

# Mongolia

<b>Status Index</b> (Democracy: 7.05 / Market economy: 5.54)		<b>6.29</b>	<b>Management Index</b>		<b>6.31</b>
<b>HDI</b>	0.679		<b>Population</b>	2.6 m	
<b>GDP p. c. (\$, PPP)</b>	1,850		<b>Population growth<sup>1</sup></b>	2.1%	
<b>Unemployment rate</b>	4.0%		<b>Women in Parliament</b>	6.7	
<b>UN Education Index</b>	0.90		<b>Poverty<sup>2</sup></b>	27.0	
			<b>Gini Index</b>	30.3 (1998)	
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. <sup>1</sup> Annual growth between 1975 and 2003. <sup>2</sup> Population living below \$ 1 (1990-2003).					

## A. Executive summary

During the period under review, Mongolia's transition has shown a dedication to democratic values and a market economy. This is particularly true when one compares Mongolia to other central Asian successor states of the former Soviet Union, which are known for their authoritarian regimes and economic systems dominated by clans and interest groups. Its rapid transformation is founded on a solidly educated, homogenous population with broad consensus on reforms and market-led policies. Therefore, its resolve regarding structural reforms has not been undermined or abruptly changed because of electoral uncertainties and changes in government. The latest parliamentary elections (June 2004) continue to demonstrate that electoral processes are functioning. Voter turnout was over 75% despite the fact that many Mongolians had to travel by camel, horse or four-wheel drive to cast their ballots. Despite the Communist party's near monopoly on the media, it proved unable to hold on to power. Irregularities during campaigning and balloting were solved in the framework of legal procedures. The new coalition government is under pressure to perform on issues including continued government wages and welfare expenditures, which complicates fiscal consolidation. At the same time, Mongolia suffers one of the highest levels of debt, which has increased significantly due to rescheduling the former Soviet debt of about \$12 billion.

The country has one of the world's weakest economic structures and poorest economies with a projected 2004 per capita income of \$480. The economy is heavily dependent on the climate, particularly by Mongolia's strong winters, which can seriously damage farm production and diminish livestock, thus reducing the performance of minerals, cashmere and textiles, which account for than 80% of total exports. Due to milder winters in 2002 and 2003, Mongolia ended several years of economic stagnation by nearly doubling its GDP growth to 10.6% in 2004.

Poverty and poverty-related problems account for the most serious obstacles to further transition. Thirty-six percent of the population lives below the national

poverty line of \$0.75 per day. Mongolia also suffers from a gap between urban and rural development and a weak infrastructure, which does not extend throughout the entire country. Beyond inherent structural problems, the further development of Mongolia is hampered by negative effects of corruption, which negatively impact society, the economy and politics.

Mongolia's transition has been significantly influenced by international factors. The country relies heavily on foreign economic assistance. International organizations and single actors set the agenda; although this has resulted in remarkable transitional progress, it might also cause dependency and hinder the implementation of blueprint strategies that do not fit the international mold.

## **B. History and characteristics of transformation**

The concept of democracy has only developed over the past ten years (1995-2005). For much of its political history, Mongolia has been ruled by a monarchy and later by a one-party Soviet style system. Mongolia's political and economic transformations have occurred largely in parallel. Transformation in Mongolia was triggered from outside the country. From 1921 to 1989, Mongolia was the "satellite state" most closely linked to the Soviet Union. After Brezhnev's death in the Soviet Union, the longstanding secretary general of the Mongolian People's Revolutionary Party (MPRP), Yumjaagiyan Tsedenbal, was replaced in 1984 by the then-chairman of the Council of Ministers, Jambyn Batmönh, a moderate representative of the ruling regime. Toward the end of the 1980s, the Soviet Union increasingly cut back its troop presence (aimed against China) and its economic support for Mongolia. The external stabilization of the Mongolian communist system dissolved along with these cuts. The first oppositional groups formed in 1989, primarily composed of the younger generation of the ruling elites. Genghis Khan became the key figure of national identification, honored as the country's founder.

After tough battles with the communist regime, the opposition used hunger strikes in the first six months of 1990 to add emphasis to its demands for free elections. The first multiple party elections were finally held in July 1990. The opposition won 22 of 53 seats in the first post-communist parliament, known as the State Great Hural. In January 1998, a new constitution was passed stipulating a mixed parliamentary and presidential system. The government is formed based on a parliamentary majority under a prime minister. The president is elected directly and has the right to confirm the prime minister in office. The parliament has the power to confirm the president in office, but also has the authority to dismiss him. In April 1992, a majority voting system was passed. The new system ensured that the party winning the subsequent elections (1992, 1996, 2000, 2004) gained an unusual predominance of parliamentary seats. The system worked in favor of the MPRP in 1992, the Democratic Union Coalition in 1996, and the MPRP again in 2000. The four-year period between 1996 and 2000 proved to be a tumultuous

time for the government. Four different prime ministers ran the country, and each left office in a fury. On June 27, 2006, the fourth parliamentary elections were held, which was marred by violations and inconsistencies. The results split 72 seats between the former ruling MPRP and the Motherland Democratic Coalition (MDC), a collation composed of the Democratic Party, Mongolian Democratic New Socialist Party, and the Civic Will Party.

The country has seen a circle of reform, stagnation, and setbacks, leading to new calls for reform. Currently Mongolia is enjoying stable economic growth and moderate inflation. However, Mongolia remains among the least developed nations, with a GDP per capita hovering around \$480. The state budget is constrained by a heavy dependency upon mineral resources and animal husbandry. Severe weather conditions during winter have diminished the livestock. Unemployed urban workers drifted back into nomadic pastoralism, which has dramatically increased during transformation.

