently declined steadily from 7 percent in 2002 to a little over 3 percent in 2007 demonstrating improvements in credit risk management, loan administration and collection.

⁷¹ Estimates based on statistics from Bank of Mongolia website (<http://www.mongolbank.mn>).

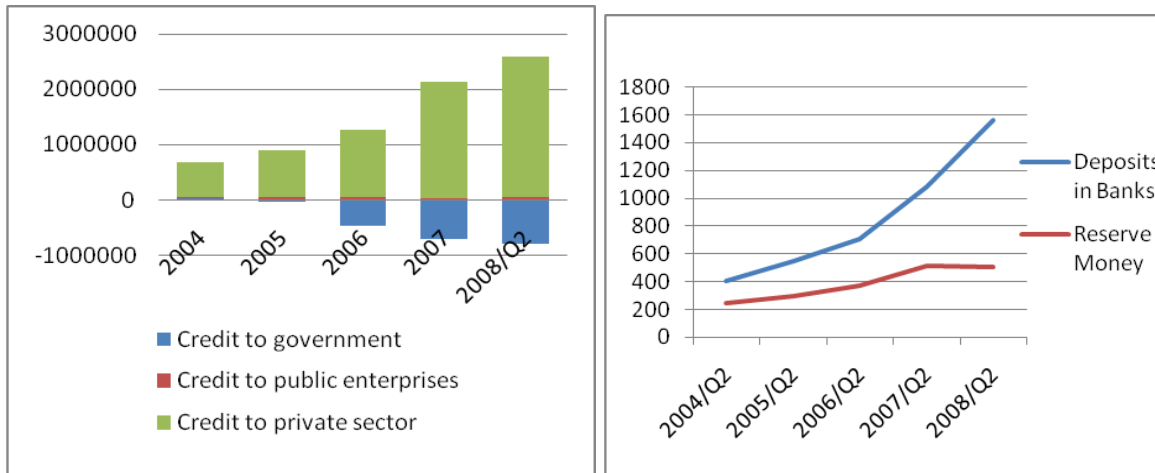
⁷² "Mongolia: 2008 Article IV Consultation", IMF Country Report 08/200, July 2008 .

Figure 4.1: Banking sector growth continues.

Source: BoM, 2007

98. Sixteen private commercial banks operate in Mongolia; the last state-owned entity, Savings Bank, was privatized in November 2006.⁷³ Four largest players (Trade and Development Bank, Golomt Bank, Khan Bank and Anod Bank) account for more than 60 percent of total assets, loans, deposits and equity.

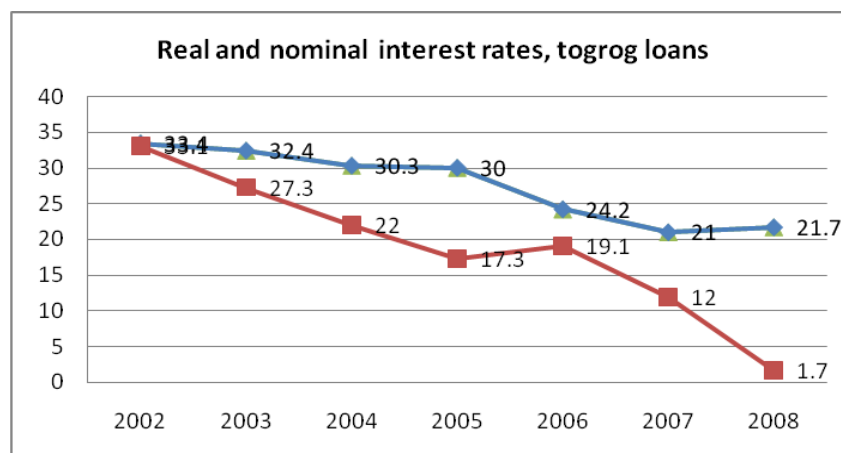
99. Private sector credit is growing; however concerns about credit sustainability remain. Private sector loans have been the largest source of credit expansion, growing at about 60 percent on average annually during 2002-2007 and 75 percent in 2007.

Figure 4.2: Credit Expansion is Supported by Deposit Growth

Source: Bank of Mongolia, 2008

⁷³ MNT 14.2 billion was discovered as missing from the bank after the privatization process was completed. The accused, two senior accounting officers, now face prison sentences of 5-10 years for illegal transfer of bank funds for personal use (including gambling).

Figure 4.3: Although the decline in nominal interest rates has somewhat stalled in 2008, real rates have plummeted due to inflation



Source: BoM, 2008

100. This credit boom reflects improved confidence in banking services (evidenced by deposit growth) as well as a healthier, more competitive banking sector. However, a number of factors raise concerns regarding the sustainability of the credit market. First, although the ability of banks to assess credit risk has improved, it is still an issue and more so during periods of rapid growth. Moreover, the prevalence of short-term loans in lending (less than 10 percent of total loans have maturities of four years and beyond) continues to pose liquidity risks during periods of downturn.. While the decline in the NPL ratios for both overall credit and private sector loans in the recent years is a favorable indicator, the situation across individual institutions fluctuates significantly, in some banks reaching 9-10 percent.⁷⁴ It has also been noted that the short maturity of major debt instruments allows banks to roll-over NPLs, thereby improving their balance sheets.⁷⁵ The recent problem with Anod Bank (in December 2008) where bank records were falsified indicates that on-site and off- site bank supervision by the BOM needs further tightening.

Table 4.4. Recent Trends in Private Sector Credit Indicators (2002-2007)

Million MNT	2002	2003	2004	2005	2006	2007	2008/6
Total Credit ^{1/} , billion MNT	214.9	409.9	547.7	789.2	1,129.4	1,944.9	2,431.8
Credit to Private Sector, %	62.7	52.8	58.7	55.5	52.7	56.0	56.9
Credit to Households, %	27.9	30.1	35.9	38.6	42.8	41.7	40.1
By Maturity ^{2/}							
Short-term	91.0	76.2	78.5	73.0	53.5	47.6	42.8
Medium-term	5.8	20.9	16.8	22.9	41.6	44.4	47.5
Long-term	3.2	2.9	4.7	4.2	5.0	8.1	9.7
NPL ratio ^{3/}	N/A	N/A	8.8	8.3	7.1	4.0	3.2

Remarks:

1/ Including foreign currency denominated loans

2/ Short term: 0-1 year; medium term: 1-4 years; long-term: over 4 years

3/ For private sector credit only

Source: IMF, BoM, 2008

⁷⁴ Medium-term Strategic Paper for Developing Financial Sector, MoF, 2007.

⁷⁵ Mongolia: Sources of Growth, Country Economic Memorandum, World Bank, July 2007.

101. The mortgage market has expanded rapidly, so has banks' exposure to real estate price risks. A large share of the credit expansion appears to be linked to the current real estate boom, a phenomenon which has many global precedents with less than desirable outcomes. As of end 2007, the total mortgage portfolio stood at MNT 144.1 billion, with 46.7 billion issued in the 4th quarter alone.⁷⁶ Interest rates in MNT are as high as 34 percent and maturities are short (a maximum 10 years). So far, mortgage default rates are very low and loan performance has been satisfactory-- benefitting from years of pent-up demand for higher quality residences and the influx of households into Ulaanbaatar. Still, with the upper-end residential market nearing saturation and macro-economic conditions becoming less favorable, special attention should be paid to avoid situations where lenders make credit decisions on the basis of housing price growth rather than borrowers' incomes. Already, signs of an impending slowing of the real estate boom have emerged. With rising inflationary pressures in late 2007 and early 2008, and the tightening of monetary policy by the Bank of Mongolia (BoM), banks have also restricted their mortgage lending.

102. Consolidation is likely in the near future with Ulaanbaatar continuing to be the primary market. While Financial Soundness Indicators (FSI) for the system are strong as a whole⁷⁷, they vary significantly among individual institutions. Growth of credit to the private sector and households (with generally higher margins) and diversification of funding sources in large banks resulted in a sharp increase in profitability in 2007. However many smaller banks performed less well, some even recording losses.⁷⁸ Stress tests by the joint IMF-World Bank Financial System Assessment Program (FSAP) performed together with the BoM staff in mid 2007 evaluated systemic risks in the banking system of Mongolia. The tests have shown that while the overall banking sector would be able to absorb losses from potential shocks in the exchange rates, interest rates and credit risks, results vary for individual banks.⁷⁹ With increased market pressures, a certain amount of consolidation is expected to take place within the next 2-3 years. Ulaanbaatar remains the primary market for banks, especially for corporate and mortgage loan services. Low population density in the regions does not provide enough support for further service expansion and administration costs are too high to motivate more banks to venture into rural areas. There are already initial indicators of market saturation in some regions with 3 banks (Khan, Xac and Mongol Post) and close to 30 non-bank financial institutions serving the rural regions.⁸⁰

103. Regulatory and internal constraints to the banking sector growth are numerous. Competition for funds is fierce with deposits continuing to be the main financing source. Although a few larger commercial banks have started accessing international capital markets, the on-going global credit crunch and Mongolia's limited visibility in the world financial circles, make it difficult to raise sufficient capital at reasonable costs. Many banks are institutionally unprepared to attract international capital: corporate governance and internal audit systems need to be established or strengthened, and personnel skills remain an area requiring upgrading.

104. The under-development of inter-bank, money, foreign exchange and capital markets (due in part to the absence of relevant legislation) limits banks' options to move some credit risk from their balance sheets to separate sources of capital, as well as to hedge their own and clients' currency exchange risks. Commercial banks' involvement in capital markets as both investors

⁷⁶ Bank of Mongolia, online Loan report, 2008.

⁷⁷ See Statistical Appendix.

⁷⁸ Mongolia: Sources of Growth,⁷⁸ Country Economic Memorandum, World Bank, July 2007

⁷⁹ "Mongolia: Financial System Assessment Program", IMF Country Report No. 08/300, September 2008.

⁸⁰ As above.

and intermediaries is partially restricted as membership in the Mongolian Stock Exchange is not allowed, and they cannot participate via a subsidiary due to the 10 percent voting share limitation.⁸¹

105. Bankruptcy, foreclosure, securitization and mortgage laws need to be adopted or revised to improve creditors' risks and consequently, lower credit costs. The civil law does not specifically define when a loan is considered in default and therefore when a property can be legally foreclosed. This interpretation of the civil law puts lenders at a disadvantage and many banks report that courts are subjective when processing claims of default. There can be up to 5 courts the bank would have to go through before the process is complete, which takes 2-3 years on average.⁸²

106. Currently, the banks' internal loan rating or classification systems are inadequate. While all banks follow the practice of requiring a loan committee approval to make credit decisions, the approval committee's level of experience, as well as the formality of the approval process itself, differs significantly. In some cases the process takes the form of informal discussions, while at others significant autonomy is granted to branches.⁸³

107. The World Bank analysis notes that the emerging levels of cross-ownership between banks and non-financial conglomerates can lead to 'extensive self-dealings to the exclusion of potentially bankable outside businesses'⁸⁴ which, coupled with weak controls on related-party lending, increases systemic risks.

108. Furthermore, the existing Credit Information Bureau does not meet the needs of the fast growing and diversifying industry. The information provided through the Bureau was reported as unreliable and often outdated or inaccurate, which impairs the ability of a lender to properly assess borrower capacity.⁸⁵ The industry is currently in discussions to set-up their own Credit Information Bureau, however regulatory and organizational hurdles are significant: collection and distribution of financial information by private sector operators need to be allowed by law, and the banks need to agree to share information on a voluntary basis as well as determine the amount of user fees.⁸⁶

109. The Bank of Mongolia (BOM) is stepping up its efforts to ensure stability and liquidity of the banking sector, while developments in the regulatory system and other initiatives are underway to further promote sector development. In June 2007, the Financial Stability Board was established, and includes the BOM, the Ministry of Finance (MoF) and the Financial Regulatory Commission (FRC) to promote financial system stability and improve coordination. In July 2007, one-week central bank bills (CBB) were introduced, and the BOM is now planning to auction 12-week CBBs more frequently (currently done every three months upon maturity of previous issue) and introduce CBBs of longer maturity.

⁸¹ Article 16.4. "Restrictions on Banking Activities", Banking Law of Mongolia.

⁸² USAID/EPRC "A Review of the Mongolian Primary Mortgage Market", June 2007. Laws on deposit insurance, securitization and mortgage collateral have been prepared by the authorities but have not been passed by the parliament.

⁸³ As above.

⁸⁴ World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, 2007, pp.64-65. Examples in the report include Tavan Bogd company with its subsidiary Khaan Bank and other affiliates such as Gobi Cashmere; Jenco company with its subsidiary Captrion Bank including shareholdings in TDB, and affiliates such as Bayangol Hotel and Makh Impex; Bodi company with its subsidiary Golomt Bank and Bodi Computer; Petrovis with shareholdings in Capitron Bank and NIC petroleum distribution; and Erel company with Erel Bank and Erel construction as subsidiaries.

⁸⁵ USAID/EPRC, "A Review of the Mongolian Primary Mortgage Market", June 2007.

⁸⁶ IMF, "Mongolia: Financial System Assessment Program", Country Report No. 08/300, September 2008.

110. The (financial) leasing law adopted in 2006 and latest amendments to the tax laws have improved the legal framework for financial leasing activities. However, the industry has yet to promote this instrument in a significant way. The Information Communication Technology Authority (ICTA) has drafted two laws and an amendment to the Civil Code regarding privacy and confidentiality issues relating to use of technologies in banking services. Other financial sector related legislation currently under discussion by the authorities include: the law on deposit insurance, amendments to the Banking law, the securitization law, and the mortgage collateral law.

111. The National Statistical Office and the BOM have started developing the housing index and with planned upgrades in the cadastre and mapping systems (with assistance from ADB). As a result, the efficiency of the real estate market is expected to improve. In 2007, the Financial Markets Association of Mongolia introduced the Ulaanbaatar interbank offered rate (UBIBOR) as a benchmark or reference rate for short term MNT interest rates. It is based on offered inter-bank deposit rates reported from UBIBOR contributor banks. Reuters Plc is the official calculating and information distributing agency for UBIBOR.

112. The banking sector's potential for diversification and growth is vast. A number of banks have started accessing capital markets (both domestic and international). The examples are: Trade and Development Bank (TDB) having issued corporate bonds in Singapore and Anod bank carrying out a successful IPO on the Mongolian Stock Exchange (MSE). Zoos Bank was the first Mongolian bank to issue stocks on the MSE.⁸⁷ Khan Bank's international IPO plans have been put on hold, mainly due to concerns over the current state of the global capital markets. In the meanwhile, banks are stepping up their efforts to improve their corporate governance, internal audit and accounting systems as initial steps to obtain or improve their credit ratings for future forays into international stock and bond markets.

113. Investment banking is a new area of interest for Mongolian banks. Already, the larger institutions (TDB, Khan Bank) have started establishing investment banking departments as strong economic growth and large mining deposits open up opportunities for high-return investments.

114. With corporate and consumer incomes growing, financial intermediaries will increasingly look into the provision of a wider array of services beyond traditional deposit and loan products. As the regulatory and legal framework becomes more comprehensive, banks will be able to expand into:

- (i) Technology-intensive services: e-banking, bank cards
- (ii) Financing of consumer durables, trade financing
- (iii) Private wealth management; and
- (iv) Strategic partnerships with other financial intermediaries, e.g. insurance companies to provide a broad range of services across the financial segments.

10. Non-banking sector

115. Capital markets are beginning to show signs of growth, with the stock market increasingly attracting private capital and the bond market continuing to rely on government issuance. Measured in terms of market capitalization, the Mongolian equity market increased 24-fold compared to 2004, amounting to 716 billion MNT in 2007⁸⁸. Still, equity market

⁸⁷ The IPO was conducted in February, 2006. Up to 39.3 percent of shares were open to public trading and the stock price in August 2008 was at 3600 togrog per share. (MSE website: <http://www.mse.mn/index.php>.)

⁸⁸ NSO, 2007 Yearbook.

capitalization is a mere 11 percent of GDP, significantly lower than that of East Asian countries⁸⁹. As of 2007, 383 companies (over 80 percent of which are private) were listed on the Mongolian Stock Exchange. While daily average trading in 2007 increased almost 100-fold since 2004, only 10 percent of 2.5 million total shares are actively traded⁹⁰

116. The bond market revived somewhat in 2007 (after drastic declines in 2003-2005) as Government bond issuance increased to 39.6 billion MNT. In 2006-07, 109,000 government bonds were issued with maturities ranging from 28 to 364 days. During 2004-2006, commercial banks were the only buyers of government bonds (in contrast, 66.6 percent of government bonds were bought by individuals in 1996⁹¹). The year 2007 saw a revival of interest from both corporations and individuals, although they still make up a very small percentage of bondholders at 0.15 and 0.002 percent respectively. Corporate bond issuance has decreased significantly since early 2000; with only three companies, Gobi Co., Monfresh Juice and Moninjar having issued a total of 320,000 bonds during 2005-08.

117. Capital market professional counterparties⁹² are emerging and so are concerns over their competence. In 2007, a total of 35 professional counterparties were operating in the market, 8 of whom offer underwriting services, including 5 with foreign equity participation. Ninety percent of transactions were handled by 5 large broker and dealer companies. This indicates weaknesses with staff competence, company management and financial capabilities of smaller companies; a fact that underscores the need for consolidation and better oversight of such professional entities.

118. Non-bank financial institutions currently constitute a small percentage of the financial sector, but their involvement is important for increased access to credit, especially in rural areas. There are 137 licensed NBFIs operating in Mongolia, 112 of which are focusing on Ulaanbaatar. Fourteen NBFIs have full or partial foreign equity participation. The majority of NBFIs traditionally provide lending (mainly to SME and households), currency exchange and money transfer services, with more recent entrants venturing into financial leasing, investment and financial advisory. According to FRC statistics, the cumulative number of clients serviced by NBFIs up to the present is close to 73,000.

119. Total NBFIs assets were 66.4 billion MNT in 2007, equal to 2 percent of banking sector assets. The increase of minimum capital requirements instituted in 2006 led to some NBFIs having their licenses revoked as some could not meet the requirements. Loan portfolio's share in total assets was 57.6 percent on average, and cash and cash equivalents took up 9.3 percent. Due to increased competition with banks, NBFIs monthly interest rates have been declining and reached 2.2 percent (per month) in 2007⁹³ from as high as 4-6 percent a few years ago.

120. The 2006 SLC crisis clearly demonstrated how deficiencies in the legal and regulatory environment may lead to systemic failures in financial markets resulting in loss of public confidence. Mongolia's first SLCs were established in late 1996 and early 1997 through a project funded by the Asian Development Bank (ADB) with input from some nongovernmental organizations. The Rural Finance Project (\$8.7 million) was launched in 2002 to support the creation of a national network of SLCs throughout the country, however in light of emerging

⁸⁹ In comparison, Indonesia's equity market capitalization in 2005 was 28.9, Malaysia's 138.0, Philippines's 40.4, Thailand's 70.1 and Hong Kong's 593.6 percent of the national GDP, respectively. East Asian Finance: The Road to Robust Markets, World Bank, 2006.

⁹⁰ Medium-term Strategic Paper for Developing Financial Sector, MoF, 2007.

⁹¹ As above.

⁹² Dealer and broker companies.

⁹³ FRC, 2007 Annual Report.

problems with SLCs the project was suspended and finally canceled in 2006. Until the creation of the FRC in early 2006, SLCs were virtually not regulated and operated under inappropriate regulations and supervision of the tax authority. To address the lack of a proper legal framework for SLCs, a law was drafted in 2005 with ADB assistance but has not yet been passed by Parliament. In 2006, a series of SLC failures were reported, and thousands of depositors lost money. The assassination of the new FRC Chairman by a manager of one of the largest SLCs experiencing liquidity problems exacerbated the situation. As of mid-2006, the FRC reported to Parliament the loss to depositors of 57 billion MNT (1.5 percent of GDP).⁹⁴ The reputation of SLCs was badly tarnished, resulting in transfers of some of SLC deposits to commercial banks and into real estate investments.

121. As of end-2007, 182 SLCs with over 20,000 members were licensed, and they are predominantly small institutions. The sector's total assets reached 36 billion MNT (0.8 percent of GDP) at the end of 2007. The loan portfolio constituted only half of total assets, way below the 70–80 percent threshold set forth by the FRC's prudential ratios.⁹⁵ According to FRC data, the NPL ratio was around 6.5 percent.

Table 4.5: Losses of 29 Failed SLCs in 2006

Number of failed SLCs	29
Number of victims (depositors)	8,903
Estimated losses MNT	67.9 billion
Loans outstanding MNT	4.0 billion
Worth of sealed assets MNT	43.0 billion

Source: IMF, 2008

122. The insurance market is at a nascent level of growth, and the industry is yet to realize its potential importance for capital market development. In 2008, 20 companies had licenses to provide a total of 220 types of insurance products. Total industry profits reached 633.5 million MNT in 2007, and 4.5 billion MNT worth re-insurance agreements were signed. The companies are actively introducing new products and public education efforts are bringing results as shown by the 40 percent growth of the industry's premium income which reached 17 billion MNT in 2007.⁹⁶

123. Total industry assets were at 28.4 billion MNT with 80 percent being cash and other current assets, and less than 10 percent constituting short-term investments. The potential for insurers to actively participate in capital markets depends on their asset growth which, depends on the further development of the industry's coverage and products. The penetration ratio⁹⁷ for the Mongolian insurance market is a mere 0.4 percent showing a substantial scope for further growth. Consolidation of the insurance industry might be an important step to its greater contribution to capital markets development. Currently, five large insurers hold over 80 percent of the market with the remaining 10 companies taking up less than 2 percent each. While the legal framework for the insurance market is considered comparatively well established, public knowledge and understanding of the benefits of insurance products is still very rudimentary.

⁹⁴ IMF, "Mongolia: Selected Issues and Statistical Appendix", Country Economic Report 08/201, July, 2008.

⁹⁵ As above. As of second quarter of 2008, 15 general Insurance companies, 1 life insurance company, and 4 insurance intermediary companies have been operating in Mongolia under relevant licenses issued by the Financial Regulatory Commission. The Insurance Market Department of the FRC is responsible for the regulatory oversight of insurance market participants. Current legislation on insurance includes the Law on Insurance and the Law on Insurance Intermediaries, both enacted in 2004.

⁹⁶ As above.

⁹⁷ Measured as the insurance premium as a percentage of GDP.

Furthermore, lack of skilled professionals (especially actuaries) is another major constraint for insurance companies.

124. As the Mongolian economy proceeds with rapid growth, there is a greater need for a diverse financial system with services and products that support private sector development. Much has been accomplished with significant external partner support in developing the financial system in Mongolia, especially in the banking sector. ADB has been providing technical assistance in the area of financial regulation and governance with a focus on capital market development as well as strengthening the capacity of the FRC. GTZ has assisted in building capacity in the banking sector and provided support for the Mongolian Mortgage Company. USAID provided assistance for the establishment of a secondary mortgage market and to strengthen the credit information bureau. The IMF has been instrumental for strengthening banking supervision, improving BOM's monetary policy framework, and enhancing the central bank's reserve management and foreign exchange market operations. Jointly with the World Bank, the IMF conducts assessment of the financial sector (FSAP) and provides advice on developing the financial sector. Training courses on bank marketing and strategic planning, external and internal auditing as well as branch management were conducted within the framework of EU-financed projects. The World Bank continues to support improvements in commercial bank risk management and payment systems and through its private sector arm, the International Finance Corporation provides investment financing to commercial banks; trade finance facilities; as well other technical assistance (in banking, leasing, housing finance, credit information bureau operations and risk management).

125. Still, a number of challenges remain in developing sustainable financial institutions, including legal, regulatory and supervisory issues:

- (i) The legal foundations of the capital market need to be build up to meet international standards, such as bankruptcy, foreclosure, securitization and collateral laws;
- (ii) Minority shareholder rights protection needs to be strengthened with tightened sanctions for non-compliance⁹⁸;
- (iii) Corporate governance and disclosure standards should be improved for both financial intermediaries and listed companies. Listing requirements should be tightened and procedures for sanctions of non-compliant companies developed (warnings, suspension, de-listing)⁹⁹;
- (iv) The securities market infrastructure needs to be strengthened considerably to support sector growth, including substantial upgrading of the Securities Clearing House and Central Depository (SCHCD) processing capacity¹⁰⁰;
- (v) The FRC needs significant improvements in knowledge and expertise, and funding to enhance its institutional capacity for supervision of non-banks and capital markets;
- (vi) Sector-wide accounting and auditing standards and systems should be upgraded¹⁰¹ for improved financial accounting and reporting; and the accuracy and timeliness of credit information services need to be improved: these actions would help develop corporate bond markets;

⁹⁸ The current legal framework does not state clearly the obligations of companies towards minority shareholders and the sanctions for non-compliance of stipulated obligations are not strict.

⁹⁹ For example, about 85 percent of listed companies fail to regularly organize shareholders meetings. "Medium Term Strategic Paper for Developing Financial Sector" draft, MoF, 2008.

¹⁰⁰ The current processing capacity of the SCHCD is 500 trades a day.

¹⁰¹ For example, adoption of IFRS and IAS standards by all market participants.

- (vii) Education and training of financial specialists should be substantially improved by aligning formal curricula with industry developments, and provision of well-designed post-graduate and on-the-job training.¹⁰²

D. Infrastructure

126. Within infrastructure, considerable progress has been made by a sector investment rate as high as 10 percent of GDP, largely supported by IFI financing.¹⁰³ However, further improvements in the planning, quality, and scope of infrastructure services are needed. Underpricing of tariffs, high cost of operations due to Mongolia's harsh climatic conditions, poor state of existing physical infrastructure, the short construction season and distance from international markets, hamper wider participation of private companies in the sector. Still, with increased government support for the private sector as demonstrated by recent changes in the regulatory environment, several sub-sectors could become more attractive from the private sector perspective.

11. Energy

127. The Mongolian energy sector is a mix of public and private operators, with the former still dominating the market. Mongolia has three main regional energy systems, the largest of which - Central Energy System (CES) – provides 96 percent of electricity needs (the other two are: the Eastern Energy System and the Western Energy System which account for 2 percent of production; the remaining 2 percent are provided by local diesel generators). Eighteen state-owned joint-stock companies generate, transmit, and distribute heat and electricity in three main networks.

128. Over 200 private companies are licensed to conduct repairs and maintenance on electricity and heating transmission and distribution infrastructure. The firms obtain work based on competitive bids organized by the Ministry of Fuel and Energy (MFE) for large scale contracts and by state-owned energy companies for their local needs. Larger, established private companies have started operating electricity distribution networks. Darkhan Selenge Electricity Network was privatized in 2003 to Khasvuu Group and was in 2007 ranked No.3 in the industry by profitability and efficiency criteria.¹⁰⁴ MCS International is the second private company which was licensed as a distributor by the ERA and since 2003 is operating some parts of Khan-Uul district distribution network in Ulaanbaatar and Zuunkharaa area in Selenge aimag.

129. In Ulaanbaatar, Central heat and power plants (CHPs) supply heat and hot water to the Ulaanbaatar District Heating Company (UBDHC) which sells directly to customers and city housing services companies. The CHPs and UBDHC are owned by the central government, and the Ulaanbaatar municipality owns services that link to city housing. Heat only boilers (HOBs) serve single buildings or small networks of several customers. Heating companies operate under management contracts with the municipality. Prior initiatives to privatize district heating distribution networks in aimags, notably Khovd and Uvs, have not been successful. The private operators were unable to invest sufficiently to upgrade the systems to the required level resulting in deterioration of services. Thus, discussion is underway in the MFE to re-nationalize the networks. The same situation prevails at the Nalaikh and Baganuur HOB operators.

¹⁰² According to MoF statistics, there are 116 professionals licensed by the FRC for securities transactions nationwide. "Medium Term Strategic Paper for Developing Financial Sector" draft, MoF 2008.

¹⁰³ Mongolia Infrastructure Report, PPIAF, World Bank, 2007.

¹⁰⁴ ERA website, <http://www.era.energy.mn/mon/modules.php?ss=4&id=16>

130. Reforms of the regulatory environment in the early 2000s provided the foundation for private participation in the sector. The Energy Law (2001) limits the central government's role to policy making, allows the operation and ownership of energy services by public and private entities and stipulates the separation of generation, transmission and distribution operations. The Law on Renewable Energy stipulates establishing an energy fund to provide incentives for the development of renewable energy sources, such as hydropower stations and wind farms.¹⁰⁵ The ERA establishes tariff systems and issues licenses for electricity generation and distribution. Special licenses for repair and maintenance operations are issued by the Energy Research and Development Center of the MFE.

131. Still, wide private sector participation in the sector is not likely in the nearest future due to a number of regulatory, financial and physical infrastructure issues. The CES has high costs due to significant technical losses, poor meter reading, partial billing, and theft. Heat supply costs are high partly because of losses in the heat transmission and distribution system. Lack of insulation and heating controls at the consumer end, lead to consumption amounts that are 5 times higher than those in northern Europe.¹⁰⁶ Current regulated utility prices are below operational (not to mention capital) costs, creating financing problems for maintenance and network expansion. According to the World Bank analysis¹⁰⁷, price increases of up to 80 percent for residential customers and 10-30 percent for industrial and commercial customers are necessary to cover the costs. Other factors enumerated in the World Bank infrastructure reports as impediments to private investment, include:

- (i) Lack of Information and unclear regulation on the rules for private sector provision and interface between public and private networks;
- (ii) Insufficient transparency of license issuance;
- (iii) Duplicated regulatory/inspection functions at the local level; and
- (iv) Uneven field for market players (an anti-competitive practice exists in the industry whereby power plants and the transmission company have permission to retain their largest customers, leaving other operators with the bulk of smaller, less profitable clients).

132. The division of the district heating market among the current 19 city housing service companies (owned by the municipal government of Ulaanbaatar) increases administrative structures and costs, and separation of transmission and distribution operations is not optimal for the market size. Distribution companies are particularly vulnerable as they take full collection risks while having very limited access to finance due to their inability to use their operational assets as collateral.

133. Government policy for the sector development aims to encourage further private investment and management of operations. The draft Concessions law¹⁰⁸ developed in 2008 includes heat and electricity generation, transmission and distribution facilities. The ERA is working to establish a wholesale electricity market based on direct bilateral contracts between generators and distributors of heat and electricity. With multiyear distribution pricing, the new structure would improve competition in the sector and create incentives to reduce distribution

¹⁰⁵ Newcom LLC, one of the largest private enterprises in Mongolia is currently implementing a project to build a large wind farm in Tuv aimag. Plans are drawn for similar wind farms in the south of the country.

¹⁰⁶ World Bank, *Mongolia Infrastructure Report, Annex One: Energy*, PPIAF, 2007.

¹⁰⁷ As above.

¹⁰⁸ The draft was developed with support by EPRC/USAID. While this is an important step for the establishment of a legal framework for facilitating greater private sector participation in sectors currently dominated by the state, a number of areas need inclusion/clarification: tax exemptions, one-stop service for obtaining licenses, identity of contracting authorities, local vs central concessions, securitization of concession value, financier of concessionaire's rights of first claim, and termination provisions.

losses and invest in new power generation. The GoM is planning (subject to approval by the Parliament) to commission the building and operation of a new 300 MW (as currently envisaged) power plant No.5 in Ulaanbaatar to a private operator. The government will allocate the land and determine coal standards for the plant operations. Whether the prices at which the GoM will buy the outputs would justify investment (estimated cost is 1 million USD per 1 MW of capacity¹⁰⁹) remains to be seen.

134. For the district heating sector, Ulaanbaatar municipality is implementing a policy to encourage HOB renovation by awarding management contracts to operators able to afford necessary investments (especially in the context of combating air pollution in urban areas).¹¹⁰ Several HOB rehabilitation projects have been successfully implemented¹¹¹, but bureaucracy and 'rent-seeking' politics continue to hamper the process.

