Privatisation, Income Distribution and Poverty: the Mongolian Experience

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GLOSSARY OF MONGOLIAN TERMS

Aimag	Province
Dzud	Freezing snow or ice covering pastures
Ger	Felt tent
Ikh Hural	Parliament
Negdel	Agricultural co-operative
Soum	Rural district

Russia
Kazakhstan
Mongolia
China
Lake Baikal
Ulaanbaatar
Ölgiy
Ulaangom
Hovd
Altay
Tayshir
Uliastay
Bayanhongor
Arvayheer
Tsetserleg
Mörön
Hanh
Bulgan
Sühbaatar
Dourhan
Dzuunmod
Mandalgovi
Dalandzadgad
Saynshand
Dzamin Üüd
Öndörhaan
Choybalsan
Baruun Urt
Tamsagbulag
Onon
Beijing
Yenisey R.
Uvs Nuur R.
Dzavhan Gol R.
Hövsgöl Nuur R.
Selenge R.
Orhon R.
Herlen R.
Onon R.
Argun R.
Hulun Chih
Ulungur R.
90°
96°
102°
108°
114°
120°
48°
42°
0 200 mi
0 300 km
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EXECUTIVE SUMMARY

The objectives of this study are to establish the degree to which privatisation has contributed to the large rises in poverty and inequality which have characterised the transition to the market in Mongolia and to highlight any lessons which might allow future privatisations to proceed with a lower distributional cost.

A number of important prior considerations condition the analysis. First, privatisation was a political decision to which successive governments have remained committed. This means that the implicit counterfactual against which the impact of privatisation is measured cannot be a world with no privatisation but rather one in which different methods and processes of privatisation are applied. Second, privatisation narrowly defined cannot be separated from other changes, such as stabilisation and structural adjustment, which are intrinsically associated with the transition.

Privatisation took place in the context of severe macroeconomic disturbances, which is independently responsible for a considerable part of the rise in poverty and inequality. The immediate transition was accompanied by the cessation of transfers from the Former Soviet Union (FSU), which amounted to 30 per of GDP. GDP contracted by over 20 per cent during the first three years of transition and the terms of trade moved sharply against Mongolia as it switched to a regime of hard currency trading. The overall effect was a precipitous decline in the standard of living of the average Mongolian.

The levels of poverty and inequality rose dramatically in the early period of transition and remain at very high levels. The Headcount measure of poverty rose from negligible levels in the late 1980s to 36 per cent of the population by 1995. This figure was essentially unchanged in 1998 but the depth of poverty and the income distribution amongst the poor had deteriorated. Although still low by comparison with some of the other transition economies, income inequality also rose substantially, from a Gini coefficient of 0.31 in 1995 to 0.35 in 1998.

The overall growth rate in income per capita has been too low to outweigh the increases in inequality so that current and projected economic growth on its own seems unlikely to be able to significantly reduce poverty and inequality in the near future.

The early privatisations were based on the distribution of vouchers. Although equitable in principle, in practice this method contributed to inequality. In particular, this method of privatisation ignored public and co-operative institutions, which have subsequently proved of enormous importance, especially for the livestock privatisation. Similarly, the privatisation of apartments to sitting tenants, while having a notional fairness was inequitable because most of the population failed to gain anything.

The theoretical connections between privatisation 'events' and the subsequent changes in poverty and inequality are extremely complex. However, a number of channels of causation seem, on theoretical grounds, likely to be significant. First, privatisation is an asset redistribution, which leads to subsequent changes in the flows in income. Second, the changes in asset ownership also lead to changes in the objectives and responsibilities of the formerly state owned institutions that seem likely to produce changes in the distribution of wages and employment. Third, privatisation leads to changes in the state budget and in the responsibility and ability of the state to provide social and other services.

International evidence provides some relevant pointers about how privatisation might impact on poverty and inequality, although the distributional impacts of privatisation have received relatively little attention. However, in general, efficiency appears to have been enhanced rather than equity and the evidence that does exist points to a worsening in both the distribution of wealth, and, with perhaps less certainty, of income also. The international evidence also suggests that it is the method of privatisation and the institutional setting in which it takes place, the other market reforms which accompany it, and the behaviour of the new owners which determine the impact on income distribution. In particular, it seems clear that privatisation on its own does not generate a dynamic private sector.

Direct evidence for Mongolia was obtained from a number of sample and participatory surveys. These broadly supported the evidence obtained from theoretical inference and from the international evidence.

In particular, with respect to livestock privatisation a number of clear conclusions emerged. Privatisation was felt to have been carried out too quickly and had not been sufficiently transparent. Too little attention had been paid to predictable consequences of hurried privatisations and to the disappearance of collective and other public institutions, which had significant effects on the ability of families to cope with exogenous shocks.

The apartments privatisation evidently led to a large initial increase in inequality as only a small proportion of the population gained anything. The extent of gains amongst the new owners of the apartments depended on a large number of factors including: the value of the initial apartment; the knowledge and ability to make use of the new asset to set up new businesses or to enter the rental market.

There is ample evidence that the inequality generated by the re-distribution of assets in both the livestock and apartment privatisations interacted with other aspects of the emerging private economy to exacerbate inequality. This was most noticeable with respect to access to credit.

The survey of Small and Medium Sized Enterprises (SMEs) demonstrated increased concentration of share ownership and large-scale downsizing of enterprises with a major impact on employment. There was also evidence that ownership was concentrated amongst 'insiders'.

In spite of the theoretical presumption that the new objectives of the SMEs would lead to the elimination of many of the social services previously provided through state owned enterprises, there was evidence that privatised SMEs were still maintaining many of these services. In addition, there was no evidence in the sample survey of increasing inequality in the wage distribution. There are, however, several ground for being suspicious of this result. Both of these unexpected results cannot be expected to survive a more competitive environment.

The report makes a number of recommendations with respect to any future privatisation

1. A very much higher priority needs to be given to transparency in any future privatisations than hitherto. This must include the more extensive dissemination of information and education and debate about the implications of privatisation.

2. A major effort must be made to correctly price any asset to be privatised. By this is meant that prices should not allow agents to make undeserved capital gains from the asset unrelated to any economic function.

3. The preferred method of obtaining such prices is through open, competitive tendering.

4. The appropriate legal and regulatory frameworks necessary to support a truly competitive environment need to be factored into privatisation decisions at the earliest stage.

5. Much greater attention needs to be paid to role of collective institutions and to the potential interdependencies and market failures that privatisation generates.

6. A much more thorough examination needs to be paid to the role and responsibilities of the state after privatisation.

7. Any subsequent privatisation needs to consider the consequences of privatisation in relation to the provision of safety nets and other social security systems than has occurred hitherto.

8. The fiscal implications of privatisation need to be made much more transparent and related to the changed responsibilities of the state in the emerging market based economy.

1. Introduction

The set of economic reforms that have defined and shaped Mongolia's transition to a market economy have been accompanied by significant increases in poverty and inequality in the distribution of income. Privatisation has been a central element in the reform process and the question that this Report seeks to address is to what extent and in what ways, if any, did privatisation, either directly or indirectly contribute to these increases in poverty and inequality.

A supplementary objective of the study is to establish whether there are any principles, or more generally lessons, that can be drawn from the examination of past experience, in Mongolia and elsewhere, which may be applicable to future privatisations. As many of the most valuable assets still remain in the hands of the State and a number of controversial privatisations in the areas of healthcare, schools and hospitals, infrastructure and the ownership of land are proposed, "…information on how to conduct privatisation in a proper and acceptable manner is still very much of value" (Birdsall and Nellis, 2002, p.3).

Privatisation was essentially a political decision, taken without very much analysis or even consideration of the likely short- or long-term impact on poverty and income distribution. In part, its purpose was to cement the political changes that had occurred in the spring and summer of 1990. As we argue below, given the specific historical, political, economic and social factors, that underpinned and shaped the transition process, some privatisation, along with the rapid development of the private sector, was both essential and desirable. However, what is important is the method or process of privatisation, and given that there is a wide variety of methods or ways to privatise, the distributional impact of privatisation, both in the short- and long-run, may depend crucially on the method or methods actually chosen and the speed with which they are implemented. The implicit counterfactual against which Mongolia's privatisation episodes should be assessed therefore, is not a world in which privatisations did not take place but rather one in which the privatisation process itself – the methods of privatisation and the institutional context within which privatisation occurs – is different.

Privatisation: a brief overview.

The term "privatisation" represents a "conceptual continuum"(Ramanadham, 1995, p.1) covering a range of both divestiture and non-divestiture options, which will have differing impacts on distributional equity and poverty. In this study however, the term is used to denote the large-scale transfer of previously publicly owned assets into the hands of private agents, leading to the growth of the private sector and the development of a market economy. The core component of privatisation is thus the transfer of state owned enterprises (SOEs) to private ownership.

Privatisation serves a number of objectives, both economic and socio-political. In a number of transitional economies including Mongolia, Russia, the Czech Republic and Lithuania, the wholesale and rapid reduction of state ownership has been seen by many as the essential condition for the transition from a command to a market economy. These economies implemented privatisation as quickly as possible, using simple, standard methods (Nellis, 2000) to break the links between the state and productive enterprises. Nellis (2000, p.2) argues that "…mass and rapid privatisation, through vouchers, came to be viewed widely as the optimal solution to the problem of what to do with the huge number of enterprises inherited from the communist era".

The balance of opinion in Mongolia in the early-1990s favoured the "shock therapy" approach to economic reform in an attempt to destroy old, and construct new institutions as rapidly as possible. Privatisation was clearly of strategic importance in this respect, leading as it did to an irreversible shift in productive assets from the state to the private sector, with the intention of creating a pluralist, liberal, capitalist, market economy.

There now exists a general consensus in the literature that few of the early expectations of mass and rapid privatisation have been realised in practice. Privatisation of necessity involves a redistribution of productive assets, which in turn leads to changes in the distribution of future income streams. Privatisation will also affect current income streams, through, for example, the loss of existing employment opportunities through post-privatisation enterprise restructuring or the creation of new employment opportunities in a newly invigorated private sector. The fiscal impact of privatisation and post-privatisation fiscal policy will also be important in determining both the direct and indirect effects of privatisation on income distribution and poverty.

But as Birdsall and Nellis (2002, p.11) argue, "…there can be no simple prediction about the distributional effects of privatisation. The effects on equity depend upon at least three factors: initial conditions, the sale event, and the post-privatisation political as well as economic environment". Pre-privatisation conditions with respect to initial income distributions and poverty levels and the efficiency/inefficiency of SOEs will in part determine the improvements that can be made. The post-privatisation environment, largely the degree of competition and regulatory arrangements, will reinforce or alter the path the economy is taking. The privatisation event itself, that is, the method of divestiture used, will also influence distributional outcomes.

The path of economic development in the post-privatisation period is thus not unidirectional and is not determined solely by the transfer of ownership of productive assets from the public to the private sector. As will be argued in the context of the Mongolian experience, privatisation occurred during, and was a major part of the process of the transition to a market economy. Stabilisation and structural adjustment policies, involving, *inter alia,* the liberalisation and deregulation of the economy, along with external factors (the collapse of the Former Soviet Union and the dissolution of the CMEA) have all played a major role in determining the nature and characteristics of the post-1990 transition in Mongolia. As is the case in all *ex post* evaluations of the impact of economic policy change, the construction of a useful and appropriate counterfactual is particularly difficult, especially so in the case of Mongolia.

The Structure of the Report.

Section 1 has introduced the key issues, highlighting the essentially political nature of privatisation and the difficulties encountered in attempting to disentangle the impact of privatisation on poverty and income distribution from the external shocks and major domestic policy changes that were occurring at the same time. Section 2 provides an overview of the macroeconomics of Mongolian development since 1990, including a discussion of the initial fall in per capita income, the subsequent slow recovery of the economy and the rise in poverty and inequality in income distribution. To support this a chronology of the transition and privatisation process is given in Appendix 1. Section 3 considers in more detail the privatisation process in Mongolia, outlining the extent of privatisation and the methods used (the voucher system). Some general problems are identified and two privatisation events in particular are discussed – the privatisation of livestock and the privatisation of apartments.

Section 4 provides a more formal discussion of the different channels through which a privatisation 'event' may, in principle, impact on poverty and income distribution, drawing on a theoretical literature which emerged in the 1990s and which attempted to further our understanding of the dynamics of change in the transitional economies of Eastern and Central Europe, the Russian Federation and the Newly Independent States of the Former Soviet Union (FSU). Section 5 looks at the actual experiences of privatisation in these other transitional economies, to see what lessons, if any, can be learnt. A number of important points can indeed be drawn from the review of the experiences of other countries although it is also important to note the diversity of that experience.

Section 6 presents the results of four sample surveys undertaken by national consultants as part of this study.[1] Two participatory surveys of herder families and owners of privatised apartments were conducted, along with a sample survey of privatised small and medium sized enterprises (SMEs) and a further sample survey of apartments which attempted to clarify issues of ownership and housing costs. The methods and sampling procedures used are discussed and the results of the surveys reported and interpreted. Finally, Section 7 provides a summary of the Report, its conclusions and policy recommendations.

[1] Although these surveys were commissioned to support this Report, they were undertaken by independent researchers. The results of these surveys are reported below, but the present authors were not responsible for the implementation of the surveys, for the reporting and initial analysis of the data or the conclusions drawn from those data.

2. Macroeconomic Performance and Poverty and Inequality

The overall levels of poverty and inequality are a function of the level of economic activity, reflected although not fully captured in GDP, and the mechanisms, such as the distribution of asset ownership, the rate of return on assets and other economic and institutional devices, for example, eligibility to state benefits, which determine to whom and on what terms these goods and services are made available. Prior to transition, although Mongolia was a relatively poor country in terms of GDP per capita, the policies of full and stable levels of employment, the subsidisation of basic necessities and the extensive system of social services including health and education that were free on point of delivery, meant that inequality was, by western standards, low and poverty largely absent. The transition drastically altered the terms of this implicit social contract, but also had a major impact on the overall levels of GDP, employment and other macroeconomic variables. This section provides a brief survey of these basic macroeconomic variables and of the scale and degree of poverty and inequality that emerged over this period.

