MONGOLIA ECONOMIC GROWTH ASSESSMENT

October 2010

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Acronyms & Abbreviations

ADB	-	Asian Development Bank
AusAid	-	Australian Agency for International Development
BAS	-	Business Advisory Services
BCM	-	Business Council of Mongolia
BDS	-	Business Development Services
BEE	-	Business Enabling Environment
BGI	-	Business Growth Initiative
bln	-	billion
BoM	-	Bank of Mongolia
BOO	-	Build, Own & Operate
BOOT	-	Build, Own, Operate & Transfer
BoP	-	Balance of Payments
BSR	-	Business for Social Responsibility
CAS	-	Country Assistance Strategy
CBS	-	Corruption Benchmarking Survey
CDCS	-	Country Development Cooperation Strategy
CES	-	Central Energy System
CFB	-	Circulating Fluidized Bed
CHF	-	Community Habitat Finance
CHP	-	Combined Heat and Power
CI	-	Community Initiatives
CIS	-	Commonwealth of Independent States
CSO	-	Civil Society Organization
CRET	-	Central Regional Electricity Transmission Company
DHN	-	District Heating Network
DNA	-	Diaspora Network Alliance
DP	-	Democratic Party
DSM	-	Demand Side Management
EBRD	-	European Bank for Reconstruction and Development
ECA	-	Economic Consulting Associates
EDN	-	Electricity Distribution Network
EES	-	Eastern Energy System
EGAT	-	Economic Growth & Trade (Office of USAID)
EITI	-	Extractive Industries Transparency Initiative
EIU	-	Economist Intelligence Unit
eop	-	End of Period
EPCRC	-	Economic Policy & Competitiveness Research Centre
EPRA	-	Economic Policy Research Association
EPRC	-	Economic Policy Reform & Competitiveness (Project)
EPSP	-	Economic Policy Support Project
ERA	-	Energy Regulatory Authority
EU	-	European Union
FDI	-	Foreign Direct Investment
FGD	-	Flue Gas Desulfurization
FIFTA	-	Foreign Investment and Foreign Trade Agency
FRC	-	Financial Regulatory Commission
FSF	-	Fiscal Stability Fund
GASI	-	General Agency for Specialized Inspection
Gkal	-	Gigakalorie

Gkal/hr	-	Gigakalorie per hour
GCR	-	Global Competitiveness Report
GDNT	-	General Department of National Taxation
GDP	-	Gross Domestic Product
GER	-	Growing Enterprises Rapidly (Project)
GIDC	-	Government Integrated Data Center
GNI	-	Gross National Income
GoM	-	Government of Mongolia
GSP+	-	Generalized System of Preferences +
GTZ	-	Deutsche Gesellschaft für Technische Zusammenarbeit
GW	-	Gig Watt
GWh	-	Gig Watt Hours
HACCP	-	Hazard Analysis and Critical Control Points
HDI	-	Human Development Index
HDF	-	Human Development Fund
HR	-	Human Resource
ICT	-	Information Communications Technology
IDA	-	International Development Assistance
IFC	-	International Finance Corporation
IFI	-	International Finance Institution
ILO	-	International Labor Organization
IMD	-	Institute for Management & Development
IMF	-	International Monetary Fund
IPO	-	Initial Public Offering
ISO	-	International Standards Organization
ITB	-	Internationale Tourismus Börse (German Travel Fair)
JICA	-	Japan International Cooperation Agency
KOICA	-	Korea International Cooperation Agency
KV	-	Kilovolt
KW	-	Kilowatt
kWh	-	Kilowatt Hours
LPG	-	Liquefied Petroleum Gas
MCC	-	Millennium Challenge Corporation
MCCI	-	Mongolian Chamber of Commerce & Industry
MD	-	Microfinance Development
MDG	-	Millennium Development Goals
MDGCDS	-	Millennium Development Goals-based Comprehensive National Development Strategy of Mongolia
MEGA	-	Mongolia Economic Growth Assessment
MFALI	-	Ministry of Food, Agriculture and Light Manufacturing
MFTA	-	Ministry of Foreign Affairs & Trade
MIAT	-	Mongolian International Airlines
MIK	-	Mongolian Mortgage Corporation
mln	-	million
MMCA	-	Mongolian Management Consultants Association
MMRE	-	Ministry of Mineral Resources and Energy
MNET	-	Ministry of Nature, Environment & Tourism
MNMA	-	Mongolian National Mining Association
MNT	-	Mongolian Tugrik
MNTO	-	Mongolian National Tourism Organization
MoF	-	Ministry of Finance

MoJ	-	Ministry of Justice
MONEF	-	Mongolian Employers Federation
MORE	-	Market Opportunities for Rural Entrepreneurs
MPI	-	Migration Policy Institute
MPRP	-	Mongolian People's Revolutionary Party
MRAM	-	Mineral Resources Authority of Mongolia
MRTCUD	-	Ministry of Roads, Transport, Construction & Urban Development
MSE	-	Mongolian Stock Exchange
MSME	-	Micro, Small and Medium Enterprise
MSWL	-	Ministry of Social Welfare & Labor
MTA	-	Mongolian Tourism Association
MW	-	Mega Watt
NBFI	-	Non-Bank Financial Institution
NDC	-	National Dispatching Center Company
NDIC	-	National Development and Innovation Committee
NGO	-	Non-Governmental Organization
NID	-	National Identification (System)
NPL	-	Non-performing Loans
NSO	-	National Statistical Office
OT	-	Oyu Tolgoi
PM	-	Project Management
PPA	-	Power Purchase Agreement
PPP	-	Public Private Partnership
PREGA	-	Promotion of Renewable Energy, Energy Efficiency and Greenhouse Gas Abatement
PRM	-	Pastoral Risk Management
RASP	-	Rural Agribusiness Support Program
REDP	-	Regional Economic Development Program
RFP	-	Request for Proposal
RMI	-	Responsible Mining Initiative
SDC	-	Swiss Agency for Development and Cooperation
SGS	-	South Gobi Sands (Company)
SME	-	Small and Medium Enterprise
SOE	-	State Owned Enterprise
SPC	-	State Property Commission
SSIA	-	State Specialized Inspection Agency
TA	-	Technical Assistance
TAM	-	Turnaround Management
TCI	-	The Competitiveness Initiative (Project)
TDB	-	Trade and Development Bank (of Mongolia)
TOE	-	Tons of Oil Equivalent
thous	-	thousand
TPP	-	Thermal Power Plants
TT	-	Tavan Tolgoi
TUC	-	Trade Union Confederation
TVET	-	Technical, Vocational and Educational Training
UB	-	Ulaanbaatar
U.S.	-	United States of America
US $	-	United States Dollar
USDA	-	United States Department of Agriculture
UN	-	United Nations

UNCTAD	-	United Nations Conference on Trade and Development
UNDP	-	United Nations Development Programme
UNIDO	-	United Nations Industrial Development Organization
USAID	-	United States Agency for International Development
USG	-	United States Government
VAT	-	Value Added Tax
WB	-	World Bank
WES	-	Western Energy System
WPT	-	Windfall Profits Tax
yoy	-	Year on Year

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Executive Summary

Among the authoritarian countries of East and Central Asia, Mongolia sets itself apart as a beacon of hope for peaceful democracy in a region known for political unrest. Throughout the past 20 years, USAID programs have supported the transition from the Soviet era to the modern era of democracy and economic freedom. With an economy rooted in valuable natural resources, Mongolia has been able to nearly double its GDP per capita over the past five years, with GDP expected to grow at 7% in2010-2011.

This transition to a free market based economy has not come without its challenges to the people. Despite the best efforts of Mongolian elected officials to manage economic policy, the country's heavy reliance on mineral industries has created an economy vulnerable to the volatility of global commodity prices. This volatility was most recently evident in 2009 when the economy contracted by 1.6% due to changes in international mineral commodity prices. In response, USAID programs in Mongolia have a strong need to remain flexible as the potential for political tension and abrupt changes in policy and economic fluctuation remain high. In addition with Mongolia's geopolitical landlocked status between China and Russia, Mongolia must balance economics and politics very carefully to maintain its stability.

The Mongolia Economic Growth Assessment (MEGA) has taken the successes and challenges of USAID and other donor programs and produced a list of recommendations across multiple levels of intervention. From examining the past programs, especially the recent Growing Enterprises Rapidly Initiative (GER), Phase II of the Gobi Initiative, The Competitiveness Initiative and the Economic Policy Reform and Competitiveness Project, the MEGA team identified a list of eight major lessons learned:

- Reforms should be part of an overall Business Enabling Environment (BEE) strategy.
- Information is critical to effective dialogue.
- Government and private-sector ownership is key.
- Local or regional implementation of the existing legal framework may be more important than the reform of national policies.
- Changing incentives can have a powerful effect on behavior.
- A successful reform strategy involves building private sector and local government capacity to engage with each other.
- BEE support structures are key to success.
- Quick successes generate opportunities for more success.

With these principles in mind, the MEGA team interviewed US and Mongolian government officials, private and public sector stakeholders, and past and potential future beneficiaries to develop a roadmap for the next five years of USAID programming. With budgets tight during a fiscally challenging time, coordination with donors and private sector partners to maximize the value of donor investments and avoid redundancy in programming will be critical to success. Mongolia's success in development will be instrumental in maintaining a partnership with the United States, an important foreign policy ally in a geopolitically sensitive location. The following are recommendations across a wide spectrum of economic development programs anticipated for Mongolia in the coming years:

Business Enabling Environment (BEE) - focus on private and public sector-demanded BEE reforms in the mining and mining supply chain sector, with the recognition that reforms can and should benefit other sectors. Demand-led reforms in the mining sector are seen as a model and catalyst for improving the BEE for a wide number of sectors in Mongolia.

Finance – continued commitment to the development of a diverse and deep financial sector by supporting the passage of laws opening and liberalizing non-bank activities.

Energy – focus development programs in four areas: technical assistance on private financing instruments; energy data monitoring and demand forecasting; energy efficiency measures; and removing barriers to renewable energy.

Mining – support in technical assistance and advice on policymaking to the Government of Mongolia's mining sector. Facilitate donor coordination on policy messages, and work to develop national consensus and assistance in public-private partnerships.

Agriculture and other traditional industries – Past USAID activities supported interventions to strengthen the dairy and meat processing industries. These projects have been successful and produced small scale returns. Small and Medium Enterprises (SMEs) in traditional sectors have often received support through other USAID programmatic activities. Given the limited impact of these activities, these areas are not recommended as priority areas for further direct program support by USAID.

The assessment provides recommendations for follow-up project areas that focus on the mining sector and less, but still significant, attention to the finance and energy sectors. While previous projects have typically separated economic growth from governance, the two are interlinked and it is recommended that they be dealt with together under one project. The following project components would address the Government of Mongolia's (GoM) struggles with proactive policy development, comprehensive planning and prioritizations, institutional capacity building, public private sector dialogue, building linkages among universities, industry, and government, and general business development. The summary of project components are as follows:

- Scenario planning: There is a lack of serious and comprehensive planning and prioritization by the GoM. A better understanding of plausible future scenarios based on analysis involving a diverse number of stakeholders is recommended. A scenario planning exercise that includes creating a framework for mining policy will be useful in determining and/or confirming future needs in the energy and domestic financial sectors.

- Planning and Policy: The GoM struggles to be proactive in policy development. There is a need to work with relevant ministry departments and agencies to turn objectives into tangible action plans that take into account capacity of civil servants, the timeframe required to improve capacity, address lack of local skills, implement changes, and identify resources. In additional, public consultation and transparency can be improved in policy making. Support for planning and policy making must take these issues into consideration in order to improve the capacity for policy changes.

- Institutional Governance, Management and Administrative Capacity and Procedures: The drafting and adoption of laws and regulations can be meaningless unless capacity exists within the institution to implement those laws or regulations. To effectively understand and communicate changes in legislation and efficiently implement those changes involves working collaboratively with the private sector, monitoring and evaluating the process of implementation, and ensuring enforcement of regulations. Technical assistance should be aimed at strengthening the capacity of civil servants to better understand their roles and the work they are supposed to undertake, the best methods to approach their work, and ensure that they have the necessary resources and support to do their work. At the same time, management within the civil service should improve HR practices to motivate their staff to be more productive and effective.

- Inter and Intra–Public and Private Collaboration, Coordination and Dialogue: Various indicators suggest that the private sector's trust of government is low, and that public sector institutions provide poor quality services. There is also a lack of trust between the large mining companies (particularly those that are foreign-owned) and government. Project efforts should therefore support collaboration, coordination and communication between and among various entities, including government, parliament, private sector enterprises, private sector associations, think tanks, research organizations, universities, diaspora communities and donor organizations. A bottom-up demand-led coordination mechanism could lead to improved dialogue, coordination and a more formal mechanism in the future. Continuing EPRC efforts in assisting Mongolians to understand the mining sector and what it means to their community and assisting the average Mongolian, through CSOs, are exiting coordination mechanisms from which to begin.

- University, Industry and Government Linkages, and Entrepreneurship Training: Though the Millennium Challenge Corporation (MCC) is making efforts to improve Technical, Vocational and Educational Training (TVET) in the mining and energy sectors (including educational reforms, an operational framework, a skills standards and competencies system, a competency-based training system, and a labor market information system), it appears that little is being done at the higher education level and with research institutions. Further research will need to be undertaken to understand the opportunities that exist in this area.

- Business Management, Corporate Governance and Business Services: The mining sector requires professional enterprises in the supply chain. Despite significant attention being paid by donors to the broad SME sector, little attention has specifically been given to SMEs in the mining supply chain. In order for the larger mining companies to work with Mongolian SMEs, these enterprises need training and capacity building in the area of potential business services that could be provided to the mining companies.

- Business Association Strengthening: Given the significant number of large and foreign-owned enterprises there is a level of professionalism within the boards and management, that is encouraging in terms of their sustainability and ability to add value to the existing services they provide to their members. These services may also include the provision of market and industry information and trainings that could be met through the improvement of these existing business associations.

Specific interventions are explained in greater detail in the concluding sections of the assessment.

An overarching recommendation is that USAID activities should focus on working hand-in-hand with stakeholders and beneficiaries, rather than treating them as beneficiaries. Implied in this notion is the desire and need to team up with the many foreign direct investors that are flooding into Mongolia for a piece of Mongolia's natural resource wealth. These corporate partners offer a strong opportunity to leverage donor funds into areas of development needs unrelated to mining and energy. For the foreseeable future, the GOM and USAID should continue to foster a long standing relationship that is built on mutual foreign policy objectives that strengthen policies and institutional transitions to create sustainable economic growth.

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The Economic Growth Assessment team is grateful to those individuals and organizations that assisted them during the process of preparing the report. Particular mention should be made of the support provided by the USAID Mongolia Mission – Mission Director, Chuck Howell, Private Enterprise Officer, Michelle Bahk, Development Assistance Specialist, Baavai Tuguldur, Management Roving Secretary, D. Otgontsetseg and Driver, B. Munkhdul.

Methodology

The Economic Growth Assessment team, comprising Dany Khy, Lawrence Camp, Stratos Tavoulareas, Margaret Herro and Alan Saffery visited Mongolia at different times between 15th August and 18th October 2010.

The methodology for the assessment comprised the following:

1) Review of written materials of the GoM, USAID Mission, USAID project implementers, international organizations and academic institutions
2) Interviews with:
    a. USAID Mission personnel
    b. Other U.S. Government officials
    c. GoM officials
    d. EPRC personnel
    e. Representatives of donor organizations
    f. Private sector stakeholders
3) Brainstorming and discussions between team members
4) Visits to relevant locations in and around Ulaanbaatar
5) Feedback from USAID personnel
6) Development of the final report

Report Format

The first part of the report provides a background to the assessment and Mongolia, assesses USAID's role in Mongolia and assistance provided to-date, analyzes the country's economic situation and challenges, and briefly suggests considerations for USAID to take into account in future planning and projects.

The second part of the report then analyzes, in-depth, the business enabling environment, energy, finance and banking, and mining sectors. The current situation is presented for each, along with details of other donor activities and recommendations for USAID consideration. An additional section focuses on the traditional economic sectors such as tourism, meat and cashmere, among others. Cross-cutting initiatives are also analyzed.

The third part of the report brings together the recommendations identified in the second part, and focuses on resource implications, time horizons and potential impacts.

Annexes include:
Annex 1 - Documents Reviewed and References
Annex 2 - Team Interviews
Annex 3 - Major Minerals in Mongolia
Annex 4 - Strategic Deposits in Mongolia
Annex 5 - Economic / Benchmarking Analyses

Background

The principal objective of the Mongolia Economic Growth Assessment (MEGA) is to analyze and prioritize the economic development opportunities and constraints facing Mongolia for the next five years and to make specific recommendations to the USAID Mission on strategic program areas that have the highest potential for catalytic impact. The assessment will directly inform the Country Development Cooperation Strategy (CDCS) for 2011-2016 and the design of a new activity to follow the Economic Policy Reform and Competitiveness (EPRC) Project, which is scheduled to end in September 2011.

The first activity in the development of the CDCS was a strategy workshop held in June 2010. A Strategy Concept Paper was developed with input from key stakeholders, outlining USAID's role in a whole-of-government approach to development assistance. It prioritized the U.S. Government's (USG) development goals in Mongolia for the next five years taking into consideration the budget constraints and overall operating environment.

Several common themes were identified in the Strategy Concept Paper: a view that Mongolia now has the minimum legal and regulatory framework necessary to support economic growth, but is weak in the implementation and enforcement of these policies; the need to further develop the mining industry supply chain; a focus on increasing competitive, value-added enterprises; improving the business enabling environment; strengthening the banking and financial sectors; and the need to diversify an economy which will become increasingly dependent on mining revenues. These underlying issues are addressed in this assessment report.

The assessment team included two team members from USAID/Washington and a consultant contracted by Weidemann Associations, Inc. under the Business Growth Initiative (BGI) managed by Steve Silcox in the Economic Growth Office in EGAT. Mr. Alan J. Saffery, a J.E. Austin Associates, Inc. consultant from BGI, served as the Business Enabling Environment (BEE) specialist and team lead while USAID/Washington team members, Mr. Lawrence Camp and Ms. Dany Khy, served as the banking and finance specialist and team coordinator. The assessment team also included a consultant for the mining sector, Ms. Margaret Herro, and energy specialist Mr. Stratos Tavoulareas. The USAID Representative to Mongolia Chuck Howell, Private Enterprise Officer Michelle Bahk, and Development Assistance Specialist Tuguldur Baavai provided valuable guidance for the team.

Country Context

In the last 20 years, Mongolia has made tremendous progress in its transition from a centrally-planned state to a democratic, market economy. The transition has been successful overall with the private sector constituting over 70 percent of the nation's GDP. Despite some initial challenges, Mongolia's economy is now growing rapidly. From 2004 to 2008, growth averaged nearly 9 percent per year. Although the Mongolian economy contracted by 1.6 percent in 2009, it is expected to grow by an annual average of 7 percent between 2010 and 2011, indicating that Mongolia's economy is rebounding strongly.[1]

Mongolia's political transition has been successful as well. In general, Mongolia is a peaceful and stable country. In the last 16 years, Mongolia has held 9 peaceful presidential and parliamentary elections. In July 2008, there was a small, violent outbreak of civil unrest

[1] World Bank, 2010

following disputed parliamentary elections but it was quickly contained. In May 2009, Mongolia held peaceful presidential elections, although a tense balance of political power remains between the ruling Mongolian People's Revolutionary Party (MPRP), which has a majority in parliament, and the Democratic Party (DP). Despite these issues, the political environment is expected to remain stable in the future.[2]

In addition to its economic performance and political stability, Mongolia's health and education statistics are notably high. These impressive indicators are, in part, a legacy of the Soviet era but they also reflect high government spending in these sectors - 6 percent for health and 9 percent for education.[3] The adult literacy rate is at 97 percent with only a 1 percent gap between men and women. School enrollment and attendance is also at 97 percent. Women in Mongolia surpass their male counterparts when it comes to education; Mongolian women are more likely than their male counterparts to graduate from high school, and more than two-thirds of all university students are women.[4] In health, over 98 percent of all Mongolian children are vaccinated against tuberculosis, 95 percent against polio, and 97 percent against measles. Life expectancy is 67 years.[5] In these areas, Mongolia out-performs many other countries in a comparable stage of development.

Although social development indicators are impressive, Mongolia still faces some key development challenges. Mongolia is a landlocked country with a limited domestic market. Its economy is poorly diversified and heavily reliant on a few raw export commodities (copper, gold, textiles, crude oil, de-haired cashmere and fluorspar). In addition, the harsh climate, vast territory, limited infrastructure and distance from international markets combine to make it difficult for Mongolia to compete in the global marketplace. Additionally, an abundance in minerals present new challenges especially in areas of governance and corruption. However, Mongolia's vast mineral wealth as well as its highly educated and healthy populace may provide Mongolia an opportunity to overcome these challenges and achieve long-term positive growth.

It is clear that Mongolia is at a critical crossroads both economically and politically. The U.S. can play an important role in shaping Mongolia's development path while simultaneously advancing U.S. foreign policy objectives in the region. Mongolia's strategic location, wedged between two powerful neighbors, Russia and China, and its increasing visibility in global affairs, make it critical that the USG engage Mongolia in a robust and effective manner.

For years, Mongolia has supported U.S. positions on key foreign policy issues. It played a constructive role in engaging North Korea and advocating for nuclear disarmament. Mongolia has also contributed a small number of troops to Iraq and Afghanistan, as well as UN peacekeeping deployments to Africa, Eastern Europe, the Middle East and other locations. In addition to being in close proximity to Russia, China, and the Koreas, Mongolia is the only stable democracy between South Korea and Eastern Europe. In contrast to its neighbors, its transition to a democracy and market economy in a region dominated by authoritarian governments is notable. From a political and economic standpoint, a stable Mongolia contributes to stability in two regions, East and Central Asia.[6]

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[2] Mongolia Investment Climate Report
[3] UNICEF Country Statistics
[4] Fitch, p. 9-10
[5] UNICEF Country Statistics
[6] USAID Strategy Concept Paper

Mongolia's strategic approach to its geopolitical situation is its 'Third Neighbor' policy, which seeks to balance the overwhelming influence of Russia and China with strong ties with other countries including the U.S., Japan, South Korea, Canada, Australia, India, and the European Union. These relationships are essential in enabling the country to achieve independence by avoiding economic dependence on a single country. The U.S. is one of Mongolia's most important third neighbors, and it consistently looks to the U.S. for advice, support and assistance. According to the Strategy Concept Paper, "Mongolia is, in short, a welcome and reliable partner in a highly strategic region, sharing common values as well as a continued commitment to achieving a market-oriented democracy."[7]

USAID Assistance in Mongolia

Since the dissolution of the Soviet Union in 1991, USAID has helped Mongolia build a solid macroeconomic policy framework and lay the institutional foundations for a stable and sovereign democracy. USAID programs focus on two of Mongolia's most pressing concerns: strengthening the economy and improving governance. Although USAID funding is small compared to other international donors, USAID has made vital contributions to Mongolia's economic and political transformation. It has strengthened more than 7,000 small businesses, increased the availability of business information to half a million people, and facilitated business loans worth over US $6.4 million. USAID is renowned for transforming the troubled Agricultural Bank of Mongolia into Khan Bank, one of Mongolia's largest banks and the bank with the most extensive branch network. After 20 years of engagement, USAID is seen as the lead donor in promoting private sector-led economic growth and good governance.

Prior USAID Assistance

USAID launched its bilateral program in Mongolia in 1991 as an immediate and tangible demonstration of bilateral cooperation following the withdrawal of all soviet support. Assistance at this time focused on short-term emergency relief including a US $10 million cash transfer to buy critical raw materials, equipment and supplies for power plants. Prior to 1998, USAID assistance continued to be short-term in nature, focused on macroeconomic stabilization, energy infrastructure, and reducing the size and scope of the state.[8]

The USAID strategy from 1999 to 2003 marked an important shift from short-term emergency relief toward long-term sustainable development. It also linked the two main themes of promoting democracy and strengthening private sector-led economic growth. The program focused on technical assistance and training for privatization, improving the business environment by strengthening public private dialogue, improving competitiveness and a more effective use of Mongolia's natural resource base. Economic projects during this period included the Economic Policy Support Project (1995-2003), the Mongolia Privatization Project (1998-2004), The Competitiveness Initiative (2000-2003) and the Energy Sector Restructuring Project.[9]

The USAID strategy from 2004 to 2009 continued the work on accountable and effective governance but also sought to accelerate and broaden private sector growth in a more inclusive and environmentally sustainable way. Specific areas of involvement included:

1) improving the enabling environment for private sector growth

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[7] Strategy Concept Paper
[8] USAID/Mongolia Strategy 2004-2008; EPRC Mid-Term Evaluation
[9] USAID/Mongolia Strategy 2004-2008

2) Supporting more competitive industries and sectors
3) Expanding economic opportunity for marginalized Mongolians.

Specifically, the economic projects during this period included the following:

1) *The GER Initiative:* Implemented by CHF international, the Growing Entrepreneurship Rapidly (GER) Initiative (US $4 million over six years, 2002-2009) promoted business development and employment services in the rapidly growing *ger* (traditional dwelling) districts that surround Mongolia's urban centers. The GER Initiative worked in five cities and their surrounding areas: Ulaanbaatar (UB), Darkhan, Erdenet, Choibalsan and Bayan Ulgii. Activities included facilitating loans to four partner banks, supply and demand linkages to larger businesses in city centers, and information services in partnership with government authorities. The project was spun off into a local NGO, Development Solutions, which continues to operate in and around the five cities.
2) *The Gobi Regional Economic Growth Initiative Phase II:* Implemented by Mercy Corps International, the second phase of the 'Gobi' Initiative (US $10 million over five years, 2004-2009) promoted economic growth by developing and strengthening rural businesses in the six southern *aimags* (provinces) of Mongolia. Activities included facilitating financial transactions with local banks; technical support for herders and small and medium-sized enterprises; and providing expanded business information services through various media, including innovative radio programs and the monthly magazine *Rural Business News*.
3) *Economic Policy Reform and Competitiveness Project:* Implemented by Chemonics, Inc., this project provides the GoM with a quick-response mechanism for addressing a wide range of economic policy reform and private sector development issues. Working in conjunction with the Prime Minister's office, long-term expatriate technical specialists provide information and analysis on key issues related to trade, investment, private sector development and related issues. Specially targeted emphases include commercialization of the energy sector and (until 2008) strengthening industries such as tourism and cashmere; key sectors of the economy.

The Gobi and GER projects, although successful, ended in early 2009 due to budget constraints while EPRC is expected to end in 2011.[10] However, support has continued with USDA (United States Department of Agriculture) funding.

The EPRC project has been the USAID/Mongolia flagship economic growth program since 2003. It was initially comprised of four main components:

1) Economic, trade, financial and policy support
2) Energy sector reform
3) Business and sector/cluster development
4) Consensus building, public education and national dialogue.

Three of these components are reflective of three predecessor projects that served as the foundation for EPRC: the Economic Policy Support Project, Energy Sector Restructuring, and The Competitiveness Initiative. [11]

Role of USAID Assistance

In the next five years, USAID has the opportunity to play a catalytic role in helping Mongolia implement the policies and strengthen the institutional foundations that will ensure sustainable

[10] USAID/Mongolia Strategy 2004-2008
[11] USAID/Mongolia Strategy 2004-2008; EPRC Mid-Term Evaluation

and equitable economic growth. USAID also plans to contribute to a more diversified economy in which the private sector continues to play a lead role; highlight important corruption concerns; promote economic independence; and ensure that important issues related to both good governance and sustainable economic growth are addressed. Mongolia is at a critical economic crossroads and how it develops in the next five years will have enormous implications for years to come, not only for Mongolia, but for Asia and the rest of the world.

As the lead U.S. agency delivering long-term development assistance, USAID programs will lock in policy reforms and strengthen institutional capacity in preparation for the massive windfall expected, with the goal of ensuring that the GDP growth will sustainably and equitably benefit the Mongolian people. Given the upcoming political and economic issues that will confront the country over the next five years, robust and effective USAID engagement in Mongolia is clearly within U.S. interests. USAID programs contribute directly to the overall USG goal of ensuring sovereignty, stability and prosperity for Mongolia, while helping it maintain economic independence from Russia and China. For the past twenty years, economic growth programs have been at the heart of the USAID portfolio and will continue to play a large role over the next five years.

Mongolia's Economic Outlook

Key Indicators

Table 1. Key Indicators of Economic Outlook

	2000	2005	2007	2008	2009
BASIC DATA					
Population, total (mln)	2.39	2.55	2.61	2.64	2.70
Population growth (annual %)	1.2	1.3	1.2	1.1	2.0
Urban Population (%)	57.2	60.2	60.8	61.8	-
Population of Ulaanbaatar (mln)				1.017	-
GNI, Atlas method (current US$ bln)	0.99	2.06	3.34	4.41	-
GNI per capita, Atlas method (current US$)	410	810	1 280	1 670	-
PEOPLE & EMPLOYMENT					
Life expectancy at birth, total (years)	64	65	66	67	-
Fertility rate, total (births per woman)	2.2	2.0	2.0	2.0	-
Mortality rate, under-5 (per thous)	63	48	43	41	-
Primary completion rate, total (% of relevant age group)	90	95	110	93	-
Ratio of girls to boys in primary and secondary education (%)	111	106	105	104	-
Labor Force (mln)	0.848	1.001	1.054	1.072	-
Employed (mln)	0.809	0.968	1.024	1.042	-
Of which agriculture (mln)	0.394	0.386	0.386	0.377	-
Of which industry (mln)	0.091	0.114	0.123	0.124	-
Of which other (mln)	0.325	0.468	0.515	0.540	-
Unemployed (thous)	38.6	32.9	29.9	29.8	-
Official Unemployment rate (%)	-	3.3	2.8	2.8	3.3
Income share held by lowest 20%	-	7.2	-	7.1	-
ENVIRONMENT					
Surface area (sq. km) (mln)	1.564	1.564	1.564	1.564	1.564
Forest area (sq. km) (thous)	106.7	102.5	100.9	-	-
Agricultural land (% of land area)	84.0	74.2	74.7	-	-
ECONOMY					
Nominal GDP (MNT bln)	-	2780	4600	6020	6055
Nominal GDP ($ mln)	-	2307	3930	5258	4203
GDP per capita ($)	-	900	1491	1921	1552
GDP growth (annual %)	0.5	7.3	10.2	8.9	-1.6
Inflation, GDP deflator (annual %)	26.1	20.4	12.3	22.4	-
Agriculture, value added (% of GDP)	33	25	23	21	-
Industry, value added (% of GDP)	20	34	41	40	-
Services, etc., value added (% of GDP)	47	41	36	39	-
Gross capital formation (% of GDP)	29	37	40	39	-
Revenue, excluding grants (% of GDP)	25.4	-	40.5	32.1	-
Cash surplus/deficit (% of GDP)	0.2	-	7.7	-3.5	-
Consumer Price Index (% yoy change)	-	9.6	14.1	23.2	1.2
Industrial Production Index	-	n/a	110.4	113.4	109.6

(% yoy change)	-	n/a	2.8	2.8	3.3
PUBLIC SECTOR					
Government balance (% of GDP)	-	2.6	2.8	-5.0	-5.4
Non-mining balance (% of GDP)(1)	-	-1.3	-13.4	-15.1	-12.9
Domestic public sector debt (% of GDP)	-	0.1	0.5	0	9.3
FOREIGN TRADE, BOP & EXTERNAL DEBT (2)					
Trade balance ($ mln)	-	-99.5	-52.4	-612.6	-157.9
Merchandise trade (% of GDP)	105.7	97.5	101.9	117.1	-
Exports of goods ($ mln)	-	1066	1889	2539	1902
(% yoy change)	-	22.2	22.4	34.4	-25.1
Copper exports (% yoy change)	-	14.7	27.7	12.1	39.9
Exports of goods and services (% of GDP)	56	64	64	57	-
Imports of goods ($ mln)	-	1021	2117	3616	2131
(% yoy change)	-	16	42.5	70.8	-41.1
Imports of goods and services (% of GDP)	71	68	66	72	-
Current account balance ($ mln)	-	29.7	264.8	-721.9	-235.1
(% of GDP)	-	1.3	6.7	-13.9	-5.6
Workers' remittances and compensation of employees, received (current US$ mln)	12	180	194	200	-
Foreign direct investment, net inflows (BoP, current US$ mln)	54	257.6	360	836	426
Net official development assistance and official aid received (current US$ mln)	217	215	239	246	-
External debt (% of GDP)	-	61.2	40.1	34.6	50
Debt service ratio (% of exports of goods &services)(3)	-	2.7	2	2	3.7
Foreign exchange reserves, gross ($ mln)	-	333.1	1001	656.9	1327
FINANCIAL MARKETS					
Domestic credit (% yoy change)		18.8	78.4	52.5	-7.5
Short-term interest rate (% per annum)(4)		3.7	8.4	9.8	
Exchange rate (MNT/US$, eop)		1221	1170	1268	1443
Real effective exchange rate (2006=100)(5)		99.6	104.8	127.4	102.9
(% yoy change)		6.1	1.9	21.5	-19.2
Stock market index (2000=100)(6)		203.6	2048	1182	n/a

(Data taken from World Bank Quarterly Review July 2010 and supplemented with data from other WB and ADB sources)

(1) Non-mining balance excludes revenues from corporate income tax and dividends from mining companies, the Windfall Profits Tax and royalties.

(2) The 2008 data for the balance of payments are based on the final revision.

(3) On public and publicly guaranteed debt.

(4) Yield of 14-day bills until 2006 and of 7-day bills for 2007.

(5) Increase is appreciation.

(6) Top-20 index, end of year, index=100 in Dec-2000.

Economic Profile

Mongolia has made tremendous progress in its transition from a state-led, command economy to a democratic, market economy. The transition has been successful overall with the private sector constituting over 70 percent of the nation's GDP; up from only 4 percent in 1990. At the time the last strategy was written (2002) annual per capita GNI was a mere US $450. The annual per capita GNI has more than tripled to US $1,670 in 2008.[12] Mongolia is now a lower-middle income country with great potential for rapid growth in the next five years.

Economic activity in Mongolia is traditionally based on herding and agriculture, which make up about 21.1 percent of GDP, while services and industry contribute 39.2 percent and 39.8 percent respectively.[13] Mongolia's wealth lies in its extensive mineral deposits, which have attracted foreign investors eager to utilize the country's vast resources. Mongolia is rich in copper, gold, coal, uranium and a vast array of other minerals, which account for a large portion of foreign direct investment and government revenues.

Growth averaged nearly 9 percent per year from 2004 to 2008, largely due to high copper prices and new gold production. In 2008, Mongolia experienced a soaring inflation rate with year-on-year inflation reaching nearly 30 percent; the highest inflation rate in over a decade. Immediately upon experiencing double digit inflation, the global economic crisis hit Mongolia hard. In 2009, the Mongolian economy contracted by 1.6 percent due to a combination of factors; the global economic downturn, falling commodity prices (copper prices decreased by 65% in one year), a decrease in demand for Mongolian exports, a domestic banking crisis and a slowdown in construction. The crisis hit Mongolia harder than other mineral rich nations due to their fiscal reliance on minerals, the lack of adequate savings during boom years, and the overheating of the banking sector (loans outpacing deposits and exposure to the construction sector).This contraction reduced government revenues and forced major cuts in spending as well as strong action on fiscal, monetary, exchange rate and financial policies, backed by bipartisan support and strong leadership. At the height of Mongolia's banking and fiscal crises, the country received a US $224 million loan from the International Monetary Fund (IMF) which was an important step in restoring confidence in the country's external position.[14]

Fiscal balances have been improving since then, mainly due to higher fiscal revenues, efforts to contain fiscal spending and external conditions improving. The GoM increased interest rates from 9.75 percent to 14 percent in March 2009. They abandoned the de facto exchange rate, introduced exchange auctions, reduced the deficit to 5.4 percent of GDP, cut public sector investment and public sector wages, increased capital adequacy requirements and revised and clarified the deposit guarantee law. Exports are now experiencing sustained recovery, supported by upward movement in metal prices and increasing copper and coal imports by China, Mongolia's largest trading partner. According to the World Bank (WB), the exchange rate against the U.S. dollar has been stable, while foreign exchange reserves are near record levels.[15] Consumer prices are rising, public finances have improved, the current account deficit has narrowed, the exchange rate has stabilized and real activity has recovered.