Mongolia has a long tradition of foreign cooperation. After 1990, dependence on the Soviet Union and the Council for Mutual Economic Assistance (Comecon countries) was transferred to Western nations and Asia, which were both interested in Mongolia's strategic location between Russia and China. Today, Mongolia has the fifth highest rate of official development aid per capita in the world; the most important donors are the Asian Development Bank (ADB), the IMF, the World Bank, and, bilaterally, Japan, Germany and the United States. So far, however, this has neither slowed social differentiation nor established lasting economic growth. Instead, national debt has steadily climbed during the last few years, reaching 92.6% of the GDP in 2002. Although the debt is mostly made up of "soft credit" from international financial institutions and bilateral donors, servicing it will create problems in the future.

Mongolia's transition can be characterized by a mixture between considerable progress driven by foreign support and concentrated in the capital of Ulaanbaatar. Meanwhile poverty and extreme winters that threaten livestock by extreme are problems in the countryside. Although Mongolia faces several structural reforms urgently needed to address widespread corruption, poverty and sustainable development, its economy is currently on a recovery path. Indeed, some progress in economic and political reform has been observed during the period under review.

## **C. Assessment**

### **1. Democracy**

#### **1.1. Stateness**

State identity in Mongolia is generally established. While the state's monopoly on the use of force is established nationwide in principle, it is not fully functional. Criminality and corruption have increased substantially since the onset of transition, and remained at a high level during the assessment period. All citizens have the same civil rights. Church and state are largely separated. According to Article 9 of the constitution, the state shall respect the church and the church shall honor the state, also the church may not pursue political activities. In practice, the state is largely defined as a secular order. Religious dogmas have no noteworthy influence on politics or law. The state's basic infrastructure extends throughout the entire territory of the country. However, its operation is curbed by the sheer size of Mongolia's territory and its small but sparsely populated inhabitants, whose livelihood largely depends on pastoral animal husbandry - the country's regional development issue.

#### **1.3. Political participation**

Unlike the countries of Central Asia, Mongolia's elections since national independence have proven to be a genuine contest with unpredictable results. The unicameral State Great Hural has 76 seats; members are elected by popular vote to serve four-year terms. Before the latest parliamentary elections on June 27, 2004, the ruling party, MPRP, had an almost absolute grip on power, with 72 of 76 seats in parliament. Now it appears they have been left 37 seats, with the opposition Democratic Party and its coalition partners emerging victorious with 40 seats. Beyond the overall positive assessment of the free and fair character of the elections, there were some constraints on the principle of equality. Domestic NGOs and observers documented illegal use of state property and civil service workers, primarily by the MPRP, for campaign activities. Approximately 10 % of the population moved from one district or precinct to another during the final two weeks of the campaign to exploit so-called "transfer voter" provisions in the law. Observers also reported abuses such as the control of mobile ballot boxes, police intimidation, fraudulent ballots, multiple voting, the ejection of political party and foreign observers from polling stations, and ballot box stuffing. On July 17, 2004, a re-vote was conducted after the capital Administrative Court ruled alleged irregularities in two election districts in eastern Ulaanbator. At the end of 2004, candidates continued to pursue their challenges through appeals in the courts.

Elected rulers have the power to govern in principle, but individual power groups can set their own domains apart by donating financial support for a particular candidate or party without making the donors names public. Furthermore, public servants have been using their “administrative resources” to influence the election outcome. In addition to the restrictions mentioned, the constitution provides for freedom of assembly and association, and the government generally respects these rights in practice.

A variety of newspapers and other publications represent major political party viewpoints as well as independent views. A media law bans censorship of public information. Nonetheless, the state continues to own the vast majority of radio and television stations and licenses. State-owned radio is the major source of news in the countryside. During an open discussion on the Mongolian media, organized by the Mongolian Press Institute on April 30, 2004, journalists complained that despite a 1998 media law, the government has so far refused to withdraw legislation making libel a criminal offence. Furthermore, taxation is also a burden for the independent growth of media agencies.

### **1.3.Rule of law**

The 1992 constitution provides a hybrid presidential-parliamentary system of government. The demarcation of power between the prime minister and the president has been a subject of several constitutional amendments and court challenges. On May 24, 2004, parliament approved the draft amendments on parliamentary law and parliamentary procedure law. The new legislation imparts that each of the seven standing committees in the State Great Hural will have its own independent committee rules, staff and budgets. This, in turn, will facilitate efforts to organize public committee hearings, which are still very rare in Mongolia.

Established in 1992, Mongolia’s Supreme Court is secure. However, problems persist with funding, education and adequate judge training. Currently undergoing change, the public also considers the legal system to be relatively corrupted.

Corruption has been a significant issue in Mongolia since the start of the 1990s. Mongolia ranks 85<sup>th</sup> of 145 countries on Transparency International’s 2004 Corruption Perception Index. According to an international survey conducted in April 2004 from a sample of 2004 Mongolian voters, 73% of the respondents disapproved of headlines of the current government’s attempt to fight corruption. Furthermore, 38% agreed with stiffening the legal penalties for officials involved with corruption, and 13% of the respondents agreed with the statement to “make current government practices illegal such as government hiring based on political connections.” The available information indicates that corrupt officeholders are not prosecuted adequately, but occasionally attract adverse publicity.

Mongolians enjoy civil liberties guaranteed not only in the constitution, but generally in practice as well. Reports on the human right in Mongolia have repeatedly underscored the poor conditions in Mongolian prisons, such as overcrowding, insufficient diet and medical care.