Macroeconomic Performance: GDP, per capita income, inflation

The transition to the market was always likely to lead to sharp falls in output as the economy re-orientated its production to market incentives. The chosen method of shock therapy meant that large falls in output and employment were not merely regarded as an inevitable side effect of the transition but the depth and speed of the output loss were interpreted as an index of how quickly and robustly a new private sector would emerge. However, Mongolia was also subject to very large external shocks, which meant that the falls in GDP very much understate the impact of the transition on the living standards of ordinary Mongolians.

Mongolia's growth performance over the years since transition began is summarised in Table 1 below. The very large falls in output in the early years of transition are clear, with a cumulative fall in GDP of over 20 per cent GDP over the period 1990-1993.

Table 1: Real GDP and Rate of Growth, 1989-2002

	1989	1990	1991	1992	1993	1994	1995
GDP	651.5	635.1	576.4	521.6	505.9	517.6	550.3
Growth	4.2	-2.5	-9.2	-9.5	-3.0	2.3	6.3

	1996	1997	1998	1999	2000	2001	2002
GDP	563.2	585.7	606.4	625.9	632.7	638.9	664.3
Growth	2.3	4.0	3.5	3.2	1.1	1.0	4.0

Note: Real GDP in billions of tugriks at constant 1995 prices
Source: IMF, 2002, Table 1.1, p.7 and ADB, 2003.

However, prior to transition, Mongolia received very large transfers from the FSU. These amounted to approximately 30 per cent of GDP (IMF, 1996). In effect, national disposable income was 30 per cent greater than GDP. The elimination of these transfers occurred at the same time as the falls in GDP and, indeed, was partly responsible for those falls as essential inputs, especially oil products, disappeared. The cessation of Soviet aid was exacerbated by the simultaneous collapse of the Council for Mutual Economic Assistance (CMEA), which had provided a market for virtually all Mongolia's exports and supplied most of her imports (IMF, 1996). Mongolia was forced to adjust suddenly to the world of hard currency trading and found that the prices of its staple exports, especially copper, which had previously been sold at guaranteed prices within the CMEA, fell precipitously so that the terms of trade moved sharply against her. The combination of these factors meant that Mongolia's absorption, which determines her national disposable income and ultimately the living standards of her people, fell by an estimated 60 per cent (Boone, 1994) over the 1989-1993 period.

Despite the initial, unprecedentedly large reduction in output, the return to growth, which began in 1994 and accelerated in 1995, was at best tepid and strongly dependent on international factors, in particular the prices of copper, gold, cashmere and oil. In 1995 favourable movements in the terms of trade added almost 8 per cent to GDP (World Bank, 1997). However, the reversal of this good fortune 1996 (World Bank, 1997) and the turbulence in the world economy in 1997-1998 led to sharp falls in the rate of growth. Its performance in the subsequent period, especially in 2000 and 2001 when Mongolia was subject to extreme weather conditions, has been relatively disappointing, although growth in 2002 recovered to a more respectable 4 per cent. Nevertheless, this means that GDP only reached its 1989 pre-transition level in 2002. However, as shown in Table 2, GDP per capita, because of the rise in population, still remains below its pre-transition level, while real national disposable income per capita remains far below that of the last years of the Communist system.

Table 2: Real GDP per capita, 1989-2002

	1989	1990	1991	1992	1993	1994	1995
GDP per capita	542364	506508	446198	397124	383775	388793	406395
	1996	1997	1998	1999	2000	2001	2002
GDP per capita	410626	421258	428662	437009	440122	438356	449672

Note: Tugriks at constant 2000 prices
Source: www.econstats.com

Although capital productivity (GDP/K) has risen more quickly than GDP, its recent performance has been sluggish and labour productivity (GDP/L) remains below pre-transition levels (IMF, 2002, p.8). The growth that has occurred appears to be based on efficiency gains reflected in total factor productivity, which has, however, grown at only 1.7 per cent over the 1995-2001 period (IMF, 2002, p.9). The average compound rate of growth of GDP between 1993 and 2002 has been only 3.1 per cent. Although world economic conditions are improving, there seems little prospect of Mongolia reaching and sustaining growth rates of 5-6 per cent projected within the Interim Poverty Reduction Strategy Paper (I-PRSP) that will, on their own, have a marked effect on the living standards of the majority of her population.

As in other transition economies, very high levels of inflation, reaching 325 per cent in 1993, accompanied Mongolia's transition (Nixson and Luvsandorj, 2000). The reasons for these levels of inflation are complex and do not fall easily within the textbook pattern of a profligate government spending beyond its means. Rather the explanation lies in the interaction between a very rapid collapse in supply of basic goods accompanied by a rapid price liberalisation that required firms to move quickly to market prices. These price rises were validated by a banking system which in the early years of transition still responded elastically to the demands of the state owned and formerly state owned enterprises; throughout the transition the growth of the money supply strongly lagged the rate of inflation (Chimeddagva *et al*., 2000, p.67)

The price liberalisations were necessary to allow firms to respond to market incentives and to reduce the level of state subsidy. However, as noted above, the subsidy of basic necessities, accompanied by full employment and the provision of basic services, were the devices by which the old system had ensured a degree of equality in living standards. The transition removed these policy levers and arguably also the commitment to the objective of equality. Unsurprisingly, both inequality and poverty rose rapidly during the immediate transition and have remained at very high levels.

Poverty and Inequality in Mongolia

The emerging pattern of poverty and inequality has been reported in a number of surveys and reports, supplementing the data collected by the Mongolian National Statistical Office (NSO). In 1995 the NSO, supported by the World Bank, conducted the first Living Standard Measurement Survey (LSMS) (World Bank, 1996). A second LSMS report, with UNDP support, was carried out in 1998 (NSO 1999). Finally, a participatory living standards assessment (PLSA) was carried out by the NSO with World Bank assistance in 2000 (NSO, 2001). These reports complement the picture emerging from several other studies, notably the UNDP Human Development Reports (UNDP, 1997 and 2000) and Griffin (1994), and summarised in the Interim Poverty Reduction Strategy Programme (I-PRSP)(Government of Mongolia, 2001). The overall results of the LSMS 1995 are summarised in Table 3 below.

Table 3: Key Poverty Indicators 1995

Region	Headcount (P_0)	Depth (P_1)	Severity (P_2)
All urban	38.5%	12.2	5.7
- UB City	35.1%	10.4	4.5
All Rural	33.1%	8.9	3.6
All Mongolia	36.3%	10.9	4.8

Source: World Bank 1996, Table 1.4, p.25.

The headcount measure of poverty has risen from a pre-transition position of almost no recorded poverty to one in which over one third of the population are defined as poor. The Survey also notes that large numbers of the population are close to the poverty line so that the elasticity of the number of the poor to changes in the poverty line is high. It estimates that a 10 per cent increase in the poverty line would raise the proportion in poverty to 43 per cent (World Bank 1996, p. 23). However, the poverty gap (P_1) and severity of poverty (P_2) measures were, by international standards, relatively low (World Bank, 1996, p.24); the poor were, for the most part, equally poor and not very much worse off than those just above the poverty line. This is consistent with the Gini coefficient of 0.31 for (price-adjusted) consumption based on the LSMS data (World Bank, 1996, p. 17), which is comparable with other Asian transition economies (World Bank, 1996, p. 17) and very much lower than for some of the countries emerging from the FSU (Milanovic, 1999).

The LSMS also provides an analysis of the characteristics of the poor that illustrates the channels through which poverty has been created. The connection with employment status is well supported, with nearly 60 per cent of the unemployed falling below the poverty line (World Bank, 1996, p.28) and with over half of the very poor unemployed (World Bank, p. 28). The Report also estimates unemployment to be considerably higher, at approximately 20 per cent, than the official figures. The under recording of unemployment is well recognised, with more up to date estimates of the unemployment rate supporting the 1995 LSMS figures (Clark et al., 2000). Herd size is also a crucial determinant of rural poverty, with herders with small numbers of animals being one of the most vulnerable groups (World Bank, 1996, p.32).

Pensioners and more generally those relying on benefits are also highly represented amongst the poor, suggesting that the failure of benefits to keep pace with general inflation and, in particular, to take account of the impact of the price liberalisation of necessities, which take a disproportionate share of the expenditure of the poor, has been one of the major reasons for the growth of poverty. However, the relationship is complex with benefit eligibility one of the key issues and with the level of benefits partly determined by contingent circumstances such as the date at which, for example, early retirement took place, so that while some pensioners and benefit recipients are poor, others are not (World Bank, 1996, pp. 33-35). Other characteristics of the poor suggest that, as elsewhere, large families and children without care, female headed households, the disabled and those with poor educational qualifications are disproportionately represented among the poor.

The second Living Standard Measurement Survey (LSMS, 1998), although not strictly comparable with LSMS 1995 (FIDE, 1999 as reported in NSO, 2001), suggests that little has changed for the better for Mongolia's poor and, in some respects, there has been a deterioration. The major results for the 3 basic indicators are reproduced in Table 4 below.

Table 4: Key Poverty indicators 1998

Region	Headcount (P_0)	Depth (P_1)	Severity (P_2)
All urban	39.4%	13.9	7.1
- UB City	34.1%	13.0	7.4
All Rural	32.6%	9.8	4.4
All Mongolia	35.6%	11.7	5.6

Source: LSMS, 1999, p.24

The overall headcount figure has scarcely changed over the period. However, more problematically, both the depth and severity of poverty had risen, with the average consumption of the poor now more than 10 per cent below the poverty line and the distribution of income amongst the poor, represented by P_2, deteriorating. The 1998 survey also found that the Gini coefficient had risen to 0.35 over the three-year period since the previous survey. Although this is still relatively low by comparison with most countries that have followed the shock therapy approach to transition, the speed of its rise (13 per cent) in only three years is worrying. It suggests that the income distribution is widening at a faster rate than the rate of growth of per capita income so that the poor are falling behind average income; this is consistent with the rises in P_2 and P_3 noted above. In addition, it also means that, in the absence of explicit policies to reduce inequality, a higher rate of economic growth will be required to lift people out of poverty than in a more equal society.

The Survey's analysis of those who were poor and the proximate reasons for their poverty found little change from 1995, with unemployment and herd size remaining important and interacting with family size, female headed households and educational qualifications to shape the profile of those with the greatest probability of being amongst the poor.

The Participatory Living Standards Assessment (PLSA) (NSO, 2001) supplements the findings of the two LSMS reports by focusing on a broader, more capability based approach to poverty using multi-dimensional criteria of well-being, based economic, social, health, physical and mental status. The PLSA indicated that "[b]etween 1992 and 1995, people identified a general decline in the share of the medium households, and a corresponding rise in the share of the poor and very poor, suggesting that many households fell into poverty over this period. Over 1995-2000, the increase in the proportion of poor and very poor households was even more marked" (NSO, 2001, p.11).

The PLSA indicated that livelihoods became vulnerable to multiple, interlocking forms of insecurity. Economic insecurity, arising primarily from the decreased opportunity of being employed interacted with environmental insecurity, arising from the decline in public action to reduce risks in animal husbandry. The PLSA also highlighted growing social insecurity due to weakening kinship networks. Households were also subject to increases in physical insecurities such as alcohol abuse, domestic violence and marital breakdown (NSO, 2001, p. 20). Participants in these surveys indicated that loss of employment was the most frequent initial trigger for impoverishment, followed by illness and the associated costs of medical treatment (NSO, 2001, p. 21). Rapidly escalating education costs were also noted, especially for households of medium well-being. Deepening income poverty was accompanied by the growth of other insecurities, including poor access to institutions, weak governance and corruption.

In summary, by 2002 the level of GDP per capita had not yet returned to its pre-transition level and average living standards measured by income per capita remain significantly below those of the late 1980's, when Mongolia was in receipt of significant transfers from the FSU. However, this level of GDP is now associated with unprecedented levels of poverty, with over one third of all Mongolians officially living in poverty and a considerable number living precariously close to it. Social safety nets have been weakened and the achievements of the socialist era in education and health are being compromised as the poor find access to these services is increasingly based on the ability to pay. Overall inequality, although still low by the standards of some of the republics of the Commonwealth of Independent States (CIS), is rising and both the data and the PLSA indicate an increasing polarisation of the society between rich and poor.

3. Privatisation in Mongolia

Privatisation was at the centre of the Mongolian reform process. Supporters of the programme have claimed that its results have been "impressive" and that Mongolia has implemented the "most successful privatisation programme" of all the Republics of the Former Soviet Union (FSU) (quotations from Griffin, 1994, p.9). We have argued above that some privatisation was indeed inevitable (and desirable) in the early stages of transition and that the relevant counterfactual in any attempt to evaluate its success would not be "no privatisation" but rather a different process and speed of privatisation. Griffin (1994), among other critics of the privatisation process, has argued that its role in the transition to a market economy has been "greatly exaggerated" and that, in the specific context of Mongolia, it should have been given a lower priority. Although a partial administrative success, privatisation did little to assist Mongolia through its transition difficulties.

In a second, follow-up report for UNDP (Griffin, 2001), attention was given to the redistribution of assets following on from privatisation. In his presentation to the National Workshop on "Integrating Poverty Reduction into Development Strategy" (GOM and UNDP, 2001), Griffin argued that higher priority should be given to accelerating economic growth that was "pro-poor". A national discussant at the workshop argued that "shock therapy" had failed and that that "…an irrational and uncontrolled privatisation opened wide opportunities for property abuse, and a wrong policy was pursued in creating a market without government co-ordination, intervention or participation. All this has recently led to the danger of shaping an unjust society and increasing the inequity in the distribution of income and wealth in Mongolia" (G. Purevbaatar as quoted in GOM and UNDP, 2001, p.19).

