

BTI 2008 | Mongolia Country Report

Status Index	1-10	6.25	# 44 of 125	
Democracy	1-10	7.00	# 40 of 125	➔
Market Economy	1-10	5.50	# 63 of 125	➔
Management Index	1-10	6.12	# 31 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	2.6	HDI	0.69	GDP p.c.	\$	1,875
Pop. growth ¹	% p.a.	1.6	HDI rank of 177	116	Gini Index		32.8
Life expectancy	years	67	UN Education Index	0.91	Poverty ³	%	44.6
Urban population	%	56.7	Gender equality ²	0.39	Aid per capita	\$	86.2

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Mongolia is a place of extremes. Located between Russia and China, it is a large country (1.5 million square km) with a small population and long, harsh winters. While many people live the traditional nomadic life of herders, growing numbers – now nearly one million – live in the capital city of Ulaanbaatar. However, unofficial figures put this number as high as 1.3 million, due to the increasing number of people migrating from the provinces (aimags) to look for work, many of whom live in traditional tents (gers) on the outskirts of the city.

Mongolia has successfully completed a political transformation initiated in the 1990s from a centrally planned, authoritarian system to a parliamentary democracy with a market economy. Mongolia shows a very high level of political stability, particularly for a post-Soviet, low-income country. Furthermore, some other developments mark Mongolia's institutional stability, such as the drafting of amendments to parliamentary law and parliamentary procedural law. The economy depends heavily upon mineral resources, cashmere and textiles exports. Due to favorable world prices in gold and copper, and mild winters, Mongolia is in its fourth year of accelerated economic growth with an average above 6%. According to the National Statistical Office of Mongolia (NSO), the GDP grew from 7.1% in 2005 to 8.4% in 2006.

Since its independence, Mongolia has had a history of free and fair elections. The last presidential elections were held on 20 May 2005, with four candidates competing. The elections were won by Nambaryn Enkhbayar of the Mongolian People's Revolutionary Party (MPRP), who won over 50% of the votes. Electoral turnout was 74.9%. In January 2006, a cabinet crisis initiated by the resignation of ten MPRP ministers led parliament to dissolve the government. With a majority of 39 votes – mostly from members of the MPRP, but including four members of the Democratic Party (DP) – parliament overthrew the big coalition government led by Prime Minister

Tsakhiagiin Elbegdorj of the DP. A new coalition government led by the MPRP with the participation of four smaller parties was formed. Miyegombyn Enkhbold, leader of the MPRP, was elected new prime minister. Three of the four DP members who voted against their own party's government were rewarded with positions in the new MPRP government but later expelled from the DP. Mongolians protested against the MPRP and the parliament's decision to overthrow Elbegdorj's government for four months. The fight for the executive branch between two major political forces undermined the government's actions and further weakened its management capabilities not only on the national but also on the local level.

Social advancements of the previous socialist era (e.g., a high literacy rate, free health care and education, social protection for the elderly and disabled and a low unemployment rate) are deteriorating both in quality and quantity. The post 1990s shock-therapy reforms were accompanied by increased unemployment, the spread of poverty, urban problems, homelessness, family break-downs and alcoholism. The country's most serious infectious disease is tuberculosis. The number of HIV/AIDS-infected persons is increasing, though Mongolia is an HIV/AIDS low prevalence country. The 22nd case of HIV was confirmed as of January 2007; but while the first five had been diagnosed between 1993 and 2005, the last 17 were diagnosed in 2005 and 2006 alone. The risk factors are all there, with many of them as serious for tuberculosis as for HIV. In Mongolia, half of tuberculosis patients are unemployed and 70% of them are poor.

In 2006, livestock farming, which accounts for 21.7% of GDP, grew by 14.4% and crop production increased by 63.4%. The real growth in the mining sector benefited from increased international gold and copper prices, and the services sector experienced rapid expansion, including in transport and construction. The mining sector accounted for 25% of the country's GDP, 71% of its export earnings, and 16% of tax revenue in 2005, according to a report released by the Ministry of Finance's Budget Policy Department. The figures are estimated to have increased to 32% of GDP and 40% of tax revenue in 2006. Arrivals of overseas visitors leapt up by 67% in 2004 and continued to rise in 2005 and 2006. Mongolia's total exports increased by 43.6% in 2006, while imports increased by 25.7%, leading to a trade surplus of 39.6 million USD, or 1.4% of GDP. There was an account surplus of 145 million USD at the end of 2006. A fiscal surplus was recorded in 2006 for the second consecutive year, reaching 9% of GDP. General revenue and expenditure amounted respectively to 42.7% and 38.7% of GDP.

History and Characteristics of Transformation

Mongolian statehood went through a long history of both glory and downturns. The Mongol Empire was formed in 1206 by a decree of Temüjin (Genghis Khan). (In 2006, the 800th anniversary of the establishment of a united Mongol state was celebrated.) In 1924, the Mongolian People's Republic was proclaimed an independent republic with the backing of the Soviet Union. As a communist country, Mongolia was characterized by a centralized command economy and a one-party system ruled by the Mongolian People's Revolutionary Party (MPRP), and it was dominated by communist ideology. Religion was totally abolished. However, the eradication of illiteracy and contagious diseases, the introduction of basic sanitary and hygiene, industrialization, farming, roads and railway and a developed social-welfare regime were the remarkable achievements that socialism brought to the country which lagged centuries behind its peers.

The "Perestroika" of the mid- and late 1980s inspired a democratic movement initiated by young and dynamic reformers in 1989/90. After several ultimatums to the totalitarian communist regime, the opposition used hunger strikes in early 1990 to strengthen demands for free elections. As a result of these events, the first multiparty elections were held in July 1990. The opposition won 22 of 53 seats in the first post-communist parliament. In 1992, a new constitution was passed stipulating a mixed parliamentary and presidential system. According to the constitution, the government is formed based on a parliamentary majority under a prime minister. The president is elected directly and has the right to endorse a prime minister. The parliament has the power to endorse the president in office, but it 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 and 2004) gained an overwhelming majority in parliament. Although there is a multitude of political parties in Mongolia, the majority system led to the emergence of two major political parties, the Mongolian People's Revolutionary Party (MPRP) and the Democratic Party (DP), as main competitors. 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 turmoil. On June 27 2004, the fourth parliamentary elections were held, but they were marred by violations and inconsistencies. As a result, the 72 seats in parliament were split between the former ruling MPRP and the Motherland Democratic Coalition (MDC), a coalition composed of the Democratic Party, the Mongolian Democratic New Socialist Party and the Civic Will Party.