#### **1.4. Stability of democratic institutions**

Institutional stability has been generally secured. In the early 1990s, a multiparty parliamentary system was introduced and the new constitution put into effect. For the first time in Mongolia's history, governors were democratically elected. However, some institutional systems have remained unchanged since their formation in the early 1900s. Reforming institutional structures so that they can provide the necessary leadership and management for public affairs is a major challenge for the Mongolian government. In recent years, the government's effectiveness has improved, as compared to its performance in the mid-1990s.

In principle, the relevant actors and the citizenship fundamentally support democratic institutions. Nevertheless, acceptance and public trust is limited because of the high amount of corruption.

#### **1.5. Political and social integration**

Boasting a pluralistic, multiparty system that consists of 18 registered political parties, Mongolia is unique in Central Asia. However, only five parties are represented in parliament. From 2000 to 2004, the MPRP held 72 of 76 seats. In 2004, an opposition coalition was created by the MDC, the Democratic Party, Mongolian Democratic New Socialist Party, and the Civic Will Party and two independent deputies. While the party system is established, the latest election outcome in June 2004, and an ongoing building and rebuilding of the coalition, underscore the system's fragility.

Interest groups are influenced by legacies of the Soviet past, when social institutions other than the Communist Party were limited to disseminating party decisions throughout society. Accordingly, 400,000 Mongolians are members of unions. On the other hand, at the beginning of the 1990s, there were no interest groups with contemporary ideas nor could they reflect or formulate opinions and interests in government policies.

According to a public survey carried out in April 2003, the consent to democracy is moderate (greater than 50%). In addition, 27.7% of the respondents preferred a transition to a limited democracy, 26.1% favored transition to a nearly full democracy and 13.9% favored democratic continuity, while 2.9% expressed nostalgia for past authoritarian structures, 11.5% were in favor of authoritarian persistence and 9.5% opted for the transition to a soft authoritarian regime.

There are several civil society groups, many supported by outside donors. However, only a few groups are represented across the country, a difficult feat considering the vast expanses of land and the sparse settlement. Groups have formed in a broad spectrum of societal interests (welfare, women, health, etcetera). Furthermore, international donors financially and administratively support social organizations. According to the most recent poll conducted by the Mongolian Sant Maral Foundation in April 2005, the vast majority (84%) of the population believes that the introduction of transformation reforms toward democracy and a market economy in 1990 was the right decision.

## **2. Market economy**

### **2.1. Level of socioeconomic development**

Despite continuing economic growth, with GDP growth nearly doubling to 10.6% in 2004, poverty remains persistent in both rural and urban areas. In 2004, 36 % of the population lived below the national poverty line of \$0.75 a day. Furthermore, income inequalities have widened, the GINI coefficient increased to 0.44 in 2002 (the latest data available) from 0.31 in 1995. Poverty persists in part due to a high unemployment rate of 14.2 % (National Statistical Office, 2003). Mongolia's economic transition has increased inequality between the genders in the past decade. In 2002, Mongolia was assessed by the United Nations Development Program's Gender-related Development Index (GDI) of 0.664. In addition to decreasing social and economic positions, women have less influence in policy-making bodies and forums than they had before transition and women's workloads have increased, particularly in nomadic and rural areas.

### **2.2. Organization of the market and competition**

There have been indications of trade liberalization and currency convertibility since Mongolia became a WTO member in 1999. The U.S. Department of Commerce reports that the government intervenes in the market to adjust prices for grain and other commodities. The government liberalized energy prices in 1996. However, it continues to control the price of fuel. A considerable informal sector persists in large part because Mongolia's herdsmen have continued to conduct a centuries old tradition of barter trade. Free market reforms brought about a decrease in incomes and increase in unemployment; most herdsmen have little incentive to embrace the cash economy.

In 1994, the government adopted the Law on Prohibiting Unfair Competition, which prohibits the state from restricting economic competition, prohibits monopolies and other constraints on fair competition, and establishes guidelines for government intervention to ensure fair competition and the regulation of natural monopolies. This law also establishes the role of the courts in defining a

monopoly and handing down legal remedies. In 2000, a new, expanded law was approved. Beyond the legal framework, the formation of monopolies is negatively influenced by the high amount of corruption. Because the number of companies is so low, large companies (for instance Erdenet Copper mine, Gobi Cashmere, MIAT national airline) frequently have a dominant position in the market.

Foreign trade is mostly liberalized with uniform, low tariffs and no fundamental state intervention in free trade. Liberalization has, *inter alia*, involved the reduction of tariff rates up to 5% in 2004 and eliminated a number of import licensing requirements.

The banking system is partly privately owned and partly state-owned. There are 12 commercial banks. The government is privatizing some of its holdings in the banking sector. Currently, the banking system is fragile and in serious need of increased training in banking skills and improvements in its legal and institutional framework. Real lending interest rates are at high levels that jeopardize economic development. The banking sector, with total assets of less than \$200 million, is small relative to the size of the economy.

### **2.3. Currency and price stability**

The average annual rate of inflation has been reduced from peak levels of 321% in 1992 to 44.6% in 1996, 20.5% in 1997 and 8% in 1998. In 1999, it increased to 10% mainly due to external price shocks. Since 2000, inflation has remained moderate and rose to 11% in 2004, primarily because of higher energy prices. In 1993, the government permitted the tugrik to float. The tugrik is fully convertible on the current account. The foreign exchange market consists of an inter-bank market and an informal cash market. Also driven by WTO membership, inflation and foreign exchange policies are brought into concert with other goals of economic policy, and are institutionalized.