Privatisation had its beginnings in Mongolia in 1991, when the government, which was then estimated to own 75 per cent of all property in Mongolia, issued its first vouchers to the public (Stubbs et al, 2000; see Appendix 1 for the chronology of early privatisations). In the programme begun in October 1991, all citizens born before 31st

May 1991 received three red vouchers with a nominal value of 1,000 tugriks, which could be used to buy shares in small state and co-operative businesses. Small enterprises in this context were defined as employing less than 50 people. The red vouchers were tradable on secondary markets.

Between October 1991 and July 1992, blue vouchers were issued, at one per person, with a nominal value of 7,000 tugriks. These were to be used to bid for shares in the joint stock enterprises that were to be formed from approximately 550 large former state enterprises. The blue vouchers were not tradable but could be assigned to nominees. The Mongolian Stock Exchange was established in January 1991 to allow trading in shares. The new Constitution of 1992 guaranteed private property rights.

Estimates vary as to the precise number of enterprises privatised. According to the Government of Mongolia (State Property Committee, 2002), 4,500 enterprises were privatised through the voucher programme over the period 1991 – 1994. From 1996 to 2000, 942 enterprises and assets were privatised through sealed bid auctions, English auctions, sales of shares through the Mongolian Stock Exchange and other methods, raising approximately 48 billion tugriks (US$65 million) in revenue.

The early privatisations offered limited opportunities for the growth of the private sector and left the state very much in a commanding position (Stubbs et al, 2000, p.141). The privatisation of, and emergence of, new retail and other service sector outlets proved to be successful, but the history of state ownership and control meant that the development of individual entrepreneurial skills was limited.

The original privatisation measures required the preparation and approval of a plan for each enterprise. Apart from problems involved in the accurate valuation of enterprise assets and the need to try and minimise so-called "spontaneous privatisation"[2], along with subsequent problems with respect to corporate governance (which arise when ownership is fragmented and minority shareholders are ineffective), a number of other problems have been identified:

[2] Sometimes referred to as "wild privatisation".

- The privatisation arrangements were often inadequate with over-ambitious timetables;
- It proved difficult to promote an active share market, essential if issues of corporate governance were to be resolved;
- There is evidence that the public were confused by the voucher schemes with many vouchers remaining unused or given away;
- The privatisation process lacked transparency and insufficient attention was given to publicity and the education of potential shareholders;
- The secondary market in shares was slow to develop, further exacerbating problems of corporate governance (Stubbs et al, 2000, pp.142-3).

Opinions inevitable differ as to the success or otherwise of the early privatisation programmes. As argued above, privatisation in Mongolia had important political objectives, and it undoubtedly led to a shift in productive assets from the state to the private sector and was important in the development of that sector. However, some have argued (Stubbs et al, 2000, p.143) that, with hindsight, it can be seen that the programme was hastily executed and seriously flawed, leaving it gravely discredited in the eyes of the public.

Following the 1996 election and change of government, a new privatisation programme was enacted in 1997 with the objectives of increasing the speed and transparency of the privatisation process, increasing the concentration of share ownership, attracting foreign investment and raising revenue for the state. The programme was accompanied by the accelerated liberalisation and deregulation of the Mongolian economy (see Appendix 1). The Privatisation Department of the State Property Committee published a series of lists of enterprises and properties on offer over the period to the year 2000 and they included both large and small wholly- and partly-owned state enterprises. The various modes of disposal of these enterprises are discussed in Stubbs et al. (2000, pp.144-5).

The Government's current privatisation strategy is outlined in Government of Mongolia (2001; 2002). The *Privatisation Guidelines for 2001-2004* (Government of Mongolia, 2001) were approved by the State Ihk Hural (Parliament) in January 2001.

The overall policy goal is to accelerate the privatisation process and increase private sector participation in the economy. The strategy focuses on the privatisation of Mongolia's largest companies (the Most Valued Companies – MVCs) that will be privatised through "transparent, credible, international tenders". MVCs are defined as companies strategically positioned in their various sectors of the economy with substantial market share and the potential to attract foreign investment. The Government intends to set out specific and identifiable objectives and benefits for each "case by case" privatisation and will monitor implementation and the privatisation outcomes for the attainment of these objectives (GOM, 2002). The Objectives, Principles, Institutional Structures and Organisation, Methods, Information and Legal Framework are detailed in GOM State Property Committee (2001).

The Government has announced its intention to extend restructuring and privatisation into infrastructure (the energy sector, roads, telecommunications, railways and a number of other sectors and activities), the social sectors (health, education, culture and the arts) and the ownership of land. The Government is proposing to undertake steps to implement land ownership and possession reforms. The implementation of the Law on Land and Law on Land Ownership is to be accelerated and the process of giving land to Mongolians for ownership is to be started on the basis of detailed land registration and cadastral surveys (GOM, 2001, p.75).

Two privatisation events deserve special mention – the privatisation of livestock that took place in 1992 and the privatisation of apartments that began in 1996-97.

The Privatisation of Livestock

Prior to the transition, livestock production in Mongolia was dominated by state-run co-operatives, although limited private ownership of livestock was allowed and a system of private contracts for livestock rearing had been introduced in the 1980s (Russell et al, 2000, p.162). Although there was some social and economic differentiation among members of the co-operatives (*negdels)*, the degree of inequality was low and most productive assets belonged to the state (Griffin, 2001, p.10). Pre-1990, Mongolia had developed and applied effective, although heavily subsidised, institutional mechanisms for support to the pastoral livestock sector and for responding to drought and *dzud* (the collective term in Mongolia for various winter-related conditions that prevent livestock from obtaining forage from open-range grazing) conditions (Miller, no date, p.5).

The privatisation of livestock led to immediate changes. The initial distribution of livestock was not equal, either among households or individuals, and the distribution of animals was not limited to herders only (non-herder employees of the *negdels* often received disproportionately large shares of the herds) (Griffin, 2001). Experienced herders and members of prominent households benefited from privatisation whilst younger herders and female-headed households did less well (there is evidence that single women herders received less than their entitlement in the distribution – see Robinson and Solongo, 2000, for a fuller discussion).

Griffin (2001) quotes data that show that already in 1992, roughly five per cent of households had herds with more than 200 animals, whereas at the bottom end of the distribution, 42 per cent of households had herds containing less than 31 animals. In 2000, estimates show that 63 per cent of households had less than 100 animals, 22 per cent had herds of 100-200 animals and 12 per cent had herds between 200-500 animals (Miller, no date, p.3). Herd sizes of less than 100-150 animals are generally regarded as being insufficient to maintain a livelihood for a herding household. *A priori*, there is evidence of widespread poverty and inequality among the rural population.

Apart from inequalities in the initial distribution, there are various reasons why this differentiation has occurred. Those households that obtained a small number of animals found it difficult to enlarge their herds; there were considerable variations in the skills and abilities of herders to manage livestock and some younger and inexperienced herders have lost their herds through natural disasters or poor management skills or have consumed their animals in order to maintain living standards during difficult economic conditions (Griffin, 2001). Obviously some households have prospered and increased their herd size.

With the privatisation of the herds came the dismemberment or collapse of the *negdels* and State Farms. It is worth quoting Miller (no date, pp.5-6) at length:

"Veterinary services, maintenance of wells for livestock watering, and other state support to livestock production declined. Productivity gains from decades of animal science research and livestock breeding were largely lost. Rural markets collapsed, leading to a barter economy and livestock hoarding. Education and health services declined. The state retreated from pastoral risk management, especially provision of emergency supplies of hay and fodder with the near-collapse of the formerly subsidized hay and fodder production system, and compulsory livestock insurance….Economic transition has led to an increase in the incidence, depth and severity of poverty; rising fuel prices; lack of spare parts [for] vehicles; broken wells; and a fall in the coverage of health and education services, all of which contributed to declining mobility of pastoral herding families. Increasing livestock congestion on pastures closer to existing wells or water supplies, to towns and roads, and to areas of better grazing led to overgrazing and growing conflicts over pasture and camp sites"

The post privatisation picture is complicated by changes in the number of animals and in the composition of the herds. Livestock numbers were estimated at 25.5 million in 1991; they grew to 33.5 million in 1999, but adverse climatic conditions brought the number down to 23 million in 2002 (ADB, 2003). The 1999/2000 *dzud* is estimated to have killed 2.8 million head of livestock. This was followed by severe drought across much of the southern and western parts of the country and much of the livestock were not in a good condition to face the *dzud* which killed an estimated 4.1 million head (all figures from Miller, no date, pp.6-7). The previously effective system of pastoral risk management was no longer in place, and the government was unable to respond effectively. Herders continued to expect assistance from the state, which was not always forthcoming, and they were themselves unprepared and unable to respond to the increased vulnerability brought about by larger numbers of animals, the collapse of the *negdels* and the harsh weather conditions.

The livestock herds consist of camels, horses, cattle, sheep and goats. The percentage of camels and sheep has declined (in the latter case from 58 per cent of the total in 1989 to 46 per cent in 2000). Goats have increased their share from 20 per cent of the total in 1989 to 34 per cent in 2000 (Miller, no date, p.3), in part a reflection of the improved market opportunities for cashmere. The issues raised relate to both numbers and composition of the herds. Does Mongolia have the pasture carrying capacity to maintain and expand numbers without significant investment in pasture conservation and improvement, improved agricultural productivity, the development of non-farm activities, improved infrastructure and better market access? Will changes in the composition of the herds be consistent with expanding consumer demands, for meat for example, and the demands of processing industries (wool, cashmere, and leather) that are an important part of the manufacturing sector? (Russell et al, 2000).

The Government of Mongolia has moved towards private and quasi-private land ownership. In 2002, Parliament approved two new land laws to be implemented in 2003. The first extends the system of quasi-ownership of urban and peri-urban land by the establishment of renewable, inheritable and tradable long-term possession and use leases that can be used as collateral (ADB, 2003, p.4). The second law will permit every Mongolian family privately to own a small piece of land. There is concern that the well-connected, influential middle- and upper-income groups will dominate the market for leases at the expense of the poorer majority (ADB, 2003).

The Privatisation of Apartments

Prior to privatisation, residential apartments and buildings were the property of the State, collectives or enterprises. Mongolian citizens would apply to the Housing Commission, local authorities or enterprises, for an apartment and would typically be put on a waiting list until one became available (although there were exceptions for priority cases).

Preparations for the privatisation of private apartments started in 1993. A first step was to identify and agree on the actual occupiers of the apartment (not always straightforward with multiple occupation quite common). Appropriate legislation was passed by the Great *Ikh Hural* in October 1996, and the actual privatisation of residential apartments began in May 1997. Apartments were given to occupants free of charge and it is estimated that between May 1997 to end-1998, 84,584 residential apartments (with a nominal value of 370 billion tugriks) became private property.

According to one estimate, approximately 22 per cent of the population benefited from this privatisation.

However, it is estimated that in 1998, approximately 52 per cent of the total population lived in *gers* (felt tents), with 75 per cent of the rural population and 29 per cent of urban dwellers living in *gers* (Griffin, 2001). The result of the privatisation was that the rural population and most of the urban poor gained nothing from privatisation, while existing occupiers (and those that were able to acquire apartments from the new owners after privatisation) gained valuable assets that could be used as collateral to borrow money, start a business on the premises, rented (often to expatriates) or sold to realise, in some cases, a significant capital gain. It could be argued therefore, that the privatisation of apartments led to a significant increase in inequality in the distribution of productive wealth (Griffin, 2001, p.10). These issues are discussed in greater detail in section 6.

4. Theoretical Perspectives

This section considers in more formal and general terms the way in which a privatisation 'event' leads to changes in poverty and the distribution of income. It identifies a number of different channels of causation linking the initial 'event' to its subsequent effects on poverty and inequality. It also emphasises that the channels of causation are influenced by a wide range of background factors, many of which are as much a part of the process of transition as privatisation itself.

The Impact of Privatisation on the Wealth And Income Distribution

Privatisation, narrowly defined, is simply a change in the wealth distribution, as state owned assets are transferred to private individuals. It is useful to begin by noting that if the previously state owned assets are correctly priced and sold to agents who have complete information then, although the privatisation re-orders the ownership of different assets, it should not immediately impact on the overall personal distribution of wealth. This is because a person buying a correctly priced asset must pay for it. To obtain the money, they must sell another asset of equal value, reduce their savings by the same amount, or borrow so that their level of debt rises by an amount equal to the value of the purchased asset. At the same time the government receipts rise by amount equal to the value of the capitalised assets sold (Alexeev, 1999, p.450). The personal distribution of wealth only changes to the degree to which state assets are not correctly priced or agents do not have access to the same information sets or an equal ability to take advantage of the privatisation offer. This would suggest that there is a *prima facie* case to suppose that the early privatisations in Mongolia produced an unequal distribution of wealth, as the assets distributed were not priced and in the early years there was little dispersed knowledge or understanding of the opportunities that specific privatisations might bring.

Although there are theoretical grounds for believing that the early privatisations led to inequitable changes in the distribution of wealth, changes in poverty and inequality are, in the first instance, reflections of changes in the distribution of real income flows[3]. The impact of privatisation is therefore dependent on the way the new, post-privatisation distribution of wealth leads to changes in real income flows. The pathways through which this occurs may be very complex. For example, the privatisation of apartments, in itself, does not immediately change real income flows. The same people are living in the same apartments and therefore are receiving the same flow of housing services after the privatisation as before. However, because of the privatisation the new owners can now take decisions that do have an effect on the distribution of income – renting out rooms or using the premises for businesses or selling the property to generate capital for other enterprises. An analysis of the distributional impact of privatisation must trace out these linkages.