135. Opportunities for private investment and growth are emerging in new power generation in the South Gobi region which is poised for economic growth based on the development of extensive mineral deposits. They include:

- (i) 220 kV transmission line Mandalgobi-Tavan Tolgoi-Oyu Tolgoi: The state will build the UB-Mandalgobi section at a cost of 238.4 billion MNT. The Mandalgobi-OT line is planned to be contracted to private investors on a 2-year payback basis (this is not finalized as yet);
- (ii) Tavan Tolgoi power plant: 600 MW, estimated cost \$350 million; Shivee Ovoo power plant complex: total capacity 3600 MW (first block 600 MW), 220 kV transmission line to Shandong, PRC, total cost \$3 billion. Negotiations are underway with Chinese counterparts.

136. Again, enactment of the Law on Concessions, finalization of amendments to the Law on Minerals (under extended discussions in the Parliament) and signing of investment agreement for the Oyu Tolgoi gold-copper deposit development in the South Gobi, are necessary pre-requisites for private sector investments in the above projects.

12. Water Supply

137. The sector is predominantly state-owned with few operations outsourced under management contracts, however monitoring and evaluation of service quality is weak. While there are some minor efforts at private water supply, and many on-site industrial wells, the primary assets are state-owned and operated by corporatized Water and Sewerage Companies (USAGs) and Public Urban Service Organizations (PUSOs) under management contracts. There are emerging signs that small-scale private sector competition is emerging in the sector. The process is mostly evident in ger areas with new water suppliers who deliver with their own transportation means or operate private wells and occasional private kiosks. However, they still account for less than 1 percent of the market.¹¹²

¹⁰⁹ Ministry of Fuel and Energy estimate.

¹¹⁰ Directive No.419, dated October 2003, of the Mayor of Ulaanbaatar city is one of the documents citing boiler renovation as one of the means to combat air pollution and authorizing certain personnel of the mayor's office to oversee the renovation activities.

¹¹¹ ANU SERVICE LLC, a private Mongolia company, has renovated over 10 heat-only boilers in Ulaanbaatar area on management outsourcing terms between 2003-2008.

¹¹² World Bank, Mongolia Infrastructure Report, Annex Four: Water Supply & Sanitation, PPIAF, 2007.

138. The World Bank infrastructure analysis undertaken in 2007 outlined the following sector performance indicators:

- (i) Thirty percent of households have access to adequate water sources, 17 percent to sanitation;
- (ii) Daily water consumption of ger area households is between 5-10 lpcd, much less than WHO recommended 25 lpcd;
- (iii) About 21.7 thousand meters were installed nationally, with 90 percent in Ulaanbaatar within the framework of the project financed by the ADB. A further 22 thousand meters were installed in Ulaanbaatar as part of USIP 1 and 2 projects by the World Bank;
- (iv) Twenty five percent of Ulaanbaatar households have individual meters; unmetered consumption in apartments accounts for 29 percent of USUG's supply;
- (v) Metered water tariff for organizations is 54 percent higher than that of households (the industrial-household tariff ratio is 2 in China and Vietnam, and 7 in India, Lao and Malaysia).

139. The Ministry of Construction and Urban Development (MCUD), Ministry of Health (MoH), Ministry of Industry and Trade (MIT) and Ministry of Nature and Environment's (MNE) water agency are responsible for policy making. Licenses for water supply, distribution, wastewater collection, treatment and sanitation are issued by the Construction and Public Utilities Support Center (CPUSC) of the MCUD. Tariffs are set by Governors of respective territories. Environmental standards compliance is overseen by the State Professional Inspection Agency (SPIA). However, no agency is responsible for monitoring and evaluating the performance of service providers.

140. Investment needs for upgrading the existing system and establishing new connections to ger areas both in Ulaanbaatar and the regions are immense, and financing until now has been mostly through external partners. According to USAID estimates¹¹³ almost 70 percent of water supply piping in Ulaanbaatar is in need of replacement. Based on MCUD long-term investment considerations for public utilities, over 50 billion MNT will be needed for the water supply sector upgrading over the period 2005-2015. Full achievement of MDG targets by 2015 will require \$415 million. Investments in the sector have come predominantly from foreign sources, close to \$90 million over 1996-2004, of which 43 percent was in the form of grants.¹¹⁴ Currently the main external partner commitments are the ADB's Integrated Development of Basic Urban Services in Provincial Towns Loan (\$23.9 million) and the World Bank's Ulaanbaatar Services Improvement Project 2 (\$23 million).

141. A number of issues and constraints make the water supply sector unable to attract sizeable private investment, limiting participation to management contracts. These are:

- (i) High technical standards required for Mongolia's environment and the short construction season (which make construction and maintenance of water supply systems costly);
- (ii) The pricing regime is regressive. While it is mostly the wealthy (those living in apartments) who are connected to networks, their service prices are still subsidized. On the other hand, not price, but quality and reliability of services are constraints for water use in ger areas¹¹⁵;

¹¹³ PSA consultative meeting, Ulaanbaatar, June, 2008.

¹¹⁴ World Bank, Mongolia Infrastructure Report, Annex Four: Water Supply & Sanitation, PPIAF, 2007.

¹¹⁵ As previously noted.

- (iii) There has been widespread introduction of management contracts, but they are not drafted or managed to the best effect, and governors make all significant decisions on a unilateral basis.

142. In the existing urban water supply system, the opportunities for private sector investment are almost non-existent at current tariff levels. Private sector investment in sewerage installations in both ger and private housing areas is called for in the MCUD's Sanitation program, however financing mechanisms remain unclear.

143. New mining developments in the South Gobi region may open up some opportunities for private sector involvement in the exploration, utilization and protection of water resources. Operation of mines and mineral processing industries in the South Gobi region will require significant water resources, the exploration of which seems to have been less than extensive thus far.¹¹⁶ Water exploration is one of the activities most certainly to be outsourced to private companies, and the financing and operation of water stations, pipes, pumps and other facilities can also be undertaken by private entities with appropriate supervision from local government agencies. Still, to encourage private investments, relevant legislation needs to be revised (especially, the Law on Water and Mineral Water Use Tariffs which has not undergone significant revisions since 1995) to clarify forms of state and private involvement as well revise the tariffs in line with the current market situation. Enactment of the Law on Concessions is another necessary step.

13. Road Construction and Maintenance

144. Private companies dominate the sector, but investments are mainly from the state budget and IFI financing. Only 4.6 percent of total roads (49,250 km) in Mongolia are paved, and the EBRD Transition Report's score for the sector is 1.67 (on a scale from 1 to 4+; 4+ being the highest) a ranking that is only above some of the Central Asian countries. While state budget investments in the sector have risen significantly (in 2007, 73.8 billion MNT or 1.6 percent of GDP, up from 1 percent in 2006¹¹⁷) maintenance is still not given priority (17.5 percent of total expenditures in 2006, compared to 25 percent in 2005). Since 1992, more than 20 large and small-scale road projects were implemented with over \$150 million financing by IFIs; 25 percent of financing was in the form of grants and technical assistance.¹¹⁸ The largest support is being provided by ADB through its Roads Development Project (Choir-Zamyn Uud paved road) and Regional Altai Western Corridor Project (linking the local road network to those in Russia and China). The World Bank is also financing upgrades of roads in the Western region of the Country, while Japan provides assistance for improvements of road sections in Ulaanbaatar.

145. One road construction company, "Erdene zam" (with Japanese equity participation), and 18 road maintenance companies have state equity participation. All are administered through the State Property Committee (SPC). Over 150 private companies have special licenses for road construction and maintenance, however only one fifth of them are active. Road construction is predominantly privatized with competitive bids are required for new works and maintenance. Routine maintenance is relegated to state-owned enterprises (SOEs) with direct contracts with MRTT.

¹¹⁶ Ivanhoe Mines' water exploration efforts have led to a discovery of at least two aquifers potentially suitable for the Oyu Tolgoi mine. However more exploration work is needed for the other deposits as well as for sources of drinking water to supply local population needs.

¹¹⁷ Presentation by D.Battur, State Secretary of MoF at the Round Table Meeting on the South Gobi Region Infrastructure Strategy, May 2008

¹¹⁸ MRTT, "2021 Sector Strategy Paper", 2007.

146. The existing legal framework does not provide a clear guidance for private investment in road construction and maintenance, and recent developments may not be particularly promising for the sector. There is no legal framework for regulating Private Public Partnership (PPP) arrangements, but only a Government decree allowing Build-Transfer (BT) schemes that stipulate payback from the budget of the total investment over 3 years after the road becomes operational. Payback terms are negotiated with the contractor on a project-by-project basis (usually 30-30-40). So far, one bridge and 150 km of paved roads have been contracted to private companies on BT terms with mostly satisfactory results (the exception is one contract for Ulaanbaatar-Lun soum route where the contractor has reported financial problems).

147. The current draft Concession law¹¹⁹, that covers roads and road facilities, stipulates only Build-Operate-Transfer (BOT) arrangements as a concession scheme. This may not be a particularly suitable option for investments in the sector if operational revenues would depend on direct road transport charges that are effectively non-existent in Mongolia. Low traffic density on most roads outside of Ulaanbaatar city and absence of a toll-road system make it economically unfeasible for private investment to be involved in BOT schemes, except on dedicated mine-to-border/port/railway station routes.

148. Finance, human resource and material sourcing issues continue to hamper the growth of private companies. Disbursement of funds from state and local budgets to road construction projects often fall behind schedule and most construction companies lack financial resources to make up for the temporary shortfall. In 2007, the overall execution of road construction projects was around 80 percent.¹²⁰

149. The highly seasonal nature of construction works makes it challenging for road companies to hire and retain skilled staff, and the lack of a professional training system for road engineers further exacerbates the problem. Dependence on imports for and high prices of bitumen, fuel and construction equipment and the resultant inability to invest in new technologies, impede the competitiveness of domestic companies. Lack of research and development capacities in the sector as well as absence of incentives for technology upgrading, contribute to poor quality of execution.

150. The MRTT is currently discussing the introduction of an accreditation and classification system for road construction and maintenance companies to monitor and encourage improvements in quality of contractors. Competitive bids for projects will be open to companies of only certain categories. Sector authorities envisage that the system will help avoid instances where the performance of contracts (predominantly awarded on a lowest bid basis) suffers because of inability of construction companies to meet contractual obligations.

151. The Government road sector development strategy for 2008-2015 calls for massive amounts of investment and the plans involve attracting significant private participation. The MRTT has prepared a list of roads (approximately 2000 km of state roads and 1000 km of local roads) for new construction to be built on BT terms for approval by the Parliament. Major projects include:

- (i) Ulaanbaatar-Mandalgobi-Dalanzadgad paved road 500 km (some sections);
- (ii) Tavan Tolgoi-Oyu Tolgoi 160 km;
- (iii) Undurdov-Mandalgobi 100km;

¹¹⁹ The draft was developed in March 2008 with the support by EPRC. If enacted, it will provide legal foundations for increased private investment and operations in sectors dominated by *the* state: energy, infrastructure, and transport.

¹²⁰ Interview with MRTT Road Department official, June 2008.

- (iv) Oyu Tolgoi-Gashuun Sukhait 105 km: a Memorandum of Understanding has been signed between the MRTT and Ivanhoe Mines Mongolia Inc, however implementation has been postponed due to delays with investment agreement on Oyu Tolgoi project;
- (v) Sainshand-Tsagaan Suvarga-Oyu Tolgoi 300km.

152. As the World Bank analysis¹²¹ shows, total investments proposed for 2008-2015 for the construction of new and maintenance of existing roads nation-wide would equal close to \$630 million or 2 percent of GDP (2008 to 2015). Some of the investments can be financed using concessional loans and grants from IFIs and bilateral agencies, and the private sector involvement will be largely determined by the type of payback scheme used: user fees, government revenue, or combination of both.

14. Railways

153. The railway sector of Mongolia is dominated by a monopoly operator, Ulaanbaatar Railway (UBTZ) and the sector is plagued by deteriorating infrastructure, capacity constraints and unsustainable tariff structure. The total length of rail tracks in Mongolia is 1,815 km: the main part being the north-south line which connects Sukhbaatar on the Russian border with Zamyn Uud on the PRC border. According to the World Bank infrastructure report¹²², annual rail traffic is around 5.5 millions of units per route-km, which compares favorably with other countries in the region, except China with 27.7 million units of annual traffic.

154. At present, the UBTZ, a fifty-fifty Mongolian-Russian joint venture, is the monopoly provider of rail infrastructure and services. As of September 2007, UBTZ owned 2,482 freight cars, 290 passenger cars and 123 locomotives.¹²³ According to expert estimates only one third of the locomotives are operational (this includes 23 freight locomotives). Issues faced by the sector include:

- (i) Physical infrastructure and fleet: The locomotive fleet needs urgent upgrade. Insufficient improvement and maintenance of tracks coupled with increased freight tonnages have led to decline in quality and imposition of weight and speed constraints and hence, capacity constraints. The tracks were laid largely to minimize initial costs, so the ballast, sleepers and rails are not appropriate for the high axle-loads that are used by bulk trains (this issue is gaining more importance in light of the increase in mineral production).
- (ii) Pricing: Pricing of railway passenger and domestic freight services is below the level required for financial sustainability and is cross-subsidized by transit freight revenues. Transit freight historically provided the bulk of railway revenues enabling the operator to cross-subsidize its domestic passenger and freight operations (the fares and tariffs are regulated and are set by the UBTZ in consultation with the government). The World Bank report¹²⁴ also notes that domestic passenger fares in 2005 were only 60 percent of what would be commercially viable fares, while domestic freight tariff was even less (50 percent). Between 2001-2007, the UBTZ had operational losses of 22.9 billion MNT. While the cost of diesel rose almost seven-fold compared to 2001, total tariff increase during the same period was less than 82 percent. The UBTZ

¹²¹ World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

¹²² World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

¹²³ Mongolian Railway Facilities, UBTZ Deputy Director presentation at the "National Workshop on Regional Intermodal Transport Planning", Ulaanbaatar, September 2007.

¹²⁴ World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

implemented a 10-80 percent hike for its freight and international passenger tariffs in July 2008, leaving unchanged domestic passenger tariffs as well as freight charges for petroleum products.¹²⁵

- (iii) Tariff structure: The current tariff structure is unsustainable as high transit tariffs discourage transit traffic. Already, due to transit tariff hikes in 2006 and the consequent discontinuation of transit crude oil shipments from Russia, the total transit freight in 2007 decreased by 35 percent from that of 2005.¹²⁶
- (iv) Decision-making structure in UBTZ is cumbersome, requiring consultation and agreement by the Russian side, and political issues tend to take precedence over economic concerns.

155. Growing demand for both transit and export-import traffic requires substantial investments in the infrastructure and service capacity. Mongolia provides the shortest overland link between Europe and China, and potential demand for railway services (in the absence of continuous paved highways) is critical. In the first 7 months of 2007, container traffic increased by over 30 percent compared to 2006.¹²⁷ In January, 2008, Germany, Poland, Belarus, Russia, Mongolia and China signed a treaty to simplify customs and border checks to allow container trains to travel from Europe to China through Mongolia. A trial run was undertaken in March, and the train took 15 days from Beijing to Hamburg --reducing by half the time required by ocean shipping. Regular services are expected to be launched in 2009.

156. To accommodate growing demand, significant investments are needed to upgrade the existing infrastructure and railway fleet; some estimates run as high as \$1.3 billion for the coming decade.¹²⁸ As the World Bank report¹²⁹ notes, between 2000 and 2005 the network has been able to accommodate annual traffic increases of 20 percent. Bottlenecks at the Zamyn-Uud border town are being addressed through the opening of a new crossing point, which doubled the freight carrying capacity.¹³⁰

157. The MCC rail project is committing \$188.38 million for improvements in the efficiency and capacity of the railway system. The project aims to promote reformed rail operations and management practices, transparency of rail finances and commercialization of the rail system. Project implementation mechanisms have not yet been clearly defined (in particular, whether the newly established state railway company will be in charge of the finances).¹³¹

158. With the expected boost from the mining sector of Mongolia, especially in the South Gobi region, the railway sector is becoming a focus of attention for many large foreign investors. Preliminary expressions of interest were put forth by companies from PRC, Japan, and South Korea. The South Gobi railway network (connecting several mineral deposits of importance¹³²) and the second north-south railway line are of most interest to private investors.

¹²⁵ Online reports, <http://www.sonin.mn/2008/07/10/4513/>.

¹²⁶ NSO, 2007 Statistical Yearbook.

¹²⁷ "Container Transport in Mongolia," MRTT presentation for the National Workshop on *Regional Intermodal Transport Planning*, Ulaanbaatar, September 2007.

¹²⁸ Interview with private industry analysts. May 2008.

¹²⁹ World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

¹³⁰ Five additional railway tracks have been installed, increasing the number of trailers handled in one day from 285 to 300 (MRTT presentation at the Round table meeting on South Gobi infrastructure strategy, May 2008.)

¹³¹ The MCC has organized a tender for a foreign consulting firm to supervise the implementation of the Railway project. Upon signing of the contract, the consulting firm will also select the Mongolian counterpart (MTZ, as the wholly Mongolian-owned entity is the likely candidate, and it is in the process of building up its capacity to meet the requirements) to implement components of the envisaged project.

¹³² Namely, Tavan Tolgoi coking coal deposit; Oyu Tolgoi gold-copper deposit; and Tsagaan Suvarga copper deposit

159. Experts estimate that construction costs will be \$1-1.2 million per km, and up to \$2 million depending on the specifics of the terrain. In 2008, the GoM made a decision to grant the right to construct and operate the Tavan Tolgoi – Chinese border railway line to Energy Resources, a Mongolian private consortium developing a section of Tavan Tolgoi coking coal deposit. Mongolyn Alt Corporation (MAK), owner of the Nariin Sukhait coal mine was also granted a permit in August 2007 to construct railway infrastructure from its mine to the Chinese border.

160. The government's policy is to inject competition into the sector and recent changes in the regulatory environment are important first steps. The new Law on Railway transport was adopted in 2007. It allows private investment, facility ownership and operations-- while maintaining state ownership of main tracks, infrastructure and right of way. The Railway Directorate under the MRTT is responsible for implementing sector policies and is currently working to formulate policies and procedures for licensing of railway operators (currently, UBTZ is the only one).

161. In March 2008, a 100 percent state-owned Joint Stock Venture "Mongolian railway" (MTZ) was established to increase competition and improve efficiency of the sector. At the initial stage, the MTZ plans to purchase 3 locomotives and 150 railway wagons (15 billion MNT have been allocated from the state budget in 2008) to be operated by UBTZ on commercial lease terms and/or other arrangements.¹³³ At a later stage, the MTZ plans to become a railway operator.

162. So far, first attempts by private entities to enter the railway sector have met with reluctance from UBTZ to allow competition (see TransCon case). Private sector involvement in the railway transport sector has so far been limited to only domestic and international freight forwarding operations. With the new Law on Railway Transport, opportunities for investing in and operating of railway infrastructure and facilities are emerging, however implementation mechanisms (e.g. procedures for railway operator licensing) are yet to be fully developed. Strong political will and serious initiatives are required to disband the natural monopoly of the UBTZ, which to a great extent will involve effective negotiations with the Russian side. For the new railway lines (north to south, mine to border) private sector participation prospects are much greater once the legal framework is established (in particular, the Law on Concessions) and required investments sourced.

Box 4.3: A Private Sector Pioneer Bears the Brunt of Sector Inertia: Transcon Case

TransCon is a private company that is attempting to implement a business model to purchase locomotives and rolling stock for commercial lease and/or sale to UBTZ. In February 2008, the company purchased 2 locomotives from PRC for approximately \$5 million. As of June 2008 the locomotives were still stationed at the Chinese border because the UBTZ, citing various reasons, has refused to allow entry. Both the MRTT and Railway Directorate tried to facilitate resolution of the issue-- but with no success. TransCon has paid over \$100,000 in demurrage charges, and its future remains uncertain. According to some industry insiders, the biggest mistake of TransCon was a failure to secure official UBTZ cooperation at the highest levels through the early involvement of government authorities. UBTZ's actions stem from the Russian side's reluctance to allow diversification of its fleet with non-Russian machinery.

¹³³ For example, joint operations.

15. Civil Aviation

163. The Mongolian civil aviation sector is dominated by a state-owned operator, and private participation which started in 2003 is gaining ground despite a number of hurdles. State-owned MIAT is the only Mongolian operator of international flights. In 2005, MIAT dramatically reduced its domestic scheduled flights and currently has only one aircraft flying to 5 aimags. Two private operators, Eznis (estb. 2006) and Aero Mongolia (estb. 2003) provide scheduled domestic flights (10-12 routes each), and a few other companies offer charter services (Central Mongolian Airways, Tengeriin Ulaachin, Blue Sky Aviation, Geosan, and Air Future Mongolia). Provision of jet fuel is contracted to a private supplier (A-Jet Co., Ltd) on a monopoly concession basis.

164. The Mongolian Civil Aviation Authority (MCAA), under the MRTT, is responsible for provision of all airport services in 17 airports nation-wide: air navigation and traffic services, economic regulation, safety oversight and accident investigation (only few services in the international passenger terminal are outsourced to private companies).

165. External partners have provided active support to the civil aviation sector reform. ADB, EBRD, USAID, GTZ and UNDP worked closely with the authorities to liberalize and re-structure the industry, improve flight safety and strengthen institutional capacity at MCAA.

166. Since 2001, private operators are allowed to provide domestic aviation services with very few minor international routes. MIAT fares are set by the government, and in the past the “monitoring process” was used to regulate domestic fares by discouraging operators from setting fares significantly higher than those of MIAT. The practice has been discontinued recently, and with cost rising cost pressures, private operators charge almost double MIAT fares (e.g. on the Ulaanbaatar-Khovd route, MIAT charges \$95, Eznis – \$167-270, and Aero Mongolia – \$140 for a one-way ticket). Cargo operations have been fully liberalized to encourage expansion of services which are currently at a nascent level of development.

167. With rapid growth in the economy, the international air traffic in recent years has seen remarkable growth, and the need for infrastructure upgrading is intensifying. Currently, only 6 airports nation-wide have paved runways. While air freight in 2007 decreased by 8 percent to 1.14 thousand MT compared to 2005, the number of international passengers increased by 55 percent to 266 thousand persons. Rising air fares and increased availability of land transport cut domestic passenger air traffic by almost 30 percent in 2007 compared to 2005. Between 2005 and 2007, the number of “over-flights” above Mongolia, a major revenue item for the sector, increased by 48 percent to over 61 thousand; and international landing and take off statistics increased by 29 percent to 4084.¹³⁴

168. Constraints to private sector growth in civil aviation are numerous. The highly seasonal nature of demand for air travel in Mongolia requires additional planning by airlines to offer sufficient capacity during the summer, while maintaining minimum winter schedules and maintaining a reasonable utilization of assets.¹³⁵ MIAT domestic aviation fares are regulated and set at levels to ensure affordability but not operational efficiency and sustainability. Thus the company cross-subsidizes its current few domestic flights with revenues from international routes. Authorities acknowledge that this practice is not conducive for private operators’ financial sustainability.

¹³⁴ NSO, 2007 Statistical Yearbook.

¹³⁵ World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

169. Aircraft currently flown by Eznis is small (SAAB-340 with 36 seats) and although the size is suited to the present market demand for domestic flights, it does not provide for economies of scale. Aero Mongolia has been experiencing problems with management and ownership structure, which negatively impacted its quality and safety of operations. In November 2007, the MCAA had to temporarily suspend its license to fly.

170. Major international routes (the highest revenue earners) remain closed to private operators. The GoM is reluctant to initiate amendments to the current inter-governmental agreements that allow only a single designated air carrier from each country. Although Korean and Chinese governments are both open to increasing the number of designated airlines, GoM is unwilling to lose MIAT's monopoly on these routes, as the authorities do not feel confident that the current capabilities of private operators are sufficient, to compete with international carriers.¹³⁶

171. Adding to the high costs of transportation and handling costs are high jet fuel prices. Jet fuel prices in Mongolia are said to be excessive. Issues of monopoly and possible collusion between the distributor and supplier are at the root of this situation (see box below).

172. Chinggis Khaan international airport experiences frequent closures (estimates run as high as 20 days out of 365) due to weather, poor visibility and unfavorable geographical conditions for plane landing and take-off. While Chinggis Khaan airport has operational profits only because the debt service is being shouldered by the MCAA, other airports continue to be loss centers for the MCAA. According to an MCAA official, at regional airports for every 7 tugrug earned in 2006, 100 tugrug was spent.

173. Several recent developments conducive to private sector growth are underway and the authorities are looking for ways to provide better incentives to operators. Current MRTT policy is to discontinue MIAT's domestic scheduled flights in order to stop unfair competition with private operators as well as to raise MIAT's value for the upcoming privatization. Two options are being discussed: 1) to spin-off domestic scheduled flights to a separate entity (possibly establish MIAT Domestic) which will compete with private operators on pure market principles (without cross-subsidy from MIAT's international flights) with the initial investment made by MIAT; and 2) to limit MIAT's subsidized domestic flights only to economically non-viable routes leaving profitable destinations to private operators.

174. The government is working with Russia and China to open up additional regional routes, e.g. Ulaan-Ud in Russia and Urumchi in China, where market demand is sufficient for current private operator capacities. Three new routes (Ulaanbaatar-Ulaan-Ud, Murun-Irkutsk, and Ulgii-Ust-Kamenogorsk) were planned for opening in the summer of 2008. Some issues concerning customs and immigration control services need to be resolved at the government level (as Ulaan-Ud and Urumchi do not have such facilities).

175. In order to provide more targeted support to private operators, the MCAA has developed a proposal to exempt spare parts for aircraft operating on scheduled flights from VAT and import tariffs and exempt operators from navigation fees on domestic routes. It is expected that the proposal will be approved in 2008.

176. A project to build a new international airport, 40 km south of Ulaanbaatar, financed by a \$270 million concessional loan from the government of Japan, has started. The construction is scheduled to finish in 2015. The airport will be able to handle 1.7 million passengers annually.

¹³⁶ Interview with MCAA official, June, 2008.

177. In order to bring jet fuel prices to an affordable level, the MCAA has made a decision to re-start the provision of jet fuel storage and re-fuelling services, where air carriers can sign supply contracts directly with the importer, and the MCAA will in turn charge reasonable storage and handling fees (sufficient to cover costs). The MRTT has allocated 1.5 billion tugrug in 2008 to build the tanks and other necessary infrastructure. The services are expected to commence in 2009.

178. The civil aviation sector is certainly poised for wider private participation, and the main areas where such involvement will take place are:

- (i) New (minor) international routes (Ulaanbaatar-Ulaan-Ud, Murun-Irkutsk, and Ulgii-Ust-Kameonogorsk)
- (ii) Airport services (catering; security, with the exception of passenger screening; luggage handling, and facility maintenance)
- (iii) Air cargo operations and
- (iv) Cargo terminal operations at the new international airport in Tuv aimag

Box 4.4: Private Monopoly - A Serious Constraint To Sector Development: A-Jet Case

A-Jet is the only supplier of jet fuel to air carriers in Ulaanbaatar. The monopoly is based on the fact that it is the only company which has fuel tanks that meet quality and safety standards. Fuel tanks previously operated by the MCAA (which used to be responsible for supplying jet fuel to air carriers) were closed by the State Professional Inspection Agency on non-compliance grounds. Moreover, problems with delayed payments by MIAT for purchased fuel, hastened the decision to outsource the service to a private entity. Currently, air carriers have to pay exorbitant prices for fuel. In March 2008, A-Jet charged \$1355 US/MT whereas in Moscow, Beijing, Berlin and Seoul prices were \$1110, \$1113, \$989, and \$1046 US per MT respectively. As of May 12, 2008, the company raised the price to \$1455 US/MT. The MCAA has submitted a complaint to the Anti-Trust Authority, which has concluded upon investigation that certain price manipulation is taking place, possibly in collusion with Sod Mongol, the importer. Sod Mongol has repeatedly refused to provide price information to MCAA citing business confidentiality reasons. However, the agency lacks any real enforcement power, and the situation remains unchanged.

16. Inter-urban Transport and Logistics

179. Deregulation of fares in inter-urban transport (and increased transport demand) has resulted in the proliferation of private operators. Urban public transport in Ulaanbaatar is a mixture of private (15) and public (4) providers, whereas inter-urban services are fully privatized. Ninety percent of Ulaanbaatar city residents use public transportation, and 30 percent of the market is served by buses and trolleybuses, 10 percent by taxis and 60 percent by minibuses. Close to 80 percent of the bigger routes are provided by private operators. Road freight services are provided by over 6,000 operators, many of them owners of single trucks.¹³⁷ Inter-urban passenger routes are allocated on a tender basis by the Road Transport Authority and with growing demand for transport, the competition is fierce. There are 7 entities licensed for international road freight services. Road freight turnover in 2007 reached 662 million ton-km, a 134 percent increase over 2004, and passenger turnover has grown by 35 percent to 870 million person-km over the same period.¹³⁸

¹³⁷ World Bank, Mongolia Infrastructure Report, Annex Three: Transport, PPIAF, 2007.

¹³⁸ NSO, 2007 Statistical Yearbook.

180. Currently, there are approximately 60 freight forwarders, with only about one-third providing integrated logistics services. The larger players are the International Freight Forwarding Center (IFFC) of MTZ, Tuushin, Erin International, MTT Co.Ltd, Mongol Express, Progress Trans, Material Impex, Mongoltrans, and Nomin Logistics. These companies offer a wider range of services, including multi-modal transport, import and export documentation, customs brokerage and other value-added services. Only one company, MTT Co. Ltd, operates refrigerated containers. For rail transit, 60 percent of the traffic is handled by about 10 Mongolian companies which obtain rail space from the UBTZ and use the International Freight Forwarding Center (IFFC) as the exclusive (appointed) customs broker.

181. Mongolia's ranking by the World Bank Logistics Performance Index (LPI) indicates a number of issues in sector development; a situation that hurts the country's competitiveness and impedes its economic performance. The World Bank Logistics Performance assessment covers 150 countries world-wide and assigns LPI rankings, 1 being the best and 150 being the worst. Mongolia's performance is at the bottom end; the only other countries in the region below Mongolia are Tajikistan and Afghanistan.

Index name	Overall LPI	Customs	Infrastructure	International shipments	Logistics competence	Tracking and tracing	Domestic logistics costs	Timeliness
Rank	136	131	129	91	144	136	70	142

182. Costs, technology, infrastructure and regulatory issues continue to hamper private sector growth. In urban transport, large bus operators cannot become financially viable due to low fares, high proportion of passengers who do not pay (through evasion or entitlement to free or discounted travel), insufficient operator compensation for free travel by low income groups, and small scale of operations. The state budget subsidy is based on 92 thousand passenger headcount, whereas the real number of the non-paying group is over 175 thousand.¹³⁹ Traffic congestion and increasing route lengths, further reduce operational efficiency.

183. Goh and Ee¹⁴⁰ (2008) note in the ADB Technical Assistance undertaken during 2005-2008 for Xinjiang (China), Mongolia, Tajikistan, Uzbekistan, Kazakhstan and Kyrgyzstan that physical infrastructure issues (poor quality, incompatibility of railway gauges), institutional and policy problems (burdensome border regulations, lack or non-implementation of agreements, rent-seeking behavior¹⁴¹) and capacity constraints (low productivity, fragmentation and poor organization, financial constraints, shortage of skills, lack of ICT applications) are the key common issues impeding the development of a functional logistic and transport network.

¹³⁹ Private industry analysts.

¹⁴⁰ Goh and Ee, Development of Trade Logistics in CAREC: *Issues and Opportunities*, ADB, pril 2008.