The 1991 Banking Law established the legal basis of banking activities. The law stops short of creating a truly independent central bank, instead charging the Bank of Mongolia with implementing the government's monetary policy. The central bank's activities include: controlling the money supply, ensuring the stability of the currency, determining the capital adequacy ratios banks are required to maintain, setting interest rates, acting as a last resort lender for commercial banks, making inter-bank settlements, and supervising commercial banks.

### **2.4. Private property**

In the beginning of the 1990s, privatization in Mongolia began before an institutional framework had been established. The key elements of such a framework have been created since then. However, the private sector still requires stronger support in terms of legal coherence and stability, land reform, and secure



property rights. Since 1991, three laws have been passed on corporate law that have successively contributed to “corporate governance” regulations. Property rights on non-pasture land have been regulated by law since 1995. In 2002, the government passed a law that allows for the sale of arable land to individuals and a new civil code came into force. However, enforcement of laws protecting private property remains weak. The judiciary often lacks the capacity to properly deal with the increasing number of cases involving economic issues, which is confounded by frequent changes in the legal framework.

Under communist rule, public goods comprised almost more than 90 % of the GDP. This changed completely after 1990. In 1997, private business constituted more than 60 % of the GDP. Currently, Mongolia’s private sector produces more than 70 % of the country’s total output. During the period under review, large state-owned enterprises dominated key sectors of the Mongolian economy, undermined competition and burdened public finances. In July 2003, the largest insurance company was sold to an international consortium, and NIC, a petroleum import company, was privatized in February 2004. Gobi, the largest cashmere manufacturer, is due to be privatized in 2005 after several unsuccessful attempts, and management of the national airline, MIAT, has been contracted to a foreign company in preparation for privatization. However, Erdenet Mining Company and Ulaanbaatar Railways are exempt from privatization. Privatization has been revitalized in recent years as most of the large-scale enterprises – after several years of abortive attempts – were finally privatized.

## **2.5. Welfare regime**

During the Soviet era, a broad network of state-run social security was set up that included pension payments to nomads and, as part of a pro-birth policy, generous child allowances. During transition and after the Soviet revenue transfers dried up, this network was severely cut back. Uninsured risks for the population have seriously increased. Birth rates have dropped sharply in consequence (from 2.9% annually in 1989 to 1.4% annually in 2004).

Before 1995, Mongolia had a universal pension system with a high degree of access. However, the system had a low pension rate and was poorly targeted. From 1995 onwards, Mongolia has financed a state pension system that collects from both employers and employees. Thus far, most of the social insurance funds are being used to finance a new pension system, which consumes 90% of the budget and leaves little room for a reasonable level of unemployment benefits. Emphasizing the importance of a private pension system, the government of Mongolia is reforming its social welfare and pension system in anticipation of demographic changes from the year 2010 onwards, which are expected to worsen by 2020. The parliament passed fundamental guidelines on the pension reforms to be followed until 2021. First stage measures introducing the pension insurance have been undertaken.

A health insurance system was introduced that guarantees at least basic insurance to broad sectors of the population. However, the poorest of the population fall through this net. The distribution and allocation of medical services is uneven across urban and rural areas. Before 1990, during the socialist regime, the health system ensured free and universal health care for the entire population. Access to health care facilities however, is far from uniform. Much of it is concentrated in Ulaanbaatar and the main cities, and aimag centers. The life expectancy in urban areas is therefore higher; mortality and disease rates lower. Differences in living and working conditions, regional environments, income levels and nutrition also account for inequalities in health status across the divide.

In the 2005 budget – passed by parliament in November 2005 – 20.8 % of the total expenditures are spent on education and 10.8 % on health care. However, revenues are often insufficient to keep the system afloat. Reducing poverty and unemployment appears vital to ensuring democratization for the long-term. Literacy rates are falling, primarily among the rural population and the poorest population groups. This trend will solidify social cleavages that have arisen during transformation.

Opportunities for human development are unequal and based largely on geographic location. Rural citizens have less access to education, health care, information and jobs. However, Mongolia stands out in terms of female education. During the transition period, the gross enrollment rate of girls in secondary education has been 20% higher than boys' enrollment, while in tertiary education women account for 70% of all students. However, the gender empowerment measure (GEM) value for Mongolia ranks 62<sup>nd</sup> (2004). Women hold 10.5% of parliamentary seats, and make up 66% of professional and technical workers. Thirty percent of administrators and managers are women. Thanks to legacies of the Soviet past, there are institutions to compensate for gross social differences, yet they are limited in scope and quality.

## **2.6 Economic performance**

During the 1980s, the Mongolian economy reached annual growth rates of about 6.2%. Mongolia has made significant strides in achieving macroeconomic stability and fundamental structural reforms since its transition to democracy and a market-based system in 1990. After the collapse of the Soviet Union, the performance of the Mongolian economy shrank by about 20%. The GDP has been growing slowly since 1994; GDP growth remained minimal especially in 2000 and 2001. However, since 2002, GDP rates rose significantly to an estimated growth of about 10.6% in 2004. This improvement is predominantly an effect of increased world market prices for copper and gold, but also a consequence of the sustainable developments in the livestock industry (favorable weather conditions led to an increase in livestock numbers) and an increase in agricultural production. Aside from a small domestic market and high transportation costs (Mongolia is a

land-locked country with weak infrastructure), both the low GDP growth rates until 2001 and the significant increase thereafter depend on two factors. First, Mongolia's few key export goods – copper, cashmere and wool – are subject to highly fluctuating prices on the world market. Secondly, pastoral agriculture accounts for 30% of the GDP and is subject to widely fluctuating climatic conditions.