Recent mining developments add an increasingly important dimension to economic growth in Mongolia. Last fall, the government passed long-awaited legislation on an investment

[12] World Bank, Mongolia at a Glance, 2008
[13] World Bank, Mongolia at a Glance, 2008
[14] EIU, p. 10-11
[15] World Bank, Mongolia Quarterly Economic Update, p. 18

agreement to develop the Oyu Tolgoi (OT) mine, considered one of the world's largest untapped copper and gold deposits. The GoM also solicited contractors to develop the Tavan Tolgoi (TT) coal deposit under state ownership. Both are in the South Gobi region, in close proximity to the Chinese border. Total investment to develop OT, TT and other announced minerals developments exceeds US $6 billion in the next three years alone.[16] Since Mongolia's GDP in 2009 was only US $3.9 billion, OT and TT represent a huge financial injection into the economy.[17] Many smaller developments, ranging from several millions of dollars to a US $1 billion iron-ore project, are waiting to be developed.[18]

In response to these new mining developments and the global economic downturn, the Parliament recently passed the Fiscal Stability Law, which is seen by international donors as a critical step for prudent and sustainable fiscal spending. The law will set in place a fiscal framework for managing mining revenues from the mining sector starting in 2016 forward, hopefully minimizing the risk of Dutch Disease. Second, a targeted poverty benefit will ensure that the poor are protected from future mining boom-and-busts in a fiscally affordable manner. Finally, the law attempts to address the current problems of the financial sector through increased transparency.[19]

Foreign direct investment (FDI), especially in mining, construction activities and Mongolian worker remittances, has increased significantly in recent years fuelling high GDP growth. Real GDP grew by 7.6 percent in the first quarter of 2010 and is expected to grow by an annual average of 7 percent between 2010 and 2011. Another support for growth in the short term will be government spending which is expected to increase significantly in the next few years. Over the long-term, capital flows from mining-sector developments will help fuel GDP growth. According to observers, GDP is expected to double by 2015, and quadruple by 2020.[20]

Economic Challenges

Economic Diversification

Although economic growth prospects are promising, Mongolia faces a number of key challenges in achieving sustainable and equitable economic growth. First, the global economic downturn and the collapse in copper prices emphasized the country's poorly diversified economy and heavy reliance on export commodities. Commodities account for around 80 percent of the country's exports, and mining revenues provide around 40 percent of the country's total government budgetary income. The challenge for Mongolia is that the sources of real GDP growth are concentrated and heavily dependent on mining, making Mongolia increasingly vulnerable to commodity price shocks.[21] A big increase in commodity exports will put upward pressure on the Mongolian currency, which can make exports in agriculture and manufacturing less competitive.

[16] Strategy Concept Paper
[17] EIU, p. 6
[18] Strategy Concept Paper
[19] World Bank, Mongolia Quarterly Economic Update, p. 8
[20] EIU, p. 3
[21] World Bank, Mongolia Quarterly Economic Update, p. 16

Geopolitical Position

Mongolia's economy continues to be heavily influenced by its neighbors. Mongolia purchases 95 percent of its petroleum products and about 8% of electric power from Russia, leaving it vulnerable to price increases. Trade with China represents more than half of Mongolia's total external trade; China receives about two-thirds of Mongolia's exports.[22] The overreliance on China and Russia as trading partners puts the Mongolian economy in a more vulnerable position and inhibits the country's goal of economic independence.

Inflation

Inflation continues to be a challenge and may undermine consumer sentiment and purchasing power. According to the WB, inflation may reach over 20 percent by the end of the year. A contributing factor is that government spending will rise by 34 percent in 2010, contradicting the targets set forth by the Fiscal Stability Law. The primary catalyst for these spending increases is the execution of promises made by both coalition parties to distribute MNT $1.5 million (c. US $1,000) to each citizen in the form of cash and non-cash handouts, as well as large public sector wage increases planned for later this year. Supply side factors, including rising meat prices and an increase in regulated electricity prices are also creating inflationary pressures. The WB predicts that Mongolia may experience a renewed bout of high inflation and macroeconomic vulnerability typical of the recent past. [23] If this is the case, the Bank of Mongolia (BoM) may tighten monetary policy by raising interest rates further, possibly hurting investment spending.[24]

Domestic Financial Sector

The rapid development of the mining sector will result in an influx of foreign capital that will require a deeper domestic financial sector to deal with increased monetary flows among the Mongolian population. The Mongolian financial sector has grown exponentially over the past decade, although almost entirely within the banking sector, which accounts for 96 percent of all financial sector assets. Mongolia remains well behind its neighbors in the depth and breadth of its financial sector. Its excessive reliance on banks as the sole source of financial intermediation is a constraint to growth and diversification of the economy. In the absence of alternatives, banks are essentially the only domestic source for financing, as well as the only domestic vehicle for investment. While not a constraint for large businesses that source capital abroad, it is a major constraint for the majority of Mongolian enterprises that must rely on domestic banks. Loans through the Mongolian banking sector are expensive, short-term, and heavily collateral dependent. This presents a constraint for start-ups and rapidly growing businesses which need the longer-term, affordable credit required for capital investment.

Poverty, Unemployment & Economic Divide

The growth of the mining industry has not yet created substantial employment generation, despite a young and educated labor force. One reason is that mining is capital-intensive and the country's workforce may prove ill-suited to the jobs created by the sector. There is potential for employment generation in the mining supply chain but it is unclear whether this will be sufficient for significant job creation.

Mongolia must manage its rapid growth without comprising its socioeconomic achievements or significantly increasing the income gap. Economic analyses and anecdotal information show

[22] World Bank, Mongolia Quarterly Economic Update, p. 16
[23] World Bank, Mongolia Economic Update, p. 11-12
[24] EIU, p. 15

that a growing rural-urban divide is emerging along with a new and disturbing division between rich and poor. Although poverty has decreased since the transition to a market economy, it remains high with an estimated 38.7 percent of the population living below the poverty line in 2009, with the richest 10 percent securing 24.5 percent of the GDP.[25] Rising unemployment and decreasing real wages are contributing factors. Although nominal wages have increased this year due to improved job opportunities in the construction sector, real wages, however, have declined due to a significant increase in the consumer price index.[26] The decline in purchasing power is compounded by rising 'real' unemployment (includes those not formally registered), which has risen to 12.8 percent, up from 10.5 percent in September 2009.[27]

Mongolia's rural-urban divide is stark for a large country with a small population. Economic decline in the countryside and harsh weather conditions (*dzuds*) have resulted in an increasing rural-urban migration. Migration has been concentrated in peri-urban, *ger* districts that surround the major cities of UB, Darkhan, and Erdenet. For example, UB has grown from about a quarter to over half the country's population in recent years, which puts enormous pressure on the city's infrastructure, services and environmental quality. Families living in the peri-urban areas reside in *gers*, without water, sanitation, or basic infrastructure. Wood- or coal-burning stoves are used for cooking and heating, which add to the city's high levels of air pollution, while fuel costs alone can eat up half a family's income. According to the WB, about 60 percent of the city's population reside in these impoverished *ger* districts.[28]

Food Security

The stark climate and recurrent harsh winters also put pressure on food security for a country that already imports all its rice, vegetable oil and sugar along with 50 percent of its wheat and flour; all staples of the Mongolian diet. A *National Food Security Program* for the period 2009-2016 has been budgeted at US $1.2 billion over seven years, focusing on the enabling environment, food security, food safety and nutrition. Given the climatic constraints, an argument exists that the country should focus more on food affordability than self-sufficiency.

Infrastructure & Transport

Many economic indicators highlight the constraints the country faces with its road, rail and air transport infrastructure. As the world's second largest landlocked country with only two countries bordering it, Mongolia relies heavily on its under-developed road, rail and air transport infrastructure for international trade. Domestically, there are few paved or graded roads, and the rail and air transport facilities and networks are limited. With population growth in UB increasing, pressure is also put on aging power generation plants. Fortunately, the speed of growth of mobile telecommunications has enabled Mongolia to by-pass the landline connectivity stage (and the associated costs) for many areas outside the capital.

Environment

Despite its size, Mongolia's environment has, for a number of years, suffered from a multitude of environmental problems. The harsh climate, industrialization, poaching, illegal logging, over-grazing and mining have resulted in loss of biodiversity, air and water pollution, and desertification. Many of these problems have been tackled but with little result; desertification

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[25] Mongolian State Statistical Office, Statistical Yearbook 2009. p.300 Ulaanbaatar, Mongolia; Central Intelligence Agency, "CIA Factbook, 2010"
[26] World Bank, Mongolia Economic Update, p. 22
[27] World Bank, Mongolia Economic Update, p. 22
[28] Word Bank, *Dzuds* and Mongolia Economic Update

and pollution are increasing. The effect of climate change and increased mining, particularly 'ninja' (informal and uncontrolled) mining, add to the problem.

Governance & Planning

Mongolia's public-sector institutions are renowned for poor capacity, limited and ineffectual planning, corruption and mismanagement. Public trust in politicians is low, there is perceived to be significant waste in government spending, the judiciary lacks independence and government policy-making is not transparent.[29] While there have been recognized improvements in the country's legal framework, implementation and enforcement have been limited.

Over the next five years, the GoM faces significant challenges in advancing its economic agenda. The Government stakeholders the MEGA team met with seem to understand the major hurdles with which Mongolia is confronted, but issues of limited capacity, bureaucracy, and lack of political will from the top, all contribute to the problem. Mongolia's rich endowment of mineral resources promises major economic benefits, but in order to maximize these benefits, Mongolia needs to transform its mineral wealth into lowering poverty, rising household incomes, and a steadily improving living standard for all Mongolians.

A number of the key challenges are entrenched within the Mongolian economy. The Mongolia Country Competitiveness Exercise, conducted in July 2000 highlighted five key weaknesses:

1) No overall coordinating strategy of policy framework that would rationalize policy decisions and ensure that there is alignment in different areas of government
2) Many policy decisions are not well thought out in advance
3) There is a lack of continuity between governments that creates an unpredictable business environment
4) Policy changes are often announced with short notice, if any, giving businesses little opportunity to provide input, discuss negative impacts, or time to prepare for compliance
5) Policies are not uniformly enforced, and are subject to extreme variations in interpretation and application

To a great extent, these weaknesses remain, indicating that further efforts using new innovative approaches must be further employed.

Development Priorities

USAID

For the last twenty years, USAID has helped Mongolia build a solid macroeconomic policy framework and lay the institutional foundations for a stable and sovereign democracy. The basic economic and political institutions are now in place to support accelerated growth but many challenges still remain in broadening and spreading the benefits of that growth. USAID has built a solid reputation for providing valuable, demand-driven technical assistance through the EPRC project, and is in a unique position to help Mongolia address those challenges.

Since 2003, the EPRC project, as USAID's primary vehicle for economic growth support, has provided technical assistance to the GoM to accelerate and deepen the economic liberalization process and promote increased competitiveness in the Mongolian economy. EPRC has been particularly effective in the areas of tax reform, trade policy, financial sector policy, and energy sector regulation.

[29] World Economic Forum – Global Competitiveness Report 2010

Objective 4: Economic Growth

Program Area 4.6: Private Sector Competitiveness

Program Element 4.6.1: Business Enabling Environment, focusing on adoption and implementation of economic policies related to business, transactions and competitiveness. Specific emphases include the mining sector and ancillary businesses, the banking and financial sector, PPPs, concessions, SMEs, the tax regime and national consensus building.

Program Element 4.6.2: Private Sector Capacity, focusing on corporate governance, and sector supply and value chains.

Program Area 4.4: Infrastructure, focusing on *policy adoption and implementation* related to urban and rural infrastructure, and energy and transportation services.

Program Element 4.4.1: Modern Energy Services, focusing on Ulaanbaatar's power plants, Gobi Power and alternative energy sources.

Program Element 4.4.3: Transport Services, focusing on roads, rail, air and inland ports.

Program Area 4.8: Environment, focusing on global climate change, with an emphasis on clean energy and adaptation.

In USAID Mongolia's Strategy Concept Paper (2011-2015), the Mission suggested a preliminary list of sectors and areas of engagement relating to economic growth (see text box above). In addition to these, cross cutting themes were suggested in the areas of capacity building, training and gender.

Key Considerations

In preparing the Country Development Strategy and outline for a follow on project to EPRC, there are a number of key factors suggested for consideration.

Continuity & Sustainability

A number of stakeholders interviewed, including one of the President's advisors, presented the case for greater continuity between projects. There is a general feeling that because project durations are linked to USAID funding cycles or USG regulations, they often do not take into account the timeframes necessary in Mongolia to develop tangible results from technical or financial assistance provided.

Through discussions, there was considerable nostalgia surrounding the 'Gobi' and TCI projects, but at the same time some disappointment that the successes achieved, relationships established and activities started, were not continued effectively.

One stakeholder, referring to the 'Gobi' Project, used an analogy to make their point; if a business is established and continues to provide good returns on investment, why would you stop it and get in new management to set up a new business. Although the 'Gobi' Project continues through USDA funding, the perception remains that changes are too frequent.

It is also evident, from talking to staff on the EPRC project, that building relationships and trust with public and private sector stakeholders in Mongolia can take time. When one project ceases and another begins, the process of trust and relationship-building must start anew.

Cost Effectiveness

The USAID Mongolia budget for the foreseeable future will be in the range of US $7 million per annum, of which approximately 60-70 percent will be designated to support economic growth. While a significant figure, it is less than the budgets of a number of other Missions and also the budgets of other donors to Mongolia (including JICA, KOICA, GTZ & ADB). Therefore, technical assistance must be cost effective, well-targeted and enable considerable USG and USAID promotion.

Timeframe

Given that the duration of USAID-funded projects typically range from a period of 3 to 5 years, it is important to be realistic with the potential impact of technical assistance provided. Many project RFPs require projects to demonstrate tangible results within a relatively short period of time. A number of the key challenges highlighted above will likely take far longer than 5 years for technical assistance to demonstrate tangible results; agriculture and food security, good governance, corruption reduction, skills development, for example. Focus must therefore be placed on those areas of economic growth that can exhibit an impact within the timeframes defined or on initiatives that demonstrate potential to sustain growth after the project ceases. Examples could include building leadership, and strengthening institutions, skills, mindsets and the BEE.

Timing & Donor Coordination

For the size of the Mongolian population and economy, there is no shortage of donors engaged in economic development. Given its small market size, constrained economic diversification and population hubs, it's not surprising that donors often find themselves treading on the toes of others in terms of sectors, businesses, public agencies and NGOs assisted, or repeating activities that were attempted several months or years before. This is not helped by the relatively poor level of coordination and communication taking place among donors and between donors and the government.

A future project must take account of lessons learned either from previous USAID-funded projects or other donors. Before attempting something new, it is critical to assess whether it has been previously attempted, and if so, the reason for failure or poor implementation. Comments from stakeholders have clearly suggested that for some donor activities, timing has not been right. For example, the concept of clustering was suggested, in relation to TCI, to be too early for Mongolia; not that it was wrong or did not achieve anything, but just too early given Mongolia's level of development maturity.

Flexibility

A key advantage of EPRC has been its flexibility in responding to the GoM's needs and emerging issues, such as the most recent economic crisis. Mongolia's political and economic environment changes so frequently that the ability to change track and respond to specific needs or opportunities has enabled them to strengthen relationships with government agencies and catalyze the development of legislation.

Impact & Holistic Approach

Just as critical as the timeframe for implementation of technical assistance, is the ability to provide tangible results. Concerns have been expressed by stakeholders over the ability to demonstrate such results on a project, such as EPRC, that focuses largely on policy. While it is appreciated that policy-focused projects have greater difficulty in showing an impact, in order to maintain USAIDs reputation for providing quality technical assistance, a balance must be maintained with activities that create measurable and indisputable results.

Similarly, it is important to see activities through to a suitable conclusion. The adoption of legislation should be deemed to be successful once administrative procedures are established, capacity for implementation is created and enforcement of legislation is undertaken; not solely on whether legislation is passed by Parliament. So, for example, EPRCs efforts in trade policy should follow through to trade administration, tax reform should move toward tax administration, financial sector policy to financial sector services, and energy regulation to energy PPPs and investment, etc.

A few stakeholders suggested that EPRC lacked focus and had not been as responsive or visible to the private sector or average Mongolian. The new follow-on project should build upon EPRC's successes but also strengthen private sector engagement and local capacity building and outreach. Interventions should, as much as possible, be market or private sector-led, since the GoM does not have service delivery capacity.

A criticism made by a senior member of staff in the GoM was that projects are often too donor-driven; donors talk to the government in the preparation stage but then fail to liaise or coordinate with the government at a high level during implementation.

Political Environment

As highlighted in other areas of the report, corruption in Mongolia, at all levels, is high and apparently increasing. Mongolia's political environment is such that there are areas of the economy that will be difficult to derive benefit through technical assistance, at least in the near future. These areas typically focus on where government ministers, officials or parliamentarians have their own business interests. Efforts should be focused on those areas that derive the least resistance from the GoM, as well as those that engage the GoM through economic growth and governance projects that support regulatory and institutional reform to improve transparency and reduce corruption.

Lessons Learned

USAID's Business Growth Initiative (BGI) project[30], through its work in and study of business-enabling environment projects highlights eight important lessons learned that should be taken into consideration:

Reforms should be part of an overall BEE strategy.

Discrete reforms should build into a larger strategy for a sustainable process of reform. A coherent strategy designed to strengthen the competitiveness of a sector or of the economy as a whole is essential to avoid falling into the trap of providing one-off ad hoc solutions that do nothing to ease the process of addressing additional or subsequent constraints. BEE initiatives should build the dialogue, advocacy, trust and momentum necessary to accelerate the removal of policy constraints and engage in the broader reform process.

Information is critical to effective dialogue.

Without quantifiable information about the impact of a BEE constraint, a business or group of businesses is just one of countless others complaining about the actions of government. By addressing reform through a value chain lens, the specific impact of policies can be identified in

[30] USAID Briefing Paper – Business Enabling Environment and the Value Chain

terms such as the volume of exports forfeited or market share lost to imported products. Such data allows for a more compelling dialogue with the relevant authorities.

Government and private-sector ownership is key.

Champions are needed within the government and among businesses within the value chain for reforms to succeed and policies to be enforced and monitored over time. The role of donors is not to advocate, but rather to support the advocacy process in an even-handed way, ensuring transparency and the flow of information. A critical part of government ownership is ensuring that the government receives public recognition and credit for its role in successful reforms.

Local or regional implementation of the existing legal framework may be more important than the reform of national policies.

In Vietnam the myriad steps, requirements, days and visits needed to register a business vary enormously among different provinces, despite the existence of a national legal framework. This illustrates two important issues:

1) Implementation of the law matters
2) What happens at the municipal level is more relevant to how businesses operate than decisions and actions taken at the national level.

An exclusive focus on the national government misses an enormous opportunity to directly address BEE constraints. Local governments determine transaction costs and the incentives for businesses to formalize. Their support of, or hostility to, business affects business relationships and upgrading decisions; key factors in the competitiveness of a value chain.

Changing incentives can have a powerful effect on behavior.

Reforming laws is often insufficient to improve the BEE since it does not change the incentives for poor government behavior. In one business registration project in Egypt, corruption was an issue and embedded resistance to reform seemed prohibitive. The project made the registration process transparent and stipulated that if the business registry completed the process within the target number of days the registry employees would receive 50 percent of the registration fee. The employees now had an incentive to keep the process moving and the new transparent systems allowed bottlenecks to be identified. In instances such as this, changing the incentives within an institution can be more effective than changing the law.

A successful reform strategy involves building private sector and local government capacity to engage with each other.

Effective engagement between the government and the private sector (including small and informal enterprises) requires training and support for both sides. Private-sector advocacy capacity can be built through studies on specific BEE issues, funding for advocacy initiatives, and the establishment of links between value chain businesses and institutions that can support reform. Similarly, local government skills can be strengthened through training and the facilitation of dialogue between local government agencies and private-sector associations or representatives. Consultation on a particular issue can provide the forum for the organic development of public-private dialogue.

BEE support structures are key to success.

For the reform process to be sustainable, support structures must be developed. Value chain stakeholders may need to be linked to specialist service providers such as think-tanks and universities. The media should be encouraged to report on BEE issues and assisted in understanding policy constraints and the positive impact of reform.

Quick successes generate opportunities for more success.
The key lesson in implementing a BEE strategy is to start with reforms that can be rapidly implemented and will quickly demonstrate impact. Successful reform in one area generally opens up opportunities for interventions in other parts of the enabling environment. Conversely, stagnation and lack of success will restrict possibilities. Quick successes demonstrate the feasibility and potential benefits of reform, and generate support for broader reforms

Government of Mongolia

Mongolia's economic growth and development priorities and policies are defined in the fifth chapter of the 'Millennium Development Goals-based Comprehensive National Development Strategy of Mongolia' (MDGCDS) adopted in 2009. The 16-year strategy is divided in to two phases, the first running to 2015.

The strategy is very ambitious, in some areas un-implementable and lacks clear priorities and timeframes.

It states the main objective of the GoM's economic policy is to achieve, in the period 2007-2015, the Millennium Development Goals:

1) Reach an average annual economic growth of 14 percent
2) Increase GDP per capita to at least US $5,000
3) Establish the basis for intensive economic development
4) Maintain an average annual economic growth at no less than 12 percent in 2016-2021
5) Consolidate and develop a knowledge-based economy
6) Increase GDP per capita to a minimum of US $12,000
7) Create economic capacity and resources to reach the level of the world's middle income countries.

Key elements of the strategy include increasing labor productivity, increasing investment efficiency, diversifying the economy, increasing exports, introducing technology, improving the business environment, and improving infrastructure.

On the macroeconomic level, budgetary policy aims to enhance economic growth, ensure budget and financial sustainability, increase incomes of the population and provide a sound welfare benefits system. Taxation policy will strengthen private sector-led economic growth and allow for the domination of export-oriented production and services. Inflation and external debt will be managed, interest rates lowered, and favorable investment, trade and banking environments created.

The country's competitiveness will be improved and obstacles to private sector growth removed. Although the mining sector features prominently in the strategy, the GoM acknowledges the need for economic diversification, SME development, food security, food self-sufficiency and agricultural development, and tourism development.

On infrastructure, the GoM will address the needs of the population and economic development by focusing on roads & transportation, energy, fuel, ICT, planning and construction. ICT is viewed as the main accelerator of Mongolia's economic and social development in the 21st century.

Business Enabling Environment

The business environment encompasses all those factors that affect a company's operations, and includes customers, competitors, stakeholders, suppliers, industry trends, regulations, other government activities, social and economic factors and technological developments.

Background

Mongolia's key to economic growth, as highlighted by Professor Michael Porter when he visited the country in mid-2008, lies in the country's ability to increase its productivity; the effectiveness with which it uses its human, capital and natural resources. Mongolia must make wise choices as to what it chooses to compete in and then evolve and upgrade those choices as more sophisticated competitiveness factors become available.

Macroeconomic policy, along with rule of law, human capacity and political institutions, creates the potential for high productivity, but it is the business environment, state of cluster development and sophistication of firms that ultimately determines the competitiveness of the country.

According to the WB, Mongolia ranks 60th out of 183 countries in the 2010 Doing Business Index[31]; suggesting that it is easier to conduct business here than it is in China, Russia and Kazakhstan, but more difficult than in other countries of the former soviet union, such as Armenia, Azerbaijan, Kyrgyzstan and Georgia. Particular advantages of doing business in Mongolia are declared to be the ease of registering property, employing workers, the protection received by investors and the ability to enforce contracts. Problematic areas include dealing with construction permits, customs procedures and closing businesses.

Despite seeing improvements in the ease of employing workers (an increase of 5 places in the sub-index) and paying taxes (an increase of 18 places in the sub-index), Mongolia's overall ranking decreased by 4 places from 2009. This is despite the government announcing 2010 as the year of Business Environment Reform. In other words, significant improvements in some areas of the business environment have had little overall impact due to increasing obstacles in others. Rankings decreased in the areas of starting a business, dealing with construction permits, registering property, getting credit, protecting investors, and enforcing contracts.

Within other transitional economies, the ease in which business is conducted can be significantly better. For example, although Mongolia is considered to have a low tax burden, senior managers typically spend four times as much time on dealing with tax administration and regulation in Mongolia than they do in Azerbaijan, two and a half times as much time as managers in Kazakhstan and almost 6 times as much time as managers in Georgia.

The WB's Enterprise Survey, conducted in 2009, further highlights a number of significant obstacles:

1) The length of time required for administrative procedures is one of the highest in the region, aside perhaps from Russia. Obtaining licenses (operating and importing) can take more than 30 days compared to less than 10 days in Georgia.

[31] World Bank Doing Business 2010

2) Corruption continues to be rife with more than 30 percent of businesses admitting to paying ‘informal payments’ to public officials to get things done or providing gifts to secure government contracts.
3) More than 43 percent of businesses feel they are competing against unregistered firms, yet many of them are likely to have also resisted business registration for up to 2.5 years after starting their business
4) With financing opportunities largely supplied solely through the banks, it’s not particularly surprising that almost 40 percent of businesses declare access to finance as a major constraint
5) Customs procedures continue to be one of the largest business obstacles. The time required to clear exports is the highest regionally; almost 19 days against less than 5 days in China, Azerbaijan, Russia, Georgia and Armenia. More than 23 percent of businesses identify customs and trade regulations as a major constraint; again, one of the highest levels of complaint in the Asia and Eurasia region.

Similar results are echoed by the Heritage Foundation’s Index of Economic Freedom[32]. They too highlight that while there are positive aspects in Mongolia’s business environment, these are offset by problems encountered. For example, the low average tariff rate is offset by export restrictions, restrictions in services markets, import and export taxes, weak enforcement of intellectual property rights, and inconsistent, inefficient and corrupt customs implementation. While foreign investors are treated equally with domestic investors, the regulatory framework is still developing (regulations and investment-related laws are said to change frequently), rules are inconsistently applied or misunderstood, and non-transparent bureaucracy can be prone to corruption. The enforcement of laws protecting private property is weak and judges rarely respect contracts and their provisions.

Transparency International lists Mongolia 120th out of 180 countries in the Corruption Perceptions Index[33]. This is 18 places lower than in 2008 and 35 places lower than in 2005!

However, Mongolia jumped an impressive 18 places in the recently published Global Competitiveness Report (GCR)[34]. Although still in the bottom half of the Index, the country performed particularly well in the areas of macroeconomic stability (49th of 139 countries), and labor market efficiency (29th).

Looking over a period of three years, 34 of the 111 indicators increased in rank, while 62 decreased. These are as follows:

Table 2. Competitive Improvements and Deterioration

Competitive Improvements		Competitive Deterioration			
INSTITUTIONS					
Public trust of politicians	+4	Property Rights	-26	Efficiency of legal framework in settling disputes	-4
Transparency of Government policy making	+3	Intellectual Property Protection	-12	Organized crime	-25
Business costs of terrorism	+23	Diversion of Public Funds	-6	Ethical behavior of firms	-10

32 Heritage Foundation – Index of Economic Freedom 2010
33 Transparency International – Corruption Perceptions Index 2009
34 World Economic Forum Global Competitiveness Report 2010

Business costs of crime and violence	+9	Judicial Independence	-6	Strength of auditing and reporting standards	-9
Reliability of police services	+18	Favoritism in decisions of Government officials	-15	Efficacy of corporate boards	-17
		Wastefulness of Government spending	-17	Protection of minority shareholder rights	-4
		Burden of Government regulation	-21		
INFRASTRUCTURE					
Quality of port infrastructure	+7	Quality of overall infrastructure	-11	Quality of air transport infrastructure	-5
Mobile telephone subscribers	+11	Quality of roads	-8	Available seat kilometers	-4
		Quality of railroad infrastructure	-1	Fixed telephone lines	-4
MACROECONOMIC STABILITY					
National savings rate	+14	Government budget balance	-86	Inflation	-30
Interest rate spread	+13				
HEALTH & PRIMARY EDUCATION					
Government debt	+44	Tuberculosis incidence	-6	Life expectancy	-8
Business impact of malaria	+104	HIV prevalence	-21	Quality of primary education	-9
Business impact of tuberculosis	+21	Infant mortality	-8		
Business impact of HIV/AIDS	+37				
Primary enrollment	+2				
HIGHER EDUCATION & TRAINING					
Secondary enrollment	+5	Quality of the educational system	-25	Local availability of research & training services	-49
Tertiary enrollment	+3	Quality of management schools	-12		
Quality of math and science education	+11				
Internet access in schools	+14				
Extent of staff training	+12				
GOODS MARKET EFFICIENCY					
Extent and effect of taxation	+30	Intensity of local competition	-12	Tariff barriers	-12
Total tax rate	+6	Extent of market dominance	-17	Business impact of rules on FDI	-12
Prevalence of trade barriers	+48	Effectiveness of anti-monopoly policy	-5	Burden on customs procedures	-3
		Number of procedures required to start a business	-20	Degree of customer orientation	-7
		Time required to start a business	-13	Buyer sophistication	-19
LABOUR MARKET EFFICIENCY					
Flexibility of wage determination	+3	Cooperation in labor-employer relations	-12	Redundancy costs	-4

Rigidity of employment	+13	Hiring & firing practices	-5	Brain Drain	-23
Reliance on professional management	+1				
Female participation in the labor force	+79				
FINANCIAL MARKET SOPHISTICATION					
		Ease of access to loans	-8	Soundness of banks	-19
		Venture capital availability	-8	Regulation of securities exchange	-11
		Restriction on capital flows	-46	Legal Rights Index	-13
TECHNOLOGICAL READINESS					
Firm level technology absorption	+23	Availability of latest technologies	-14	Internet users	-23
FDI and Technology transfer	+24				
MARKET SIZE					
		Domestic market size	-3		
BUSINESS SOPHISTICATION					
Nature of competitive advantage	+20	Local supplier quantity	-3	Control of international distribution	-8
Extent of marketing	+29	Local supplier quality	-7	Production process sophistication	-24
		State of cluster development	-15	Willingness to delegate authority	-23
INNOVATION					
Capacity of innovation	+23	Quality of scientific research institutions	-14	Availability of scientists and engineers	-19
Government procurement of advanced technology products	+12	Company spending on R&D	-12	Utility patents	-1

It is important to point out that the Indexes highlighted above rely heavily on subjective opinion and, therefore, results are subject to the degree of pessimism that exists within each economy. The number of countries ranked also differs slightly from year to year so small changes may reflect the addition of new countries or the exclusion of others.

However, the results outlined above clearly indicate that Mongolia's business environment is not competitive, that any improvements to the business environment have been offset by problems in other areas, and in some aspects of the business environment Mongolia has failed to improve.

By benchmarking the results, it is also clear that other transitional countries have been able to improve their business environments at a faster pace than Mongolia has; their rankings have increased at a faster pace than those of Mongolia.

Various business leaders in Mongolia found it difficult to pinpoint specific problem areas in the business environment. Such attitudes may be due to a cultural acceptance of the business environment or a lack of experience of business environments in other countries. The term 'ease' of doing business is also subjective, is based on prior experience and may be interpreted in different ways: ease in terms of time spent, bureaucratic procedures encountered or paperwork required.

Policy & Planning

For some considerable time, the country has lacked a sound comprehensive economic development strategy and structure, providing guidance and direction for the government. Ten years ago, the National Development Board took on the role of coordinating Ministries. This then became a National Development Ministry and subsequently planning moved under the Ministry of Finance. On the basis of a need for increased private sector involvement resulting from substantial mining investment, the Government established the National Development and Innovation Committee (NDIC) in 2009, separating again the roles of finance and planning. They have since developed a 'Millennium Development Goals-based Comprehensive Development Strategy of Mongolia' (MDGCDS), supported by United Nations Development Programme (UNDP) (see section on Government Development Priorities above). NDIC has a staff of 47 and is supported by GTZ in regional development, UNDP in the Millennium Development Goals, Asian Development Bank (ADB) in market research and the WB in economic policy capacity building.

The Strategy lays out six priority areas:

1) Achieve the Millennium Development Goals and provide for all-around development of the Mongolian people.
2) Intensively develop export-oriented, private sector-led, high technology-driven manufacturing and services, with particular focus on development of information, communication, bio and nanotechnologies, transit transportation, logistics, financial mediation services, deeper processing of agricultural products, and create a sustainable, knowledge-based economy.
3) Exploit mineral deposits of strategic importance, generate and accumulate savings, ensure intensive and high economic growth, and develop modern processing industry.
4) Ensure intensive development of the country's regions, their infrastructure, and reduce urban-rural development disparities.
5) Create a sustainable environment for development by promoting capacities and means for adaptation to climate change, terminating imbalances in the country's ecosystems and protecting them.
6) Consolidate further political democracy, foster a transparent, accountable, just system free from corruption and red tape.

However, there are concerns over the extent of research and participation involved in the process of preparing the document. The newly established Economic Policy & Competitiveness Research Centre (EPCRC) is now focused on bringing competitiveness research into public sector planning. Independent from Government, but with apparently strong links, the EPCRC claims there is now renewed interest in citizen-centered state policy making, green economic development, competitiveness, transparent procurement and use of the Citizens' Khural. EPCRC is currently engaging IMD (Institute for Management Development) to undertake a thorough competitiveness assessment of the country. However, it is not clear what will be done with the results once they become known.

A number of stakeholders indeed feel that there is no prioritization of government initiatives. There is also strong belief that policy and planning is inhibited by poor coordination and communication between and among Parliament, the GoM, ministries, agencies, donors, think tanks, universities and NGOs. When it comes to policy-making and legislation, a major criticism from the Business Council of Mongolia (BCM) is the lack of public consultation that takes place prior to adoption. Often laws are passed without any public knowledge that it was even planned.

In the government's defense of the current policy environment, the President's Economic Advisor believes that donors are often unrealistic in their assumptions when advising on new legislation. He argues that they fail to understand Mongolia's culture, social and political life and history and endeavor to implement legislation that they have implemented elsewhere without adapting it sufficiently to Mongolia's nuances.

According to the Economic Faculty at the National University of Mongolia, the Government has focused too heavily in the last two decades on economic rather than socio-economic development; social development and economic development should have been viewed together rather than as separate goals. They believe that although the country has moved forward in some areas, Mongolian attitudes and behavior have remained the same.

Public Sector Institutions

Through discussions held, much of the criticism for Mongolia's poor business environment was directed at the GoM, Parliament, judicial and public-sector institutions; even from discussions held with public sector representatives. And the criticism was widespread – corruption among all institutions (see cross-cutting section), lack of planning, nepotism, financial mismanagement, limited capacity of officials, lack of public consultation in planning and legislation, bureaucratic procedures and lack of accountability, transparency and trust.

According to WB data[35], Mongolia has generally worsened in the areas of accountability, political stability, government effectiveness, rule of law, and control of corruption.

There have been a number of attempts to improve the operation of public sector institutions, such as the Prime Minister's Consultative Committee. However, according to the BCM, this has failed to gain traction.

To help combat this problem, the Mongolian National Chamber of Commerce and Industry (MCCI) claims that it is planning to establish the 'Economic Freedom' Award for Parliamentarians for their transparent efforts in the economic development field.

A number of public sector stakeholders have also called for support in developing mechanisms to audit the performance of public sector institutions and individuals. This would, for example, help to prevent MPs legislating to protect their own private businesses or cause problems for competing companies. The NDIC emphasizes the need to improve governance and is in the process of developing public service standards. This and other issues highlighted above are tackled in the MDGCDS:

Trade

Mongolia's trade with 118 countries in 2009 led to a total turnover of US $4,033.9 million, of which exports accounted for US $1,902.6 million and imports for US $2,131.3 million[36]. The total external trade turnover itself declined 30.2 percent, exports falling 24.9 percent, and imports 34.3 percent.

[35] World Bank – World Governance Matters Report 2009
[36] Mongolian Chamber of Commerce & Industry – Foreign Trade Overview of Mongolia 2009

The majority of exports are destined for China (73 percent), Canada (7.8 percent), the UK (6.7 percent), and Russia (3.4 percent). Imports largely originate from Russia (36.1 percent), China (25.0 percent), Korea (7.3 percent) and the USA (4.9 percent). With 76.4 percent of exports and 61.1 percent of imports focused on its two neighbors, the need for greater economic independence is obvious. The majority of Mongolia's exports (63.6 percent) are related to fuel and mining, followed by agriculture (9.9 percent). Imports are dominated by manufacturing (60.9 percent) followed by fuel and minerals (26.3 percent).[37]

Mongolia ranks 116th in the world for its trading environment.[38] This is one of the lowest in the region, although followed closely behind by Russia in 114th position. China ranks 48th. There are a number of reasons for the poor score; although many are related to the quality of transport infrastructure for which short-term improvements in ranking will be impossible.

