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**PRIVATISATION AND
REGULATION IN AN ASIAN
TRANSITIONAL ECONOMY: THE
CASE OF MONGOLIA.
IS THE ELITE IN DENIAL?**

**Richard Marshall
United Nations Development
Programme
and
Frederick Nixon and Bernard Walters
University of Manchester**

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Centre on Regulation and Competition,
Institute for Development Policy and Management, University of Manchester,
Harold Hankins Building, Precinct Centre, Oxford Road, Manchester M13 9QH, UK
Tel: +44-161 275 2798 Fax: +44-161 275 0808
Email: crc@man.ac.uk Web: <http://idpm.man.ac.uk/crc/>

Abstract

Mongolia, unlike several other Asian Transitional economies, has since 1990 pursued a “Russian-style” transition to a market economy. This has entailed rapid and extensive privatisation accompanied by, *inter alia*, stabilisation, liberalisation and de-regulation. The transition process has been characterised by relatively poor macroeconomic performance and increased levels of poverty and inequality in income distribution. Privatisation had the central objective of cementing the new political and economic framework, and little consideration was given to issues of competition and regulation. Proposed privatisations in the social sector, infrastructure and land increase the urgency with which these issues must be addressed.

In this paper, we briefly describe the chief features of Mongolia’s transition and of the privatisations that accompanied and, to a degree, defined it. We identify a range of issues relating to regulation and discuss the degree to which they are being addressed by the post-1990 political class. We conclude that although there exist, or that there are plans to establish, a number of regulatory agencies, nevertheless there is a lack of political commitment to implementation and enforcement. There is also little official recognition and appreciation of the extent, depth and implications of market failure. The scarcity of experienced and technically competent staff capable of establishing and operating effective regulatory agencies and ensuring compliance is a major problem. It is possible that regulatory capture is already a significant problem in key sectors of the economy.

“Private sector development entails not only privatisation, but also strengthening of the legal and regulatory framework. Considerable progress has been made to build the legal and judicial infrastructure to support private sector development. There are many laws in effect in Mongolia and the rule of law is the norm” (Government of Mongolia, State Property Committee, 2002, p.5)

INTRODUCTION

Although the privatisation process and the concomitant attempts to introduce and regulate competitive behaviour in transition economies have some generic similarities with the processes adopted in the non-transitional world, there are some significant differences. The transition to the market involved many other changes besides privatisation and included, *inter alia*, stabilisation, liberalisation and de-regulation on a much larger scale. These were undertaken against a background of poorly-defined property rights, with little commercial law and with few of the normal institutional supports for commercial activity, such as accounting practices and auditing standards. In addition, there was little appreciation of how commercial societies operate, and this lacuna was more pronounced for those societies such as Mongolia which had been a command economy since the early decades of the twentieth century, and a feudal theocracy before then. To this was added an often naïve belief, fostered by the claims of the early proponents of rapid transition, of the welfare benefits of unfettered markets.

The unusual background presented by transition economies has generated particular problems for fostering competitive behaviour and constructing appropriate regulatory frameworks. All too often competitive behaviour was simply assumed and regulatory structures added as an afterthought and often grudgingly. The objective of this paper is to review this process in Mongolia, to provide an initial appraisal of the regulatory structures that have been established and to identify the key issues confronting policy makers for the future.

At the outset it is also worth stating what is meant by effective regulation for the purposes of this paper and the broad objectives that any regulatory framework ought to address. In general, regulation is taken to be; the exercise of authority, generally though not necessarily by governmental institutions, to affect the behaviour of independent agents (enterprises, individuals, and non-commercial organisations) to achieve economically and socially beneficial, outcomes¹.

For purposes of analysis this notion is disaggregated under three fairly standard headings;

- Economic regulation, relating to the conduct of (predominantly) enterprises, in matters of pricing, output and trading practices;
- Environmental, pertaining to the protection and maintenance of the ecosystem;
- Social regulation, concerning the broader societal impacts of private, commercial and official activities.

The paper begins by reviewing, in section 2, the chief features of Mongolia's recent experience, highlighting the transition strategy adopted and the particular regulatory challenges faced in Mongolia stemming from both specific locational and demographic factors. In section 3 the main features of Mongolia's privatisation programme are briefly outlined, with some discussion of the major privatisations. Section 4 then reviews the policy responses and structures that have been established by the authorities in the light of these challenges. Section 5 discusses the regulatory experience in telecommunications, energy, civil aviation, and the environment. The paper closes by commenting on the quality of the arrangements and identifying the associated key issues.

THE TRANSITION AND MONGOLIA'S 'SPECIAL CHARACTERISTICS'

The regulatory issues raised by the transition to the market in Mongolia are conditioned both by the choice of transition strategy and its implementation by successive Mongolian governments and also by the special circumstances of the Mongolian economy, shaped by history, geography and demography. This section provides a brief review of these key features.

Mongolia's transition to the market began in the spring of 1990 and led rapidly, and peacefully, to the resignation of the Government, the amendment of the constitution to allow new political parties, and elections by July. The new Government, still based on the old Mongolian People's Revolutionary Party (MPRP), moved rapidly to dismantle the old apparatus and to move the system of government and the economy irrevocably towards a multi-party, liberal capitalist model. Although the party of government has changed several times since that first election of the transition era, the strong commitment to reform along market lines has been re-affirmed in each subsequent election; there is little doubt that it reflects the strongly held convictions of the Mongolian electorate. This commitment to effect real, irreversible shifts in economic and political power has been a much more important

determinant of policy than any calculus of the costs and benefits of particular reforms. This commitment, reinforced by western advice, led to the adoption of a ‘shock-therapy’ strategy of transition to the market. This has important consequences for the shape and health of the emerging economy, and ultimately, for the character and effectiveness regulatory structures.