In 1998, the annual inflation rate fell under 10 % for the first time. In 2000, it slightly increased, only to decrease to 1.5% in 2002. The 2004 inflation rate is estimated at about 11% again. Improvements in fighting inflation are due to the strong position of the “Mongolbank” – the central bank of Mongolia. The official unemployment rate remains low level at around 4% – but this official unemployment figure is expected to be a gross underestimate. According to the Asian Development Bank, 25% is suggested as a more realistic figure based on international measurement standards. Since the end of the 1990s, the budget deficit has decreased: 14.3% in 1998 to an estimated 4% in 2004. However, the budget deficit is primarily financed by development aid (grants and loans) and thus does not immediately endanger macroeconomic stability. However, in the long-run the debt service might pose a problem for economic development.

Foreign direct investments remain low because of the small domestic market, the protraction of privatization and the lack of legal certainty. Since 2000, foreign direct investments have been on the rise, but they are primarily related to raw materials, such as copper and gold. Nevertheless, encouraging signs have been observed in recent years as the banking sector has been strengthened and approval rates for small loans have increased, which will promote economic diversification. In the early 1990s, the trade balance was even or positive because of major reductions in imports. Since the end of the 1990s, the balance of trade has been negative (although it has been reduced since 2001) and will remain so for the medium term, according to IMF estimates. The national debt has steadily climbed during the last few years to an estimated \$1.191 billion in 2004 – more than 90% of the GDP. Although this debt is comprised mostly of “soft credit” from international financial institutions and bilateral donors, servicing it will create problems in the future.

## **2.7. Sustainability**

Economic transformation and impoverishment have endangered environmental sustainability. The herds were privatized over the course of the transformation, but access to pasture land has been inadequately regulated. The capital, Ulaanbaatar, suffers from air pollution caused by coal-fired power plants and, more significantly, the population living in yurts and heating with inferior fuel. Furthermore, overgrazing pastures and grazing lands have induced negative environmental effects. Forested areas are increasingly shrinking. Widespread poverty is contributing to phenomena such as illegal logging. As an arid country,

Mongolia is also hard hit by forest and steppe fires. Institutional and financial capacities for meeting such challenges diminished in the 1990s, which led to increased damages. Further exploitation of mineral resources also threatens to inflict further environmental damage. Environmental protection has been institutionally anchored in the government through the creation of its own ministry. However, the ministry has difficulty in effectively implementing measures aimed at guiding environmentally compatible growth that competes with economic interests.

The education sector during the transition period faced a series of setbacks following the cessation of Soviet aid. Schools suffered particularly from inadequate resources for heating and school infrastructure maintenance. Moreover, the privatization of livestock led to an increase in school dropout rates, especially among boys who were needed for cattle rearing. Institutions for education, training, and research and development are present in significant segments, but remain highly inconsistent.

### **3. Management**

#### **3.1. Level of difficulty**

The level of difficulty is considerable given Mongolia's low economic development level. Positive characteristics include the high level of education (UN Education Index: 0.85) and the society's ethnic homogeneity. At the beginning of transformation in 1990, social homogeneity was also high; during the assessment period, a great deal of social differentiation developed. Mongolia shows low HIV rates. In 2003, less than 0.1% of people lived with HIV and AIDS.

Nevertheless, here are a moderate to high number of factors exercising structural constraints on governance. Natural disasters, droughts and *zud* (severe snowfalls), which have occurred in Mongolia over the last years (winters in 1999 to 2000, 2000 to 2001, 2001 to 2002), badly hurt the livestock sector, which is the backbone of the country's economy. Thousands of herdsman and their families were forced to join the ranks of the poor. Furthermore, Mongolia's infrastructure development is weak; the countryside in particular suffers from a lack of basic infrastructure such as roads, electricity and health care.

Dominated by legacies of Mongolia's position as a Soviet satellite state, civil society traditions are weak. During the transition period, public understanding of democracy and civic engagement have consolidated somewhat. Opinion polls demonstrate a low trust in democratic institutions while the assessment of indicators associated with democratic values such as freedom of speech and association have drastically improved. As an ethnically homogeneous country,

there are almost no irreconcilable ethnic or religious cleavages. Some social protest has arisen in response to corruption, poor wages and pensions.

### Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	2
System of government:	<i>semi-presidential</i>	Latest parliamentary election:	27.06./17.07.2004
		Effective number of parties:	2.3
1. Head of Government:	<i>Nambaryn Enkhbayar</i>	Cabinet duration:	07/00- 08/04
		Parties in government:	1
2. Head of Government:	<i>Tsakhi Elbegdorj</i>	Cabinet duration:	08/04- present
Type of government:	<i>coalition majority</i>	Parties in government:	2
		Number of ministries:	13
		Number of ministers:	13

Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) =  $1 / (\sum p_i^2)$ ;  $p_i$  is the share of parliamentary mandates controlled by party  $i$ . Number of ministries/ ministers denotes the situation on 1 January 2005.

### 3.2. Steering capability

In general, Mongolia enjoys remarkable political and social stability for a low-income country. As such, electoral uncertainties related to the three changes between a government headed by the successor party of the former Communist Party and democratic coalitions have not undermined policy resolve regarding structural reform. Nor have these changes resulted in abrupt policy changes.

In August 2003, the previous government of Mongolia submitted its Poverty Reduction Strategy Paper, which is called the Economic Growth Support and Poverty Reduction Strategy (EGSPRS), to the World Bank and IMF for review. Under this strategy, the government seeks to reduce poverty by ensuring higher economic growth and focusing on education, health and social welfare sectors. The development of more efficient budgeting mechanisms and financial management, as well as public sector reforms are also important factors.