However, policy and administrative procedures rate similarly poorly as shown below (indicators shown are those relating to policy or administrative procedures that ranked in the bottom third):

Table 3. Trade Competitiveness

	2010 Rank/125	2009 Rank/121	2008 Rank/118
DOMESTIC AND FOREIGN MARKET ACCESS			
Share of duty-free imports, %	125	117	n/a
Tariffs faced, %	107	107	n/a
Margin of preference in destination markets, index 0–100 (best)	118	114	n/a
EFFICIENCY OF CUSTOMS ADMINISTRATION			
Burden of customs procedures, 1–7 (best)	104	107	109
EFFICIENCY OF IMPORT-EXPORT PROCEDURES			
Efficiency of the clearance process, 1–5 (best)	124	106	103
Time to import, days	113	108	105
Documents to import, number	73	66	89
Cost to import, US$ per container	109	104	110
Time to export, days	115	113	n/a
Documents to export, number	91	83	n/a
Cost to export, US$ per container	113	108	n/a
TRANSPARENCY OF BORDER ADMINISTRATION			
Irregular payments in exports and imports, 1–7 (best)	109	108	108
AVAILABILITY AND QUALITY OF TRANSPORT SERVICES			
Ease and affordability of shipment, 1–5 (best)	109	80	77
Logistics competence, 1–5 (best)	112	118	116
Tracking and tracing ability, 1–5 (best)	105	109	108
Timeliness of shipments in reaching destination, 1–5 (best)	122	117	114
REGULATORY ENVIRONMENT			
Property rights, 1–7 (best)	106	97	n/a
Ethics and corruption, 1–7 (best)	110	110	n/a
Undue influence, 1–7 (best)	113	112	n/a
Government efficiency, 1–7 (best)	119	114	n/a
Domestic competition, 1–7 (best)	92	93	n/a
Efficiency of the financial market, 1–7 (best)	103	n/a	n/a
Openness to foreign participation, index 1–7 (best)	87	84	n/a
Business impact of rules on FDI, 1–7 (best)	110	110	84

[37] World Economic Global Enabling Trade Index 2010 (data for 2008)
[38] World Economic Global Enabling Trade Index 2010

Not only is Mongolia ranking poorly, but the trade environment is worsening. Between 2009 and 2010, Mongolia decreased its rank in 16 of the 24 indicators above.

Similarly poor results are disclosed by the WB with Mongolia ranking 155th out of 183 countries in the Doing Business indicators relating to Trading Across Borders.

The Ministry of Foreign Affairs and Trade (MFAT) reports that it is currently in the process of establishing Free Trade Agreements with China, Japan, Korea and the European Union (EU). The EU is Mongolia's third biggest trading partner, and Mongolian exporters already benefit from the virtually tariff-free entry into the EU markets through the Generalized System of Preferences + (GSP+) program.

The Ministry further believes that foreign policy must be reoriented towards trade and states that it is working with United Nationals Industrial Development Organization (UNIDO) to draft an industrial strategy. Constraints to trade policy development in Mongolia, according to MFAT, include the lack of local specialists in the field resulting in a lack of priorities established and gaps in trade law. UNDP apparently implemented one project in trade development recently, but is against starting a second phase.

Tax Administration

Mongolia's overall tax burden is relatively low and has improved significantly in recent years; it ranks 16th in the Global Competitiveness Index.[39] Administrative procedures have also improved here with only 9.1 percent of businesses declaring tax administration as a major constraint in doing business.[40]

Working closely with the Ministry of Finance (MoF), Mongolian Tax Authority, Parliamentary Standing Committees, and representatives of private sector associations, EPRC has assisted with the formulation of competitiveness-based tax reform objectives, model draft laws, economic and fiscal impact analyses, awareness raising and public engagement, training tax inspectors, revision of tax forms and regulations, and information campaigns about the new person income, corporate income, VAT and excise tax laws. Impact analyses, as well as the positive indicators shown above, demonstrated positive impacts.

However, a major complaint of the tax authorities that remains is the fact that agents are incentivized to extort money from businesses.

Standards & Inspections

Many private sector stakeholders, as mentioned above, indicated that they felt burdened by the number and procedures used for inspections. Indeed, there are some 3,800 state inspectors under the General Agency for Specialized Inspection (GASI). According to the BCM, the director of GASI would welcome technical assistance in reducing bureaucracy.

The MDGCDS highlights the need for improving, implementing and/or enforcing standards in education, healthcare, taxation, the financial system, mining, food safety, tourism, construction, transportation, urban planning, construction, environmental monitoring and property registration.

[39] World Economic Forum – Global Competitiveness Report 2010
[40] World Bank – Enterprise Survey 20009

Insurance

The diversity of insurance products has increased in recent years despite the lack of a compulsory insurance law. Life, health/illness/disability, motor, travel, agricultural, property, and commercial insurance packages are available, to varying degrees. There are no restrictions on the products that can be offered so growth will be linked to demand. At present, there is a limited insurance culture and insurance products are not tax deductible.

Transport & Infrastructure

The quality of Mongolia's transportation systems and infrastructure hinders foreign and domestic trade, tourism development, and the expansion of IT networks. The number of vehicles on UB's roads has also outpaced the city's road infrastructure creating difficulties in undertaking business meetings and visits. This is exacerbated by the lack of urban planning and increasing urban population. According to the GCR[41], Mongolia ranks third from bottom in terms of the quality of its overall infrastructure, second from bottom in terms of its road infrastructure and in the bottom ten countries in terms of its air transport infrastructure. For the quality of its electricity supply, it is ranked 111th.

The Ministry of Roads, Transport, Construction and Urban Development (MRTCUD) is seeking to develop a new master plan for roads and housing in UB and has held various discussions with international engineering companies. This is despite a number of previous master plans being completed; the most recent by the Japan International Cooperation Agency (JICA).

Air transportation has been a major bottleneck for a number of years, largely due to the government's reluctance to privatize MIAT. At one stage, it was argued that it was important to keep it within the public domain as it served a social welfare purpose by providing domestic flights at affordable prices for the population. However, this policy no longer applies as domestic flights have now ceased.

Public Private Dialogue

The MDGCDS, which forms the basis for Mongolia's economic growth policy, has had little to no private sector involvement or consultation in its development. Indeed few private sector stakeholders were aware of the document. While some public private dialogue is undertaken, largely through organizations such as the BCM, MCCI, the Trade Unions Confederation (TUC) and Mongolian Employers Federation (MONEF), it tends to be ad-hoc and private sector driven.

Through the MDGCDS, the GoM acknowledges the need to strengthen public private dialogue through a consultative committee and ensure private sector participation in economic decision-making. However, at present, there is no formal mechanism for public-private dialogue in place.

Foreign Direct Investment

Between 1990 and 2009, Mongolia registered around 9,940 foreign investors from more than 95 countries with a total portfolio of some US $3.8 billion[42]. China, Canada, South Korea, Japan, Russia, the USA, Netherlands and Singapore led investment in 2009. 61.3 percent of total investment was targeted in geology, mining and oil, 19.7 percent in trade & catering, 3.1 percent in banking and finance, 2.8 percent in light industry, 1.9 percent in construction and 1.4 percent in animal by-product processing.

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[41] World Economic Forum – Global Competitiveness Report 2010
[42] MCCI – Inspiring Mongolia Magazine – Summer 2010

A Foreign Investment Law was adopted in 1991 with amendments made in 1993, 2001 and 2002. Double taxation agreements have been signed with 32 countries and investment protection agreements with 40 countries.

The Foreign Investment and Foreign Trade Agency (FIFTA) is the governmental body responsible for investment promotion (trade has moved to the Ministry of Foreign Affairs and Trade). The Agency is also responsible for investment registration, which is apparently the most troublesome aspect of their responsibilities. FIFTA has requested assistance from JICA in establishing an investment database. At present they are restricted in their ability to analyze investments and therefore make recommendations on investment policy.

Investment promotion is largely undertaken on an ad hoc basis, limited by the capacity of the Agency and its staff and the lack of a foundation on which to develop a strategy. The Deputy Director of the Agency claims that, apart from the mining sector, there are also no substantial incentives to attract other investors, although the greatest potential, aside from mining, lies in logistics, transport, food/agriculture and tourism.

FIFTA employs 25 staff, half of them focusing on registration, regulations and administration. Unfortunately, little has changed within the organization in the past ten years due to financial and capacity constraints. The United Nations Conference on Trade and Development (UNCTAD) has offered assistance in developing an investment promotion strategy and policy review. Another issue of concern is the extent to which FIFTA's role has been taken up by other Ministries: Ministry of Agriculture, Food and Light Industry (MAFLI) for agricultural investment promotion, Ministry of Mineral Resources and Energy (MMRE) for mining investment promotion, etc. Mongolian companies are forced to use outdated financial accounting techniques and standards that apparently put off some investors from Mongolia.

SMEs

According to the National Statistical Office (NSO) in 2007, there were 32,105 registered enterprises active in business in Mongolia with 99 percent having less than 199 employees. These enterprises contributed 57.4 percent to GDP. The real figures for the number of small and medium size enterprises (SME) is likely to be double this given the significant size of the shadow economy. The SME Development Agency states that 70 percent of businesses in Mongolia are SMEs.

Table 4. Breakdown of SMEs by Sector

Sector	Number	Percentage
Manufacturing and service	18,443	57.4
Trade	11,429	35.6
Social Sector	2230	7
TOTAL	32105	100

The majority of enterprises are concentrated in UB (2007).

Table 5. Enterprise Locations

Region	Ulaanbaatar	Western Region	Khangai Region	Central Region	Eastern Region
Number	19,199	2823	3653	4829	1601
Percentage	59.8	8.7	11.4	15.1	5.0

Almost 81 percent of Mongolian enterprises employ up to 9 employees and only 11.1 percent employ more than 20 employees.

Table 6. Enterprise Employment Levels

Number of Employees	Number	Percentage
1-9	25703	80.1
10-19	2830	8.8
20-49	2351	7.3
50+	1221	3.8

According to the SME Development Agency, the Government has given significant priority to the sector in recent years. A law on SMEs was passed in 2007 with the purpose of comprehensively promoting SME development by establishing basic principles and policies. A program is currently in place for the industrialization of rural areas, and concessionary loans valuing US $30 million were distributed in 2009; another US $30 million earmarked for 2010. However, there is still no comprehensive study of the SME sector, no legal classification of SMEs by size, no well-planned strategy, only an ad-hoc training structure and a lack of business development services (BDS). The law has therefore had limited impact. It is suggested that SMEs suffer largely from a lack of finance, bureaucratic inspections and a lack of knowledge, training and information. There are plans to develop advisory services in each *aimag* but the lack of a proper structure and qualified personnel are hindering their development. SMEs rarely participate in government procurement opportunities. There is a lack of well-organized, sustainable and well-functioning SME associations.

Business Regulation & Licensing

Mongolian businesses feel overly burdened by the regulations they face and the situation is getting worse. Ranked 92nd in 2007 for the burden of government regulation in the GCR, their rank has now dropped to 113th position. Related to this are poor scores for favoritism in decisions of government officials (134th) and transparency of government policy-making (120th). Such desk research is backed up on the ground by comments from private sector individuals who, while able to get around some of the regulations (often through informal payments), feel pressured by the bureaucracy of administrative procedures and the number of inspections that take place on an annual basis.

Again, despite 2010 being the year of business environment reform and the NDIC promising a reduction in the number of regulations applied to businesses, very little progress, if any, is seen by the average business.

The worst sector in terms of business regulation appears to be construction, where an apparent 144 signatures are required prior to digging foundations. It's not surprising that the length of time required for all construction permits is stated to be 215 days and Mongolia's ranking for dealing with construction permits is 103rd in the world.[43] In fact, 32 percent of businesses consider licensing and permits as a major constraint to their business.[44]

Business Management & Marketing

As mentioned at the beginning of this chapter, while the government is responsible for laying the foundations for increased productivity, it is the private sector that is responsible for actually increasing that productivity. Few, if any, private sector business representatives highlighted the

[43] World Bank – Doing Business 2010
[44] World Bank – Enterprise Survey 2009

quality of business management and marketing skills as an obstacle to their growth. However, the issue was certainly raised by the MCCI and MONEF.

In fact, according to the GCR[45], Mongolia's level of business sophistication is far worse than many neighboring and Commonwealth of Independent States (CIS) countries – 127th out of 139 countries. The quality and quantity of local suppliers, state of cluster development, extent of market dominance, degree of customer orientation, breadth of value chains, and willingness to delegate authority are all ranked below 125th position.

The low ranks and obvious failure in this area could be attributed to Mongolia's business culture, established from a number of historical, cultural, social and demographic factors. While in many developed nations competition is evident, in Mongolia it is clearly underdeveloped. Two characteristics of the business culture have been suggested through stakeholder interviews:

1) Mongolians would rather see failure in their competitors than strive to develop competitive advantage in their own business
2) There is a lack of envy of competitor success, which could lead to stronger competition

Such characteristics are evident in the hospitality sector where prominent hotels in UB have failed to maintain their facilities to high standards despite new hotels being constructed.

Business Associations

In general terms, business associations continue to struggle to provide effective services for or information to their members, suffer from poor management, accountability and organization, fail to effectively lobby their members' interests to the GoM or create unity and cooperation within particular industries. They also often demonstrate a mismatch with donor goals. Even the well-established MCCI, MONEF and TUC, which supposedly have large enough and prominent memberships to garner respect from the government, still appear ineffectual to the majority of businesses. One fairly new association that appears to have significant support from the Mongolian and foreign-owned businesses is the BCM.

Aside from a few exceptions, it is also apparent that those associations set up by and supported by donor organizations have largely failed to be sustainable once the technical and financial support ceases. An example of this is the Fibermark Promotion Board, established with the support of The Competitiveness Initiative that was unable to gain significant traction due to disagreements between individual members of the association.

However, where associations have grown organically around donor projects, there are examples of success, such as the Tourist Guide Association that was established around the time of TCI, which continues to provide annual tour guide training courses seven years on.

Business Services Development (BSD)

The market for business services certainly exists in Mongolia , according to the stakeholders interviewed, but does not appear to be very well developed or in considerable demand, although a number of donors are providing support in this area and declare that it is growing. Mercy Corps, after providing business services directly to clients under the 'Gobi' Project have now graduated to building capacity within local business service providers to supply services directly to clients. Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), through their Regional Economic Growth Program are similarly attempting to strengthen business service capacities

[45] World Economic Forum – Global Competitiveness Report 2010

through training of trainers, mentoring, and linkages with the School of Business and Management at the Mongolian Agricultural University, and MONEF and MCCI regional offices. They also run a business plan competition which awards business service vouchers.

The European Bank of Reconstruction and Development's (EBRD) Business Advisory Services (BAS) program furthermore uses Mongolian business service providers to assist enterprises in a wide range of business-related activities. They maintain a database of regularly used consultants.

Corporate Governance

The EPRC Project, since 2008, has focused significantly in the area of Corporate Governance (CG) training of trainers, facilitating annual conference, research, standard setting, advocacy and increasing public awareness of the importance of CG. The Corporate Governance Development Centre (CGDC) was established in 2009 with support from the Financial Regulatory Commission (FRC), Institute of Finance and Economics, several banks and MONEF.

The concept of CG appears to be gaining traction in Mongolia, particularly in the mining sector where the Mongolian National Mining Association formed a partnership with CGDC in 2009 to undertake training within the sector.

Property Rights & Property Registration

Mongolia scores poorly and demonstrates decreasing scores in the areas of property rights and intellectual property protection (115th and 130th respectively) according to the GCR[46]. However, in the process of registering property, the WB ranks Mongolia in 25th place for having only 5 procedures and 11 days required for registration.[47]

Employment & Labor Regulations

One of Mongolia's more competitive advantages is in the area of labor regulation, ranking 29th in the world this year.[48] Wage determination, hiring and firing practices, redundancy costs and employment regulations are all deemed to be liberal.

However, the labor markets suffer significantly with brain drain as skilled and experienced individuals go off to work abroad for better salaries and in better living standards. Attempts are being made to draw back these individuals (see cross cutting section under Diaspora).

Education & Workforce Development

As a legacy of the former Soviet Union, Mongolia maintains high education enrolment rates; ranking 40th for secondary education and 47th for tertiary education[49]. However, the overall quality of the education system is ranked fourth from last, the quality of management schools 5th from last and the availability of research and training services in last place.

The quality of the educational system was confirmed through discussions with stakeholders indicating the significant level of difficulty in finding qualified and experienced workers with the right character, skills, attributes and ethics. At the same time, however, stakeholders also

[46] World Economic Forum – Global Competitiveness Report 2010
[47] World Bank – Doing Business 2010
[48] World Economic Forum – Global Competitiveness Report 2010
[49] World Economic Forum – Global Competitiveness Report 2010

admitted to the limited university-industry linkages formed, internship programs developed and career development facilities available. There is also a disconnect between the public sector and the educational system. The School of Economic Studies at the National University of Mongolia has rarely worked in partnership with Ministries, think tanks or public-sector research organizations.

Technology, Innovation & R&D

Mongolia's unique geography and low population density, combined with the inherent difficulty in communications may have given impetus for technological readiness, as evidenced by the modest ranks demonstrated in the GCR[50]. Although the availability of the latest technologies is an obstacle (119th position), Mongolia ranks comparatively better in terms of firm level technology absorption (84th), number of secure internet servers (72nd), government prioritization of Information and Communications Technology (ICT) (54th), government procurement of advanced technology products (84th), the importance of ICT to the government's vision of the future (88th), government success in ICT promotion (49th), Government Online Services Index (20th), E-Participation Index (28th), and Internet bandwidth (50th).

Similarly, when it comes to technology, Mongolia's capacity for innovation is ranked well (74th) as is university-industry collaboration in research and development (R&D) (86th) and the availability of scientists and engineers (72nd).

The Government has, with assistance from the Korea International Cooperation Agency (KOICA) developed an E-government framework and master plan to consolidate and develop a number of key government services online. The Government has also established a National Data Center to act as a country-wide gathering point for the Government's computerized data.

The IT sector, according to NDIC, is said to contribute 9 percent to the GDP. The MDGCDS puts significant emphasis on the development of ICT: establishment of free economic zones; incentives for R&D and technology adoption; development of ICT use in all spheres of economic and social life; and ICT software, equipment, structural and human resource improvements.

Rural-Urban Economic Divide

The economic divide between the rural areas of Mongolia, traditionally associated with agriculture and small-scale light industry, and UB is significant. Poor quality infrastructure, transportation constraints, the lack of BDS, small markets, limited availability of well-educated and qualified workforce and predominance of SMEs all make doing business in rural areas significantly more difficult. The situation may change with the growth of the mining sector and subsequent need for supply chain services and infrastructure, although the extent is currently unclear.

The MDGCDS lists rural development as a major goal, with a particular program anticipated to be developed.

Activities of Other Donors in the Business Enabling Environment

Japanese International Cooperation Agency (JICA)

JICA currently provides support (through the Country Assistance Program 2004) in the BEE through their Japan-Mongolia Centre, which offers courses in business studies, Japanese

[50] World Economic Forum – Global Competitiveness Report 2010

language and cultural understanding. Business courses are deemed to be in most demand and practical training courses have been organized in factories and shops. Seminars have also been held on business diagnostics for SME managers and entrepreneurs.

JICA has also provided advice in the establishment of the National Development Bank, advised on alternate dispute mechanisms, and is working with Ulaanbaatar Municipality in relation to air pollution. They have supported primary education facilities and teacher training in 30 schools.

Going forward, JICA intends to continue its support for 'Institution Building and Human Resource Development Necessary for Promoting a Market Economy', support for 'Development of the Infrastructure to Promote Economic Activities' and will commence a new project on 'Poverty Reduction and Social Development'.

Korean International Cooperation Agency (KOICA)

Under its Mongolia Country Assistance Strategy (2010-2012), KOICA aims to support the GoM in eradicating poverty and achieving economic and social development. With the support of the Korea IT Industry Promotion Agency, KOICA assisted the GoM in May 2005 in developing an e-government master plan and framework (the Government Integrated Data Centre - GIDC) to consolidate all bureau information systems, the meteorological database, customs system, document database of the MFAT and other administrative systems. There are future plans to focus on the National Identification (NID) system, Administration Portal (e-Approval, knowledge management, e-Document), Enterprise Architecture, e-Tax, Immigration Management System and e-Educational Administration System. Additional support may then focus on a Real Estate Registration System, Passport Registration System, Social Insurance System, Business Registration and Approval Management System, e-Customs, e-Procurement, Intellectual Property Management System, expansion of ICT resources, reform of the e-Government law, enhancement of ICT organizations, a National Unified Code System Build, Information Protection System, development of ICT literacy and an HR development program. KOICA has so far spent US $7.6 million on 6 projects in the ICT field – approximately 20 percent of their budget.

European Bank for Reconstruction & Development (EBRD)

EBRD is currently providing finance to enterprises in the food & beverage, cashmere (2 companies), oil and financial sectors. It is also involved in policy dialogue to improve legislation in a number of fields. EBRD is interested in providing technical assistance in the cashmere sector because of their investments.

The EBRD BAS Program works with Micro, Small and Medium Enterprises (MSMEs) to improve their performance with assistance from local business advisors. BAS assists individual enterprises (more than 100 since 2008) to engage with local consultants on short-term projects with narrowly defined objectives, which result in rapid payback. The projects typically last around four months and assist enterprises to develop and grow by enhancing their competitiveness, marketing and financial management, quality management systems and strategic business planning. At the same time, BAS broadens and deepens the skills of local consultants by hands-on training during projects and through group training in seminars and workshops. Specific areas of assistance include:

1) Management information systems and other IT solutions
2) Strategy development, including enterprise restructuring, reorganization and management

3) Business planning, including proposals, business plans and feasibility studies for project finance
4) Market research and marketing planning
5) Cost accounting and cost reduction studies
6) Engineering studies
7) Energy efficiency and environment-related advisory services
8) Business partner and investor search

They do not focus on audit, tax and legal counseling services. BAS maintains a database of local consultants and provides support in project development, monitoring during implementation and a grant of up to 30-70 percent of the net project cost (capped at €10,000), the amount depending on location. Impact evaluations are undertaken one year after assistance is given. BAS is assisting the Mongolian Management Consultants Association (MMCA) to become a strong institution.

Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)

The overall objective of GTZ's Regional Economic Development Programme (REDP – 2006-2010) is to improve the conditions in the economic regions of Darkhan, Erdenet and Uliastai, leading to a more dynamic, but sustainable development of regional economics, by ensuring a sustainable use of local resources. The Programme consists of three components:

1) Assistance to SMEs and cooperatives in developing markets by strengthening local business service providers
2) Development of financial services for SMEs and cooperatives through a Loan Guarantee Fund (up to 50 percent of loan risk), a Leasing Fund (planned) and a Business Plan Competition (involving vouchers exchanged for business services)
3) Assistance to policy development for the regional economy through One Stop Shop Services (in partnership with the Swiss Agency for Development Corporation (SDC)), capacity building, discussion forums and working groups.

Key services provided under the Programme are stated:

1) Support in studying promising markets for existing and new products, improving and certifying quality, and thus rendering them locally and internationally marketable
2) Identifying, supporting and promoting value-chains based on agricultural products (wool, cashmere, leather, meat, etc.)
3) Advisory services to promising enterprises in the areas of strategic management, financial management, marketing and technological innovations. The Programme provides this support through qualification and strengthening of suitable professional, training and other business service providers
4) Facilitating the provision of financial means through existing and new financial institutions and products in order to provide SMEs with the required finances for investment, especially on a mid- and long-term basis.

GTZ cooperates with regional branches of the MCCI, Mercy Corps, MONEF, regional branches of the cooperative training center, vocational training centers and private entrepreneurs.

GTZ has established a business desk alongside the One Stop Shop (established with support from SDC) in Erdenet with funding for one individual from the local authority. The business desk has been operating for 1-2 months. In an attempt to improve local public private dialogue, GTZ also established committees in each of its three project locations, although they have taken two years to reach any level of momentum. They have also run a business plan competition and received 1,000 ideas, of which 300 were selected. Entrepreneurs were then provided with business plan writing training - 5 days of business service support. 90 percent of entrepreneurs went on to write plans and 200 received loans from banks or SME funds.

Millennium Challenge Corporation (MCC)

In October 2007, MCC signed a US $285 million Compact with the GoM aimed at reducing poverty and promoting sustainable economic growth through investments in several key projects. Indirectly related to the business environment, projects include:

1) Property Rights Component (improving the formal system for recognizing and transferring land rights and issuing land titles to *ger* residents, and a system of leasing peri-urban pasture land to herder groups along with training to improve livestock management, productivity and farm income)
2) North-South Road project (between Choir and Sainshand and a bridge in Bayanzurkh district in UB, and a road between UB and Nailakh),
3) Energy & Environment Project (air quality in UB, integration of wind energy in to the power grid)
4) Labor Market Information System with the Ministry of Social Welfare and Labor (MSWL)
5) Vocational Education Project (increasing employment and income among unemployed and marginally employed Mongolians by improving the quality and relevance of the Technical and Vocational Education and Training (TVET) system. Training will be provided to 1500 TVET instructors and administrators, curricular for over 30 priority trades will be developed and learning environments of 15 TVET schools will be improved).

The Compact started implementation in September 2008.

Swiss Agency for Development and Cooperation (SDC)

SDC currently has a diverse portfolio of projects:

1) “Green Gold“ Pasture Ecosystem Management Programme
2) Mongolian Potato Programme
3) One-Stop-Shop Project
4) Scholarship Programme
5) Culture Support Project
6) ‘Baruun Bus’ Regional Socio-Economic Development Project
7) Combating Human Trafficking Programme
8) Combating Violence against Women Project
9) Jura and Gobi-Altai Partnership Project
10) Small Action Projects
11) Telemedicine Network in Mongolia Project
12) Livestock Project
13) Index-Based Livestock Insurance Project

They are currently preparing their strategy for the period 2012-2016, which will focus in three main areas:

1) Employment and Income Generation - access to credit, vocational training, animal product value chains, livestock productivity (yaks and camels), herding, small scale mining, fair mining
2) Environment and Natural Resource Management – desertification, community based pasture management

3) Governance – improved service delivery through decentralization and one stop shops, NGO capacity development, licensing and social security, pensions, child benefit

Their budget will be around US $9.5 million per year. Traditionally, SDC has focused on the western *aimags*, although more of their programs are now operating nationwide. Their strategy until now has been to work mostly with local partners, many of them involved in implementation rather than policy development. They have co-funded a number of initiatives with the WB, the UN and Mercy Corps in business services and access to finance, for example. They have an interest in becoming involved in vocational training (working with Swiss NGOs and GTZ), entrepreneurship and in civil society with WB and USAID (NGO strengthening, NGO networking).

Their main project in the economic sphere has been to assist in establishing One-Stop-Shops to offer a number of administrative services through a single service center, 'one door' or 'one window'. The main idea of a One-Stop-Shop is to reduce the steps in administrative services procedures and to change the way these services are provided.

United Nations Development Program (UNDP)

The UNDP has focused on implementing projects with Government agencies and the private sector focusing on attaining the Millennium Development Goals (MDGs) rather than broader economic development.

However, they have worked extensively with the NDIC to make Government policies consistent with the MDGs and assisting NDIC to develop the MDGCDS. This Strategy replaced the previous 2008 National Development Strategy, created on the initiation of the president, which was deemed to be too broad and not clearly linked to policies or specific sectors. The new strategy, among other areas clearly links poverty reduction to economic growth. They are also working to improve the national statistical system to clearly measure progress toward the MDGs. With the MSWL, the UNDP is assisting with poverty mapping down to *aimag* and *soum* level.

Under the title 'Enterprise Mongolia' and with funding from the Japanese, the UNDP is providing support to SMES in the *aimags* of Selenge, Dundgov, Khentii, Khuvsgul, Uvurkhangai, Bayan Ulgii and Khovd. The project aims to improve livelihoods of the poor and marginalized men and women, particularly in rural areas and to contribute to achieving the MDG 1 (poverty reduction) in Mongolia, through increased income and job creation. The expected outputs of the project are capacity strengthening of small and micro enterprises in producing more value-added products with appropriate markets and capacity development of business support service providers in their operation on the ground. The project has provided training, study tours, access to loans through guarantee funds, the establishment of SME Development Centers (offering market assessments, branding, product identification, website development and access to finance). The UNDP continues to promote and publish the Human Development Index (HDI) and reports.

The UNDP is currently in the process of developing their strategy for 2012 to 2016, which should be ready by the end of 2011.

World Bank (WB)

The Mongolia Second Sustainable Livelihoods project is the second phase of a three-phase adaptable program. The overall objective of the program is to enhance secure and sustainable livelihoods in communities throughout Mongolia. The project has four main components with the first being the pastoral risk management (PRM) component. The main objective of the PRM component is to scale up and replicate effective strategies to prepare for and respond to pastoral risk. The primary target group is herder households, while recognizing that risk preparedness and response also requires well-coordinated support from national and sub-national governments, and private-sector and civil-society institutions. The second component is the community initiatives component. The objective of this component is to establish, on a nationwide basis, effective, transparent, and socially inclusive mechanisms that empower citizens to identify and implement small public facility improvement projects. The third component is the microfinance development component. The overall objective for the microfinance development component will be to deepen and widen access to sustainable financial services to rural citizens. Finally, the fourth component is for capacity building and project management. This component will finance all the necessary functions to ensure effective, efficient, and timely implementation and management of all project activities at the national level.

The WB has provided a specialized team on poverty counting, supporting the NSO in data gathering an analysis.

Asian Development Bank (ADB)

The ADB is providing support, and partnering with MCC, in the area of higher and vocational education. They are also working in the area of trade facilitation and customs clearance.

United Nations Conference on Trade and Development (UNCTAD)

UNCTAD has been requested to provide assistance in the development of an investment strategy.

United Nations Industrial Development Organization (UNIDO)

UNIDO has been requested to provide assistance in the drafting of an export strategy.

European Union (EU)

The European Union currently co-finances the WB Sustainable Livelihoods Project and is an observer on the steering committee. Their major project is in animal health and livestock marketing in 5 *aimags* and Ulaanbaatar (€9 million over 5 years). They are anticipating a €4 million project with EBRD and the SME Agency and also a €15 million project on EU standards and norms, and TVET, for the period 2011 to 2013. An identification mission is anticipated in November.

Mercy Corps

Through funding from the Mongol Rally, Mercy Corps have since 2006, worked with rural communities in the implementation of projects focusing on income generation; vegetable cultivation, sewing and traditional felt, leather and craft making, as well as providing local services. Funds were given in 2010 to 82 community groups and 46 local non-profits to implement the projects.

The Rural Agribusiness Support Program (RASP) is funded by the USDA and is being implemented in eleven *aimags* in central and southern Mongolia that present both an opportunity for greater agribusiness development and a significant challenge in advancing that development. Project objectives include increasing the production and sale of marketable animal products and crops, and creating a more market-oriented agricultural production and marketing system. Program components include value chain development, market access and expansion, food safety, agribusiness development, animal health and natural resource management.

Their Market Opportunities for Rural Entrepreneurs (MORE) project is a rural business development support project co-funded by the SCD. The project objective is to create new market opportunities to help diversify and expand rural businesses in Mongolia.

Prospects for USAID Involvement

Aside perhaps from taxation, insurance, and employment and labor regulations, Mongolia's BEE is far from supportive of economic growth and increased productivity. In each of the sections above, evidence from economic indicators and discussions with stakeholders has shown the need for significant improvements across the board. It is therefore difficult and perhaps impractical, to focus broadly the BEE: this is indeed one of the criticisms given of the current EPRC project. Efforts must be targeted at deeper reform within particular areas of the BEE or at specific sectors; a demand-led focus for reform.

Many of the BEE obstacles require long-term efforts and/or significant donor support, particularly those relating to transportation, infrastructure, food security and the environment. Given the overall scope involved in improving so many aspects of the BEE, technical assistance is beyond the capacity of one donor alone, particularly as solutions require tackling some of the most deeply entrenched problems in the economy such as accountability, transparency, trust, nepotism, financial mismanagement, dialogue, human and institutional capacity, corruption, bureaucracy and enforcement; not just a 'papering over the cracks' or piecemeal efforts. Donor coordination, although difficult, is also therefore going to be essential in future economic growth efforts

In identifying prospects for USAID involvement, it is critical to integrate USAID's and the GoM's priorities with lessons learned from elsewhere, the key considerations (outlined earlier) and *windows of opportunity* that present themselves.

The windows of opportunity are those based on aspects of the economy that derive or will derive GoM political will, increasing private sector engagement, public interest, significant investment, high revenues, growing exports, rural development, innovation, technology use, and the promise of increased wealth.

The mining sector provides these windows. If one looks at more traditional sectors of the economy (see further section in this report), they typically don't have public interest, the potential for high revenues or significant investment interest. Take tourism as an example. Tourism has supposedly been a priority sector for the GoM for a number of years and has received considerable donor support. Yet public expenditure has remained limited, the private sector has not organized itself efficiently, investment has been limited, the GoM has refused to liberalize air transport regulations and institutional capacity remains poor. There has not been enough incentive for either the public or private sector to change or engage.

It is easier to feed a hungry man than it is one that is full or satisfied. Therefore, efforts to improve the BEE should focus on the needs of, and obstacles facing, the mining sector and its supply chains.

This does not mean a disregard of other sectors of the economy; in fact the opposite. By focusing on those elements of the BEE that are in most demand for change (not necessarily the greatest need for change), the spillover effect on other sectors will likely be more significant than if they were dealt with independently from mining.

For example, one of the most significant problems, according to the GCR and GETR is Mongolia's trade environment. Focusing on improving the trade environment with respect to mining imports (equipment, raw materials, infrastructure, etc.) and exports (raw and processed materials), particularly in relation to efficiency, bureaucracy faced (number of documents and time required, costs and procedures), policy, accountability and administrative capacity, would, if implemented appropriately, have a knock on impact on other imports and exports. Increasing efficiency and decreasing bureaucracy as a method to increase revenues is a stronger incentive for the GoM than just to improve rankings in international indicators.

Similarly, by establishing greater capacity in institutional investment promotion and improving investment policy covering the mining sector, there is the possibility to improve the overall investment environment. Encouraging greater use of ICT, innovation and adoption of R&D in mining, would have a positive impact on the use of ICT, and adoption of R&D in other sectors of the economy.

In other words, the mining sector could be a model and catalyst for improving the BEE for a wide number of sectors.

The potential impact is enhanced due to the broad supply chain that feeds the large mining companies and on which they depend. As the mining section below indicates, this includes a variety of service (mining-specific and general), logistics and technical suppliers, consulting services and basic goods and service providers. Many of those firms in the supply chain have the ability to provide goods and services to other sectors in the economy, thus the impact of reform spreading beyond mining.

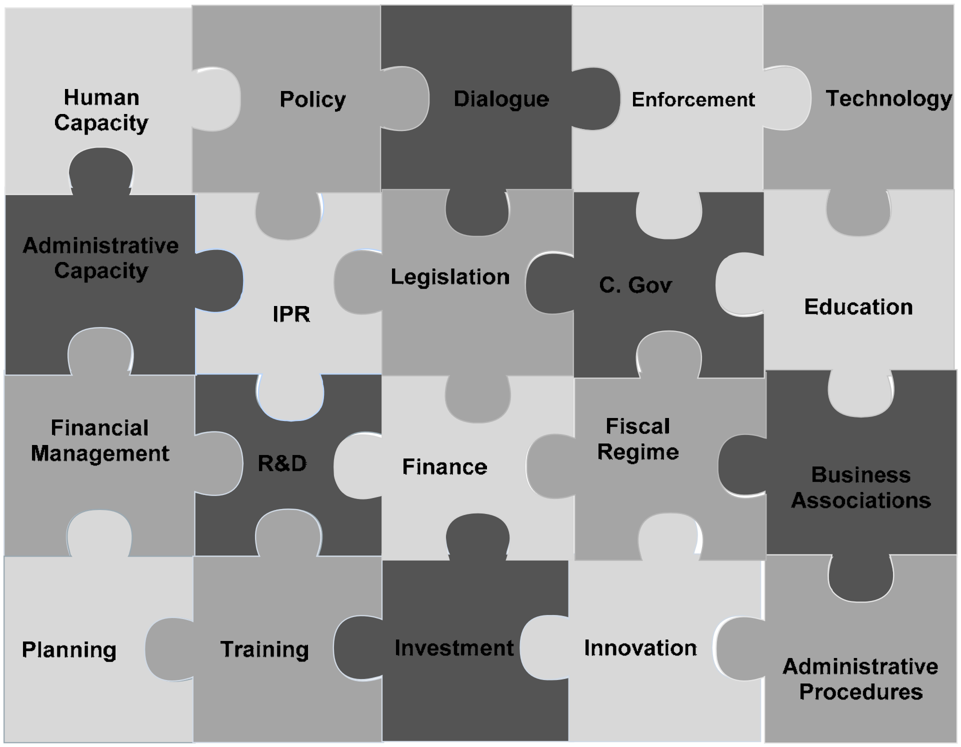
According to the findings outlined in the mining section below, the most significant obstacles in the business environment are the lack of: a clear policy stating the GoM role in promoting and developing the sector; competitive, stable and predictable fiscal regime, transparent legal and regulatory framework to manage mineral wealth, protect the environment and ensure CG; policies to attract and retain investors that have the resources, management and technology to exploit minerals in a sustainable way, policy responses to avoid Dutch Disease, financial sector sophistication; transparency and accountability of state enterprises and the judiciary; management and technical skills; private sector involvement in policy formulation; and public sector capacity.

These constraints in the mining sector thus reflect many of the more general BEE constraints listed above.