The policy referred to as ‘shock-therapy’, was rapid and uncompromising in its speed and adherence to laissez-faire economics. Measures were taken near simultaneously to liberalise prices, trade and financial markets, with mass privatisation by direct assignment of state assets. Transition policies of this nature are rationalised in terms of the need to establish rapidly the key structures that underpin a functioning market economy, and signal very strongly, the new modalities of economic conduct and institutional values. It was also assumed, following the then position of the Bretton Woods institutions, that large falls in output and employment were not merely an inevitable side effect of the transition, but that the depth and speed of the output loss were interpreted as an index of how quickly and robustly a new private sector would emerge. Markets, it was asserted, would emerge naturally to fill the vacuum created by the elimination of the old state run enterprises. Additionally, of course, advocates of shock-therapy base their case on the political imperatives of rapid change, arguing for a need to cement and make the new (capitalist) order irrevocable.

The combined effects of the transition itself and the chosen policies of ‘shock therapy’ have had a number of effects which condition the subsequent development of regulatory frameworks. First, although not directly relevant to regulation, it is important to note that Mongolia has become a country with very high levels of poverty and growing inequality. The rates of growth achieved to date are not sufficient to make significant reductions in poverty likely over the next few years. The levels of poverty and inequality mean that the behaviour and regulation of basic industries, such as utilities, the prices of which impact strongly on poverty, are of particular significance. Second, the speed and nature of the privatisation and liberalisation process have generated a number of further problems for the subsequent establishment of a regulatory framework. These issues are briefly discussed below.

The transition to the market was always likely to lead to sharp falls in output as the economy re-orientated its production to market-based incentives, but Mongolia was also subject to very large external shocks, which meant that the falls in GDP very much understate the impact of

the transition on the living standards of ordinary Mongolians. Prior to transition, Mongolia received very large transfers from the former Soviet Union (FSU). These amounted to approximately 30 per cent of GDP (IMF, 1996). In effect, national disposable income was 30 per cent greater than GDP. The elimination of these transfers occurred at the same time as the falls in GDP and, indeed, was partly responsible for those falls as essential inputs, especially oil products, disappeared. The cessation of Soviet aid was exacerbated by the simultaneous collapse of the Council for Mutual Economic Assistance (CMEA), which had provided the markets for virtually all of Mongolia's exports and supplied most of her imports (see IMF 1996 for details). Mongolia was forced to adjust suddenly to the world of hard currency trading and found that the prices of its staple exports, especially copper, fell precipitously, so that the terms of trade moved sharply against her in the early 1990s. The combination of these factors meant that Mongolia's absorption, which determines her national disposable income and ultimately the living standards of her people, fell by an estimated 60 per cent over the years 1989-1993 (Boone, 1994).

The return to growth was at best tepid and strongly dependent on international factors, in particular the prices of copper, gold, cashmere and oil, over which Mongolia has no control. The return to growth began in 1994 and accelerated in 1995. This was almost entirely the consequence of favourable movements in the terms of trade, which provided a windfall equivalent to almost 8 per cent to GDP (World Bank, 1997). The reversal of this positive shock and the turbulence in the world economy in 1997 and 1998, led to sharp falls in the rate of growth. The economy's subsequent disappointing performance is evident in low rates of growth in the last few years, which have been particularly affected by poor weather conditions.

The disappointing growth rate of output has been paralleled by the growth of widespread poverty and growing inequality. This has been reported in a number of surveys and reports, supplementing the data collected by the Mongolian National Statistical Office (NSO). Specifically, in 1995 the NSO supported by the World Bank conducted the nation's first Living Standard Measurement Survey (LSMS) (World Bank, 1996). A second LSMS report conducted with UNDP support was carried out in 1998 (NSO, 1999). These reports complement the picture emerging from several other studies, notably the UNDP Human Development Reports (UNDP, 1997 and 2000) and Griffin (1994), and the World Bank

funded Participatory Livings Standards Measurement Survey. The overall results of the two LSMS surveys are summarised in Table 1 below.

Table 1. Key Poverty Indicators

Region	Headcount (P_0)		Depth (P_1)		Severity (P_2)	
	1995	1998	1995	1998	1995	1998
All urban	38.5%	39.4%	12.2	13.9	5.7	7.1
- UB City	35.1%	34.1%	10.4	13.0	4.5	7.4
All Rural	33.1%	32.6%	8.9	9.8	3.6	4.4
All Mongolia	36.3%	35.6%	10.9	11.7	4.8	5.6

Source: LSMS, 1999, p.24

The headcount measure of poverty has risen from a pre-transition position of almost no recorded poverty to one in which over one third of the population are defined as poor. There are also large numbers of people who are close to the poverty line so that the elasticity of the number of the poor to changes in the poverty line is high. The data suggest that a 10 per cent increase in the poverty line would raise the proportion in poverty to 43 per cent (World Bank, 1996, p. 23). However, the poverty gap (P_1) and severity of poverty (P_2) measures were, by international standards, relatively low in the 1995 report (World Bank, 1996, p.24). This is consistent with the Gini coefficient of 0.31 for (price-adjusted) consumption based on the LSMS data (World Bank, 1996, p. 17), which is comparable with other Asian transition economies (World Bank, 1996, p. 17) and very much lower than for some of the countries emerging from the FSU (Milanovic, 1999). The Living Standard Measurement Survey (LSMS) 1998, although not strictly comparable with LSMS 1995 (FIDE, 1999), suggests that little has changed for the better for Mongolia's poor and, in some dimensions, there has been a deterioration.