Mongolia is one of the least densely populated countries in the world; a near one-third of its population is made up of nomads tending to primarily sheep, cattle and yaks in a harsh continental climate that threatened to decimate livestock numbers from 1999 to 2002. Mongolia's political and economic transformations occurred largely in parallel. The "shock-like" liberalization and privatization of the economy and the dependence on foreign aid have had extremely serious implications for the economy. In 1990-1995, per capita GDP decreased by approximately 20%, inflation rose to 325% in 1992, and social protections collapsed. Mongolia's development has been concentrated on mining activities, animal farming, and the service sector, and it has been characterized by a virtual collapse of manufacturing production. Despite a highly educated population, unemployment and poverty have become rampant. Twenty-six percent of the population has lived 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 the negative effects of corruption, which has a severe impact on society, the economy and politics.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force is established nationwide in principle but, due to a weak infrastructure and rampant corruption, it is not fully functional.

Monopoly on the use of force

All citizens have the same civic rights, and the constitution prohibits the deprivation of citizenship, exile or extradition. Up to now, there have been no officially registered controversies on Mongolia's legal grounds regarding political and economic rights, such as the right to elect or be elected into governmental office or regarding discrimination against individuals, who have either gained or been deprived of citizenship.

State identity

Church and state are separated. Political processes are secularized. Religious dogmas have no marked influence on politics or laws. The freedom of individual beliefs, capacities and choices has no barriers. Although the "Law on Relations between the State and Church" provides that Buddhism is the major religion in Mongolia, there is in fact no preference given to Buddhism in any sphere. The total number of monasteries and temples is increasing every year. In 2006, there were altogether 245 religious organizations, including 150 Buddhist monasteries, 85 Christian organizations and churches, seven Islamic organizations and mosques, and three other religious registered organizations. In 2007, the number of Buddhist organizations has decreased slightly, whereas the number of Christian organizations and churches is increasing.

No interference of religious dogmas

An administrative system guaranteeing public security and order is for the most part functioning. The public administration system is considered to be acceptable in terms of institutional organization. However, its effectiveness, methods of implementation and performance results are unsatisfactory. The performance of public service providers is not uniform everywhere, and red tape and bureaucratic inaction are widespread at the lower and mid-levels of public service.

Basic administration

2 | Political Participation

Political participation is remarkable high in Mongolia, where levels of voter turnout across all elections since the transition are around 80%. There are in general no constraints on free and fair elections. However, some doubts concerning the principle of equality and fairness of election do exist. Recounts were held in several districts, and the court ruled a re-vote in one of the districts and declared a re-vote invalid in another. NGOs reported cases of violations of the principle of secret balloting and inadequate voter registration.

Free and fair elections

Elected rulers have the power to govern in principle, but interest groups (such as business associations) may influence the parliament's decisions. The military and clergy do not have the power to veto the results of democratic decisions.

Effective power to govern

The law provides for freedom of assembly and association, and the government generally respects these rights in practice. There were 18 parties and approximately 4700 NGOs registered in 2005.

Association / assembly rights

The law provides for freedom of speech and of the press, and the government generally respects these rights in practice and does not restrict academic freedom. In 2005, the Law on Public Radio and Television transformed the state-owned radio and television stations into publicly owned entities. However, government interference with licensing and indirect intimidation of the press, especially the broadcast media, remains a concern. A variety of newspapers and other publications have represented both major political party and independent viewpoints. Due to transportation difficulties, unreliable postal service and fluctuations in the amount of newsprint available, not all publications are available in rural areas.

Freedom of expression

3 | Rule of Law

Despite the formal separation of powers laid out in the 1992 constitution, there remains a dispute over whether members of parliament can simultaneously hold posts in the cabinet, which has been allowed since a measure was passed with the 1999-2000 amendments to the constitution. Allowing such dual officeholders compromises horizontal accountability, and conflicts of interest may arise. The disproportionately high number of cabinet members in the State Great Khural and a high number of state administrative officers among representatives of local self-governing bodies create an environment conducive to undermining these institutions' oversight of the executive. Formation of the new administrative court system triggered some positive movement, but the poorly defined functions of the newly formed court system as well as the insufficient experience and knowledge

Separation of powers

of judges, reluctance of citizens to seek protection of their rights through courts are all obstructions to fully implementing the rule of law. Of all the obstacles mentioned, the most destructive factor has been the ruling of the Constitutional Court of Mongolia, which left the decisions issued by the General Election Committee and the government outside the jurisdiction of administrative courts, thereby creating conditions for government activity that is above and beyond the law.

Established in 1992, Mongolia's Supreme Court is secure. However, the judiciary's independence is hampered by the following: an insufficient enforcement of rules regulating the independence of the judiciary, an underdeveloped culture of the rule of law in the political system, the appointment of higher ranking judges based on political criteria, insufficient resources, salaries, travel allowances and housing for judges, and the communication and administration of justice.

Independent
judiciary

According to numerous sources, corruption is growing and has become a widespread phenomenon in Mongolia over the last decade. The policy of Mongolia on combating corruption is defined by the National Program to Combat Corruption (2002), the Anti-Corruption Law (1996), the Criminal Code and other legislative acts. In late 2005, Mongolia joined the UN Convention against Corruption. But the implementation of the above laws and policies and the control over their implementation remains poor. Corruption is thought to be a growing problem at both lower and upper levels of government. Government and parliamentary decision-making are not sufficiently transparent, and public legislative hearings are rare. There is no clearly determined policy aimed at preventing the improper influence of large companies and businesses on state organizations and their officers. The linkages between politics and private business have been strengthened, and there is a tendency toward the increased influence of the interests of narrow political-business groups. In July 2006, Mongolia's parliament adopted an amended Anti-Corruption Law. The law provides for an anti-corruption agency aimed at investigating corruption cases, preventing corruption and educating the public. While investigating, the agency has the power to gather intelligence, interrogate, and monitor income declarations submitted by officials. The agency is an independent body with a vertical structure legally required to follow the principles of respecting the law, being autonomous and transparent, and respecting the confidentiality of information.