The recommendation for USAID intervention in the BEE is therefore to focus on private and public sector-demanded BEE reforms in the mining and mining supply chain sector with the foresight that reforms can and should have benefit to other sectors.

Whereas the approach adopted by the EPRC project was to broadly focus on the BEE without a particular sector of focus, resulting in immeasurable and intangible results, and efforts not necessarily reaching a conclusion, the proposed approach is to link all aspects of the BEE together. This approach, illustrated in the chart below, provides the opportunity for deeper engagement in the BEE.

Figure 1. Integrated BEE Reform Approach



Using the approach illustrated above, R&D is linked to policy, which is linked to planning, linked to fiscal regime, linked to legislation, linked to corporate governance, and so on. The integrated nature means that legislation should not proceed unless the ability to enforce and implement that legislation is taken into account. It should also mean that due attention is paid to human and institutional capacity to implement policy and legislation.

Given the broad extent of the BEE, there will always be an opportunity to complement the work of other donors, be flexible and change tack should obstacles appear suggesting a lack of success in a particular BEE area, enable sustainability and continuity of current activities, respond to defined timescales, and take account of lessons learned. The prioritization of actions will largely be demand-led by either the government or the private sector.

Given the cross-cutting nature of the BEE and the potential linkages with the finance and banking, energy and mining sectors, more specific recommendations are prescribed in the final section of the report.

Financial Sector

Background

Mongolia's financial sector has grown exponentially over the past decade – but almost entirely within the banking sector, which accounts for 96 percent of all financial sector assets. The banking sector expanded 14 fold from MNT 287 billion (US $263 million) at the end of 2000 to MNT 4.1 trillion (US $3 billion)[51] in July 2010[52]; a singularly impressive achievement. However, Mongolia remains well behind its neighbors and peers in the depth and breadth of its financial sector. Its nascent equity and debt markets are narrow, illiquid, and not fully functional. Its excessive reliance on banks as virtually the sole source of financial intermediation is a constraint to growth and diversification of the economy. In the absence of alternative intermediation mechanisms, banks are essentially the only domestic source for financing, as well as the only domestic vehicle for investment.

While not a constraint for the 30-50 'blue chip' businesses which are large enough to source capital and loans abroad, it is a large constraint for the vast majority of Mongolian enterprises which must rely on Mongolian banks. Loans through the Mongolian banking sector are expensive (both in nominal and real terms), are relatively short-term, and are heavily collateral-dependent. This presents a particular constraint for those start-up and rapidly growing businesses which need the longer-term, affordable credit, which is required for capital investment. It is also a constraint to poorer Mongolians (those without capital or collateral which can be pledged) who want to invest in housing upgrades or new business ventures.

Table 7. Indicators of Financial Sector Development – Neighbors and Peers - 2008

2008	Mongolia	China	Russia	Korea	Kazak	Malaysia	Viet Nam
Domestic Credit to Private Sect (%GDP)	34%	125%	26%	112%	34%	115%	95%
Interest Rate Spread (Lending less deposit)	9.4%	3.1%	6.5%	1.3%	N/A	3.0%	3.1%
Sec. Market Capitalization to GDP (%)	8%	65%	78%	53%	23%	84%	11%
Securities Trading (% of GDP)	1%	126%	34%	158%	3%	38%	5%

(Source – World Bank)

The Mongolian financial sector is facing a chicken and egg problem; historically low demand for diverse financial products and services has led to too little supply, and too little supply has led to limited demand. As the economy has experienced growth, demand for credit has increased sharply, but this demand has almost entirely been met by the banking sector. And there have been consequences. First, the interest rate spread (the difference between deposit rates and lending rates) has remained stubbornly high (most recently just over 7 percent), imposing a high burden on borrowers. Second, the nature of bank credit (short-term and collateral-dependent) constrains the ability of start-up businesses and SMEs to make capital investments.

[51] Assuming exchange rates per USD in 2000 and 2010 of 1,091 MNT and 1,350 MNT respectively.
[52] Mongol Bank

As Mongolia undergoes significant mining sector led growth in the next five years, there will be increasing demand for alternatives to bank financing. The business community and the Mongolian citizenry need access to longer-term affordable capital, and in the form of instruments which are suited to their needs. With the rise in income, the demand for pensions and insurance is also expected to increase. This in turn will provide the basis for development of non-bank investment products (beyond bank deposits) for domestic and international investors wanting to invest in Mongolia's growth.

As such, a key thrust of USAID's economic growth strategy should be development of the non-bank financial sector, focusing in three areas:

1) Non-bank products (developing a broader range of financial instruments beyond bank loans – to include insurance and pension funds)
2) Deepening financial intermediation capability (developing stronger corporate finance/capital markets/institutional investor capacity to structure non-bank financing)
3) Support to the Financial Regulatory Commission to establish an appropriate non-bank regulatory framework.

Particular attention should be given to housing finance, which is cross-cutting and has the potential for huge impact across many areas – increased household savings, energy efficiency and emissions abatement, health improvement, and expansion of the construction industry.

Economic growth is achieved through increased productivity. And productivity increases require investment; investment in human resources, infrastructure, technology and equipment. A key function of the financial system is the pooling of savings and profits in the form of lending/investment capital, and the allocation of that capital in the form of loans/investments to businesses and individuals for productive investment. In a fully developed financial sector, savings can be deployed in a broad array of instruments to meet the varying investment requirements of prospective borrowers.

This is not the case in Mongolia. The financial sector remains shallow and dominated by a small number of banks. The securities exchange is essentially non-functional and the non-bank financial institution (NBFI) sector remains quite small and undeveloped. As a result, there are virtually no debt or equity markets or institutional investors which can provide alternative funding sources. Capital market activity is quite limited. There are a number of firms seeking to provide investment banking services in Mongolia, but they are largely focused on a small number of larger companies. As a result, the opportunities for investment of capital in Mongolia are largely limited to bank deposits and real estate.

The good news is that the NBFI sector and the capital markets appear poised for rapid development. With the prospect of strong economic growth for the foreseeable future driven by the mining sector, there is a growing cadre of young, bright, educated Mongolians who are establishing investment banking services, mutual funds, insurance companies, leasing companies and other NBFIs; the type of institutions which will be positioned to provide the longer-term investment capital needed to support diversified growth throughout the economy. In its economic growth strategy, the Mission should take advantage of this opportunity to support deepening and broadening of the financial sector.

Banking Sector

Size and Composition

The Mongolian banking sector has grown exponentially over the past decade, with total bank loans growing over 40 fold from MNT 67 billion (US $61 million) at the end of 2000 to MNT 2.9 trillion (US $2.2 billion) in July 2010. Although notionally comprised of 15 banks (two failed banks were merged into the State Bank in 2009), four banks (Khan, Golomt, TDB and Xac) dominate with 66 percent of total loans. The banking sector is quite liquid as cash has been flowing into Mongolia and has little where else to go; though recently much of this liquidity is flowing to Khan Bank as solvency concerns have arisen about other banks.

There are strikingly different views on the health of the banking sector. Of the total MNT 2.4 trillion in loans to the private sector, MNT 410 billion (17 percent)[53] are shown as non-performing. Some contend that this significantly underestimates the actual level of non-performers. An EPRC report on the banking sector from December 2009 indicates that only three banks are in compliance with all prudential ratios. There is a contention that Golomt Bank in particular has been optimistic in its treatment of loans to Olon Ovoot Gold LLC/Mongol Gazar and the Just Group. While there are quite different perspectives, the general consensus is that the banking sector is not likely to collapse, and that the growing economy and high profitability of the banks will allow them to grow their way out of the crisis.

The cost of credit is extremely high in both nominal and real terms – as of July 2010, the average cost of borrowing was 19.4 percent in domestic currency and 14.3 percent in foreign currency. The interbank rate was 11.0 percent and the Central Bank bill rate was 10.57 percent. The average net interest margin for the three largest banks (with 60 percent of total loans) was 7 percent.

Table 8. Lending and Deposit Rates by Major Bank

	Khan	Golomt	TDB	Average
Average Lending Rate	19.6%	19.4%	17.8%	18.9%
Average Deposit Rate	9.7%	12.9%	13.1%	11.9%
Margin	9.9%	6.5%	4.7%	7.0%

In general, the larger banks are relatively innovative and forward leaning. The four largest banks all benefit from international ownership and/or management. Khan and Xac Bank in particular have large ownership stakes by International Financial Institutions (IFIs) and NGOs, and have a particular focus on pro-poor lending and MSMEs. Mobile banking services are available and all large banks are now offering mortgages. Ten banks have formed the Mongolian Mortgage Corporation (MIK) as a vehicle to securitize mortgage loans. The Trade and Development Bank of Mongolia (TDB) recently issued one of the first corporate bonds (a 3-year bond at 8.75 percent) for a Mongolian company (issued internationally). And under a recent amendment to the banking law, banks have been given universal banking authority and are now able to establish non-banking subsidiaries. The Chairman of FRC noted that he has recently been deluged by banks seeking licenses to enter non-bank areas such as custody, underwriting and insurance. This strong interest in diversifying bodes well for non-bank financial sector development.

[53] Mongol Bank Monthly Report July 2010

Regulation

The WB/IMF Financial Sector Stability Assessment, completed in May 2008, found that "banking supervision is relatively well developed in comparison to other countries at Mongolia's stage of development" and concluded that the supervisory framework largely complies with Basel Core Principles. Some have taken issue with this assessment based upon the recent (and perhaps still on-going) financial crisis, while others would argue that Mongol Bank has effectively managed the situation. There is contention that Mongol Bank has been too subject to political influences, citing as examples the failure to act on Anod Bank and Zoos Bank until too late, and the seeming inability or unwillingness to take a strong stand on Golomt Bank. Regardless, Mongol Bank itself acknowledges the need for continued assistance in improving its regulatory and supervisory capacity, requesting that USAID support it in three areas:

1) Support for implementation of bank restructuring
2) Support to the newly formed Financial Stability Committee (comprised of the Chairs of Mongol Bank, the FRC and the Minister of Finance) with the objective of harmonizing fiscal and monetary policy
3) Support to implement changes in the banking law and regulations with regard to:
    - Prudential regulations
    - Asset classification
    - Licensing
    - Prompt corrective action

Banking Infrastructure

With regard to the interbank payment system, Mongol Bank has implemented a Real Time Gross Settlement System. A new card processing system is under consideration which will replace the individual proprietary systems banks now use. The Central Bank provides a credit information system (the Credit Information Bureau) although banks report that it is not completely reliable and, because it does not include retail credit history, is of no value for retail loans. The EPRC has supported development of a private credit bureau and it is reported that agreement is near with Dun and Bradstreet. Property registration on real property is done at the *aimag* level and has been a challenge. However, MCC and GTZ are supporting modernization of the cadaster and introduction of an electronic real property registration system. There is no mechanism for recording moveable and intangible property (with the exception of automobiles and trucks). With regard to the legal framework, substantial progress has been made, including passage of a modern banking law and securitization law[54]. A draft pledge law (secured transactions) has been developing in conjunction with the EBRD and is currently before the Ministry of Justice. With regard to training resources, ADB and GTZ have supported Mongol Bank in developing and implementing a Bankers Training Center which met basic requirements. Based on demand for higher-level and more sophisticated training and certification programs, the EPRC is currently working on development of the Center for Banking and Finance which would be a bank member-owned NGO.

Challenges and Opportunities

Despite current concerns, the banking sector, as a whole, has shown remarkable development and maturation over the past decade. The larger banks have significant resources and (at least in their UB operations) demonstrate a reasonable level of sophistication.

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[54] The World Bank and EPRC have been supporting a new Bank Restructuring Law, a major part of which was capitalization of a 'bad bank' which would absorb troubled assets. At this point passage seems unlikely.

Assuming that the pledge law is approved as anticipated, support will be needed to establish a moveable property registry and to provide technical assistance to financial intermediaries in understanding how to utilize this system. Modern movables registries are internet-based and relatively inexpensive to launch and maintain. There are tremendous benefits associated with introducing a secured transactions regime; it essentially opens up a class of collateral which here-to-fore has not been available, including assets such as equipment, livestock, accounts receivable and inventory.

With regard to risk capital/corporate finance development, adoption of universal banking allows banks to move into the non-bank/capital markets space. As noted, most of the ostensible investment banks operating in Mongolia are focused on the handful of large corporates and have seemingly have little interest in the remaining 32,000+ Mongolian enterprises. While most of these enterprises are undoubtedly too small to need such services, there is certainly a subset which could utilize and pay for advisory and corporate finance services; mergers and acquisition support, restructuring, private placements, and even Initial Public Offerings (IPOs).[55] According to the NSO, over 1,200 Mongolian businesses have more than 50 employees – not big, but not small either. Arguably the development of the Mongolian financial markets (as well as diversification of the Mongolian economy) depends upon the emergence and growth of these firms. Assistance to support these newly formed banking subsidiaries and other prospective corporate finance/investment banking providers to serve this client base would support broad-based and diversified economic growth.

Non-Banking Financial Institutions

Size and Composition

Mongolia has a relatively large number of NBFIs, but they constitute only 4 percent of overall financial sector assets. At the end of 2009, the composition of the NBFI sector was as shown in the table below.

Table 9. Assets of Financial Companies

Type of NBFI	#	Est. Billion MNT
Finance Companies	80	120
Savings and Credit Cooperatives	200	50
Brokers and Securities Firms	34	N/A
Insurance Companies	16	50
Leasing Companies	4	20
Total		**240**

But while total NBFI assets are small (estimated to account in total for less than MNT 250 billion (US $185 million)), the NBFI sector is poised for expansion and presents an area of opportunity for USAID assistance.

Neither finance companies nor savings and credit cooperatives are candidates for assistance. Finance companies engage in small scale lending and provide services such as money changing and processing remittances; savings and credit cooperatives are member organizations which collect deposits and extend small loans to members. Following the collapse of the savings and credit cooperative bubble in 2006-2007, these institutions are now

[55] Within this group, the National Statistics Office estimated that in 2007 11 percent of these firms had over 20 employees and almost 4 percent had over 50 employees.

heavily regulated. They may be valuable resources to their members, but are not of a size and scale to have a significant impact.

While the scope and activities of brokers and securities firms at present are limited, these intermediaries could assume a significant role. Most of these firms are small operations providing brokerage services (and when and if the securities market develops, will be important in price discovery and imposition of market discipline). A few have licenses to perform underwriting, debt placements, IPOs and bond issuance. As suggested, these actors, in conjunction with the new bank subsidiaries, should be engines for introducing financial and advisory services to medium-size enterprises, as well as in the development of investment funds, mutual funds and other collective investment instruments.

There is great potential for impact in the insurance industry. At present total insurance assets are around US $38 million, with 15 of the 16 firms providing property and casualty (P&C) insurance and only one providing life insurance. There is limited understanding of the economic role which insurance plays in mitigating risk. In a fully developed economy, insurance companies play an invaluable role; not only in mitigating risk, but in providing a pool of funds for longer-term investment. At this point the insurance companies cannot perform this function as almost all insurance is P&C, which has a shorter-term payout horizon, and the FRC is quite conservative in the type of investments which it allows insurance companies (limited to Central Bank Bills and deposits with banks).

There is limited potential in the leasing area. The total leasing book today accounts for less than US $16 million and is primarily vehicle based. Most leasing is done through financial leases (which are essentially installment sales as the leasing company holds title until the asset is repaid). It is reported that operational leases are also permitted; the benefit of which is that the lease rate is lower as the tax benefits go to the lessor. Further exploration will need to be conducted of the tax code and leasing law, but this does not appear to be in common usage.

Finally, there is tremendous opportunity for financial sector deepening in the area of pension and social welfare funds. Private pension systems are rare and remain quite small, but the Government does intend to move forward with comprehensive reform of the pension and social welfare system, eventually moving to a three pillar system which would include private pensions. The benefit of a properly structured and funded pension and social welfare system (as opposed to pay-as-you-go) is that it generates substantial pools of longer-term 'patient' capital for investment. The MSWL is drafting pension reform legislation to go to before the Parliament this fall and would welcome USAID support.

NBFI Regulation

The NBFI sector is regulated by the FRC which was only formed in 2005. The FRC has a huge portfolio and faces enormous challenges as it seeks to develop its regulatory capacity. The FRC is aware that this is currently a critical stage for Mongolia's financial sector development, and that the non-bank financial sector is about to show strong growth. Like all regulators, Chairman Bayarsaikhan is in a difficult spot. He understands that the proper role of a regulator is to encourage activity and foster activity in the markets; however when failures occur the regulator is blamed for letting things get out of control. He understands the need to develop institutional investors, alternative long-term capital pools, and fix the securities market. But these are huge areas to tackle and the FRC has limited capacity (both in terms of personnel and know-how).

With regard to the securities market, the FRC has developed a five year strategy (which supposedly revolves around 'establishing an international framework' in conjunction with a new securities law, and in developing investment funds, which apparently requires a new law). This will entail long-term support for capital markets infrastructure, development of corporate governance, improved ICT, and reform of the clearinghouse and central depository (currently maintained outside of the exchange). Additional areas of focus are development of the insurance industry (perhaps to include compulsory insurance in some areas as automobile insurance and support in developing actuarial capacity), development of FRC capacity, and support for development of capital markets support services such as improved financial reporting, audit and valuation services.

Challenges and Opportunities

The NBFI sector is poised to take-off and will be critical to sustaining and diversifying economic growth in Mongolia.

The pension reform process is at a critical stage. The MSWL is in the process of drafting a new pension and social welfare fund law and has received only advisory support from the International Labor Organization (ILO). Support would be welcomed and strongly beneficial in assisting the Ministry to prepare sound legislation, to provide advisory support to parliamentarians on the proposed law, and in developing a comprehensive action plan for implementation of a three pillar system.

With regard to FRC capacity building, the FRC reports surprisingly that it has not received sustained support for development of its regulatory capacity; the support which has been provided has more-or-less been on an ad hoc basis. The FRC would welcome support in developing its regulatory and supervisory capabilities. This is particularly important at a time when the markets are beginning to open and the Commission is walking a delicate tightrope between encouraging market development and preventing market abuses. An overly heavy hand will deter NBFI development at a time when it is most urgently needed.

Capital Markets

Size and Composition

Given the rapidly expanding prospective domestic and international investor base, the Mongolian capital markets are woefully underdeveloped. The Mongolian Stock Exchange (MSE) was established in the early 1990s to provide a vehicle for trading shares of privatized state-owned enterprises, but unlike other CIS countries, has not evolved into a robust exchange. The MSE is chartered as an exchange for both debt and stocks. However no bonds have been listed on the exchange for several years.

The equities market is essentially defunct. The current volume of equities trading is under US $100,000 per day. Total market capitalization of the top 20 firms is under US $300 million (total market capitalization was only US $610 million in July 2010). And the most recent market capitalization as a percent of GDP was only 8 percent compared with 400 percent for Malaysia, 295 percent for Korea, and 52 percent for Kazakhstan. Of the 339 companies listed on the exchange, 22 are still state-owned, and it is estimated that as many as 200 of the 339 companies are no longer under operation.

A key challenge facing the MSE is that there are no obvious benefits to listing. No IPOs have been completed since the ill-fated Anod Bank and another problem IPO for a failed real estate investment venture. Nor have there been any debt issues. And indeed, by international standards, most of the companies listed on the exchange are too small to be of interest to foreign investors. Of the top 20 listed companies in terms of market cap, only one has revenues in excess of US $50 million, seven have revenues from US $10-50 million, four have revenues from US $1-10 million, four have revenues under US $1 million, and the remaining four report no sales (or sales figures are not provided – unusual for a publically traded company).

There is virtually no activity in the bond markets as well. There are, as yet, no government bonds which are acknowledged as a critical cornerstone in development of a bond market as it provides the risk-free rate against which other bonds can be priced. The MoF is working on development of government bonds. In the absence of a government bond market, the banks formed the MIK (with significant support from the EPRC). MIK is owned by ten Mongolian banks and is headed by the highly competent Ms. Enkhbayar. In the absence of a government bond benchmark, mortgage bonds can provide a substitute yield curve as they are (or at least were) traditionally considered extremely low risk. Of the current estimated MNT 240 billion (US $177 million) in housing loans in Mongolia, MIK has securitized around MNT 8 billion (US $5.9 million). Constraints to securitization are the fact that the Mortgage Law and Asset Securitization Laws have passed, but the regulations have not yet been completed and the lack of a non-bank investor base. As such, there is limited benefit for mortgage loan issuers to sell loans to MIK, particularly if the underlying mortgages remain full recourse. MIK is working on a non-recourse bond (technically these are corporate bonds issued by MIK rather than mortgage backed bonds) and hopes to securitize MNT 5 billion in the coming year.

The TDB issued the first foreign currency denominated corporate bonds for a Mongolian firm, with a three year maturity at 8.75 percent which has since been repaid.

Regulation

The securities market (including the MSE) is regulated by the FRC, which also regulates non-bank debt issuance, including bonds and bond markets.

Challenges and Opportunities

As in the NBFI sector, the capital markets also offer an effective intervention point for USAID, with the potential for a remarkable outcome. The Mission should give consideration to intervention in two areas: development of bond markets and development of capital markets financial intermediation capacity (basically akin to the risk capital/corporate finance development activity proposed earlier).

Development of bond markets - There is growing interest in tugrik denominated debt instruments and the GoM has expressed the intent to raise US $1 billion or more through an international bond offering. At this point, however, there is no yield curve for Mongolia risk. As such, the GoM will most certainly incur a risk premium penalty. The MoF is working on developing a government bond market and will be receiving support from a US Treasury advisor. USAID has long experience in developing sovereign and sub-sovereign debt markets, and there is much which it could bring to the process. Beyond government bonds, the opportunity is ripe to begin development of the corporate bond market and asset-backed bonds, such as housing-finance bonds, and even sub-sovereign and municipal bonds.

With regard to development of capital markets intermediation capacity, as noted earlier, there are already a number of aspiring investment banking and corporate finance providers in Mongolia, and there will be more to come as the banks establish non-bank subsidiaries. The challenge is in enabling these entities to support the non-blue chip Mongolian enterprises and specifically to provide risk capital and advisory services to start-ups and SMEs.

Activities of Other Donors in the Financial Sector

World Bank

The WB's *Multi-Sector Technical Assistance Project* (US $12 million) provides support to the Treasury Department of the MoF for improved fiscal management, to the MSWL for improved poverty benefit programs, and to Mongol Bank for improved supervision and bank restructuring. Its *Indexed Based Livestock Insurance Program* provides livestock insurance for herders. Its *Private Sector Development Program II* provides on-lending funds through commercial banks for SME lending. It also has a US $2.5-3 million project in the Public-Private Partnership (PPP) area in conjunction with infrastructure development requirements (primarily related to the mining industry). It is working with the MoF, SPC and NDIC to identify projects (total infrastructure needs estimated to cost at least US $5 billion). Once a number of prospective PPPs are selected, the International Finance Corporation (IFC) will support structuring and financing of the first three transactions as pilots.

Asian Development Bank

ADB is providing support to the FRC to help it enforce the revised security law and recommend regulation of the Savings and Cooperative Associations. It is not providing support for regulation of other NBFIs. Going forward it has made the decision to narrow its focus and as such it will not be heavily involved in the financial sector. It is providing a small level of support to the SPC to assist it in developing a process for PPPs. It is also looking at establishing a fund to support municipal infrastructure on a cost-sharing basis (based upon commitments to reform, etc.). There is potential for collaboration if USAID were to become involved in municipal/sub-sovereign bond issuance.

European Bank for Reconstruction & Development

Beyond its investment activities, the EBRD is providing support for secured transactions (it supported draft of a new Pledge Law which appears to be stuck in the Ministry of Justice) and insurance reform.

Deutsche Gesellschaft für Technische Zusammenarbeit

GTZ is involved in rural economic development, providing access to finance (BDS and loan guarantees), business environment reform, and SME finance. It is piloting loan guarantee programs in 11 *aimags*. It was also instrumental in establishing the bankers training program at Mongol Bank.

International Monetary Fund

The IMF's program with Mongolia is nearing its end. The Resident Representative noted that "Mongolia is on the cusp of a financial revolution" and that while it has good and grand plans for development, it faces two challenges: the human and financial resources to advance these plans, and governance. The lack of financing will hopefully be met in part by PPPs (although the government's habit of changing the rules of the game is a determent to prospective investors). But beyond this, development of the financial sector is critical. The IMF's representative noted that "the government should not pay for everything; there is domestic capital in Mongolia which should be channeled into investment. But instead it goes into banks as deposits, and from there into high-coupon Mongol Bank (essentially creating a vicious circle)." The FRC needs support to understand its roles and responsibilities.

United Nations Development Program

UNDP is not active in the financial area other than in SME development. It is working with the SME Development Agency to establish SME Development Centers in every *aimag* and has a very small (US $123,000) loan guarantee program.

Japanese International Cooperation Agency

JICA provides credit for SME development (US $30 million) through the MoF and commercial banks. 137 SMEs have already benefitted from loans (concessional rates and terms) averaging US $300,000. JICA has provided support to strengthen CG in commercial banks by supporting improvements to banking supervision by the Mongol Bank.

Millennium Challenge Corporation

The MCC Compact has six components – none of which is finance related:

Prospects for USAID Involvement

Prospects for USAID involvement in the financial sector are excellent, with several potential points of entry and a high likelihood of successful outcome. Mongolia is strongly committed to development of a diverse and deep financial sector and this is being reinforced by the passage of laws opening and liberalizing non-bank activities. The challenge facing Mongolia is whether non-bank development will occur in an orderly and positive manner, and in a way which fosters broad-based growth and economic diversification.

Financial Sector Infrastructure

The financial sector infrastructure with regard to banking is relatively well developed. However, without exception there was universal support (in fact, high enthusiasm) within the financial community for development of a movables property registry and secured transactions regime. Work in this area should involve close coordination with EBRD which has worked on the pledge law with the Ministry of Justice. USAID has significant experience in this area, and given that it is a relatively inexpensive intervention (under US $1 million) the returns should be significant.

As noted, Mongol Bank has requested assistance in the areas of banking restructuring, harmonizing monetary and fiscal policy, and improved regulation. Assistance in these areas would undoubtedly be beneficial. The Mission would need to further explore what other assistance is being provided by other donors in this area, and whether this is an area of critical importance to economic growth.

Financial Sector Deepening

Mongolia's financial sector will inevitability deepen and diversify, but USAID can play an instrumental role in accelerating and smoothing the process, while ensuring that the benefits extend down to small-and-medium Mongolian enterprises.

Risk capital/corporate finance strengthening

The Mongolian financial sector has mastered the art of commercial lending; short-term loans based on repayment from cash flow, but fully supported by collateral. The next frontier is developing capability in corporate finance and investment banking; non-collateral based lending and investment where the risks and returns are higher. It is widely agreed that with mining sector growth, money will be flowing into Mongolia and wealth will be created. The challenge is how those funds and that wealth will be channeled into productive investment to benefit Mongolians; into vehicles other than commercial bank deposits or real estate (and in particular, made available to start-up and SME enterprises in need of investment capital). Technical assistance is critical to support the nascent but growing cadre of corporate finance providers to establish capital pools outside of banks and deploy that capital into investment. Support could be provided in areas as diverse as developing government, municipal and corporate bonds, support for project finance (a fundamental element in PPPs), and support for prospective institutional investors such as private pension funds and insurance companies. This could be accomplished in combination with the Mongolian universities and the existing and proposed finance and banking training centers. It could play a key role in reinvigorating the MSE, through developing new products for listing.

Development of Bond Markets

Bond market development could be incorporated into a broader initiative such as the above, or could be a stand-alone activity. The bond market is on the brink of taking off, but USAID could provide invaluable support in ensuring that it develops in an orderly manner and in rapid expansion into corporate bonds, asset-backed bonds and sub-sovereign bonds.

Pension Reform

Mongolia has a national social insurance system for employed individuals with an automatic salary deduction which goes into five co-mingled funds: pension, unemployment, sickness and maternity, disability, and health. The pension fund currently has a negative balance and is being funded on a pay-as-you go basis. The GoM intends to put into place a program for broader coverage (only 50 percent of citizens are covered) and, as noted, preparations are underway for comprehensive reform of the social insurance system. What is proposed is a three pillar system eventually leading to a private pension system (and indeed there are some private pension systems reportedly in operation). The importance of a well-structured and operated pension system is not only the assurance of payment retirement benefits, but perhaps as importantly (in systems which actually require a funded pension system) it provides a significant pool of long-term capital for investment.

FRC Capacity Building Support

The FRC faces a daunting challenge as it seeks to expand non-bank financial activity, while promoting and enforcing an even playing field. The FRC is highly receptive to a comprehensive and sustained program of support, with particular emphasis in the following areas:

Legal reform – the FRC expressed the need to establish a ‘clear, internationally compliant legal framework’. Not only do they need support with specific legislation, such as the new Securities Law, but also in ensuring that the many different laws which impact financial activities of enterprises are harmonized and enforced.

Insurance sector – As yet insurance is entirely voluntary. Support is needed to explore if, and in what areas, insurance should be made mandatory (such as automobile insurance), as well as to assist the FRC in understanding how to regulate the sector, and in developing actuarial capacity.

Capacity of FRC – While Mongol Bank has received a tremendous amount of support, FRC has received little. It needs support with institutional and human capacity in becoming an effective regulator. [56]

Securities Market

A number of those interviewed proposed USAID support for the MSE, and indeed the MSE needs a great deal of support. A plan is underway to bring in outside management and there appears to be preliminary interest by, among others, the London Stock Exchange and the Korean Stock Exchange. And there is a parallel need to reform the clearing house and central repository which are antiquated, expensive and dysfunctional. The key challenge, however, is that there is simply not enough product on the MSE and thus there is limited investor interest. The MSE does have the capacity to provide tiered listing (a dual listing exchange on which smaller companies could be traded, with more flexible requirements for listing). However there does not seem to be any current effort in moving in that direction. As one observer said, "what this country needs is a good penny exchange."

Cross-Cutting Opportunities

Affordable housing finance would have a broad range of benefits with regard to financial inclusion, pro-poor wealth creation, health improvements, and energy efficiency and pollution abatement. It would also have a major positive impact on financial sector development. As noted, the mortgage bond market has traditionally provided a proxy for a government bond market (in the US trading only about 30-40 base points above government bonds), and could provide a benchmark and yield curve for the development of the bond market. Assuming that 300,000 *ger*-residing households would like to move into upgraded housing over the next ten years with an average cost of US $10,000, this equates to US $3 billion in investment. The challenge for many *ger*-based families is that US $10,000, even if amortized over 15 years, is beyond their capacity to service.

One potential solution is an output-based assistance subsidy program which would provide beneficiaries with means-tested subsidies to allow them the ability to access mortgage loans for a range of housing upgrade options. MCC has a pool of funds committed to energy oriented subsidies. As the most immediate energy gains in Mongolia can be realized through energy efficiency and reduced energy consumption, some portion of this fund might be earmarked for this purpose (and MCC has initially appeared receptive). The resulting benefits to the beneficiaries are significant. It provides *ger* residents with the first step to inclusion in an ownership society; it entails huge fuel cost savings (fuel is estimated to cost *ger* residents up to 50 percent of household income), and generates health benefits and huge energy savings. It would also have the ancillary effect of stimulating the construction industry.

In the area of financial literacy/financial management, there are several areas for intervention. Several people interviewed reported a need for broad financial literacy education, particularly in light of the vouchers which are supposed to be forthcoming and the potential distribution of mining shares. The experience with privatization vouchers makes a strong case for ensuring that prospective recipients understand the value of and the options for investing or monetizing these instruments. Another area would be support to the *aimags* and municipalities with regard

[56] Note: Both the EPRC and the ADB have a different take on the FRC, seeing lack of leadership and lack of political will, and noting that they have provided training to the FRC with limited improvement. Another interpretation is that the FRC is understaffed in the face of an enormous regulatory portfolio. Before any commitment to additional support for the FRC, USAID should require a corresponding commitment from FRC to utilize the assistance and adopt recommended reforms.

to budget and financial management. There will be increasing devolution of tax revenues to the *aimag* and municipal level, as well as opportunities for sub-sovereign debt issuance. A key concern however is the capacity of those entities to manage those finances. One *aimag* supported by GTZ has requested an ISO certification for municipal governance. The concept of training and certifying provincial and local government authorities in municipal governance and budget management has been successful elsewhere (particularly those programs which created a competition for certification) and would be a forward-looking project to support eventual decentralization and devolution of budgets.

With regard to financial reporting, audit and valuation, several people reported that, although standards have been established, capacity is very weak in these areas. As the financial sector develops, these skills will be increasingly important. USAID might consider training and certification programs in these areas – potentially with Mongolian universities.

Energy Sector

Background

Energy Demand

The industrialization of Mongolia's economy has resulted in a substantial increase in energy consumption. Total consumption of primary energy has increased from 2.55 million tons of oil equivalent (TOE) in 2000 to 3.14 million TOE in 2005. The table below shows the increase in electricity and heat over the period 1992-2007.

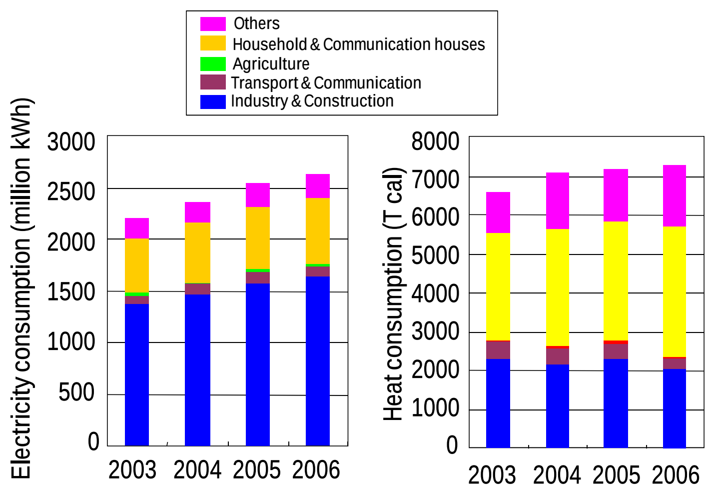
Table 10. Total Primary Energy Consumption

Year	1992	1993	1994	1995	1996	1997	1998	1999
Electricity, million kWh	2,175	2,006	1,861	1,909	1,936	1,939	1,929	1,867
Heat, thousand Gkal				6,790	6,115	5,996	5,769	6,686
Year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Electricity, million kWh	1,910	1,948	2,031	2,194	2,357	2,534	2,619	3,078
Heat, thousand Gkal	6,747	6,537	6,722	7,133	7,746	7,805	7,850	7,281

Note: Total electricity consumption excludes power station internal use and losses on transmission and distribution, but total heat distribution excludes only internal use.

Figure 1 shows energy consumption by sector. The industry and construction sectors use approximately 70 percent of electricity.

Figure 2. Energy Consumption by Sector



Source: NDC

Electricity Supply

The electricity supply system consists of the national transmission and distribution grid and seven power plants. The country is divided into three main networks which are not interconnected: Western Energy System (WES), Central Energy System (CES) and Eastern Energy System (EES). CES is by far the largest, representing 91 percent of installed electricity generating capacity and 96 percent of electricity generated. The high, intermediate and low voltage transmission lines in each of these networks are shown in the table below.

Table 11. National Electricity Grid

Electrical System	Voltage Level 220 kV	Voltage Level 110 kV	Voltage Level 35 kV	Voltage Level 6-15 kV
CES	1,486.7	3,158.4	4,930	6,182.2
WES	0	463	266	546.5
EES	0	188	116	319
Other *aimags*	0	0	193.8	673
Total Country	**1,486.7**	**3,809.4**	**5,505.8**	**7,720.7**

Source: NDC

Approximately 90 percent of electricity is produced by coal-fired power plants, 8 percent is imported from Russia and the remaining generated by small diesel and hydro plants. The total installed capacity of the power plants is 828 MWs (see Table below) and most of them are located in the CES, which provides electricity to the central part of the country including UB, Darkhan, and Erdenet, as well as 140 *soum* centers. As the table below shows, while installed capacity is 828 MWs, the available capacity is only 649 MWs (78 percent of the installed capacity).

Table 12. Capacity of Energy Generators in Mongolia

Power & Heating Plant	Installed Capacity (MW)	Available Capacity (MW)	Heat Production Capacity (Gkal/hr)	Year of Commission
UB TPP2	21.5	17.6	31	1961-1969
UB TPP3	148.0	105.1	518	1968-1982
UB TPP4	540.0	432.0	1045	1983-1991
Darkhan TPP	48.0	38.6	181	1966, 1986
Erdenet TPP	28.8	21.0	120	1987-1989
Subtotal CES	**786.3**	**614.3**	**1,895**	
Choibalsan TPP	36.0	29.5	NA	1969, 1979
Dalanzadgad TPP	6.0	5.0	NA	2000
Total	**828.3**	**648.9**	**1,895**	

Sources: NDC and PREGA 2006 for heating capacity

Considering the seasonal variations in electricity demand, imported electricity is required to meet demand especially during peak demand times in the winter. Typically 10 MWs is imported from Russia into the WES and up to 130 MW into CES during peak demand hours. The maximum available capacity from Russia is 255 MW.