The overall headcount figure has scarcely changed over the period. However, more worryingly, both the depth and severity of poverty are rising, with the average consumption of the poor now more than 10 per cent below the poverty line and the distribution of income amongst the poor, represented by P_2 , deteriorating. The new survey also found that the Gini coefficient had risen to 0.35 over the three-year period since the previous survey. Although this is still relatively low by comparison with most countries that have followed the shock therapy approach to transition, the speed of its rise should be a cause for concern.

In addition to this background of disappointing growth and rising poverty and inequality, the nature of the transition has directly shaped the fundamentals which face policy makers in dealing with regulatory pressures. Specifically:

- Rapid, poorly managed privatisation has resulted in concentrations of ownership in the hands of an increasingly powerful and politically well-connected elite.
- Privatisation has also rapidly changed the balance of the economy markedly, with private sector activity now amounting to 75 per cent of GDP (NSO, 2003) but without the development of effective competitive pressures or strong, market based forms of control.
- On-going sales, without industrial restructuring, to overseas ‘strategic investors’ has led to some instances of single-firm market dominance².
- Badly phased price and trade liberalisation has taken place without regard to supply-constraints, and especially, the backwardness and disorientation of the command economy’s industrial base. Huge swathes of industry failed, few domestically owned enterprises remain which are profitable and the goods market is dominated by cheap imports. Few if any opportunities exist for local competitors to challenge this position.
- Stabilisation policy, which was itself a by-product of poorly conceived price liberalisation, has led to a creeping fiscal conservatism, which has shrunk the size, capability and capacity of the Mongolian state, precisely at the same time that complex and technical functions, like regulation, have emerged as priorities.
- Finally, and potentially most significantly, the speed of the transition has meant that institutions, in the sense of the new institutional economics, and particularly informal institutions, are poorly developed. Thus, the set self-imposed consensual restraints which mediate economic behaviour in the marketplace simply have not had time to develop; transactions costs are high, and markets function poorly. As a result more rigorous formal regulation is required if productive outcomes are to be secured.

A second group of considerations is associated with the particularities of Mongolia. Although these are not as unique as is sometimes claimed, the country faces highly problematic climatic, environmental and demographic conditions. Moreover, the severity of these conditions are over and above the familiar market-failures associated with developing economies, which are also present, such as missing and truncated markets, agricultural backwardness and poorly developed infrastructure.

There are two main sets of issues. The first relates to the demographics of Mongolia; the population is small, unevenly distributed, and often very sparse, and this has resulted in a market place which lends itself to monopolisation. The market is small and the low population density and great distances between population centres compromise supply and distribution networks. Thus the supply conditions of many commodities approach those of natural monopolies.

The second set of issues relate to environmental conditions, which exacerbate the tendency to monopoly. The challenging climate and difficult terrain generate risks and hence barriers to entry, thus the monopolistic tendencies noted above are reinforced.

PRIVATISATION IN MONGOLIA

Privatisation was at the centre of the Mongolian reform process. Supporters of the programme have claimed that its results have been “impressive” and that Mongolia has implemented the “most successful privatisation programme” of all the Republics of the Former Soviet Union (FSU) (quotations from Griffin, 1994, p.9). Some privatisation was indeed inevitable (and desirable) in the early stages of transition. Griffin (1994), among other critics of the privatisation process, has argued that its role in the transition to a market economy has been “greatly exaggerated” and that, in the specific context of Mongolia, it should have been given a lower priority. Although a partial administrative success, privatisation did little to assist Mongolia through its transition difficulties.

Privatisation had its beginnings in Mongolia in 1991, when the government, which was then estimated to own 75 per cent of all property in Mongolia, issued its first vouchers to the public (Stubbs et al, 2000). In the course of the programme begun in October 1991, all citizens born before 31 May 1991 received three red vouchers with a nominal value of 1,000 tugriks, which could be used to buy shares in small state and co-operative businesses. Small enterprises in this context were defined as employing less than 50 people. The red vouchers were tradable on secondary markets.

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

Exchange was established in January 1991 to allow trading in shares. The new Constitution of 1992 guaranteed private property rights.

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

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

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

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

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

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

The Government's current privatisation strategy is outlined in Government of Mongolia (2001; 2002). The *Privatisation Guidelines for 2001-2004* (Government of Mongolia, 2001) and were approved by the State Ikh Hural (Parliament) in January 2001. The overall policy goal is to accelerate the privatisation process and increase private sector participation in the economy. The strategy focuses on the privatisation of Mongolia's largest companies (the Most Valued Companies – MVCs) that will be privatised through “transparent, credible, international tenders”. MVCs are defined as companies strategically positioned in their various sectors with substantial market shares and the potential to attract foreign investment. The Government intends to set out specific and identifiable objectives and benefits for each “case by case” privatisation and will monitor implementation and the privatisation outcomes for the attainment of these objectives (GOM, 2002). The objectives, principles, institutional structures and organisation, methods, information and legal framework are detailed in GOM (2001).