Prosecution of
office abuse

Mongolians enjoy civil liberties guaranteed not only by the constitution but generally in practice as well. However, the protection and guarantee of the right to life and security, equality before the law and access to justice are insufficient, and the measures for protecting physical integrity rights and preventing torture are eroding. The Human Rights Survey reports that the actual number of criminal offences is six times higher than the number registered with the police. Following

Civil rights

this number, there are numerous victims whose human rights have been violated. Furthermore, domestic violence against women and children remains a serious problem. The law specifically prohibits trafficking in women and children; however, there was evidence that female and teenage Mongolian citizens working in the sex trade in Asia and Eastern Europe may have been the victims of trafficking rings. The country is both a source and transit point for trafficking. There have been no instances of violence among citizens stemming from ethnic or religious differences.

4 | Stability of Democratic Institutions

In principle, democratic institutions are fundamentally supported by the relevant actors and the citizenry, but their performance is imperfect. The legal requirements for the responsiveness and accountability of members of national, provincial and district parliaments toward citizens are ambiguous, and there are no formats or mechanisms for enforcing them. Members of parliament and citizens' representatives show little initiative to contact or establish communication lines with their constituencies. The ability of Mongolia's government to develop and maintain an effective system of government responsibility and accountability is a major – and possibly the greatest – challenge it faces.

Performance of
democratic
institutions

All relevant actors support and consider democratic institutions to be legitimate, but the level of confidence and trust in democratic institutions is not solid. In a series of public opinion surveys carried out by the Sant Maral Foundation in Mongolia between 1999 and 2005, respondents showed high support for the transition to democracy and market economy in general but much less support for the political system itself. Respondents placed greater trust in the president than in either the parliament or the judiciary, and they had a relatively low level of support for state organizations and political parties. There is not a favorable environment for people to assess and trust the representative institutions, as they are not monitored adequately by citizens. Moreover, decision-making processes are not open and transparent.

Commitment to
democratic
institutions

5 | Political and Social Integration

A multiparty system became a reality in the 1990s, as political parties were formed as an institutionalized expression of multicultural opinions and one of the main components of a democratic society. Mongolia has seen a marked shift in recent years toward two-party politics compared to the lop-sided outcomes of the past, and there has been an effective number of parties of 2.01 in 2004. Although a multiparty system exists and is maturing as a pillar institution of democracy, the

Party system

role of political parties in consolidating, further developing and protecting democracy can be defined as fairly weak. There are many factors contributing to such passiveness, such as the level of internal democracy within a political party, the participation of members, the status of women and the fair competition for power within the party, the campaigning practices during elections, financial oversight mechanisms, accountability and transparency. Party membership sometimes becomes a matter of discrimination and a barrier to employment in the civil service. Political parties are to some extent becoming isolated from the general public and their supporters. There are no substantive studies on the internal democracy within political parties and therefore no grounds for comparisons and conclusions to be made at this moment. Although all political parties include provisions for increasing the participation of grassroots members and women as well as openness and transparency in the decision-making process in their charters, none of these promises has thus far materialized in practice.

Mongolia has a weak tradition of interest groups that exemplify a contemporary liberal democratic concept. During the last 16 years, various interest groups expressing various views and beliefs while advocating specific interests formed in parallel with the evolution of social relationships in Mongolia's democratizing society. According to 2005 statistics, there are approximately 4,700 NGOs operating in Mongolia. In terms of sheer quantifiable measures, this relatively high number of NGOs points to an acknowledgment of the need for democratic representativeness. However, in terms of developing democracy, these institutions are at a rather nascent stage. The following civil society organization activities, as a primary means of engaging the public in active, voluntary, and knowledgeable participation, are not sufficient in Mongolia: a) the coordinated expression of interests; b) delivering humanitarian, social and environmental protection services (which are not carried out by the state) to citizens; c) the influence in decisions made by public institutions within the framework of legislative and executive power; d) the independent monitoring of activities and decisions of public institutions; e) the dissemination of up-to-date or factual information to citizens, the provision of transparency, and political education in order to promote a consolidation of the value of democracy.

The survey "Democratic Governance Assessment" conducted as part of the International Conference on New or Restored Democracies-5's Follow Up Project in 2005 as well as survey results from the Institute of Philosophy, Sociology and Law of Mongolian Academy of Sciences, Sant Maral Foundation and East Asia Barometer show overwhelming (almost 85%) public support for democracy in general. This illustrates that Mongolians wish to expand democratic achievements much more broadly. However, the "Democratic Governance Assessment" also reveals that the level of fundamental support for democracy per se is higher than the level of support for the democratic processes and institutions

Interest groups

Consent to
democratic
norms

of democracy in Mongolia today. This result is further differentiated across the urban-rural divide, where rural inhabitants are generally more satisfied with democracy than their urban counterparts. Such a result is further complicated when taking into account the different income strata within Mongolian society, where support for democracy and the democratic process is higher among those in the higher income stratum.