Heat Supply

Heating is vital for Mongolia because of the very cold climate; in fact, UB is considered to be the coldest capital in the world. Presently, heat supply can barely satisfy demand. The annual growth rate of heat demand during the period 2002-7 was 2.5 percent; but has recently accelerated. For example, heat demand increased by 7.9 percent[57] in the first six months of 2010 compared to the same period in 2009. The available capacity is not adequate to meet peak demand.

[57] Source: ERA (Sept 2010)

Energy Resources

Mongolia has substantial coal reserves; proven reserves are estimated at 10 billion tons, but probable reserves are as high as 150 billion tons. Much of the coal (approximately 80 percent) is lignite, with the remaining being bituminous and sub-bituminous. Mongolian coals typically have sulfur content between 0.3 and 1.0 percent. There are 30 coal mines in operation, but approximately half of the production is from two; Baganuur and Shivee-Ovoo.

In 2007, two thirds of the coal produced was utilized in Mongolia with the remaining exported. Most of the coal used domestically is lignite, while that exported is bituminous coal. In 2007, 3.245 million tons of coal was exported largely from the South Gobi to China. The South Gobi area is estimated to have 5-6 billion tons of reserves, 40 percent of which are coking coal suitable for exports. Further development of this mine is expected in the near future with the aim to increase coal exports.

Mongolia also has substantial renewable resources including[58]:

1) 6,200 MW of hydro of which 1,800 MW is the lowest cost capacity which could be developed first; consisting of run-of-river (up to 5 MW each) and mini hydro plants less than 1 MW each
2) 160 GWs of wind
3) Geothermal resources estimated to be in the 45-900 MW range
4) 11 GWs of solar/photo voltaic

However, as the same reference concludes, only a few renewable projects are likely to be developed within the present tariff structure. This is based on the fact that the most cost-effective hydro (800 MW) and wind (61 GW) projects have a production cost of approximately US $100/GWh, while the cost of the remaining hydro and wind projects is US $200-250/GWh; significantly above the present tariff. As a result, it is likely that the following projects may be developed in the next few years:

1) Newcom wind farm: 50 MW
2) Egiin hydro: 220 MW
3) Orkhon hydro: 100 MW

Energy Sector Structure

During the last decade, Mongolia has taken steps to unbundle and deregulate the power sector to create an environment which will attract private sector investment. After the implementation of the Energy Law of Mongolia in 2001, the power sector unbundled according to the Government Decree #164. This resulted in 18 state-owned companies involved in generation, transmission or distribution, and operating under the framework of the 'Single-Buyer Model':

1) Five generation companies arranged around Thermal Power Plants (TPPs): #2, #3 and #4 in UB, Darkhan TPP and Erdenet TPP
2) Central Regional Electricity Transmission Company (CRET)
3) National Dispatching Center Company (NDC)
4) Regional electricity distribution network companies (EDNs) including: UB, Darkhan-Selenge, Erdenet-Bulgan, Baganuur and South-Eastern Region
5) District Heating Network Companies (DHN) including UB and Darkhan[59]

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[58] Mongolia: Regulatory Analysis Report, EBRD, October 2008

[59] Heat distribution in Erdenet is undertaken by Erdenet TPP. Heat supply in Baganuur is undertaken by a separate company using heat-only boilers.

The MMRE is involved in the formulation of policies, which are eventually approved by the Parliament. Since all energy sector enterprises are government-owned, MMRE is also involved in approving investment decisions.

Since 2001, Mongolia has had an Energy Regulatory Authority (ERA) which was established according to Government Resolution #83. The ERA is the regulatory agency in charge of setting energy prices and regulating energy system operation (including dispatching) and further development. As a result, ERA issues licenses, sets tariffs and issues guidance on energy system operation.

Energy Sector Issues and Options

Inadequate electricity and heat supply

The period to 2016 (when the first new power plant may start operating) can be characterized as a crisis period, where both heat and electricity will not be adequate to meet demand; urgent as well as long-term actions toward development of the energy sector should be taken. During peak demand hours, Mongolia imports electricity from Russia; from 2012 the situation is expected to worsen.

As the following table shows, the total installed capacity of the power plants in Mongolia is 828 MWs, but the available capacity is only 649 MWs (78 percent of the installed capacity); the available capacity in CES is 614 MWs.

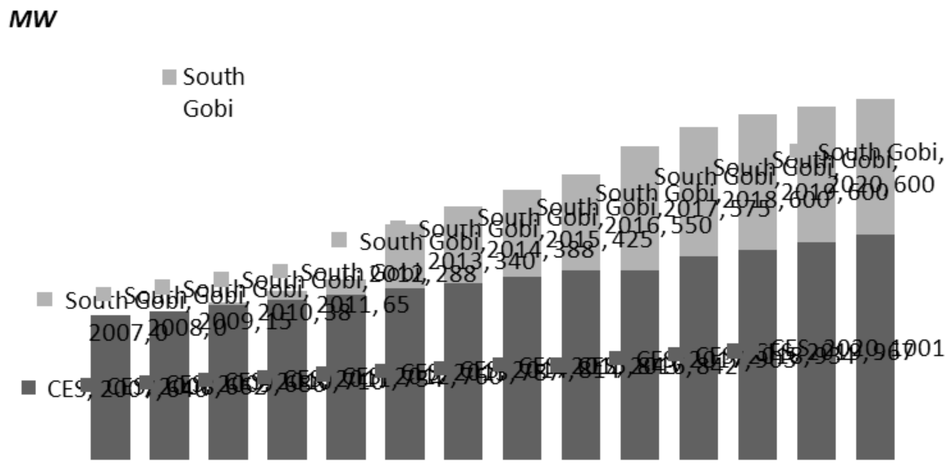
Table 13. Capacity of Energy Generators in Mongolia

Power & Heating Plant	Installed Capacity (MW)	Available Capacity (MW)	Year of Commission
UB TPP2	21.5	17.6	1961-1969
UB TPP3	148.0	105.1	1968-1982
UB TPP4	540.0	432.0	1983-1991
Darkhan TPP	48.0	38.6	1966, 1986
Erdenet TPP	28.8	21.0	1987-1989
Subtotal CES	**786.3**	**614.3**	
Choibalsan TPP	36.0	29.5	1969, 1979
Dalanzadgad TPP	6.0	5.0	2000
Total	**828.3**	**648.9**	

Source: NDC

As the following graph shows, peak demand in CES is already above the available capacity (614 MW) and is expected to grow rapidly with increasing demand in South Gobi.

Figure 3. Peak Demand Forecast (2007- 2020)



Source: "Mongolia: Power Sector Development and South Gobi Development", World Bank/ECA (2009)

In fact, actual demand growth experienced in 2009-10 exceeded earlier forecasts, largely because of the harsh winter of 2009-10 and rapid population increase in UB. Peak demand increased by 6.6 percent in the first six months of 2010 compared to the same period in 2009; August 2009 to August 2010 increase was 8 percent[60].

Mongolia relies on Russia for power system reserve capacity. Electricity imports are expensive (US¢7-10/kWh); adversely affecting the viability of the power sector. While Mongolia exports electricity to Russia, too, this is usually during non-peak hours when heat demand dictates how the power plants operate; resulting in excess electricity flowing to Russia at very low prices.

From 2012 until a new combined heat and power (CHP) plant is built in UB, the situation will become worse; especially with regard to heat supply. Considering that CHP#5 will take at least 5 years to build, the period 2011 - 2016 is critical. Actions which need to be taken should pursue two parallel objectives:

Implementation of short term options

Options which could have short-term impact (2010-2016) include:

1) Rehabilitation/minor repairs to the existing power plants to maximize their efficiency and reliability and increase output. This may include: replacement of equipment which has deteriorated and is likely to fail; use of variable speed drives; replacement and cleaning of condenser tubes; combustion optimization or reduction of excess air.
2) Loss reduction in transmission and distribution networks
3) Shift in demand from peak to non-peak hours; implementation of heat storage; time-of-day tariff to encourage off-peak operation; on-demand disconnection of certain appliances
4) End user energy efficiency measures; rehabilitation of large buildings (insulation, efficient doors and windows, lighting); upgrade of district heating system to reduce

[60] Source: ERA (Sept 2010)

energy losses, and meter/control of energy in each apartment; improvement in efficiency of industrial facilities and construction machinery; and use of efficient street lighting

The above measures should reduce peak demand and overall energy use, and increase supply. While the increase is likely to be marginal, in a tight energy supply-demand situation, it would be useful.

Development and implementation of a long-term power development plan (Master Plan)

The latest Master Plan[61] was developed in 2002 with assistance from ADB and is in need of updating. The rapid development of the mining sector must be taken into account. In addition to the increased power demand from the new mines, some of them may build power generation facilities for their own needs, but could provide excess power to the national grid. The development of mine-mouth power plants increases the need for a national transmission network. Also, the addition of renewables (especially wind turbines) requires a strengthening of the transmission network capacity and modification of operating procedures (stand-by capacity needs to be identified to compensate for variations in power generation from wind turbines). One issue associated with the Master Plan is that no agency in Mongolia is responsible for energy data monitoring and demand forecasting. This is an important issue as forecasting is the first step in developing a Master Plan.

Implementation of the long-term power development plan would require mobilization of substantial financial resources. At a time when the country needs substantial investment to develop the infrastructure for mining (e.g., South Gobi infrastructure needs are estimated at US $5.2 billion[62]), it is essential to attract private investors at least for some of the power sector investments. Mongolia has taken the right steps in implementing the Concession Law (February 2010) and the Privatization Guidelines for 2010-2012 (approved by the Parliament). However, this is not enough for commercial transactions to be concluded in a timely manner. There are many details which could complicate and delay commercial agreements. So, it is important to further enhance the understanding of key decision-makers and provide them with transaction-related support. It is also important to continue improving the regulatory framework of the power sector and enhance its viability. Key questions which would come up in transactions include:

1) Do the electricity and heat tariffs allow for full cost recovery? In present industry practices, maintenance costs are being capitalized rather than expensed annually, interest payments owed to Government are being deferred, and depreciation is not being fully recovered.
2) Are the key public sector enterprises credit-worthy?
3) Is the Government willing to provide sovereign guarantees?

Mongolia needs to continue strengthening its power sector policies and improving its risk profile, while strengthening its capacity to utilize various financial instruments and complete commercial transactions efficiently.

Options which need to be considered as part of the long-term power development program include:

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[61] Having a Master Plan does not necessarily mean centrally planned power sector development. However, a Master Plan is essential as an indicative roadmap even if the private sector is involved. This is particularly the case with Mongolia, where the power sector is presently publicly owned.

[62] Southern Mongolia Infrastructure Strategy, World Bank (2009)

1) *Demand side management and energy efficiency:* energy efficiency in the heating network (heat generation, transport, and end use); efficient stoves and coal briquettes; retrofit of existing buildings and code for construction of new buildings; industrial energy efficiency; heat loss reduction in electricity transmission and distribution; improvement in efficiency of power generation facilities; peak shifting options; and time-of-day tariffs.
2) *Renewables*: Mongolia has introduced legislation based on feed-in tariffs which promote wind, solar, and small hydro projects. The tariffs for wind and hydro are reasonable and should soon result in actual projects. Impeding the implementation of such projects are a number of barriers:
    a. The law envisions that a renewable fund will be established to provide funding for the cost differential between conventional and renewable sources. However, this fund has not been established. In absence of this fund, it is not clear what organization will pay the tariff specified by the law.
    b. The law does not specify the duration during which the feed-in tariffs will be valid for each project; the project developer needs to negotiate the Power Purchase Agreement (PPA) with the transmission company. Considering the difficulty in collecting electricity payments, the cash allocation scheme needs to be modified to accommodate renewable sources.
    c. The electric grid requires strengthening to accommodate renewables without any stability or system operating problems. An EBRD-commissioned report[63] estimates that up to 190 MW of wind capacity or 85 MW of hydro capacity could be added to the existing CES power system without any problems. Even if this capacity is safe to be added, it is likely to increase the intermittent purchase of power from Russia and exacerbate adverse financial impacts.

Until the above barriers are removed, the uptake of renewables will be slow. Considering the time required addressing some of the above barriers, it is unlikely that the stated targets (3-5 percent by 2010 and 20-25 percent by 2020) will be achieved.

3) *Clean Coal Technologies:* It is understood that coal is the cheapest option for power and heat generation in Mongolia. However, every effort needs to be made to utilize 'clean coal' options such as: potential for coal cleaning/upgrading; high efficiency power plants; and technologies which reduce local pollutants (particulates, SO_2 and NO_x) such as Circulating Fluidized Bed (CFB), Flue Gas Desulfurization (FGD) and deNOx technologies. Combined Heat and Power (CHP) is likely to be the most desirable option for a plant located close to cities.

In addition to power generation options, the Master Plan should evaluate alternative development options for the transmission network and identify the most appropriate path for its development. Transmission projects need to be implemented in coordination with power generation projects, but should be consistent with a long-term development program. A key transmission line (Mandalgov 220kV connecting UB with the south) has been delayed for many years.

Need for development of the South Gobi infrastructure

Development of the mines in the South Gobi region would require substantial investment, not only for the mines, but also for the infrastructure. The infrastructure alone is estimated to require US $5.2 billion[64] including roads, railways, new townships, and power and heat supply.

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[63] Mongolia: Renewable Energy Regulatory Development Road Map, EBRD/ECA, October 2009
[64] Southern Mongolia Infrastructure Strategy, World Bank (2009)

Mining investments are expected to be provided by private investors who will enter into an agreement with the GoM. Infrastructure (not including power and heat) would require substantial participation of the GoM; even if investments could be financed through PPPs, the GoM would be a strong participant along with multilateral and bilateral banks and agencies.

Power demand in the South Gobi region is expected to reach 294 MW in 2012 and 650 MW by 2020[65]. Investment to supply this power (power generation and transmission) is estimated at US $2.7 billion. Local power and heat supply for townships is estimated to require an additional US $125 million.

Some of the power facilities could be financed by mine developers, while others could be financed by other private investors along with the GoM. The more rational approach to take with regard to power sector investment in the South Gobi is to handle them the same way as other power projects: power demand in the South Gobi should be included in the Master Plan and investment decisions should be similar to the development of power projects in any other part of the country. For this reason, all the comments made in the previous issue (inadequate energy supply) are also applicable to the South Gobi. The cross-cutting issue of financing infrastructure projects (see below) is also relevant to the development of the South Gobi.

Urbanization-Urban pollution

With UB approaching 1.2 million people (60 percent in *gers*), demand for basic services (water, heat and electricity) is increasing rapidly. Just this year, the population increased substantially the *dzud* killed approximately 7.8 million livestock[66] and left the herders without any other option but to move to the cities in search of shelter and employment. The inability of the existing energy supply system to satisfy the rapidly increasing demand forces residents to revert to the few available options; cheap and available, but highly polluting, raw coal.

JICA has assisted the UB in developing a Master Plan and the WB has carried out comprehensive studies regarding the needs and options for UB. However, development of viable alternatives hinges on reaching an understanding (among key stakeholders including financial institutions) whether *gers* in UB should be looked at as temporary or permanent structures. This is an important differentiation which will affect the selection of appropriate energy supply options. While most stakeholders feel that *gers* should be looked at as permanent (mainly for heritage and land ownership reasons), others disagree. As a result, programs to address these issues are being delayed. When they are ready for financing, organizations such as the WB, ADB, and JICA are eager to provide the required assistance.

Cross-cutting issues

Financing of infrastructure projects: Mongolia has appropriately introduced a concession law and PPP-related legislation. However, key stakeholders who will be involved in PPPs and, in general, dealings with private investors lack the necessary understanding to conclude such agreements. Most GoM officials recognize this weakness and are eager to receive support. More specifically, Mongolia needs assistance in the following areas:

[65] Mongolia: Power Sector Development and South Gobi Development, World Bank/ECA (2009)
[66] Food & Agricultural Organization website – May 2010

1) Alternatives for private sector participation (direct investment; PPPs; equity investments; joint ventures; BOO (Build, Own & Operate); BOOT (Build, Own, Operate & Transfer); etc.) and the advantages and disadvantages of each
2) Risk management: improving the risk profile of the country and the project; importance of sound policies, transparent environment, legal framework, etc.
3) Identification of key financial instruments which are suitable for Mongolia
4) Training on how a financial transaction is carried out, best practice examples and examples to avoid
5) Transaction support: this is not to complete a specific agreement (a transaction-specific advisor should be hired for each case), but to provide preliminary support to develop a strategy for the transaction, train and advise key individuals and assist in hiring the right transaction advisor

Capacity building: GoM officials need to increase the participation of Mongolians in future industrial activity. While there is no consensus on how this should be done, there is consensus on the need. This is best done as part of signed industrial agreements. Examples:

1) A commercial agreement should include a training component for locals, both professionals and manual labor. Also, such agreements may include a technology transfer component to trained individuals on key aspects of the industrial activity (e.g., mining, processing of metals and manufacturing)
2) Foreign loans could be accompanied by a technical assistance component, which includes technology transfer and training programs
3) When the country hires a financial advisor (e.g., for a PPP), it may include in the contract a training component for 2-3 people to go abroad and be trained on similar financial transactions.

The GoM should carry out an assessment to establish reasonable goals for capacity building considering the demographics of the country, educational level and unique qualities of the population, likely industrial development in the next 20 years or so, etc.

Activities of Other Donors in the Energy Sector

Asian Development Bank

ADB's investment in Mongolia is approximately US $100 million per year. It is not planning to invest directly in mining (even though it has a private sector arm), but it is involved in the development of infrastructure in the South Gobi region.

1) ADB is providing technical assistance to carry out a feasibility study for CHP#5. The consulting team (led by the U.S. H&J Group) had their kick-off meeting in UB on September 8th. It is not clear if ADB will finance the project; it would depend on the outcome of the study and the decision of the GoM. GoM anticipates a PPP mechanism, but it is possible that the study will recommend 100 percent public financing.
2) Starting early 2011, ADB plans to develop a Master Plan for Energy in Mongolia. This will include:
    - Electricity and heat demand assessment (including mining)
    - Assessment of energy efficiency measures
    - Development of the country's transmission system
3) Advisory services to the ERA and the Ministry of Nature, Environment and Tourism (MNET) to develop emission standards for industrial and power plants (report and recommendations to be completed by the end of 2010)

4) Assessment of energy efficiency potential from large buildings.
5) Small grants program (each grant up to US $2-3 million) which has funded:
   - Rehabilitation of heat-only boilers
   - Rehabilitation of hybrid electricity supply systems

European Bank for Reconstruction & Development

EBRD is active in private sector projects in mining, electricity and infrastructure. It has the option to take an equity position in a company or provide a loan to a private company or public sector organization. In Mongolia, it focuses on private sector projects.

Contrary to the other multilateral banks, it has no annual maximum investment in the country. There is a US $600 million maximum per project, but this is significantly above most projects being considered in Mongolia. Hence, EBRD's financing is practically unlimited.

Projects currently pursued include:

1) Financing of mining projects
2) 50 MW wind project - EBRD will provide US $60-70 million equity
3) A second larger wind project may follow
4) Technical Assistance on water regulation in the South Gobi
5) Technical Assistance to develop a fund (from coal taxes) to subsidize briquettes and efficient stoves

One planned project focuses on assessing energy efficiency potential in Mongolia and identification of attractive projects

Deutsche Gesellschaft für Technische Zusammenarbeit

GTZ has an active on-going program with staff located in the offices of the ERA and MMRE. GTZ's approach consists of identifying specific needs based on technical-economic analysis. It then seeks to identify financing, including grants and soft loans mostly from German (but sometimes other European) organizations and finally participates in project implementation and provides guidance and training.

Past projects:

1) Development and financing of two small hydroelectric projects (Zavkhanmandal 110 KW, Tsetsen-Uul 150 KW) to supply electricity to five communities (€2.8 million)
2) Training on planning and implementation of small off-grid renewable projects
3) Identification, financing and implementation of energy efficiency measures in power plants (CHP#4 and Darkhan)
4) Rehabilitation of heat-only boilers in Uliastai
5) Rehabilitation of 5-storey building with energy efficiency measures (insulation, lighting, doors/windows, etc.)
6) Energy efficiency projects in high voltage transmission network

Planned Activities:

1) Comprehensive assessment of energy efficiency potential throughout the energy chain (power generation, transmission, distribution, and end-use applications) and efficiency options for heat supply to buildings
2) Energy efficiency and output enhancement projects in CHP plants
3) Training/capacity-building

Japanese International Cooperation Agency

JICA is in the process of revising its assistance policy and expects that the Country Assistance Program would have to be revised accordingly. To-date, JICA has provided assistance to Mongolia in the following areas:

1) Development of UB Master Plan (2009) including transport development, solid waste management, water supply, sewage, and air pollution control
2) Investment (both grants and soft loans) to rehabilitate CHP#4
3) Funds for development of master plans for mining infrastructure
4) Human resource development

It is unlikely that JICA will be involved in mining investment, but it is possible that it will be involved in the infrastructure associated with mining. JICA may provide a Foreign Investment Advisor to the GoM.

Millennium Challenge Corporation

MCC's vocational education and training project includes training on mining and energy, even though they are not the focal points of this program.

Their energy and environment project is a 3-year program (2009-12) with a budget of US $47.2 million. Activities included under this program:

1) Energy Efficiency Innovation Facility (US $31.3 million) providing small grants through Khan Bank for
    - Heat-only boilers in *gers* which have no heating
    - Neighborhood heating
2) 50 MW wind project (US $10 million) funding integration to the grid, strengthening the substation, a fiber optic line for monitoring and some incremental costs for wind turbines

World Bank

The WB's lending program is approximately US $40 million per year. In 2009, US $80 million additional support was provided to address the economic crisis. A new Country Director has just been appointed and the Country Assistance Strategy (between the WB and GoM) is about to be updated. As a result, both the target sectors and the level of funding may be adjusted.

In the last few years, the WB has focused on economic development in the South Gobi and issues resulting from rapid urbanization.

The WB is not involved and not planning to be involved in mining investment, but is providing technical assistance to the GoM to develop the infrastructure needed in the region including:

1) Assessment of investment needs for infrastructure (US $5.6 billion)
2) Establishment of Revenue Management instrument
3) Development of commercial agreements with private companies, etc.

Urbanization-related problems have accelerated in recent years due to adverse weather conditions. As a result, 60 percent of UB residents live in *gers*. The WB has studied the issues associated with urban problems, but there is no agreement with the GoM on how they should be addressed. As a result, specific programs are being delayed. For example, a project which is intended to address UB area pollution has not proceeding. This project would include more efficient stoves utilizing briquettes for cooking and heating and implement small heat-only boilers for *gers* not connected to district heating.

Other on-going programs:

1) 100,000 solar *ger*, which provides photo voltaic for the basic needs (light, radio, etc.)
2) UB Services Improvement Project which (among others) supplies water to *ger* areas in the capital (520 water kiosks)
3) Sustainable Livelihood Project including a pilot project

Prospects for USAID Involvement

USAID involvement in the energy sector should be considered in four areas.

Technical assistance on private financing instruments

The GoM would benefit from assistance on further enhancing their understanding of private sector financing instruments (especially PPPs, through training), development of a PPP financing strategy, the provision of preliminary transaction advice and assistance in selection of a transaction advisor. Support should also be given to strengthening relevant policies and implementation mechanisms[67]

There are numerous organizations which will be involved in PPPs, so technical assistance should be targeted at the SPC, MoF, MMRE and NDIC. Assistance should focus on the energy sector and other infrastructure projects.

The WB and IFC have proposed technical support in PPP development, but the GoM has yet to accept given the cost.

Energy data monitoring and demand forecasting

There is a need to increase the capacity to monitor energy consumption and undertake energy demand forecasting. As mentioned above, there is no organization in Mongolia currently involved in systematic energy data monitoring and demand forecasting. While the electricity and heat distribution companies have historical consumption rates, future forecasts are not always a linear extrapolation, as they are affected by new policies (especially tariffs), the implementation of more efficient options, demand-side management programs, new technologies, and inter-fuel substitution, etc. It is therefore essential that one organization collects information from the distribution companies, as well as other sources, and synthesizes to create a forecast for all energy sources, with consistent assumptions and taking into account future technological and policy developments.

An energy forecasting model should be created alongside the training of 4-5 analysts on how to collect the data, check them for quality, and use them in the model to develop forecasts. If Mongolia is going to use a power system planning tool, it is important to take into account the specific information needed for planning, so the forecasting provides information at the appropriate level of detail. It is recommended that forecasting for 2 years is carried out jointly by the consultant and trainees.

USAID should collaborate with the GoM to determine in what organization the energy forecasting team should reside. Based on the experience of other countries, possible options

[67] ERA requested support on a Public Relations campaign (including both the public and the Government officials) to educate them how energy costs are affected by various parameters and why tariffs need to be adjusted. In my view this is an optional item which can be added if USAID agrees.

are the MMRE, ERA and electricity transmission company (even though this is not going to include heat, oil, LPG (liquefied petroleum gas) or natural gas).

Energy efficiency measures

USAID could assist the GoM to identify and recommend implementation of options for demand-side management (End Use Energy Efficiency) and demand peak shifting for application in the immediate future (next 2-3 years) to reduce the likelihood for rotating brownouts or black outs. Such options may include: efficient street lighting, on-demand shut-down of certain electrical equipment, time-of-use tariffs, etc. The consultant would have to evaluate the demand profile in detail and identify the options which have the highest payback and can be implemented immediately. The objective of this task would be to achieve immediate results to close the supply-demand gap, which exists in both electricity and heat.

Assistance could also focus on evaluating the potential for energy efficiency in large (communal) buildings and recommend step-by-step planning and implementation of rehabilitation projects; implementing one demonstration project. Options which should be evaluated include:

1) Upgrading of the district heating system to reduce energy losses
2) Metering and control of heat in each apartment
3) Insulation
4) Efficient doors and windows
5) Efficient lighting

The Consultant, jointly with the GoM and USAID, would select one building to implement some of the above options, to demonstrate the approach which should be followed, as well as the benefits. At the end of the project a guidance document outlining step-by-step how to plan and implement building rehabilitation projects would be provided. This activity could be undertaken in coordination with the Clean Energy Project. The general field of energy efficiency is very crowded as most donors operating in Mongolia have on-going or plan energy efficiency projects. Coordination is needed, especially with ADB and GTZ.

Removing barriers to renewable energy

Technical assistance would identify the main barriers inhibiting or delaying the implementation of renewable projects and provide specific recommendations on how to overcome these barriers. As mentioned above, Mongolia has introduced a law based on feed-in tariffs which promotes wind, solar and small hydro projects. However, there are a number of barriers which make it difficult to implement renewable projects:

1) The law envisions that a renewable fund be established to provide funding of the cost differential between conventional and renewable sources. This fund has not been established.
2) The law does not specify the duration during which the feed-in tariffs will be valid for each project.
3) The electric grid requires strengthening to accommodate renewables without any stability and system operating problems. In general, grid access is an issue.

Support would evaluate the above and other barriers which may exist, and based on the experience from other countries, and make specific recommendations on how to overcome these barriers.

Miscellaneous ideas

In addition to the suggestions above, the MMRE has requested support in the development of a strategy paper (update the Black Book, USAID report on 2002-10) and support to improve the governance of State Owned Enterprises (SOEs). Dispatch optimization software has also been requested (US $500,000).

Mining Sector

Background

Mongolia's mining sector has grown rapidly over the past ten years. In 2010, mining revenue is expected to total US $2.4 billion and make up more than 50 percent of GDP. Over 80 percent of Mongolian exports are mineral products, and this could potentially rise to more than 95 percent when new mines are developed. Two giant projects, OT and TT, located in the South Gobi are being developed now and both are expected to begin production in 2013.

While Mongolians and others have known there are vast mineral deposits, the mining sector (other than Erdenet Mine) has taken time to develop. In 1997, the Minerals Law facilitated an expansion of mining exploratory licenses. As mineral prices increased so did the number of exploration licenses awarded. Many were bought only to be held until a bigger firm became interested in the area when the license could be sold for a profit.

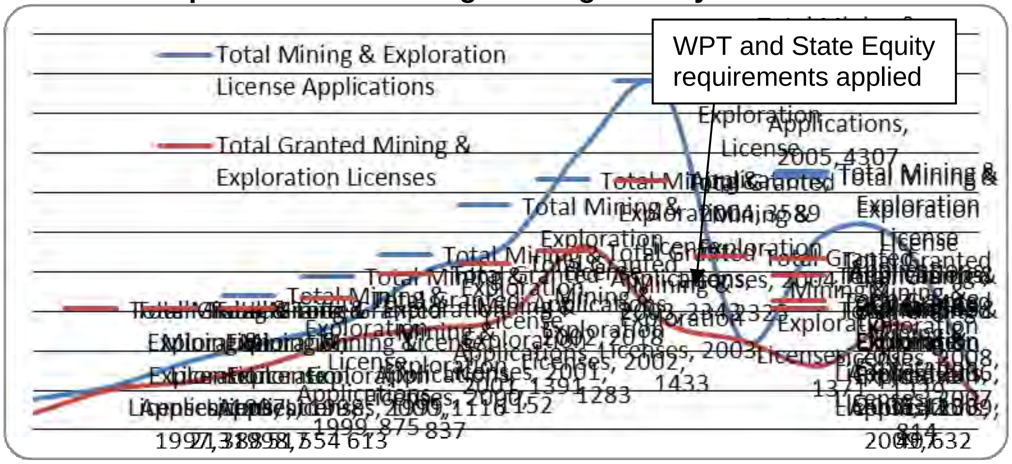
Mining companies can operate in Mongolia by applying for and periodically renewing their exploration and mining licenses with the Mineral Resources Authority of Mongolia (MRAM), overseen by the MMRE. They can also apply for a 'stability agreement' with the central government to negotiate the terms of their license, tax and royalty arrangements. Stability agreements are required for certain mines that have been designated as strategic deposits by the GoM. There are currently fifteen strategic deposits (see Appendix 5 for list and map). The stability agreements detail other special conditions attached to the license.

Around 2006, the GoM began implementing a number of mining policies that have affected interest in working in Mongolia; resulting in a lower demand for licenses (see Figure 3). At the same time, the GoM amended the Minerals Law to enable and, in some cases require, state equity ownership of mineral projects. This continues to be a politically hot topic and is repeatedly discussed by Parliament. The GoM also passed a Windfall Profits Tax (WPT) on copper and gold mining projects; slowing development of many gold projects. (Coal mining was not subject to the WPT and began experiencing a substantial increase in development as prices increased.)

In late 2008, due to the global financial crisis, mineral prices dropped as did mining activity. In August 2009, Parliament amended the WPT to end its application effective 1 January 2011. Other legislative changes included liberalizing the policy environment and making it possible for the private sector to develop certain types of infrastructure, formerly reserved for the State. These included passage of a state policy on PPPs in October 2009, changes to the Law on Roads to permit private sector construction and management of certain roads, amendments to the Law on Water to provide for private sector water resource extraction and management of water supply infrastructure, and a change to the Income Tax Law, improving the loss-carry-forward provisions and making them more consistent with international practice.

The OT Investment Agreement between the GoM, Ivanhoe and Rio Tinto, which was in discussion for 9 years, was signed in October 2009.

Figure 4. Trends in Exploration and Mining Leasing Activity



Source: Mongolian authorities and WB staff

Prior to the completion of negotiations for the OT investment agreement, the GoM amended the Value Added Tax (VAT) Law to exclude exporters of mineral products from being able to claim VAT refunds for the VAT paid on the inputs used for these mineral products. In most countries where VAT is applied, exported products are zero rated, and this includes mineral exports.

From April 2010, the government suspended the issuance and transfer of mineral exploration licenses in relation to the Law to Prohibit Mineral Exploration and Mining Operations at River Headwaters, Protected Zones of Water Reservoirs and Forested Areas. Inspection of all mining and exploration operations is due to be completed by November 2010. As of June 2010, 37 mines were forced to close, mainly due to environmental breaches. According to the MNMA, the GoM will owe the mining companies US $4.7 billion for revoking minerals licenses. The GoM has not yet responded to requests for meetings by the MNMA on this issue.

OT is considered to have the potential to be one of the world's richest producing mines, with reserves that will last 60 years. Capital costs for OT are now expected to exceed US $5.5 billion. TT is a 6 billion ton high quality coking and thermal coal resource. Capital costs for TT are expected to cost around US $2.5 billion.

In addition, there will be significant infrastructure requirements (approximately US $5 billion) for rail, power, road and township development to support mine development of the two projects. These infrastructure investments are beyond the capacity of the state to finance and will likely require PPPs.

When both of these projects are brought into production they will more than double GDP and potentially increase exports four to fivefold. Mongolia's economy is becoming extremely mineral dependent. GoM revenue will become increasingly dependent on mining and oil, which exposes the Government to serious economic risks particularly during periods of low mineral prices.

The majority of Mongolian mines are medium-sized deposits. They are predominately legal operations that have obtained exploration and mining licenses from the central government, and have formal permits from the provincial authorities. While the majority of the medium-sized mine deposits are Mongolian-owned, most of the foreign-owned mines in Mongolia fit into this category as well, with Russian, Canadian, Chinese, and Australian operations using the standards and methods employed in their respective countries.

Regarding uranium, Parliament recently passed a Nuclear Energy Law which provides for 51 percent state ownership of uranium mines and processing facilities. It also provides for the establishment of a uranium mining cadaster office which appears to operate in parallel with the Mining Cadaster. This has the potential to create overlaps and a duplication of licenses for a single deposit. There is no clarity on legislative priorities and which piece of legislation has priority.

Coal exports have increased substantially over the last 3 years. A private Mongolian firm, Energy Resources LLC, which holds a license adjacent to TT, is currently developing the project and commenced coal exports in early 2010. Large scale development will be contingent on completion of a railway. Another mine at OT, west of TT and adjacent to Nariin Sukhait, has also commenced the exportation of coal to China and is proposing to build a railway to handle increasing tonnages. Total coal exports exceeded 6 million tons in 2009 and could reach 8 million tons in 2010, although this will depend on road transport infrastructure coping with this level of traffic. Total coal exports could ultimately exceed 30 million tons per year once rail infrastructure is in place.

Mongolia has a large informal mining sector characterized by illegal, artisanal and small-scale mining by individuals and groups, locally referred to as ‘ninja’ mining. It is estimated that there are currently 60,000 to 100,000 such miners extracting a range of commodities from gold to coal and fluorspar with an annual production value estimated at US $140 million. The sector directly or indirectly contributes to the livelihoods of an estimated 10 percent of the population of Mongolia. Mining methods and equipment are poor by world standards and are a cause for concern to the GoM, due to the lack of environmental and safety standards. The miners typically use mercury and cyanide for gold extraction and occasionally explosives under often hazardous conditions. Formalization of the sector should happen soon, as a MMRE official in a recent meeting said that the Minerals Law had recently been amended to regulate ninja miners, ensure their safety and deal with environmental concerns. The amended law should be available by December.

Constraints and Opportunities

According to the WB mining expert, mining sector development is currently limited by the government's inability to establish and maintain:

1) A clear policy stating the role of government in promoting and developing the sector
2) A competitive, stable and predictable fiscal regime for mining
3) A stable and transparent legal and regulatory framework to manage the development of its mineral wealth, protect the environment, and ensure sound corporate governance
4) Policies and procedures to attract and retain world class investors who have the resources, management, and technology to locate and exploit mineral deposits in a sustainable way
5) Efficient mining sector institutions and strong administrative capacity for oversight
6) Appropriate policy responses to, and transparent management of, the expected increases in mineral revenues to avoid the ‘resource curse’ and ensure lasting benefits.

For example, after rescinding the WPT, the GoM is now proposing to introduce a new schedule of higher royalties in order to claw back revenues lost with the repeal of the WPT; further destabilizing the fiscal regime with ad-hoc and poorly designed tax measures.

The WB mining expert believes that Mongolia's current legal, regulatory and fiscal policies were formulated during a period of unprecedented high commodity prices and strong international competition for mineral resources. These policies are not realistic and sustainable in the longer-term, particularly given the recent fluctuations in commodity prices, concurrent with the global financial crisis.

It is not easy to finance projects in Mongolia. The history of legislative changes forced renegotiation of contracts (e.g. Boroo Gold), and claw-back (nationalization) of the TT interest from Energy Resources means that in the minds of many banks, Mongolia has significant sovereign risk. Even western companies such as Toronto-listed South Gobi Energy have had to source financing from Chinese Banks.

The mismatch of the Mongolian population to the needs to the mining industry is another constraint. The GoM with assistance from MCC and the mining companies are working to train Mongolians. However, with the push to move on the projects, many Chinese workers have been employed. Currently at OT on the construction side, there are 2,300 workers; roughly 1,700 of them Chinese construction workers. (The production side of the work has more Mongolians to ensure that OT meets the current 60 percent Mongolian workforce requirement.)