The Government has also announced its intention to extend restructuring and privatisation into infrastructure (the energy sector, roads, telecommunications and railways amongst others), the social sectors (health, education, culture and the arts) and the ownership of land.

The Government is proposing to undertake steps to implement land ownership and possession reforms. The implementation of the Law on Land and Law on Land Ownership has already begun and the process of allocating titles for urban land to resident nationals is underway on the basis of detailed land registration and cadastral surveys which were completed during 2003. This remains however, an area of some controversy within Mongolia and the proposals have, as yet, not been extended to cover pasture land.

The privatisation of livestock that took place in 1992 deserves special mention. Prior to the transition, livestock production in Mongolia was dominated by state-run co-operatives, although limited private ownership of livestock was allowed and a system of private contracts for livestock rearing had been introduced in the 1980s (Russell et al, 2000, p.162). Although there was some social and economic differentiation among members of the co-operatives (*negdels*), the degree of inequality was low and most productive assets belonged to the state (Griffin, 2001, p.10). Pre-1990, Mongolia had developed and applied effective, although heavily subsidised, institutional mechanisms for support to the pastoral livestock sector and for responding to drought and *dzud* (the collective term in Mongolia for various winter-related conditions that prevent livestock from obtaining forage from open-range grazing and drinking water) conditions (Miller, no date, p.5).

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

Griffin (2001) quotes data that show that as early as 1992, roughly five per cent of households had herds of more than 200 animals, whereas at the bottom end of the distribution, 42 per cent of households had herds containing less than 31 animals. In 2000, estimates show that 63 per cent of households had less than 100 animals, 22 per cent had herds of 100-200 animals and 12 per cent had herds between 200-500 animals (Miller, no date, p.3). Herd sizes of less than 100-150 animals are generally regarded as being

insufficient to maintain a livelihood for a herding household. *A priori*, there is evidence of widespread poverty and inequality among the rural population.

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

With the privatisation of the herds came the dismemberment or collapse of the *negdels* and State Farms. These were responsible for the provision of public and collective services which the rapid and poorly thought through transfer of assets and wholesale retreat of government destroyed. The outcome is clearly summarised by Miller (no date, pp.5-6) at length:

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

The post privatisation picture is also complicated by changes in the number of animals. Livestock numbers were estimated at 25.5 million in 1991; they grew to 33.5 million in 1999, but adverse climatic conditions brought the number down to 23 million in 2002 (ADB, 2003).

The 1999/2000 *dzud* is estimated to have killed 2.8 million head of livestock. This was followed by severe drought across much of the southern and western parts of the country and much of the livestock were not in any condition to face the subsequent *dzud* which killed an estimated 4.1 million head (all figures from Miller, no date, pp.6-7). The previously effective system of pastoral risk management was no longer in place, the government was unable to respond effectively. Herders continued to expect assistance from the state which was not always forthcoming and they were themselves unprepared, and unable, to respond to the increased vulnerability brought about by larger numbers of animals, the collapse of the *negdels* and the harsh weather conditions.

REVIEW OF THE CURRENT AND EVOLVING REGULATORY FRAMEWORK

Mongolia's formal regulatory structure might optimistically be described as a 'work-in-progress'. In recent years there has been a spate of donor and governmental activity, yet many arrangements remain incomplete and in flux. Each of the three standard categories given above has seen some activity, though economic regulation has attracted most attention.

In this area the key driving force has been the prospect of further privatisations, notably in the electricity industry and in telecommunications. Both of these sectors are, or in principal will, be regulated by independent bodies; the Energy Regulation and the Communications Authorities. The industry-specific arrangements adopted in the United Kingdom and Canada appear to have provided the blueprints, and unsurprisingly the level of donor input to designing these structures has been substantial³.

The aspiration of these bodies is to manage the conduct of the respective industries, promoting competition, whilst also determining pricing structures and levels of output. Yet the fact that these are aspirations and not current practice, underscores the key issue, a chronic and ongoing failure to complete the implementation stage. In these and other similar cases, for example the moribund economy-wide Competition Supervision and Regulation Authority, full operational working remains a distant prospect. Moreover, in the case of telecommunications, reform appears to have fallen off the Government's agenda altogether.

Environmental regulation has been a second area of donor interest. In contrast with many other transitional economies, Mongolia has a functioning Environmental Protection Agency

(EPA), and large tracts of land designated as specially protected, and under the management of national parks authorities and the Environment Ministry.

Here again though, practice departs somewhat from official statements. Many in civil society, the press and the donor community doubt the efficacy of these arrangements in the face of growing mineral extraction and a greater intensity of livestock rearing, and hence, overgrazing, in the central regions. A growing body of evidence suggests that environmental priorities are frequently set aside in the face of commercial interests⁴.

Finally alongside these developments, there has been an attempt to establish a wide ranging inspection system covering 'social' regulatory functions, health and safety, environmental and public health, food quality and so forth. These functions have been allocated to a new single State Inspection Agency (SIA). Paradoxically, these activities have attracted very little donor interest, despite their potential contribution to a successful transition. Moreover, of all the regulatory structures, the SIA although starved of resources, is potentially the most effective because of its wide remit.