¹⁴¹ Mongolia currently operates a total of 38 regular or temporary road border crossings, 12 with China and 26 with Russia. However, only three crossings with Russia (Altanbulag, Tsagaannuur, and Ereentsav) and four with China (Zamyn Uud, Bichigt, Bulgan and Sumber) are open for international communications. The others are open for national traffic only and then only for part of the year. The international border crossing points with Russia are all open for customs clearance under TIR procedures. Inland customs clearance under TIR procedures takes place at the inland customs offices in Ulaanbaatar, Darkhan, Erdenet, Selenge, Bayan-Ulgii, Khovd, Uvs and Dornod province centers. All these border crossing points except Ereentsav are provided with necessary terms and conditions to undertake customs clearance continuously for 24 hours. Existing border crossings are not compliant with international requirements, in that they do not provide comfort, adequate facilities and services, and they only have low handling capacities. Highly bureaucratic border crossing procedures on the Mongolian side are compounded by equally if not more bureaucratic procedures on the Russian and Chinese sides of the borders.(World Bank, Mongolia Trade and Transport Facilitation Action Plan, Draft, November 2008.)

184. Over 90 percent of current operating warehouse terminals in Mongolia (of about 300 thousand square meters) have manual loading facilities. Most of the equipment has been in operation for over 20 years.¹⁴² The dispersion of terminals impedes the provision of single point services in terms of customs clearance, insurance, warehousing and sorting. The Zamyn-Uud border station does not have a container terminal, a situation which most certainly will hamper its development as a free trade zone.

185. The logistics sector macro-level constraints include lack of centrally managed transportation and warehousing terminal facilities capable of serving local and transit flows of goods; and absence of coordinated customs policies with neighboring countries. Intermodal transportation system is yet to be established in the country. Most of the policies approved by the government and parliament lack coordination and input from industry stakeholders.

186. Although the establishment of free trade zones, industrial parks and road networks has been under discussion for the past 10 years, significant progress has been evident only in the road construction area. Still, the construction of the Choir-Zamyn Uud paved road, a vital part of the transit auto network, is not complete.

187. Lack of progress on tripartite transit agreement between Russia, Mongolia and China is a significant constraint to the development of international freight services. While Mongolian trucks are allowed to travel within Russia, security concerns are immense and even federal authorities acknowledge their inability to improve the situation. The case with China is reverse, with the authorities there reluctant to grant access to Mongolian companies. A new round of negotiations in Moscow was scheduled for the second half of 2008.

188. Transportation costs are high and transit time is lengthy. As the World Bank analysis¹⁴³ notes, 'tariffs and service quality provided for Mongolian goods in Russian and China are high and low, respectively'. It has been estimated that transit tariffs and related fees in China are between 1.4-2 times higher for Mongolian goods. Russian customs, for instance, demand a deposit of 20 percent of the value of Mongolian transit goods going to Kazakhstan to be repaid when the goods exit the country.¹⁴⁴

189. With increasing freight traffic between Europe and China, there is the potential for the logistics sector to grow, and the new "Transit Mongolia" national program just approved in 2008 is an important milestone. Transit freight traffic between China and EU accounts for 115 million tonnes per annum, and annual merchandise trade between China and Russia is about \$18 billion, which can be translated into 40 million MT of freight volume. According to MRTT estimates, the total size of the transit market accessible by Mongolia is 6 million containers per year for China-EU traffic and 2 million containers carrying China-Russia trade items.¹⁴⁵

190. The national "Transit Mongolia" program was approved by the Government in May 2008. Within the framework of the program two centrally-managed warehousing and logistics terminals are planned for establishment in Ulaanbaatar (western and eastern ends of the city territory) as well as a number of similar facilities in other major urban areas. The government envisages wide private sector participation in the project (especially in Ulaanbaatar) based on

¹⁴²Survey of Terminals in Mongolia, National Road Transport Association presentation for the National Workshop on Regional Intermodal Transport Planning, Ulaanbaatar, September 2007

¹⁴³World Bank, Mongolia Infrastructure Report, Annex Three: Transport, 2007, p.37.

¹⁴⁴'Transit Mongolia National Program', Final version, 2008.

¹⁴⁵"Container Transport in Mongolia," MRTT presentation at the National Workshop on Regional Intermodal Transport Planning, Ulaanbaatar, September 2007.

preliminary expressions of interest. The PPP involves provision of land by the state, infrastructure connections and some regulatory measures to ensure operational sustainability (e.g. restrictions on warehousing operations in inner city to improve traffic conditions, etc) and investment and running of the facilities by private operators. Detailed arrangements as to the form of the PPP, implementation mechanisms, and timing are yet to be determined. Currently, the government has allocated some budget funds for conducting feasibility studies, but financing of infrastructure connections remains to be identified.

191. On a wider scale, the program has detailed strategies:
- (i) To improve the legal framework and physical infrastructure to support the growth of the logistics sector;
 - (ii) To establish a national transport system linked to international networks,
 - (iii) To link the development of free trade zones, industrial parks and mines to transit and logistics networks,
 - (iv) To establish new transit corridors and foster the growth of multi-modal transport and
 - (v) To intensify foreign diplomatic efforts (supported by international organizations) to obtain favorable tariff and service conditions for Mongolian goods abroad.

192. External partners have always recognized the importance of the logistics sector for the development of the Mongolian economy, and a number of initiatives have been and are being implemented. These initiatives include investments in physical infrastructure (ADB projects in road construction in the Western Mongolia and Dornogovi, USAID's support for construction of a modern customs clearance terminal in Zamyn-Uud, Japan's financial assistance for road improvements, construction of new airport), as well technical assistance for policy development and institutional capacity building. ADB, WB, EBRD and JICA provided support to develop sector strategies, policies and master plans, facilitate trade and modernize customs.

193. The development of the logistics sector of Mongolia will require effective public-private partnerships aided by external partner technical expertise and financial capabilities. For the vital logistics sector, with significant potential for growth, it is necessary that internal and external policy coordination is improved and linkages between private operators and state agencies are strengthened. From the government's part, effectively planned and executed investment in hard infrastructure (roads, rails, free trade zones) and well thought-out policies and initiatives (enactment of relevant legislation, provision of "single electronic window for customs clearance", resolution of land use issues, greater industry incentives and stronger external coordination with neighboring countries) will be instrumental for encouraging private investment. Investments are needed in multi-modal transport centers, cargo and container terminals, training and technology, and in new logistical services. External partner support is needed especially in facilitating dialogue with neighboring countries for the harmonization of customs and border regulations, as well as strengthening of institutional capacity and cooperation for policy formulation.

17. Information and Communication Technology

194. The telecommunications industry has been a success case within the infrastructure sector; deregulation has led to vibrant private sector participation. Since 2005, Mongolia's information and communication technology (ICT) sector has developed rapidly, aided by a complementary policy and regulatory framework, institutional set-up and investment from private software, hardware and infrastructure development companies. In 2007, total ICT sector revenues were over 230 billion MNT, 69 percent of which were from mobile phone services,

13.6 percent from fixed line telephone subscriptions, and the remainder from cable TV, internet, mail and other services.¹⁴⁶

195. In 2001 the Act on Communications was approved by the Parliament, setting the stage for the liberalization of the market by separating the sector's commercial and regulatory functions, limiting state involvement in the latter. The Communications Regulatory Commission (CRC) was established in 2004 as the independent regulatory agency with the aim of establishing fair and effective competitive conditions in the IT market and to facilitate the provision of high quality services. Moreover, under the direct supervision of the Prime Minister of Mongolia, the Information and Communication Technology Authority (ICTA) was created in October 2004 to stimulate ICT development, starting with the development and implementation of the 'e-Mongolia' national program, and followed by further changes to the legal and regulatory framework for ICT sector. The authority also spearheads cooperation and coordination with telecommunications companies, local and international organizations, and external partners.

196. The government's policy for the ICT sector sets its aims as digitalization, expansion of optical fiber transmission systems, connecting all aimag centers to the national broadband network, as well as introduction of wireless and satellite communications into rural areas. Within the framework of its sector privatization policy that stipulates a structural separation between service provision and ownership of network assets, the GoM is in the process of unbundling the state-owned assets. The backbone infrastructure owned by the government, which is currently leased to Mongolia Telecom¹⁴⁷ (MT) has been placed under the control of the newly founded Information and Communication Networking Company (ICNC). Once MT is fully privatized, it will become a service-only company. The ICNC is responsible for managing and developing the state-owned backbone network. However, the agreement with Korea Telecom stipulates MT's exclusive rights over leasing of the network to third parties. The full privatization of MT and final unbundling of the sector's state-owned assets is subject to successful negotiations with Korea Telecom on the termination of exclusive rights.¹⁴⁸

197. The e-Mongolia national program was developed by the ICTA and approved by the Government of Mongolia in 2004. The program has 16 objectives indicated in a plan of action and the objectives are being pursued through a variety of projects. One of the first activities carried under the e-Mongolia initiative was to develop proposals for a favorable legal and regulatory framework for ICT development in Mongolia.¹⁴⁹ Extensive work has been undertaken in drafting general laws on ICT; however, they lack detailed provisions for regulating the sector. The legislation (covering interconnection, dispute resolution, radio spectrum monitoring, e-signatures and e-government) needs improvement.¹⁵⁰ The 'Computers for All' program has partnered with Intel to provide quality computers at affordable prices to citizens of Mongolia. In 2007-2008, 100,000 computers were imported specifically for this project.¹⁵¹

¹⁴⁶ "ICT sector revenue report", CRC website,

http://crc.gov.mn/index.php?option=com_content&task=view&id=351&Itemid=48

¹⁴⁷ Partially privatized in 1995; 54.33 percent owned by the GoM, 40 percent by Korea Telecom, and 5.66 per cent by individual shareholders. MT website, <http://www.telecommongolia.mn/index.php?pid=9>

¹⁴⁸ World Bank, Mongolia Infrastructure Report, Annex Two: Telecommunications, PPIAF, 2007.

¹⁴⁹ Digital Review 2008.

¹⁵⁰ World Bank, Mongolia Infrastructure Report, Annex Two: Telecommunications, 2007.

¹⁵¹ ICTA, 2008.

198. Through structural reforms¹⁵² in the telecommunications sector, several private foreign telecommunications operators entered the market. Currently there are three fixed-line operators, Mongol Telecom (MT), RailCom and a new entrant, Skynetcom.

199. From 1995, several joint ventures with private foreign mobile phone operators entered the telecommunications sector. MobiCom, the pioneer, still retains that largest market share, followed by Skytel, UNITEL and G-Mobile (whose primary focus is the rural areas). At the end of 2007, there were 1,185,279 cellular phone users nationwide, i.e. 1 in 2.2 citizens had a mobile phone, compared to 48,200 in 1999.¹⁵³ The entry of private telecom operators has resulted in the substantial decline in international tariffs, facilitated by technological changes in the sector globally.¹⁵⁴ In 1996, international tariffs were between \$2.20-\$6.00/min compared to \$0.05-\$0.65/min in 2007.

Table 4.6: Growth of Mobile Subscribers 2000-2007

Year	Number of Subscribers						
	Fixed		Mobile				Total
	MTC	RailCom	MobiCom	Skytel	Unitel	GMobile	
2000	113,000	4,000	80,000	23,000			220,000
2001	120,000	12,000	190,000	38,000			360,000
2002	129,390	8,826	193,182	41,624			373,022
2003	140,789	9,035	258,911	61,386			470,121
2004	150,951	9,391	395,107	81,806			637,255
2005	147,631	14,328	478,987	101,663			742,609
2006	149,900	11,000	614,000	123,000	37,000		774,000
2007	144,100	10,700	739,247	245,080	192,952	17,664	1,194,943

Source: CRC online statistics

200. Mongolia has 34 Internet service providers (ISPs), offering a variety of services ranging from dial-up to broadband and wireless. There has been a 30 percent increase in the number of ISPs in the last year alone, showing the increasing demand for Internet services. For the period 2005 to 2006, the number of wireless local loop users increased by 38 percent from 32,000 to 44,200. The formation of the Mongolian Association of Internet Service Providers (MISPA) was primarily to protect the rights of ISPs and to collaborate on addressing issues common to service providers. Another priority was to improve the quality of services at reduced costs; initial targets were largely achieved by the end of 2006. In 2004 using VSAT, ISPs were paying \$3500 for 1Mps, which was reduced by the end of 2006 to \$1250 for 1Mps.¹⁵⁵ Due to the decrease in satellite costs coupled with other technological advances, subscription charges also decreased from \$59 in 2004 to \$20 in 2006, allowing for a sharp increase in the number of internet subscribers. Private internet cafes and commercial internet centers have sprung up all over Ulaanbaatar city offering inexpensive access to the general public. Access outside the city however remains limited.

¹⁵² These included partial privatization of Mongolia Telecom, establishment of an independent regulatory authority and liberalization of the market allowing multiple operators. World Bank, Mongolia Infrastructure Report, Annex Two: Telecommunications, PPIAF, 2007.

¹⁵³ CRC statistics, 2008.

¹⁵⁴ In the early 1990s, Mongolia had an analogue network that allowed only basic telephony services. By 2005, 99.5 percent of the national network was digitalized through installation of modern switching and transmission systems.

¹⁵⁵ ICT White Paper, 2007.

201. Currently, there are no manufacturing companies in the Mongolian ICT sector. There are 35 companies with licenses issued by the CRC to install, configure and maintain telecommunications cables. Licenses have been issued to 141 companies to provide call center services, 3 to provide leased line services and 19 to provide Internet Protocol (IP) based telephony services. MCS, MagicNet and Micom are the largest players taking up close to 70 percent of the market.¹⁵⁶

202. Government and external partner initiatives are to further develop the sector's potential. The Information and Communication Infrastructure Development Project was approved by the GoM in May 2006 and offers \$10 million in technical assistance from the World Bank. The three major components of the project are universal access, improving the regulatory environment for ICT, and e-government. The feasibility study carried out at the start of the project showed that herders across different *soums* were willing to pay at least MNT 5000 (USD 4.29) per month for telephone services as long as the services are provided in locations closer to them.¹⁵⁷

203. The Last Mile Initiative (LMI) is a global program to extend telecommunications services to the rural poor in Mongolia, and was launched by USAID in April 2004. The goal of LMI is to stimulate productivity and transform the development prospects of farmers and small businesses in rural areas. The Mongolian LMI aims to install low-cost community-centric telecommunications services in four *soum* centers to provide those living in rural areas a telecommunication link with Ulaanbaatar and the rest of the world.

204. The Japan-Mongolian Information Technology Association (JMITA) was established in 2002, primarily to introduce Japanese software engineering to Mongolian trainees. The aim is to assist Mongolian software developers in obtaining the necessary qualifications to compete in the Japanese software development industry by outsourcing.

205. The Ministry of Health, through the Luxemburg and UNFPA supported project, is executing a small-scale initiative in telemedicine and tele-diagnosis. The main emphasis is on cardiovascular medicine and maternal and child health. The project focuses on providing diagnostic support and in-service training and continuing medical education. Phase 2 has recently been launched to extend the project to 8 aimags and there will be a 3rd phase to cover the whole country. The 2nd Health Sector Development Project of the ADB is providing support to the Bagh Feldshers via PDAs while infrastructure and hardware in UB hospitals is supported by the Indian Embassy.¹⁵⁸

206. Another on-going initiative is the 'ICTs for Health Services in Rural Mongolia' spearheaded by the Health Sciences University of Mongolia. The project has been adapted so that it can be effective even in areas with poor IT infrastructure. The 'Doctor system' for distance diagnosis is planned to be operational even on low bandwidth.¹⁵⁹ The project is currently limited to the Health Sciences University and its regional medical and health science colleges.

207. To facilitate the rapidly growing ICT industry, the Mongolian government in partnership with the Government of Korea established the National Information Technology Park in Ulaanbaatar to provide incubator services for newly established software companies (Box 4.6). The primary goal of the Information Technology Incubator is to create an environment that is conducive for companies willing to focus on information technology offshore outsourcing. It also

¹⁵⁶ World Bank, Mongolia Infrastructure Report, Annex Two: Telecommunications, 2007.

¹⁵⁷ World Bank, 2008.

¹⁵⁸ Information provided by Dr. Indermohan Narula, JICWELS representative.

¹⁵⁹ Digital Review, 2008.

serves as a bridging company between the emerging software companies and their offshore counterparts to ensure complete management support. The IT Incubator offers support to enterprises for establishing contacts with foreign customers, and appoints qualified individuals to oversee tenant companies' operations-- ensuring quality and services standards. In addition, it also offers workshops and seminars to train professionals on the necessary skills for offshore outsourcing.

208. Despite rapid changes that have occurred within the ICT sector, challenges remain. Firstly, the draft laws on ICT and the law on e-commerce, digital signatures and e-government need to be re-evaluated and adapted to incorporate new emerging concerns such as those related to e-security.

209. The framework for e-government has been established but additional work is required to integrate ICT into the lives of public administration officials and public servants. There exists a significant digital divide between high tech users, everyday users and the policy makers who have to implement IT services.

210. MT's monopoly lease over state-owned transmission assets continues to be a bottleneck to sector development. As MT's tariffs for local and domestic long distance calls are regulated to levels below cost and international call rates have dropped under competitive pressures, the company lack funds to finance new investments and service its debt. The terms and cost of leasing network backbone capacity are often unfavorable for private operators.

211. Another challenge lies in the area of human resource development. Currently, there is a shortage of skilled workers and a need to alter the curriculum of tertiary institutions to ensure that students graduate with the necessary industry skills. Three private and 6 state tertiary education institutions offer bachelor degrees in IT technology, including software engineering. Information Technology training centers are few and there's a gap in the facilities that offer marketable skills. Only the major state owned institutions offer ICT-related courses and private establishments teach a restricted range of subjects. With the widening of the market, there is a growing need for institutions that produce students with the skills that ICT firms require. Most ICT firms seek employees who possess three key credentials: programming skills, network design and administration, and technical support & database development.

212. Perhaps the biggest challenge involves providing the general public training and education in basic ICT literacy and in the use of ICT-related services such as online banking, on-line payment of bills, tax filings etc. Programs such as "One PC-one home" are only useful if the public is able to fully benefit from owning a computer and *being connected* to the services that are offered.

213. Worldwide trends in the ICT industry provide opportunities for the growth of Mongolian companies. Software development companies have changed business models towards software outsourcing. While Mongolia's software industry is small, it has the potential to capture niche markets in countries like Japan and Korea (and even in the USA). As noted by the World Bank's CEM¹⁶⁰ : to achieve recognition of Mongolian software engineering qualifications by overseas clients and establish effective outsourcing partnerships, local companies need skills in a mix of disciplines (software architecture, engineering, programming and quality assurance). Furthermore, intellectual property rights, language and cultural proficiency are other prerequisites. Industry experts note that following the example of India, the Mongolian ICT

¹⁶⁰ World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, July 2007.

sector needs to develop “islands of consistency, rather than excellence everywhere”.¹⁶¹ Currently, 36 percent of ICT companies operating in the country are specialized in software development and 30 percent in web development.

214. E-commerce is a venture that is yet to be popular in Mongolia. Given the vast and rough terrain that characterizes the Mongolian countryside, e-commerce could prove advantageous for small businesses in rural areas which could expand their reach. An objective of the e-Mongolia program is to encourage organizations to develop their online presence and to encourage government organizations to make information available for the public. Currently, there are only a few businesses that offer online services, but as people gain greater access to and increased familiarity with IT, demand is likely to increase.

215. With the growing global popularity of computer games, a range of companies in Vietnam diversified into online gaming. By 2005, the leading online gaming company reached a turnover of \$ 5 million.¹⁶² Mongolia’s software companies might be able to tap into this market working with overseas developers as well as developing educational and gaming software for the domestic market.

216. The government’s policy to facilitate and ensure universal access to telecommunications in all parts of the country offers opportunities for greater private sector investments in the sector. Certainly, complete unbundling and commercialization of the state network management is necessary and policy implementation mechanisms need to be further enhanced, including clear subsidy disbursement procedures, transparent tendering and selection processes, as well as reasonable tariff structures. Intensification of the e-Government reform reaching all levels of the public sector, including local governments, hospitals and schools, is another action that policy-makers can pursue to encourage further ICT development led by the private sector.

Box 4.6. Cluster Approach to ICT Development: The National Information Technology Park

The IT Park in Ulaanbaatar has two distinct features that define an industry cluster: geographical proximity and sector specialization. Interestingly, the IT Park is an unconventional cluster constructed by public policies rather than a spontaneous gathering of enterprises. The cluster was formed in an attempt to support up-and-coming companies to overcome business constraints. In addition, the incubator aims to ensure that Mongolian firms possess the necessary skills and adhere to the standards that are required in international outsourcing of services. International business practices, relevant knowledge and technology are essential for growth and attaining local competitive advantage--banking on a young, literate, numerate and entrepreneurial population.

Currently, there are 17 companies operating from the National Information Technology Park, dealing in a variety of services from system integration, IT consulting, networking, database management, to software development. After the opening of the ICT market, a multitude of ICT related services began to surface. The inauguration of the IT Park in the early 2000s, helped structure the emerging industry. As a result, the incubator has become a sponsor for companies engaged in offshore outsourcing and a bridge between investors and entrepreneurs. Following the success of the incubator, another cluster is emerging within Mongolia’s ICT sector, namely the Mongolian Internet Service Providers Association (MISPA) which was founded to bring together all operating ISPs to create an environment

¹⁶¹ World Bank, Mongolia: Sources of Growth. Country Economic Memorandum, July 2007, p. 60.

¹⁶² Digital Review, 2008.

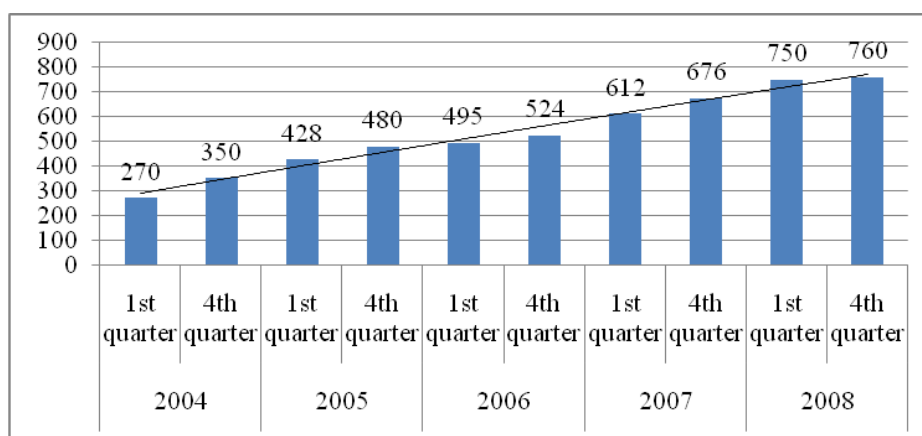
that is conducive to their success.

E. Construction, Real Estate

217. The construction and real estate sector has experienced a boom since 2004, and private investment has been the engine of growth. Currently, over 2000 companies (engaged in construction, engineering, design, and construction material production) are operating in the country, employing over 60,000 workers.¹⁶³ Housing works are predominantly financed by the private sector with significant influx of foreign investment. Close to 430 thousand square meters of housing was completed in 2007 by private entities with a total financing of 71.6 billion MNT. The Government's '40,000 housing' program is financed through the Housing Finance Corporation. In the one and half-years since its establishment, 7.5 billion MNT have been expended: 2 billion MNT in loans to 229 individuals, and 5.5 billion MNT to finance construction of housing projects for government staff.¹⁶⁴

218. The residential market of Ulaanbaatar has consistently grown over the last few years, with supply still very much struggling to meet the high levels of demand. The strong growth witnessed within the Mongolian economy has fuelled housing demand by local residents as well as increased number of expatriates living and working in Mongolia. Rental yields in Ulaanbaatar are currently about 15-18 percent per annum, which is considerably higher than any other Asian country.¹⁶⁵ Over half of the residents of Ulaanbaatar are currently living in ger areas. Although Mongolia has one of the lowest population densities in the world, it also has one of the highest population densities per square meter of apartment space (as most of the population lives in the capital). The living area per person within the city is 31.2 percent lower than normal international levels.¹⁶⁶ This has affected property demand, property prices and the plans for developers who have grasped the implications of this trend. Average apartment price in Ulaanbaatar in 2008 reached \$760 per square meter compared to \$310 per square meter in 2004.

Figure 4.4: Average Apartment Price Growth, 2004-2008, USD per square meter



Source: Industry analyst estimates

¹⁶³ NSO, MCUD, 2007 Statistical Yearbook.

¹⁶⁴ HFC report, 2008, <http://www.barilga.mn/newsmore.php?cid=1737>

¹⁶⁵ Average rental yields in 2008 were 7.4 percent in Bangkok, 9.9 percent in Jakarta, 5 percent in Beijing, 3.6 percent in Hongkong and 7 percent in Hanoi. (Global Property Guide 2008) <http://www.globalpropertyguide.com>

¹⁶⁶ Mongolian Properties LLC analysis, <http://www.mongolianproperties.com>

219. While concerns of an impending rupture of the real estate bubble grows, developers and construction companies face rising land and material prices, shortages of skilled labor and increasing infrastructure bottlenecks. Prices for main construction materials such as cement and steel bars have grown by 40 and 30 percent respectively compared to 2006.¹⁶⁷ Rising iron ore prices worldwide¹⁶⁸ and limited number of domestic and foreign steel bar suppliers (who arbitrarily raise prices), lack of sufficient domestic cement production, and transportation bottlenecks for cement and other material shipments from China, are the main factors for cost inflation.

220. Availability of land suitable for residential development is declining and prices are growing exponentially. Already, land in prime areas of Ulaanbaatar is priced at \$1 million per hectare and above.¹⁶⁹ Developers have to acquire land either through auctions organized by the municipality or from existing land license holders. A flourishing land license black market has sprung up in the past few years as the current legal and regulatory framework is riddled with loopholes and enforcement is weak at best.

221. Besides high prices, developers have to face lengthy and complicated land use license and building permit issuance processes. Zoning and building codes are outdated and duplicated, and rent-seeking by inspectors is wide-spread. As rapid urbanization in the Ulaanbaatar area has started straining the energy and water supply systems, obtaining infrastructure connections to new development areas is one of the major hurdles construction companies face while planning developments.

222. Skilled labor shortage is particularly intense in the construction sector. According to the JICA 2007 survey¹⁷⁰, domestic supply of construction labor only meets half of total demand. The shortfall is currently being filled by Chinese construction workers, and the authorities continue to tighten visa and quota regimes as well as raise fees on labor imports.¹⁷¹

223. Construction companies acknowledge that quality of execution is often poor, and calls have been made to improve the regulation of construction material quality and strengthen the enforcement of building code compliance.

224. Increased inflationary pressures in 2007-2008 as well greater concerns over the sustainability of the rising real estate prices have forced commercial banks to slow down lending. Consequently, apartment sales have slowed down in 2008 forcing some developers with weaker financial capabilities to start providing hefty discounts to buyers who can pay a larger percentage of total apartment costs upfront.

225. In order to ensure further growth and maturity of the construction sector, investments in construction material manufacturing capacities as well as skilled labor training is needed. Current domestic cement production capacity is a little over 300 thousand MT per year. In contrast, total market demand in 2008 is estimated at 850 thousand MT. In 2006, 48 percent of cement used in construction was imported from China.¹⁷² With growing cement demand not only in Mongolia but in the adjoining Siberian region as well, investments in new cement production

¹⁶⁷ NSO 2007 Statistical Yearbook, Industry statistics.

¹⁶⁸ In June 2008, Chinese steelmakers agreed to a 96.5 percent price hike for iron ore supplied by Rio Tinto, <http://www.guardian.co.uk/business/2008/jun/24/riotinto.bhpbilliton>.

¹⁶⁹ Industry analyst estimates.

¹⁷⁰ JICA, "Baseline Survey on Vocational Education and Training", Ulaanbaatar, 2007.

¹⁷¹ The authorities in 2008 entered into agreements to import North Korean labor, ostensibly to fill the shortage in construction workers.

¹⁷² Industry analyst estimates.

capacity would yield good returns. Although several domestic companies have developed cement plant projects (notably, Mongolyn Alt Corporation and Yalguun International), they have yet to source the financing as investment requirements are in the range of \$30-70 million (depending on technology, capacity and infrastructure requirements).

226. Given the short construction season in Mongolia, increased use of prefabricated concrete panels is a viable option for construction companies to pursue. Worldwide, there is a growing trend for using less *in-situ* technologies to eliminate complicated logistics that involve concrete casting works. Although the technology or the prefabricating plant itself is not overly capital-intensive, continuous and reliable supply of raw materials (cement and aggregates) needs to be ensured. Given harsh climatic conditions of Mongolia and strained capacities of the existing infrastructure, increased use of energy saving materials should be encouraged. A few initiatives involving tests of EPS (Expanded Polystyrene) in construction of small housing have started recently.

227. The construction industry would certainly benefit from a strong research and development facility, established on the basis of existing academic resources and bolstered by government (and external partner) support.¹⁷³ Expanding technical and vocational education tracks in construction technologies and supported by greater linkages to industry, is necessary if the sector is to reduce its dependence on costly and not necessarily fully qualified Chinese workforce.

228. Continued IFI and external partner support is indispensable to improve the efficiency and transparency of cadastral mapping, zoning and land registration systems, as well as enhancements of infrastructure connections in Ulaanbaatar city and the regions. Currently, notable support is provided by the ADB and the World Bank to improve existing regulatory systems and physical infrastructure networks. Significant Japanese support was given to improve urban planning (e.g. Ulaanbaatar City 2020 Master Plan was developed with this assistance). The Millennium Challenge Corporation's Property Rights Project is also expected to contribute to better efficiency and transparency in the property registration system which will help reduce the regulatory burden for urban developers. However, more efforts are needed to improve the institutional capacity for formulation, regulation and enforcement of building codes and quality standards. At the enterprise-level, direct support to the private sector in the form of technical assistance and provision of loans and other financing for new manufacturing capacities and innovative technologies will certainly contribute to improved performance.

229. The on-going real estate boom in Ulaanbaatar city is starting to show signs of slowing down due to worsening macro-economic conditions (higher inflation, tighter lending policy and declining commodity prices). As shown by examples of other countries which have experienced real estate bubbles, the sector's future road is certainly not clear of bumps. Once the bubble bursts, many smaller companies will go out of business, leaving only a few, more professional and better established operators. Vertical integration and consolidation in the construction market where construction material manufacturing and research, architectural and engineering design, as well as construction works are executed by a single company, is a future prospect.

F. Mining Services

230. Mongolia has extensive reserves of natural resources, and the mining sector is expected to stimulate and benefit the economy at least in the coming decade and possibly beyond that. These resources have not been fully developed despite a number of long-term government

¹⁷³ GTZ has taken lead in this area through its assistance for the vocational and technical education sector.

programs to explore and develop minerals such as coal, copper and fluorspar. Government sponsored exploration since independence has identified more than 6,000 mineral occurrences (deposits) of 80 mineral types. About 160 of these deposits are actively being pursued.¹⁷⁴ Despite the issuance of a significant number of exploration and (or) mining licenses, about 70-75% of the country's land mass has not been investigated and remains available for private development. The recent mining boom has brought in the much needed financial resources for the country's development and can accelerate economic growth through its spillover effects. For example, about 55 percent of the total FDI coming into the country has gone into the mining sector.¹⁷⁵ Most mines in Mongolia can be considered "small to medium" in size (from a global perspective) and are geographically spread; although both the Oyu Tolgoi and Tavan Tolgoi mines have the potential to become world class projects.

231. The main features of major mining projects are: long term nature of investments (spanning forty years or more); capital intensity-- costing more than \$500 million and upwards to more than \$5 billion; low job creation compared to the investment size (a \$1 billion mining project might generate fewer 500 jobs); remote location of mines --in deserts or at high altitude (as in Mongolia); many potential risks-- including technical, market, political, and fiscal risks (technical risks includes geological and production risks, market risks include price volatility, fiscal risks include actions by host government and political risks include civil disorder and disruption); little value addition to mining exports (mining products from developing countries are exported with little or no added value activity taking place in the host country); limited impacts on the local economy but they may have a large impact on the Gross Domestic Product (GDP); and specific equipment is imported and used by specialized sub-contractors.