Over the last two years, the level of the voluntary association of citizens for purposes of self-help has considerably increased. There are many NGOs focusing on issues of youth and children, gender, family, human rights, social welfare and international cooperation, with a few of them working on regional or local development issues, such as environment protection.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

During the period under review, economic reforms have proved successful, and world commodity prices have been favorable. The country enjoyed an economic growth rate of 7.1% in 2005 and of 8.4% in 2006. The positive economic development has yet to be automatically distributed among the Mongolians: the poverty rate of 36% in 2004 has not changed much and was still frozen at about 32.2% in 2006. Ulaanbaatar and large city suburbs have expanded as rural migrants have set up their gers, or the traditional felt-covered, tent-like dwellings. The inequality gap between rich and poor measured by the Gini Index has increased from 0.31 in 1995 to the more unequal 0.35 in 1998, and it climbed again to 0.44 in 2002 (the last year for which data is available), thereby approaching the value of the United States of America. The recent World Bank Poverty Assessment (2006) for Mongolia finds that, of all households in which heads of household were engaged in some form of activity, the households of herders had the highest incidence of poverty (41.2%). There is an increasing level of disparity between the urban and rural areas and within the urban areas themselves between the better-off and the worse-off in the formal residential and informal suburban areas. Lack of employment opportunities, an increasing number of street children, and the vulnerability of women in particular are typical aspects of life for the residents of ger areas. The ger areas comprise individual fenced plots and have densities of between 45 and 65 persons per hectare. The households use pit latrines for sanitation and rely on coal-, wood- or dung-fired

Socioeconomic
barriers

stoves for heating and cooking. Unemployment is typically considered to be higher than the official figure of 3.2% (2006), and women are more likely to be unemployed than men. There are regional disparities, with Western regions (Khovd, Bayan-Ulgii, Zavkhan, Gobi-Altai and Uvs provinces) lagging behind the rest of the country. The rural poverty incidence is 37% (2006).

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	1,118	1,274	1,612	1,880
Growth of GDP	%	4.0	5.6	10.7	6.2
Inflation (CPI)	%	5.2	8.2	3.6	8.9
Unemployment	%	-	14.2	-	-
Foreign direct investment	% of GDP	7.0	10.3	5.8	9.7
Export growth	%	9.6	2.8	-	-
Import growth	%	7.4	9.2	-	-
Current account balance	\$ mn.	-105.0	-98.7	63.4	-
Public debt	\$ mn.	949.0	1,137.5	1,306.6	1,266.7
External debt	\$ mn.	1,035.8	1,472.3	1,517.9	1,326.7
External debt service	% of GNI	4.7	22.8	2.6	2.5
Cash surplus or deficit	% of GDP	-	-0.5	-	-
Tax Revenue	% of GDP	-	22.6	-	-
Government consumption	% of GDP	19.1	17.3	16.9	15.1
Public expnd. on edu.	% of GDP	9.0	7.3	5.4	-
Public expnd. on health	% of GDP	5.3	4.2	4.0	-
R&D expenditure	% of GDP	0.3	-	-	-
Military expenditure	% of GDP	2.3	2.0	2.0	1.6

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Mongolia's economy by-and-large allows market-driven forces to regulate entry, and it is generally characterized by non-discriminatory competition practices. There is a broad spectrum of commercial entities in the Mongolian economy, from enclaves of foreign (mostly mining) companies to a wide range of small-scale private businesses (often single-operator) to the MCS Group (Mongolia's first domestic diversified corporation). The country became a member of the WTO in 1999. Traditional trading patterns have changed, with large volumes of new imports from new sources entering Mongolian markets. Industries that developed during the era of a centrally planned economy and were based on the ability to export to COMECON markets have declined or disappeared altogether. The distribution of goods and services, formerly controlled by a rigid state-planning apparatus, is now almost entirely market-driven. Retail prices have been almost entirely freed from control, with the only exceptions being a few state-owned utility monopolies. These changes have contributed to a burgeoning and dynamic urban informal sector, particularly in Ulaanbaatar. The gray economy is estimated to be at least one-third the size of the official economy. The actual size of this gray – largely cash – economy is difficult to calculate, as the money does not pass through the hands of the tax authorities or the banking sector. Remittances from Mongolians working abroad, both legally and illegally, constitute a sizeable portion.

Market-based
competition

Anti-monopoly legislation has been in place since 1993. The Unfair Competition Regulatory Authority of Mongolia was established by government resolution in November 2004. The mission of the authority is to create a competitive and free market environment in Mongolia's economy as well as to implement the state competition policy and thereby ensure fair competition. The agency tries to make a vital contribution to economic development, public welfare, competition and consumer protection by halting and preventing unfair competition acts, regulating any resolution that restrains or lessens fair competition, and encouraging advanced techniques and technology. In 2006, 29 companies were declared to be monopolies and 40 companies were labeled as having dominant status in the market.

Anti-monopoly
policy

An open-trade regime has yet to be fully implemented as a result of an export ban, and later an export tax, on raw cashmere being imposed. Nevertheless, the Mongolian government has laid down fundamental economic reforms, such as price liberalization, privatization and the development of the market institutions. In 2006, the value-added tax was lowered from 15 to 10%. A market economy based on private property has been fully transformed from its initial early stages into a well-functioning system. With the top 100 companies comprising the lion's

Liberalization of
foreign trade

share of GDP, the structure of the economy is unbalanced, and smaller-sized formal and informal entities operate in trading, services, urban transportation, and unsophisticated production. The new, large telecommunications industry had only two mobile phone service providers, though a third was created in 2006, which resulted in a slashing of prices in the oligarchic market.

The Mongolian financial system is dominated by commercial banks. Prior to 1990, Mongolia had a mono-banking system administered by the state bank. The bank performed both central and commercial banking functions, but its main purpose was to transfer government resources to public enterprises. In 1991, the mono-banking system was replaced by a two-tiered banking structure with a central bank and commercial banks. In April 1991, a banking law was passed that established the new central bank, called Bank of Mongolia (BOM), and provided licenses for new commercial banks. Since then, several banks have failed. The first banking crisis occurred in September 1994, as a result of insolvency from fraud and bad loans. Direct and corrupt loans, poor corporate governance and poor accounting and auditing practices brought about the insolvency of two banks in 1996, and non-liquidity of the then still state-owned Savings Bank in 1998. Two new laws, the Central Bank Law and a new banking law, were enacted to strengthen Mongolia's weak financial sector. As of January 2007, there were 15 commercial banks, of which the leaders were Khaan Bank (Agricultural Bank), Trade and Development Bank, and Golomt Bank. Recent development changes included the imposition of a capitalization requirement of no less than 10 billion tugrik (2006). Most commercial banks met this requirement, and expected banks mergers did not take a place. Proper prudential controls, real independence from the government, stronger management capacity of the BOM are goals that have yet to be pursued. Poor financial intermediation is to blame for high interest rates. The fact that short-term loans for working capital replenishment is as hardly available for businesses as are long-term production investments further impedes economic development.