Indirect Effects on the Distribution of Income

In addition, the privatisation will have a number of indirect effects, which will compound any direct changes in the distribution of income. Privatisation and the changes associated with it are also likely to change the rate of return on assets (Birdsall and Nellis, 2002; Alexeev, 1999). For example, the rate of return on capital invested in Small and Medium Sized Enterprises (SMEs) is likely to change following privatisation and the associated liberalisation of prices. In addition, asset ownership alters agents' control and access to other economic resources and, more generally, to other forms of economic power. In particular, an agent's access to credit is usually a function of their ability to muster sufficient collateral. An unequal privatisation will change the potential collateral available to agents and will, therefore, generate unequal access to credit and in agents' ability to participate in the newly emerging private sector. This will have a separate and continuing effect on the distribution of real income flows (Ferriera, 1999). For example, the privatisation of apartments has allowed many recipients to borrow against their newly acquired asset to start new businesses; this opportunity is not open to those who were not sitting tenants. Similarly, those who acquired large herds during the livestock privatisation have an access to credit which is not available to those with a small number of animals.

The change in asset ownership also directly alters agents' fallback positions. This increases agents' vulnerability to shocks and changes their ability to take risks and to take advantage of what economic opportunities do emerge. For example, a herder with five hundred animals can be much more confident in taking risks than someone with only a small herd. Even if unsuccessful, the impact is cushioned by the stock of wealth; no such cushion is available to the small herder. This means that the same economic opportunities will be perceived differently by those with different herd size; the smaller herders will be more risk averse. A similar point applies to the ability to survive unforeseen shocks, such as winter *Dzuds* and summer droughts. Those with large herds can absorb the same shock that reduces to destitution those without such a fallback. These factors mean that privatisation will influence the distribution of income, and thereby poverty and inequality over time, with a strong degree of path dependence. A corollary of this is that judgement about the impact of privatisation on poverty and inequality depends on the time period under review, with the final equilibrium effects perhaps many years in the future (Birdsall and Nellis, 2002, p.7).

Changes in the Behaviour of Privatised Institutions

The change in asset ownership that defines privatisation usually leads to changes in the behaviour of the privatised institution. In fact, privatisation is very often justified

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[3] Real income flows must be broadly defined because of changes in the boundaries between the market

in such terms. Such effects follow from the changes in objectives and control which privatisation brings to the management of the formerly state assets. However, it is important to note that such changes are not necessarily the result of privatisation *per se*; they may, and in many countries often are introduced during the period of state control prior to privatisation. Nevertheless, the effects on poverty and inequality flowing from these changes in objectives and control are usually seen as part of the privatisation process. These effects are complex and difficult to isolate, even in theory. They also operate at several different levels.

The narrowing of the business objective to a focus on profit suggests that many forms of provision, for example, child care, some educational provision, some forms of health provision and, in some circumstances, even housing, are likely to be eliminated or sharply reduced (Commander *et al.*, 1999, note this phenomena in the case of Russia). Many of these represent non-market elements of a social wage, which the new state may be unwilling or unable to provide. Their removal is likely to have an immediate effect on poverty and inequality. At the same time, the new emphasis on profit leads to a wide range of further changes, which must be viewed as direct consequences of privatisation. The most important in terms of their impact on poverty and inequality are changes in employment, wages and prices.

Privatisation has led to major re-structuring and retrenchment of the labour force in most countries (Birdsall and Nellis, 2002). In almost all cases this has led to large rises in unemployment, with immediate effects on poverty and inequality. Of course, the precise impact depends on a large number of contingent circumstances (Ferreira, 1999). These include the health and vitality of the emerging private sector, which largely determines the speed with which those who lose their jobs are re-employed. In addition, the range and level of benefits available from the state has a potentially cushioning effect. However, there seems little doubt that a considerable transitional cost is usually borne by those who lose their state jobs and that this may extend many years after the initial privatisation and may, indeed, be a characteristic of the new, long run steady state (Ferreira, 1999).

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and non-market sectors and between the formal and informal sectors.

A further consequence of the new found desire and ability to pursue profits is the impact on the income distribution within firms. Two effects may be distinguished. First is the distribution between the new asset holders and workers; broadly we may think of the functional distribution between wages and profits (Milanovic, 1999). For example, the new owners of SMEs will receive profits that formerly would have been remitted to the state, which will widen the gap with non-shareholders. Second, however, the distribution within the factor shares is likely to change. Privatisation typically leads to a stretching of the distribution between those with managerial and professional incomes and the ordinary worker (Milanovic, 1999). In newly privatised and newly established businesses, for example, economic theory would suggest that the pursuit of profit would lead the new owners to take advantage of the pressure of unemployment and poverty in the labour market to reduce wages for the unskilled manual worker, so raising the gap with those in skilled and managerial positions. This 'hollowing' out of the centre of the distribution, with some benefiting but many experiencing sharp falls in wages, is a common experience in transition from Soviet style economies (Milanovic, 1999; Commander *et al.,* 1999).

Privatisation has also led to very sharp changes in relative prices. Privatisation is part of the process of removing the system of subsidy through which the socialist (and, indeed, other) governments in the past ensured that basic goods remained accessible and cheap. One of the inevitable impacts of privatisation is, therefore, the large rise in the relative prices of necessities. This disproportionately impacts on the living standards of the poor. Large price rises in basic utility prices, heating, water, electricity, have been a notable feature of Mongolia's transition. Note that this effect is quite separate from the contemporaneous inflation that took place in all transitional economies. However, the long run effect is ambiguous (Birdsall and Nellis, 2002, pp. 15-16). If privatisation raises efficiency then the relative price of the privatised output may fall. However, this largely depends on the competitive environment and regulatory frameworks, which are not, in themselves, guaranteed results of a privatisation programme. In addition, it should be noted that privatisation very often leads to access restrictions on the poor, which can be thought of as raising prices for the poor to such a degree as to exclude them from the market completely (Birdsall and Nellis, 2002, p.16).

The Impact of Privatisation on Government Finances and Objectives

A final important potential channel through which privatisation may influence levels of poverty and distribution of income is through its impact on government finances (Birdsall and Nellis, 2002, p.17). This effect is complex and the direction of its likely impact on poverty and inequality is ambiguous. Many state owned assets, and particularly, the state owned enterprises, received extremely large subsidies. Privatisation, at least in principle, removes the necessity for such subsidies. In addition, once privatised, formerly state owned enterprises are, in principle, subject to tax and should make a positive contribution to the state treasury. However, at the same time, many of the social functions of the state were carried out through state owned enterprises and other collective entities. In Russia the evidence points to a cut back in the provision of such benefits (Commander *et al*., 1999) and it must be assumed that such a profit maximising approach is likely in other transition economies. The responsibility for the provision of such non-monetary benefits shifts to the state, which, on the basis of the evidence from other transition economies (Commander *et al*., 1999), it seems unprepared to accept.

It is also worth noting that government policy, both in broad terms and more precisely defined, is endogenous to the process of privatisation. That is, as privatisation proceeds the resource base of the state (the balance of taxation and spending), the policies available (in terms of the number and power of policy instruments) and the range of responsibilities (for housing, for example) all change. The counterfactual against which privatisation is assessed must include a specification of how government policies could reasonably have evolved under different models and sequences of privatisation.

The Main Channels of Causation

This initial consideration of the channels through which privatisation may influence poverty and the distribution of income suggests that we may classify effects as operating through three main channels:

- The impact on real income flows of the change in asset ownership;
- The restructuring consequent on the change in ownership;
- The fiscal implications of the privatisation.

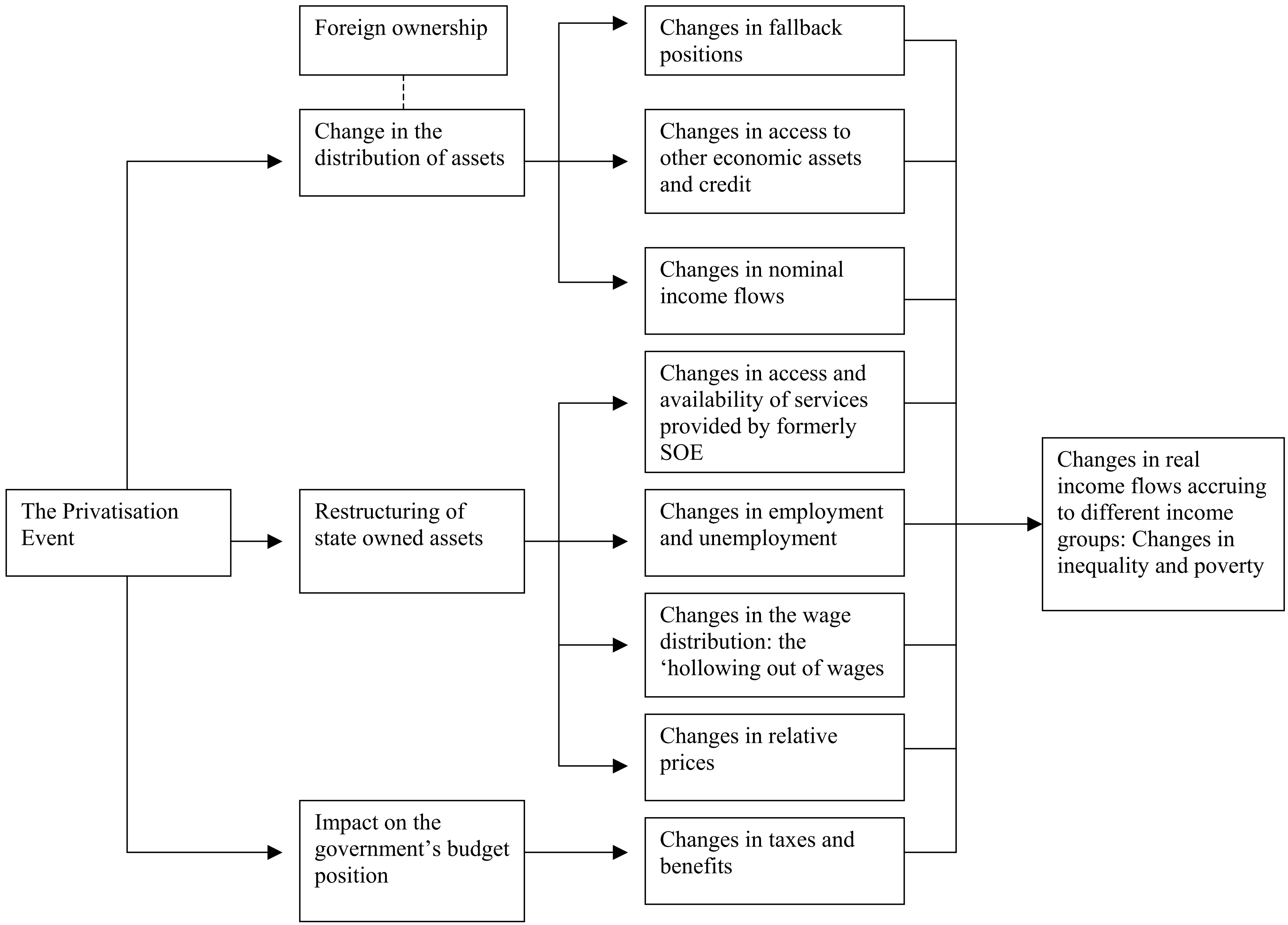
However, although these connections are likely to operate with any privatisation, the degree to which one or another is the dominant effect and the overall impact will depend on a wide range of other, contingent factors. Many of these background factors, which mediate the initial causal influences are themselves important elements in the transition to the market.

The transition to the market was accompanied in every country with very large falls in output and employment, which occurred independently of and in addition to any changes that can be associated with privatisation. In fact, these initial falls in output usually preceded the privatisation events but are, nevertheless, extremely difficult to separate in terms of their impact. In addition, the transition to the market was accompanied by episodes of very high inflation. Both the price inflation itself and the changes in relative prices, which the high rates of inflation tended to conceal, are likely to have had very sharp impacts on the real incomes accruing to the poor.

As well as the more immediate and obvious conditioning factors there are a large number of other influences that mediate the impact of privatisation. The most important of these is the institutional framework within which privatisation occurred. At its broadest this includes the overall framework of law and law observance, especially in crucial areas such as property rights and contract law more generally. More narrowly, the behaviour of the newly privatised sectors will depend very strongly on the regulatory structures that were in place at the time of the privatisation event, the way in which these were applied and the way they evolved as further privatisations took place.

We conclude this section by summarising, in Figure 1 below, the different channels by which a privatisation event may impact on distribution and poverty. This illustrates the complexity of the pathways but does not capture the conditioning factors; nor can it handle the counterfactual judgements that must be made in any evaluation of the privatisation process. This means that, as concluded by Birdsall and

Nellis, while "…it is possible to analyze the distributional impact…the best approach is at the country level." (Birdsall and Nellis, 2002, p.26).


Foreign ownership
Change in the distribution of assets
Changes in fallback positions
Changes in access to other economic assets and credit
Changes in nominal income flows
Changes in access and availability of services provided by formerly SOE
The Privatisation Event
Restructuring of state owned assets
Changes in employment and unemployment
Changes in real income flows accruing to different income groups: Changes in inequality and poverty
Changes in the wage distribution: the 'hollowing out of wages
Changes in relative prices
Impact on the government's budget position
Changes in taxes and benefits

5. The International Experience

Privatisation programmes have been designed and implemented to meet a wide variety of often-conflicting objectives.