Before commenting further, it is useful to briefly review the main regulatory arrangements which are in place or are in the planning stages. This is provided in the matrix below; arrangements are grouped under the standard headings, and are appraised in the light of interviews undertaken with donors, reviews of official documents and anecdotal evidence (including press comments). The quality of regulation is appraised subjectively with activities being classified five ways as; Strong, Adequate, Barely-Adequate, Weak and Non-Existent.

Table 1: Subjective Appraisal of Regulatory Quality

Category & Agency	Sector & Responsibilities	Status	Appraisal
(a) Economic			
Communications Regulation Authority (CRA)	Telecommunications and specifically conduct of Mongolia Telecom.	Established and staffed, but inactive. In spite of donor input, GoM appears to have lost interest in further reform.	Weak
Energy Regulation Authority (ERA)	Electricity sector, conduct of state, and soon to be privately owned entities.	Established, and staffed but not yet operational. Prospects seem little better than CRA though. In spite of strong donor backing, recent political decisions have over shadowed its effectiveness.	Weak
Competition Supervisory Authority (SRA)	Antitrust, abuse of market position, strategic competition policy	Not yet established, but enabling act passed in 2000. Future position unclear in spite of donor interest. Effectively moribund.	Non-Existent
Mongol Bank, Supervision Department	Banking supervision, capital adequacy monitoring, and financial institutions licensing.	Operational and active. Banking supervision judged good, but anecdotal evidence of irregularities in exercise of powers ⁵ .	Adequate
(b) Environmental			
Mineral Resources Authority	Licensing of minerals extraction	Somewhat straddles the boundary between economics and the environment, and hence faces a contradictory brief. The pressure for development, and anecdotal evidence of political pressure, suggest environmental considerations have been compromised. But Agency is also reported to be well run and well resourced.	Adequate
Environmental Protection Agency (EPA)	Protection of environmental quality and pollution control.	Operational and well-intentioned, but lacking in resources and political will.	Weak
Agency for Land Management, Geodesy & the Cadastral Survey (ALMGCS)	Lead agency on land use, zoning and privatisation.	Operational and well resourced, but somewhat compromised by the imperative of land transfers ⁶ .	Weak
Category & Agency	Sector & Responsibilities	Status	

(c) Social & Other			
Regional and local Environmental Agencies	Various environmental functions carried out by Aimag and Soum Governments	Little information is available about these agencies, but what is generally suggests, that they are less compromised, although less well funded than national counterparts.	Barely-Adequate
Civil Aviation Authority	Oversight of safety, air navigation and domestic carrier licensing. Operator of Mongolia's airport system.	Operational and active: safety and ATC regulation judged adequate and improving. The key issue is, however, price regulation of domestic airlines which although nominally conducted through agency, remains within the 'gift' of the Ministry of Infrastructure, and this gives considerable grounds for concern.	Adequate ⁷
State Inspection Agency (SIA)	Umbrella agency incorporating various branches of regulation; trading standards and environmental health to consumer protection to workplace health and safety.	Active and functioning, in spite of resource shortages, but faces allegations of corruption and managerial difficulties.	Adequate
Aimag and Soum Inspection Agencies	Regional and local counterpart of the above, unclear if SIA has overall jurisdiction.	Little information but generally thought to be barely functioning as starved of resources.	Barely-Adequate

The most significant findings to emerge from this admittedly very limited appraisal are the imbalances between intent and action, and the lack of transparency. Considerable efforts on the part of both donors and legislators have been made to enact laws and establish formal regulatory institutions. Yet these remain either non-operational or ineffective with many controversial decisions bypassing those structures which are in place. As yet, policy makers seem either unable or unwilling to make these commitments real or to apply the rules which have been enacted.

Whether this stems from a lack of capacity or deliberate intent can only be speculated upon. Reliable evidence is hard to come by, and official explanations consistently emphasise inadequate technical inputs and resource constraints. But regardless of the motivations, the record is more than suggestive of a lack of political will on the part of the Government. This question is returned to in more detail below.

A further useful piece of analysis, which is provided in Table 2 below, is a breakdown of the budgets of the various regulatory bodies alongside their staffing complements.

Table 2: Annual Budgets and Staffing Levels (2002 allocations)⁸

Agency	Total Staff	Expenditure <i>Tugriks</i> millions	Expenditure per Staff member <i>Tugriks</i> millions
(a) Economic			
Communications Regulation Authority (CRA)	<i>Not operationally separate from the Post and Telecommunications Agency⁹</i>		
Energy Regulation Authority (ERA)	43	46.3	1.1
Competition Supervision & Regulation Authority (SRA)	<i>Not Operational</i>		
Mongol Bank, Supervision Department	<i>Data not available in the material provided</i>		
(b) Environmental			
Minerals Resources Authority	<i>Not disclosed</i>		
Environmental Protection Agency (EPA)	232	482.9	2.1
Agency for Land, Geodesy & the Cadastral Survey	91	817.0	9.0
National Parks (total)	320	296.8	0.9
(c) Social & Other			
Civil Aviation Authority (CAA)	<i>Not disclosed</i>		
State Inspection Agency (SIA)	371	951.3	2.6
Aimags and local inspection	649	1,108.2	1.7

The most significant point to make regarding the above, was the difficulty encountered in gaining the very rudimentary budgetary and staffing information quoted. Even with assistance from officials at the Ministry of Finance and Economy, various regulatory agencies were either unable or refused to supply basic staffing and financial data. This is hardly the hallmark of an open, transparent and accountable system.