232. Mining operations however, could create significant domestic supply chains in terms of demand for goods and services and impetus for local economic development. Also, the burgeoning informal mining sector and service providers could be transformed into viable SMEs. With growth in mining, there is a strong potential for SMEs to provide basic goods and services related to mining expansion (food, clothing, boots, hats, glasses, labor services etc).

233. Mining services is a new area where private participation has significant potential, although a number of constraints remain. As in many developing countries, Mongolia has not yet developed a vibrant mining support industry. Currently, the major mining service companies are those engaged in drilling, geological surveying and mapping, hiring and recruiting, procurement and catering. A few potential mining services that could develop into successful private ventures would be: haulage of mined rock supplies, equipment for the mine, and quarrying of minerals required by the mines. Most of these activities need some specialized and expensive equipment. Financing schemes (including leasing) for these equipment purchases need to be developed.¹⁷⁶ Also, large mining operations require many goods and services, including trucking, equipment repair, chemicals supply, and utilities. In addition, consulting services in the areas of geological and environmental management (e.g., water management in the desert, treatment of residues) would be needed and are potential growth areas for the private sector in Mongolia.

234. SMEs at the local level face the same barriers as their larger counterparts--including high cost of financing, corruption and red tape, ineffective support systems, low skills

¹⁷⁴ Mineral and Petroleum Authority of Mongolia, online information, <http://www.mram.mn>

¹⁷⁵ See Chapter on Macroeconomic Background.

¹⁷⁶ The mining companies could extend long term contracts that have "take or pay" provisions to help such financing.

development and a banking system that has yet, the capacity to lend to SMEs.¹⁷⁷ Local populations need specialized training to be employed in mines. For local SME's to be engaged in the local mining related supply chains, further capacity-building is needed. This is an area for further examination and study, given the limited information that exists on this area presently. If quality supply services can be developed and ensured by local suppliers to major mining companies, financing schemes can probably be developed with local financial institutions. As discussed earlier in this report, there is a significant skills shortage and mismatch in Mongolia. Most of the workers are either over-qualified or under-qualified for their current work assignments, especially in construction and mining, and firms have responded to inadequate skills among local workers by hiring foreign workers from elsewhere.¹⁷⁸ Complex labor laws have also been cited as a hindrance in hiring and training workers for the mining sector. Given the structural shifts taking place in the economy, demand has risen for workers with foreign language skills, IT and technical skills, and behavioral (e.g., communications) skills.¹⁷⁹ Such gaps in the capabilities, may explain, for example, foreign domination of Mongolia's mining sector. More joint public and private sector support for R&D institutes related to mining are needed and would garner support from the private sector.

235. Perhaps the biggest constraint affecting large and small enterprises providing mining services, has been the reversal over the course of the past two years of the overall investment climate affecting the mining sector. These policies have included-- adverse changes to the Mining Law, more direct government participation (and ownership) in mining, and the introduction of windfall profits tax and proposed export duties. These policies have had a knock-on effect on the entire supply chains of products and services serving the mining industry¹⁸⁰.

G. Tourism

236. Since 2000, Mongolia's tourism industry has expanded exponentially as Mongolia established a reputation as a unique adventure destination. Pristine environment and unique nomadic lifestyle and culture continue to be the major factors attracting foreign tourists to the country. However, to fully utilize the revenue-generating potential of the sector a number of issues faced by the tourism industry need to be addressed at the policy level. In addition, other key factors that influence pricing in a direct manner, such as fuel, food and beverages, and availability and quality infrastructure connections, continue to adversely impact the industry. These factors are having a multiplier effect on the operational costs of running a tourism business in Mongolia.

237. The number of 'genuine' tourists has not grown significantly over the years although discrepancies in statistics make meaningful analysis difficult. Estimates differ as to the number of tourists visiting Mongolia every year. For example, in 2006, border control statistics reported 389,000 tourist arrivals, MRTT estimates were 200,000, and tourism industry experts maintained that the number of 'genuine' tourists did not exceed 100,000. It is estimated that 25-30 percent of tourists are backpackers that do not use tour operators' services. In 2004, 57 percent of total tourist arrivals were organized by tour operators, 8 percent less than in 1998

¹⁷⁷ The new SME law provides for direct interventions, such as provision of funds at below market rates to SMEs. Although the operational guidelines are still to be developed, this can often lead to weaker financial discipline by SMEs and distorted credit risk assessment of these SME's by their creditors.

¹⁷⁸ Especially from countries like China.

¹⁷⁹ World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, 2007

¹⁸⁰ The local taxation regime and the uncertainty over fluctuating user fees for utilities (water) have also been concerns of the mining companies.

and 7 percent less than 2002.¹⁸¹ Over 450,000 arrivals were declared as ‘tourism purposed’ in 2007, but almost half of them were visitors from China who predominantly travelled by Erlian – Ulaanbaatar train (an indication that they were more likely seasonal construction workers rather than genuine tourists).

Table 4.7: Annual Arrivals between 2000 and 2007 (thousand persons)

	2000	2001	2002	2003	2004	2005	2006	2007
Visitor	158.2	192.0	235.1	204.8	305.1	344.6	389.6	454.5
Tourist	137.4	165.9	228.7	201.1	300.3	338.7	385.9	451.5
Growth (percentage)	-0.4	20.8	37.9	-12.1	49.3	12.8	13.9	17.0

Source: NSO, MRTT

Table 4.8. Arrivals by MIAT and Mongolian Railway, by Season, 2006

Season	MIAT	Mongolian Railway	Total	Percentage
June, July and August	93,427	31,104	124,531	55%
May and September	38,938	12,960	51,899	23%
March, April, October and November	32,458	18,662	51,120	22%
Total	164,813	62,726	227,539	100%

Source: NSO, MRTT

238. The industry is fully privatized and dominated by small operators, integration is effectively non-existent and quality of hotels and restaurants is low. Nation-wide, over 600 tour operators and travel agent companies are active. A majority (close to 75 percent) of tour operators are Mongolian owned; with Korean, Japanese, Chinese, American and European investors operating the others. Over the last few years, many hotels have emerged both in Ulaanbaatar and around the country. However, it is questionable if these hotels offer services which are demanded by tourists. International hotel chain operators are just entering the market (construction projects for Hilton, Shangri-la, Park-Inn hotels are examples). Tourist camps in the countryside offer camping experiences that focus on nature rather than comfort. In 2005, the EPRC conducted a tourism survey, which interviewed tourists about their experiences whilst visiting Mongolia.¹⁸² The worst overall rating was given to local ground transportation, hotels were the second worst.

239. The tourism industry continues to face limited international connections, weak overseas promotion, increasing operational costs, dearth of diversified products and services, and poor quality human resources. Presently, access to Mongolia is still restricted. Rail services are limited and the existing ones need urgent upgrading. International flights are sparse, with only four airlines operating in the region, but these do not meet the demand. Domestic flight services are gradually increasing with the opening of Eznis Airways, a domestic carrier which links key towns in the countryside with Ulaanbaatar. Border crossings are still limited as there are very few entry/exit points which cannot adequately handle the high levels of traffic. Infrastructure in the rural areas is severely underdeveloped. Roads between soum centers are few and of poor quality. However, they are slowly being improved in some regions. There are many tourist attractions in rural Mongolia with limited access and accommodation. Investment into accommodation in rural areas is slow and new incentives are required to stimulate activity.

¹⁸¹“Mongolian Tourism Sector Development Strategic Paper (2008-2012)”, MRTT presentation, 2008.

¹⁸² USAID, Mongolian International Tourism Survey: Report of Results, EPRC, January 2006.

240. Overall inflation is making Mongolia more expensive and less attractive for tourism businesses and tourists. Fuel costs have a direct impact on the prices of airline tickets, fuel for buses and jeeps, import costs of food and drink for rural accommodation and ger camps. Operators have little choice other than to allow the inflation to cut into their profit margins as raising prices is not an option, since Mongolia is already a highly expensive travel destination.

241. As Mongolia is a relatively new tourism destination, intensive marketing to promote the country is needed. However, there is a lack of government support in selected destination marketing. Participation in international travel fairs and advertising in international media and publication helps to increase global awareness about Mongolia. Private operators would benefit from more active government involvement in this area.

242. With the expansion of the tourism market, the number of tour groups has increased. Yet, product development is stagnant as most operators offer the same classic tours and activities, providing little differentiation between operators and offering little variation for tourists, making repeat visits unlikely. There is also limited cooperation between businesses operating in the tourism sector. This has led to a thin specialty market and a saturated general tour service market.¹⁸³

243. A common misconception among market participants is that entering and surviving in the tourism industry is easy and that the market produces high profit margins. Due to this reason, many companies are managed by non-professionals, who in turn negatively influence the level of service. As a result, the industry lacks professionalism that is required to offer quality service to visitors. Most of the 'tour operator served' category of travelers to Mongolia are highly educated and experienced travelers who already have a benchmark of the quality of service they wish to receive (backpackers are a different category, as they look for cheap prices and 'adventure' experiences). Hence, it is necessary that personnel interacting with tourists are well-educated in history, arts and culture of Mongolia. Current guide courses and training are conducted at a basic level, delivering very basic information. Compared to western countries, where tour leaders are certified via courses lasting for more than a year, a Mongolian guide can obtain certification in two weeks. Not only is their general knowledge of geography, biology and ethnography lacking, but crucial issues such as safety and security, first aid, risk assessment are limited. This is noteworthy, considering that guides are responsible for any mishap that happens in the field.

244. Government support is vital to ensure that the tourism potential of Mongolia is fully realized. The Mongolian tourism law was adopted in 2000, but since then, despite the changing dynamics of the industry, no meaningful amendments have been made, especially on industry promotion. The "Future prospects of the Mongolian tourism industry" survey conducted by the Mongolian National University team of researchers among tourism companies in 2007 has illustrated private operators' dissatisfaction with government policies. On a scale of 1 to 5 (1-very poor, 5-very good), the evaluation results were as follows: tax regime 3.4; sector policy 2.0; tourism related legislation 2.6; government actions 2.3; project impact 2.0; and private sector input in policy formulation, 2.0.¹⁸⁴

245. Many tour operators complain that MIAT's policies constrain their business growth.¹⁸⁵ While it is a worldwide established practice that the majority of large group tour agreements is concluded between November-December each year, MIAT's summer flight schedules are not

¹⁸³ According to Zanján Fromer, General Director of Ger to Ger Nomad centered tourism agency.

¹⁸⁴ Mongolian Tourism Sector Development Strategic Paper (2008-2012), MRTT presentation, 2008.

¹⁸⁵ As above.

determined until late April-May, effectively restricting Mongolian tour operators' opportunities to cooperate with global counterparts. Since 2006, MIAT has stopped providing group reservation discounts, and it arbitrarily cancels reservations even after having signed agreements with tour operators.¹⁸⁶

246. Mongolia has numerous monasteries and cultural sites, most of which have undergone severe deterioration. Rehabilitation of these sites would attract tourists as well as inject the surrounding areas with business opportunities. The majority of Mongolia's tourists come from the neighboring countries: Russia, China and South Korea. However, there are no tourism partnerships with these countries.

247. External partners (GTZ, EU, JICA, USAID) have been assisting the government to develop tourism development policies, and their recommendations need to be meaningfully incorporated in sector strategies and, most importantly, action plans. There are many countries worldwide which have developed and implemented successful travel promotion campaigns, and their experiences can be drawn upon (e.g. Bhutan). Efforts need to be intensified to increase the number of international air and rail connections; and air fare and reservation systems upgraded to a more tourism-friendly model. The quality of human resources should be improved not only by tightening certification measures but by upgrading teacher qualifications and curricula. The cluster approach to development (major focus of USAID/EPRC initiatives) will certainly be beneficial for the industry, however as the USAID analysis¹⁸⁷ emphasizes, it needs to be driven by the private sector itself and requires major changes in business mentality and practices. The private-public partnership in tourism promotion and marketing, namely the Tourism Information Center (the establishment of which was spearheaded by the EPRC) as well as the on-going work on the national tourism portal are examples of areas where external partner support and facilitation is particularly suitable.

H. Education

248. Presently, concerns over human resources, education and skills are high on the policy agenda of the nation as it gears up for a period of high growth. Equally important, is the realization that quality human resources should form the base for broadening and diversifying the economy over the medium and longer term. The economic transition in the 1990s affected education outcomes in the early years of the transition, but the sector has made significant progress since then. Private participation has grown exponentially, but issues remain with quality and availability of teachers, curricula modernization, alignment with market demand and physical facilities upgrade.

249. Increased private sector participation in education has supported sector revival, but the structural inefficiencies¹⁸⁸ are becoming more pronounced. Currently, there are 754 primary and secondary schools in Mongolia, with an increase of nearly 100 schools in the last ten years: 63 private pre-school and general education institutions were registered in 2007.¹⁸⁹ The number of private teaching institutions in tertiary and vocational education sectors has over taken public numbers, and presently there are 89 public and 123 private institutions. Within the public sector, emphasis is on technical and vocational schools of which there are 42, whilst in the private sector, higher educational institutions are prominent with 106 centers. There are 6 universities

¹⁸⁶ As above.

¹⁸⁷ USAID, "Promoting Competitiveness in Practice: An assessment of Cluster-based Approach", The Mitchell Group for USAID, November 2003.

¹⁸⁸ See paragraph 4.188 below.

¹⁸⁹ NSO, 2007 Statistical Yearbook

that are branches of international learning institutions. The number of students has nearly doubled since 1996—reaching almost 734 students per thousand, out of which 73 % attend either primary or secondary school. Universities and higher educational institutions account for the rest (27 %) of students, the majority attending public universities. The private sector accounted for nearly 73 % of higher education institutions and 32 % of students in 2007.¹⁹⁰ As the average tuition fees in private institutions have been around \$400 per student, annual turnover can be estimated at \$20.3 million. In August 2008, the MECS set benchmark tuition fees for state universities as follows: computer science subjects – 813,800 MNT; engineering, architecture, agriculture, veterinary subjects – 772,500 MNT; arts – 720,000 MNT, medicine – 750,000 MNT and nursing – 520,000 MNT. Thus, the average tuition fee is estimated to not exceed 690,000 MNT.¹⁹¹ Private institutions have the liberty to set their own tuition rates, and in light of rampant inflation, tuition hikes are expected to be significant.

250. When state-owned establishments and new private institutions are included, Mongolia has over 160 higher education institutions. In a country with a population of about 2.6 million, this is an extremely high number. The ratio of tertiary institutions per 100 thousand population in Mongolia is 8 times of that of Japan, 9 times of India, 10 times of Korea, and 103 times of that of Thailand).¹⁹²

251. Between 1996 and 2007, there has been a steady decline in the number of institutions devoted to sciences. In 1996, there were 84 institutions whereas by 2007 the number had dropped to 59. The percentage of engineering graduates was a mere 6 percent of total in the academic year of 2006-2007. Over 80 percent of private universities and colleges specialize in law, business and other social sciences.

252. Despite the high levels of student attendance at a variety of educational institutions, the number of graduates is substantially lower. In 2006-2007, only 132 students out of every thousand graduated from their respective institutions, the greater part graduating from general educational schools. The teacher-student ratio is a significant concern; presently there are only 34 teachers per 1000 persons, most of whom teach at general education schools.¹⁹³ Vocational and technical schools have the lowest number of teachers (1.4) which is directly reflected in the number and quality of students graduating from these institutions.¹⁹⁴ The drop-out statistics show a gradual decline in numbers but they are still high for a population of roughly 2.6 million. The majority of these drop outs are males.¹⁹⁵

253. State budget expenditures for the education sector are substantial¹⁹⁶, and IFI support for sector reform and improvement is increasing in light of greater need for qualified workforce. State budget expenditures for the education sector in Mongolia are high, although the bulk of it

¹⁹⁰ Same as above

¹⁹¹ Online report on interview with Minister for Education Mrs. Bolormaa, August 2008, <http://www.oloo.mn/modules.php?name=News&file=article&sid=1133257&catid=87>

¹⁹² Industry analyst estimates.

¹⁹³ NSO, 2007 Statistical Yearbook.

¹⁹⁴ A number of reasons can be offered for the lack of teachers: low salary of teachers and low supply of accepted level of teachers' qualification (according to the law, teachers at HEIs should have at least MA degree to teach BA programs). It seems that there is no clear response to this problem from the Government, however, individual institutions are trying to attract qualified teachers by offering some incentives, or to upgrade lower level teachers to the level of qualified teachers through skills development training/or sending them to abroad for higher degree.

¹⁹⁵ NSO, 2007 Statistical Yearbook.

¹⁹⁶ Four percent of GDP for China and 5.5 percent on average for OECD countries, International Comparison of Education Statistical Indicators 2007 Edition, <http://english.moe.gov.tw/ct.asp?xItem=8395&ctNode=815&mp=1>.

goes to financing of primary and secondary schools (for which the main cost items are heating and facility maintenance).

Table 4.9: Education Sector Expenditures

	2004	2005	2006	2007
Total expenditures, billion MNT	752.5	764.6	1 223	1 749
Education expenditures, billion MNT	141.1	147.8	208.7	273.2
Education expenditure, percent to total	18.7	19.3	17.1	15.6
Education expenditures, percent of GDP	7	5	6	6

Source: NSO, 2007 Yearbook

254. Starting in January 2008, budget financing of state-owned universities' fixed costs has resumed, and 3 billion MNT were allocated from the budget. For the academic year 2008-2009, the financing from the Education Budget will be increased to 13.1 billion MNT reflecting greater financing needs of public education institutions and students.¹⁹⁷ In 2006, the Government adopted the Education Sector Master Plan 2006-2015. The master plan highlights the vision, policy goals and objectives, implementation strategies (including institutional mechanisms) and estimated resources for implementing sector reforms over the next decade. With the revised Education Law endorsed in January 2007, the transition to a 12-year public education system will begin in the 2008-2009 school year. A draft "Higher Education Law" is being prepared by the Ministry of Education, Culture and Science (MECS), and efforts are under-way to determine benchmark tuition rates for different subject categories in tertiary education institutions.

255. The Education Donors' Consultative Mechanism (EDCM), which the MECS chairs, was established in 2005 and provides an effective mechanism to facilitate the partnership between the Government and its development partners. The success of this partnership resulted in Mongolia gaining access in 2006 to grant resources from Education for All-Fast-Track Initiative. At the moment, ADB is the lead development partner in the education sector and co-chairs EDCM with Japan on behalf of external partners. Several analytical studies on education have been conducted by the World Bank and there is an on-going Rural Education and Development Project which supports school cluster development in an attempt to strengthen sector management at school levels.

256. ADB's new education project that was developed in 2007 aims at (i) revising the curriculum framework, education standards, accreditation system for pre-service teacher training and certification system for in-service teacher training for the new 12-year school system, (ii) improving the learning environment, including the rehabilitation of schools, and (iii) promoting demand driven vocational education.

257. Participants of vocational education--- employers, policy makers and training institutions-- have jointly released a memorandum of social consensus on development of vocational education and training. Industry insiders' comment¹⁹⁸ that analysis of vocation training needs at the sector level is necessary, and the solutions need direct industry (employer) involvement rather than top-down government initiatives to really make a difference. In addition,

¹⁹⁷Online report on interview with Minister for Education Mrs.Bolormaa, August 2008, <http://www.oloo.mn/modules.php?name=News&file=article&sid=1133257&catid=87>.

¹⁹⁸Comments made by representative of Vocational Training Association at the PSA Consultative meeting in ADB office, July 2008.

amendments to the law on vocational education and training were submitted for approval to the Mongolian parliament. The Millennium Challenge Corporation is investing \$25.51 million to help build up the institutional framework to support the vocational education system. The project will develop new curricula for career development and 30 new career preparation tracks as well as new capacity for career guidance.¹⁹⁹ Technical and vocational education is an area of focus also for GTZ, and USAID has a special scholarship project for IT training in partnership with Cisco Systems and the US Technology Training Institute.

258. The education sector faces significant challenges, and private sector growth and development is impeded by a number of factors. An urgent task is the need to restructure the school curriculum and teaching methods, which are outdated, across the education sector and significantly below international standards. As a result, students who emerge from this system lack the necessary knowledge and skills to survive in the workplace. The supply of vocational education does not meet the skill needs of the labor market.²⁰⁰ Furthermore, the quality and relevance of vocational teaching material is outdated and fields of specialization are obsolete. According to the ICA survey²⁰¹, one third of surveyed firms reported vacancies for professionals and nearly two-thirds have vacancies for skilled workers. In the rapid survey conducted in 2008 to support this assessment exercise, over 50 percent of companies identified skill and education of workers as a severe or major obstacle to growth.²⁰²

259. Most schools have outdated learning materials and equipment and poor ICT capacities. A survey undertaken by the Mongolian Development Gateway NGO in 2003 among 89 private universities and colleges in Ulaanbaatar revealed that less than half had computer facilities with Internet connection.

260. The reputation of private tertiary education institutions has suffered significantly over the past few years, and poor qualifications of graduates are the main reason. A number of factors are behind this trend. Many institutions were founded by non-professionals intent on earning quick money, and the low quality of premises, educational facilities and teachers was inevitable. According to the Mongolian Development Institute, only a half of private institutions passed the accreditation test conducted by the MECS in 2006. Recent rounds of inspection by the State Inspection Agency identified numerous violations in the safety of premises, ratio of full-time teachers, quality of teaching methods and subject curricula.

261. Private universities and colleges do not receive any direct or indirect financial support from the state, and tuition revenues are the only source of funding. As the number of private university and college students eligible for Treasury loans is limited, state institutions are the first choice for most high school graduates. Lack of adequate financing and qualified teaching personnel forces private institutions to concentrate on social sciences (where expenditures are minimal). The growth of vocational and technical training institutions is stunted, again due to high costs associated with provision of such education.

262. Quality premises are essential for appropriate learning conditions. Today, teaching institutions do not enjoy any preferential treatment when applying for land permits to build or expand their premises. One example is the Sant secondary school which lost a land permit case in the courts to a private residential building developer, and as a result has no facilities for physical education activities. The recent decision by the authorities to stop issuing land and

¹⁹⁹ Millennium Challenge Corporation Factsheet, <http://www.mca.gov>.

²⁰⁰ Only half of demand for construction workers is met by domestic educational institutions, while supply of professional mining workers is minimal.

²⁰¹ An Investment Climate Assessment and Trade Integration Study, World Bank, 2007.

²⁰² See Chapter 3 on survey.

building permits in the downtown area to education institutions was met with dismay. Educators have expressed indignation over the fact that while the government policy is to move universities and colleges to Ulaanbaatar's suburbs (on the pretext that they are the main cause for traffic congestion), no definite actions have been planned and no financing is allocated to provide the infrastructure necessary for a modern university campus.²⁰³

263. Branches of foreign universities operating in Mongolia are taking advantage of the growing segment of affluent households able and willing to pay higher tuition for higher quality education. They include branches of:

- (i) Plekhanov Academy (Russia)
- (ii) University of Buryatia (Russia)
- (iii) Irkutsk Institute of Technology (Russia)
- (iv) Moscow Energy Institute (Russia)
- (v) University of Kazakhstan (Kazakhstan)
- (vi) Hartford Institute (Singapore)

264. For example, Bachelor's and Master's programs at Hartford Institute cost \$6,000 and \$9,000 per year, respectively, which is 15-20 times higher than what Mongolian counterparts charge. However, quality of premises and availability of options to continue their education in Singapore seem to be strong enough incentives for students and their parents. Enrolment at Hartford Institute in 2007 was at 54 percent having increased from 12 percent in 2005.²⁰⁴

265. In summary, introducing better quality assurance systems, encouraging university--industry partnerships, improving management and teacher accountability to the students, and providing new financing models-- are steps not only to support private education development but foster overall sector improvements as well. An example of a private-public partnership particularly effective for supporting private sector involvement in the sector as well as improving educational standards could be an establishment of a competitive education fund.²⁰⁵ Financing from this fund (either in form of direct financing to schools or tuition reimbursement to students) should be open to both public and private qualifying institutions to foster healthy competition. Selection criteria could be set by the MECS with input by the academia and private school management. External partner involvement (e.g. ADB) in form of financial, operational and advisory assistance will be particularly valuable, especially in the beginning.

Box 4.5. To Meet the Growing Demands for Post-basic Skills.²⁰⁶

Technical and vocational education must be encouraged to become a real alternative to (but still integrated with) the academic track, and produce skills that are relevant to the labor market. New guidelines for the sector need to be developed and implemented. Guidelines should cover the following areas:

- Occupational standards (with the input of employers) as well as a testing and certification system
- A modular, competency-based curriculum to attain those standards
- An accreditation system of TVET institutions
- Partnerships with employers to connect TVET institutions to the workplace

²⁰³ Association of Mongolian private universities and colleges, Online sources.

²⁰⁴ See Chapter 3 on survey.

²⁰⁵ In the Indonesian case 25 percent of the recurrent budget to public universities is allocated through competitive bidding. (World Bank, Mongolia: Sources of Growth, Country Economic Memorandum, p. 102)

²⁰⁶ Excerpt from "Mongolia: Sources of Growth, Country Economic Memorandum", World Bank, July 2007, p.104.

- Alternative forms of financing of TVET institutions (vouchers, performance-based financing and competitive funding)

Higher education should become the focus of joint (public-private) efforts to create the necessary human resources that would help diversify the economy, and create Mongolia's version of the knowledge economy (given its small population size). To do so, the focus should now be on:

- strengthening the current accreditation system and make it compulsory
- introducing a well-designed and unified higher education admission test
- developing guidelines for alternative forms of financing (vouchers, performance-based financing and competitive funding) and partnerships with employers.

And for young people who failed to acquire basic skills the first time around, the focus right now should be on developing a coherent strategy for second chances that meets the diverse needs of youth, and clearly linked to the formal school system and informed by the demands of the labor market. The next step is to design and implement second chance programs – remedial education, equivalence education, literacy and skills training consistent with this strategy.²⁰⁷

I. Healthcare

266. The private delivery of health care can improve the quality of care and increase efficiency in terms of treatment techniques, clinical management, and financial administration.

267. Today, Mongolia's healthcare service sector is a mix of public and private facilities. In 2007, 857 private health facilities, 229 privately operated Family Group Practices (FGPs) and 706 private pharmacies and drug stores were operating nationally in the health sector.²⁰⁸ According to the Ministry of Health (MoH) close to 75 percent of private practices and institutions are in Ulaanbaatar, the number of treated patients in private hospitals has increased 9 times; funding from the Health Insurance Fund (HIF) to private hospitals has increased 9.5 times and the percentage of HIF allocations to private hospitals increased 2 times during the period 1997 and 2001.

268. There are several large private health facilities that are jointly owned and managed with foreign investment. These are the Yonsei Hospital (Korean-Mongolian venture) and the Russian Hospital (Russian-Mongolian Venture) with hospital beds. The Song Do Diagnostic Centre (a fee for service based Korean-Mongolian venture) and the SOS Clinic (American Hospital branch with a subscription and fee for service) are not hospitals but they have beds for observation and conducting overnight investigations and serve as out-patient clinics. A few new private hospitals are in the pipeline involving some of the large holding companies in Mongolia but have not been established.

269. In future, private primary care clinics are likely to be established as private for-profit enterprises in Ulaanbaatar and other affluent centers. These comprehensive primary care providers might refrain from signing contracts with the HIF and local governments by simply registering individuals under subscription payments and charging fees or entering into service contracts for primary care services with private enterprises. The growing middle and upper income classes in Ulaanbaatar provide a potential market for the growth of private primary care practices.

²⁰⁷ Examples are: the education model for out-of-school individuals by the Mexican National Institute for Adult Education, the Tutorial Learning System in Colombia and the Balsakhi program in India.

²⁰⁸ NSO 2007 Statistical Yearbook

270. Although the trend for the privatization of the health sector is on the increase, there is no integrated legal framework on the development and regulation of the private sector, privatization and optimization of hospitals. Currently there are no formal efficiency and competitiveness measures except for the use of the licensing and accreditation system. Regulation of quality and adherence to standards and any form of monitoring is very weak because the regulatory mechanisms are generally non-operational and this is especially so in the rural areas. A system for monitoring medical ethics is in place, but enforcement of these ethical standards is inadequate. This is because there is no independent professional medical association that represents all the medical personnel in the health sector. There is, however, a private sector medical professionals association but it has no authority to impose sanctions on medical professionals, especially those operating in the public sector, for any proven case of malpractice by the medical professionals. This Medical Ethics Board as it is called in the health sector, is appointed by the Ministry of Health and is under the full control of the Ministry of Health and majority of the medical professionals are employed by the Ministry of Health. Consequently, the application of sanctions, if and when they are approved and applied, is invariably mild unless the malpractice case has already entered the public domain and is widely publicized in the mass media.

271. There is no systematic review to determine what will be required to build an effective private public partnership in the health sector and define the role of the state and the HIF, in the operations of the private sector.

272. Public (state) assets in the health sector set for privatization by the State Property Committee include sanatoria, hospitals, and health-related industries/factories. Two basic forms of privatization are applicable to the health sector, namely, full privatization including property rights, and management contracts in which the state retains full property rights. The differences between full privatization and management contracting are not made clear.

273. The current insurance legislation is considered underdeveloped and insufficient for the development of a modern private health insurance industry. The amendments (approved by Parliament on 16 April 2004) introduced two main reforms: one on long-term insurance, which sets the basis for providing life insurance; and another on reinsurance. For now, all that is available is general insurance for property, casualty, fire, and documents. With life insurance products now coming onto the market (e.g. NOMIN Insurance) private health insurance may begin.

274. Currently the social health insurance is operated by the government and although its management and operations are governed under the Health Law and Citizens Health Insurance Law, the services provided by the public and private sector facilities are of inadequate quality. The premium is low (currently 6000 Tugs per annum) and the agreed reimbursements are unable to ensure and sustain affordable and acceptable quality of services and support the operations of high quality and technically advanced health care facilities. The private health insurance industry has yet to develop appropriate products (a package of services covered by reasonable health insurance reimbursements with a premium that is affordable) that will be attractive to the emerging middle and upper-income classes to capture the market segment of clients who currently go abroad for treatment (mainly to China). Thus, there is an emerging demand for the building of modern, high quality and efficient private hospitals and for a network of private medical facilities that can be sustained by the public and private health insurance industry.

275. Mongolia has limited capacity to regulate the emerging private health insurance industry. The State Insurance Supervisory Agency in concert with the National Audit Agency oversees

the operations of the government social health insurance but it is considered to be weak and is staffed by personnel who lack knowledge of the private insurance business. The lack of actuaries in the existing oversight mechanism to evaluate how the insurance companies calculate risks and premiums is currently a major constraint for the development of private health insurance (and for that matter, life insurance).²⁰⁹

276. The recent formation of a new Association of Mongolian Insurers to represent the interests of the industry should be further encouraged. Also, attention should be given to revise, and modernize the insurance law so that it is comprehensive and distinguishes between public and private insurance.

277. Issues remain with the pharmaceutical industry, and FGPs. Since the deregulation of the pharmaceutical subsector, access to a wide range of generic and trade name drugs has improved. At the same time, because of the fragmented drug registration and assurance system, the number of proprietary drugs is much higher than that of generic drugs as they provide for a higher profit margin in a relatively low volume market.

278. There is also a growing concern about increasing number of counterfeit or sub-standard drugs coming onto the market and some of the smaller private health facilities including the Family Group Practices could fall prey to these drugs as they are cheaper to procure in small amounts. Current supervision and inspection capacities are weak, and prescription-only drugs are few with most medicines sold over the counter.

279. The consolidation of family medicine in Mongolia is particularly challenging as there has been no tradition of family medicine, whereas there is still a long-standing culture of hospitalization. The clinical capacity of FGPs is low, particularly the capacity of primary care physicians. Thus, the need to introduce an intensified program of clinical training while widening access to diagnostic services is urgent.