Furthermore, the Ministry of Finance and Economy elaborated a strategy paper "Economic Growth and Poverty Reduction Strategy" presenting the government's main policy direction for the medium term.

One of the main causes for the outcome of the parliamentary elections on June 27, 2004 was the disaffection with the former ruling MPRP and its failure to improve living standards as promised. The number of poor increased, some economic reforms were halted and Mongolia's rate of economic growth slowed. The previous democratic coalition, which favored free market reform, implemented a shock therapy approach. However, ironically, it was their generous social-welfare promises during the latest campaign that appeared to have won over many voters.

Among other promises, the democratic coalition introduced a monthly child allowance in the amount of 10,000 tugriks (\$7 to \$8) per child. Since many Mongolian families have five or more children, especially in rural areas, the child allowance was a convincing part of the campaign. However, the allowance will also be a burden for the heavily indebted state budget with fiscal deficits persisting at 5% of the GDP (which reflects heavy capital investment) and an unaffordable social system, which has produced high government expenditures - about 41% percent of the GDP in 2004.

After the elections, the new government of Mongolia defined an action plan for the next four years. Its key objectives include upgrading the quality of public services, intensifying legal reforms, sustaining higher rates of private sector-led growth, improving living standards and raising education standards.

A significant gap exists between the declared strategic priorities and the restrictive framework of weak public finances, which is characterized by one of the highest levels of ineptness among nation-states. While the leadership seeks to build democracy and a market economy, its strategic aims are not in line with the country's financial situation. Even though the two governments in power during the period under review have shown commitment to democracy and a market economy, they have had only limited resources in implementing announced reforms. Driven primarily by public pressure on the eve of elections, the political leadership responds to mistakes and failed policies with changes, but its policies frequently remain trapped by the problems associated with being one of the poorest and infrastructurally underdeveloped countries.

### **3.3. Resource efficiency**

Human, financial and organizational resources are scarce. Ministries, parliamentary committees and administration lack trained and adequately educated personnel, including advisors. On the one hand, resources are saved because the parliamentary system does not lead to a doubling of government functions within the presidential administration, which is frequently observed in post-Soviet countries. However, on the other hand, weak public administration at all levels of government often leads to significant waste as the government fails to maximize loans and effectively implement aid programs. Mongolia's economy is driven by a few economic and political elites, has meant corruption and limited accountability. One example is the recent settlement of Soviet-era debt with limited finance transparency and little public consultation on its merits. Although a positive development in ensuring medium-term debt sustainability, the process highlights problems with decision-making that can often exacerbate policy missteps.

The high debt burdens and the economic vulnerabilities inherent in a small, underdeveloped, commodity-based economy reflect Mongolia's fiscal

inflexibility. It enjoys remarkable political stability and economic policy consensus for a low-income country, with governance benefiting immensely from foreign and international donors. However, despite substantial donor funds and a windfall gain from higher prices for copper and gold, Mongolia continues to make little progress consolidating public finances. In 2004, additional revenues in mining have been spent primarily on government workers and heating-related expenses rather than being used to consolidate the budget and cut debt. As a result, the deficit of the general government is estimated to be 4.5% in 2004. In turn, despite some decline as a percentage of GDP because of strong growth and high inflation, net general government debt remains high at 89.1% in 2004.

Budgetary oversight by parliament and an independent court of auditors remains underdeveloped. A court of auditors was set up in 1995. An Asian Development Bank project has been working since 1999 to strengthen the court's role. The predilection for government intervention, high expenditure needs and an unaffordable social system continue significant fiscal pressure. There is only limited political will to curtail the inherited social welfare state, as evidenced by the large government wage and pension increases, and election-related promises to increase welfare grants to families and children. Exacerbating matters are significant expenditure needs due to an inadequate and dilapidated infrastructure, the lack of effective basic services, the disproportionate amount of heating-related expenses, and the continued ineffective use of public funds, despite recent improvements. Corruption remains a widespread phenomenon.

By balancing the transition strategy between shock therapy approaches driven by free trade and market economy on the one hand and third way strategies considering social targets on the other (but also the influence of the international donor and finance organizations), the government tries to coordinate conflicting objectives and interests. The limited success is also related to the high amount of corruption and widespread poverty.

Corruption and patronage are widespread phenomena in Mongolia and substantially increased since the onset of transition. The discrepancies between formal and informal regulation are considerable. For that reason, Mongolia was ranked 85<sup>th</sup> of 145 countries in the Corruption Perception Index (CPI) of Transparency International in 2004. During that period, the score of the CPI declined from 4.3 to 3.0 (10 is highly clean, 0 is highly corrupt). Perceived to be most prone to corruption are – in descending order – the customs organizations, judiciary, taxation organizations, police organizations, banks and financial institutions, educational institutions, state and public service institutions, parliament, hospitals, government and the State Property Authority. These figures show that the crime of corruption is rapidly taking root everywhere, impacting society at every level – primarily the institutions pertinent to the country's development.

In 1996, the first, albeit vague and ineffective, anti-corruption law was passed in Mongolia. The first idea for an Independent Committee Against Corruption (ICAC) came at the end of 1998 and under the anti-corruption bill currently drafted, it is being suggested that an organization be established to combat corruption next to the General Prosecutor. Mongolia was not yet become a signatory of the United Nations Convention against Corruption. So far, the battle against corruption is not commensurable with the people's expectations as the findings of the fourth Mongolia Voter Survey in April 2004 indicates. Only about 20% approve of the government's efforts in the anti-corruption campaign, while 73% are dissatisfied. During the MPRP's rule, opposition parties accused the MPRP of corruption. A handful of independent newspapers and television stations in Mongolia's capital have blamed several ministers of shady business deals and corruption, including commercial fraud and taking bribes. The authorities did not pursue these allegations. Government and parliamentary decision-making was also not sufficiently transparent, and open public legislative hearings were rare. The State Secrets Law inhibits freedom of information and government transparency and accountability. There were public calls not only to amend the law but also to implement the equivalent of a freedom of information act. International donors have been increasing pressure to improve the fight against corruption as well.