Where the data are available, huge variations are apparent in resources. The Agency for Land Geodesy and the Cadastral Survey, the body assigned the highly controversial and politicised task of land privatisation, secures the highest level of funds per staff member. National Parks staff fared the worst, with an allocation some 10 times smaller, at only 900,000 *Tugriks* per annum, equivalent to approximately \$850 at current (2003) rates of exchange.

SECTOR SPECIFIC EXAMPLES

The Telecommunications Sector

The first phase of the privatisation process was completed in mid-1995, when the state-owned Mongolian Telecommunications Company (MTC) was replaced by Mongolia Telecom (MT), a Joint Venture between the Government of Mongolia (55 per cent) and Korea Telecom (40 percent) and minority individual shareholders (5 per cent). MT replaced MTC for operating the telecommunications network but the assets remained the property of the Post and Telecommunications Authority (PTA) under the Ministry of Infrastructure (MoI) and leased to MT.

MT operates the fixed-line domestic residential and business network as a monopolist and has made a number of investments in the backbone network. The position with respect to the ownership of assets is thus unclear.

An Asian Development Bank (ADB) loan to the Telecommunications Sector (Loan Number 1300-MON(SF)) including provisions for the international training of ten regulatory staff at the Royal Melbourne Institute of Technology, Australia. In compliance with the Loan Covenants, a regulatory body was to be established no later than 30th June 1995. But as of May, 2001, no regulatory body had been established (ADB, 2001).

According to the ADB (2001), the telecommunications law was to be amended to specify the powers and functions of the regulator. The amendment was delayed owing to changes in the

administration and the amended law was expected to be passed in the 2001 autumn session of the Parliament:

“Assurance was given to ADB that upon approval of the amended law the regulatory body will be set up and adequately staffed. The Government recognised the need to have the regulator operational prior to implementing the second phase of sector privatisation to ensure sound and sustainable development of the sector” (ADB, 2001, p.5).

The second phase of privatisation, assisted with technical assistance financed by the Government of Norway, involves the Government acquiring additional shares in MT through the transfer of PTA telecommunications assets to MT. A portion of these state-owned shares will be sold to a strategic investor through a competitive tender (GOM, State Property Committee, 2002). There is a further commitment to establish a regulatory body and to foster a more market-oriented development of the sector.

As of the time of writing (October 2003), it appears that a regulatory body has been established but appears to do little except act as a collective complainant on behalf of users. The sector is profitable. In 2001, profits amounted to US\$ 3.7 million representing an estimated return on capital employed of 18.5 per cent.

Neither the report nor subsequent documents disclosed, provide information on what happened to the ten staff originally trained in 1995, any further training of regulatory staff undertaken or details of the activities and staffing complement of the Agency. However; ADB sources have commented that some work on pricing policy to correct abuses of market position by MT, and further progress on telecommunications sector restructuring has taken place. Specifically, ADB has advised and secured changes to MT's behaviour in relation to access to international lines, and 'through pricing' to other mobile telephony operators; and is with partners¹⁰ involved in work to resolve the complex web of ownership and usage charges of the network infrastructure, though this latter project has solely been undertaken to examine the options for further divestitures.

Overall we can tentatively conclude that MT operates largely as an unregulated monopoly and that competition, consumer and regulatory issues are not ranked highly.

The Energy Sector

The Government of Mongolia has proposed to restructure the energy sector in two phases. The first phase will involve the commercialisation of management and production systems to conform to market principles and this includes the separation of the state regulatory functions from the current functions of the Energy Authority and their transfer to an independent regulatory body. After restructuring 14 Energy generation, and 3 distribution entities will be transformed into companies operating on a commercial basis, the central transmission grid will be operated on a not for profit basis (GOM, State Property Committee, 2002). Actions to be implemented during the second phase include the phased privatisation of state-owned power generation and distribution companies to a strategic investor through a competitive tender. The energy transmission network will remain state-owned.

Unlike other state-owned industries, which are in principle 100 per cent owned by the State Property Committee (SPC) prior to privatisation, the Energy Authority is jointly owned by the Ministries of Finance and Economy, Infrastructure and the SPC. This ownership arrangement reflects the strategic importance of the industry. However, it may well create tensions as to the objectives that privatisation is meant to achieve, namely the revenue achieved from the sale of assets and taxes generated by the privatised companies versus consumer welfare and protection issues and the role and effectiveness of the regulatory agency.

An Energy Regulation Authority has been established with assistance from USAID but it is not yet fully operational and it is not clear whether it will be granted the autonomy necessary to fulfil its regulatory obligations. At present no information is available on staff levels and training.

More problematic is the Government's announced intention to sell the Darkhan distribution system and Ulaanbaatar's Power Station Number 2 before any regulatory reforms have been implemented. Concerns have also been voiced regarding the integrity of the bidding process.

Air Passenger Transport

MIAT is the state-owned national carrier, established in 1957. In 2001 it was reorganised into MIAT Joint Stock Company conducting commercial activities. It is proposed to privatise MIAT as a single entity through a competitive tender to an internationally-recognised foreign

airline, on the condition that the investor makes investments and improves MIAT's operations and services. MIAT has had a chequered commercial history, and although in profit in 2001, remains at the edge of viability. It has a limited international flight schedule and is required to cross subsidise domestic routes through punitive domestic service requirements and price caps on the charges levied on Mongolian nationals (it is estimated that price capping has resulted in the real value of fares chargeable to nationals on domestic routes falling by 34 per cent since 1994). MIAT also offers significant discounts to Mongolians flying on its international routes.