280. FGPs are in practice, a unique form of limited and controlled outsourcing of a publicly financed primary health care service to restricted private entities. They show the limitations and weaknesses of creating models by decree without giving full consideration to all legal and institutional issues. For any future development of this model, the "private" nature of FGPs needs to be clarified.

281. The peculiar legal status of FGPs is illustrated by the fact that as budgetary institutions, because they receive capitation payments partially financed from the state budget, finance inspectors enforce the same standards to FGPs as they apply to other public entities, making it illegal for FGPs to distribute savings among their members. Consequently, no legal method exists for supplementing FGP personnel income for good performance. This is compounded by inventorying equipment purchased by the FGPs, as being state property. In some cases, local authorities even tax FGPs with a 15 percent levy as private entities (leaving these FGPs caught somewhere between private and public status).

282. Family doctors and family nurses are licensed to practice medicine, but their qualifications to provide the full clinical package of services to serve as gatekeepers are considered inadequate, as the licensing process was done rapidly (without thorough investigation and the required training). The precondition for licensing consisted only of short courses with no follow-up, support, or supervision. A limited number family medicine protocols

²⁰⁹ Development of health (life) insurance markets is an important enabling factor for greater private participation in the sector. Detailed analysis of the relevant legislation and institutional framework is beyond the scope of this assessment, however. ---details

are available now but of questionable content and quality with no system for monitoring and enforcing protocols.

283. FGPs often operate out of apartments, shops, and public buildings as standards for FGP infrastructure have not been devised. Local governments invariably provide premises in public sector buildings. Despite the civil works and investments made under HSDP I, most PHC/FGP facilities need upgrading.

284. For the FGP model to succeed, adequate funding and incentives will be needed. FGPs need sufficient financing to motivate health personnel and provide essential drugs. Likewise, FGPs need adequate equipment and enhanced clinical skills, particularly if they are to take on a greater burden of clinical care from hospitals.

285. Privatization of the health sector is now a major reform agenda of the government, but conditions need to be established beforehand. State clinical hospitals were selected for attracting private investments, including foreign investors, to be privatized totally or partially as joint ventures. Other forms of privatization such as management contracting out, contracting in of auxiliary contractual services and leasing are encouraged, depending on the type of public health institutions and services. To speed up the process and ensure smooth transfer of healthcare service delivery to private hands, the following actions are needed by the public sector:

- (i) Develop a single transparent payment mechanism with appropriate incentives and penalties;
- (ii) Create a Master Plan for optimizing the UB based health facilities including expected outcomes;
- (iii) Develop transparent and robust policies, documents and tender procedures for privatization initiatives, as well as meaningful performance indicators;
- (iv) Develop contract management capabilities. Develop international standards – to improve the quality of service outcomes;
- (vi) Develop a mature dynamic licensing and accreditation system, to be applied systematically, transparently and without discrimination.

286. In summary, the Mongolian private sector continues to face numerous constraints--some of which are cross cutting, while some are more sector-specific. Infrastructure and logistical bottlenecks raise operational costs, limit access to markets and weaken the competitiveness of firms engaged in both production and service sectors. Inefficiencies in supply chains largely due to wide geographical dispersion of suppliers, absence of adequate support services and competition for raw materials by Chinese buyers create difficult conditions for agro-business and foodstuff manufacturing companies. Private operators engaged in infrastructure segments face increasingly obsolete physical facilities and high regulatory burden -- a situation further exacerbated by anti-competitive policies, particularly in the railway and civil aviation sectors. Financial sector development continues to be affected by existing gaps in legal and regulatory frameworks, limited size of the market and weak corporate governance compliance which not only impedes institutions' access to international capital (the latter being further squeezed by the ongoing global credit crunch) but also raises well-founded concerns for the health of the system as a whole.

287. Although recent years have shown improvements in access to and costs of funds for private enterprises, these particular issues continue to be major constraints for small and medium enterprises. Moreover, the current situation on the global financial markets could possibly lead to reversal of positive developments in these areas. While recent amendments to

the tax code certainly contributed to reducing of the overall tax burden, issues with tax administration remain largely unchanged. Corruption, bureaucracy, gaps in legal framework, policy uncertainty and weaknesses in the judicial system affect private firms regardless of the sector they operate in. Private sector involvement in policy formulation continues to be minimal and confidence in public sector capacity for efficient service delivery is low. Growing skills mismatch is another major cross-cutting constraint affecting enterprises in all sectors including healthcare and education. These cross-cutting constraints and sector specific constraints on private sector participation and PPPs are given in Matrix 6.2. Examples of successful PPP experiences are shown in Matrix 6.3. Specific PPP problems are outlined in Matrix 6.4. The next two chapters review government and external partner response to these challenges and constraints.

VI. GOVERNMENT AND EXTERNAL PARTNER RESPONSE TO PSD CONSTRAINTS AND CHALLENGES

288. Multilateral and bilateral partners have been instrumental in promoting the private sector since the mid-1990s. A number of multilateral and bilateral partners have been involved in resolving private sector issues and promoting the private sector since the adoption of the 1992 Constitution which provided the legal framework for private property ownership. External partners working in concert with the authorities have helped shape the phasing and sequencing of the policy framework for liberalizing the economy, fostering private ownership, and strengthening the legal foundations of the market. Some have worked directly with enterprises, while most have influenced private sector development by working through government agencies, banks, and industry associations as intermediaries. The forms of actions have also varied: ranging from sector investments (infrastructure, banking, agriculture, education, etc), sector policy reforms, and technical assistance to strengthen institutional capacity for reform and implementation (tax, customs, competition, mining and investment policies).

289. Private sector development has been the focus for many multilateral and bilateral partners. Significant emphasis has been on *enterprise-level assistance*, including enterprise restructuring, business development, capacity building and access to finance (IFC, Japan, GTZ, UN, EU, EBRD, SDC, USAID, other bilateral agencies). Large-scale direct enterprise (and bank) financing through loans and equity investments has been increasing lately with IFC and EBRD in the lead, followed by ADB. *Agriculture sector reform and development* has been on the assistance agenda for virtually all external partners; their current actions mostly focus on strengthening livestock extension services and regional cooperation as well as improving value chains for agribusiness development. In the *infrastructure* area, significant amount of investments and work has been accomplished to improve both the physical infrastructure and policy environment (World Bank, Japan, Kuwait Fund, ADB and USAID). The financial sector has been a major recipient of financial and technical assistance as well (IFC, EBRD, GTZ, KfW, ADB and USAID). External partner support for transport, trade and logistics to improve access to markets for Mongolian enterprises is set to increase with the Millennium Challenge Corporation's grant, being the most notable new development. Assistance in the vocational education sector is also increasing taking into account the growing and hitherto unmet workforce needs of the economy (Japan, MCC, USAID, and GTZ). External partner involvement in the continuing healthcare sector reform and development process remains significant with new source of assistance coming on-board (MCC's Health Project). At the *policy level*, significant work has been undertaken in the areas of 1) enabling environment—tax, customs, competition, PPP, trade and investment policies (World Bank, Japan, GTZ, USAID, ADB, UN), 2) institutional capacity strengthening for the public sector (World Bank, Japan, IMF, ADB, GTZ, UN, USAID, SDC, OSF), and 3) systems and mechanisms—judicial and financial systems,

property rights (World Bank, ADB, Japan, IMF, GTZ, MCC, USAID, SDC, EU). (Details of external partner programs are given in Matrix 6.5 and 6.6.)

290. External partners have just about covered all the levels that affect the start-up, growth and performance of private enterprises; now the bigger challenge would be to synergize for better impact of their PSD programs and policies on the overall business environment and public/private interface. Also, a special role could be seen for the IFIs, who can lend directly to the private sector, as capital needs have become larger with the growth of the economy. While most external partner actions have been motivated by their own analytical and research foundations that underpin their respective private sector strategies²¹⁰, more attention should now be directed towards coordination and alignment with government development policies and programs.

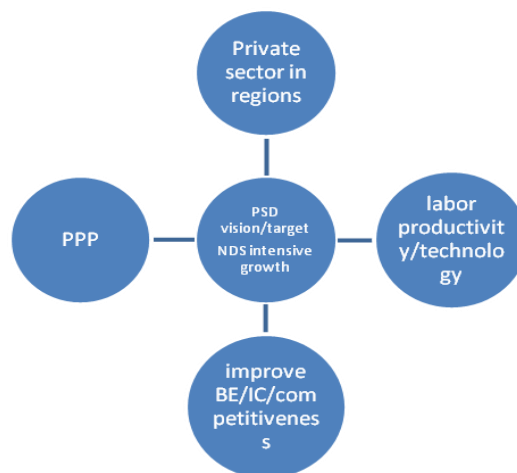
291. Until very recently, the Government of Mongolia had no specific policy to promote private sector development.²¹¹ Mongolia has paid more attention to macro-fiscal, sector and other structural policies since its transition to the market over the past 15 years. With macro-stability largely achieved and budget balances in good stead, Mongolia has now embarked on a longer term economic development vision to achieve the Millennium Development Goals (MDG) by 2015 and to become a middle income economy by 2021, as envisaged in the first comprehensive strategic planning document of this kind – the MDG-based National Development Strategy. Priorities in the NDS include: human and social development through the achievement of the MDG's and the introduction of science and technology development policy; economic growth and development policy to increase competitiveness; introduction of PPP's, industrial development policy and support to processing industries (mineral and non-minerals); and development of SME's, especially in agro processing, food and tourism, linked to regional and rural development policies. In terms of rough funding requirements, about \$14 billion was estimated to achieve the goals of the MDG's by 2015 and between \$ 21-28 billion to achieve the real sector goals between 2007 and 2021. Only 10 percent of the financing for the NDS was to come from public funds, while the bulk (80 percent) was to be financed by the private sector and foreign investment. Foreign loans and aid financing was estimated at 10 percent.²¹²

292. Around the same time that the NDS was passed in parliament (Feb 1, 2008), a PSD strategy was formulated for the first time since the transition. Prior to this, Mongolia relied on general policies to influence the development of the private sector (tax and regulatory reforms, financial sector development). This strategy is vision based but also has clear targets (e.g. to increase private sector contribution to 90 percent, while raising the processing industries share to 36 percent, etc). These targets would certainly pose an implementation challenge with the increasing trend of public sector expansion and the increase of SOE's in mining. The strategy has five main parts and has as its core the aim of generating intensive growth as envisioned in the NDS (Figure 5.1).

²¹⁰ The external partners with larger financial roles prepare longer term strategic programs (e.g. ADB's CPS, World Bank CAS/CPS—2008-2012, Japan's Country Assistance Program 2004-2008, EBRD Country Strategy prepared in 2006; EU Strategy paper for 2007-2013 and USAID Strategic Plan 2004-2008).

²¹¹ The lack of policy clarity over the past four years was also due to institutional constraints imposed by three coalition governments that were formed. The executive branch also lost its policy leadership, bequeathing a substantial role in this area to a divided parliament.

²¹² While defined sector targets and investment estimates were developed by the NDS Working Group, they were excluded from the final version of NDS approved by the Parliament. The targets and estimates are to be included in implementation documents and updated annually or as needed.

Figure 5.1: Structure of the Government's PSD Strategy

293. Linked to this core aim are the other parts of the strategy, such as increasing labor productivity and flexibility (through skills and technology policy for the private sector); improving the business environment and investment climate and competitiveness of the private sector (through macro-stability, financial market development, incubation centers, branding, improved financial and accounting practices); promoting PSD in the regions (through support to agro industries, tourism, mining services); and creating various types of PPPs (by improving the legal environment²¹³, arbitration, infrastructure, logistics, and consultation mechanisms including those with external partners).

294. Although government strategies put significant focus on promoting PPPs as means to support private sector development, planning and implementation mechanisms (both from legal and institutional perspective) are still not in place. As mentioned above, both the National Development Strategy and Private Sector Development Strategy are vision-based documents which set broad areas of focus for future government actions. Realistic action plans to achieve the fairly ambitious objectives spelt out in these documents (presumably by successive governments) are yet to be formulated. Furthermore, no legal framework exists to regulate such arrangements as yet, and the Law on Concessions, if enacted, will certainly be the necessary first step. For many sectors of the economy, tariff policies need major revisions to encourage private participation, especially those in the infrastructure category. Moving forward, it would be useful for Mongolia to learn from countries in Asia and elsewhere, how successful PPP frameworks are designed and implemented.

295. For PPP's to take a foothold especially in infrastructure, and other sectors more generally, competition policies need to be enforced. The government's competition policies lack clarity and enforcement is weak. Although the Law on Prohibiting Unfair Competition was approved in 1993, the Unfair Competition Regulatory Authority was established much later in 2005 with all competition-related policy enforcement having been overseen previously by different ministries. The agency (with 30 staff) is mandated to implement government's policies to ensure fair market competition, however capacity constraints and strong government involvement in many areas of the economy continue to weaken its' regulatory and enforcement abilities. While the agency can and does investigate instances of possible unfair competition, such as predatory pricing and price collusion, its powers to discipline and ensure compliance

²¹³ The current draft Concessions Law, if enacted, will be one of the major actions to improve the legal environment conducive to PPPs.

are limited. External partner involvement in strengthening of competition policy enforcement capacities has been limited so far, bilateral cooperation agreements with Japan International Cooperation Agency (JICA) IFC, and Korea International Cooperation Agency (KOICA) being the exceptions.

296. Institutional gaps still remain in coordination of government strategies and external partner programs. Over the last few years, the previous Ministry of Industry and Trade (MIT) had emerged as the focal ministry to influence policies on the private sector.²¹⁴ However, a larger number of agencies affect policy outcomes, and coordination is still unwieldy, compounded by changes in governments (Fig 5.2). Coordination was assumed between the MIT, MoF and Bank of Mongolia on the one hand, and the sector ministries on the other. Each sector ministry (agriculture, infrastructure etc.) also has a private sector policy component. In addition there are many specialized implementation agencies (such as the SPIA, customs, etc). Added to this are a large number of private sector associations --about 30, that represent private sector interests. As part of the Paris Declaration for Policy Harmonization, the external partners formed a Working Group on private sector issues. However over a number of years, the discussions on harmonization of private sector issues among the partners and the government, has encountered difficulties as it has not been easy to identify the appropriate institutional focal points on the Mongolia side.

Figure 5.2: Institutional framework for PSD policy and implementation



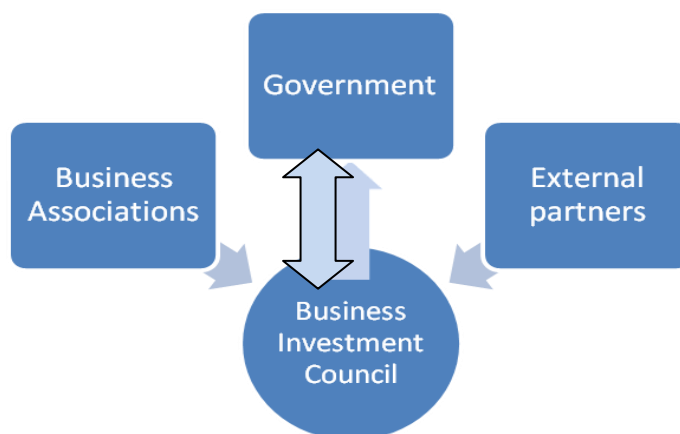
297. The newly founded Business Investment Council (and its secretariat) was established by the authorities in early 2008, and is supported by the EBRD (Fig 5.3). This new institutional structure could become the focal point for all the key players (government agencies, business associations, and the external partners) to table issues for resolution and their follow up, including the further development of the PSD strategy itself.²¹⁵ If the new structure can be made

²¹⁴ Under the new government that was recently formed after the June 2008 elections, the Ministry of Industry and trade was dismantled. Part of its portfolio was given to the Ministry of Food and Agriculture (on SME policies) and the new Ministry of Mining and Energy. Both of these Ministries can be expected to play important roles in private sector development policies in the present administration.

²¹⁵ The BIC (and its Secretariat) has the following aims: support and complement existing public-private dialogues; formalize the exchange, ensure follow-up; assist smaller companies to have their opinions reach top government levels. The structure of the BIC planned to include the Prime Minister, (Former) Ministry of Industry and Trade, Ministry of Finance, 3 PS representatives (Business Council of Mongolia, CEO Club, Chamber of Commerce and

to work, then the existing Government–External Partners Working Group on private sector could be folded into this new framework.

Figure 5.3. Institutional Structure for BIC-Government Dialogue

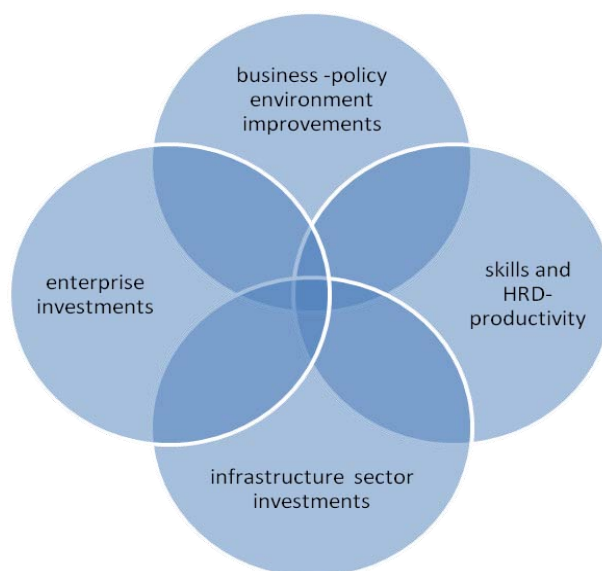


298. While progress has been made by the government and external partners in addressing private sector development challenges, much more needs to be done. Specific actions in this regard are outlined in the final chapter.

VII. POTENTIAL AREAS FOR FURTHER ASSISTANCE IN PRIVATE SECTOR DEVELOPMENT

299. Based on the findings of the previous Chapters, this chapter summarizes the potential areas for actions by development partners (including ADB) over the medium term. The present financial crisis makes it all the more imperative to focus on the following issues to reduce structural constraints and improve competitiveness of enterprises. Four broad areas can be identified (see Fig 6.1 and table 6.1) for future actions: infrastructure investments, enterprise level actions; increasing skills and productivity; and improving the business and policy environment. There is no doubt that enterprise finance will overshadow other actions in the short term. However over the medium term the four sets of measures identified, should guide the further development of the private sector. In addition, supporting institutional coordination at the level of the BIC would add value to the other intended actions.

Industry), 1 IFI, 1 Bilateral donor representative. A government decree on the establishment of the BIC was approved early in 2008. The Secretariat's work is expected to be aligned with the External Partner working group (WG) on PSD.

Figure 6.1: Potential PSD actions

A. Infrastructure

18. Public sector operations

300. Despite heavy investments in infrastructure stock and services²¹⁶, considerable infrastructure bottlenecks remain, given the country's geography and need for rapid growth. The list of planned infrastructure projects at the sectoral level runs into more than \$ 7 billion²¹⁷ over the next decade. To meet these demands the public sector's role will continue, by relying on tax revenues, and infusions from external development partners (including the MCC). Still, these efforts would not be enough to meet infrastructure demands. Pricing reform and a greater role for the private sector investments would be needed. On the part of the public sector, the three key challenges should be met: aligning more closely prices with costs, improving efficiency and governance, and better planning and project prioritization.²¹⁸ Public sector operations aided by external partners should focus on these issues; alongside the expected investments in roads, energy, railway, water, and urban services.

19. Private Sector Operations

301. Private sector operations in energy, heating, railways would require the necessary policy reforms as noted in Chapter 4. Once the necessary improvements in legal framework are achieved, a wider range of infrastructure projects (roads, rail, energy, urban services, logistics) can be considered for co-financing arrangements with the Government of Mongolia (under potential PPP arrangements).

302. Although the mining sector has not been covered in this assessment, significant potential exists for external partners' financial involvement, and this could happen in partnership with international investors. Participation in project financing of mine area infrastructure projects

²¹⁶Sector investments have been as high as 10% of GDP.

²¹⁷See World Bank, Mongolia, Foundations for Sustainable Development: Rethinking the Delivery of Infrastructure Services in Mongolia, June 2007.

²¹⁸As above.

(including roads and railway spurs, highways, urban settlements and power generation facilities) with selected support to mine investments would help capture greater regional economic development benefits.²¹⁹

B. Skills and Productivity

20. Public Sector Operations

303. Rapid growth in recent years has brought forth a greater need to rebuild better worker skills to overcome skills mismatch and shortage facing the private sector. A number of external partners have been involved in skills development (ADB, MCC, GTZ). Going forward, the tasks should aim to improve the quality and relevance of primary, secondary and vocational education. For this to be successful, improvements are needed in TVET organization and management, in fostering better links between government, TVET institutions and employers; and in developing appropriate qualification standards and implementation mechanisms. The MCC will also focus on addressing these public sector institutional issues.

21. Private Sector Operations

304. Opportunities to support private sector initiatives through competition-based education and skills development funds, and PPP's in vocational education and technology institutions²²⁰ should also be explored.

C. Business and Policy Environment

22. Public Sector Operations

305. Support by a number of external partners over the years in tax reforms, cadastral mapping, land registration, building codes, trade facilitation and customs modernization, have addressed a segment of the business environment constraints identified earlier in this Report. Continuing reforms in these areas would be essential, and even more urgent under current lower growth scenarios. Further attention is clearly warranted in the following 5 constraints to reduce the administrative burden (and corruption): 1) regulatory simplification in licensing and inspection at the SPIA (this agency should target more risky areas such as health, safety, environment etc.); 2) implementing the "single window" concept for business registration, land registration, and customs through e-government initiatives; 3) reforming labor regulations and labor taxes; 4) strengthening the competition policy agency in policy formation and implementation; and 5) reforming business related laws in bankruptcy, foreclosure, collateral, and dispute resolution.

306. A stronger private sector has emerged over the past decade. However given the present policy, legal and institutional settings in the country-- measures at improving both the policy environment and providing financial support at the sector and enterprise levels-- are necessary. Where investment needs and project risks (policy, market) are both high, preference can be given to assistance for reform initiatives supported by government co-financing schemes. In this regard, technical assistance to establish the necessary legal and institutional framework for Public-Private Partnerships (PPPs) will bring about longer term benefits for Mongolia. Matrix

²¹⁹ In the same vein, there is potential in further developing SME's in mining services as noted in Chapter 4.

²²⁰ Especially in agro-industry and construction, from the cluster development perspective as mentioned earlier. Another priority is the area of environmentally friendly energy technology institutions.

6.2 provides detailed sector by sector summary of private sector participation status, constraints, and PPP potential to guide further actions at the sector level. Given the weaknesses in institutional coordination of private sector development policies, external partners should explore how they could support the functioning of the BIC.

D. Enterprise Level Operations

23. Public Sector Operations

307. Since the transition, development partners have actively assisted Mongolia in strengthening the financial sector and access to finance by enterprises of various sizes. From about 2004 until the recent financial crisis (which began in September 2008), access to finance improved dramatically. Improving the functioning and stability of the financial markets have been and will continue to be priorities of external partner assistance, especially the International Financial Institutions. In the short-term, the ability of enterprises to repay bank debt will become priority as liquidity and credit have become tight, and NPL's have increased (to 7.2% of total outstanding loans by the end of December 2008).²²¹ Bank credit backed by collateral, continues to be the primary source of short and medium term financing for firms. While securities market development has been given priority, and was given a boost during the rapid economic growth of the past 3 years, its role in financing enterprises is still minimal. The recent financial downturn has put pressure on banks and the current case of Anod Bank's financial problems points to the need for better oversight and observance of prudential regulations and supervision of the banking system by the authorities. While the institutional framework for this is already in place, including coordination among the regulatory authorities, swift implementation of measures and "early-warning systems" are needed.

24. Private sector operations

308. Khan Bank, Trade and Development Bank, Xac Bank, Zoos Bank and Golomt Bank, have been the recipients of direct assistance in the form of equity and loan financing from International Financial Institutions and international banks. Further interest by international banks in investing in Mongolian banks, will depend on the management and corporate governance capabilities of Mongolian banks which will no doubt be tested by the present financial crisis. Over the medium –term, enterprise level assistance in improving corporate governance would be especially beneficial for promoting the further development of capital markets and increasing enterprise access to both domestic and overseas funding.²²²

309. Direct support of insurance companies (including the development of private health insurance) through equity and loan products (either on a stand-alone basis or in partnership with other IFIs) into soon-to-emerge private equity funds, can help the further diversification of financial services and accelerate sector development. However, the current economic situation necessitates detailed analysis of such investments on a case-by-case basis. More promising results can be achieved in the productive sectors of the economy. In the urban sector, direct lending support to enterprises expanding into environmentally-friendly energy-saving construction technologies and materials manufacturing (cement, pre-fabricated concrete, expanded polystyrene blocks and panels, etc) would be a way to achieve significant benefits both from the economic and social perspectives.

²²¹ National Statistical Office, December 2008.

²²² Plans to support the privatization of the Mongolian Stock Exchange or establishment of alternative stock exchange platforms – following the NASDAQ model – should be undertaken in tandem with improvements in the regulatory capacities and compliance of international financial standards by corporations.

310. Although agro-enterprises (engaged in cultivation and manufacturing of vegetable origin health products, as well as livestock herding) have longer gestation periods and slower payback terms, supporting their growth can help alleviate rural poverty, unemployment, increase the number of small and medium enterprises from the grassroots, and help diversify the export base. In this regard, the cluster development approach found in many emerging economies is particularly suitable for the agro-business and foodstuff sector (meat, dairy, leather, cashmere) with integrated supply chains involving raw material sourcing, support services, packaging, testing, storage and logistics.²²³

E. A PSD Roadmap for ADB over the next four years

311. Changing the role of Government from a provider of services to a facilitator of a growing role for private initiative in the economy would be a cross-cutting thrust of ADB's support. ADB will promote balanced development and continuing market reforms by supporting private sector development and engagement of other nongovernment actors through TA and non-sovereign operations. Public sector operations will work with the central Government, local governments, and domestic banks to promote public-private partnerships for investments. Private sector operations will capture new opportunities to be involved in private sector financing of infrastructure projects and help develop the country's financial sector to meet private financing needs.

312. Through its public sector operations, ADB will continue to support policy, legal, and regulatory reforms to encourage the private sector's continuing development and improve its access to finance. ADB will support the central and local governments to provide capacity development assistance for strengthening the enabling environment for the private sector for structuring public-private partnerships—particularly with respect to the use of this modality in the energy, transport and urban development sectors. ADB support for the implementation of the anti-corruption action plan would help reduce the hidden operating costs that hamper Mongolian firms. ADB assistance for skills development and tertiary education would help to address skill shortages by better matching training outcomes with labor market demand. Building on previous support, ADB will help to improve the governance of the capital markets to create more stable, long-term sources of finance for the private sector, and as an alternative to the predominant collateralized loans from commercial banks.

313. ADB's Private Sector Operations Department will continue to help improve access to finance and will finance projects with high development and demonstration impacts in the sectors which maximize synergy with ADB's public sector operations, focusing on infrastructure and the financial sector. In infrastructure, ADB will seek new opportunities for private sector involvement in the sectors where ADB has strengths and which are relevant to the Government's policy, and will also help develop financial solutions with innovative contractual and financial structures to encourage private sector participation, enhance management expertise, and improve corporate governance. ADB will promote private sector participation to support reliable and efficient energy, transport, and urban environmental services. ADB will promote private sector development and private-public partnerships by assisting technology and management transfer to local entities currently owned by the public sector through acquisition, rehabilitation, or expansion projects.

²²³Furthermore, external partners could support these activities leading to modernization and integration of logistics and cargo terminal services augmented by efficiently-run air cargo operations.