### **3.4. Consensus building**

Despite Mongolia's frequent change of ruling party, very limited traditions of democracy, limited bureaucratic resources and still-developing institutional framework, the country exhibits remarkable political stability particularly for a low-income country. All major political actors agree on building a market-based democracy. At the same time, public opinion polls illustrate that the general assessment of democratic values is much higher than the trust in the ruling institutions such as state authorities and the judiciary. Due to the lack of anti-democratic veto actors, reforms face little opposition among the population. Older and conservative politicians who might still be attracted to a communist system are incorporated into the democratic consensus through the MPRP.

The most significant potential cleavages run between rich and poor, and between urban and rural. However, social divisions so far have not given rise to political conflicts. Under the socialist system, the state enforced solidarity. State solidarity networks were seriously hollowed out during transformation. Attempts are being made at this time to reinforce networks corresponding to the new economic system and to partially re-integrate the informal sector into public insurance systems. In rural society, after three exceptionally hard winters, societal resources are insufficient to take care of the thousands of families left destitute each year by the loss of their herds. The political leadership tries to promote social capital, but given the difficulties in coordinating private activities in a large, sparsely-populated country with a poor communication system, underdeveloped



infrastructure and widespread poverty, it is likely that only a relatively small number of citizens are involved in inter-personal solidarity and civic engagement. Despite the large number of NGOs (3,000)s nationwide, organizational capacity is limited and their agendas are partly driven by international donor organizations. Domestic and international NGOs generally operate without government restrictions. The political leadership generally takes into account and accommodates the interests of civil society actors.

Following the Soviet civil war in the early 1920s and the occupation of the Mongolian capital Urga in July 1921, Moscow became the major outside influence in Mongolia. Between 1925 and 1928, power under the socialist regime was consolidated by the MPRP. In August 1924, the party adopted a communist type program, thus condemning the country to many years of political terrorism. The first deputy Prime Minister Danazan and others who stood in opposition were executed, which marked the beginning of a purge. Many prominent leaders fell victim to violence; religious repression was especially severe. Between 1937 and 1939, more than 700 temples and monasteries were destroyed and more than 17,000 monks executed. In June 2003, a mass grave containing hundreds of Buddhist monks and civilians executed during the 1930s was found in an Ulaanbaator construction area. This event indicates that the political leadership recognizes the need to deal with historical acts of injustice. However, the process of reconciliation is limited in part because the political leadership accuses the Soviet leaders in Moscow, irrespective of whether murder was carried out by Mongolians. Furthermore, the reaction on the part of the Communist Party's successor was expressed regret but failed to include an apology.

### **3.5. International cooperation**

Mongolia's international situation is marked by its geographic situation between two dominant neighbors, the People's Republic of China and the Russian Federation. In 1994, China and Mongolia signed a Treaty of Friendship and Cooperation. However, the various governments have followed a fundamentally pragmatic policy with regard to their dominant southern neighbor. However, there is still a history of mistrust toward China and the fear of being economically and demographically assimilated like Inner Mongolia, which is now an autonomous Chinese province currently inhabited by approximately 3.6 million Mongolians and 16.4 million Chinese. In 2003, Chinese President Hu Jintao visited Mongolia. Relations with Russia have intensified again in the last few years. President Putin paid a state visit in November 2000 to sign the 25-point Ulaanbaatar Declaration, reaffirming Mongol-Russian friendship and cooperation on numerous economic and political issues. In 2002, Prime Minister Kasyanov came to Mongolia and the Mongolian prime minister to Moscow in 2003. Thanks to bilateral endeavors, relations with Russia and China have increasingly developed; relations with both countries have advanced into the partnership dimension. Mongolia has to seek international cooperation, both because of its geographic location between two

dominant neighbors and for financial reasons. Mongolia is a member of several international organizations, and has signed the standard international agreements. Mongolia has been a member of the WTO since 1997.

With the assistance of international financial institutions and the wider donor community, Mongolia has made substantial progress over the past decade.

By subscribing to the Millennium Declaration in September 2000, Mongolia committed to upholding human rights, the rule of law, fighting poverty, hunger, illiteracy, gender inequality, child and maternal mortality, HIV and AIDS and other diseases and environmental degradation. Mongolia's main multilateral donors include the Asian Development Bank, the World Bank, the European Bank for Reconstruction and Development, the European Union, and various United Nations agencies. Japan is its major bilateral donor, followed by the United States and Germany. Non-governmental organizations such as the Soros Foundation and World Vision also endorse Mongolia's transition. Programs of international donors cover a wide range of areas, such as reducing poverty, developing human resources and infrastructure, building market economy institutions, promoting economic growth, consolidating democracy and strengthening good governance. In 2003, the Mongolian government presented its Economic Growth Support and Poverty Reduction Strategy, a comprehensive medium-term framework of strategies, policies, and programs to reduce poverty by promoting strong economic growth. Overall, Mongolia cooperates intensively with international donors, adapts external advice, and integrates international assistance into the domestic agenda of reforms.

Aside from the positive impact of large amounts of financial and administrative international support, a critical assessment should also consider the problem of ineptitude as well as dependency on Western donors.