Infrastructure development is also a constraint; the nearest road to OT is 500 miles away. PPPs will be crucial to establish the needed infrastructure. Future developments in the coal sector are now becoming limited by transport logistical problems and cannot grow significantly without rail infrastructure development from the mining areas to the main markets in China.

Located between Russia and China, there are fears that these geopolitical giants will pressure Mongolia in an attempt to gain access to its valuable resources. Mongolia feels the need to be able to ship products to both neighbors is a necessity and therefore is designing what some consider 'extra' infrastructure.

Supply Chain

Developing and strengthening businesses that can service the mining boom will be important for Mongolia to ensure development of goods and services beyond mining and more equitable wealth distribution. Some economists estimate that for every one job in mining, ten are created in the supply chain. Currently, most Mongolians are focused on direct mining activities and mining companies. The GoM is focused on developing over US $20 billion of public investment projects in energy, mining and heavy industry, and roads and transport.

The direct supply needs for mining can be broken down into the following categories:

1) Mining service companies providing drilling, geological surveying and mapping, hiring and recruiting, procurement, and catering. Nearly all of these services are provided by foreign companies in Mongolia, at present.
2) Logistical support including trucking and utilities.
3) Technical supplies including equipment and equipment repair, chemical supplies
4) Consulting services in the areas of geological and environmental management (e.g., water management in the desert, treatment of residues). These services depend partly on GoM policies and regulations.

5) Basic goods and services related to mining expansion including food, clothing, boots, hats, glasses, labor services, etc. OT and other mining companies are working with local producers to supply some of these items.

Beyond the direct level of support to mines, infrastructure support will be needed in the construction industry; roads, railroads, and power and water plants. These activities will again require suppliers, contractors, consulting, and other service providers.

Many ancillary businesses beyond direct mining and infrastructure development can be developed in Mongolia too. These businesses should be based in sectors that Mongolia has a comparative advantage such as agriculture (meat, leather, cashmere), and in services, tourism, and other value added businesses. As the mining sector lifts the wealth and development of Mongolia, increasing demands will be placed on other sectors to meet the needs of these projects and an advancing economy. The GoM is interested in production based businesses, especially downstream processing of mining.

At OT's Economic Impact Assessment Presentation, OT and School of Economics economists projected that the mining, transport, and services sectors will grow dramatically over the next 10 to 20 years as a portion of the GDP, while the manufacturing and agricultural sectors will decline initially and then, depending on how the GoM reinvests their share of the mining profits, may improve. They predict these sectors will decline partly due to currency appreciation and the inability of Mongolian products to compete internationally.

The mining companies are cognizant of the fact that they should be procuring supplies locally and talk about assisting Mongolia to develop a supply chain. However, first and foremost, their business is mining with the objective of making a profit. They claim they are actively trying to purchase supplies from Mongolian companies. However, most suppliers interviewed in the assessment believe they are still more comfortable going to China for the majority of their needs. For example, for OT, Rio Tinto claims they will procure +90 percent of their needs locally. However Fluor, OT's construction partner, estimates that they will spend US $780,000,000 to develop the OT mine in 2010 to construct OT's mining initial needs such as roads, an airport, etc. Of that, currently, Fluor is spending roughly US $1.5 million per month in Mongolia or US $18 million per year which is less than 3 percent of the total amount. (However this could be an underestimate since some Mongolian companies bill offshore to reduce the risk of currency instability, which is discussed later.)

OT procurement officials said prices in Mongolia are generally much higher than in China, delivery time is longer and goods or services are often promised at a certain time and are then not available. They said the few Mongolian companies that can supply them with their needs are so stretched with other mining projects that it is difficult to trust them. They also said that while there are many Mongolian companies listed in the yellow pages in a certain industry, often all the companies are related to each other and so when they win a bid, all the equipment from all the companies will be unavailable. Procurement officials did feel that longer term financing for equipment needs is still an issue.

In the Gobi, the large mines feel confident that small businesses can be created and expanded to provide basic goods such as uniforms, mattresses, gloves, foodstuffs and other non-capital intensive goods. Most mining companies are designing programs to assist small businesses in the area to produce goods that they can purchase. For example, at this level both OT and South Gobi Sands (SGS) is assisting banks with financing small companies around their mining sites. OT is partnering with, and providing US $1 million to give loans to, small and micro businesses.

OT has also set up a business incubator in Dalanzadgad and is handpicking suppliers in the region to supply things like uniforms, safety vests, and other basic needs that are easily made. SGS is providing US $100,000 to Golomt Bank for small and microbusinesses to access loans and have contracted EBRD's BAS program, which is outsourcing at least some of their consultancy work to Development Solutions (the spinoff of USAID/CHF's GER Initiative).

OT community workers, however, expressed the feeling that anyone who wants to be working in the Gobi is already working and it will be difficult to grow businesses there without more migrants. They also thought that loans are not priority, but rather businesses need equipment and improvement in their product quality. This is the case for smaller businesses without major equipment needs.

The GoM is interested in supporting cluster development around mining. They want to be involved at least partly in downstream processing of mining. The *National Champions* (large mining companies) draft law is currently being designed by the GoM; the objective being to support cluster development. Currently the draft bill requires that 75 percent of a company is Mongolian owned, that the company employ a large number of people, and that the company bring new technology to the country. It is not designed to support monopolies. The Champions are then required to support MSMEs within the cluster. The GoM will support the Champions with tax incentives for those businesses meeting the criteria. They will receive disincentives if they do not have modern corporate governance and are not working with SMEs. It is unclear how much support this bill has at the moment or how far it has progressed.

The GoM is also focused on downstream economic activities from mining such as the Sainshand Industrial Complex, a smelter, and construction plants in several cities around Mongolia.

The MFALI that has the mandate to strengthen Mongolian SMEs is providing concessionary loans. They are reported to have US $100 million in a revolving loan fund to disburse, which includes US $20 million from the Japanese will increase to US $50 million next year. The loans are given out through banks at concessionary terms (around 10 percent rather than 18 percent). The MSWL also has funds that are disbursed as loans through banks to create employment.

According to private sector banks that are disbursing the loans, these loans are not solving the problem of growing Mongolian businesses. Banks are extremely liquid and would be making the loans with or without the GoM funding. Other than receiving a bit of a discount on a very high interest rate, the businesses benefit very little.

The policy department of the MFALI focuses on developing agriculture products demanded in the mining sector. However based on discussions with them, they are focused only in the Gobi region around OT and TT. MFALI is working on providing information to the public on products, standards, and on the necessity of working. Most GoM officials interviewed felt that Mongolians need motivation to work.

The BCM, with funding from Ivanhoe, undertook a survey of supply chain companies in Mongolia. The list is on the BCM website and includes 1,500 Mongolian companies[68]. The BCM is not working with the businesses at this point, but has plans to. Ivanhoe funded the initial assessment of the supply chain and Sant Maral managed the assessment. Initially Newcom was interested in developing the information on the businesses into a sustainable database by

[68] http://bcmongolia.org/miningsupply/

linking companies to each other for a fee. However, with a change in management at Newcom, this initiative was dropped. Many of the businesses on the list are very eager for information and to become involved in the supply chain.

The GoM representatives interviewed also talked about the burgeoning business lobby that has begun in Mongolia. There is the *CEO Club* that is made up of the most influential business owners in Mongolia, the BCM that is an association of foreign and Mongolian businesses, and other associations supposedly now lobbying the GoM.

Within the supply chain, there are private equity firms that are looking for capable companies for equity investment. These firms are interested in working with the donor community. Most of the private equity firms are currently interested in supporting mining companies directly for now. However, as the field becomes more crowded, there should be interest in moving into the supply chain.

Most mining companies and larger suppliers expect that major suppliers will soon open offices in Mongolia to service the mining sector directly. These bigger companies will bring in the machinery and equipment needs that Mongolians cannot produce. For larger procurement needs, the mining companies will contact these companies (Caterpillar, Leibherr, etc.) for bids and these companies in turn will contract the smaller companies to be part of their overall bid.

Constraints and Opportunities

There are a number of constraints that keep Mongolian companies from growing to compete in the direct mining supply chain, infrastructure development, and ancillary businesses.

1) 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.
2) Corruption and red tape, gaps in legal and regulatory framework, policy uncertainty and weaknesses in the judicial system affect private firms regardless of the sector they operate in.
3) Management and technical skills presents a significant skills shortage and mismatch in Mongolia.
4) Private sector involvement in policy formulation continues to be minimal and confidence in public sector capacity for efficient service delivery is low.
5) Lack of infrastructure and low population densities make it difficult to run a profitable business from some geographical areas.
6) A lack of GoM policies that support Mongolian business.

In terms of sourcing (goods and services) needs for mining, there is a perception that products can be bought in China cheaper than being sourced in Mongolia. However, this is not always the case and with a few changes in policy, even more can be provided within Mongolia. The more that is purchased in Mongolia, the more services that will need to be based on Mongolia.

There are a number of policies that can be worked on to assist Mongolian businesses improve their competitiveness and support a vibrant mining supply chain. For example, the GoM could enact a preference law for Mongolian registered and VAT paying businesses to assist in development of the mining sector. The GoM could enact a law that provides a certain preference percentage (10 to 20 percent) for Mongolian businesses able to better compete with foreign companies for a limited time. (The larger mining firms have already pledged to pay this premium to support Mongolian businesses.) This would help Mongolian SMEs competing with foreign firms on bids. The GoM could eliminate VAT and import waivers that are given to certain industries and value added and go to a flat import and VAT fee. This would even the playing field for Mongolian companies who are trying to compete with foreign companies that can often bring in supplies without VAT.

The current exchange law places too much risk Mongolian companies given the instability of the tugrik. Currently, when mining companies buy in UB, they are given a 45 day grace period to pay and by law, companies must charge in MNT. Whereas, if a company buys from China most Chinese companies only deliver after payment and charge in Yuan, a more stable currency. To get around this, larger Mongolian companies have created offshore accounts in Hong Kong or other places to bill in Yuan, USD, Euros, or other stable currencies. However, smaller companies do not have the ability to set up an offshore office. It is also necessary to be more transparent regarding ownership. With equity funds coming in to Mongolia, companies will be forced to open up and need to be more transparent on who owns them.

Assisting the GoM in safety, standards, and rehabilitation will ensure miners, transport and other Mongolian workers are better cared for and it will also create a need for new companies in those areas.

An organization of GoM officials, mining companies and other Mongolian businesses or associations acting as an independent board could be organized to identify needs within the supply chain that are not being provided by any existing business. Support could be given to start this endeavor by an existing or new organization. With a guaranteed market for goods or services at defined standards, a limited amount of support from an outside funder would be needed in the short term.

Working at the mezzo level, while there are many donors implementing SME programs that provide limited financing and basic technical assistance to improve businesses, most are not targeting the mining sector as a market. There is an opportunity given the market demands from the mining sector to link projects and the SMEs that they are supporting to this demand. It would require some organization between the mining companies or the major contractors to the mining companies (such as Fluor) and either the SME project implementers or directly to the potential supply companies. If financing is an issue, with a guarantee from the mining companies of the major contractor, most Mongolian banks would be willing to make a loan to the Mongolian business.

Working directly with supply chain firms in trainings on improving corporate governance, creating independent boards of directors and other types of general trainings would be welcomed by the GoM, mining companies, venture capitalist firms, and potentially larger firms up the supply chain. These trainings can have a mentoring component designed for companies that show the most potential.

The possibility of a Global Development Alliance (GDA) was discussed with the OT CFO, Chad Blewitt, based on training companies on how to respond to procurement tenders. It has money set aside for this and wants to help more Mongolian companies become active in bidding for upcoming work.

Selecting an industry or industries to support may also give a donor a high rate of return at this moment in Mongolia as the demand for goods and services is guaranteed. The construction and trucking/logistics industries would provide high employment and need limited technical skills to support. Two Mongolian construction companies were informally interviewed and both described their companies as being Mongolian owned with Mongolian management with most of their workers being Chinese. Both said this is because Mongolians don't want to work in construction. Therefore, depending on the goal of USAID programming (building equity in Mongolian companies or trying to make a more equitable society), the Mission may want to support this industry. Finally, the construction industry in Mongolia historically has been quite corrupt especially in road construction.

Currently, there are many accidents in the trucking industry (as well as in the mining sector). One procurement official said that 10 drivers had died last year on the dirt roads that are being used to truck coal from the Energy Resources site to the Chinese border. This is partly due to driving on dirt roads and partly due to trucks that are unsafe.

National Consensus

There are high expectations for Mongolia's mining sector among the GoM, the general public, and the individual communities around the mines. Expectations are exacerbated by politicians who think of their short term future and make promises to the general public. At the last election, one political party promised MNT 1.5 million per citizen based on mining revenue. Since then, MNT 90,000 per citizen has been distributed. GoM officials report that they may make another disbursement at some point, although they realize that cash disbursements are not economical and will not honor the full MNT 1.5 million pledge. Some vouchers for higher education, however, are planned for students.

Also some mining company officials admit that they have made unrealistic promises in their communities and now have problems with community members. Some have distributed cash to citizens in *aimags*. The MoF said the distributions were illegal, but were helpless to do anything about it. Local governments are establishing development funds and more money will be heading to those funds. The funds are not counted as part of the budget. Local government units are in essence taxing mining companies. State government officials acknowledge that local government officials are being paid off rather than effectively using the funds to help develop Mongolia.

Regarding OT, the GoM and OT's investor agreement includes the formation of a Regional Development Council; the Council will develop the communities around the mine. However, the document fails to designate who is responsible for doing what. The GoM and the local community will use the agreement to hold OT responsible for doing everything while OT will most likely try to do as little as possible. OT for their part is bringing in Business for Social Responsibility (BSR), a company that specializes in working with mining companies and their communities. BSR will do a visioning exercise with the communities to see what their expectations are for the future and how they can get to that future.

Many people (including many GoM officials) reported that they are expecting an 'Erdenet'; meaning a mine that is owned by the state, and that while not always transparent, feeds a lot of people and includes a rotating leader in the mining corporation.

The Asia Foundation began a series of multi-stakeholder meetings around mining that, in 2008, culminated into an NGO called the Responsible Mining Initiative (RMI). The forums brought mining companies, Civil Society Organizations (CSOs), and GoM officials together to talk about mining. The NGO is active today and is trying to disseminate information. However, some see it as a group that represents the mining companies, yet the mining companies now feel it is ineffective. The NGO is walking a fine line also trying to be funded by the three stakeholders. To-date they have received funds from international NGOs, mining companies, and in-kind contributions from the GoM.

Mongolia is also implementing the Extractive Industries Transparency Initiative (EITI). This is a multi-stakeholder initiative with a clear mission and goals. It has a national council and a working group made up CSO, mining industry, and GoM representatives. Mongolia has now prepared and disseminated two reconciliation reports for the 2006 and 2007 fiscal years and is preparing the third report for 2008. The 2007 study included 38 mining companies. Mongolia completed a validation audit of its processes and actions for the country to be classified as EITI-compliant by the International EITI Board. This process was completed early 2010 and Mongolia is currently classified as 'near compliant', pending resolution of a small number of minor issues over the next few months.

The CSOs have formed another coalition called *Publish What You Pay Mongolian Coalition.* The coalition is part of an international network that plays watchdog to mining companies in many countries. Most of the CSOs that are involved in these organizations are environmentally-oriented. Another environmental coalition of NGOs has developed a good working relationship with the MNET. The coalition and Ministry meet regularly to discuss ideas and upcoming legislation.

Erdenes MGL, the state-owned holding company that will be comprised of Erdenes TT, Erdenes OT and Erdenes Shivee Ovoo, as well as other strategic investments that the GoM will be part owner in, will be issuing stock in Erdenes TT to all Mongolian citizens sometime in the future. Currently, 10 percent of Erdenes TT stock will be given to Mongolian citizens, 51 percent will be owned by Erdenes MGL, 30 percent will be sold in an IPO and 10 percent will be owned by Mongolian National Enterprises. While this presents an opportunity for the GoM to provide for the expectations of its citizens, it also presents big risks as many Mongolians do not have the needed information to make informed decisions about their shares.

Constraints and Opportunities

The Mongolian public needs objective information about mining and the future development of Mongolia as well as a way to participate in activities. Education of, and information to GoM officials, communities surrounding the mines, and the general public is critical. Many Mongolians want jobs, yet there is a lack of understanding as to what types of companies and what types of skills are needed to be involved in mining or the supply chain. For businesses, there is also a lack of information on the quality of goods required by the mining companies; small businesses are not prepared to produce the quality needed.

Rural communities, around the major mines, are and will continue to be inundated with new people. For example, Khan Bogd has grown from 800 to 3,000 people in recent years. There are now three factions of the community and many 'newcomers' are not accepted by any of those factions.

GoM officials interviewed for this assessment admitted that more discussion needs to take place between the Government and the business community, including mining companies. There is no trust between the mining companies (especially those that are foreign owned) and the Government.

Media outlets are owned by politicians in Mongolia. Since these politicians are from different parties, the population tends to watch a variety of media outlets to get as much information as possible. It would be difficult to work with media organizations unless the messages were non-political and then it would be necessary to work with more than one. Public service announcements with basic messages may be a good way of getting out some needed information.

While working with CSOs seems like a good mechanism, most CSOs are very weak. Mongolians tend to view them with suspicion. When there are protests, most Mongolians assume the leader is a disgruntled politician. CSOs remain an odd concept to most Mongolians and domestically there isn't a lot of money to support such endeavors.

If a donor wanted to support CSOs, there needs to be short-term, tangible results in the beginning, so that the organization's objectives and the meetings they undertake do not become too theoretical or lack direction. EITI is working because of their objective. While an institutionalized mechanism to work on expectations would be very helpful, it is difficult to do with weak CSOs, politicians, and mining companies that can easily pay off any complainants in the short-term. Choosing topics that could be the basis for regulatory reform would be a concrete way of working with a number of different groups. With some of the issues, more public participation should be encouraged, while in others the GoM with input from the mining companies would be necessary. This activity could be done in coordination with WB's work on regulatory issues in mining.

The creation of a BCM-style association for SMEs could provide many people who want to participate in mining or infrastructure development, a forum to get information and network with each other and possibly mining companies. If the group becomes more organized they could begin lobbying government. Again, it would be important to set the group up with short-term tangible goals to keep participatory levels high.

Universities could also be a good potential partner in building national consensus. More research would need to be done in this area.

Public Private Partnerships

The state policy on PPPs, a Parliamentary decree, was passed on October 15, 2009 and in January, 2010 the GoM passed the Law on Concessions furthering clarifying how PPPs would work.

The current process is that the SPC requests infrastructure projects from the line Ministries. These projects are then sent to the NDIC. The NDIC decides if the project should be a GoM project financed by the state budget or a PPP. If it should be financed by a PPP, the SPC is designated the Agency for administration. The SPC then works with the specific Ministry that requested the project and the MoF to shepherd the project.

Currently, the SPC is working on developing materials to administer the process such as bylaws, tenders, bidding procedures, etc. At present, the SPC has a list of 123 projects from the different Ministries. An SPC official estimated that 80 percent of the projects are from the MRTUD or MMRE.

Infrastructure experts who work for the international donors estimate that implementing a PPP agreement should take 18 months. Mining companies and GoM officials believe the timeline should be much shorter.

The process is being driven by GoM needs and not the private sector. For example, Newcom Company is interested in fixing the Erdenet Airport and is willing to pay to develop the needed infrastructure to begin utilizing the airport. However, the GoM is not interested in this infrastructure and has not responded to requests by Newcom.

Constraints and Opportunities

There are some problems with the current legislation and the situation appears that it will remain muddled in the near future. Problems include:

1. Ministries having more power than the SPC where the current PPP work is designated. It is not clear how the SPC will answer to the Ministries and be able to manage the PPP process.
2. The current law allows SPC to bypass the MoF and go to the cabinet to get approval to finance projects.
3. The GoM will be responsible for guarantees that should at least be shared with the private company.

There is speculation that the MoF wants PPPs to be managed from NDIC. At this point it is not clear whether the responsibility will be moved or not.

While these issues remain, the GoM will continue to make projects work that they feel comfortable with, with or without a well-functioning law. Mining companies and the GoM are anxious to see infrastructure development occur where needed. Therefore, some mining companies, such as Energy Resources, are going forward without an official PPP, but with a blessing from the GoM. Energy Resources awarded the contract to a Canadian company to build the road to China from their mining site. It is speculated that SGS will move forward with building a road in the near future as well. SGS has a draft contract to build a road to China, for which they are paying US $60 million (more than US $1 million per kilometer); they will own it for 20 years. Other nearby coal and resource companies (Mongolyn Alt (MAK) and a Chinese owned coal company) will be charged to use the road.

OT often goes solves problems themselves. For example, on the border, customs officials do not have enough computers or electricity and their working hours are too short. While OT would like to do a PPP and upgrade the border, at this point, OT has loaned customs officials computers and a generator to be able to process the amount of goods coming up from China.

Many donors have been involved in the policy and initial training on PPPs including the WB, IFC, ADB, KOICA, GTZ and USAID. There remains a major need in assisting the GoM in amending the policies, creating regulations and in implementing PPPs. Many donors are interested and willing to assist so there is a need to coordinate donor assistance.

Mining Inflows

Three new funds have been created around mining inflows: two were created by legislation and one by Government Resolution. The *Human Development Fund* was created in late 2009 by law to support all Mongolian citizens. The *Fiscal Stability Fund* was created June 2010 by law to ensure fiscal management principles are adhered to given the pending mineral revenues inflow.

The WB played a role in the creation of this fund. The *Development Bank* was passed in spring of this year as a Government Resolution to assist in the creation of heavy industry and infrastructure.

Erdenes MGL, a state-owned holding company, is receiving state-owned portions of all mining revenues related to strategic mineral deposits. The MoF will receive all other mining revenues (except licensing fees which go to MMRE). Erdenes MGL will then transfer money to both the MoF and the Human Development Fund.

The *Human Development Fund* (HDF) Law was passed in November, 2009 and establishes a fund to ensure equitable distribution of assets from mineral resources in Mongolia. The law also defines the role of a state owned company, Erdenes MGL.

The Human Development Fund is made up of revenue from four sources:

1) State dividend revenues from the development of strategic mineral deposits by the legal entity holding a mining license and proceeds of share sales;
2) State budget revenue part of royalty payments collected from the legal entities conducting extraction and processing activities [on strategic mineral deposits][69]
3) Net profits from investments
4) Parts of prepayments and loans received in relation to the development of strategic mineral deposits.

While Erdenes MGL will transfer monies to the HDF, the MoF is given the responsibility of fund management (Article 8.1). The Cabinet annually approves how much of the Fund resources will be spent.

The structure of Erdenes MGL is defined in the law. It is independent, transparent to the public, and free from influence of businesses, officials, individuals, and political parties (Article 9.1) The Company will have a board of directors with nine members approved by the cabinet. One member will be from the Bank of Mongolia, one from the FRC, one from MoF, and six nominated by the Cabinet. The Chairman of the Board shall be nominated by the board and approved by the Cabinet. The Cabinet appoints the CEO of the company upon the Board's proposal. To date, Erdenes MGL does not follow these regulations. The Law does not stipulate to which Ministry or Agency the company reports. Currently, Erdenes MGL reports to the SPC.

There will also be a supervisory board that consists of five members from Parliament. The Economic, Social Policy and Legal Standing Committee each nominate one member and the Budget Standing Committee nominates two members. Parliament approves all members of the supervisory committee. The Committee is mandated to supervise the company's activities regularly and report to Parliament. It is not clear what is meant by 'supervise'.

Article 13 of the HDF Law mandates that Erdenes MGL can hire an international financial institution to manage the fund through a tender approved by the Cabinet. The selection of the institution will be chosen by a working group made up of representatives from the MoF, the Bank of Mongolia and the FRC. However it is stated earlier in the law that the fund will be administered by the MoF.

The funds will be given to Mongolian citizens in the form of:

1) Contributions to pension and health insurance

[69] Text in brackets not in the Mongolian version.

2) Repayment of mortgage loans
3) Cash
4) Medical and Education Service Fees

In Article 15.2, the law states that upon the Cabinet's proposal, Parliament sets the amount of resources for distribution. Then in Article 17.4, the law says that the Cabinet will approve the regulation on Fund distributions.

In June 2010, the GoM passed the *Fiscal Stability Fund (FSF) Law* to ensure fiscal stability and provide a cushion for mineral price swings. The WB has been working closely with the GoM on this fund. The fund will be made up of revenues from major minerals generated from revenues equal to and greater than 3 percent of the consolidated budget revenue. This will be determined annually by estimating the average pricing using international commodity prices over a number of years.

The law defines the fiscal requirements in creation of the annual budget and of the medium term (three year) fiscal framework. The law provides four special fiscal requirements that are being phased in over the next few years:

1) Planning - based on 'major mineral' prices, comparing the previous 12-year average price against current estimated price. If the mineral generates revenue equal to or above 3 percent of the consolidated budget revenue, the mineral is considered a major mineral and the GoM is required to save this revenue in the Fiscal Stability Fund.
2) Deficit – the budget deficit cannot be more than 2 percent of GDP.
3) Growth – budget growth should be lower than either non-mineral annual GDP growth or average annual GDP growth within the past 12 years. This will force the GoM to save more unless the non-mineral GDP is growing. It will also push the GoM to diversify their economy.
4) Debt – any loans taken in advance of future profits from foreign invested mining entities must be less than 40 percent of nominal annual GDP. This will keep the GoM from borrowing too much from mining partners.

The FSF source shall not be less than 5 percent of GDP. If over 5 percent, the GoM can transfer some of the funds back to the budget as mandated in the Law on Special Government Funds. When the FSF is above 10 percent of GDP, the President of the Bank of Mongolia and Cabinet member in charge of finance and budget shall determine investments to be made from the savings generated by the FSF that exceed 10 percent of the GDP. If they make domestic investments, it will be through the Development Bank as a bond. If they decide to invest overseas, the Development Bank will not be involved.

Within the Law on Special Government, other revenues that will be in the FSF are:
1) Revenues exceeding planned expenditures
2) Budget surplus
3) Special Risk Fund – any remaining funds at the end of the year.
4) Reserve Fund – any remaining funds at the end of the year

Investments may be made to the *Development Bank* in the form of long-term securities. The FSF law also mandates that the sale of these securities can be used to establish a railroad network, oil processing factory and energy power stations or for producing export goods and services that meet international and EU standards.

Other investments will be made by the GoM in foreign markets under contract by the MoF.

Once above 10 percent, funds will go to the *Development Bank*. If the funds are below 10 percent, the GoM can borrow and redirect funds to the *Development Bank* until 40 percent of debt of GDP. If the *Development Bank* wants to borrow beyond this amount, they can borrow directly and it will become a loan guarantee from the Government. Once the FSF is above 10 percent this is not allowed.

Some years ago, the Bank of Mongolia proposed the idea of a *Development Bank* to assist in Mongolia's infrastructure needs. In July this year, after support from JICA, a study of two Japanese Development Banks and the development of a business plan, Parliament supported the idea and provided the initial funding of US $14 million to establish the *Development Bank*. The Bank was created by Government Resolution in July 2010.

GoM officials believe a *Development Bank* is needed because the individual Ministries do not have the expertise to work on investment projects. The MoF staff has the ability to do the investment calculations, but cannot do the needed technical work. The *Development Bank* will also shield the GoM from having to take sovereign debt.

The Bank was formed to assist in implementing Government Action Plans. The current Plan has roughly US $30 billion of heavy industry and infrastructure projects that are to be completed in the next four years. It is estimated that 30 percent of these projects will be funded by PPPs, although the GoM will need funds to complete the non-PPP infrastructure needs.

The SPC and NDIC are currently creating a tender for a competent international management team to carry out the activities of the bank. The GoM officials are aware that the Bank will need very clear CG and they have completed a charter for the Bank that is designed to shield it from political pressure. The selection procedures for the management team will be made up of a working group organized by the Board of Directors of the *Development Bank*, the NDIC, and the SPC. There are no documents on how the Board of the Development Bank will be formed.

The Bank can receive funds from the GoM directly from the budget, through the HDF and FSF. The Bank can also receive funds from international organizations such as the IMF, WB, bilateral loans, and from private investors. Projects will be both bankable projects and non-bankable projects through bridge lending for social projects needed in Mongolia.

Activities of Other Donors in the Mining Sector

World Bank

The WB's activities are in both mining and infrastructure development. Mining activities are divided into the four components below and support activities with four main agencies: MoF, General Department of National Taxation (GDNT), MMRE and MRAM. The amount of funding is US $10 million.

Component 1: Strengthening the Capacity to Manage Mining Revenues and Develop Economic and Sector Policies (US $4.1 million). Support to enhance capabilities of staff to

1) Prepare various mineral sector policies related to sustainable mining development, revenue sharing with sub national levels of government, state equity participation, minerals taxation and exploration
2) Carry out mineral sector financial planning and forecasting

3) Prepare model contracts and investment agreements for future projects
4) Establish a sector communications strategy to convey to civil society, investors, and the political leadership the objectives, outcomes, and policy initiatives resulting from the project
5) Undertake a review of the institutional framework and responsibilities and authorities of the various government agencies engaged in mining sector management.

The Tax Department will be provided support to

1) Prepare new mining tax legislation
2) Carry out a review of Double Taxation Treaties
3) Receive training on mining taxation assessment techniques, including risk assessments; and
4) Carry out full mining and petroleum project tax audits.

*Component 2: Improving Regulatory Capacity to Manage Mining Sector Development (US $3 million)***.** This component will include five main activities

1) Support to MMRE and MRAM to improve the legal and regulatory framework governing the sector especially regarding licensing, environmental protection, social mitigation and mineral sector institutional roles and responsibilities
2) Ongoing support to the cadaster office to complete the establishment and operation of a fully computerized mineral licensing system (i.e., cadaster) and completion of the cadaster regulations
3) Support to MRAM and MNET to further develop the regulatory frameworks for environmental and social management of large- and small-scale mining, including establishment of mine closure regulations and coordination and clarification of mineral sector institutional roles and responsibilities
4) Support staff development and capacity building for effective implementation to achieve improved mineral industry regulatory compliance based on the newly developed regulatory frameworks
5) Supplementing the assistance given by the SDC Small and Artisanal Mining Project to develop environmental training programs for operations and rehabilitation of ASM sites, support the formalization of the sector and outreach activities, including miner education and training, establishment of a database of artisanal and small-scale locations and miners
6) Support to improve the management of mineral reserve and resource data, particularly with respect to strategic mineral deposits, develop an information management policy and support the development of systems for an increase in the scale and scope of data digitizing of the very large stores of geological information.

Component 3: Developing the Capacity for Management of State Equity (US $1.4 million). The component will support the building of capacity and institutional frameworks for the management of state mining sector equity holdings through Erdenes MGL. The component will put in place an appropriate legal framework, governance and oversight structure, financial and fiduciary arrangements, support the training and development of the company's directors, assist the company to prepare for listing on the MSE, and assist Erdenes staff, management and board with advice on investment strategies and project financing, technical training of staff on mineral project evaluation, and financial modeling.

As detailed in the finance section, the WB is assisting the GoM with technical assistance to implement PPPs. The WB will provide policy advice and capacity building to the MoF, SPC and the NDIC to identify projects (total infrastructure needs estimated to cost at least US $5 billion). They are a year and half into the five year strategy and have roughly US $3 million for activities in this area. Currently they are planning to provide policy advice to improve the Concessions Law and establish regulations. They also will provide technical advice in coordination with the IFC to help the GoM actualize three of their PPP projects.

European Bank for Reconstruction & Development

As mentioned in the energy sector, EBRD is active in private sector projects in mining, electricity, and infrastructure. EBRD has invested in two coal mining projects (MAK – US $50 million, Energy Resources - US $120 million) and an oil and gas project (Petro Matad) and is actively pursuing more mining deals.

EBRD also operates the TAM and BAS consultancy projects for businesses to improve their management. TAM is focused on larger businesses while BAS works with smaller companies. Energy Resources recently provided US $100,000 to finance BAS work with companies in the South Gobi to help them participate in the supply chain for their mine. BAS, in turn, hired Development Solutions NGO to provide some of the training courses.

EBRD also has limited technical assistance funds that are used to assist the GoM in specified areas. For example, EBRD assisted in the digitization of Mongolian mineral maps and training of the MRAM staff.

Asian Development Bank

The ADB is implementing infrastructure projects in the South Gobi in coordination with mining companies. With OT, SGS, and Energy Resources, the mining companies are providing the water supply while the ADB is undertaking distribution.

Regarding PPPs, ADB is attempting to be 'drivers of change' through their initial grant projects. They are assisting in the creation of a PPP policy framework, developing PPP regulations and oversight in key sectors, and assisting in structuring pace-setting PPP transactions. They are funding the salaries of two national PPP implementation experts at the SPC to initiate the start-up of the PPP unit and implementation of the plan for the PPP unit within the SPC.

Results to date are:

1) Prepared English language versions of sample PPP tender documents and related assessment procedures.
2) Presented and discussed the projects on the priority list of infrastructure projects approved by the Cabinet most suitable for PPP delivery and how they should be prepared in order for the tender to be successful.
3) Provided training to PPP unit staff on how to successfully prepare and structure PPP priority projects to make them more successful during the tender phase, by increasing private sector interest and participation (and thus competition).

Deutsche Gesellschaft für Technische Zusammenarbeit

GTZ is working with the State Specialized Inspection Agency (SSIA) on the inspection and monitoring of mining sites. They are training and building capacity of inspectors, advising on standards, and designing clearer regulations with MRAM, MMRE and the inspection agency. They are in the second phase of the project that will run through 2012.

GTZ is also working on PPPs with the GoM and supports the SPC with training and other capacity building activities.

Millennium Challenge Corporation

MCC is implementing a TVET Project that will improve technical skills of Mongolians to meet labor market demands in key industries such as construction, mining, electronics, mechanics, and transport. The total budget of the project is US $47.6 million.

The project consists of the following components:

1) Reforms to TVET Policy and Operational Framework
2) Creation of Skills Standards and Competencies System
3) Competency-Based Training System
4) Career Guidance and Labor Market Information Systems Development
5) Improvement of learning environments

The TVET Project will work in 45 centers with an expected enrollment of 50,000 students. Enrollment in short-term training courses is also expected to significantly increase.

MCC is also funding the north-south road which will assist with supply chain activities for mining.

Swiss Agency for Development Cooperation

The Sustainable Artisanal Mining Project works with artisanal miners and is focused on improving sustainable use and rehabilitation of natural resources, and supporting ecologically-oriented social and economic development. The Project works with all stakeholders to ensure that artisanal miners are recognized as responsible members of a key economic sub-sector contributing to sustainable rural development. The project has successfully organized the miners into groups that work with local governments and pay taxes to the GoM. SDC works with the MRAM in this activity. The project began in 2007 and runs to 2012.

The Sustainable Artisanal Mining Project has the following objectives:

1) To improve the development and implementation of a transparent and straight-forward policy and regulatory framework for artisanal mining
2) To improve the formation and functioning of institutional structures and organizations within artisanal mining at all levels
3) To strengthen the capacity of artisanal mining communities to engage in profitable and responsible mining and extended business activities aiming to reduce poverty
4) To empower artisanal miners and other resource users to address and solve ecological as well as social existing and potential conflicts responsibly

It works in four *soums*: Bumbugur and Jargalant in Bayankhongor aimag; Bornuur in Tov aimag and Mandal in Selenge aimag.

Prospects for USAID Involvement

Mongolia continues to change at a rapid pace. USAID's support in technical assistance and advice on policymaking to the GoM is appreciated by the GoM and other international donors because of the flexibility in its programming. The GoM and other donors that provide support recognize that USAID's approach at the policy level has been able to quickly move to assist the GoM when needed.

With the influx of private sector monies coming into Mongolia and given the opaqueness of the situation around mining, there is a major need for donors to coordinate their messages and work with each other, especially in the areas of developing national consensus and in assistance in developing PPPs.