In developed market economies, privatisation has frequently been driven by both economic and ideological considerations. Economic objectives have included improvements in efficiency and competitiveness, the generation of revenue from the sale of public sector assets and the consequent improvement in public sector finances. Ideological considerations included reducing the role of the state and weakening the power of public sector trades unions. In low-income developing countries, privatisation has usually been part of a reform package aimed at stabilising the macro economy, especially with respect to public sector finances and the balance of payments, and liberalising and deregulating the domestic economy in order to reallocate factors of production to the tradable goods sector. In transitional economies, privatisation, apart from its other objectives, has been seen as an essential component of the rapid push to establish a market economy and to cement the new political and economic order.

The experience of privatisation has differed greatly between countries and regions, in part reflecting this diversity of objectives but also reflecting the extent of privatisation, the speed at which it has been implemented, the methods used to privatise enterprises and the post-privatisation competitive and regulatory environment. In the first phases of privatisation in low-income and transitional economies, largely small enterprises in agribusiness, light manufacturing and services were disposed of. By the end of the 1980s however, large public enterprises, especially in the utilities and infrastructure sector, were being privatised, using foreign capital and stock market equity issues, and which accounted for almost one half of low income economies' privatisation revenue (and with Latin America accounting for over 60 per cent of this sales revenue) (Kirkpatrick, 2002, p.121).

Even with respect to the transitional economies, the procedures for, and the outcomes of, privatisation have varied enormously. The balance between the sale of assets to domestic and foreign capital has varied widely, and where the lack of domestic capital has proved a constraint on privatisation, many countries have moved towards the "free distribution" model (Lavigne, 1995, p.165, provides an excellent discussion) involving either a distribution of vouchers or coupons or the distribution of shares in investment funds or holding companies. The Czech and Slovak Republics, Romania, Bulgaria, Poland and Russia have all used variations of these schemes. In a number of countries, so-called "spontaneous privatisation" has occurred (for example, Poland and Hungary) where members of the former communist *nomenklatura* have become owners of the companies they previously managed. Where the companies themselves have initiated privatisation, as in the case of Russia for example, "insider information" has led to a kind of spontaneous privatisation (Lavigne, 1995, p.169).

What therefore, can we learn from the international experience of privatisation that will help us better understand the impact of privatisation on poverty and income distribution in Mongolia? The existing evidence can be summarised as follows:

- The distributional impacts of privatisation have attracted relatively little attention (Ramanadham, 1995, Chapter 14, quotes case study evidence from the Philippines, Thailand, Bangladesh and Nigeria); greater transparency associated with the privatisation event might focus attention on this issue;
- The shift of enterprises to private ownership in general improves the enterprise's performance, although there are exceptions (Birdsall and Nellis, 2002, p.12);
- In low income and transitional economies, the evidence suggests that privatisation is more difficult to launch and is less likely to generate quick, positive, effects (Birdsall and Nellis, 2002, p.12);
- Outcomes with respect to ownership have often been "troubling or disappointing"; the distributional impact of vouchers has also been "disappointing" in countries such as Russia, Czech Republic, Moldova, Kazakstan, Lithuania and Mongolia, not in the sense of worsening the income position of those who received vouchers but in the sense that returns on vouchers were less than expected or promised and that much of the wealth was gained by an "agile" or "dishonest" few (Birdsall and Nellis, 2002, pp.18-19).

Often the best companies were not privatised by vouchers but via non-transparent deals with managers and their supporters.

- With respect to the employment impact of privatisation, the evidence suggests that more people have lost jobs then gained them through privatisation (most obviously where privatisation has led to the loss of jobs in previously overstaffed SOEs);
- With respect to prices and access, utility privatisation has resulted in network expansion and increased access to services by the population, especially the urban poor, but increased access has often been accompanied by increases in prices.
- With respect to the fiscal effects of privatisation, there is some empirical evidence to suggest that privatisation proceeds transferred to the budget are saved, that is, used to reduce domestic financing on a one-for-one basis (Barnett, 2000). Birdsall and Nellis (2002) argue that, given tax systems in low income economies are typically regressive, there is an indirect gain when privatisation reduces loss-making public enterprises in that either taxes can be reduced (which is admittedly unlikely) or that the revenues made available may be put to "better use". Furthermore, newly privatised enterprises may pay more tax, thus increasing government revenue, and expenditure patterns might become more progressive.

Overall, it is concluded by Birdsall and Nellis (2002) that most privatisation programmes have done more to enhance efficiency than equity and that at least initially, and on average, privatisation has worsened the distribution of wealth (highly likely) and the distribution of income (likely). As is to be expected, the negative wealth distribution effect arises largely from the transfer of assets to the relatively rich. The negative income distribution effect appears to result from movements in prices and wages although, as we noted above, assets generate income streams that may also feed into greater levels of inequality.

To what extent are these conclusions location or system specific? Birdsall and Nellis (2002) in fact argue that their conclusions with respect to privatisation and income distribution depend heavily on findings from the FSU and Eastern Europe (and especially Russia and the Czech Republic), and that generalisations should not be made on the basis of these experiences alone. While this is undoubtedly the case, it would nevertheless be difficult to argue that the Mongolian experience of privatisation did not share a great deal with those of these two countries and that important lessons can be learned from an examination of all three countries.

To conclude this section, a number of significant points need to be re-emphasised.

First, we must be careful not to ascribe, without empirical evidence, a causal relationship between privatisation and the increase in inequality or poverty in any particular country for any period of time. Changes in income distribution and poverty may well be the result of the other reforms and policy changes taking place simultaneously. The counterfactual must attribute to ownership change only those post-privatisation changes in performance that are clearly the result of ownership-change *per se.* In a transitional economy where economic, social, political and institutional change are rapid and all pervasive, this is a technically demanding task.

Second, there is some evidence to suggest that it is not the amount or speed of privatisation that might impact adversely on income distribution but rather it is the method of privatisation used, the behaviour of the owners of the newly privatised enterprises, the sequencing and intensity of other market reforms and the extent and quality of the institutional framework prior to, and during, the privatisation process (Birdsall and Nellis, 2002, pp.24-25). In particular, what is important is the functioning, accessibility and honesty of the legal/judicial system, the structure and prudential regulation of capital markets and insolvency/bankruptcy regimes, and the capacity of the state to regulate natural monopolies to prevent the abuse of monopoly power (Djankov and Murrell, 2000, cited in Birdsall and Nellis, 2002).

Third, if it is indeed the case (as argued by Barnett, 2000) that there is empirical evidence to support the hypothesis that privatisation is positively correlated with improved macroeconomic performance and higher real GDP growth, which, other things being equal, will raise incomes and employment and reduce poverty, then the point at which we evaluate the impact of privatisation becomes of crucial importance. Birdsall and Nellis (2002) highlight the changing fortunes of the Czech Republic and

Polish economies and the corresponding swings in opinion as to whether or not those economies were pursuing the correct paths of reform. What period of time needs to elapse between the privatisation event and the evaluation of the impact on inequality and poverty?

Fourth, the empirical evidence overwhelmingly supports the conclusion that it is the competitive market structure, rather than ownership *per se* which determines enterprise performance. The force of this argument may well of course be enterprise, sector and economy specific, that is, some enterprises in any sector, and some sectors in some economies may not be amenable to, or have access to the resources required for the necessary restructuring which will raise productivity and competitiveness whilst remaining in the public sector. But in general we cannot ignore the force of both theory and empirical evidence in concluding that market structure matters more than ownership as far as efficiency is concerned.

Fifth, privatisation in market economies is fundamentally different in at least one respect from privatisation in transition economies. In the former case, the market economy and its institutions are given. In the latter case, the market and its institutions have to be created as part of the transition process itself. Privatisation by itself will not create these institutions, and as Stiglitz (2002) and others have argued, privatisation in the absence of a proper institutional infrastructure will be unlikely to yield the desired or predicted outcomes, especially with respect to economic growth. This highlights the strategic importance of industrial development policy, in its broadest sense, and the continued role for the state (especially with respect to dealing with market failures) throughout the whole of the transition period.

Sixth, a number of economies, including Poland and the Czech Republic, have embraced the notion of “popular capitalism” based on widespread share ownership in privatised enterprises (and of which, at least implicitly, we see echoes in Mongolia). As noted above, the distribution of vouchers or shares allows for rapid privatisation and “solves” the problem of enterprise valuation and the lack of private savings to buy them, and guarantees the irreversibility of the transition process. But as Bos (1995, p.64, in Ramanadham, Ed., 1995) argues, “Popular capitalism is a bad instrument for good types of redistribution (that is, taking from the rich and giving to the poor). It may, however, be a good instrument for bad types of redistribution (that is, favouring particular interest groups)". This argument once again emphasises the dynamic impact that privatisation will have on income distribution and poverty and that privatisation by itself is not sufficient to guarantee the development of a dynamic, competitive private sector. In particular, voucher distribution does not guarantee the funds needed for post-privatisation enterprise restructuring, does not ensure access to the technologies and expertise required for raising productivity and competitiveness and (except in special circumstances where investment trusts might be effective), does not deal with the issue of corporate governance effectively.

To summarise the discussion so far. Measures of income inequality (as measured by the Gini Co-efficient) have risen in post-privatisation, transitional economies. In some countries – Czech Republic, Hungary, Slovenia – the rise has been substantial. In other countries, the rise has been enormous – Russia, Tajikstan, Armenia (Birdsall and Nellis, 2002, p.24). But given our present state of knowledge, we cannot be certain of the role that privatisation itself played in this increase in inequality. It is also the case that in the longer run, privatisation *per se* will not determine the path of income distribution. As Greenidge (1995, p.263) has argued in a very different country context (Guyana): "[Privatisation]…may have beneficial or adverse impacts on income distribution, depending on the time perspective and one's objectives, but the final pattern will be settled by overall economic policy and the capacity of the private sector in alliance with its partners, local and foreign, government and private sector, in relation to its foreign competitors".

Poverty and income distribution, although closely related, are conceptually separate. The international experience surveyed so far has focused on the distributional consequences of privatisation. What can be said more directly about the impact of privatisation on poverty? To our knowledge, relatively little has been written on this question. The exception is Bayliss (2000) but even here the focus is on utility privatisation and its impact on poverty. Nevertheless there are general issues that can be raised to indicate the directions that empirical research should take.

The impact of privatisation on poverty is mediated through channels similar to those with respect to income distribution – its impact on economic growth and employment, the provision of non-wage employment benefits, the development of the private sector, the fiscal impact, improved enterprise performance and, when part of a bilateral or multilateral aid programme, the release of aid funds once privatisation conditionalities have been met. Adverse impacts include the problem of "cherry picking" (the focus of private enterprises on the most profitable activities or sectors at the expense of less profitable or socially beneficial areas), negative impacts on prices and employment, weak institutional and supervisory capacities in the post-privatisation period and the association of privatisation with cronyism and corruption, leading to the consolidation of economic and political power in the hands of interest groups that rarely represent the interests of the poor (a similar point is made by Cook and Kirkpatrick, 1995).

Bayliss (2000, p.17) concludes that the impact of privatisation on poverty can be complex, a view that would now command universal acceptance. From a policy perspective however, her conclusion is worth quoting:

"If policies are to be policy focused they need to be reconsidered at a fundamental level rather than rehashed changing just the language to recognise the needs of the poor. Blanket privatisation needs to be abandoned in favour of a case-by-case approach where the overall objective (such as universal service delivery for example) is the starting point. From this point, alternative options can be considered and evaluated. Privatisation is just one possible option. Public sector reform and corporatisation are others. Such approaches may be far better suited to meeting the needs of the poor".

A fundamental question underlying much of this discussion is whether we view privatisation as an end in itself or a means to the achievement of other objectives. If privatisation is seen merely as an end in and of itself, that is, simply, the transfer of resources from the public to the private sector, then speed and simplicity are the important characteristics of the privatisation process.

If, on the other hand, privatisation is viewed as a means to an end, that is, broadly, the development of a dynamic and competitive private sector within the context of a rapidly growing market economy, then the whole range of factors mentioned above –

timing, sequencing, modes of divestiture, the post-privatisation regulatory framework, the competitive environment, issues relating to corporate governance and the behaviour of privatised enterprise owners, access to, and cost of, investment funds for re-equipment and restructuring, access to new technologies, expertise and markets, government policies to put appropriate incentive structures in place, create the institutions to deal with market failures and assist enterprises in the development of their capabilities (to use Lall's terminology (Lall, 1991)) become more important. The quality of the "privatisation event" becomes more important than the quantity.

From this perspective, it becomes clear that privatisation in certain circumstances, may well be counter-productive. The absence of an effective institutional framework, a weakened state, limited access to foreign capital and technology, a weak or poorly developed domestic entrepreneurial class without appropriate government support and public opinion which may well have become hostile to privatisation (in part because of perceived cronyism and corruption), will all make the achievement of development goals in general and poverty alleviation in particular, very difficult.

6. The Sample surveys

A number of surveys were commissioned by UNDP (Mongolia) to attempt to investigate further the impact of privatisation on poverty and inequality. The Centre for Social Development (CSD) conducted two participatory surveys, on livestock privatisation and on apartment privatisation respectively. In addition, the National University of Mongolia (NUM) conducted two sample surveys, on apartment privatisation and on Small and Medium Sized Enterprises (SMEs). The main points from each of these surveys are presented and discussed below.

Livestock Privatisation Participatory Survey

The privatisation of livestock (and livestock related assets) took place over the period 1991-1993 and had an important symbolic as well as practical significance. Despite its importance there is a dearth of reliable data on its detailed implementation. There are a number of reasons for this. The overall approach to this privatisation – distribution to the members of the agricultural co-operatives – was determined by

Parliament. However, each collective determined the precise way in which this was executed with little formal centralised records kept of the individual privatisations. In particular, data about the details of allocations to individuals and families were, in most cases, not kept. Finally, of course, this first privatisation of the transition era took place more than 10 years ago. For all of these reasons, it is extremely difficult to make satisfactory generalisations about the privatisation and even more difficult to establish with any precision how livestock privatisation impacted on poverty and inequality. It seems likely, however, that there was wide variability in its effects.