<p>- Non-Bank Financial entities TA</p>	<p>WB/JBIC: two-step loan to corporate and SMEs</p> <p>ADB: Technical Assistance to improve regulatory capacity (FRC/MSE)</p> <p>ADB: Corporate Governance Code for Listed Companies; Trust Law;</p> <p>ADB/EBRD/IFC: Assistance to a holding company structure for government shareholding in mining</p> <p>IFC: Leasing Law</p> <p>USAID: Germany: Establishment of Mongolia Mortgage corporation (MIK); credit information bureau.</p>	<p>-- TA to strengthen FRC; Explore investments in insurance companies, investment banks private equity funds;</p> <p>--TA for health insurance;</p> <p>--improve corporate governance of non-bank entities</p>	<p>USAID: ADB:TA for FRC and capital markets development</p>	
<p>Enterprise—capabilities TA</p>	<p>ADB:USAID: Improving corporate governance practices</p> <p>ADB:JICA: Support for strengthening accounting and auditing capacity</p>	<p>--TA in corporate governance ;</p> <p>--TA in corporate social responsibility ; management training</p> <p>--Explore establishments of training programs through PPPs</p>	<p>USAID: ADB: JICA: improving corporate governance</p>	<p>Improve access to capital markets and enhance the competitiveness of enterprises PSD strategy</p>
<p>Enterprise--capabilities SMEs TA</p>	<p>IFC: Support to SME through toolkit for small businesses and leasing industry.</p> <p>Germany: EU: Financial services for SMEs: Promotion of SMEs;</p> <p>USAID: training among peri-urban and rural small and micro-enterprises, cooperatives; the Business Competitiveness Fund (BCF) for business development, information services, linkage to the markets</p>	<p>--Business incubation;</p> <p>--SME cluster development in ICT, agro-business, mining services</p>	<p>GTZ: Business incubation; product promotion, SME training; USAID: business development</p> <p>ADB: Agriculture Development Project to assist agro enterprises with financing etc. GTZ: product promotion and SME training</p>	<p>SME promotion law 2007 PSD strategy</p>

	and inputs, trainings among business groups; UNDP: Financial services to herders in remote areas; credit cooperatives; commercialization of super-insulated buildings			
Infrastructure sector— investments and TA	ADB: WB: Japan: Germany: Public sector investments in roads, other forms of transport, energy, water urban services; heating in urban centers; ICT expansion; TA for national airlines management; TA for national transport strategy; TA for national infrastructure strategy; TA for heat efficiency in buildings; USAID: energy sector commercialization; TA for ERA and financial improvements of energy entities; TA for ICTA; Korea: transport/roads; water and heating in UB; TA for transport system; Turkey: roads; China: energy (hydro), transmission lines Netherlands: rural electricity; Czech R: water and energy investments; UN: India: ICT expansion; WHO: UNICEF: water and sanitation investments	--Filling large infrastructure investment needs given country's geography and climatic conditions -- Aligning prices with costs -- Improving efficiency and governance reforms -- better planning and prioritization of public investments --developing policy and institutional framework for PPP in infrastructure --Explore possibilities for non-sovereign lending in infrastructure enterprises	WB: Energy distribution system efficiency. ADB: Urban development , heating, roads; EBRD: fuel switching; USAID: policy reforms MCC: Railways— organizational efficiency Japan: construction of new airport	PSD Strategy Transit Mongolia
Infrastructure sector--mining related TA and investments		-Support for South Gobi infrastructure development; -TA exploring financing and support to mining services; -enclave loans; -guarantees; -partial risk guarantees; -enclave guarantees etc;	WB,ADB: South Gobi Development Strategy EBRD:IFC: ADB: mine/infrastructure investments	South Gobi Development Strategy

<p>Skills and productivity</p>	<p>ADB; Japan: JICA: WB Education Development Projects; curriculum reform and reform of vocational technical education system; non-formal skills for vulnerable youths; technical training; non-formal education for youths; TA baseline study for technical and vocational education; Germany: TA on policy framework on vocational and technical education; USAID: matching and skills training in peri-urban areas; Korea: distance education center; technical college; Turkey: education institutes and vocational training; UN: piloting of voucher training system</p>	<p>--Closing skills mismatch between labor supply produced by education and training systems to needs of labor market; inadequacies in public education system in terms of curricula, teaching and provision of adequate learning opportunities; - improving quality and relevance of education and training systems; - Promoting private sector through competitive education support fund; -Promoting PPP in vocational education; -Improving functioning and relevance of technology institutions</p>	<p>ADB; WB: reforms and investments in public education system MCC: ADB: GTZ, JICA: reforms and investments in vocational and technical education/training systems</p>	<p>PSD Strategy</p>
<p>Business-policy environment</p>	<p>Tax Reform, USAID:IMF: Japan: Enactment of new PIT, CIT, VAT and excise taxes; USAID: WB: Germany: Japan; computerization and re-design of the courts, installation of the public access terminals, improvement of the courts management, drafting civil and criminal codes; improvement of ethics and accountability of the justice sector; UNDP; WB: ADB: USAID: supporting anticorruption WB: IMF: ; support for public finance management reform; capacity building for efficient management of government assets and liabilities; Korea: Support for Customs modernization training, Police</p>	<p>--tax administration(reduce discretion) --reduce burden of social security taxes --further public finance management reform— --reform of State Professional Inspection Agency --supporting anti-corruption efforts --implement collateral reform-movable registry --registration --single windows, one stop shops --land administration and collateral reform --customs, trade and logistics reforms</p>	<p>Switzerland (One-stop shops for business establishment) ADB: Urban Land Cadastral project MCC—property rights project for suburban/peri-urban land WB: Mining cadastre USAID: ADB: trade and logistics TA</p>	<p>PSD Strategy Transit Mongolia</p>

	<p>investigation training; Korea: Turkey: Support for legal reform in Fair Competition field ADB: Turkey: property rights and land Cadastral mapping and land registration WB: ADB; Assistance in Civil Service Reform; strengthening regulatory and fiscal regimes; Capacity building of the state audit and inspection system; standardization of regulations registry Germany: ADB: USAID: Support in policy framework for trade and export; trade and logistics, cross border issues Germany: IFC: Capacity building of Inspectors in SSIA Japan: WB: ADB: strengthening accounting and auditing capability; ADB:USAID: Modernizing Customs capacities in terms of both physical infrastructure, software and human development;</p>	<p>--legal reforms --support EBRD sponsored Public-Private Institutional Arrangement; --TA to strengthen institutional capacity for competition policy formulation and enforcement; --TA to establish legal and institutional settings for PPPs</p>		
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Matrix 6.2: Private Sector Participation and PPP Analysis by Sectors

Sector	Present form/s of private sector participation (PSP) and PPP	Present enabling legal and regulatory framework for PSP and PPP	Possible form/s of private sector participation (PSP) and PPP	Constraining policy and regulatory issues against PSP and PPP
Agro-business				
Cashmere	PSP: 100 percent <ul style="list-style-type: none"> - Large and small scale dehairing and spinning factories, end-product manufacturers, traders/exporters; - Significant foreign involvement - Industry alliance for export marketing and brand promotion (Mongolian FiberMark society) PPP: <ul style="list-style-type: none"> - Assistance for overseas promotion activities (supported by external partner initiatives) 	<ul style="list-style-type: none"> - No regulatory restrictions on PSP - Attempts by the state to regulate cashmere prices through manufacturer subsidies and direct government procurement are underway - Law on SME 	PSP: <ul style="list-style-type: none"> - Cluster-based arrangements (tighter links with herders, long-term procurement contracts, involvement with support services) - Strategic alliances with foreign brand makers - Industry alliances for overseas marketing PPP: <ul style="list-style-type: none"> - Quality assurance, research and design institute - Marketing houses linked with overseas embassies and consulates - Joint committees for development of sector-specific policies and trade negotiations 	<ul style="list-style-type: none"> - Lack of comprehensive and specific sector development policy and action plan that balances interests of herders and manufacturers - Weak customs control over cashmere smuggling to China
Meat	PSP: 100 percent <ul style="list-style-type: none"> - Large and small scale processing and packing factories, traders/exporters, vertically integrated companies - Foreign involvement is limited - Industry association (Mongolian Meat Association) PPP: <ul style="list-style-type: none"> - State-financed arrangement for annual meat reserve funds 	<ul style="list-style-type: none"> - Limited regulatory restrictions on PSP (licensing regime for meat packers/exporters) - Government programs to encourage domestic sales of meat (exemption from VAT, interest rate subsidy, direct financing for meat reserve funds) - Law on SME 	PSP: <ul style="list-style-type: none"> - Full vertical integration (livestock farming, slaughterhouse, packing, processing, manufacturing of end-product, storage, retail, export) - Higher value-added product manufacturers (canned meat, , specialty foods, pet foods) PPP: <ul style="list-style-type: none"> - Industrial park (cluster with phyto-sanitary labs, storage facilities, infrastructure connections, etc) - Joint committees for development of sector-specific policies and trade negotiations 	<ul style="list-style-type: none"> - Weak foreign trade negotiating power by the government - Lack of policy to support industrialization of meat sector (through financial incentives, cluster approach)

Leather	<p>PSP: 100 percent</p> <ul style="list-style-type: none"> - Mostly small-scale processing and end-product manufacturers - Foreign involvement is not extensive - Industry association <p>PPP: Negligible</p>	<ul style="list-style-type: none"> - Limited restrictions on PSP (mostly environment-related regulations to control pollution, including import permits for chemicals) - Law on SME 	<p>PSP:</p> <ul style="list-style-type: none"> - Vertical integration and/or strategic alliances with herders/meat companies/slaughterhouses; <p>PPP:</p> <ul style="list-style-type: none"> - Industrial park (design and marketing houses, research institute, central waste water treatment, storage facilities for chemicals, centralized procurement for raw materials and chemicals) - Joint committees for development of sector-specific policies and trade negotiations 	<ul style="list-style-type: none"> - Lack of support policies (financial incentives, overseas promotion, etc)
Niche products	<p>PSP: 100 percent</p> <ul style="list-style-type: none"> - Small-scale, start-up companies - Some interest and involvement from foreign investors - External partner support <p>PPP: Negligible</p>	<ul style="list-style-type: none"> - No regulatory restrictions on PSP - Law on SME 	<p>PSP:</p> <ul style="list-style-type: none"> - Vertical integration (raw material, processing, storage, retail, exports) - Industry alliance (marketing, research) <p>PPP:</p> <ul style="list-style-type: none"> - Industrial park (research, phyto-sanitary labs, infrastructure, marketing and other support services) 	<ul style="list-style-type: none"> - Lack of support policy (financial incentives, overseas promotion, etc)
Food and Beverage	<p>PSP: 100 percent</p> <ul style="list-style-type: none"> - Small and large-scale producers, importers - Significant foreign involvement (brewery business) - Industry associations <p>PPP:</p> <ul style="list-style-type: none"> - Activities within the framework of the Dairy Sector Revival Strategy 	<ul style="list-style-type: none"> - Limited regulatory restrictions on PSP (licensing regime for alcohol production and sales) - Government support programs (interest rate subsidy for dairy producers, etc) - Law on SME 	<p>PSP:</p> <ul style="list-style-type: none"> - Vertical integration/and or strategic alliances (intensified livestock farms, vegetable cultivation, processing, storage, frozen and processed foods manufacturing, exports) - Organic (green) foods <p>PPP:</p> <ul style="list-style-type: none"> - Industrial park (infrastructure, livestock and vegetable farms, phyto-sanitary labs, storage, research, export support services) - Joint committees for development of sector-specific policies and trade negotiations 	<ul style="list-style-type: none"> - Lack of specific support policies, with an exception of dairy farm (financial incentives for vegetable growers, assistance to new production, etc)

Finance				
Banking	PPP: 100 percent <ul style="list-style-type: none"> - Commercial and investment banks - Industry associations PPP: <ul style="list-style-type: none"> - BoM training center - Credit Information Bureau - Housing Finance Corporation - Microfinance Development Fund - Mongolia Mortgage Corporation 	<ul style="list-style-type: none"> - Limited restriction on PSP (licensing, capital and other requirements) - Law on Banking and other related laws - Law on SME 	PSP: <ul style="list-style-type: none"> - Professional Investment banking - Integration/strategic alliances with other financial intermediaries PPP: <ul style="list-style-type: none"> - Low-cost housing finance arrangements - SME Development Fund 	<ul style="list-style-type: none"> - Under-development of capital markets - Gaps in legal framework relating to financial sector development and supervision (legal protection of supervisors, bankruptcy, foreclosure, securitization, corporate governance, electronic security, etc)
Non-banking	PSP: <ul style="list-style-type: none"> - NBFI - SLC - Insurance companies - Dealer, broker companies PPP: <ul style="list-style-type: none"> - MSE - Mongolia Mortgage Corporation - Housing Finance Corporation 	<ul style="list-style-type: none"> - Limited restriction on PSP (licensing, capital and other requirements) - Law on NBFIs, insurance, financial leasing, and other related laws - Law on SME 	PSP: <ul style="list-style-type: none"> - Institutional investors (insurance companies, pension funds, private equity funds) - Strategic alliances with banking sector - Privatization of MSE PPP: <ul style="list-style-type: none"> - Low-cost housing finance arrangements - SME Development Fund 	<ul style="list-style-type: none"> - Lack of laws on SCLs, mortgage, securitization, etc - Weak listing requirements and unclear de-listing procedures - Gaps in legal framework relating to financial sector development and supervision (legal protection of supervisors, bankruptcy, foreclosure, securitization, corporate governance, electronic security, etc)
Infrastructure				
Energy	PSP: <ul style="list-style-type: none"> - Maintenance and repair companies - Electricity distribution companies - Housing service companies (facility management) - District heating distribution companies - HOBs (management and operation) - Renewable energy generation (wind farm) 	<ul style="list-style-type: none"> - Some regulatory restriction on PSP (electricity transmission is fully state-owned, licensing regime for maintenance and repairs) - Law on Energy (allows private ownership and operation of generation and distribution facilities) 	PSP: <ul style="list-style-type: none"> - Power generation facilities (CHP, other) in urban areas - Mine-based power generation - Renewable energy generation (solar, wind) PPP: <ul style="list-style-type: none"> - Whole-sale electricity market - Concession contracts for investment and management of generation, transmission and distribution networks and facilities 	<ul style="list-style-type: none"> - Regulation of tariffs - Uneven market field - Licensing and tendering procedures not transparent - No Law on Concessions

	<p>PPP:</p> <ul style="list-style-type: none"> - Competitive bids for installation and repair works (electricity transmission and distribution infrastructure) - Management contracts between municipality and HOBs (district heating) - Management contracts between UBDHC and Housing Service Companies (hot water, heating) 			
Water	<p>PSP:</p> <ul style="list-style-type: none"> - PUSOs (management contracts) - Individual well operators - Individual water distributors <p>PPP:</p> <ul style="list-style-type: none"> - Management contracts between PUSOs and Water and Sewerage companies 	<ul style="list-style-type: none"> - No restriction on PSP - Sector development plans - External partner initiatives 	<p>PSP:</p> <ul style="list-style-type: none"> - Waste water treatment plant operations - Maintenance and installation of infrastructure <p>PPP:</p> <ul style="list-style-type: none"> - Outsourcing contracts for asset management and maintenance, water distribution 	<ul style="list-style-type: none"> - Regulation of tariffs - Absence of government policies and plans for privatization
Roads	<p>PSP:</p> <ul style="list-style-type: none"> - Construction and maintenance companies <p>PPP:</p> <ul style="list-style-type: none"> - Competitive bids for construction and maintenance - Built-Transfer contracts 	<ul style="list-style-type: none"> - Limited restriction on PSP (routine maintenance is limited to state-owned company, licensing and (planned) certification for private operators) - Government Decree allowing Built-Transfer contracts 	<p>PSP:</p> <ul style="list-style-type: none"> - Road construction conglomerates (combining research, design and construction work capacities) - Specialized companies (tunnels, steel bridges, special installations) - Mine-operated roads <p>PPP:</p> <ul style="list-style-type: none"> - Build-Operate-Transfer concessions - Research and design institute 	<ul style="list-style-type: none"> - No Law on Concessions
Railways	<p>PSP:</p> <ul style="list-style-type: none"> - Freight forwarders <p>PPP: Negligible</p>	<ul style="list-style-type: none"> - Law on Railway Transport 	<p>PSP:</p> <ul style="list-style-type: none"> - Provision of railway services (passenger, freight) - Investment in and management of railway infrastructure (under concession contract, general or dedicated), locomotives and rolling stock - Railway equipment (locomotives, 	<ul style="list-style-type: none"> - Natural monopoly of UBTZ - No mechanisms for implementation of Law on Railway Transport (e.g. licensing of railway operators) - No Law on Concessions

			<ul style="list-style-type: none"> rolling stock) leasing Railway repairs and maintenance <p>PPP:</p> <ul style="list-style-type: none"> Concession contracts for investment in and management of railway infrastructure and equipment 	
Civil Aviation	<p>PSP:</p> <ul style="list-style-type: none"> Domestic airline companies Helicopter and charter service companies <p>PPP:</p> <ul style="list-style-type: none"> Outsourcing of fuel supply services to private operator Outsourcing of some airport services (limited to Chinggis Khaan airport) 	<ul style="list-style-type: none"> Law on Civil Aviation Government support policies (VAT exemption for spare parts, exemption from navigation charges at domestic airports) 	<p>PSP:</p> <ul style="list-style-type: none"> Cargo operations International regional airlines Airport services (catering, baggage handling, facility management) <p>PPP:</p> <ul style="list-style-type: none"> Outsourcing contracts (airport management, aircraft repair and maintenance) 	<ul style="list-style-type: none"> MIAT monopoly on major international routes No Law on Concessions
Transport and Logistics	<p>PSP:</p> <ul style="list-style-type: none"> Small and large scale freight forwarders, truck companies, interurban bus operators Urban large and mini bus operators Warehouse operators <p>PPP: Negligible</p>	<ul style="list-style-type: none"> Subsidies for urban large bus operators De-regulated fares for inter-urban transport “Transit Mongolia” program Government units for trade facilitation (Logistics Council, Trade Facilitation Commission , etc) External partner initiatives Law on SME 	<p>PSP:</p> <ul style="list-style-type: none"> Cargo and container terminals Comprehensive warehousing and logistics Large scale inter-urban bus and freight services <p>PPP:</p> <ul style="list-style-type: none"> Large-scale warehousing terminals (land and infrastructure provided by the government) Outsourcing contracts for border point facilities (investment in and management of container and/or customs clearance terminals) 	<ul style="list-style-type: none"> Land access issues No Law on Concessions Lack of coordination for customs regulations with neighboring countries No progress on signing of tripartite transit treaty with China and Russia
ICT	<p>PSP:</p> <ul style="list-style-type: none"> ICT companies (software engineering, web development, etc) ICT training companies Mobile operators ISPs Industry association <p>PPP:</p> <ul style="list-style-type: none"> National Information Technology 	<ul style="list-style-type: none"> ICT development strategies Universal access strategy E-Mongolia program Telecommunications market liberalization On-going unbundling of state telecommunications 	<p>PSP:</p> <ul style="list-style-type: none"> Software outsourcing clusters (finance, mining-related, educational and gaming software, etc) <p>PPP:</p> <ul style="list-style-type: none"> IT training and research institute Outsourcing of government institutions’ IT functions Universal access implementation (remote areas) 	<ul style="list-style-type: none"> Gaps in legal framework related to ICT Incomplete unbundling of state telecommunications assets

	Park	assets - External partner initiatives		
Construction, real estate	<p>PSP:</p> <ul style="list-style-type: none"> - Small and large scale construction companies - Architectural and engineering design companies - Industry association <p>PPP:</p> <ul style="list-style-type: none"> - Housing Finance Corporation - Urbanization of peri-urban areas - Housing Fund (in plans) 	<ul style="list-style-type: none"> - 40,000 housing program - Laws related to housing 	<p>PSP:</p> <ul style="list-style-type: none"> - Large conglomerates with construction material manufacturing, research, architectural and engineering design and construction works in-house capacities - Special technology companies (façade design and installation, high-rise buildings, special purpose buildings, etc) - Professional facility management companies (especially for buildings with complicated infrastructure like office high-rise) - Construction material manufacturers (traditional and new technologies) <p>PPP:</p> <ul style="list-style-type: none"> - Research and training institute - Peri-urban area urbanization initiatives - Low-cost housing programs - Outsourcing contracts for government building facility management 	<ul style="list-style-type: none"> - Land issues: transparency of license, registration processes, 'rent-seeking', black market - Weak enforcement of zoning and building codes - Inefficiencies in the property rights system: registration, protection of rights, conflict resolution
Mining services	<p>PSP:</p> <ul style="list-style-type: none"> - Mostly foreign investor founded and operated from UB as sector new to the economy - Services provided: drilling, security, equipment sales and leasing, geological surveying and mapping, recruiting, catering, trucking, environment assessment <p>PPP: Negligible</p>	<ul style="list-style-type: none"> - Limited restrictions on PSP (licensing for transportation and environment assessment companies) - Law on SME 	<p>PSP:</p> <ul style="list-style-type: none"> - Contract mining - Specialty services (underground tunneling, complicated earthworks, water exploration and supply, special knowledge management, etc) - Local-based service companies <p>PPP:</p> <ul style="list-style-type: none"> - Outsourcing contracts for mine development and operation works 	<ul style="list-style-type: none"> - Uncertainty with mining legislation - Delays with signing of investment agreements - Unfavorable tax regime
Tourism	<p>PSP:</p> <ul style="list-style-type: none"> - Small and large scale tour operators - Ticketing agencies - Tour camps - Hotels and restaurants - Industry association 	<ul style="list-style-type: none"> - Limited restriction on PSP (licensing for hotels and restaurants, certification for guides) - Law on Tourism - External partner initiatives 	<p>PSP:</p> <ul style="list-style-type: none"> - High-end tourism - Specialty tourism (eco, mining, bird-watching, cultural, extreme, etc) - Vertical integration: camps, hotels, air transportation <p>PPP:</p>	<ul style="list-style-type: none"> - Lack of updated and comprehensive sector development policies with input from private sector - Weak progress with infrastructure connection

	<ul style="list-style-type: none"> - Arts and souvenir shops - Song and dance a ensembles <p>PPP:</p> <ul style="list-style-type: none"> - Tourism Information Center 		<ul style="list-style-type: none"> - Destination marketing supported by overseas embassies and consulates - Joint committees for development of sector policies - Outsourcing museum management 	<ul style="list-style-type: none"> - development (air, rail) - Not enough efforts to establish tourism agreements with foreign countries
Social Sectors				
Education	<p>PSP:</p> <ul style="list-style-type: none"> - Kindergartens - Secondary schools - Colleges and universities - Technical and vocational education institutions - Other special subject schools (language, IT) <p>PPP:</p> <ul style="list-style-type: none"> - Competitive bids for textbook development and production 	<ul style="list-style-type: none"> - Limited restriction on PSP (licensing and accreditation regime) - Legislation related to Education - External partner initiatives 	<p>PSP:</p> <ul style="list-style-type: none"> - Engineering education - University camps <p>PPP:</p> <ul style="list-style-type: none"> - Competitive education fund - Outsourcing contracts for second chance education, distance learning, literacy initiatives 	<ul style="list-style-type: none"> - Lack of government support policies (financial and other incentives) - Deficiencies in formulation and enforcement of education standards and requirements
Health	<p>PSP:</p> <ul style="list-style-type: none"> - Specialized clinics (gynecology, dental, pediatrics, orthopedics, etc) - Pharmacies - Diagnostic labs <p>PPP:</p> <ul style="list-style-type: none"> - Family group practices - Outsourcing contracts for hospital management - Contract-based reimbursements from the Health insurance fund 	<ul style="list-style-type: none"> - Limited restriction on PSP (licensing regime) - Sector privatization plans - Related legislation - External partner initiatives 	<p>PSP:</p> <ul style="list-style-type: none"> - Large scale in-patient treatment and diagnostic establishments - Health insurance funds <p>PPP:</p> <ul style="list-style-type: none"> - Outsourcing contracts for hospital management - Medical Research institute - Outsourcing contracts for the State Health Insurance Fund management 	<ul style="list-style-type: none"> - Lack of implementation mechanisms for sector privatization - Absence of an integrated and comprehensive quality assurance and accreditation system - Lack of a single and transparent payment mechanism for reimbursements from the state HIF

Matrix 6.3: Examples of Successful PPP Cases

Project Name	Sector	PPP Arrangements	Outcomes	Main Success Factor
Kenya-Uganda Rail Line	Infrastructure	Concession with private operator signed in December 2006 w	The arrangement was named Euromoney Project Finance Magazine's African Transport Deal of the Year	<ul style="list-style-type: none"> Well-designed PPP process: feasibility study, selection of contractor Donor support in designing the scheme PPP units in both Kenya and Uganda
Water supply in Vietnam	Infrastructure	Single contract s(design, build, lease) between private operators and local authorities (signed in January 2006)	90 percent of households in two towns (22,000 people) agreed to connect to networks, projects are planned to be replicated in 60 more towns	<ul style="list-style-type: none"> Demand-driven approach (household were surveyed to assess demand and ability to pay for services) Community participation Support from donors: World Bank
Energy Delivery in Armenia	Infrastructure	Management contract between government and private operator	Efficient operations, 24-hour uninterrupted power supply (used to be 2 hours a day by state-operated provider)	<ul style="list-style-type: none"> Reform of energy sector
The Rural Telecommunications Fund in Peru (FITEL)	Infrastructure	Private operators bid for subsidies from the fund to provide services in remote areas	6,500 pay phones are operating in remote towns on subsidies from FITEL; similar universal access funds are being adopted in 13 Latin American countries	<ul style="list-style-type: none"> Choice of appropriate incentives for private operators Favorable regulatory background: already established open and competitive telecommunications market
Electricity Supply in Rural Philippines	Infrastructure	The state-owned National Power Corporation opened up its service areas to competitive bidding by independent power producers, a government-funded subsidy is aimed at keeping prices affordable while allowing	US\$ 28 million will be invested in private power supply projects establishing 100,000 new connections over the next 5-10 years.	<ul style="list-style-type: none"> Support to local electric cooperatives External facilitation of dialogue between local communities and private power suppliers Donor support (IFC, Global Partnership on Output-Based Aid, Government of Norway, Infrastructure Development Collaboration Partnership Fund)

		cost recovery		
Inkosi Albert Lithuli Hospital, South Africa	Healthcare	The agreement (signed in 2001) secures the provision and maintenance of specialized medical equipment, hospital upgrade and facilities management over a 15-year concession period to Impilo Consortium	Hospital commissioned in 2002, total project value 4.5 billion rand (US\$ 548 million). Named Euromoney Project Finance Magazine's African Healthcare Deal of Year.	<ul style="list-style-type: none"> • Clear PPP law, process, standard terms • PPP Unit in strong National Treasury • Good project design • Rigorously commercial approach to financial analysis and planning • Full-time project 'champion' • Engagement of Transaction Advisor (usually a legal and/or financial counsel) throughout the whole project cycle
Department of Industry and Trade Campus, South Africa	Government	25-year master concession for the design, construction, lifetime management and financing of campus, total value US\$54 million	Campus completed in 2004, providing a venue for consolidating all agencies under the Department of Industry and Trade, and rejuvenating the area (part of the Nelson Mandela Development Corridor)	

Source: World Bank publications.

Matrix 6.4: Can Mongolia meet the success standards? Short analysis of Mongolian settings against six major categories of obstacles to PPP success²²⁴.

Type of obstacle	Mongolian settings
<p>Misallocation of risks Significant political, social, technical, economic and environmental risks may be associated with executing of a PPP project. Both public and private sectors should have a good understanding of potential risks and agree on an equitable risk allocation.</p>	<p>Project and financial risk assessment and management capabilities in both public and private sector are fairly weak. Significant external support is necessary for any large-scale PPP initiatives.</p>
<p>Private Sector Failure Private parties should be sufficiently competent and financially capable of taking up the projects.</p>	<p>With the exception of very few private companies (e.g. MCS Group, Newcom LLC), most Mongolian firms currently lack financial, technical and managerial capabilities for large-scale PPP projects.</p>
<p>High Transaction Costs and Lengthy Lead Time PPP arrangements are complex and involve multiple parties with conflicting objectives and interests. They may incur higher transaction costs than conventional public sector procurement arrangements since they often require extensive expertise (technical, financial, legal, etc) and take long time for negotiation.</p>	<p>Absence of a legal framework to regulate PPP arrangements will further increase transaction costs and lead times. Lack of sufficient local expertise related to PPP (legal, finance, management) will require involvement by external counsels.</p>
<p>Political/Social Obstacles PPP in public projects often incur issues like land appropriation, employment, heritage and environmental protection which can result in public opposition. Public may complain about high prices charged for private service delivery. The outsourcing of public services to private contractors may also raise fears of downsizing and loss of employment.</p>	<p>Most decisions to steeply raise tariffs (which will be required to cover the costs of operations) are most likely to be very unpopular politically in light of current income levels, inflation, employment as well as issues with access to land and urban development.</p>
<p>Lack of Well-established Legal Framework PPPs involve a significant amount of legal structuring and documentation. Without fully-developed legal framework (e.g. protection of public interests vs. legal rights of private sector) disputes will be impossible to avoid (thus, less likely to attract international capital)</p>	<p>No law on PPP has been enacted so far (the Law on Concessions is still in draft stage). Furthermore, supporting regulatory framework and implementation mechanisms (PPP manuals, PPP units) are yet to be developed. The problem is further exacerbated by deficiencies in the judicial/conflict resolution systems.</p>
<p>Non-conducive Financial Markets Private parties to PPP bear financial risks of the investment. Unattractive financial market conditions (limited access to funds, high costs of funds) is often a major obstacle to PPP success.</p>	<p>Costs of funds on the domestic market, while declining for the last few years, are still high. Capital markets are under-developed, thus access to large-scale capital internally is virtually non-existent, a situation compounded by limited access by Mongolian firms to international markets.</p>

²²⁴ Chan, A. P. C., Lam, P. T. I., Chan, D.W.M., Cheung, E. and Ke, Y. (2008). "Potential Obstacles to Successful Implementation of Public Private Partnerships (PPP) in China and the Hong Kong Special Administrative Region." *Journal of Management in Engineering, ASCE*.

²²⁵ Chan, A. P. C., Lam, P. T. I., Chan, D.W.M., Cheung, E. and Ke, Y. (2008). "Potential Obstacles to Successful Implementation of Public Private Partnerships (PPP) in China and the Hong Kong Special Administrative Region." *Journal of Management in Engineering, ASCE*.

Matrix 6.5: External Partner Programs in Mongolia

Enterprise-level interventions		Sector-level interventions		Policy and Institutional level interventions	
Enterprise re-structuring	IFC, Japan, EBRD, EU, GTZ, USAID, UN, SDC, AusAID, Korea, ADB, WB	Agriculture (Agro-business, Extension services, Regional development)	WB, IFC, ADB, Japan, EBRD, EU, GTZ, Netherlands, UN, USAID, SDC, Korea	Enabling environment (tax, customs, trade, competition, PPP, mining, investment policies)	WB, Japan, IMF, GTZ, UN, USAID, OSF, ADB, Korea
Business development		Infrastructure (energy, water, roads)	WB, Japan, EBRD, GTZ, ADB, Korea	Institutional capacity (Government, local, public)	WB, Japan, IMF, GTZ, UN, USAID, ADB, SDC, OSF, Korea
Finance/microfinance		Education (vocational training)	WB, Japan, EU, MCC, UN, USAID, Korea, ADB	Physical infrastructure (property rights, financial systems, etc)	WB, Japan, IMF, GTZ, MCC, USAID, SDC, ADB
Corporate governance		Trade and logistics	ADB, Japan, EU, GTZ, USAID, EBRD	Skills and capabilities (human resource development)	WB, Japan, GTZ, MCC, UN, USAID, OSF, ADB
Investment and business information		Transport (auto, railway, aviation)	EBRD, MCC, Korea		
		Healthcare	UN, WHO, MCC, ADB		
		Mining	EBRD, WB		
		Manufacturing	Japan, USAID, UN		
		Finance	IFC, EBRD, ADB, GTZ, USAID		
		ICT	WB, Japan, Korea		

Matrix 6.6: External Partner Programs in Mongolia as Categorized According to ADB Strategy Thrusts for 2004-2008

Creating Enabling Conditions							
Public sector Governance/Justice system	Commercialization and privatization	Private sector Governance	Financial Intermediation	SMEs	PPP		Regional and Sub-regional Cooperation
					<i>Physical and Social Infrastructure development</i>	<i>Agriculture and rural sector development</i>	
<p>ADB: Governance Reform Program, policy conditions developed to comply with; Modernizing Customs capacities in terms of both physical infrastructure, software and human development; Support for harmonizing investment planning; Strengthening effective Anti-Money Laundering Regime within BOM; Capacity building in Statistical Systems; Yearly ADO and ADO Updates published including macroeconomic analyses and recommendations; Strengthening GOM's research capacity;</p>		<p>ADB: Corporate Governance Code for Listed Companies; Trust Law; Assistance to a holding company structure for government shareholding in mining;</p>	<p>ADB: Financial regulation and Governance with focus on capital market development; strengthening capacity of Financial Regulatory Commission; Strengthening of legal environment for Social Security Fund management; Housing Finance through strengthening commercial banks; "Effective Anti-Money Laundering Regime" analytical paper published in 2007; Private sector assessment update (2008) identifying the bottlenecks published earlier</p>		<p>ADB: Construction of the central north-south corridor connecting PRC-RUS through MON (AH3), focusing on promotion of regional trade; Construction of a new road corridor in Western Mongolia connecting PRC-RUS through MON (AH4); Support to develop the National transport strategy for Mongolia; Improved access to urban services; Upgrading and rehabilitating basic infrastructure and public services in the selected provincial centers in eastern and central Mongolia; Improved district heating and steam system operations in Ulaanbaatar; sustainable heating services in remote rural areas;</p>	<p>ADB: Establishment of cadastral database for a national land information system and creation of institutional basis for land administration for development of the land property market; Developing a market oriented, efficient, and sustainable agriculture sector and reduce poverty by providing increased income opportunities; Support for a market-based agricultural sector; Assistance in irrigation and seed production; Branding of agriculture products produced in Mongolia;</p>	<p>ADB: Trade Policy initiatives and Trade Facilitation Cooperation initiatives under CAREC Program; Regional cooperation projects;</p>

<p>Japan: Support for capacity development of Tax administration; strengthening accounting and auditing capability; Supporting legal reform-Strengthening advocate Association; support for harmonizing investment planning JICA: Support for capacity development of tax administration (Enhancement of Tax Administration Project); Strengthening of Mongolian bar association (Legal Reform Support Project); JICA: Support for strengthening accounting and auditing capacity (Strengthening Accounting and Audit Capability Project);</p>		<p>Japan: JICA: Strengthening of supervising operation of the Bank of Mongolia (Banking Corporate Governance and Information Technology Project)</p>	<p>Japan: Support for financial law reform; Two step loan for SMEs development; Policy advice for Trade and investment; industrial development policy JICA: Policy advice for Trade and Investment (Expert for Trade and Investment Development Policy)</p>	<p>Japan: Two step loan for SMEs development;</p>	<p>Japan: UB development Master Plan; Improvement of selected roads in UB city including community roads in ger areas; construction of new international airport; support for long-term energy policy; non-project grant aid for energy sector; Support for improvement of ICT infrastructure; Road improvement in Easter direction JICA: Study for revising UB City Master Plan (UB City Master Plan and Urban Development Program); Rehabilitation for the power station IV</p>	<p>Japan: Support for rural finance; Support for crop-livestock management; training of veterinary specialists; JICA: Support for crop-livestock management; Training of veterinary specialists; Follow-up assistance for OVOP of Bayankhongol; Follow-up assistance for Study on Improvement Plan of Farming System</p>	
		<p>EBRD: Support to a holding company structure for government shareholdings in mining;</p>	<p>EBRD: Co-investment with reputable investors; Support for sustainable development of natural resources sector;</p>		<p>EBRD/Netherlands: Support for UB urban transport</p>		
			<p>EU: Financial services for SMEs;</p>	<p>EU: Financial services for SMEs;</p>	<p>EU: Co-financing and execution of investments in basic infrastructure;</p>	<p>EU: Rural micro-finance services;</p>	