Supply Chain Recommendations

Recommendations for working in the supply chain:

1. Continuation of advice at the policy level in creating a better business enabling environment. Some issues that could be addressed include: the current draft bill on *National Champions*, trans-shipping through China, improving corporate governance, the exchange rate law, foreign worker law, concessions law.
2. Continuation of advice to improve legal and regulatory environment that will promote local procurement and reduce administrative burdens and corruption. For example as discussed above, assist in regulatory simplification in licensing and inspection at the SSIA; implementing a single window concept for business registration, land registration and customs though e-government initiatives. It would be advisable to select a ministry and its implementing arm. For example the SSIA reports directly to the Deputy Prime Minister. The SME department reports to the MFALI. Working on health and safety issues with SSIA and the relevant implementing agencies for mining or the supply chain companies is needed and could assist in expectations as well as improving the enabling environment.
3. Creation of an association for SMEs for the purpose of lobbying GoM, mining companies, and information sharing. The BCM has started this activity with a database of roughly 1,500 Mongolian companies that can be active in the supply chain[70]. Ivanhoe funded the initial assessment of the supply chain and Sant Maral managed the assessment. Most of these businesses have email addresses. If a similar activity can be done with the mining companies, USAID can assist in matching mining companies to supply companies or smaller supply companies to the bigger supply companies in Mongolia. Assistance in providing information, improving the quality of products, meeting mining company standards, responding to tenders, and other needed training/activities could also be provided. USAID can also look at working with banks to assist in financing issues using mining company or larger supply company contracts as collateral.
4. Promotion of a Mongolian foundation that has an independent board to promote innovation in the mining supply chain. The foundation could support new businesses that can be spun off from the foundation after a certain amount of time or that would promote a joint public and private sector support for R&D related to mining. The foundation could work with universities, the EPCRC or other organizations as well as support the private sector.

Developing National Consensus

EPRC is working on educational materials related to mining which is the first step in assisting Mongolians to participate in or at least understand the mining sector and what it means for their community. They are also looking at facilitating the GoM to work with CSOs and designing a grievance process for citizens who have a complaint against a mining organization. It is important that the next project take the activities that EPRC has started and continue to work on this important issue.

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[70] Ivanhoe funded the initial activity and San Maral undertook the survey. The list of companies is on the BCM website.

1. Continuation of the work EPRC has undertaken in education and information dissemination around mining. Work with GoM, mining officials and limited CSOs to promulgate messages about mining to the general public. Consider undertaking a road show to communities with the different stakeholders or hiring a PR firm to help with non-political TV messages about mining for the public. For example, difference between placer and hard rock mining and the environmental issues around each type of mining.
2. Ensure communities, mining companies and government entities enter into a clearly defined agreement on what the expectations, responsibilities and rights of the different organizations are. The Gobi Regional Development Council did not do this and the GoM sees it as a monitoring tool rather than a partnership with the mining company.
3. Support an SME association that works within the mining supply chain; the information on opportunities sent to them becomes a forum for information sharing on mining.
4. Coordinate work with WB on better regulation of the mining sector. This would mostly be undertaken with MMRE and MRAM.

PPPs

As recommended in the energy sector, there is room for USAID to provide technical assistance in the area of PPPs related to mining. To improve PPPs, there should be constant coordination among donors. The GoM needs help with streamlined designed contracts. The GoM is interested in heavy industry and socially-oriented sectors (schools, kindergartens, and hospitals where UNDP is helping.).

USAID should continue the work of EPRC and provide any needed capacity building assistance for GoM staff as to how to implement a PPP. Other activities that will be needed include:

1. Continuation of assistance on the policy side of amending laws, creating regulations and oversight
2. Assistance in project readiness and project specific support in feasibility studies, creation of initial investment memorandums and other transaction support.

Mongolia's Traditional Economic Sectors

The diversity of Mongolia's economic sectors is constrained by its climate, geography, territorial size, geopolitical location, natural resources, cultural heritage and limited market size.

Largely resource rich, the country has, for many years, focused on agriculture, cashmere, mining, and tourism. In the last couple of years, the growth of the mining sector and the investment it has attracted has appeared to result in the much of the country focusing solely on this sector.

Outlined below is a brief analysis of Mongolia's traditional economic sectors. Time was a constraint in focusing significantly on each sector.

Agriculture

Agricultural production, a major source of the country's economic development, faced substantial difficulties in the 1990s during which domestic production virtually collapsed. The GoM took direct and immediate action to halt the collapse of the sector and ensure its further growth. Livestock and croplands were privatized. Various programs were implemented at the national level to increase employment in the sector, address the issues of poverty, withstand natural disasters, introduce new technology and machinery, ensure food security, protect vegetation, and control pests and diseases.

These measures resulted in an increase in agricultural outputs (44 percent since 1995 and 7.5 percent since 2003). In 2008, the share of the agricultural sector in the GDP was 18.8 percent.

Between 1990 and 1996, all state-owned crop farms were put on public sale in an effort to promote private ownership and increased productivity. However, investors avoided this industry, and production dropped steadily in 2000 and 2001. Considering the minimal interest, agricultural production continues to represent a rational resource allocation. The remaining domestic wheat production is supported by Government subsidies. Russia and Kazakhstan periodically provide Mongolia with wheat priced to compete with, or undercut, domestic wheat prices.

Horticulture production is increasingly achieved on small family-owned plots in addition to small commercial greenhouses. Private investment in vegetable production has expanded strongly. This is especially so in areas where the Government does not intervene and in which capital requirements are modest.

Mongolia's small- and medium-scale agro-processing industries are generally not competitive domestically. Therefore, aside from meat, there are no exports. Although Mongolia had a few large agro-processing industries prior to 1990, the combination of outdated equipment and technology as well as the lack of capital caused their collapse.

Agricultural production currently comprises of 31 percent wheat and wheat products, 30 percent meat products, 27 percent dairy products, 2 percent skins and hides, 2 percent fruit and vegetables, 2 percent livestock feed and 1 percent animal and plant oils.

Some 40 percent of the Mongolian labor force continues to be involved in mostly nomadic livestock herding (43.3 million head of livestock in 2008). Almost 8 million head of livestock were lost in the 2010 dzud.

Of the 43.3 million head of livestock in Mongolia in 2008, 46.1 percent were goats, 42.4 percent sheep, 5.8 percent cattle, 5.1 percent horse and 0.6 percent camel. In 2008, Mongolia consumed 8.2 million head of livestock (17.4 percent of total) of which 223,100 tons were processed and 10,200 tons were exported. Only 5-10 percent was processed industrially.

In 2008, there were 172 dairy farms, 48 cattle farms, 57 meat and wool sheep farms, 172 swine farms, 225 chicken farms, 56 bee farms and 10 rabbit farms in Mongolia. 13 percent of intensive farms are in UB and 23 percent are in Tov *aimag*. Demand for chicken and pork is apparently increasing.

Meat exports during the last six years averaged around 7.8-13.1 thousand tons and apparently reached 18,000 tons in 2009. Major export markets include Russia, Japan, Korea, and China. Limited livestock numbers were exported to Russia and China last year. There are 28 meat processing plants and over 70 meat workshops in the country with capacity for 85 thousand tons per annum. Yet processed meat is as low as 7.8 thousand tons. Potential is said to exist for heat processed and frozen cut exports. There are 32 registered slaughterhouses in the country, although only 18 are currently in operation; which have cold storage capacity for 42,000 tons.

There are 90 dairy processing facilities operating throughout the country with the capacity of 70 tons per day (30 million liters per year.) However, only 20 SME processing facilities operate throughout the year to provide milk and yogurt. The MAFLI has recently imported high yield cows and established 6 model farms and 20 cooling facilities with a capacity of 500-2500 liters per shift. Dairy production increased by 24 percent since 2000, but current demand cannot meet supply. The dairy supply chain and distribution are critical issues to overcome in order to serve the domestic market. Dairy companies are apparently able to benefit from tax-free imports on equipment, VAT exemption, interest-free loans, and subsidies for production.

There is a need for further development on international standards, particularly Hazard Analysis and Critical Control Points (HACCP), in Mongolia, although some processors in the meat, fruit juice and other soft drink sectors already meet HACCP requirements.

Manufacturing

The manufacturing sector contributed 6.1 percent to GDP in 2008. Between 1989 and 2002, the manufacturing industry declined significantly. However, there has been a positive increase in the manufacturing sector since 2002.

The manufacturing sector includes production in such industries as food and beverage (34.8 percent), textiles (19.7 percent), and basic metals (18.9 percent) in 2008.

At the end of 2009, the food and beverage industry increased by 63.8 percent compared with 2005. The textile and garment industry increased by 40 percent in 2006 compared with the previous year. The basic metals industry increased 5.7 times from 2002 to 2006. Other manufacturing sectors include tobacco, tanning, printing/publishing, wood processing, and non-metallic mineral products.

Cashmere

After China, Mongolia is the world's second largest raw cashmere producer, preparing around 1,153 tons of cashmere each year. The sector produces 5.3 percent of the country's GDP. There are currently annual reserves of some 6,600 tons of cashmere.

It is estimated that 80 percent of the cashmere produced in Mongolia has a micron of 16.5 and is 35-37 millimeters in length. Compared to Chinese cashmere, Mongolian cashmere is considered to better because of its length but not as fine. Most Mongolian cashmere is rather dark in color (10 percent white, 40 percent reddish, and 50 percent blue). Around 70 percent of the raw cashmere is processed locally (approximately 1,064.4 tons of scoured cashmere, 38.5 tons of spun thread, and 4,529 thousand pieces of woven articles)

There are 82 enterprises with local or foreign investment operating in the sector; 60 percent engaged in scouring and washing, while the remainder processes woven garments, blankets, and other types of finished cashmere products. The quality of scoured cashmere and woven cashmere products meet international standards and many locally made products have international quality certificates. Of 54 cashmere processing facilities operating in the country, 48 are joint investments with foreign countries. Twenty-six of the joint ventures are with China, and others with are with the USA, Japan, Italy, the UK, and Switzerland.

The cashmere sector has developed significantly in the past 10 years; a notable achievement being the successful privatization of Gobi Company in 2007. Seventy-five percent of the company is now owned by Tavan Bogd group, the remainder by smaller private investors. Since privatization, it has invested significantly in new technology, new equipment, and the repair of existing equipment. The company is now primarily focused on the production of finished goods, whereas it used to also sell yarn. They claim to have significantly increased their exports, particularly to France, Germany, Italy and Japan (50 percent through their own label and 50 percent through private labels). They are now seeking to open their own stores overseas: one on the outskirts of Milan and one in Dusseldorf. They work with Italian and Dutch designers.

Goyo appears to work in a similar fashion to Gobi. They are also working with Italian designers and produce both their own and private label products for the same markets. They currently export 30 percent of their production and will shift more of their products from local to export markets (where prices are higher) as demand increases.

Mongolia currently only uses 15-20 percent of its domestic raw cashmere supply. The remainder is exported to China where significant investment has been made into large processing facilities. The economy of scale existing in China has enabled them to compete with Mongolia on the price of finished garments. Mongolian companies promote themselves as not being Chinese but in reality there is still little differentiation in products. Because 65-70 percent of costs are raw supply-related, companies face cash flow difficulties. Little R&D or innovation is undertaken in the sector which could potentially solve problems with goat worms, bobbling caused by varying lengths of cashmere fibers in the finished product, and deterioration of the yarn through bleaching. Little collaboration is undertaken with universities either in design or R&D despite Mongolia having a textiles institute.

Although both companies acknowledge difficulties in collaboration within the sector (more due to the owners of the companies (Tavan Bogd and MCS) rather than the companies themselves), they both highlight their interest in receiving technical support in the areas of production, sales, sales representation, management, branding, market research, and financing.

Wool Processing

The wool processing industry processes more than 20 thousand tons of wool (sheep, camel, goat, yak, camel, etc.). Seventy percent of the wool originates from sheep. Because Mongolian sheep wool is coarse and abundant, it is used for manufacturing felt carpets and rugs. More than 716,000 square meters of pure woolen carpets are produced, 20 percent of which are exported to foreign markets. Sheep wool is also used for felt and boot production. In recent years, the production of wadding items for blankets, mattresses, and mats has rapidly developed. Approximately 40 percent of raw sheep wool is exported, 90 percent to China. There are currently reserves of some 22,000 tons.

Camel wool constitutes an important raw material among livestock products. 5,800 tons of camel wool is prepared annually. More than 34,400 square meters of woolen blankets and 250,000 woven garments are produced annually. There are currently reserves of some 1,300 tons of camel wool.

Yak hair is soft and fine and can be compared with cashmere. Over 300 tons of yak hair is prepared annually. Once used for felt and boot production, in recent years, it has been used for a diverse range of woolen products.

There are 45 factories with domestic and foreign investment operating in the wool processing industry. Of these, 40 percent engage in early-stage processing and 60 percent in the production of final products.

Leather

Mongolia currently produces 9.8 million raw skins and hides, of which 43.8 percent (4.3 million) are sheepskin, 38.7 percent (3.8 million) goatskin and 5 percent (0.5 million) cowhide. The production volume in 2008 represented MNT 3.874 billion. Products valued at US $41 million were exported. This represents 1.3 percent of GDP and 8.6 percent of total exports. Most exports are semi-processed.

More than 58 companies are engaged in the leather processing industry; 20 of which produce finished goods. However, operating capacity is only between 10 and 40 percent of total capacity.

Textiles

Approximately 136 enterprises operate in the textile industry, of which 44.3 percent are fully foreign owned, 37.8 percent are joint ventures and 13.9 percent are domestically owned. Around 20,000 workers are employed in the industry, representing almost 12 percent of the industrial sector’s total workforce.

Tourism

Foreign tourist arrivals in the first seven months of 2010 totaled 307,468. This compares to 250,060 for the same period in 2009 – an increase of almost 23 percent. While such an increase may not be due to an influx of leisure tourists, it is significant nonetheless. It also counteracts the decline in visitor numbers between 2008 and 2009. As the table below shows, the majority of tourists (not leisure tourists) are from China, Russia, South Korea, the U.S. and Japan. The markets have not significantly changed from 2007.

Table 14. Incoming Tourists by Country

Country	2009	2008	2007
Visitors	464850	468765	454576
Tourists	411640	446317	451598
China	232038	196832	211007
Russia	109391	109975	98604
South Korea	38551	43394	43930
USA	11508	12474	12219
Japan	11399	14939	17244
Germany	6995	8027	8250
France	6737	6688	6341
UK	5895	6781	6716
Kazakhstan	5094	5473	4882
Australia	3741	4466	4502
Other	-19709*	37268	33823

Source: Mongolian Tourism Board
* The error in the table is noted but not explained by the tourism authorities

The tourism sector, perhaps given its cross-cutting nature across many other sectors, the egos in play, personal agendas, and the political appointment of mid-level government officials, has not been an easy one for any donor to work in. There have been numerous changes in the past 10 years to the structure of public sector institutions and significant growth in the number of associations and NGOs working in tourism (they now number around 30). Such changes in the public sector are reasons given to the failure of the information centers and web portal established with EPRC support. However, given the history of institutional change, it could be argued that the assistance provided was inappropriate at the time. The goal of creating a public-private body in the tourism sector, the Mongolian National Tourism Organization (MNTO), to bring together the government agencies and associations did not proceed as originally desired. The result is that now there is a greater split within the industry rather than collaboration; another NGO to add to the list rather than consolidation of interests. Support was also provided to establish a Tourism Satellite Accounting System but due to lack of statistics it was unable to be completed.

The government currently has overly ambitious and unrealistic plans to develop Kharhorin into a resort; a project which apparently has received backing from the state budget to the amount of US $500 million. There are also plans in conception stage for the western *aimags*, Gobi, eastern *aimags*, UB and Khuvsgul. Government promotional expenses are anticipated to be MNT 1 billion in 2011 compared to just MNT 200 million in recent years.

The Mongolian Tourism Association (MTA), an association supported significantly under the TCI project, continues to serve more than 200 members and has an independently and transparently elected board. To some extent, their continued success is related to the fact that the long-standing President is also the Head of the Economic Standing Committee. Through his influence, he has managed to devolve a number of former-government responsibilities, such as promotion, to the MTA. They now claim to be self-sufficient financially, although getting fees from their members continues to be a struggle. They now have two additional staff members (one with assistance from GTZ) and a volunteer from Korea. They are also expecting volunteers through AusAid and JICA. They assist annually in the organization of a local trade exhibition, organize events, assist in preparing an industry newsletter, undertake promotional activities overseas (particularly in Japan), sponsor television documentaries, and have been recently announced as ITB (Internationale Tourismus Borse) Cultural partner.

Despite their differences, both MTA and MNTO believe there is still much to be gained from USAID support in the tourism sector, particularly given the obvious attention given to the mining sector. They believe such support would demonstrate positive signals that USAID still believes in the value of the sector and would bring about renewed invigoration

Prospects for USAID Involvement

Mongolia's traditional economic sectors provide opportunities for donor intervention. However, it is not recommended that USAID become involved in any of them in the near future. Reasons are as follows:

1) Donor investment in these sectors is not anticipated to bring about returns as significant as those in the mining sector.
2) The breadth of support required by each and every sector is extensive. Anticipated USAID financial resources would be difficult to stretch to provide tangible results across the mining, finance, energy and traditional economic sectors.
3) Significant donor support has been given in recent years, and continues to be given, to the agricultural, cashmere and tourism sectors without major achievements in terms of revenue or employment generation. Certainly, on a sector and national level, there is little evidence to show the positive impact of donor activities
4) In those sectors that received donor support, many significant issues remain unresolved – institutional capacity, firm sophistication, skills, association capacity, educational quality, standards, marketing capability, etc.
5) Political interest in the traditional economic sectors has been overshadowed by the mining sector. It will therefore be difficult to get support at the highest levels of government.
6) Many of the enterprises working in the traditional sectors are SMEs that are already receiving support through other donor projects

Each of the sectors has its own particular challenges too.

In agriculture, despite national policy striving toward food security and self-sufficiency, the challenge to create a well-functioning agricultural sector capable of reducing dependency on food imports and being able to export significant volumes of raw of processed agricultural products is enormous, particularly given the size of the country, its transport networks and infrastructure, as well as its harsh climate. Efforts have been made to increase the value-added of agricultural products with little success; both TCI and EPRC initially looked at meat exports but then felt the potential results were limited due to the challenges of international standards and transportation.

Mongolia's cashmere is not significantly different in terms of quality to that of China's. Given the economies of scale in China, the significant investment in processing facilities, the better infrastructure networks and the more advanced financial services, Mongolia finds it difficult to compete. Currently, the greatest opportunity for differentiation comes from branding (China having a poorer reputation). However, despite the efforts of EPRC and TCI, the cashmere companies have not been able to work collaboratively together to create a competitive brand. The price for finished garments therefore remains relatively low and demand in international markets, relatively stagnant. Opportunities exist for technical assistance in reaching international markets, R&D, design, financing and management skills development, but without significantly improving the international perception of Mongolian cashmere, such efforts will have limited overall impact.

Although tourist arrivals continue to rise in Mongolia, few of them appear to be 'vacation' tourists; those most likely to travel around the country and spend significantly to benefit local communities. Although, again through TCI and EPRC, donor support has been provided to the sector, many of the challenges identified 10 years ago remain. They are particularly evident in the public sector and include regular changes in institutional structure, the political appointment of civil servants in tourism departments, limited promotional funding and a restrictive air transport policy. Private sector enterprises and associations have continued to develop. However, public sector management of tourism development hinders their progress.

Cross Cutting Themes

Corruption

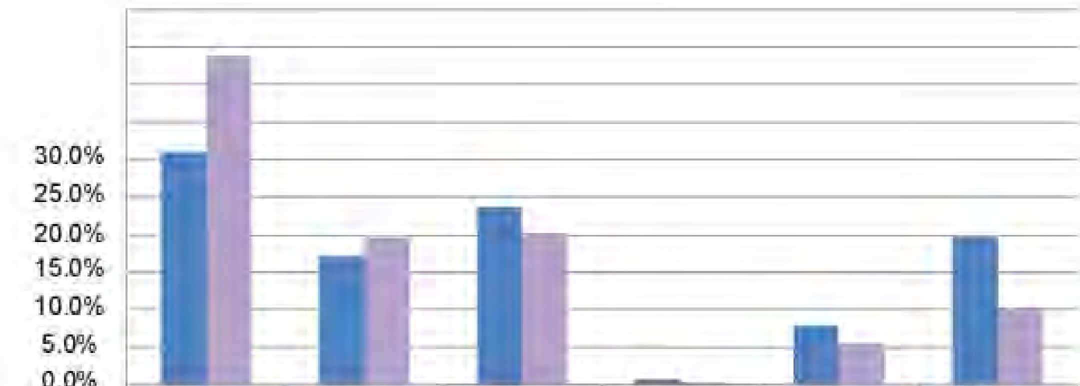
Corruption is inherent, widespread and increasing in Mongolia. The country's rank in the Corruption Perceptions Index has decreased annually since 2005 to its current position of 120th in the world (out of 180 countries). This position is better than that of Azerbaijan, Russia and Kyrgyzstan but equal to that of Kazakhstan and Armenia.

In March 2010, the Sant Maral Foundation in collaboration with the Asia Foundation undertook the ninth semi-annual Corruption Benchmarking Survey (CBS). Conducted twice a year, the CBS provides a unique and robust tool for government policy-makers, enforcement bodies and civil society groups to observe and assess the impact of government and civil initiatives to fight corruption in Mongolia. CBS measures both public perceptions of institutional corruption, and the impact of petty corruption on the day-to-day life of Mongolian households.

Corruption is listed as the third most pressing issue facing Mongolia, although its perceived importance decreased to 10.1 percent of respondents, from 14.3 percent in September 2009.

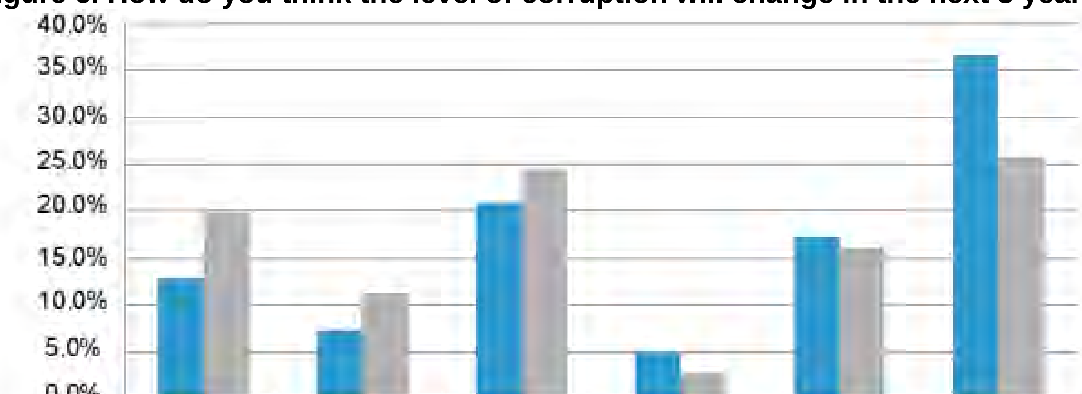
However, although the perception of corruption as a pressing issue had decreased, 64 percent of respondents believed that corruption had increased in the past three years and 31 percent believed that corruption would increase further in the next three years.

Figure 5. In the past three years, how has the level of the corruption in Mongolia changed?



	Increased a lot	Increased a little	Is the same	Decreased a lot	Decreased a little	Don't know / Missing
Sep-09	31.0%	17.2%	23.7%	0.7%	7.8%	19.7%
Mar-10	43.8%	19.7%	20.2%	0.5%	5.5%	10.3%

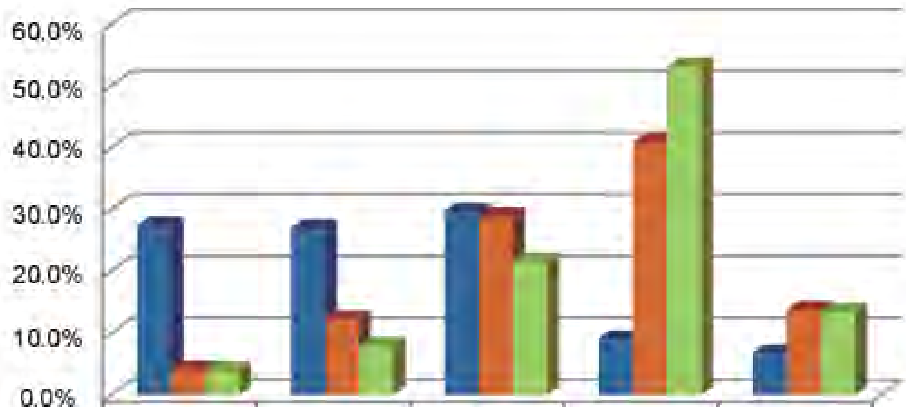
Figure 6. How do you think the level of corruption will change in the next 3 years?



	Increase a lot	Increase a little	Remain the same	Decreased a lot	Decrease a little	Don't know / Missing
Sep-09	12.8%	7.3%	20.8%	5.0%	17.3%	36.7%
Mar-10	19.9%	11.3%	24.3%	2.8%	16.0%	25.8%

Seventy percent of all respondents said that corruption affected the business environment to a moderate or large extent. Seventy-five percent said corruption affected political life to a moderate or large extent.

Figure 7. How much does corruption affect personal/family life, business environment, and political life in Mongolia?



	Not at all	To small extent	To a moderate extent	To a large extent	Don't know / No answer
Personal life	27.4%	27.0%	29.7%	9.1%	6.8%
Business Environment	4.1%	12.3%	28.9%	40.9%	13.8%
Political life	3.9%	7.9%	21.6%	53.1%	13.5%

In the series of nine surveys, respondents were asked to rank public institutions by their level of corruption, including the judiciary, the legislature, the president, political parties, the mining sector, and executive agencies such as the tax office, the police, customs, etc. For the last eight surveys, the land authority, customs, mining, and judges have occupied the first five ranks, in various orders. For the first time, political parties were ranked in the top three. One positive sign was a decrease in the perceived corruption of the police, education, and the health care system, with the police moving downward in the latest survey to rank 8 from rank 3.

Table 15. To what extent do you perceive the following sectors in this country to be affected by corruption?

	1st Rank	2nd Rank	3rd Rank
March 2006	Land Authority	Customs	Mining
September 2006	Land Authority	Customs	Mining
March 2007	Land Authority	Customs	Mining
September 2007	Land Authority	Mining	Customs
March 2008	Land Authority	Mining	Customs
September 2008	Land Authority	Mining	Customs
March 2009	Land Authority	Mining	Judges
September 2009	Land Authority	Judges	Police
March 2010	Land Authority	Mining	Political Parties

Respondents suggested strong punitive measures, improvement in legislation (procedures), increasing public sector salaries, and transparency in administrative decision making were necessary to prevent corruption. Doctors, teachers, administrators, and the police are the most frequent bribe recipients and the average amount paid was MNT 195,000.

Diaspora Engagement

Diaspora communities play an important role in supporting development by transferring knowledge and resources to their countries of origin and integrating these countries into the global economy. Financial flows or remittances are at the heart of the relationship between migration and development. Today, remittances are the second-largest source of financial resources to developing countries, second only to foreign direct investment. According to the Migration Policy Institute (MPI), remittances to developing countries are estimated at US $316 billion in 2009.[71] Although diaspora remittances are sizable, their developmental potential remains largely untapped by international donors.

USAID recognizes that leveraging diaspora communities can significantly increase its development impact. Accordingly, USAID formed the Diaspora Network Alliance (DNA), a framework to facilitate partnerships between USAID, the private sector, donor organizations, and diaspora communities, centered on knowledge generation and engagement to promote economic and social development. Since diaspora engagement is a relatively new concept, the Asia Bureau has primarily focused on outreach. However, the Agency plans to institutionalize this framework including new activities to facilitate direct participation in the capital markets and new guidance that requires an analysis of diaspora engagement in the Country Development and Cooperation Strategy (CDCS).

With the prospect of strong economic growth driven by the mining sector, there is a growing cadre of highly educated Mongolians returning to Mongolia to work in both the private and public sectors. Interestingly, a growing number of returned Mongolians are establishing their own businesses including investment banking services, mutual funds, insurance companies, leasing companies and other NBFIs; the type of institutions that will be positioned to provide the longer-term investment capital needed to support diversified growth throughout the economy. The financial and social implications are substantial, making the diaspora community increasingly critical to Mongolia's development.

According to a local organization, Tsahim Urtuu, there are over 200,000 Mongolians living and working abroad. This includes about 40,000 Mongolians living in South Korea, another 20,000 living in the U.S. and 10,000 residing in Europe. Overseas Mongolians send about US $150 to $200 million in remittances annually.[72] According to the EIU and other sources, remittances have helped fuel GDP growth in recent years. Although Mongol Bank maintains figures on remittances, there is limited data on their full impact.

The GoM has recognized the development potential of diaspora communities and have taken steps to facilitate and leverage their contributions through the recent establishment of a national diaspora engagement program called the 'Bee's Nest'. This program is managed by the Council for Mongolian Expats under the Prime Minister's Office but its activities are jointly organized by the planning agency, the NDIC. The Parliament recently approved a US $1 million budget for the program to attract talented overseas Mongolians to return and provide their skills and expertise to Mongolia's development. The council, in collaboration with local NGOs, will develop an implementation plan over the next few months for engaging the Mongolian diaspora communities.

The Mongolian Bee's Nest program has three main goals:

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[71] MPI, p. 3
[72] Based on data from the NGO, Tsahim Urtuu

1) Establish a database of Mongolians abroad with information on their education and skills which will eventually help match Mongolians with employers
2) Provide incentives and a support network for Mongolians to return by assisting them in securing a competitive job or small business loan
3) Help link qualified Mongolians to jobs in the mining sector.

According to Tsahim Urtuu, one of the implementers for the Bee's Nest program, there are an estimated 40,000 mid-level managers (likely to be an overestimate) needed to serve as specialists in areas such as human resources and finance in the mining sector, but the current skill sets available in Mongolia do not meet these demands. Mongolians educated overseas could possibly fill this employment gap.

Given its development potential, diaspora engagement is a possible avenue for future USAID collaboration. However, further exploration is needed on the type of collaboration. USAID may want to engage with local and overseas organizations to study Mongolian diaspora engagement patterns including the role and impact of remittances. Are Mongolians primarily using informal or formal channels for remittances? Are these remittances linked to financial products? TDB and the Korean Exchange Bank recently launched a service to allow Mongolians studying, working, and living in Korea to transfer money to Mongolia easier and faster.[73] And what is their potential impact on citizen engagement and civil society? Specifically, do the Mongolian diaspora demand more from both the public and private sectors? With such a limited budget, USAID can start by engaging diaspora communities through outreach events and inviting diaspora groups to trainings, workshops, and conferences. Another avenue is to engage the Development Credit Authority in facilitating their direct participation in the capital markets.

Environment

Environmental issues were not investigated in significant detail as part of this assessment. As highlighted earlier in the report, environmental challenges include the harsh climate, industrialization, poaching, illegal logging, over-grazing and mining.

USAID has an interest in environmental protection, global climate change and clean energy. Within the mining sector, recommendations have been made to improve environmental standards, compliance and inspection.

Within the energy sector, recommendations were made to support legislative barriers to renewable energy.

Gender

Women play a critical role in driving economic development throughout the world. According to the *Economist*, the main driving force for global economic growth in the last few decades is the increase in female employment.[74] Empowering women economically has major development benefits. For example, women are more likely than men to spend their income on food, education, and healthcare for their children; creating powerful, positive and measurable benefits to society.[75]

USAID has a special interest in the advancement of women worldwide and is working to improve women's equality and empowerment in developing countries. The Agency is

[73] Mongolia-Web
[74] Economist, "Women in the Workforce: The Importance of Sex," April 12, 2006
[75] ICRW, http://www.icrw.org/employment-enterprise-development

increasingly integrating gender into its program planning process. Although a gender analysis is not required for the purposes of this assessment, it is mandatory for the design of strategic plans and development objectives. With this in mind, the assessment team completed a cursory desk study of the various roles men and women play in Mongolian society, their access to resources, and their participation and power in the economic sector. Due to the technical nature of our meetings, gender constraints did not come up as an issue. However, this is not to say that gender barriers do not exist.

The WEFs Global Gender Gap Index ranks Mongolia 27th in the world for its gender equity; higher than much of Asia and Eurasia. A solid legal framework is in place that supports women's rights and gender equity. Consequently, Mongolian women actively participate in economic, political, and social life. In addition, the health and higher education indicators for women in Mongolia are impressive. Compared to men, women enjoy similar levels of health and have a higher life expectancy. When it comes to education, women in Mongolia surpass their male counterparts. Mongolian women are more likely than men to graduate from high school and they make up almost two-thirds of all students at the university level.[76]

Mongolian women have also taken advantage of the new economic opportunities in the last 20 years. The high education level among Mongolian women resulted in relatively high levels of female participation in the labor force. According to a 2005 USAID gender analysis, women have a higher share of jobs in professional and white collar occupations than men. However, the higher education levels for women have not directly translated into higher salaries, senior-management, or decision-making positions. Mongolian women have lower levels of income for similar work, and higher levels of unemployment and poverty than men.[77]

The USAID, Mercy Corps and ADB reports cited other potential barriers to female economic participation including the following:

- Limited access to assets: In Mongolia, assets are generally registered in the name of the head of household. Therefore land, housing, and livestock are registered under men rather than women. Without clear ownership rights, this may limit the ability of women to use their assets as collateral for credit.[78]
- Under-representation of women in leadership: Women are under-represented in senior management and decision-making positions in both the private and public sectors. Mongolia ranks in 123rd place for the number of women in parliament and 102nd for the number of women in ministerial positions[79]. There is no data to confirm that this is a direct result of discrimination per se but it may be a consequence of traditional perceptions of gender roles and gender-based divisions of labor.[80]
- Increased vulnerability to poverty: Although comprehensive data is limited, the ADB and Mercy Corps findings suggest that women are more vulnerable to poverty than men. The data that they use to assess poverty levels among women is based on information on female-headed households. The conditions of female-headed households provide insights into factors that influence economic and social development common to all women.[81]

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[76] Fitch, p. 9-10
[77] Fitch, p. 4
[78] Mercy Corp, p. 6-8
[79] World Economic Forum – Global Gender Gap Index 2009
[80] Mercy Corp, p. 4
[81] Fitch, p. 6; Mercy Corp, p. 3-5

- Traditional gender-based divisions of labor: Many women still face the extra burden of working at the same time that they are managing the household and serving as the primary caretaker for their children and elderly parents. For female business owners, this limits their abilities to network and expand their business.[82]

USAID addressed some of the aforementioned issues in previous projects including the 'Gobi' Initiative and GER. With such a limited budget, USAID should not look at gender as a topic in isolation. Instead, USAID can leverage its resources by promoting the full participation of women in its economic programs, including encouraging the participation of women in trainings, workshops, and leadership roles. When conducting policy analysis, data should be disaggregated by sex when appropriate, and it should also assess the impact of new policies and regulations on women.

[82] Mercy Corp, p. 8-9

Recommendations

In devising the recommendations outlined below, consideration has been given to:

1) Economic Challenges
2) GoM Priorities
3) USAID Key Considerations
4) Best Practice Lessons Learned
5) USAID Priorities

These have been presented in the preceding sections but are summarized below:

<table>
<tr><th>Economic Challenges</th><th>USAID Key Considerations</th></tr>
<tr><td>1. Economic Diversification
2. Geopolitical Position
3. Inflation
4. Domestic Financial Sector
5. Poverty, Unemployment & Economic Divide
6. Food Security
7. Infrastructure & Transportation
8. Environment
9. Governance & Planning</td><td>1. Continuity & Sustainability
2. Cost Effectiveness
3. Timeframe
4. Timing & Donor Coordination
5. Flexibility
6. Impact & Holistic Approach
7. Political Environment</td></tr>
<tr><th>GoM Priorities</th><th>Best Practice Lessons Learned</th></tr>
<tr><td>1. Competitiveness/Productivity
2. ICT Development
3. Investment
4. Economic Diversification
5. Exports
6. Business Enabling Environment
7. Infrastructure
8. Finance & Banking
9. SMEs
10. Food & Agriculture
11. Tourism
12. Energy
13. Logistics
14. Regional Development</td><td>1. Reforms should be part of an overall BEE strategy
2. Information is critical to effective dialogue.
3. Government and private-sector ownership is key.
4. Local or regional implementation of the existing legal framework may be more important than the reform of national policies.
5. Changing incentives can have a powerful effect on behavior.
6. A successful reform strategy involves building private sector and local government capacity to engage with each other.
7. BEE support structures are key to success.
8. Quick successes generate opportunities for more success.</td></tr>
<tr><th colspan="2">USAID Priorities</th></tr>
<tr><td colspan="2">Program Area 4.6: Private Sector Competitiveness
Program Element 4.6.1: Business Enabling Environment, focusing on adoption and implementation of economic policies related to business, transactions and competitiveness. Specific emphases include the mining sector and ancillary businesses, the banking and financial sector, PPPs, concessions, SMEs, the tax regime and national consensus building.</td></tr>
</table>

Program Element 4.6.2: Private Sector Capacity, focusing on corporate governance, and sector supply and value chains.

Program Area 4.4: Infrastructure, focusing on *policy adoption and implementation* related to urban and rural infrastructure, and energy and transportation services.

Program Element 4.4.1: Modern Energy Services, focusing on Ulaanbaatar's power plants, Gobi Power and alternative energy sources.

Program Element 4.4.3: Transport Services, focusing on roads, rail, air and inland ports.

Program Area 4.8: Environment, focusing on global climate change, with an emphasis on clean energy and adaptation.