Banking system

8 | Currency and Price Stability

With an average annual rate of inflation of 13% in 2005, prices have stabilized. This was again 5.1% lower in 2006 compared to its peak levels of 321% in 1992, the reduced levels of 44.6% in 1996, and the moderate level of 8% in 2001. Prices are sensitive to external shocks caused by price increases for oil in neighboring Russia, Mongolia's main oil importer, as well as by price fluctuation or an uneven supply of basic food commodities such as meat, flour, rice, cooking oil and sugar. The government still controls electricity and heating prices, although they were slightly increased and better structured as a result of efforts by the Energy Regulatory Authority. The full economic picture of this otherwise

Anti-inflation /
forex policy

bankrupt energy sector is not transparent. In 1993, the government permitted the tugrik to float. The tugrik is fully convertible on the foreign exchange market consisting of an inter-bank market, licensed exchange-rate vendors and an informal cash market. The strong balance-of-payments position has lessened depreciation pressures on the tugrik. In 2005, the tugrik depreciated by only 1.7% as compared with about 3% over 2001-05. But in 2006, the tugrik appreciated in nominal terms by about 4% as compared with the end of 2005. In 2005, the real effective exchange rate depreciated by 1.3% as compared to 10% in 2004. The absence of real exchange appreciation before 2005 suggests that the boom in the mineral resource sector has yet to hurt Mongolia's competitiveness. However, the recent appreciation of the nominal exchange rate, partly fueled by massive foreign direct investment inflows in the early 2000s (primarily into the mining sector) and the ongoing commodity price boom, raises concerns about "Dutch disease."

In 2006, Mongolia's economic growth was marked by a steady increase for the fourth consecutive year, reaching 8.4%. This increase, coming after a series of bad winters coupled with unfavorable world gold and copper prices around the turn of the millennium, seems to be a complete break from past performance.

Macrostability

9 | Private Property

Property rights and property acquisition are adequately defined with regard to the acquisition, use, benefits and sale of property. They have their necessary protections enshrined in the basic civil rights.

Property rights

A sustainable private sector is an engine for economic growth and generates employment opportunities. Throughout the 1990s, Mongolia has been undergoing a process of de-industrialization. As many inefficient state enterprises shuttered their facilities during the early 1990s, the contribution of industry to GDP fell from 33% in 1990 to 23% in 1998. The basic transfer of property from public to private hands came in the form of giving private ownership of apartments to their residents and of livestock to herders. However, in hindsight, the mishandled and opaque privatization process was used to sell the public assets to the managers of SOEs, many of whom failed to use the resources effectively and efficiently. The private sector's share in GDP rose from 53% in 1995 to 78% in 2006.

Private
enterprise

10 | Welfare Regime

Mongolia's welfare regime was inherited from the socialist era with a strong inclination toward state-run social security, including generous child allowances. During the period of transition, this dense network was severely cut back.

Social safety nets

Uninsured The risk of being uninsured has seriously increased for the population. As a result, birth rates have dropped sharply (from 2.9% annually in 1989 to 1.4% annually in 2004 and – slightly reversed – in 2005 to 1.9 % in 2005, and to 2.1 % in 2006). 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. Since 1995, 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, Mongolia's government is reforming its social welfare and pension systems in anticipation of demographic changes, which are expected to start in 2010, and worsen by 2020. The parliament passed fundamental guidelines for 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, but the poorest fall through this net. The distribution and allocation of medical services is uneven across urban and rural areas. Before 1990 (still during the socialist regime), the health system ensured free and universal health care for the entire population. Access to health care facilities, though, is far from uniform, and much is concentrated in Ulaanbaatar, the main cities and provincial centers. The life expectancy in urban areas is therefore higher; and mortality and disease rates are 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 2006 budget, 17.1 % of total expenditures were devoted to education and 8.8 % to health care. Nevertheless, revenues are often insufficient for keeping the system afloat. Reducing poverty and unemployment appears vital to ensuring democratization in 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 it in 62nd place (2004). Women hold 10.5% of parliamentary seats and make up 66% of professional and technical workers. Women account for 30% of administrators and managers. As a legacy from the Soviet past, there are institutions to compensate for gross social differences, yet they are limited in scope and quality.

Equal opportunity

11 | Economic Performance

As a result of a mild winter and rising international commodity prices, Mongolia's economy grew markedly in 2006. Personal bank deposits grew 9.2 times compared with the 2000 level. Non-performing loans remained at 6% of total loans. Mongolia's economy has expanded by an average of 7.6% over a five-year period. Substantive mineral resources and Mongolia's advantageous location between two large, accelerating economies – China and Russia – also provide a good basis for economic activities. Fiscal and current accounts are in surplus. The current account position is likely to reach 7% of GDP in 2007, owing primarily to a favorable trade surplus and current transfers of remittances from workers overseas. Foreign exchange reserves have more than doubled to a record high of over \$900 million at the end of 2006. Parliament passed four new tax laws in 2006 – personal income, corporate income, value-added and excise – so as to reduce the overall tax burden on taxpayers and to stimulate the economy. Most provisions of the new laws took effect on 1 January 2007.