<p>Germany: Support in policy framework for trade and export; Training and retraining for judges and other legal professionals; Support in the improvement of the legal framework regarding economic development; Establishment of a legal framework and database; Capacity building of Mining Inspectors in SSIA;</p>	<p>Germany: Support in privatization of veterinary services</p>	<p>Germany: Capacity building/ improvement of management of cooperatives</p>	<p>Germany: Capacity building in banking sector; Microfinance/ financial services in rural area; Loan guarantees for small businesses; Support of the Mongolian Mortgage Company; Support for Xac Bank</p>	<p>Germany: Promotion of SMEs, Microfinance/ financial services in rural area; Loan guarantees for small businesses;</p>	<p>Germany: Support for rehabilitation of thermal power station in Darkhan-Uul Aimag; Rehabilitation of existing buildings into cost- and energy-efficient housing; Promotion of economic use of renewable energy in rural areas; Construction of small hydro power plants; Improvement of regional roads</p>	<p>Germany: Microfinance/ financial services in rural area; Training of veterinarians;</p>	<p>Germany: Support in regional economic development (Darkhan, Erdenet, Uliastai); Land management and fiscal cadastre; development of regional infrastructure</p>
<p>USAID: Enactment of new PIT, CIT, VAT and excise taxes; computerization and re-design of the courts, installation of the public access terminals, improvement of the courts management, drafting civil and criminal codes; public education campaign including TV broadcast and radio programs, improvement of ethics and accountability of the justice sector; supporting anticorruption</p>	<p>USAID: Support in Energy sector commercialization for long term financial sustainability; Privatization of large enterprises</p>		<p>USAID: Establishment of a secondary mortgage market private sector financial institution –Mongolia Mortgage corporation (MIK); credit information bureau; loan facilitation,</p>	<p>USAID: trainings among peri-urban and rural (both herder and non-herder) small and micro-enterprises, cooperatives; the Business Competitiveness Fund (BCF); business development, information services, linkage to the markets and inputs, trainings among business groups</p>	<p>USAID: Staff training and capacity building at Energy Regulatory Authority (ERA), improvement of the financial statements of the energy sector, including introduction of the uniform charts of accounts among energy entities; improved tariff program and electricity market, promotion of the national consensus and regulatory environment in the energy sector; support to ICTA in improving security among GoM agencies' websites and IT network installations; Washington-funded scholarships for professional courses at the US Telecommunications Training Institute (USTTI) programs</p>	<p>USAID: Support of the nationwide monthly periodical "Rural Business News"; Gobi Forage – satellite imagery, modeling for local use; implementation of the National AI strategy in addressing animal health planning, preparedness, surveillance, response and communication.</p>	

	<p>MCC: the Rail Project --promotes reformed rail operations and management practices, transparency of rail finances and commercialization of the rail system</p>				<p>MCC: Improvements in the efficiency and capacity of the rail system, thereby creating new jobs directly and indirectly through increased economic growth. To ensure sustainability, the Rail Project promotes reformed rail operations and management practices</p>	<p>MCC: The Property Rights Project will help Mongolian citizens obtain secure, long-term rights to the suburban and peri-urban land (the small plots of land located in the crowded suburbs around Ulaanbaatar and other cities) they occupy, and promote investments in home improvement, business activities and agricultural productivity.</p>	
<p>UNDP: Support of local governance, anti-corruption activities; UNICEF: Capacity building of local governments in pro-poor, child focused development planning, Reform of juvenile justice system UNDP/ Sweden: Good governance for human security program; UNFPA: Strengthening policy measures and legal framework; support of policy development at national and sub-national levels; enhancing institutional capacity for integration of population into development planning and budgeting in selected areas</p>	<p>UNDP: Commercialization of super-insulated buildings</p>		<p>UNDP: Financial services to herders in remote areas; credit cooperatives</p>		<p>UN: Capacity building for ICT sector; UNICEF: Construction of new cold room for the National EPI programme, Rehabilitation/construction of water and sanitation facilities in schools and communities, Development of construction standards for CFS WHO: Support for a 'data warehouse' including ICD-10 codes, licensed health facilities and pharmacies. Infrastructure support includes water and sanitation to selected soum hospitals, a reference and quality control system including specimen transport from non-sustainable labs.</p>	<p>UN: vocational training for young herders; Sustainable pasture management; support for development of dairy production</p>	<p>UNICEF: Capacity building of Regional Development Councils in focus areas in planning, implementation and monitoring of country programme.</p>

<p>IMF: Support for implementation of new income tax and VAT laws; assistance in implementing the new AML/CFT law; advice on strengthening central bank governance; advice on amendments to the Banking Law and Central Bank Law; support for public finance management reform; capacity building for efficient management of government assets and liabilities; and assessment of macroeconomic statistics (ROSC, data module) and assistance in improving real sector statistics; Advice on mining taxation and the Development Fund.</p>			<p>IMF: Strengthening banking supervision; assessment of the financial sector (FSAP) and advice on a financial sector development strategy jointly with World Bank; improving BOM's monetary policy framework; and strengthening central bank reserve management and foreign exchange market operations.</p>	<p>Switzerland: Financing of small businesses; support for artisanal mining; development of one-stop-shop for business</p>	<p>India: Center for Excellence in IT; VC Center in UB and rural areas</p>	<p>Switzerland: Support for revitalization of potato sector; pastoral ecosystem management; desertification prevention</p>	
				<p>Australia: Support for small businesses</p>	<p>China: Construction of hydro-power plant; Construction of transmission line;</p>	<p>China: Supply of solar power to rural areas;</p>	

<p>Australia: Community based development initiatives in governance</p>			<p>Luxembourg: Short-term courses on bank marketing and strategic planning, external and internal auditing as well as branch management, banking and financial industry in a market economy, EU financial framework.</p>	<p>Czech: Renewal of small factory's production facility of skin processing</p>	<p>Czech: Delivery of water-supply units; Drinking water sources for supply to newly inhabited districts in UB; Modernization of Power Plant # 4 in UB; Drinking water supply of Erdenet city and its surroundings</p>	<p>Czech: Renewal and reservation of water resources in semi-desert regions in Suchbaatar aimag; Improvement of vegetable production in Dornogobi;</p>	
<p>Korea: Support for Customs modernization training, Police investigation training, Support for legal reform in Fair Competition field</p>					<p>Korea: Installation of Water-wells; Construction of Choir-Sainshad-Zamynud highway, Establishment of Government Integrated Data Center, Establishment of UB Intelligence Transportation System, Establishment of Information Network System; Rehabilitation for UB Water and Heat Distribution Centers; Urban planning training</p>	<p>Korea: Capacity building in Disaster Protection, Establishment of Viral animal disease diagnostic center, stockbreeding training</p>	
					<p>Netherlands: Increase access to electricity and improve reliability and affordability of electricity service among the herder population and in off-grid soum centers. Drinking water Utility Support Programme</p>	<p>Netherlands/UN: Improvement of natural resource management program, Reducing water pollution by industries</p>	<p>Netherlands: Promotion of economic activities in the regions (Darkhan en Uliastai), based on a sustainable usage of natural resources.</p>

<p>Turkey: Training and cooperation/assistance in statistics, intellectual property rights and land registry.</p>					<p>Turkey: Road construction from Kharkhorin to Khushoo Tsaidam, Museum construction for Orkhon Monuments in Khushoo Tsaidam.</p>	<p>WWF: Community development and pasture management</p>	
<p>WB: Capacity building for public expenditure management, Assistance in Civil Service Reform; Mining policy framework, strengthening regulatory and fiscal regimes; Capacity building of the state audit and inspection system; Improving coordination of development efforts of government, donors, private sector and civil society; Enhancement of macroeconomic management; Studies on the sources of growth; Supporting Administrative Court System; Capacity Building to Foster Access to Justice; Enhancement of the Legal Education and Legal Profession; EITI; standardization of regulations</p>	<p>WB: Resolution of the Savings Bank under the Financial Capacity Development project</p>	<p>IFC: Assistance to a holding company structure for the government shareholding in mining;</p>	<p>WB: Supporting Improvement of commercial bank risk management and payment systems; Enhancing commercial bank term-lending capacity; IFC: investment in commercial banks; trade finance facilities; provision of assistance in banking, leasing, housing finance, credit information bureau and risk management</p>	<p>IFC: Support to localize its SME toolkit for small businesses in Mongolia and to develop the leasing industry</p>	<p>WB: Reducing system losses and improve revenue collection; Improving reliability and financial sustainability of electricity distribution system in UB and 10 aimags; Improvement of Center – West road upgrading to an all-weather gravel surface from the earth road; Urban -water supply provision for ger areas of UB city; ICT - support in universal access to telephony and internet services in rural areas WB/NDF: Vehicle registration and inspection system and support in design and implement a revised accident reporting system; WB/Netherlands and WB/GEF: Supporting use of renewable energy sources</p>	<p>WB: Community investment fund – co-financing and execution of investments in basic infrastructure; Rural micro-finance services; index based livestock insurance; Improving government debt servicing and payments in rural areas;</p>	<p>WB: Support in provision of best international practices in mining including sound regional development; promotion of local participation</p>

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VIII. STATISTICAL APPENDICES²²⁶

Table 1: Basic Data, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
Population						
Total population, end-year (million)	2.48	2.50	2.53	2.56	2.59	2.64
Population growth rate (annual percentage change)	1.35	1.16	1.16	1.16	1.26	1.56
Income						
Gross domestic product (GDP), at current market prices						
(In billions of togrog)	1,413	1,660	2,152	2,780	3,715	4,558
(In millions of U.S. dollars)	1,273	1,448	1,814	2,307	3,156	3,894
(In U.S. dollars; per capita) 1/	518	582	720	906	1,224	1,489
(Annual percentage change)						
Real GDP, at constant 2000 prices	4.7	7.0	10.6	7.3	8.6	9.9
Mineral GDP 2/	-5.6	-0.4	31.1	10.6	6.3	1.7
Nonmineral GDP 2/ 3/	7.5	8.8	6.2	6.4	9.2	12.2
Agriculture, hunting, forestry, and fishery	-10.1	6.3	15.8	10.7	7.5	15.8
Other	15.2	9.6	3.0	4.8	9.8	10.8
Savings-investment balance						
(In percent of GDP)						
Gross national savings	18.0	28.4	36.0	39.2	42.1	43.7
Government	3.9	6.6	7.8	8.4	14.8	14.1
Private	14.1	21.8	28.2	29.9	27.3	29.6
Gross investment	26.7	35.5	34.5	37.0	35.1	41.1
Savings-investment balance	-8.7	-7.1	1.5	1.3	7.0	2.6
Inflation						
(Annual percentage change)						
Consumer price index (CPI), period average 4/	0.3	5.1	8.3	12.7	5.1	9.0
CPI, end of period 4/	1.6	4.7	11.0	9.5	6.0	15.1
GDP deflator	5.1	9.8	17.2	20.4	23.1	11.6
General government budget						
(In percent of GDP)						
Total revenue and grants	33.8	33.4	33.1	30.1	36.6	40.6
Mineral revenue	1.6	2.5	3.7	4.0	10.5	14.7
Nonmineral revenue and grants	32.2	30.9	29.4	26.1	26.1	25.9
Total expenditure and net lending	39.0	37.1	35.0	27.5	28.5	38.4
Overall balance	-5.2	-3.7	-1.8	2.6	8.1	2.2
Nonmineral overall balance	-6.8	-6.2	-5.5	-1.4	-2.4	-12.5
Money and credit						
(Annual percentage change; unless otherwise indicated)						
Broad money	41.9	49.7	20.3	37.3	30.8	57.3
Reserve money	21.7	14.7	16.8	19.7	37.7	39.6
Interest rates on central bank bills, end of period (in percent) 5/	8.0	15.0	15.8	3.7	5.1	8.4
Balance of payments						
(In percent of GDP; unless otherwise indicated)						
Current account balance (including official transfers)	-8.7	-7.1	1.5	1.3	7.0	2.6
Exports (percent change)	0.1	19.7	39.0	22.5	44.6	26.3
Imports (percent change)	8.6	9.8	23.5	19.8	23.9	43.2
Gross official reserves (in millions of U.S. dollars)	268	204	208	333	718	1,001
(In months of next year's imports of goods and services)	3.0	1.7	1.6	2.1	3.3	3.6
Public and publicly guaranteed debt						
(In percent of GDP; unless otherwise indicated)						
Total public debt	79.5	98.5	81.4	60.3	46.7	40.0
Domestic debt	2.7	13.1	6.8	3.7	1.7	0.6
External debt 6/	78.9	85.4	74.6	56.6	45.0	39.4
(In millions of U.S. dollars)	978	1,237	1,352	1,306	1,420	1,535
Debt service (in millions of U.S. dollars)	32	284	91	43	57	52
(In percent of exports of goods and services)	4.5	34.0	7.5	2.9	2.8	2.0
Fund quota						
(In millions of SDRs)						
	51.1	51.1	51.1	51.1	51.1	51.1
Exchange rate						
(In togrog per U.S. dollar)						
Period average	1,110	1,147	1,187	1,205	1,177	1,170
End of period	1,125	1,168	1,209	1,221	1,165	1,170

Sources: Data provided by the Mongolian authorities; and Fund staff estimates.

1/ Based on period average exchange rate and population.

2/ Data in 2002-05 are slightly different from those in the Staff Report due to revisions received from the authorities in May 2008.

3/ Total GDP minus mineral GDP.

4/ The overall CPIs in 2002-05 are slightly different from those in the Staff Report due to changes in the consumption basket starting from December 2005.

5/ Yield of 14-day bills until 2006 and of 7-day bills for 2007.

6/ Includes IMF loans, guarantees, and arrears.

Table 2: GDP at Current Prices, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
	(In millions of Togrog)					
Agriculture, hunting and forestry	296,561	342,407	478,380	608,229	723,070	937,718
Fisheries	39	63	68	106	111	113
Mining and quarrying	125,976	185,868	365,682	608,209	1,112,605	1,248,593
Manufacturing	57,891	71,286	76,296	101,963	128,891	188,432
Energy	55,313	56,884	69,074	80,021	95,076	106,150
Construction	30,998	50,617	50,245	58,835	63,188	85,623
Wholesale and retail trade	160,770	183,688	200,231	226,961	274,243	345,947
Hotels and restaurants	11,858	12,449	14,750	19,135	22,955	27,241
Transport, storage and communications	182,766	203,578	242,872	309,100	334,975	415,281
Financial intermediation	41,645	62,174	81,485	99,967	106,266	129,921
Real estate, renting and business activities	153,371	170,191	185,413	217,120	240,665	280,324
Public administration and defense	45,999	50,683	58,203	66,847	117,961	175,526
Education	57,698	66,552	65,826	84,916	121,148	177,352
Health and social services	22,839	25,789	33,283	37,967	54,113	80,721
Other community, social and personal services	18,698	21,156	25,998	28,323	35,184	43,620
Less: Indirect services of financial institutions	-35,491	-47,624	-64,930	-79,859	-120,750	-175,088
Goods and services net tax (indirect taxes)	186,103	204,604	269,218	311,738	405,254	490,037
Nominal GDP	1,413,032	1,660,365	2,152,095	2,779,578	3,714,953	4,557,512
Mineral GDP	125,976	185,868	365,682	608,209	1,112,605	1,248,593
Nonmineral GDP 1/	1,287,056	1,474,496	1,786,413	2,171,369	2,602,348	3,308,919
Agriculture, hunting, forestry, and fishery	296,600	342,470	478,448	608,335	723,181	937,832
Other	990,456	1,132,026	1,307,964	1,563,034	1,879,167	2,371,087

Sources: Data provided by the Mongolian authorities; and Fund staff estimates.

1/ Total GDP minus mineral GDP.

Table 3: Output of Major Agricultural Products, 2002-2007

	2002	2003	2004	2005	2006	2007
						Est.
(In thousands of metric tons; unless otherwise indicated)						
Meat	413.1	318.1	424.5	384.5	359.4	402.6
Milk (million tons)	317.0	347.2	406.3	425.9	450.1	465.6
Eggs (millions)	4.2	7.1	16.0	21.3	19.0	46.2
Wool	17.0	15.2	15.3	22.6	22.4	25.6
Wheat	123.1	160.4	135.6	73.5	127.8	109.6
Cereals	125.9	165.0	138.4	75.5	138.6	114.8
Potatoes	51.9	78.7	80.2	82.8	109.1	114.5
Other vegetables	39.7	59.6	49.2	64.1	70.4	76.4
(In millions of head)						
Livestock	23.9	25.5	28.0	30.4	34.8	40.3
Sheep	10.6	10.8	11.7	12.9	14.8	17.0
Goats	9.1	10.7	12.2	13.3	15.5	18.3
Cattle	1.9	1.8	1.8	2.0	2.2	2.4
Horses	2.0	1.9	2.0	2.0	2.1	2.2
Camels	0.3	0.3	0.3	0.3	0.3	0.3
(Percent change)						
Meat	-11.8	-23.0	33.4	-9.4	-6.5	12.0
Milk	-4.7	9.5	17.0	4.8	5.7	3.4
Eggs	-45.5	69.0	125.4	33.1	-10.8	143.2
Wool	-14.1	-10.6	0.7	47.7	-0.9	14.3
Cereals	-11.5	30.3	-15.5	-45.8	73.9	-14.2
Potatoes	-10.9	31.1	-16.1	-45.4	83.6	-17.2
Other vegetables	-10.8	51.6	1.9	3.2	31.8	4.9
(In percent of total head)						
Memorandum item:						
Privately owned livestock	97.4	97.9	98.2	98.4	98.6	98.7

Source: Data provided by the National Statistical Office.

Table 4: Output of Basic Industrial and Mining Products, 2002-2007
(in thousands of metric tons, unless otherwise indicated)

	2002	2003	2004	2005	2006	2007 Est.
Electricity (million kilowatt hours)	3,111.7	3,137.7	3,303.4	3,418.9	3,544.2	3,700.7
Coal	5,544.4	5,666.1	6,865.0	7,517.1	8,074.1	9,237.6
Fluor spar	513.9	488.2	468.2	507.9	521.9	637.9
Copper concentrate	376.3	372.2	371.4	361.6	370.5	371.9
Gold concentrate (kilograms)	12,097.1	11,118.6	19,417.6	24,121.9	22,561.3	17,472.5
Bricks (millions)	13.2	22.9	12.5	14.6	22.2	20.8
Cement	147.6	162.3	61.9	111.9	140.8	179.8
Lime	42.5	42.1	30.0	81.2	60.4	43.3
Sawn timber (thousand of cubic meters)	10.2	16.6	17.8	13.2	9.6	11.0
Scoured wool	1.2	0.5	1.8	0.9	1.1	1.7
Felt (thousand meters)	112.9	303.0	67.8	69.1	68.8	87.8
Woolen fabrics (thousand meters)	32.0	54.6	58.7	64.8	50.4	120.2
Camel woolen blanket (thousand meters)	38.3	27.4	36.8	33.5	34.4	37.7
Coats (thousands)	0.0	3.6	2.9	3.6	4.0	4.0
Suits (thousands)	60.7	73.5	98.5	59.8	30.4	12.9
Leather footwear (thousand pairs)	9.5	4.6	3.0	3.0	4.9	21.4
Sheepskin coats (thousands)	2.1	3.5	3.5	5.5	7.1	12.4
Meat (excluding pork)	6.8	11.1	4.3	3.6	7.8	6.8
Sausages	1.0	1.2	1.3	1.3	1.2	1.4
Flour	49.6	54.1	57.8	58.3	63.6	70.8
Bakery products	5.9	6.5	7.1	8.3	10.2	13.0
Confectionery	0.2	0.1	0.1	0.1	0.1	0.1
Milk and dairy products (million liters)	3.2	5.2	5.9	7.1	6.2	9.2
Carpets (thousands of square meters)	533.9	663.1	690.4	586.9	606.3	658.1
Processed metal	26.3	60.0	84.4	101.7	124.3	147.8

Source: Data provided by the National Statistical Office.

Table 5: Employment by Sector, 2002-2007
(number of employees in thousands, at the end of year)

	2002	2003	2004	2005	2006	2007 Est.
Total employment 1/	870.8	926.5	950.5	968.3	1009.9	1024.1
Agriculture and forestry	391.4	387.5	381.8	386.2	391.4	385.1
Industry	99.2	109.5	114.2	113.9	118.9	123.1
Transport and communications	38.8	39.5	42.2	42.4	41.2	44.1
Construction	25.5	35.1	39.2	48.9	56.3	60.0
Education	59.3	55.3	57.8	58.8	62.0	64.8
Health	34.5	36.8	39.4	39.5	39.3	40.2
Other	222.1	262.8	275.9	278.6	300.8	306.8
Memoranda items:						
Labor force	901.7	959.8	986.1	1,001.20	1,042.80	1,054.00
Unemployed	30.9	33.3	35.6	32.9	32.9	29.9

Source: Data provided by the National Statistical Office.

1/ Excludes foreign employees.

Table 6: Ulaanbaatar Consumer Price Inflation, 2002-2007

	2002	2003	2004	2005	2006	2007											
	Dec.	Dec.	Dec.	Dec.	Dec.	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Overall consumer price index (CPI) 1/	1.6	4.7	11.0	9.5	6.0	4.2	5.4	5.9	5.2	5.7	6.3	7.1	11.3	13.2	14.2	14.4	15.1
Food and Non-alcoholic beverages	-1.8	8.7	15.9	16.2	3.3	2.3	5.2	6.6	4.6	6.4	7.5	8.9	15.2	21.4	19.7	21.2	24.6
Alcoholic beverages, Tobacco	-0.8	-3.0	6.9	7.2	3.3	2.9	1.1	2.5	2.3	2.2	1.9	1.7	5.0	4.6	5.1	2.9	2.7
Clothing and Footwear	5.7	-0.1	1.3	-0.4	7.5	6.7	5.6	3.1	0.1	-1.3	-0.2	0.4	-0.3	1.3	2.7	2.3	3.0
Housing, Water, Electricity, Gas, and Others	4.8	-1.7	3.9	4.3	8.7	3.7	3.7	4.8	7.9	7.7	8.1	11.0	14.4	7.7	16.4	13.3	11.3
Furniture, Household equipment etc.	2.3	-2.8	5.1	5.2	7.4	7.3	8.1	7.5	10.1	9.6	9.1	9.7	11.1	14.2	13.8	12.5	13.9
Health	9.2	4.9	3.6	7.2	23.6	23.8	23.0	22.3	23.2	23.7	23.7	35.0	32.9	13.8	13.0	14.2	
Transport	0.7	3.1	11.6	6.2	12.1	5.4	6.7	5.2	6.1	4.8	6.7	6.7	8.7	7.3	16.7	17.0	10.6
Communications	10.8	0.0	42.9	5.6	-13.4	-16.6	-17.3	-10.3	-9.4	-7.6	-6.7	-13.5	-10.8	-10.6	-10.3	-10.6	-10.7
Recreation and Culture	1.8	10.0	8.2	-2.6	6.3	6.8	6.5	4.4	3.3	5.0	2.9	2.2	2.5	-0.2	1.0	2.8	4.2
Education	6.7	12.5	6.9	12.5	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	20.2	20.2	20.2	20.2	20.2
Restaurant and Hotels	0.0	4.2	12.4	8.8	10.1	11.4	13.1	11.8	11.3	11.6	11.6	11.6	11.9	17.0	13.2	13.6	14.0
Miscellaneous Goods and Services	4.3	13.6	8.2	2.7	7.7	6.9	7.0	6.8	7.6	4.1	1.3	1.3	1.7	1.5	2.6	3.9	3.8

Source: Data provided by the National Statistical Office.

1/ The overall CPIs in 2002-05 are slightly different from those in the Staff Report due to changes in the consumption basket starting from December 2005.

Table 7: Privatization of State-owned Enterprises, 2001-2007

	No. of Enterprises Privatized	Privatization Revenue (In millions of togros)
2001		
Total privatization	11	4,903
Large enterprises	1	4,446
Construction sector	0	0
Mineral sector	0	0
Agriculture sector	0	0
Other	1	4,446
Small enterprises and assets	10	457
2002		
Total privatization	25	15,912
Large enterprises	10	14,681
Construction sector	3	456
Mineral sector	0	0
Agriculture sector	1	145
Other	6	14,080
Small enterprises and assets	15	1,231
2003		
Total privatization	15	11,174
Large enterprises	7	10,928
Construction sector	2	106
Mineral sector	0	0
Agriculture sector	0	0
Other	5	10,823
Small enterprises and assets	8	245
2004		
Total privatization	20	18,429
Large enterprises	4	17,818
Construction sector	0	0
Mineral sector	0	0
Agriculture sector	0	0
Other	4	17,818
Small enterprises and assets	16	611
2005		
Total privatization	22	3,291
Large enterprises	5	1,671
Construction sector	0	0
Mineral sector	2	95
Agriculture sector	0	0
Other	3	1,576
Small enterprises and assets	17	1620.6
2006		
Total privatization	16	33,975
Large enterprises	1	23,418
Construction sector	1	107
Mineral sector		
Agriculture sector		
Other	7	9,781
Small enterprises and assets	6	670
2007		
Total privatization	13	20,411
Large enterprises	1	16,119
Construction sector		
Mineral sector		
Agriculture sector		
Other	6	3,876
Small enterprises and assets	6	416

Table 8: Government Employment and Wage Bill, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
	(Number of positions)					
Government employment						
General public services	16,114	14,744	13,807	14,443	14,188	15,845
Public order and safety	12,186	14,506	9,569	15,055	15,095	16,353
Education	50,928	47,927	48,444	46,113	46,076	47,019
Health	25,770	24,643	23,023	22,332	22,953	23,998
Social security and welfare	686	643	608	788	821	2,297
Recreation and culture	5,923	5,721	5,174	5,457	5,311	6,635
Agriculture and forestry	1,404	1,207	1,037	1,417	1,283	1,343
Other services	22,582	22,774	18,833	19,652	19,238	21,712
Total	135,591	132,164	120,493	125,255	124,964	135,202
	(In billions of togrogs)					
Wages and salaries						
General public services	14.9	16.2	18.5	20.3	27.8	39.6
Public order and safety	13.5	14.9	17.9	20.1	28.3	46.0
Education	41.4	46.4	45.4	50.2	67.6	106.3
Health	16.2	17.8	22.9	24.8	35.1	51.4
Social security and welfare	0.4	0.4	0.5	0.8	1.0	4.6
Recreation and culture	4.1	4.3	4.5	5.3	7.0	10.7
Agriculture and forestry	0.9	0.8	0.8	1.2	1.7	2.5
Other services	13.6	16.1	18.0	20.0	29.0	46.1
Total	105.0	116.9	128.5	142.8	197.6	307.3

Table 9: Summary Operations of the General Government, 2002-2007

	2002	2003	2004	2005	2006	2007	
						Amended Budget	Est.
(In billions of togrogs)							
Total revenue and grants	477.0	553.9	713.1	837.9	1,360.4	1,699.3	1,851.2
Total expenditure and net lending	550.5	615.8	752.5	764.6	1,059.5	1,847.1	1,751.6
Overall balance (incl. grants)	-73.4	-61.9	-39.4	73.3	300.9	-147.7	99.6
Nonmineral overall balance	-96.2	-103.1	-119.2	-37.9	-88.3	-764.5	-571.7
Financing	70.9	51.1	39.4	-73.3	-336.4	147.7	-99.6
Foreign (net)	81.8	-116.8	77.4	89.9	87.1	78.2	79.9
Domestic (net)	-10.9	166.9	-38.0	-163.2	-423.5	69.5	-179.5
(In percent of GDP)							
Total revenue and grants	33.8	33.4	33.1	30.1	36.6	37.3	40.6
Current revenue	33.2	32.8	32.8	30.0	36.4	37.2	40.5
Mineral revenue	1.6	2.5	3.7	4.0	10.5	13.5	14.7
Nonmineral revenue	31.6	30.4	29.1	26.0	26.0	23.6	25.7
Tax revenue and social security contributions	25.4	25.4	27.1	24.9	30.4	29.6	32.9
Income taxes	5.1	5.9	6.7	6.4	12.8	12.6	14.2
Enterprise income tax	3.3	4.1	4.6	4.3	6.0	5.1	4.8
Personal income tax	1.9	1.7	2.1	2.1	2.1	1.5	1.6
"Windfall" tax	0.0	0.0	0.0	0.0	4.8	5.9	7.8
Social security contributions	3.8	3.9	3.8	3.4	3.0	3.1	3.5
Sales tax and VAT	8.4	7.3	7.6	6.5	6.5	5.0	5.8
Excise taxes	3.6	3.5	3.3	2.8	2.7	2.4	2.9
Customs duties and export taxes	1.7	2.0	2.1	2.0	1.9	2.1	2.2
Other taxes	2.7	2.7	3.7	3.6	3.4	4.4	4.3
Nontax revenue	7.8	7.5	5.7	5.1	8.1	7.6	7.5
Capital revenue and grants	0.5	0.5	0.3	0.2	0.2	0.1	0.2
Total expenditure and net lending	39.0	37.1	35.0	27.5	28.5	40.5	38.4
Current expenditure	29.4	26.2	25.0	21.6	21.7	27.0	26.4
Wages and salaries	7.4	7.0	6.4	5.6	5.3	6.7	6.4
Purchase of goods and services	12.8	10.5	10.1	8.3	8.6	8.2	8.4
Subsidies to public enterprises	0.6	0.6	0.5	0.3	0.3	0.3	0.3
Transfers	7.2	7.0	6.9	6.6	7.0	11.1	10.8
Interest payments	1.4	1.1	1.1	0.7	0.5	0.5	0.4
Contingency allocation	...	...	...	0.0	0.0	0.0	0.0
Capital expenditure and net lending	10.9	10.9	9.9	5.9	6.9	13.6	12.1
Capital expenditure	4.8	5.4	4.9	3.2	4.7	11.3	9.8
Domestically-financed	3.7	4.0	3.8	2.9	4.5	10.5	9.5
Foreign-financed	1.1	1.4	1.0	0.4	0.2	0.8	0.4
Net lending	4.7	5.4	5.1	2.7	2.1	2.2	2.2
On-lent foreign project loans	4.7	5.1	4.9	3.2	2.4	2.0	1.4
Domestic lending minus repayments	0.0	0.4	0.1	-0.5	-0.3	0.0	0.8
Current balance (excl. privatization receipts)	3.9	6.6	7.8	8.4	14.8	10.2	14.1
Primary balance	-3.8	-2.7	-0.8	3.4	8.6	-2.7	2.6
Overall balance (incl. grants)	-6.2	-3.7	-1.8	2.6	8.1	-3.2	2.2
Nonmineral overall balance	-6.8	-6.2	-5.5	-1.4	-2.4	-16.8	-12.5
Discrepancy between deficit from above and below the line	-0.2	-0.6	0.0	0.0	-1.0	0.0	0.0
Financing	5.0	3.1	1.8	-2.6	-9.1	3.2	-2.2
Foreign (net)	5.8	-7.0	3.6	3.2	2.3	3.5	1.8
External borrowing (net)	5.8	-7.0	3.0	3.0	2.3	1.0	1.8
Disbursements	6.8	11.6	4.3	4.0	3.0	2.1	1.8
Amortization	1.0	18.6	1.3	0.9	0.6	1.1	0.0
External arrears	0.0	0.0	0.6	0.2	0.0	0.0	0.0
Domestic (net)	-0.8	10.1	-1.8	-5.9	-11.4	1.5	-3.9
Banking system (net)	-2.0	8.4	-2.5	-5.9	-11.8	0.8	-4.2
Nonbank	1.2	1.7	0.7	0.0	0.4	0.7	0.2
Privatization receipts	1.2	1.3	0.8	0.2	0.4	0.7	0.4
Other nonbank (net)	0.0	0.4	0.0	-0.2	0.0	0.0	-0.1
Memorandum items:							
Mineral revenue/total revenue and grants (in percent)	4.8	7.4	11.2	13.3	28.6	32.2	36.3
Total public debt (incl. IMF)	79.5	98.5	81.4	60.3	48.7	41.1	40.0
Foreign debt (incl. IMF)	76.9	85.4	74.6	56.6	45.0	40.5	39.4
Domestic debt	2.7	13.1	6.8	3.7	1.7	0.6	0.6
Governments deposits	4.5	6.9	4.5	5.3	14.5	10.0	15.0
Net public debt	75.0	91.6	76.9	55.1	32.2	31.0	25.0
NPV of total public debt	55.1	70.5	57.9	44.5	29.8	25.7	21.6
Nominal GDP (in billions togrogs)	1,413	1,660	2,152	2,780	3,715	4,568	4,558
Copper price per ton (in U.S. dollars)	1,560	1,779	2,863	3,676	6,731	7,132	7,132