Until recently, MIAT had a monopoly on domestic routes. A newly established domestic airline, Aero-Mongolia, has made major inroads into the profitable tourist traffic, which is not constrained by price limits and moreover, appears also to have been granted a derogation from the price cap on fares for nationals¹¹.

The price regulatory process is however far from transparent, and although nominally effected via the Mongolian Civil Aviation Authority (MCAA), price are determined by the Minister of Infrastructure without reference to any prescribed or published schedule. There is a suspicion that Aero-Mongolia has high level political backing or connections which ensure this favourable treatment will continue, though some commentators have questioned whether the very limited derogation will enable the domestic routes to make a profit during the winter Season.

Given the constraints that MIAT operates under; namely its ageing fleet of aircraft (on average approximately 35 years old), the weak international demand during the winter and the domestic price cap, it is difficult to envisage the company's early privatisation. But equally, given the geographical size of Mongolia and the urgent need to develop both the international and domestic networks if the potential for tourism is to be exploited effectively, the development of civil aviation should have a high priority and the development of an effective and transparent regulatory regime is necessary in helping to achieve these objectives.

Environmental Issues

The Government's privatisation principles include, *inter alia*, a commitment to provide environmental safety and protection. In order to prevent ecological imbalance and reduce the

negative impact of privatisation on human health and the environment and to meet sustainable development objectives, the Government has undertaken to carry out environmental impact assessments when necessary and appropriate, to confirm that land usage and possession rights are certified and to take gradual steps, through the establishment of research and testing laboratories, to monitor the impact of companies on the environment

There are three principal agencies that have statutory responsibilities for environmental regulation, namely the Environmental Protection Agency (EPA), the Minerals Authority of Mongolia and the relatively recently established, Agency for Land Management, Geodesy and the Cadastral Survey (ALMGCS). In addition, both national parks and local and regional governments exercise some independent powers (however, the ALMGCS exercises some authority over national parks and protected areas in relation to zoning and designation).

On inspection, the legislative framework appears more than adequate by developing country standards but the quality of the regulatory institutions, in terms of capacity and implementation, is very poor. There thus exists a clear disjuncture between intention and commission. A political will to protect the environment still exists, and a proposal to open all protected areas to mining operations has been rejected by the EPA's Standing Committee. There is also a suggestion that that decision may be reviewed. There exists anecdotal evidence of high-level political backing for mining operations. More generally, given the weakness of operational level enforcement, national prohibitions count for little and unauthorised extraction of minerals and environmental damage is common. There is some evidence to suggest that in general local government enforcement is stronger than that of the national agencies and is less swayed by political influences.

A key limiting factor with respect to more effective environmental regulation is the current restraint on public sector wages and staffing levels, as part of the overall medium term expenditure framework (MTEF) negotiated with the IMF. It is argued that this restraint has prevented the hiring and retention of effective enforcement officers and rangers. Individual corruption, however, remains a significant problem.

A number of high profile cases of regulatory failure can be quoted:

- A road bridge in the Southern Gobi across the Chinese frontier and the opening of a connecting road in a strictly protected area. This was permitted despite a public outcry and donor lobbying against the bridge and road scheme;
- Overgrazing in the Central (Tuv) Aimag has gone unchecked regardless of the very clear environmental threat;
- Illegal exploitation of gold in the Northern Aimags by Russian miners;
- Hunting permits within strictly protected areas were and are, effectively being sold on demand, and the issue of permits and thus threatens the survival of certain species.

Whilst there is evidence of compliance with the regulatory environmental framework by transnational mining companies, it is also apparent that this compliance is largely self-imposed.

COMMENTARY AND KEY ISSUES

Foremost, it is clear from the above that the often ‘world class’ policy statements and legislative instruments, are not matched by operational performance. Implementation of regulatory reform has been both slow and patchy. Moreover, although there are undoubted resource difficulties, there is considerable evidence of an intentional and policy-driven inertia within government. Three factors appear to underpin this; political expediencies surrounding difficult and politicised decisions; a continuing doctrinaire adherence to a need to secure privatisation rapidly, regardless of the regulatory consequences; and finally the influence of the outright sectional interests of the powerful.

In relation to the first factor with respect to political expediency, it is apparent that regulatory reform has been slowest in those areas where the state faces difficult trade-offs between regulatory imperatives on the one hand, and fiscal benefits and industrial policy objectives on the other. In the telecommunications sector, for example, reform has effectively stalled in the face of the need to secure both revenue streams for the State, and to appease the existing strategic investor, Korea Telecom. Mongolia Telecom’s effectively unregulated monopoly rests on both the need to extract rents and to ensure the process of technological transfer and the flow of investment continues. Whilst these sorts of tensions, particularly between industrial and regulatory policy, are not unusual, the means by which they are defined in

Mongolia lack transparency and balance. As a result, the final ‘deal’ or trade-off gained for consumers and taxpayers is rarely the best outcome.

With respect to the ideological imperative of rapid privatisation, it is apparent that although the pace of sales has slowed, the Government’s desire to see still higher levels of economic activity in private hands seems undiminished. The absence of regulatory controls both facilitates quick sales and eases the disposal process. The proposed privatisation of some facilities and activities in the social sector and the controversial Land Law, provide more recent examples.