Output strength

The Mongolian economy is no longer dominated by agriculture and, more specifically, pastoral herding. In a country with 2.6 million people, out of which 360,000 are herders, Mongolia is also a home to 34.8 million sheep, goats, cattle, horses, camels and yaks. Agriculture's share as a percentage of GDP has been steadily declining over the years (from one-fourth in 1999 to less than one-fifth in 2006), ceding its former position of dominance to the service sector and the fast-growing mining sector, which is supported by FDI. This structural shift, which further shrinks an already shrinking traditional agriculture sector depletes scarce resources and thus threatens to turn Mongolia into the next Nigeria. Animal husbandry is important in Mongolia for its role as a preserver of nomadic traditions, but there are increasing concerns about changes in pasture management and changes in the quality of livestock as herders transition from traditional pasture husbandry to intensive livestock farming. Agriculture is characterized by inadequate infrastructure and a lack of market access for agricultural production, which limits domestic supply of raw materials and livestock products to the processing industry. Great care and thought will be devoted in the upcoming years to how natural resource wealth will affect the economy.

Mongolian exports are dominated by minerals and textiles. Minerals – primarily copper, gold, molybdenum and fluorspar – have accounted for 50% to 70% of Mongolia's annual earning from commodity exports since 1999. The tripling of mining revenues since 1999 mainly reflects a 130% rise in copper prices, a doubling of gold production and a 60% rise in gold prices. Parliament passed a windfall profits tax on copper and gold that took effect in mid-2006, and major

amendments to the minerals law allows the government to take an equity stake in major new mines. It is unknown what effect these laws will have on mining activities in Mongolia, although major potential investors expressed considerable concern about the changes. The dependence of Mongolia on livestock in the domestic economy and minerals in the international market make it open to natural and external shocks.

Domestic debt repayment, strong nominal GDP growth and a robust primary surplus have permitted conditions for the public debt burden to decrease to only 42% of GDP in 2006. Despite these positive developments, Mongolia's fiscal position remains vulnerable to shocks. The government's revenue base remains heavily exposed to the commodity price cycle (particularly to copper prices and, to a lesser extent, to gold prices). Regarding expenditures, the hike in civil service wages, the elimination of a method for determining child allowances and the introduction of new universal allowances worsens the discipline of the government's current spending program and exposes the government to a continuing dependence on fiscal reserves in the event of a possible terms-of-trade shock.

12 | Sustainability

There is a government Biodiversity Action Plan (1996) has been enacted, but a lack of government financing has resulted in a lack of proper implementation. Environmental threats may result from the over-grazing of pastures and the over-exploitation of natural resources resulting in deforestation, desertification, and dangerously low water levels in rivers and lakes, urban pollution and pollution resulting from legal and illegal small-scale mining. In addition, illegal trading with China and poaching in endangered wildlife habitats has worsened environmental degradation. Weak environmental governance is the overarching challenge to Mongolia's environment. Mongolia has been exemplary in ratifying international environmental conventions and in developing a comprehensive system of environmental laws and regulations. However, it has been less successful at implementation owing to vast distances, a lack of clarity in ownership and management responsibilities, a lack of information, and a lack of centralization for locally collected tax revenues. The new amended environmental law of 2005 provides better community participation and more room for local initiative.

Environmental
policy

Mongolia allocates about 20% of the state budget to the education sector; it sets education as a social priority and undertakes complex measures to improve the physical condition of schools and to ensure access to education for children from socially vulnerable and disadvantaged groups. As a result, the net enrollment rate in primary education was 84% in 2005, and the rate of school dropouts has

Education policy
/ R&D

declined from 8.8% to 2.2% over the last 12 years. There are insufficient learning materials for both students and teachers. Kindergartens, schools and dormitories are overcrowded, especially in suburban areas, and there is a lack of proper heating, sanitation and safe water. Research and development institutions are financed by the government budget; they still operate under the socialist-era arrangement and are largely ineffective in meeting market demands.

Transformation Management

I. Level of Difficulty

In terms of structural constraints, Mongolia possesses an array of negative and positive factors, but overall its difficulties are very significant. Mongolia's landlocked geographical position – with Russia to the north and China to the east, south and west – represents one of the infrastructure constraints impeding the country's openness toward trade and tourism. The principal carrier of industrial products and international trade is the trans-Siberian railway, which connects Russia and China and passes through Mongolia's capital, Ulaanbaatar. The rail operates on Russian wide-gauge track that differs from the Chinese narrow-gauge track. At the Erlian border crossing, the axles on the railcars must be changed, an action which accounts for up to 25% of the overall transport cost to the closest seaport in Tianjin. Nevertheless, Mongolia's location might even lead to a positive development, in that it might be able to absorb the external spillover effect of the fast-growing economies of China and, recently, Russia as well. The vastness of Mongolia's territory, its small population, the remoteness of its cities and towns, and the insufficient development of infrastructure result in increasing costs for social services and high costs for improving living standards. The recent trend of migration from the rural to the urban areas further increases the high cost of providing services to a reduced number of qualified recipients in less populated rural areas, and it increases the burden of providing infrastructure services, such as the supply of electricity, heating, water, housing, and transport to the urban centers. Mongolia is also vulnerable to natural disasters such as steppe and forest fires, floods, dust storms, droughts and severe snowfalls (which also mirrors the global warming effect). On the more optimistic side, Mongolia's low-cost, literate, and predominantly young labor force, which is culturally adapted to industrial production, is a great asset.

Structural
constraints

Effective civic organizations, nongovernmental organizations, community-based organizations and emerging civic movements have been increasing their calls on the government to fight corruption, illegal exploitation of natural resources, and the growing inequality between rich and poor. They have also asked the government to address issue regarding the constitutional right of a public stake in mineral and mining proceeds, the functional inability of the government to

Civil society
traditions

fulfill its own action plans and other problematic political, social and economical issues. Despite the tremendous progress that has been made over the past 10 years – with the growth from 30 organizations in 1989 to about 5000 in the mid-2000s – there are still many weaknesses to be addressed. Most of these organizations still have limited capacities for program development and implementation, financial management and resource mobilization. Most of them are based in Ulaanbaatar and have limited geographical outreach and little experience in participatory processes. Almost all of them face severe financial constraints.

As an ethnically homogeneous country, Mongolia has almost no irreconcilable ethnic or religious cleavages. The Khalkha, the largest Mongolian ethnic group, comprise 90% of the population. Buddhism, respect for the elderly, and a peaceful state of mind continue as cultural values to be passed from older to younger generations of Mongolians.