Table 10: General Government Revenue, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
	(In billions of togrogs)					
Total revenue and grants	477.0	553.9	713.1	837.9	1,360.4	1,861.2
Current revenue	469.7	545.2	708.3	832.6	1,354.1	1,843.7
Tax revenue and social security contributions	359.2	421.0	583.1	692.2	1,128.1	1,500.7
Income taxes	72.4	97.6	144.1	178.5	476.8	647.8
Enterprise income tax	46.3	68.8	98.6	120.6	222.3	219.1
<i>of which</i> Erdenet	9.5	29.8	52.9	61.3	130.4	73.9
Windfall profit tax						363.7
Personal income tax	26.2	28.8	45.5	58.0	77.0	75.0
Social security contributions	54.4	65.2	82.1	95.6	111.9	168.4
Sales tax and VAT	118.7	121.9	163.1	181.0	241.3	263.2
Domestic VAT (Sales tax prior to 1998)	40.7	47.9	57.4	70.6	87.9	108.2
VAT on imports (Sales tax prior to 1998)	78.0	94.3	136.9	157.5	199.5	198.8
VAT refund						-41.8
Excise taxes	51.3	58.6	70.3	79.0	100.1	133.8
Excise on alcohol	20.6	19.8	23.3	26.1	28.2	37.2
Excise on vodka and tobacco	3.5	3.7	4.2	6.3	8.0	11.0
Excise on imported beer	2.9	3.3	3.3	2.0	2.6	3.2
Excise on vehicles	6.0	10.5	14.7	16.7	26.1	38.9
Excise on petroleum	18.3	21.3	24.8	25.2	28.2	29.3
Customs duties and export taxes	24.6	32.6	44.7	57.0	72.1	102.5
Customs duties	23.8	31.1	40.8	53.2	65.2	96.3
Export taxes	0.8	1.6	3.9	3.8	6.8	6.2
Other taxes	37.7	45.1	78.8	101.1	125.9	165.0
Petrol and diesel tax	4.9	5.7	6.1	5.9	6.0	6.7
Vehicle license fee	3.7	4.0	4.8	5.1	5.3	6.3
Tax on private property	3.4	4.6	5.7	6.3	6.9	8.1
Other	25.8	30.8	62.1	83.8	107.7	173.9
Nontax revenue	110.6	124.3	123.2	140.4	226.0	342.9
Interest and fines	9.1	17.6	20.5	14.5	19.2	27.7
Own budget revenues	48.0	65.0	65.2	68.8	116.9	130.1
Dividends	6.4	1.3	4.1	22.8	48.4	141.9
<i>of which</i> : Erdenet	2.5	0.1	1.9	18.1		
Other nontax revenue	47.2	40.4	33.4	34.3	41.4	43.2
Capital revenue and grants	7.3	8.7	6.8	5.3	6.3	2.5
Capital revenue	0.5	0.0	0.8	1.0	1.6	2.5
Grants 1/	6.8	8.7	6.1	4.3	4.7	5.0
	(In percent of total revenue)					
Current revenue	98.5	98.4	99.0	99.4	99.5	99.6
Tax revenue and social security contributions	75.3	76.0	81.8	82.6	82.9	81.1
Enterprise income tax	9.7	12.4	13.8	14.4	16.3	11.8
Personal income tax	5.5	5.2	6.4	6.9	5.7	4.1
Social security contributions	11.4	11.8	11.5	11.4	8.2	8.6
Taxes on goods and services	35.6	32.6	32.7	31.0	25.1	21.4
Customs duties and import surcharges	5.2	5.9	6.3	6.8	5.3	5.5
Other taxes	7.9	8.1	11.1	12.1	9.3	10.5
Nontax revenue	23.2	22.4	17.3	16.8	16.6	18.5
Capital revenue	0.1	0.0	0.1	0.1	0.1	0.1
Grants	1.4	1.6	0.8	0.5	0.3	0.3
	(In percent of GDP)					
Total revenue	33.8	33.4	33.1	30.1	36.6	40.6
Current revenue	33.2	32.8	32.8	30.0	36.4	40.5
Tax revenue and social security contributions	25.4	25.4	27.1	24.9	30.4	32.9
Enterprise income tax	3.3	4.1	4.6	4.3	6.0	4.8
Personal income tax	1.9	1.7	2.1	2.1	2.1	1.6
Windfall profit tax						
Social security contributions	3.8	3.9	3.8	3.4	3.0	3.5
Taxes on goods and services	12.0	10.9	10.8	9.4	9.2	8.7
Customs duties and import surcharges	1.7	2.0	2.1	2.0	1.9	2.2
Other taxes	2.7	2.7	3.7	3.6	3.4	4.3
Nontax revenue	7.8	7.5	5.7	5.1	6.1	7.5
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.1
Grants	0.5	0.5	0.3	0.2	0.1	0.1

Table 11: General Government Expenditure, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
(In billions of togrogs)						
Total expenditure and net lending	550.5	615.8	752.5	784.6	1059.5	1751.6
Current expenditure	415.3	434.8	539.7	600.3	804.8	1202.1
Wages and salaries	105.0	116.9	137.5	155.4	196.6	292.5
Goods and services	180.8	174.9	217.5	231.3	318.4	383.5
Subsidies and current transfers	109.9	125.4	160.5	192.9	271.8	507.9
Subsidies 1/	8.8	9.4	11.4	8.1	12.3	15.5
Transfers	101.1	116.0	149.1	184.8	259.5	492.4
Social Security Fund	73.3	87.5	116.2	132.0	173.0	253.1
Social Assistance Fund	17.4	19.8	23.0	41.7	74.8	120.9
Other transfers	10.6	8.7	9.8	11.0	11.7	118.4
Interest payment	19.6	17.6	23.2	20.7	18.1	18.3
Capital expenditure and net lending	135.2	180.9	213.8	184.3	254.7	549.5
Domestically financed capital expenditure	52.3	67.2	82.7	79.4	167.0	432.2
Domestic lending minus repayment	0.7	6.1	2.8	-14.2	-10.0	37.4
Foreign financed projects	82.2	107.6	128.3	99.1	97.6	79.9
(In percent of total expenditure)						
Current expenditure	75.4	70.6	71.6	78.5	76.0	68.6
Wages and salaries	19.1	19.0	18.3	20.3	18.6	16.7
Goods and services	32.8	28.4	28.9	30.2	30.0	21.9
Subsidies and transfers	20.0	20.4	21.3	25.2	25.7	29.0
Subsidies	1.6	1.5	1.5	1.1	1.2	0.9
Transfers and other	18.4	18.8	19.8	24.2	24.5	28.1
Social Security Fund	13.3	14.2	15.4	17.3	16.3	14.4
Other	5.1	4.6	3.1	6.9	8.2	13.7
Interest payments	3.6	2.9	3.1	2.7	1.7	1.0
Capital expenditure and net lending	24.6	29.4	28.4	21.5	24.0	31.4
Domestically financed capital expenditure	9.5	10.9	11.0	10.4	15.8	24.7
Domestic lending minus repayment	0.1	1.0	0.4	-1.9	-0.9	2.1
Foreign financed projects	14.9	17.5	17.0	13.0	9.2	4.6
(In percent of GDP)						
Total expenditure and net lending	39.0	37.1	35.0	27.5	28.5	38.4
Current expenditure	29.4	28.2	25.0	21.6	21.7	28.4
Wages and salaries	7.4	7.0	6.4	5.6	5.3	6.4
Goods and services	12.8	10.5	10.1	8.3	8.6	8.4
Subsidies and current transfers	7.8	7.6	7.5	6.9	7.3	11.1
Subsidies	0.6	0.6	0.5	0.3	0.3	0.3
Transfers	7.2	7.0	6.9	6.6	7.0	10.8
Social Security Fund	5.2	5.3	5.4	4.8	4.7	5.6
Social Assistance Fund	1.2	1.2	1.1	1.5	2.0	2.7
Other transfers	0.7	0.5	0.0	0.4	0.3	2.6
Interest payment	1.4	1.1	1.1	0.7	0.5	0.4
Capital expenditure and net lending	9.6	10.9	9.9	5.9	6.9	12.1
Domestically financed capital expenditure	3.7	4.0	3.8	2.9	4.5	9.5
Domestic lending minus repayment	0.0	0.4	0.1	-0.5	-0.3	0.8
Foreign financed projects	5.8	6.5	6.0	3.6	2.6	1.8

Table 12: Monetary Survey, 2002-2007

	2002	2003	2004	2005	2006				2007			
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	(In billions of togrogs)											
Broad money	470	704	846	1,162	1,205	1,463	1,528	1,520	1,725	1,998	2,175	2,391
Currency	121	131	144	152	145	198	189	185	216	262	267	283
Deposits	349	572	703	1,009	1,061	1,265	1,339	1,335	1,509	1,736	1,908	2,108
Demand deposits	67	81	78	117	130	130	142	147	185	240	248	307
Togrog deposits	147	240	301	448	492	543	576	677	815	927	1,015	1,104
Foreign exchange deposits	135	250	324	445	439	592	621	511	509	569	645	697
Net foreign assets	308	232	283	544	555	791	945	1,106	1,237	1,369	1,465	1,401
Net international reserves	322	278	294	551	564	782	942	1,118	1,249	1,387	1,479	1,414
Bank of Mongolia	254	151	198	364	411	449	595	801	994	1,136	1,241	1,141
Commercial banks	68	128	96	187	153	333	347	317	256	250	238	273
Other NFA	-13	-47	-11	-7	-9	10	3	-12	-12	-17	-14	-13
Bank of Mongolia	0	0	1	8	4	20	14	0	0	0	0	0
Commercial banks	-13	-47	-13	-15	-13	-10	-11	-12	-12	-17	-14	-13
Net domestic assets	162	472	564	618	650	672	583	414	489	629	710	991
Domestic credit	243	601	740	904	946	983	910	837	953	1,080	1,204	1,444
Net credit to government	7	152	94	-1	-50	-121	-267	-440	-510	-587	-732	-691
Credit	71	266	190	146	135	134	114	77	73	92	100	60
Minus: Deposits	63	114	96	146	185	256	381	517	583	680	832	751
Claims on nonbanks	236	449	646	905	996	1,103	1,177	1,277	1,463	1,667	1,935	2,135
Claims on public enterprises	12	16	13	34	29	30	33	36	36	23	22	26
Claims on the private sector	204	390	552	776	858	966	1,011	1,122	1,298	1,511	1,743	1,957
Nonperforming loans	17	37	71	79	90	89	110	95	99	107	135	115
Accrued interest receivable on loan	4	7	11	16	19	19	23	24	30	27	36	36
Other items, net	-82	-129	-176	-286	-296	-311	-326	-423	-464	-451	-494	-453
Memoranda items:	(12-month percentage changes)											
Broad money 1/	41.9	49.7	20.3	37.3	35.1	45.0	37.4	30.8	43.1	31.5	42.4	57.3
Net foreign assets	40.1	-24.9	22.0	92.4	68.1	110.4	96.8	103.3	122.7	23.8	55.0	26.7
Domestic credit	43.2	147.0	23.0	22.3	26.6	22.1	9.8	-7.5	0.7	29.0	32.4	72.6
Claims on public enterprises	17.1	32.8	-22.5	171.6	114.8	33.6	54.1	6.3	25.6	-37.1	-33.5	-28.5
Claims on the private sector	77.4	91.3	41.6	40.6	47.6	49.6	44.1	44.5	51.2	34.7	72.4	74.5
	(Key ratios)											
Currency/total deposits	34.6	23.0	20.4	15.1	13.7	15.7	14.1	13.9	14.3	15.1	14.0	13.4
Demand deposits/total deposits	19.2	14.2	11.1	11.6	12.2	10.3	10.6	11.0	12.3	13.8	13.0	14.6
Togrog time deposits/total deposits	42.1	42.0	42.8	44.4	46.4	42.9	43.0	50.7	54.0	53.4	53.2	52.4
Foreign exchange time deposits/total deposits	38.7	43.7	46.1	44.0	41.4	46.8	46.4	38.3	33.7	32.8	33.8	33.0
Currency/broad money	25.7	18.7	17.0	13.1	12.0	13.5	12.4	12.2	12.5	13.1	12.3	11.8
Demand deposits/broad money	14.2	11.6	9.2	10.0	10.7	8.9	9.3	9.7	10.7	12.0	11.4	12.8
Time deposits/broad money	60.1	69.7	73.9	76.8	77.2	77.5	78.3	78.2	76.7	74.9	76.3	75.3
Foreign exchange deposits/broad money	28.8	35.6	38.3	38.3	36.4	40.4	40.7	33.6	29.5	28.5	29.6	29.1

Table 13: Balance Sheet of the Bank of Mongolia, 2002-2007

	2002	2003	2004	2005	2006				2007			
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	(In billions of togrogs)											
Reserve money	175	201	235	281	308	376	377	387	436	520	460	540
Currency outside Banks	121	131	144	152	145	198	189	185	216	262	267	283
DMB reserves	55	69	91	129	163	178	187	202	220	258	192	257
Cash in vaults	14	21	25	39	42	43	50	60	49	57	66	81
Demand deposits of DMBs	41	48	66	90	121	135	137	142	172	200	126	176
Deposits of business units	0	0	0	0	0	0	0	0	0	0	0	0
Net Foreign Assets	254	151	199	372	415	469	609	801	994	1,136	1,241	1,141
Net international reserves	254	151	198	364	411	449	595	801	994	1,136	1,241	1,141
Assets	302	238	251	407	449	489	633	837	1,027	1,168	1,273	1,171
Minus: Liabilities	48	87	54	43	39	39	38	36	34	32	31	30
Other assets, net	0	0	1	8	4	20	14	0	0	0	0	0
Assets	0	0	1	8	4	20	14	0	0	0	0	0
Minus: Liabilities	0	0	0	0	0	0	0	0	0	0	0	0
Net Domestic Assets	-79	50	36	-91	-107	-93	-233	-414	-557	-616	-782	-600
Net Credit to Government	6	128	106	52	-2	-72	-190	-333	-431	-510	-637	-571
Credit	40	219	159	143	130	129	107	73	69	69	61	36
Government bonds	40	59	53	43	39	39	82	73	69	69	61	36
Treasury IMF account	40	55	53	43	38	38	36	36	34	33	34	33
Reconstruction bonds	0	4	0	0	1	0	0	2	2	2	3	2
Treasury bills	0	0	0	0	0	0	45	34	34	34	24	0
Other	0	160	105	99	91	91	26	0	0	0	0	0
Minus: Deposits	34	92	53	90	132	201	297	405	501	579	698	607
Domestic currency	30	73	43	48	88	97	112	246	204	382	453	553
Foreign currency	4	19	10	42	45	104	185	159	297	197	246	54
Claims on deposit money banks	8	13	22	18	18	18	18	18	22	20	22	19
Claims on nonbanks	1	1	0	0	0	0	0	0	0	0	0	0
Minus: Central bank bills (net)	61	76	69	126	110	69	84	71	129	120	128	103
Other items, net	-33	-15	-23	-35	-13	30	23	-28	-19	-6	-38	55
Of which: precious metals	7	8	6	10	11	51	43	11	26	26	45	133
Memoranda items:												
Reserve money growth (12 month percent change)	21.7	14.7	16.8	19.7	21.7	27.2	26.8	37.7	41.7	38.4	22.1	39.6
Broad money/reserve money (ratio)	2.7	3.5	3.6	4.1	3.9	3.9	4.1	3.9	4.0	3.8	4.7	4.4

Table 14: Financial Soundness Indicators for Banking Sector, 2002-2007
(in percent, unless otherwise stated)

	2002	2003	2004	2005	2006	2007
Capital Adequacy						
Tier I capital ratio	17.7	18.5	17.4	15.8	15.6	11.8
Total regulatory capital/risk-weighted assets	20.0	20.4	20.0	18.2	18.1	14.2
Total regulatory capital/total assets	12.4	13.4	15.6	13.6	13.6	11.2
Asset Quality						
Distribution of risk weight category in (billion togrog)						
0 percent	0.0	0.0	0.0	0.0	0.0	0.0
20 percent	13.5	26.8	31.1	52.0	87.2	97.1
50 percent	2.1	2.6	13.0	22.2	43.9	33.9
100 percent	283.5	499.2	739.8	994.7	1,392.4	2,321.3
Large exposures/total assets	19.2	22.4	23.3	22.5	18.1	21.1
Large exposure/total capital	154.6	167.7	149.8	165.8	133.1	185.9
Foreign exchange loans/total loans	32.5	42.8	45.6	47.0	46.7	33.2
Non performing loans (NPLs)/total gross loans (or exposures)	5.0	4.7	6.0	5.6	4.7	3.2
NPLs net of provisions/total capital	-1.0	0.0	0.7	0.2	2.5	2.4
Provisions to NPLs	105.2	99.9	97.2	99.2	87.8	87.1
Asset Sectoral Concentration						
Agriculture, hunting, forestry and fishing	4.1	5.7	4.7	6.7	8.2	7.6
Electricity, steam and water supply	1.5	1.9	2.5	2.2	1.1	1.5
Construction	6.2	7.5	8.6	8.9	9.1	15.6
Mining and quarrying	15.4	8.4	8.6	9.0	7.8	6.3
Manufacturing	24.2	20.1	18.7	16.2	12.9	13.0
Wholesale & retail trade, repair of goods	30.8	34.0	34.6	33.2	31.0	29.2
Tourism and hotels, restaurants	1.7	1.8	2.0	2.1	1.6	1.3
Transport, storage and communication	2.9	3.0	2.8	4.3	4.2	1.7
Immovable asset renting business	1.1	2.2	2.6	2.4	2.5	2.5
Health and education	0.6	0.5	1.0	0.7	0.9	0.7
Financial intermediaries	0.5	1.0	0.9	1.0	1.2	0.7
Others	11.0	13.8	13.1	13.2	19.2	19.8
Profitability						
Return on (average) assets	4.3	3.1	2.5	2.2	2.7	2.5
Return on (average) equity	20.8	14.7	12.3	12.1	14.3	20.8
Interest margin/gross income	39.8	35.9	31.5	30.9	27.8	28.3
Expenses/income	78.9	84.7	85.5	86.0	83.5	83.5
Non-interest expenses/gross income	50.3	49.1	58.8	54.3	55.4	46.5
Personnel expenses to noninterest expenses	22.4	22.3	26.7	28.5	15.5	20.4
Trading and fee income to total income	23.1	10.8	13.7	16.2	17.3	13.6
Liquidity						
Loans to deposits	67.3	78.5	91.9	89.7	95.6	101.3
Liquid assets/total assets	39.9	35.3	31.6	36.0	37.9	28.1
Liquid assets/short-term liabilities	90.9	83.5	28.8	37.7	38.2	37.0
Demand deposits/total liabilities	12.0	10.9	11.9	14.0	14.3	16.4
Deposits to total non-interbank loans	83.8	85.4	82.5	72.6	70.6	62.4
Memorandum item:						
Net foreign exchange open position to total capital	8.9	36.5	33.6	27.4	30.8	30.1

Table 15: Balance of Payments, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
Current account balance (including official transfers)	-110	-102	27	29	222	101
Trade balance	-229	-199	-149	-155	30	-218
Exports, f.o.b.	524	627	872	1,069	1,645	1,952
Of which : Copper	140	182	284	326	635	812
Gold	118	157	240	331	270	235
Imports, c.i.f.	-753	-827	-1,021	-1,224	-1,616	-2,170
Services, net	-12	-49	-48	65	122	161
Receipts	185	208	338	414	486	574
Payments	-196	-257	-383	-350	-364	-413
Income, net	-7	-15	-48	-106	-144	-79
Private transfers (net)	64	74	146	134	77	84
Official transfers	53	49	87	88	112	133
Other transfers	20	38	36	3	26	20
Financial and capital account	125	-30	10	88	110	182
Direct investment	78	132	129	258	290	328
Portfolio investment	0	50	-53	0	0	6
Medium- and long-term (net)	99	-170	75	61	39	150
Disbursements	182	176	157	91	88	237
Amortization	-83	-346	-82	-31	-49	-86
Currency and deposits, net	-9	-21	-120	-162	-244	-249
Others (including short-term capital flows)	-43	-20	-22	-68	26	-52
Errors and omissions	51	34	-5	8	57	6
Overall balance	66	-98	32	125	399	289
Financing	-66	98	-32	-125	-399	-289
Increase in net official reserves (-)	-66	97	-37	-131	-399	-289
Use of IMF credit (+)	-4	3	-7	-6	-4	-6
Increase in gross official reserves (-)	-61	94	-30	-125	-385	-283
Arrears accumulation (+) / payments (-) (net) / 1	-1	1	5	6	0	0
Exceptional financing / rescheduling	0	0	0	0	0	0
Memorandum items:						
Current account balance (including official transfers; in percent of GDP)	-8.7	-7.1	1.5	1.3	7.0	2.6
Gross official reserves (end of period)	268	204	208	333	718	1,001
(In months of next year's imports of goods and services)	3.0	1.7	1.6	2.1	3.3	3.6

Table 16: Commodity Composition of Exports, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
Copper concentrate (value)	140.2	161.7	284.3	326.2	635.4	811.5
Volume (concentrate in '000 tons)	548.6	563.2	562.6	567.1	599.5	607.8
Refined copper equivalent	153.6	157.7	157.5	164.4	167.9	170.2
Unit value--refined (per ton)	912.9	1,025.6	1,604.8	1,964.5	3,765.2	4,768.6
Molybdenum concentrate	10.1	15.0	20.0	46.7	47.8	75.4
Volume (tons)	3,469.0	3,967.3	2,250.2	2,395.1	3,335.8	3,155.3
Unit value (per ton)	2,916.5	3,790.7	8,888.1	19,488.5	14,327.2	23,691.0
Zinc ores and concentrates	...	...	...	...	91.1	173.2
Volume (tons)	...	...	...	...	105.8	130.8
Unit value (per ton)	...	...	...	...	0.9	1,324.8
Fluite ore	...	...	...	...	...	18.4
Volume ('000 tons)	...	...	...	...	...	228.9
Unit value (per ton)	...	...	...	...	...	80.4
Fluorite concentrate	17.0	15.0	11.4	24.7	35.0	26.5
Volume ('000 tons)	192.5	187.5	140.5	311.4	355.0	131.1
Unit value (per ton)	88.1	80.0	81.1	79.3	98.7	202.5
Coal	...	...	...	26.6	45.5	115.7
Volume (concentrate in '000 tons)	...	...	...	2,217.6	2,373.8	3,227.0
Unit value (per ton)	...	...	...	12.0	19.2	35.9
Gold	117.6	157.3	239.9	331.4	270.1	234.9
Volume (kg)	12,388.3	14,220.6	19,043.6	23,811.5	15,378.8	11,575.9
Unit value (per kg)	9,496.5	11,061.1	12,597.4	13,918.1	17,563.5	20,289.9
Crude petroleum oils	...	...	...	...	...	53.4
Volume	...	...	...	...	...	0.7
Unit price	...	...	...	...	...	71.1
Sawn wood	0.0	0.0	0.0	0.1	0.2	0.1
Volume ('000 cubic meters)	0.0	0.0	0.2	0.5	1.1	0.3
Unit value (per cubic meter)	0.0	0.0	134.0	137.0	198.4	173.7
Cashmere tops	0.9	1.8	1.1	1.1	1.0	1.0
Volume (tons)	15.4	28.1	12.7	13.9	13.0	15.5
Unit value (per kg)	59.1	63.1	82.7	81.7	78.5	64.8
Cashmere, dehalred	30.5	25.7	44.1	52.8	81.7	114.3
Volume (tons)	632.3	563.1	831.7	919.2	1,427.5	1,784.5
Unit value (per kg)	48.3	45.6	53.0	57.4	57.3	64.0
Cashmere garments	12.8	15.6	33.1	17.5	15.7	13.4
Volume ('000 pieces)	483.6	645.5	1,500.1	476.5	467.7	1,809.7
Unit value (per piece)	26.4	24.1	22.1	36.8	33.5	7.4
Cashmere, greasy/raw	0.9	1.1	0.6	0.3	0.0	0.0
Volume (tons)	53.7	67.1	43.4	11.3	0.0	0.0
Unit value (per kg)	16.8	17.0	13.8	26.8	0.0	0.0
Cashmere, washed	...	...	...	...	...	114.3
Volume (tons)	...	...	...	...	...	1,784.5
Unit value (per kg)	...	...	...	...	...	64.0
Textiles	34.6	74.8	96.5	42.3	41.3	29.4
Volume ('000 pieces)	11,310.8	21,648.0	26,900.6	13,234.3	14,164.9	9,054.6
Unit price	3.1	3.5	3.6	3.2	2.9	3.2
Camel wool, raw	0.7	0.7	0.7	1.9	0.9	1.0
Volume (tons)	345.0	354.8	281.8	609.2	523.4	416.5
Unit value (per kg)	2.1	1.9	2.4	3.1	1.8	2.5
Skin and hides	11.3	6.1	5.9	3.0	7.4	7.6
Volume ('000 pieces)	1,332.2	409.5	406.4	437.8	463.3	471.2
Unit price	8.5	14.8	14.4	6.8	16.0	16.1
Sheepskin coats	0.1	0.2	0.2	0.5	0.0	0.1
Volume ('000 pieces)	1.2	1.0	0.8	5.2	0.0	0.5
Unit value (per piece)	111.6	233.1	205.1	104.5	0.0	179.6
Carpets	0.9	0.0	0.0	0.0	0.0	0.0
Volume ('000 square meters)	101.0	0.0	0.0	0.0	0.0	0.0
Unit value (per square meter)	9.4	0.0	0.0	0.0	0.0	0.0
Meat	20.5	15.7	13.2	10.1	10.1	11.4
Volume ('000 tons)	17.2	11.0	52.2	34.9	39.8	52.5
Unit value (per ton)	1,187.5	1,434.2	252.2	289.8	254.8	216.6
Scrap Metal	3.5	3.7	8.7	8.3	16.6	22.3
Volume ('000 tons)	8.6	8.0	8.7	3.8	3.0	3.5
Unit value (per ton)	411.7	467.6	1,002.2	2,178.7	5,473.6	6,444.2
Other	122.0	132.8	112.6	175.0	245.2	128.6
Total Exports	523.9	627.3	872.1	1,068.6	1,545.2	1,952.4
Mineral exports	285.0	349.1	555.6	755.6	1,125.0	1,536.2
Nonmineral exports	238.9	278.2	316.5	313.0	420.2	416.2
Memoranda items						
			(In percent of total exports)			
Mineral exports	54.4	55.6	63.7	70.7	72.8	78.7
Nonmineral exports	45.6	44.4	36.3	29.3	27.2	21.3
			(In percent of GDP)			
Total exports	41.2	43.3	48.1	46.3	49.1	50.1
Mineral exports	22.4	24.1	30.6	32.8	35.7	39.5
Nonmineral exports	18.8	19.2	17.5	13.6	13.3	10.7

Table 17: Direction of Trade, 2002-2007

	2002	2003	2004	2005	2006	2007 Est.
Exports 1/	100.0	100.0	100.0	100.0	100.0	100.0
Countries of the former CMEA	9.2	7.2	3.2	4.7	2.9	3.1
Former U.S.S.R.	9.1	7.2	3.2	4.7	2.9	3.1
Russia	8.6	6.3	2.4	2.6	2.9	3.0
Kazakhstan	0.1	0.5	0.0	0.1	0.0	0.0
Other	0.4	0.5	0.8	2.1	0.0	0.0
Korea, Democratic People's Republic of	0.0	0.0	0.0	0.0	0.0	0.0
EU countries	6.5	7.4	21.4	12.3	10.7	6.1
Belgium	0.0	0.1	0.1	0.1	0.1	0.0
France	0.0	0.3	1.8	0.1	0.1	0.3
Germany	0.5	0.8	1.3	1.2	0.0	0.0
Italy	1.7	1.5	2.0	2.3	2.6	3.0
Netherlands	0.5	0.4	0.4	0.4	0.2	0.4
United Kingdom	3.5	4.4	15.8	8.2	2.5	0.9
Other	0.2	0.0	0.0	0.1	5.2	1.4
Other	84.4	85.3	75.3	82.9	89.3	90.9
China	41.7	46.1	46.8	48.1	67.8	74.1
Hong Kong, China	0.6	0.5	0.8	0.2	0.2	0.3
Japan	1.3	1.4	3.8	0.5	0.5	0.8
Korea	4.4	1.2	1.1	6.1	1.4	2.2
Singapore	0.0	5.8	2.3	0.1	0.2	0.0
Switzerland	0.1	0.1	0.2	0.4	0.4	0.1
United States	31.6	23.3	18.0	14.3	7.7	3.4
Other	4.5	6.9	2.3	13.2	11.1	10.0
Imports	100.0	100.0	100.0	100.0	100.0	100.0
Countries of the former CMEA	38.5	37.6	41.0	43.0	38.0	35.8
Former U.S.S.R.	36.7	35.2	38.8	41.2	36.9	34.6
Russia	34.1	32.6	33.5	35.3	36.9	34.6
Kazakhstan	1.1	0.6	2.6	3.4	0.0	0.0
Other	1.6	1.9	2.7	2.5	0.0	0.0
Bulgaria	0.1	0.2	0.2	0.1	0.1	0.1
Czech Republic and Slovak Republic	0.5	0.7	0.5	0.4	0.0	0.0
Hungary	0.2	0.5	0.7	0.3	0.3	0.2
Poland	0.8	1.0	0.9	0.8	0.9	1.1
EU countries	8.3	11.0	8.3	8.3	9.8	10.5
Denmark	0.4	0.5	0.5	0.3	0.1	0.1
France	0.7	1.4	1.5	2.5	1.1	1.1
Germany	4.5	4.8	3.3	3.2	0.0	0.0
United Kingdom	0.4	0.5	0.4	0.7	0.6	0.6
Austria	0.1	0.7	0.5	0.1	0.1	0.3
Finland	0.5	0.3	0.2	0.2	0.2	0.4
Other	1.6	2.8	1.9	1.3	7.7	8.1
Other	53.2	51.4	50.7	48.8	52.1	53.6
China	20.2	21.8	22.0	24.9	27.2	31.3
Hong Kong, China	4.3	3.0	3.2	1.0	0.8	0.4
India	0.2	0.1	0.1	0.1	0.0	0.0
Japan	6.2	8.0	7.3	6.4	6.6	6.0
Korea	12.2	8.5	6.0	5.4	5.6	5.5
Singapore	1.7	1.3	1.5	1.4	1.4	1.3
Switzerland	0.5	0.6	0.4	0.1	0.1	0.0
United States	3.5	2.9	4.6	3.4	3.0	2.7
Other	4.7	5.3	5.7	6.1	7.6	6.3