The inadequacy of the data available meant that a participatory survey was considered the most appropriate approach to follow. A number of sites across Mongolia were selected based on the population distribution, the numbers of livestock and the number of poor and very poor households. Structured interviews were held in three *Soums* (districts) from the Arkhangai, Tuv and Zavkhan *Aimags* (provinces). The major points raised by participants are reported below.

As noted earlier, although the major livestock privatisation took place over the period 1991-1993, there had been some privatisation of herder services prior to this, with herders being contracted to herd and raise animals up to set numbers and standards, with the possibility of their keeping any animals above the 'contract'. It seems that some herders regretted that this 'intermediate' system was so swiftly replaced with a full privatisation and it is clear that many participants regarded the privatisation as being too hasty, with insufficient attention given to the dissemination of information and knowledge and too little attention paid to the predictable consequences of the privatisation, both in economic and social terms.

The process of privatisation was on the basis of the voucher system. However, the Government's decision to allow the Cooperatives to choose the precise methods by which the assets were privatised meant that there were considerable disparities in the distribution of the assets across the rural communities in different *Soums*.

There appears to have been two broad options followed with respect to the initial, small voucher privatisation of herds and other, herd-related assets such as wells and shelters. The first of these defined those eligible very broadly as those in the Soum holding the requisite vouchers and included both those working directly for the cooperative, their families and those working for related cooperative trades and even some of the local Soum officials. This option appears to have met with broad acceptance as being fair. However, a second option defined cooperative members much more narrowly as active cooperative members, with vouchers distributed to these members according to a prior allocation of animals and other assets. This form of privatisation appears to be regarded as much less fair, with several categories of rural dwellers excluded, including, it is clear, in some cases pensioners who had worked on the cooperative for many years, those who had contributed their livestock to the initial establishment of the cooperative and, on occasion, children and students.

The administrative process of privatisation appears to have been generally regarded as fairly executed although a wide range of simple administrative errors were recalled, including failures of registration of members, failure to issue vouchers, failure to register children's entitlement as well as more obvious examples where 'insider' knowledge led to bias in final allocations. However, participants noted that the simple arithmetic of privatisation devolved to the local *Soum* meant that the chance differences in the density of population relative to herd population generated unequal outcomes. In addition, of course, privatisation by individual entitlement meant that outcomes for different family groups could be markedly different.

The initial livestock privatisation using red vouchers took place in 1991-1992 and was followed by an attempt to implement a grand privatisation of the larger assets and organisations of the collectives, using the blue vouchers, with cooperative members being encouraged to pool their entitlements to purchase assets jointly under plans drawn up by the previous cooperative administrations. These privatisations appear to have been universally unsuccessful with almost all of the companies unable to operate successfully in the new environment of the early 1990s. Almost all of these initial companies have disappeared with their assets effectively divided between the 'owners' who had held the vouchers.

The failure of the newly established companies meant that many of the assets of the old cooperatives fell into disuse, or were dismembered and dispersed as the individual 'owners' removed 'their' share. At the same time, participants noted that some of the central assets were effectively transferred to the central ownership of the *Soum* and then into private hands. Such 'underground' privatisation meant that only a small circle knew the precise distribution of assets and their worth. There appears to be general agreement that this form of privatisation was wholly inequitable.

The physical collapse of the buildings and plants was paralleled by the collapse of the organisations of the cooperative; businesses simply ceased to exist and the output of the varied goods and services which had characterised the cooperatives disappeared, generating unemployment and increases in poverty. The collapse of cooperative businesses also had knock on effects on the chain of other livelihoods not formally part of the cooperative. Participants also pointed to the disappearance of the social services provided through the cooperative; these included education and health services as well as other support networks. Participants argued in general that the privatisation had lacked forethought with respect to the likely economic and social outcomes.

The decade since the major part of the livestock privatisation took place can be divided into the period 1993-1998 and 1998-2003. In the early period prices for livestock products increased, herd size rose by a quarter and many of the new herders became comparatively wealthy. However, at the same time the numbers engaged in herding increased considerably with large numbers of urban dwellers inexperienced in the practice of herding taking to the land in response to the industrial collapse that was taking place in the cities and towns. Indeed, animal husbandry was one of the only sectors to show any vitality in the early years of transition. Inevitably, both prices and productivity declined. To compound this, since 1998 extreme weather conditions, during both winter and summer, have led to many of the newer and smaller herding families losing their livelihoods and all herders suffering considerable loses with the national herd falling dramatically.

Although it is quite clear that the primary cause of this change in fortunes was climatic, the privatisation arguably exacerbated many of the problems generated by the weather. The comments of participants broadly support the claims of Miller (no date) and others, reported in section 3 above. Participants noted that in the period after privatisation there was a lack of attention to the subsidiary aspects of animal husbandry. A number of critical areas were highlighted. Many of the herders, especially the small herders, lacked experience and the demise of the collective meant that there was no way in which this experience could be widely disseminated, either locally or intergenerationally. In addition, the skills of collaboration, which had allowed specialisation and a more efficient division of labour within the cooperative, fell into abeyance. A range of essential communal services had also been destroyed or severely reduced by the privatisation. Participants mentioned wells and animal shelters, many of which had fallen into disrepair or had simply disappeared. The production of fodder was also severely reduced because the machinery for making fodder had been privatised and, for the most part, lost as a communal asset. The participants also highlighted veterinary services, which had been supported by the cooperatives, and, in particular, breeding and stock selection. The rundown of these services meant that a range of problems such as premature births of animals, falling yields and the elimination of good stock increased in incidence. It was also noted that the composition of herds changed due to privatisation, with individual herders responding to the increased price of cashmere to raise the proportion of goats in their herds so that the aggregate herd size rose above the level necessary to sustain the pastureland; in some areas the pasture was reported to be under severe pressure. The collectives had been able to internalise these decisions and maintain a sustainable pasture.

While the weather was clement all of these emerging problems were not treated with any urgency. However, they were brutally exposed by the winter *Dzud* and the summer droughts. As many of the participants argued that, rightly or wrongly, new institutions will emerge to deal with such interdependence. However, the speed of privatisation and the failure to investigate the possible consequences of the elimination of collective services were the reason for the lack of elasticity in the system in the face of the exogenous shock of extreme weather. These were policy choices that could have been different.

The participants also highlighted the changing balance in herders' income portfolio, with the market-dependent proportion rising at the expense of the regular wage provided by the collective and supplemented by collective social services. The net effect of these changes is clearly to increase general vulnerability to downturns. This especially affects the poorer families living much closer to the margins of subsistence. Their problems have been exacerbated by the decline in social and health service provision and the costs of insurance cover for such services, which, while individually small, are noted to be considerable burdens on the poor and are very often not paid. The participants also highlighted the increasing costs of education for children. Some of these problems were exacerbated by the failure of records of eligibility for benefits; these records had been kept at the level of the cooperative and many were reported lost, generating considerable hardship for many.

The impact of agents' different herd size on their access to credit is well supported by participants' comments that noted the inability of small and medium sized herders to borrow from financial institutions. Borrowing from such institutions was reported to require collateral of at least 500 animals. Most of the poor and many of the medium sized herding families are therefore locked out of using the formal financial system for working capital or for other investment projects.

Apartments Privatisation Participatory Survey

The intention to privatise housing was evident in the very early days of transition and by 1992 was formally part of the new Government's action plan. By March 1994 the Privatisation Commission, in cooperation with relevant ministries and other agencies had formulated an Action Programme for the 1994-1996 period in which the major issues relating to apartment privatisation, such as maintenance and service charges, legal and other implications and the new administrative arrangements appropriate for the housing sector were, at least partially, addressed. In 1995, the objective of undertaking housing privatisation once such preparations were complete was passed in Parliament. Finally, in October 1996 the *Ihk Hural* passed the Law on Housing Privatisation, which determined that apartments would be passed without charge to their sitting tenants. Although some earlier apartment privatisations had occurred, the vast majority of privatisations occurred in the years immediately after the passage of this law. By 2001 the great majority of apartments (97.13 per cent of those identified in 1996) had been privatised. In addition to the transfer of ownership, a number of further important changes relating to the emergence of a private housing sector occurred. In particular, the organisations which provided utility and apartment services were re-structured into the Association of Apartment Owners, which had the objective of providing communal services and of dealing with issues relating to communal ownership. By 2001 such organisations covered over 75 per cent of the privatised apartments.

The CSD undertook a Participatory Survey on apartment privatisation in the first half of 2003. This consisted of 30 structured interviews with residents from two districts of Ulaanbaatar and twenty further interviews in Darkhan-Uul City. Ulaanbaatar contains 63 per cent and Darkhan-Uul 11 per cent of privatised apartments. In both cases households were randomly selected and included both those who had and who had not participated in the privatisation process.

The results are very striking and indicate that many of the channels potentially generating inequality were operative in the Mongolian apartment privatisation process. However, one of the most immediately noticeable features emerging from the survey is the complexity of the dimensions of inequality, as perceived by participants, upon whom the privatisation impacted.

Participants indicated that the process of privatisation was equitable or fair in the sense that, for the most part, those who met the criteria for obtaining an apartment did receive what they expected. However, with only 22 per cent of the population gaining from this privatisation there were many who failed to gain anything and amongst those who benefited, there were large differences in the extent of gains.

Participants were clear that the transfer of apartments at no charge was iniquitous *vis-à-vis* the *ger* dwellers. However, participants also highlighted several other dimensions of inequality. In particular, there were 'good' and 'poor' apartments. The 'good' apartments were already almost exclusively in the hands of the already better off or those with power and status. The transfer of these apartments at no cost provided much greater initial capital to those who had the position, information and connections to make the most profitable use of it. This effect was exacerbated by the large differences that emerged in terms of locational advantage. Central Ulaanbaatar rapidly became the most expensive and sought after area, both by wealthy Mongolians and foreigners. Those owning apartments in this area made very handsome profits, either through sale or rent, compared with those in peripheral parts of the city and in the other regional centres.

There was also the problem of several families living in a single apartment, in which case only one of the families gained ownership rights. A further iniquity highlighted by the survey was the position of those on the waiting list for apartments. The previous system had allocated apartments according to a waiting list (although this could be overridden on behalf of 'special' cases). However, privatisation allocated apartments to sitting tenants only – those on the waiting list, no matter what their situation and how long they had been waiting, were excluded. Participants were still keenly aware of the implicit contract under which apartments were a 'public' good on which those currently without an apartment nevertheless had a legitimate claim. Young couples, those who had been studying, and those who had recently completed compulsory military service all now found themselves with very little chance of obtaining an apartment which they had formerly expected as their right. This also highlights the difficulties generated by the privatisation of very nearly the entire housing stock; with almost no residential apartments left in the public sector there is no provision of any form of social housing. A retreat to the *ger* areas seems the only alternative open to those left without apartments and without the wherewithal to enter the newly emerging rental market.

One of the key results is that the single most important factor raising poverty levels for apartment dwellers was not the privatisation *per se* but the concomitant increases in basic service charges – gas, electricity, water, heating. The increase in these charges far outweighed the disappearance of the heavily subsidised rent. This left the vulnerable much worse off after the privatisation than before and frequently induced 'distress' sales of apartments as well as other, less drastic methods of dealing with falling real incomes.

The privatisation of apartments was an asset re-distribution – and the consequences for poverty and inequality centre on the extent to which the newly acquired asset could be employed to generate an income stream sufficient to outweigh the impact of the price liberalisation of service charges. The Participatory Survey indicates that a great many devices were used to translate the asset into an income stream. As indicated above, for the very poor this often meant the sale of the apartment with the family moving into one of the *ger* areas or into a fenced area with a *ger*. In less pressing circumstances some families ‘downsized’ to smaller apartments or sold off some of their rooms. In other cases the apartment was not sold but sub-let, either in its entirety or rooms let to, for example, students or single people.

The attempt to obtain cash from the asset, either by liquidation or by generating an income stream, in most cases, seems to have been driven by the rising costs of living in apartments that had formerly been heavily subsidised. In some senses, now that households were facing the ‘real’ costs of living in relatively large apartments they were adjusting the size of living accommodation consistent with their real income. It is clear that the average room space per apartment has fallen since privatisation.

However, for those with capital, often gained from petty trading in the early years of transition, the privatisation represented a considerable opportunity. In particular, participants reported that apartments were often used as a base for business enterprises of various sorts, often to the great annoyance of other residents, who reported being unable to get the local authorities and police to rein in such activities, purportedly because of bribery. In addition, it is quite clear that the use of the newly acquired apartments as collateral for loans was one of the consequences of privatisation, which, perhaps inevitably, stretched the distribution of wealth and income even further. The potential loan would be partly a function of the amount of collateral so those who acquired the ‘better’ apartments would be likely to gain, not just at the expense of the *ger* dwellers, but also relative to others in less attractive apartments. Participants also noted the extent to which such opportunities could be exploited was partly a function of knowledge and experience, with many residents lacking the requisite information and skills to exploit their new asset.

An interesting further point that the participants highlighted was the difficulties encountered with respect to the residual common property – stairwell, landings, and public areas in front of the apartment blocks. New institutions had been created to deal with such problems (the Union or Association of Apartment Owners). However, these were widely reported to be inefficient and, in many cases, it seems, completely ineffective. A similar series of comments emerged with respect to issues of repair and maintenance. The participants also pointed to more difficult issues relating to shared property rights – in particular, the structural integrity of the buildings has become a common property of the tenants with no method of integrating the common interest into an individual's decisions. The focus groups reported considerable problems with load bearing walls being knocked down, internal reconstruction work impacting on neighbours and general nuisance from manufacturing and service provision on premises designed as living accommodation. The method of privatisation seemingly failed to consider the extent of such problems of interdependence and the emergence of legal structures for dealing with such problems seems far distant.