Conflict intensity

II. Management Performance

14 | Steering Capability

One of the main causes of the outcome of the parliamentary elections of 27 June 2004 was dissatisfaction with the former ruling MPRP and its failure meet its promises to improve living standards. The number of poor increased, some economic reforms were aborted and Mongolia's rate of economic growth slowed. The previous democratic coalition, which favored free market reforms, 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. After the elections, Mongolia's new government outlined an action plan for the next four years. Its key objectives included upgrading the quality of public services, intensifying legal reforms, sustaining higher rates of growth led by the private sector, improving living standards and raising educational standards. In January 2006, the political struggle over the government prevented the cabinet from carrying out its normal functions and delayed the legislative process in parliament. After the resignation of ten MPRP ministers and the subsequent dissolution of the cabinet led by the democrat Tsakhiagiin Elbegdorj, a new coalition government led by Miyegombyn Enkhbold, official leader of

Prioritization

the MPRP, was formed with the participation of four smaller parties. The fight for the executive branch between two major political forces undermined government actions and further weakened its management capabilities not only on the national but also on the local level. The public trust eroded even further with the imprisonment of Kh. Baatar, the ex-head of the Customs Authority, who was accused of corruption.

One political and two institutional factors are having a profound impact on the Mongolian government's ability to meet the strategy it elaborated in the Government of Mongolia Action Plan. First, frequent government changes and the factionalism between and within coalition political parties have created a decidedly unstable political situation. The opposition has used this to their advantage and has succeeded in stalling vital reform programs by walking out of the parliamentary sessions whenever reform legislation is introduced. Second, the make-up of most ministries and public sector organizations has not changed much since soviet-era days and continue to be weak, protectionist and controlling. Many key officials do not understand the relevance of reform or have a vested interest in maintaining the status quo. A third factor is the weak human resource base. A significant number of Mongolians, while appreciating what democracy and growth have provided, are still tied to a soviet ways of thinking. This transformation will be a long and tedious, and every effort must be made to accelerate the transformation in people's thinking by means of public information and informal education.

Implementation

A number of factors have contributed to a general public mistrust of and lack of belief in the Democratic Party and the MPRP. These include: the ineffectiveness of both parties, the lack of action aimed at the public interest, the use of power for personal gain and corrupt campaigning (with there being anecdotal rumors in the press claiming that the minister's seat could be purchased for 20 million tugriks or more). There is a significant gap between the declared strategic priorities and the restrictive framework of weak public finances, which is also characterized by one of the highest levels of ineptness among nation-states. While the leadership seeks to install democracy and a market economy, its strategic aims do not harmonize with the country's financial situation. Although the two governments in power during the period under review have shown a commitment to democracy and a market economy, they have had only limited resources with which to implement 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 world's poorest and infrastructurally underdeveloped countries.

Policy learning

15 | Resource Efficiency

Human, financial and organizational resources are scarce. Ministries, parliamentary committees and the administration lack trained and adequately educated personnel, including advisors. On the one hand, resources are conserved because the parliamentary system does not lead to a doubling of government functions within the presidential administration, as is frequently the case 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. Because Mongolia's economy is driven by a few economic and political elites, corruption and limited accountability for decision-making often exacerbate policy missteps. During the hearings and discussions on the 2007 budget, 250 million tugriks were allocated to each of the constituencies via members of parliament. The members of parliament started to actively participate in spending the budget. In addition, political parties were increasingly financed from the state budget in direct contravention of electoral promises to "save the people from poverty, save the state from crisis." As a result, the parliament failed to fulfill its watchdog duties and instead collaborated with the government; the rule of law as well as the principles of democracy and justice have eroded. Moreover, the public is still excluded from the decision-making process.

Efficient use of assets

The high debt burdens and the economic vulnerabilities inherent in a small, underdeveloped and 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 toward consolidating public finances. 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 and the disproportionate amount of heating-related improvements.

Policy coordination

Bureaucratic inefficiency in the public sector – a sure sign of bad governance – retards investment and economic growth. The government ratified the United Nations Convention against Corruption (UNCAC) in late 2005, and it adopted the Anti-Corruption Law in July 2006, which came into force on 1 November 2006. The law contains elements that address the major provisions in the

Anti-corruption policy

UNCAC – most notably those regarding investigation and intelligence gathering, public education and awareness, and asset and income disclosure – and thus contributes to increased compliance with the convention. Despite the strides that have been taken in the legislative arena, perceptions and the incidence of corruption are little changed. On 6 November 2006, Transparency International (TI) released its annual Corruption Perceptions Index (CPI). Mongolia ranked 99th out of 163 countries, down 14 places from the previous year. In 2006, Mongolia received a total score of 2.8 out of 5, which compared with 3.0 in 2005. Perceived to be most prone to corruption are – in descending order – customs organizations, the judiciary, taxation organizations, police organizations, banks and financial institutions, educational institutions, state and public service institutions, parliament, hospitals, the government and the State Property Authority. The process of obtaining permits is not transparent, and many companies have to employ expensive mediators whose job it is to negotiate the process of obtaining a permit. Inspectors, most commonly from the tax offices and the State Professional Inspection Agency, frequently visit firms. According to calculations of the World Bank (2006), the total cost of fines, fees and unofficial payments made up over half of the direct financial costs incurred by firms. These figures show that the crime of corruption is rapidly taking root and impacting society everywhere. Government and parliamentary decision-making were also not sufficiently transparent, and legislative hearings were rarely open to the public. The State Secrets Law inhibits freedom of information as well as 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 exerting increasing pressure to improve the fight against corruption as well.

16 | Consensus-Building

Despite Mongolia's frequent changes of the 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 indicate that the general assessment of democratic values is much higher than is trust in the ruling institutions, such as state authorities and the judiciary.

Consensus on goals

Due to the lack of anti-democratic veto actors, reforms face little opposition from the population. Older, more conservative politicians who might still be attracted to a communist system are incorporated into the democratic consensus through the MPRP.