#### **4. Trend of development**

##### **4.1. Democratic development**

Mongolia shows a very high level of political stability, particularly for a post-Soviet, low-income country. Parliamentary elections were held on June 27, 2004, during the period of review. These elections changed the character of government from a communist successor party to a democratic coalition – although both have been committed to democratic values and transition. The issue differentiating both governments has been the choice of a more socially oriented reform strategy. Despite all positive assessments, national and international observers have criticized the lack of free and fair elections. Re-counts were held in several districts and the court stayed a re-vote in one of the districts and declared a re-vote invalid in another. Furthermore, some other developments mark Mongolia's institutional stability, for instance the drafting of amendments to parliamentary

law and parliamentary procedural law. Overall, stateness, political participation and the rule of law have remained at their former levels of quality.

## 4.2. Market economy development

**Table: Development of macroeconomic fundamentals (2000-2004)**

	2000	2001	2002	2003	2004
Growth of GDP in %	1.1	1.0	4.0	5.5	10.6**
Export growth in %	18.0	-2.7	0.5	17.5	nn
Import growth in %	19.8	3.8	8.3	16.0	nn
Inflation in % (CPI)	11.8	8.2	1.5	4.6	11.0**
Investment in % of GDP	nn	nn	30.7*	30.7*	nn
Tax Revenue in % of GDP	34.0	38.6	37.9	38.7	nn
Unemployment in %	4.6	4.6	3.4	3.5	4.0**
Budget deficit in % of GDP	-7.7	-4.5	-5.8	-5.9	-4.5**
Current account balance in billion \$	-63.5	-59.7	-105.1	-98.7	nn

Sources: Asian Development Bank; \* World Bank; \*\* estimate

World commodity prices and the positive effect of milder winters on livestock nearly doubled the GDP growth to 10.6 % in 2004. Although continuing economic growth increases living standards, poverty remains problematic in both rural and urban areas. Thirty-six percent of Mongolians live below the national poverty line of \$0.75 per day. In addition, income inequalities have widened. Overall, the country's level of development has improved slightly in the past five years (HDI change falls between 0.010 and +0.030). The HDI in 1995 was 0.629 and 0.658 in 2000.

The institutional framework has not significantly improved but the government has been continuing market reforms initiated in the 1990s, including the establishment of an open trade regime and market-based economy. In July 2003, Russia nominally cancelled Mongolia's 11.4 billion rubles, debt left over from Soviet era, in return for a cash payment of \$250 million, causing a substantially increased debt burden of approximately 78% of the GDP. The economic task ahead is to improve living standards, welfare and to reduce poverty. The Economic Growth Support and the Poverty Reduction Strategy, as well as the Action Plan of the new government, are dedicated to these targets but their implementation might be limited by the shortcomings of a heavily indebted state budget. The 2005 budget passed by parliament in November 2004 incorporates a new system of cash payments to children and families below the poverty line, fulfilling a promise made during the election campaign. This program will additionally burden the state budget with \$14 million per year.

#### **D. Strategic perspective**

Since the breakdown of its relations with the former Soviet Union in 1990, Mongolia has succeeded in implementing remarkable formal reform progress in its transition to democracy and a market-based economy. Finally, yet importantly, Mongolia was able to compensate its political and economic dependency from the former Soviet Union by engaging foreign governments and international finance organizations because of its strategic position between Russia and China. The main tasks ahead for future success are to improve structural weaknesses and informal requirements.

Persistent economic difficulties and the associated poverty and inequality might become a long-term threat to democratization already achieved. The most important structural transition challenges to be solved include decreasing poverty and social fragmentation between the urban and rural population and diversifying an economy dependent on the weather, which can seriously damage agricultural production. These challenges are compounded by Mongolia's large land mass, complicated by weather conditions, numerous isolated population centers in the countryside - almost without the requisite infrastructure - do not lend themselves to the efficient provision of government services. Beyond remarkable progress in democratic development and institution building, the country suffers from an increasing amount of political, economic and social corruption.

Despite all promises made during election campaigns (reform programs and Western technical assistance), the government was unable to reduce the poverty problem. In order to reform the welfare system, Mongolia must overcome two difficulties: first, to overcome the legacies of its Soviet-style welfare system, which does not rely on social necessity but first and foremost on a "one size fits all" approach; and second, to some funding based on political targets. So far there is limited political will to curtail the Soviet style welfare state, as large increases of government wages and pensions (25%) in 2004 shows, and election-related promises to increase family welfare grants defiantly overstretching the state budget. To implement a tailor-made approach, the government requires a modern administration not influenced by corruption and with access to sustainable sources for funding. Currently, the government's limited capabilities and lack of resources make it highly dependent on external loans and multilateral loan programs, but further action is also restricted because of the high level of state debt.

The major economic problems are caused by vulnerabilities inherent to a small, underdeveloped, primarily commodity-based, low-income economy. Mongolia's extreme weather conditions, inadequate infrastructure, poor provision of utilities and underdeveloped legal framework must be addressed to stimulate strategic investment and sustainable economic growth. To reduce dependency on harsh winters, Mongolia's economy and particularly its industrial structures, must diversify. Today, Mongolia's private sector produces more than 85% of GDP.

However, the private sector requires stronger government support in strategic areas: legal coherence and stability, land reform and reliable property rights.

By praising Mongolia's unique reform progress from a Soviet satellite state with almost no democratic or market economy experience, one should not overlook the hasty change from one externally driven agenda to another. Future sustainable development depends on whether the country will succeed in overcoming structural reform problems that cannot be resolved through external support.