Economic Opportunities

Undoubtedly, Mongolia's most significant economic opportunities – the 'windows of opportunity' – lie in the anticipated growth of its mining sector. Despite the involvement of a number of donors in the sector, there is still potential for engagement without donor overcrowding, and the sector is yet to experience 'donor fatigue'. The mining sector has political and public interest, has huge revenue forecasts, has the potential to increase FDI and exports, demonstrates potential growth for subsidiary businesses in the supply chain (particularly those in rural areas), has the ability to encourage innovation and R&D, and constrain rural-urban migration.

Given the size and speed of growth of the sector (led by both private and public institutions), it demonstrates opportunities for tangible results to be achieved within a five year timeframe and provides for flexibility given the wide range of issues that need to be addressed. Because of the national interest in the sector, it has the potential to catalyze the country's competitiveness and productivity, reduce poverty and unemployment, and at the same time, indirectly assist in economic diversification, particularly in the rural areas of the country. The strength of the businesses and business associations in the sector, combined with the influence of large investors bodes well in the creation of greater transparency in the BEE, accountability of government organizations, and the development of CSOs.

As the mining sector leads to increased wealth among the population, disposable incomes will become available to spend on and support other economic sectors. A recent OT economic assessment, anticipating Dutch disease, suggests that in next 10-20 years, the mining, transport and service sectors will increase dramatically, while agriculture and manufacturing will decrease (partly due to currency appreciation and inability to compete internationally). Depending on how the GoM invests their profits, these sectors could then increase again.

However, the mining sector does provide important links to other sectors of the economy with which USAID is interested. For example, although energy supply has been critically low for a number of years, little has been done to resolve the issue. The adoption of the Concessions Law earlier this year now provides the basis for new sources of power generation through PPPs. The demand for electricity is also increasing rapidly, fuelled by mining sector growth. The opportunity to upgrade the grid and power generation systems is therefore greater than at any time in the recent past.

The growth of the mining sector and its supply chains will also increase demand for alternatives to bank financing. Current financial services are short-term in nature, expensive and highly collateral dependent. With incomes anticipated to rise, the demand for other financial products (pensions and insurance) is also expected to rise.

Although there are risks associated with the mining sector, particularly in relation to fluctuating commodity prices, it is believed that efforts to diversify the economy elsewhere are limited and are not well supported by the government. It is anticipated that focusing on mitigating risk will be more effective than specifically focusing resources on other sectors. However, it should be noted that a focus on the mining sector will need to include efforts to limit the resource curse. Mongolia must reinvest their mining revenues into building competitiveness and sustainable economic growth (skills, infrastructure, value chains, etc.).

Project Design

The proposed follow on project to EPRC should have the following features:

It is recommended that the follow on project to EPRC be an economic growth and economic governance project focusing primarily on the mining sector with less but still significant attention to the finance and energy sectors. While previous projects have typically separated economic growth from governance, the two are interlinked and it is recommended that they be handled together under one project.

It is further recommended that the project be divided into the following components:

1) Planning & Policy
2) Institutional Governance & Management, and Administrative Capacity & Procedures
3) Inter- and Intra- Public and Private Collaboration, Coordination & Dialogue
4) University-Industry-Government Linkages, Entrepreneurship & Training
5) Business Management, Corporate Governance & Business Services Development(BSD)
6) Business Association Strengthening

The successes achieved and relationships established under the existing EPRC project should be continued where there is relevancy to the activities outlined further below. These include activities in the trade, tax, energy and financial reform, and corporate governance areas. However, these activities may require some refocus to link them more closely to demand-led reform that the mining sector provides so as to *jump on the moving train rather than the one still standing in the station.*

The next project should focus significantly on building local capacity and undertaking activities *with* project partners rather than for them. Establishing links with Diaspora communities and involving them could have positive, long-lasting impacts. The project should look at cost-effective measures to support the wide range of organizations highlighted. Such support could be provided by Mongolian university graduates looking to get a leg on the career ladder, Mongolian business service providers, the U.S Peace Corps or through other volunteer initiatives. It should work more collaboratively with other donor organizations since a sharing of ideas and coordination of activities will lead to more significant outcomes. After all, a project that promotes coordination and collaboration should show by example. It should also demonstrate an ability to fill in intervention gaps; important areas not necessarily tackled by other donors.

Given the size and relative wealth of many mining sector firms, there is significant opportunity for costs sharing and leveraging, and this too should feature prominently in the project; utilizing the finance of others to achieve objectives. There are also significant opportunities for GDA activities that the project should seek to establish through corporate social responsibility initiatives on the part of the firms.

Proposers should be encouraged to demonstrate sound knowledge of previous donor initiatives (those that have worked well and those not so well) to avoid duplication of past failures. Whilst best practice is important, proposers should acknowledge that the time has to be right to introduce new ideas and concepts to the country.

A number of the activities suggested for intervention below may have changed or be unnecessary by the time the follow on project starts. Therefore, flexibility remains a key factor.

Lastly, project efforts must be linked to GoM goals and objectives. Improving economic governance will be easier if the project is seen to support GoM initiatives. Activities will be focused on private and public sector stakeholders.

Proposed Future Program Areas

This report recommends that USAID establish a BEE project primarily targeting reforms in the mining sector, acknowledging that by so doing, it will become the foundation and catalyst to achieve their broader objectives (including those in the finance sector and to some extent energy sector). The project will work very closely with and complement other donor efforts, filling in intervention gaps and supporting realistic GoM goals and objectives.

The project should initially focus on rapid implementation and quick results to open opportunities in other areas.

An outline of elements of the proposed project is presented below. Specific actions are listed, although some of them will need to be reviewed at the time proposals are devised as the situation may have changed.

Scenario Planning

As the study of Mongolia's energy, BEE and mining sectors shows, there is a lack of serious and comprehensive planning and prioritization by the GoM. This is partly due to a lack of capacity amongst civil servants, but largely because the economic path the country is traversing is unknown. The speed with which the mining sector has developed over the past few years has been rapid. GoM policy responses demonstrate that they are largely reactive to economic challenges rather than proactive (as evidenced by the significant legislative changes made to support the mining sector in recent years). They are clearly unaware of what the economic environment may be like in five years' time and therefore what policies will be required to fulfill the opportunities that present themselves.

Traditional forecasting techniques often fail to predict significant changes in a country's external environment, especially when the change is rapid or when information is limited, as is the case in Mongolia. Consequently, important opportunities and serious threats may be overlooked. Scenario planning is therefore a suitable tool; designed to deal with major, uncertain changes in the external environment. Initially used in military strategy studies, scenario planning is not about predicting the future. Rather, it attempts to describe what is possible. The result of analyses is a group of distinct futures, all of which are plausible. The challenge then is how to deal with each of the possible scenarios. The scenario development process involves a diverse range of stakeholders with the aim of bringing together a wide range of perspectives.

With a better understanding of plausible futures, the GoM will then be in a better position to review their current policy frameworks and plan for the mid to long-term future, not only in economic terms, but also in regard to social welfare.

Specifically relating to the mining sector, it will take into account the risk associated with commodity price decreases and what realistically needs to be undertaken to minimize these risks. A scenario planning exercise, as well as being critical in framing mining policy, will also be useful in determining and/or confirming future needs in the energy and domestic financial sectors. It is therefore a useful cross-cutting exercise.

Proposed Actions

1) Undertake a scenario planning exercise to establish plausible outcomes for Mongolia's current economic trajectory. Focus particularly on the outcomes in the BEE, mining, energy and finance sectors
2) Utilize results of scenario-planning exercise and work with stakeholders in the mining, energy and financial sectors to devise strategies or plans, as well as project work plans, to ensure appropriate policies and legislation are put in place (or removed) to facilitate opportunities and minimize risks.
3) Share outcomes of scenario planning exercise with other donor organizations and government organizations
4) Involve government representatives, NGOs (such as EPCRC) and universities in the scenario planning process in order that capacity is strengthened to undertake similar planning exercises in the future

Planning & Policy

As indicated above, the GoM struggles to be proactive in its policy development. This is particularly relevant in regards to the institutions responsible for mining, finance and energy. For example, in the mining sector, there have been sporadic legislative amendments in relation to the Windfall Tax, Law on Roads, Law on Water, VAT Law, and Income Tax Law – all reactive rather than proactive. There are also clearly issues with the Law to Prohibit Mineral Exploration and Mining Operations at River Headwaters, Protected Zones of Water Reservoirs and Forested Areas that could leave the GoM US$4.7 billion out of pocket! The GoM is now planning to increase royalties from mining because of losses in windfall tax. According to the WB, mining legislation, regulations and fiscal policies were devised when commodity prices were high and are no longer realistic or sustainable in the long-term.

The NDIC, through the MDGCDS has outlined areas for GoM intervention in various areas of the economy. However, these interventions or objectives are not prioritized, no indication of clear timeframes is given, resources are unclear, and the methodology to meet objectives is not established. There is therefore a need to work with relevant ministry departments and agencies (as other donors are doing for some parts of the MDGCDS) to turn objectives into tangible action plans that take into account capacity of civil servants, the timeframe required to improve capacity, resources available, obstacles that will be faced, any lack of skills or abilities, etc. These plans or strategies needn't be long-term but focus on incremental steps necessary to move toward implementation, and establishing greater capacity and knowledge.

Policy-making efforts are rarely undertaken transparently; little public consultation is involved. This is evident particularly in the mining sector, which has perhaps contributed to mining being ranked second in terms of corruption in the business environment. Policy making needs to be made more inclusive; integrating efforts of other government organizations, think tanks, NGOs (such as EPCRC), the private sector and universities. The policy-making process must also examine existing legislation so as to avoid issues such as that of mining licenses in protected areas and the overlaps created with regard to uranium mining (the likelihood of needing licenses from the mining and uranium cadasters).

Considerable policy work has been undertaken by EPRC, in collaboration with the Bank of Mongolia and the FRC in the area of financial sector policy, as well in energy regulation. The relationships established, and successes achieved should be continued in order to transform policy and regulation into tangible actions and implementation.

Given that 40 percent of companies believe financing to be a major constraint in the business environment, the financial sector is also one that requires particular attention. Economic growth, particularly in the mining sector, requires long-term, affordable finance that is not collateral dependent. There is already significant SME financing through the banks, so this is not an area of concern. Support will be required in regard to NBFIs (particularly pension schemes and insurance products), finance and banking policy, and bank restructuring.

Proposed Actions

1) Provide guidance on revising general policy-making processes to ensure greater collaboration, dialogue, public consultation and transparency
2) Based on the strategies developed for the mining, energy and finance sectors, formulated from the scenario planning exercise, assist ministries and agencies (NDIC, MMRE, MMRA, MoF, ERA, SPC, etc.) to develop, refine and amend existing policy, legislation and regulation in each sector; taking account of existing legislation that may impact on the reforms
3) Prioritize reforms, examine resource requirements (financial, human capacity), implementation needs (regulations, administrative procedures, enforcement, etc.) and implications for other aspects of the BEE (investment, trade, tax)
4) Specific support may be required for:
    a. Implementing the amended Mineral Law that provides for greater safety and environmental protection in relation to ‘ninja mining’
    b. Understanding, revising and implementing mining inflows legislation and instruments; the Development Bank, Financial Stability Fund and Human Development Fund (coordinating with the WB)
    c. Increasing corporate governance in mining, energy and finance sectors (coordinating with the WB)
    d. Implementing or amending the proposed National Champions Law that incentivizes efforts by mining companies to increase local employment and technology absorption through tax incentives
    e. Resolving the issue in the OT and GoM agreement relating to Regional Development Councils and the role of both organizations
    f. Revising policies to support local over international procurement of mining products and services, and growth of domestic over international private sector mining enterprises

g. Reviewing and revising policy and legislation relating to foreign workers, exchange rates, corporate governance, investment, mining health and safety, and environmental standards and inspections
h. Assisting the Mongol Bank in bank restructuring, harmonizing monetary and fiscal policy and improving regulation (in coordination with the WB)
i. Implementing the banking law, securitization law and pledge law (in coordination with ADB).
j. Establishing a movables property register and secured transactions regime (if pledge law is adopted) and assisting financial intermediaries in how to use the system (in coordination with EBRD)
k. Assisting in the development of a government bonds market, ensuring it is introduced in an orderly manner with rapid expansion into corporate bonds, asset-backed bonds, housing finance bonds and sub-sovereign bonds
l. Developing and implementing a three-pillar pension system as an initial step toward a private pension system, in partnership with the MSWL. Focusing on legislation, advisory support to parliamentarians and the creation of an action plan
m. Examining the potential for pursuing affordable housing finance for improving energy efficiency in residential dwellings (in coordination with MCC)
n. Investigating appropriate areas for mandatory insurance legislation and the development of relevant legislation
o. Assisting the Financial Stability Committee in harmonizing fiscal and monetary policy

Institutional Governance & Management, and Administrative Capacity & Procedures

The drafting and adoption of laws and regulations can be meaningless unless capacity exists within the institution or the staff working at that institution, to effectively understand and communicate the provisions of the legislation, productively and efficiently implement provisions, work collaboratively with the private sector, monitor and evaluate the process of implementation, or ensure enforcement of regulations.

The mining sector has recently observed the adoption of a number of policies and laws; the Fiscal Stability Law, Concessions Law, Development Bank, etc. All these have had donor support in their drafting. However, it is not clear to what extent those in the relevant line ministries or agencies understand or have the ability to enact what was adopted.

Technical assistance should be aimed at strengthening the capacity of civil servants to better understand their roles and the work they are supposed to undertake, the best methods to undertake their work, and ensure that they have the necessary resources and support to do their work. At the same time, management within the civil service needs to improve HR practices to motivate their staff to be productive and effective.

Corruption is rife within the country; as shown by national (30 percent of businesses indicating corruption to be a major obstacle in the business environment) and international studies. Efforts have been made to increase transparency, accountability and good governance, but the situation is getting worse, particularly in regard to perceptions of corruption in the mining sector. Therefore, it is recommended that USAID employ a new approach to tackling this issue; investigating, and better understanding the psychology of the workforce that leads them to be corrupt, particularly civil servants, and then tackling the psychology behind corruption.

Prioritization should again be focused on those institutions related to the mining, financial and energy sectors; and institutions that show dedication to change, transparency, quality leadership, and potential impact from change. Positive changes in the ministries and agencies that deal with mining and finance, will likely impact the sectors for which they also have responsibility.

Proposed Actions

1. Employ an 'economic psychologist' or 'behavioral economist' to understand the reasons behind the inherent corruption within Mongolia and devise strategy to change the way individuals behave and think in relation to their work
2. Strengthen capacity of civil servants of ministries and agencies working directly or indirectly in the mining/finance/energy sectors. These may include MMRE, MMRA, GDNT, GASI, FRC, ERA, NDIC, MoF, and BoM. Assistance should be focused on:
    a. Increasing motivation and enthusiasm of staff, utilizing modern methods of work, instilling concepts of accountability, nurturing leaders and champions
    b. Increasing professional and technical capacity of staff through on the job training, mentoring, consultancy and external training courses
    c. Reviewing and understanding job descriptions
    d. Working with management to develop sound HR practices, work incentives, career development paths, appraisal systems,
    e. Working with management to improve organizational structures and financial management practices
3. Develop regulatory, supervisory and monitoring functions of ministries and agencies, and standards, particularly:
    a. Strengthen regulatory capacity in mining sector (within MMRE and MRAM) in regard to licensing, environmental protection, social mitigation, institutions, staff capacity, environmental training programs, artisanal mining database, monitoring & inspections (in cooperation with GTZ)
    b. Strengthen regulatory capacity and create standards in the finance sector (within the FRC) with regard to supervisory capacity, enforcement, legislation harmonization, and the development and regulation of NBFI products
    c. Supporting changes to the banking law and regulations in regard to prudential regulations, asset clarification, and licensing.
4. Advocate for, with sound justification, reform in specific sectors to prevent political appointees at mid-level positions
5. Seek to significantly improve administrative procedures and processes within government agencies and ministries so as to reduce numbers of documents required, procedural hoops, timeframes, administrative costs, regulatory burden, etc.
6. Introduce to relevant government organizations, the various alternatives for private sector financing mechanisms, including direct investment, PPPs, equity investments, joint ventures, BOO, BOOT and the benefits/disadvantages of each
7. Enhance public and private sector understanding of PPPs, assist in reviewing PPP proposals and designing feasibility studies, develop PPP financing strategies, provide preliminary transaction advice, and advise on strengthening policies, concluding agreements and implementing PPPs. Support could be directed to a number of organizations including SPC, MoF, MMRE and NDIC. (Coordinate with WB and ADB)
8. Assist in clarifying roles in PPPs between the MoF, SPC and ministries
9. Work with KOICA to improve IT administrative procedures, software, networks and capacity within specific ministries and agencies

10. Seek to support the one-stop-shops, created in the aimags with support of SDC and GTZ, in providing relevant advice and support to mining supply-chain companies
11. Seek coordination between ministries, agencies and FIFTA to develop a policy for mining investment, including activities to be undertaken, target markets, promotional activities, investment incentives
12. Assist FIFTA and/or other government organizations in developing investment registration system
13. Support *aimags* and *soums* with regard to budget and financial management to enable them to manage increasing devolution of tax revenues to the *aimag* and *soum* level.

Inter- and Intra- Public & Private Collaboration, Coordination & Dialogue

Various indicators suggest that public and business trust of the government is low and that public sector institutions provide poor quality services. There is also a lack of trust between the large mining companies (particularly those that are foreign-owned) and government. These issues will be partly addressed through improved administration, capacity and governance. However, what is also important is the means with which the government collaborates, coordinates and communicates with the public, business community, as well as internally.

Project efforts should therefore support collaboration, coordination and communication between and among various entities: government, parliament, private sector enterprises, private sector associations, think tanks, research organizations, universities, diaspora communities and donor organizations. There are various methods and vehicles that can be used, including the media, but it is important to point out that, whilst there may be agreement in the need, and willingness for, collaboration, coordination and communication, capacity may be limited. Training may be required as well as facilitation.

At this stage, it is not recommended to establish a high level Competitiveness Council or similar organization. However, a bottom up, demand-led coordination mechanism could lead on to bigger and better frameworks in the future.

Proposed Activities

1) Seek to strengthen formal and informal relationships between stakeholders in the mining, financial and energy sectors to improve dialogue, consensus building, understanding, trust, accountability and partnership, through training and facilitation
2) Continue EPRC efforts in assisting Mongolians to understand the mining sector and what it means to their community. Assist the average Mongolian, through CSOs, on practical information – where to get jobs, skills needed, etc. – and supply chain companies on how to work with larger mining companies. Activities could include the organization of a mining road show or TV programs
3) Collaborate in similar efforts undertaken by the WB (mining communications strategy for investors, government and civil society)
4) Build and strengthen partnerships between local communities and mining companies
5) Continue capacity building of the media in order for them to report objectively and accurately on mining issues
6) Assist public and private sector organizations in collecting, obtaining, analyzing and disseminating pertinent information about the mining sector

University-Industry-Government Linkages, Entrepreneurship & Training

Though MCC are making efforts to improve TVET in the mining and energy sectors (reforms, operational framework, skills standards and competencies system, competency-based training system, labor market information system), little appears to be done at the higher education level and with research institutions.

Given that universities and TVET providers are responsible for providing the country's future workforce, it is important that they are closely linked with the private sector and government while the students go through their education; not just handing them over when their education is completed.

For Mongolia to advance its mining sector it's also important for universities and research institutes to become involved in innovation and research projects either directly related to mining or within the mining supply chain. Further research will need to be undertaken to understand the opportunities that may exist, particularly those relating to IT. It may be worth engaging KOICA in this activity.

Opportunities may exist for involving the diaspora in training the workforce.

Proposed Activities

1) Better prepare university and TVET graduates for employment through the introduction and continuation of internships with mining companies and supply chains
2) Utilize the skills of MBA graduates in undertaking BDS assignments for mining, mining supply chain, energy and financial services companies. Recent graduates should be encouraged to undertake business planning, strategy development, feasibility studies, market research, financial modeling and other tasks for companies pro bono as a means to gain experience
3) Encourage private sector engagement with universities through lecturing, organization of research projects or competitions, etc.
4) Establish careers guidance services or events within engineering and finance faculties to provide information and guidance on identifying and working with mining and financial services companies
5) If not already undertaken, assess skills and knowledge needs within the mining and mining supply chain in order to better understand training needs and educational curricula amendments – focus on mining services, logistics, technical supplies, consulting services and basic goods and service providers
6) Seek to integrate training components within PPP and financial agreements in order to build the skills of local professionals and manual labor
7) Seek to establish, through training and study tours, a pool of local experts in the mining and energy sectors than can advise government on policy, legislation and administrative issues
8) Work with existing donors to establish and support entrepreneurship program or business incubator in the mining, financial services and energy sectors.

Business Management, Corporate Governance & Business Services Development

The mining sector requires professional enterprises in the supply chain. As the research team identified, despite significant attention being paid by donors to the broad SME sector, little attention has been given specifically to mining supply chain SMEs. The larger mining companies wish to procure more locally (rather than from China) but report that in Mongolia, delivery times are longer, deadlines are poorly met and a lack of qualified firms results in poor service delivery (as the competent smaller firms are overburdened with orders)

In order for the larger mining companies to want to work with Mongolian SMEs, these enterprises need training and capacity building in a number of areas: understanding market demand, customer service, procurement processes (including responding to tenders), quality assurance, productivity, attention to deadlines, customer orientation, business management, corporate governance, and accountability.

With the anticipated growth in non-bank financial products and services, there will also be a number of new enterprises being created that will need both technical and management support.

Skills and experience can be transferred through a variety of means; training courses, mentoring, study trips, on-the-job training, online courses, self-study materials, etc. Strengthening the capacity of business services providers and linking them with mining supply chain companies, with larger mining company support will help to bolster professionalism and skills.

Proposed Activities

1) Seek to work with JICA (through their efforts in business diagnostics and business training), UNDP Enterprise Mongolia, GTZ and Mercy Corps to direct their efforts at SME development and capacity building to the mining supply chain enterprises
2) Support larger mining company efforts or activities of BAS Programme and Development Solutions to engage and subsidize training and provide consulting for local supply chain enterprises
3) Undertake a BSD needs assessment and supply chain analysis among mining, mining supply chain and financial services companies to identify specific areas of consulting and support
4) Seek to strengthen applied knowledge and skills of business service providers to engage and benefit mining supply chain and financial enterprises, either through mentoring or short term apprenticeships in activities involving international consultants.
5) Support EBRD BAS Programme's efforts in strengthening the capacity of the Mongolian Management Consultants Association. Work with the Association to integrate and strengthen their skills within the mining supply chain sector and among financial enterprises
6) Widely promote the benefits of business services within the mining and financial sectors
7) Facilitate training in financial reporting, auditing and valuation and seek to amend accounting standard to comply with international norms (perhaps in coordination with universities.
8) Facilitate linkages between investors seeking equity investment in mining supply chain companies
9) Promote and facilitate training/public education in financial literacy/financial management, particularly to guide the public on what to do with the vouchers due to be provided and the potential distribution of mining shares.
10) Provide support to corporate finance providers to establish capital pools outside of banks and deploy that capital into investment. Support could be provided in areas as diverse as developing government, municipal and corporate bonds and support for prospective institutional investors such as private pension funds and insurance companies.

Business Association Strengthening

Business Associations provide an important function in representing the combined views of, and advocating on behalf of, its members. Although the BEE assessment observed the limited capacity and limited ability to develop capacity within a number of Mongolian business associations, there were exceptions. One of these is the relatively new BCM, which has its own sub-committee devoted to the mining sector. In fact the majority of members in the association are actually mining companies.

Given the significant number of large and foreign-owned enterprises in this and the MNMA, there is a level of professionalism within the boards and management that strengthens their sustainability and ability to add value to the services they provide to their members. These services may also include the provision of market and industry information and training.

Other associations with a role to play in the mining sector are not as strong, such as the Responsible Mining Initiative, which appears to lack support from mining companies, even though many assume it largely represents their views, and the ‘Publish What You Pay’ Mining Coalition.

There is also an identified need to create an association to represent the views and interests of the 1,500 supply chain enterprises identified through a recent study. Although the risk associated in supporting the creation of such an association is high, it appears that the larger mining companies are supportive, for their own interests, and wish to become involved.

Within the financial sector, EPRC has provided support to the Centre for Banking and Finance, a bank member-owned NGO to serve the training and certification needs in the sector.

Evidence from best practice examples and earlier projects suggests that the way in which a project works with associations is critical. Growth must be member-led with donors providing a supporting rather than leadership role. A positive sign is the apparent willingness of the GoM to engage with professional business associations.

Proposed Activities

1) Support and facilitate the creation, in partnership with some of the larger mining enterprises and with the assistance of BCM and MMRA, an association of mining supply chain enterprises based on the list of 1500 companies already identified by Ivanhoe
2) Create support structures for the association that enables them to obtain advice and guidance from universities, think tanks and other relevant associations.
3) Assist the newly-create association in lobbying, information gathering and dissemination, coordinating with mining sector organizations, training of members, networking with larger companies, holding seminars, and providing or facilitating BDS
4) Support the implementation of training in the Centre for Banking and Finance.

Assistance to Specific Organizations

Based on the research undertaken by the assessment team, the following organizations could be considered for support:

1) Bank of Mongolia
2) Business Council of Mongolia
3) Centre for Banking & Finance
4) Economic Policy & Competitiveness Research Centre
5) Energy Regulatory Authority
6) Financial Regulatory Commission

7) Foreign Investment & Foreign Trade Agency
8) General Agency for Specialized Inspection
9) General Department of National Taxation
10) Mineral Resources Authority of Mongolia
11) Ministry of Finance
12) Ministry of Foreign Affairs and Trade
13) Ministry of Justice
14) Ministry of Mineral Resources and Energy
15) Ministry of Nature, Environment & Tourism
16) Ministry of Social Welfare and Labor
17) Mongolian Management Consultants Association
18) Mongolian National Mining Association
19) National Development and Innovation Committee
20) National Statistical Office
21) Publish What You Pay' Mining Coalition
22) Responsible Mining Initiative
23) State Specialized Inspection Agency
24) State Property Committee

Notes

Although the Energy sector of the report suggested involvement in energy data monitoring and demand forecasting, it also indicated that this would form part of an energy assessment to be undertaken by ADB. The same assessment is also due to evaluate opportunities for energy efficiency in large buildings, another suggestion made by the energy consultant. MCC and GTZ are also engaged in energy efficiency initiatives.

Since funds would not be available through the project for implementing any large-scale projects in the energy sector it is not recommended that USAID engage beyond those areas listed above, since otherwise it may be difficult to see initiatives through to a satisfactory conclusion.

Project Goals/Targets

Project goals should focus on the enterprise, sector and economy as a whole:

Enterprise Level

1) Increase in number of SMEs operating in the mining supply chain
2) Annual increases in revenue and in contracts signed between Mongolian mining supply chain SMEs and mining companies
3) Increased information availability and use among mining supply chain companies
4) Decrease in proportion of Chinese procured products and services
5) Increase in businesses sourcing non-bank financial services
6) Market linkages created between mining firms and mining supply chain SMEs

Sector Level

1) Removal of mining sector from the top five areas of most significant corruption as indicated by the Corruption Survey undertaken by the Asia Foundation and Sant Maral Foundation
2) Major projects undertaken collaboratively with other donor organizations
3) Business association established for mining supply chain SMEs

4) BSPs providing portfolio of services specifically for mining supply chain SMEs
5) PPPs established through project intervention
6) Linkages established between government, industry and universities
7) GDA Proposals submitted

Economy Level

1) Increase in ranks and/or scores within the GCR, GETR, GGCR, WB Enterprise Surveys
2) Increase in rank in the Corruption Perceptions Index by a minimum of 10 places
3) Decrease in unemployment in those Mongolian Aimags that have significant gold and copper mines / increase in employment
4) Major legislative and policy reforms adopted, implemented and enforced
5) Diaspora linkages established
6) New HR and organizational practices established and operational in ministries or agencies
7) NBFI established and operational (bonds, pensions, insurance)

Monitoring & Evaluation

A Performance Monitoring Plan will be critical to measure the ongoing and final results of the project, and should measure quantitative and qualitative impacts at the business, sector and economy-wide levels to match with the project goals and targets.

Baseline data should be collected upon commencement of the project and data gathering techniques employed on a regular basis throughout the length of the project using primary and secondary research methods.

At the individual enterprise level, those businesses and GoM organizations that are provided with extensive assistance must be encouraged to provide data on employment, revenue or services provided.

At the sector level, quantitative data should be collected on employment, revenues, exports, labor productivity, investment and other measures suggested by proposers. Qualitative data should be collected from both public and private sector enterprises on perceptions and opinions relating to efficiency, bureaucracy, timescales, corruption, accountability, communication, technology use, satisfaction of civil servants and institutions, BEE variables, etc. Primary and secondary research methods can be employed at the sector level.

At the economy-wide level, secondary data can be used to measure tangible impacts. These could comprise statistics from the NSO and the various indices compiled by international organizations such as WB, WEF, Transparency International, Heritage Foundation, etc.

Economy-wide data should be benchmarked with other appropriate competitor and comparator countries to measure Mongolia’s performance against others.

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Annex 3: Major Minerals in Mongolia

Mineral	Geology	Geography	Production
Gold (Au)	Mineralized deposits Gold Bearing Veins Placer deposits	There are ten major gold bearing areas in Mongolia, with the main recoverable reserves are mineralized zones and placer deposits.	Gold production grew significantly between 1990 and 2005, with 24.1 tons of gold produced in 2005. Data suggests this trend has declined in recent years due largely to the introduction of the windfall tax, however it is speculated some mines engage in practices to avoid paying the tax and production levels have not decreased.
Copper and Molybdenum (Cu-Au-Mo)	Copper-molybdenum (Cu-Au-Mo) mineralization mainly occurs in three types, including copper (Cu) porphyries deposits; copper-nickel (Cu-Ni) magmatic segregations; and stratabound (Cu) deposits.	The Cu-Au-Mo deposits described above occur in three belts across Mongolia, located in the Altai, northern Mongolia, and southern Mongolia.	Production mainly through the Erdenet Mine. The mine produced 130.2 thousand tons of copper concentrate and 1.978 thousand tons of molybdenum concentrates for export. The development of the Oyu Tolgoi deposits expected to significantly increase Mongolia's share of world production as a major copper producer.
Fluorspar (CaF2)	The fluorite mineralization occurs in two economic types: epithermal vein and metasomatic ore bodies.	Three major areas, including, the North Mongolia, Trans-Mongolian, and South Mongolian fluorite provinces. Trans-Mongolian province has the largest reserves and is the most actively mined.	5th largest producer; 4% of the world's total production. Its share of metallurgical grade CaF2 increased between 2005-08, with Monros, upgrading its process to produce 120,000 tons of chemical grade CaF2 concentrate.
Coal (Co)	Coal occurs within units of intercalated sandstone, siltstone, and conglomerates.	Numerous. Central and Southern Mongolia. The deposits of the Ulaannuur Basin are the richest.	Estimated deposits are 160 billion tons. Annual coal production in 2009 was 13Mt per year. Past coal production was mainly for domestic energy production. Since 2004 export opportunities have increased with the

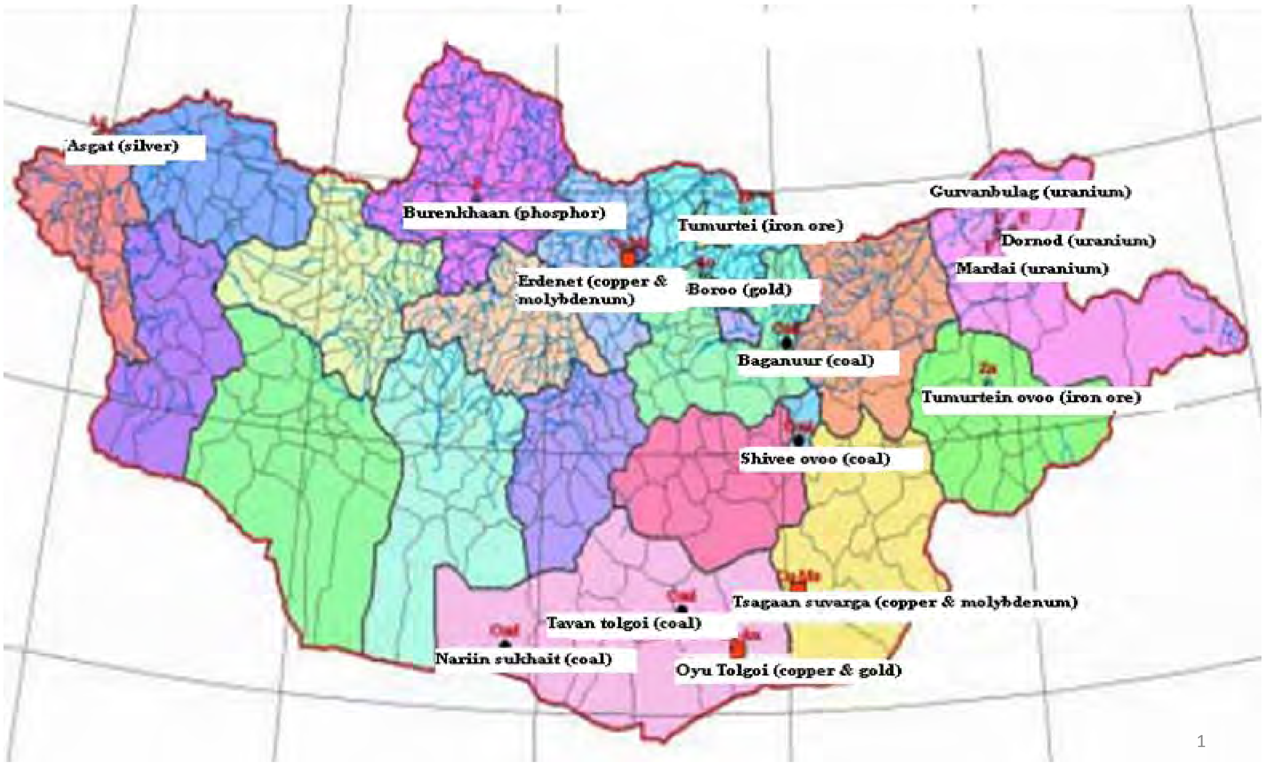
			discovery of high quality, coking coal deposits at Tavan Tolgoi, Ukhaa Khugag, Bortolgoi, Ovoot Tolgoi, Khoshoot and Altai Nuurs.
Uranium (Ur)	Four major uranium belts, including the Priargun, Gobi-Tamtsag, Khentei-Daur and in the Northern Mongolia uranium provinces.	The most commercially viable uranium deposits are found in the Dornod, Gurvanbulag, Mardai regions in eastern Mongolia and the Kharaat region of southern Mongolia.	Estimated reserves to be 1.3 Mt, of which 62 Mt are proven. Past uranium mining has taken place at the Mardai open pit mine from 1989-1993, but this mine has since closed.
Rare Earths (REE)	Mainly felsic and alkalic rocks	Commercially viable quantities are mainly found the Altai, North Mongolian Khentii, Khangai, Southeast Mongolian, and South Mongolian provinces.	The most common and economically viable rare earth metals are: tantalum, niobium, yttrium, thorium and zircon.

(Source Mbendi, Minerals Resources Authority of Mongolia, The World Bank)

Other minerals in order of commercial value include zinc, silver, tungsten, lead, nickel and iron ore.

Annex 4: Strategic Deposits in Mongolia

Strategically Significant 15 deposits



Name of Deposit	Location (Province)	Reserve Amount
Tavan Tolgoi	Omnogov, Tsogtsetsii	4.3 bln tons, coal
Nariin Suhait	Omnogov, Gurvantes	90.79 mln tons, coal
Baganuur	Ulaanbaatar, Baganuur	512.8 mln tons, coal
Shivee Ovoo	Govsumber, Shiveegov	564 mln tons, coal
Mardai	Dornod, Bayandun	1104 tons, uranium
Dornod	Dornod, Dashbalbar	58933 tons, uranium
Gurvanbileg	Dornod, Bayandun	16073 tons, uranium
Tumurtei	Selenge, Huder	229.3 mln tons, iron ore
Oyu Tolgoi	Omnogov, Khanbogd	16.39 mln tons, copper; 623.3 tons gold
Tsagaan Survarga	Dornogov, Mandakh	1.28 mln tons, copper; 43.6 thousand tons, molybdenum
Erdenet	Orkhon, Erdenet	3.2 mln tons, copper; 90 thousand tons, molybdenum
Burenkhaan	Khuvsgul, Alag-Erdene	40.5 mln tons, phosphorus

Boroo	Selenge, Bayangol	22 tons, gold
Tumutein Ovoo	Sukhbaatar, Sukhbaatar	820 thousand tons, zinc
Asgat	Bayan Ulgii, Nogonnuur	2247 tons silver

Source: Ministry of Finance, Investor Report, Dec. 2008

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