The Apartments Privatisation Sample Survey

The NUM researchers undertook a sample survey of apartment dwellers in the spring of 2003. The survey consisted of a random sample, stratified by living area and location from 5 different locations across Mongolia. 481 apartments were initially identified. However, difficulties in establishing precise ownership rights in the case of absent owners or due to the sale of the apartment meant that only 342 responses gave usable answers to the questionnaire. It should be noted that this means that the questions relating to the ownership and sale of apartments need to be treated with considerable caution; the expedient of eliminating these samples may lead to the systematic under-representation of sale and ownership changes in the remaining sample. The 342 samples were distributed across Ulaanbaatar (204), the Western Region (16), the Kangai (36), the Central Region (65) and 21 from the Eastern Region.

The survey primarily attempted to clarify issues of ownership and housing costs, although there was also a wide range of questions relating to educational attainment.
The evidence indicates that the apartments were indeed transferred to those who had previously been tenants, with on average 12 years of occupancy. The survey also indicated that 57 of the overall sample (17 per cent) had purchased privatised apartments. In addition, 9 respondents indicated that they owned a second, third or fourth apartment. This is 2.6 per cent of all respondents, and is also likely to be an underestimate, given the observations above about sample selection bias with respect to questions of unclear ownership. The evidence is, therefore, of the emergence of a

housing market, particularly in Ulaanbaatar, with some evidence of increased concentration.

Although the evidence is less clear cut, there is a clearly a rental market developing, especially in Ulaanbaatar with some respondents living in rented accommodation, paying on average 105,000 T per month for a 1 or 2 room apartment, although this result must be treated with considerable caution as only 17 respondents answered the question about the monthly rent. However, it is apparent from recently published materials, that apartments let to the wealthy and the expatriate community by local estate agencies in Ulaanbaatar attract considerably higher rents. These average approximately $1,000 per calendar month and there is no shortage of supply.[4]

A second key result demonstrated by the survey was the very large increase in utility and service charges consequent upon privatisation. The sample question asked for the price of services before and after privatisation. The results were as follows:

Table 5: Monthly expenditure on household services

	Before Privatisation				After Privatisation			
	Total	Power	Heating	Water	Total	Power	Heating	Water
Mean	15147	5176	3350	2240	29551	10231	7270	7454
Max	35500	15000	13000	1500	122670	30000	72000	28000
Min	785	105	150	150	7700	1400	736	500

Note: Figures in current Tugriks

There are evidently problems interpreting these data; the precise date of privatisation differs, as does the date defining 'after' privatisation. In addition, the figures are not in real terms. However, as most privatisations occurred in or after 1997, since when general inflation has been relatively low, some inferences seem justified. There has clearly been a very large increase in housing living expenses, with the average total expenses approximately doubling – reflecting a more or less doubling of each of the constituent elements. If the total service charges are expressed as a percentage of reported total income then there is an increase from 29 per cent to 37 per cent – reflecting a very large sudden increase in the relative cost of housing. However, from the perspective of inequality and poverty, the figures for the minimum before and after privatisation are of much greater interest. These indicate an extremely large

[4] Refers to brochures published for the Ulaanbaatar area and advertisements placed in local newspapers during November 2003.

increase, with the average total cost of housing services rising very nearly tenfold. If it is reasonable to infer that the cheapest apartments prior to privatisation were homes for the relatively poorest, then the rise in service charges that accompanied privatisation will have borne down most heavily on this group.

The data on the estimated value of apartments also indicated a very large increase in the price of privatised apartments, especially in Ulaanbaatar. Comparing the value on privatisation with the stated value at the time of the sample indicates a 470 per cent increase. Of course, some of this is simply a reflection of general inflation, but given that the majority of the apartment privatisations have taken place since 1997 this can account for only a small part of the overall increase. In addition, the present 'value' represents the best guess of the owners rather than a market determined price. However, this does seem to provide clear evidence of an extremely large increase in the relative price of apartments. Interestingly, the increase in the value of the maximally valued apartment on privatisation is 180 per cent while that for the minimum valued apartment is 4900 per cent.

The dearth of social housing, the increase in the relative price of apartments and the levels of monthly rent in the emerging rental market suggest that one of the effects of housing privatisation has been to remove the possibility of living in an apartment for those poor who were not tenants at the time of the privatisation. The extremely high levels of service charges indicate that even those poor fortunate enough to have acquired an apartment may have suffered a decrease in their real income. For many this probably meant a retreat into alternative, chiefly *ger* accommodation.

The survey also provides ample evidence of the newly acquired apartments being used as collateral for loans, with many of the loans evidently being for housing 'improvements' or 'alterations' of various kinds.

SME Privatisation Sample Survey

The NUM conducted this survey in the first half of 2003. They report from data obtained from the State Property Committee that over the 1991-99 period 1146 enterprises were privatised by means of capital investment vouchers (red and blue vouchers), open and closed auctions and sale on the Stock Exchange. However, the number of currently existing privatised enterprises does not correspond precisely to this figure as very often there were several privatisation 'events' associated with a given enterprise. In addition, some of the privatised enterprises from the early period have either stopped operating or have disappeared. The enterprise privatisation population was reported to be 751 at the time of the sampling exercise. This population was divided into 'large' and 'medium and small' enterprises. As there is no official definition of a large enterprise it was defined as one with a privatisation value of greater than or equal to 50 million Tugriks. On the basis of this definition the privatised population of Small and Medium Sized Enterprises (SMEs) was 651. From this 82 enterprises were sampled with a stratification based on location, privatisation value and year of privatisation. These were distributed across the country with 38 enterprises in Ulaanbaatar, 7 in the Western region, 15 in the Central region, 9 in the Eastern region and 13 in the Khangai region. However, from amongst these 21 were discovered to have either ceased trading or gone bankrupt at the time of the survey.[5] The final 'effective' sample, for most purposes, was therefore 61 enterprises.

The distribution of the privatisations of the sample enterprises by year is of some interest as is shown in Table 6.

Table 6: Year of Privatisation of sample enterprises

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Numbers	3	18	12	7	3	3	10	18	2	1	1	0

Note: 3 enterprises in the sample had no date of privatisation and are excluded from this table.

There are clearly 2 peak years for privatisation of SMEs, 1992 and 1998, when over half the enterprises in the sample were privatised. It is noticeable that since 1998 there have been very few privatisations.

A sectoral decomposition by the time of privatisation shows that transportation (71.4 per cent of the sample) and processing (64.3 per cent of the sample) were, for the most part, privatised in the early pre-1995 phase, with construction and trade and services broadly distributed over both phases.

[5] A feature of the responses to the questionnaire was that enterprises had 'gaps' in their answers, presumably reflecting periods when they had ceased trading but had not been liquidated.

The sampling questionnaire attempted to elicit, among other factors, information from which inferences might be made about the impact of the privatisation on the distribution of income and poverty. The chief areas of interest were the evolution of share ownership and concentration, of employment and wages, and of non-wage employment benefits. Other data were also obtained on revenues, profits and tax payments. However, the clear incentives to give less than fully accurate returns to these questions, combined with the way in which the data generated from these questions contradicted other information, make these answers of much less use.

Share Ownership

Ownership was divided into 3 categories: corporations, limited companies and partnerships. Corporations are limited companies with shares that are publicly bought and sold on the Stock Exchange. Limited companies are distinguished from corporations by their shares not being freely and publicly bought and sold on the Stock Exchange. Finally, partnerships are simply small businesses with pooled capital and without limited liability. The great majority of SMEs in the sample had opted to for an ownership structure with limited liability. Of the 61 firms in the sample, 37 were classified as corporations, 22 as limited companies, with only 1 partnership/co-operative and one unclassified.

The distribution across the main sectors indicates that 41 per cent of the newly privatisated SMEs were defined as processing, 29.5 per cent were in trade and services, 23.3 per cent in construction, with the rest divided between transportation (4.9 per cent), mining (1.6 per cent) and education (1.6 per cent).

The information on share ownership and concentration is of considerable interest. It is clear that privatisation favoured those with insider knowledge. Fully 55.7 per cent of main shareholders in the sample had worked at the enterprise prior to privatisation. At the same time there is evidence of increasing concentration, with an average of 855 shareholders per enterprise at the time of the initial privatisation declining to 538 at the time of the sample. As the sample included enterprises privatised at different points in time, and we may infer at different points in the process of concentration, it is of some interest to examine the pattern of concentration through time of the early privatisations.

As well as the decline in the number of shareholders there has been a trend of increasing concentration with the major shareholder at the time of privatisation substantially increasing their holding. The detailed results for the four largest shareholders are given in Table 7.

Table 7: Share ownership by 4 largest shareholders

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Shareholder 1	42.4	51.0	51.0	44.2	47.7	42.9	47.5	50.3	55.5	56.5	55.6
Cell size	3	6	6.	9	14	21	25	32	24	25	30
Shareholder 2	40.0	37.7	37.7	34.2	28.1	25.9	27.7	24.4	27.0	27.4	29.1
Cell size	3	4	4	5	9	16	16	19	15	17	21
Shareholder 3	0.0	13.0	13.5	16.0	15.9	16.9	17.9	18.0	15.8	15.6	15.1
Cell size	0	2	2	4	7	12.	13	14	9	9	13
Shareholder 4	0.0	0.0	0.0	19.0	17.8	15.7	16.2	14.5	8.3	8.3	10.7
Cell size	0	0	0	1	2	3	6	7	3	3	6

The survey found that the major stakeholder increased their shareholding from 42 per cent in 1992 to 56 per cent in 2002. For the most part, the holdings of the other large shareholders remained constant so this concentration was at the expense of the smaller shareholders.

The balance of shareholding between workers and management has also moved in the direction of greater concentration, with workers dramatically reducing their proportionate share from 33.9 per cent at the time of privatisation to 12.7 per cent at the time of the sample. As the proportion held by ‘others’ has remained constant this reflects purchases by managers from workers. The details are shown Table 8.

Table 8: Share ownership by managers, employees and others

	Managers	employees	Others
Now	57.5	12.7	29.9
At privatisation	34.8	33.3	31.9

This change in the structure of share ownership is reflected in the evolution of the structure of the management boards of the privatised companies, where we see a large reduction in worker representation. In fact, the present structure of the management board now broadly mirrors the share ownership structure.

Employment impact

The survey indicates that almost all firms 'downsized' after privatisation. The downsizing had considerable employment effects, shown in Table 9 below, with the average level of employment per enterprise in the sample falling continuously from 1992 until 2000 after which a small recovery takes place.

Table 9: Average employment of privatised enterprises

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
No. in cell	8	13	15	17	23	31	37	46	33	35	34
Average Employment	270	198	162	136	105	79	67	63	42	56	74

However, this falling average consists of firms that were privatised in different periods and so to some extent disguises the pace of employment loss consequent upon privatisation. As noted above the number of privatisations per year was not constant and the overall figure conceals the average employment size on privatisation. The small cell size in the early years means that there is a much larger random variability to discount. However, disaggregating the figures by year of privatisation, shown in Table 10 below, indicates a more or less continuous loss of employment in each cohort.

The disaggregated evidence also shows that the privatisation almost always signals large scale job shedding and that the average employment size upon privatisation is also falling. The falling average size of a privatised unit may reflect job losses prior to privatisation, which have occurred in many privatisation programmes, but the survey does not provide any information about this possibility. Finally, it is also clear that the rate of job losses is not constant year by year. Economic conditions have varied over the years since transition began so that this is not unexpected but the rate of job losses in the 1999-2000 period is very striking. The overall or total employment effects are much more difficult to gauge because of the changing cell size. It is evident from Table 10 that part of the reason for the sudden increase in the average employment size is the very high attrition rate evident from 1999 and 2000 – for example, the 1992 cohort cell size falls from 8 to 1. It seems reasonable to infer that the withdrawal of smaller competitors from the market was one of the reasons for the increase in the average size of the enterprises. In addition, the addition of a single firm in 2002 with 423 staff clearly biases the final year's overall average enterprise size.

Table 10: Average enterprise employment by privatisation cohort

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1992 cohort	270	252	223	206	171	125	108	99	212	248	249
cell size	8	8	8	8	8	8	8	8	1	1	2
1993 cohort		112	128	66	61	60	45	42	20	23	28
cell size		5	4	3	3	3	4	5	3	3	4
1994 cohort			46	49	47	35	34	33	16	26	27
cell size			3	3	3	3	3	3	2	2	2
1995 cohort				105	100	76	79	78	61	54	56
cell size				3	3	3	3	3	3	3	3
1996 cohort					72	68	68	64	17	28	35
cell size					6	6	6	6	3	3	2
1997 cohort						67	51	53	63	76	69
cell size						8	8	7	4	3	3
1998 cohort							58	80	33	33	41
cell size							5	4	3	3	2
1999 cohort								51	35	40	46
cell size								10	8	6	5
2000 cohort									36	31	29
cell size									6	6	6
2001 cohort										118	122
cell size										5	4
2002 cohort											423
cell size											1

An alternative way of thinking about the overall employment effects is to examine the behaviour of total employment in each cohort. This is shown in Table 11, which shows enterprises reducing employment sharply in the years immediately following privatisation in almost all cases. Once again, the data show that in 1999-2000 there was a very sharp reduction in total employment for all cohorts with a very sharp fall in the number of enterprises reporting *any* employee numbers. As the businesses were still in existence at the time of the survey in 2003 we can only conclude that many firms laid off all of their staff at that time. There is an evident recovery in 2002 but the rise is modest.