Anti-democratic veto actors

The most significant potential cleavages run between rich and poor and between urban and rural. However, social divisions have yet to give rise to political conflicts. Under the socialist system, the state enforced solidarity. State solidarity networks were seriously hollowed out during transformation. Attempts are currently being made to reinforce networks corresponding to the new economic system and to partially reintegrate the informal sector into public insurance systems. 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 will be involved in interpersonal solidarity and civic engagement.

Cleavage / conflict
management

Despite the large number of NGOs 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 civic actors.

Civil society
participation

Following the civil war in the early 1920s and the occupation of the Mongolian capital in July 1921, Moscow became the major outside influence over 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 Danzan and other opponents to the regime were executed, which marked the beginning of a purge. Many prominent leaders fell victim to violence, and religious repression was especially severe. Between 1937 and 1939, more than 700 temples and monasteries were destroyed and more than 17,000 monks were executed. In June 2003, a mass grave containing hundreds of Buddhist monks and civilians executed during the 1930s was found in a construction area in Ulaanbaatar. 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 former Soviet leaders in Moscow, without giving proper consideration to whether Mongolians deserve some blame for the murders, too. Furthermore, the reaction on the part of the Communist Party's successor was to express regret but not to include an apology.

Reconciliation

17 | International Cooperation

By subscribing to the UN Millennium Declaration in September 2000, Mongolia committed to upholding human rights and the rule of law as well as to fighting poverty, hunger, illiteracy, gender inequality, child and maternal mortality,

Effective use of
support

HIV/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 Germany and the United States. Nongovernmental 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. Overall, Mongolia cooperates intensively with international donors, adapts external advice and integrates international assistance into the domestic reform agenda. In addition to 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.

The problem with donors is that they are generally open and willing to express criticism in response to the Mongolian government's economic or social policies, but are less willing to criticize political matters for fear of being accused of interfering in domestic politics. They thus effectively turn a blind eye to democratization failings. The establishment of governance and democratic institutions in Mongolia therefore lag behind as the government is indirectly encouraged to take its time in improving its self-management. Given Mongolia's political instability, the likelihood of programs succeeding in these areas is uncertain. Donors will not simply throw their taxpayers' money into projects unlikely to succeed. The only good news in this respect is that Mongolia has managed to avoid the violent unrests and riots observed in other transitional countries.

Mongolia initiated and undertook many activities that helped it regain its reputation as a credible partner. It led the newly emerging and restored democracies effort early in the decade, hosted United Nations efforts aimed at better addressing human security, advanced itself as a nuclear weapons-free zone, supported international peacekeeping efforts and sited a major regional peacekeeping initiative, and – most recently – it has offered itself as a host venue for dialogue on easing tensions on the Korean peninsula, given its good relations with both North and South Korea. The first sitting American president's visit to Mongolia occurred on 21 November 2005, when President George W. Bush came to Mongolia to hail a young democracy that had sent troops to Iraq. Mongolia heavily relies on official development assistance. As a result, its approach to multilateral and bilateral international organizations is positive and constructive in trying to accommodate the donors' recommendations. Since 1991, the International Monetary Fund (IMF), World Bank and Asian

Credibility

Development Bank have worked closely to support the macroeconomic stabilization and reform program of Mongolia's government. With the assistance of international financial institutions and the wider donor community, Mongolia has made substantial progress over the last 16 years.

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, Mongolia's 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, as was the case with Inner Mongolia, which is now an autonomous Chinese province 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 Vladimir 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. Thanks to bilateral endeavors, relations with Russia and China have increasingly developed and advanced to partnerships. Mongolia is forced 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.

Regional cooperation

Strategic Outlook

Mongolia successfully completed political transformation from a centrally planned, authoritarian system to a parliamentary democracy with a market economy. Despite enormous difficulties, Mongolia has been able to free itself from its political and economic dependency on the former Soviet Union by receiving foreign development assistance as well as taking advantages of its natural assets (copper, gold and cashmere).

A wealth of natural resources is expected to play a central role in the country's economic development, though a major problem is that the mining industry does not generate a significant number of new jobs, nor do individuals seeking jobs in the mining industry have the requisite level of skills and qualifications. Mongolia's government has to adopt a fiscal policy to avoid quick spending on social allowances, and it must aim to save boom revenues by saving them for future recessions, or by investing in infrastructure and education, and promoting competitiveness in its declining manufacturing and trade sectors.

An absence of employment-generating policies that benefit the poor require that significant efforts be undertaken to address poverty in real terms. A study analyzing the nature and composition of poverty in Mongolia shows that poverty is income-based (i.e., the result of a lack of employment and sufficient income) and not a result of a lack of education, health deprivation or social exclusion. Poverty is mainly found in urban areas, and the majority of the poor are the unemployed and households headed by women, civil servants, pensioners, and small herders. At the same time, the majority of the poor remain close to the poverty line, and they are sinking more and more to lower levels of poverty, which in turn puts them beyond the reach of employment opportunities by means of which they can lift themselves out of poverty. Moreover, although poverty at this time is not caused by lack of access to social services, a lack of action aimed at resolving it could soon lead to the development of new forms of poverty based on health and education deprivation.

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 and 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 marked progress in democratic development and building

institutions, the country suffers from an increasing amount of political, economic and social corruption.

Despite all the promises made during election campaigns (e.g., reform programs and Western technical assistance), the government has been unable to redress the poverty problem. In order to reform the welfare system, Mongolia must overcome two difficulties: first, it must 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, it must devote some funding to political targets. So far, there has been only limited political will to curtail the Soviet-style welfare state (as large – 30% – increases in government wages and pensions in 2006 shows), and election-related promises to increase family welfare grants defiantly exceed the state budget. To implement a tailor-made approach, the government needs a modern administration that is not influenced by corruption and that has 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 in order 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 governmental support in strategic areas: legal coherence and stability, land reform and reliable property rights.

In praising Mongolia’s unique reform progress from a Soviet satellite state with almost no democratic or market economic 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.