Table 11: Total Enterprise employment by privatisation cohort

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1992 cohort	2163	2015	1782	1644	1366	996	862	793	212	248	498
cell size	8	8	8	8	8	8	8	8	1	1	2
1993 cohort		558	510	197	183	180	181	211	59	69	111
cell size		5	4	3	3	3	4	5	3	3	4
1994 cohort			138	148	141	104	101	99	32	51	54
cell size			3	3	3	3	3	3	2	2	2
1995 cohort				315	300	228	236	234	183	163	168
cell size				3	3	3	3	3	3	3	3
1996 cohort					429	410	405	382	50	84	70
cell size					6	6	6	6	3	3	2
1997 cohort						534	407	372	250	227	207
cell size						8	8	7	4	3	3
1998 cohort							290	318	99	99	81
cell size							5	4	3	3	2
1999 cohort								507	278	238	231
cell size								10	8	6	5
2000 cohort									213	185	172
cell size									6	6	6
2001 cohort										590	486
cell size										5	4
2002 cohort											423
cell size											1
Total	2163	2573	2430	2304	2419	2452	2482	2916	1376	1954	2501
cell size	8	13	15	17	23	31	37	46	33	35	34

The Wage distribution

The sample evidence with respect to the wage distribution is extremely surprising. In other transition economies there has been a very sharp hollowing out of the wage distribution (Milanovic, 1999), with some workers, largely senior managers, receiving large wage rises while the 'middle' of the distribution has become increasingly impoverished with meagre wages eroded by inflation so that real wages have fallen dramatically. There is evidence of falling real wages in Mongolia (NSO, various issues). Unemployment has undoubtedly risen and most studies discount the official rate of unemployment and estimate a real level of around 20 per cent (Clark *et al.*

2000), which implies downward pressure on wages, particularly of the unskilled. We know that while inequality is relatively low compared with some other transition economies, it has risen sharply in the last few years. Nevertheless, the evidence from the sample survey suggests no hollowing out of the wage distribution, and, in fact, suggests a significant narrowing of differentials between the top and bottom.

The survey obtained data on wages for senior managers, middle managers and supervisors, clerical staff and manual workers in the years since firms were privatised. This data are not in real terms and the changing cell size, because of the different years of privatisation, make the results difficult to interpret. However, as Table 12 indicates, expressing the different categories as percentages of senior managers' wages over time indicate no significant changes *at all* in relativities between senior managers, middle managers/supervisors and clerical workers over the period as a whole, although it is interesting to note a significant increase in inequality in the middle period. However, even more striking is that the data appear to support a significant narrowing of relativities between senior managers and manual workers, although with considerable year on year variability as cell size changes.

Table 12: Wages/Salaries as a proportion of senior managers' salaries

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Middle managers/ Supervisors	79.7	88.3	73.2	65.2	62.3	67.2	96.1	98.4	63.6	70.7	80.1
Clerical Workers	48.8	51.4	52.7	58.4	37.7	37.8	30.9	36.3	38.0	37.1	50.6
Manual workers	30.5	41.7	49.6	62.2	50.8	62.8	64.2	72.7	81.0	75.3	71.9

These are surprising results and ones that are very difficult to reconcile with other evidence of rising inequality discussed above. Of course, wages represent only one part of overall income but with high unemployment, falling real wages and a largely stagnant rate of growth in the last few years it is difficult to see by what market process such a narrowing of differentials can take place. It seems legitimate to question whether the survey is correctly capturing the process. In particular, it is rather difficult to adequately define the different categories of employment so as to examine distribution; failure to capture these may mean that large changes in the spread of wages and salaries are hidden beneath an inappropriate classification. Alternatively, the inherited culture of the formerly state owned enterprises may still be a dominant influence on the differentials within such firms, with aggregate wage inequality driven by changes elsewhere in the newly established businesses. There is undoubtedly a need for further research into this question, but it seems unlikely that the low degree of wage equality found in the survey can long survive a genuinely competitive environment.

Non-wage benefits

There was considerable evidence from the sample that the privatised SMEs were continuing to pay a variety of important fringe benefits. These included pensions and health benefits but also housing, schooling and 'social and cultural activities'. Unfortunately, the data related to 2002 only so it was impossible to tell whether such expenditures had fallen since privatisation. In addition, it was extremely difficult to link the data to employment levels so that it was impossible to calculate spending per employee. Nevertheless, the data do indicate that wide ranging non-wage benefits of a type not normally paid in market economies continue to be part of the effective real wage in these formerly state owned enterprises.

7. Summary and Conclusions

The objectives of this Report were to establish the degree to which privatisation has contributed to the large rises in poverty and inequality experienced since the beginning of the transition period and, if possible, to highlight any lessons which might allow future privatisations to proceed with a lower distributional 'cost'.

We noted that in Mongolia, as elsewhere, privatisation was largely a political decision with little attention given to the poverty and inequality impact of privatising state owned property and enterprises. In addition, Mongolia since 1990 has followed a strategy of shock therapy, of which privatisation was a key component, along with liberalisation, deregulation and stabilisation. The degree of inequality and levels of poverty have been influenced by all of these elements of the strategy, and also, of course, to the sharp falls in output and employment that accompanied it. A first problem is, therefore, to ask whether the impact of privatisation can be separately identified with any precision from the other changes that were taking place simultaneously. In general, this seems unlikely and this fact must condition any conclusions reached. In addition, however, a further problem is to identify the counterfactual against which the changes resulting from privatisation should be measured. The nature of the decision to move to a market orientated economy and society, and the need to irrevocably shift economic and political power, mean that some form of privatisation was inevitable (and desirable). The problem is, therefore, not to measure the impact of privatisation against a world of no privatisation, but to ask whether alternative methods or processes of privatisation, which remain consistent with the transition goals of successive governments, might have had different and less onerous effects on poverty and inequality.

Privatisation took place alongside a number of large macroeconomics shocks, which separately from other policy decisions reduced output and employment, with immediate effects on poverty and inequality. The break up of the FSU led to the sudden elimination of large-scale transfers that had supported a level of income considerably above that suggested by GDP *per capita.* This was accompanied by the collapse of the CMEA and the need to rapidly adjust to the world of hard currency trading, which exposed Mongolia to a very large fall in her terms of trade. The overall result was a catastrophic fall in real income per head. Growth resumed after 1993 but was (and is) very dependent on international conditions, in particular, the prices of its staple exports *vis-à-vis* essential imports. This early period is marked by a substantial rise in poverty, which has stabilised at approximately 35 per cent, although this is arguably an underestimate. However, the period has also seen increases in the depth and severity of poverty. Income inequality also rose sharply with the Gini coefficient rising from 0.31 to 0.35.

The initial privatisation strategy was based on the distribution of vouchers. Although equitable in principle, in practice this has generated large inequalities. An examination of the initial privatisations indicates a number of key factors contributing to inequality. In particular, the livestock privatisation was inequitable in a number of ways. The *Negdels* collapsed as a result of the chosen method of privatisation and this collapse made the livestock sector highly vulnerable to the harsh winters and summer droughts, with the effects of these shocks exacerbating an initial, inequitable distribution of livestock. In general, the method of privatisation, by ignoring the public and co-operative institutions that provided collective goods and services, was partly responsible for the scale and depth of the subsequent collapse. Similarly, although the privatisation of apartments to sitting tenants had a notional fairness based on *de facto* ownership, the expedient of giving the apartments to these tenants was highly inequitable because most of the population gained nothing.

A deeper consideration of the ways in which privatisation impacted on poverty and inequality requires a thorough examination of the possible links between privatisation 'events' and subsequent changes in real income flows. In general these channels are very complex. However, in the broadest terms privatisation leads to a change in ownership of assets that then leads to changes in real income flow. But these effects are strongly conditioned by other, contingent factors and are strongly path dependent. Nevertheless, all the theoretical work points unambiguously to income inequality rising with the transfer of assets from the state to the private sector. Three broad channels can be identified. First, changes in real income flows consequent upon the asset re-distribution. Second, changes in the distribution of wages and employment due to the release of the previously state owned enterprises from their previous objectives and responsibilities. Third, the impact on the state budget and on the responsibility to provide social and other services.

An examination of the international experience of countries, which have pursued similar transition strategies, in principle provides a method of identifying the likely impacts on poverty and inequality of Mongolia's privatisation choices. However, this turned out to be less revealing than might have been expected. The distributional aspects of privatisation have attracted relatively little attention. A number of broad conclusions do, however, appear to be emerging from the international literature.

Privatisation typically has done more to enhance efficiency than equity and, in so far as research has equity has been studied, it seems that privatisation is highly likely to have worsened the distribution of wealth and worsened the distribution of income. The international evidence also suggests that it is the method of privatisation, the extent and quality of the institutional framework, the sequencing and intensity of other market reforms and the behaviour of the owners of the new privatised enterprises that determine the impact on income distribution. There seems general agreement that privatisation by itself does not, and cannot, guarantee the development of a dynamic private sector

Direct evidence relating to Mongolia was obtained from a number of sample and participatory surveys which covered the main privatisations. Their results broadly support the evidence gleaned from international surveys and from theoretical inference.

With respect to livestock privatisation, it is difficult to determine precisely how it impacted on poverty and inequality but from the Participatory Surveys it is clear that many people felt privatisation had been carried out too quickly, was not sufficiently transparent and too little attention had been paid to the predictable consequences of privatisation, especially the disappearance of the co-operatives, which had significant consequences for herder household livelihoods. Inevitably the post-privatisation period saw some increase in inequality and there is evidence of increasing concentration with respect to the size distribution of herds.

The privatisation of apartments was felt to be 'fair' by those who had benefited from the process. Yet, privatisation clearly led to greater inequality with respect to the initial distribution of assets and with respect to the re-distributions that followed. There is strong evidence of increased concentration of ownership and this is likely to intensify as private housing sales and the private rental market develop further. Inequality was further exacerbated in so far as the ownership of these new assets generated new income streams and allowed access to credit where ownership of apartments was required as collateral. The large increases in price suggested in the survey evidence mean that the poor are effectively excluded from the private housing market. At the same time, the privatisation of practically all the housing stock means that there is also no social housing available. In fact, there seems to be no housing policy of any sort that is matched to poverty and other social objectives.

With respect to the survey of SMEs there is evidence of increased concentration of share ownership and the downsizing of enterprises with a consequent decline in employment in the newly privatised sector. However, the survey found no empirical evidence to support the hypothesis of increasing inequality in the wage distribution and it was evident that a range of services were still being provided by these firms long after they had been privatised. Neither of these seem likely to survive a harsher competitive environment.

Recommendations

In line with our terms of reference those conclusions that can usefully be collected as recommendations are listed below.

1. A very much higher priority needs to be given to transparency in any future privatisations than hitherto. This must include the more extensive dissemination of information and education and debate about the implications of privatisation.

2. A major effort must be made to correctly price any asset to be privatised. By this is meant that prices should not allow agents to make undeserved capital gains from the asset unrelated to any economic function.

3. The preferred method of obtaining such prices is through open, competitive tendering.

4. The appropriate legal and regulatory frameworks necessary to support a truly competitive environment need to be factored into privatisation decisions at the earliest stage.

5. Much greater attention needs to be paid to role of collective institutions and to the potential interdependencies and market failures that privatisation generates.

6. A much more thorough examination needs to be paid to the role and responsibilities of the state after privatisation.

7. Any subsequent privatisation needs to consider the consequences of privatisation in relation to the provision of safety nets and other social security systems than has occurred hitherto.

8. The fiscal implications of privatisation need to be made much more transparent and related to the changed responsibilities of the state in the emerging market based economy.

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Appendix 1 Chronology of Privatisation and Economic Reforms

1990
- Establishment of multi-party democracy
- New Government formed in September
- Recognition of private property
- Reform of customs and labour laws
- Elimination of restrictions on private ownership of herds
- Freeing of selected retail prices
- Legalisation of two-tiered banking system and the establishment of two commercial banks
- Promulgation of new foreign investment law
- Devaluation of tugrik for commercial transactions
- Decision taken to privatise state property through the issue of vouchers

1991
- Bank of Mongolia established
- Mongolia joins the IMF and the World Bank
- Establishment of the major elements of company law
- Privatisation law passed and guidelines for voucher privatisation established
- Establishment of the Privatisation Commission
- Programme for small privatisations initiated
- Preparatory work for the privatisation of co-operatives begins
- Establishment of the Mongolian Stock Exchange

1992
- New constitution established
- First major price liberalisation takes place
- Reform of tax laws
- Steps to increase convertibility of the tugrik.
- First trading of shares of voucher privatised companies

1993
- Establishment of international accountancy standards
- Social Security reform to protect pensioners and other benefit recipients
- New law passed to encourage foreign investment
- Tugrik is floated
- Further price liberalisation of transportation, utilities and services to apartments
- Establishment of a minimum living standard baseline
- Guidelines for the privatisation of the telecommunications sector adopted

1994
- Preparation for apartment privatisation begins
- Establishment of National Poverty Alleviation Programme
- Guidelines for privatisation of arts and cultural organizations adopted.
- Guidelines for coal mining privatisation adopted.

1995
- Secondary trading in securities on the Mongolian Stock Exchange begins
- Re-organisation of the Mongolian Stock Exchange
- Mongol Telecom partially privatised

1996
- Election of the Democratic Union government
- Liberalisation of energy prices
- Greater independence of Bank of Mongolia with power to determine monetary policy
- Government issues 35 billion Tugriks of bonds to re-finance failing banks
- Abolition of customs duties on imports
- Law on state and local property adopted.
- The State *Ikh Hural* ratifies Law on housing privatisation and on common property housing.
- Privatisation of apartments begins

1997
- Review of minimum living standard baseline
- Reform of bankruptcy laws

1998
- Revision of minimum living standard baseline
- Introduction of value added tax

1999
- Further reform of company and labour law

2000
- Law prohibiting unfair competition

2001
- Re-structuring of energy sector

2002
- Law on ownership of land
- Guidelines published for re-structuring and privatisation of social services.