It is not always easy to provide hard evidence of such an ideological predilection. But off-the-record conversations indicate that some key players within policymaking circles hold the view that so-called government failures (rent-seeking, corruption, abuse of authority, etc) are a more serious threat than the potential market failures generated by rapid and unregulated privatisations. These arguments are used to justify acceleration of the divestiture programme regardless of the advice offered from disinterested parties. It is instructive that virtually all of the donors have expressed concern at the proposals to privatise certain activities within the social sector.

It is still more problematic to substantiate the effects of the interests of the powerful on regulation. Where evidence does exist it is both anecdotal and of a functional nature, but there are regulatory outcomes which suggest the operation of political power for sectional and even personal gain. Examples from the energy and civil aviation sectors and environmental protection have been discussed above.

There is also evidence of a growing conflict between competing interests, and especially between Parliament and Government. The seemingly permanent setting-aside of the Unfair Competition and Antitrust legislation by the Executive has been met with pressure from the Parliamentary Committee on Economic Affairs, which has through its control of donor funded technical assistance monies, forced an evaluation of how the proposed legislative framework might be made operational. Similar tensions can be observed in relation to the energy sector¹².

The role played by donors in this conflict and in general, is somewhat ambiguous. Certainly donors continue to press the reform agenda, but often this is secondary to the narrow project or sector based objectives of their programmes. As with other cross-cutting themes, regulatory goals like consumer protection, environmental sustainability and equity considerations, are not likely to override internal rates of return calculations or project delivery goals.

Secondly in relation to donor activity, it is clear that many of the legislative measures and regulatory mechanisms proposed, and subsequently adopted by law-makers are overly complex. The unfair competition legislation in particular shows much evidence of ‘gold-plating’. Indeed, the functions of the proposed SRA are more extensive than those performed by counterparts in the developed world. Arrangements like this lend support to the lack of capacity defence articulated by Government sources.

The result of this cocktail of influences, is more than likely to be a weak response to the particular and severe challenges faced by Mongolia which were identified in the section two above. Indeed, in relation to the transition, the failures of the process, particularly the concentration of ownership and the dominance of monopolistic forms of competition, are both the cause and consequence of a weak and ineffective regulatory system.

CONCLUSIONS

This paper is a first attempt to identify and evaluate issues relating to regulation in an Asian transition economy. We argue for a threefold classification of Mongolia’s regulatory problems, namely generic, specific to transition and specific to Mongolia (and perhaps a limited number of other central Asian transitional economies which share some of Mongolia’s characteristics). Using this classification we examine regulatory issues in a number of key sectors – telecommunications, energy, civil aviation and the environment. However, there are several important sectors which we have not examined. The financial sector and mining, in particular, raise major regulatory issues which require further more detailed research.

We have described in some detail the transition process and its consequences and have highlighted, in particular, the impact of transition on poverty and income distribution. The point we are emphasising here is that, other things being equal, the creation of effective

mechanisms and agencies will be more difficult in a poor, low growth, resource constrained economy. We have also highlighted the specific characteristics of the privatisation process in Mongolia to argue that the process itself is an important influence on the nature and characteristics of subsequent regulatory framework.

We argue that the lack of transparency with respect to the privatisation process makes more difficult any future regulatory control. Issues of transparency operate at several different levels and in different ways in different sectors. There is evidence of regulatory capture, not necessarily by the industry as such, but by important and influential figures both political and otherwise.

We identify a number of problems relating to the role of the donor agencies in Mongolia, and perhaps more widely in other transition economies. Donors have a somewhat ambiguous role. First, there is evidence of donor rivalry, which makes a coherent approach to regulatory policy difficult and might well weaken Mongolian policy makers who wish to take a more robust approach. Donors also very often have a fragmented view, with support for particular programmes meaning that there is often little space for an overall regulatory perspective. Finally, it must be observed that donors bring their own ideological preferences which become incorporated into policy advice and often policy.

We point to an evident mismatch between laudable policy statements and the limited and frequently non-existent, implementation. This may be the result of resource constraints which also constitute a clear problem for Mongolia, which has few trained experts in the area of regulation. However, we argue it also reflects a number of other influences, namely, the lack of awareness or perhaps, the refusal to acknowledge the extent of market failure; and a naïve belief in the efficacy of markets. These exacerbate the failure of political commitment to regulation.

Finally, there appears to be evidence of conflicts of interest at various levels. We have argued that the transition to a market economy in general and the privatisation process in particular, have generated new sets of vested interests, based on a new distribution of productive assets which are inimicable to the development of robust, effective regulatory mechanisms.

Notes

¹ This definition would be widely accepted. This particular formulation follows the discussion in Begg et al (2002).

² An example of this is the sale of 40% of the Mongolian Telecommunications Corporation to Korean Telecom.

³ USAID has been the major actor in the Energy sector, whilst ADB has dominated in Telecomms.

⁴ Interviews with donors' representatives, and specific cases such as the bridge crossing in Sukhbaatar Aimag and illegal mining in Khenti, support this argument.

⁵ IMF took exception to several irregular inter-bank transactions in April 2003.

⁶ In that land privatisation responsibilities potentially conflict with zoning policy and land management.

⁷ Discussions with interviewees indicate a distinct lack of transparency over domestic airfare price regulation, which appears to be conducted directly by the Minister of Infrastructure.

⁸ Source: MOFE Budget Department.

⁹ This body is the government agency which owns the Telecoms infrastructure - and has a controlling share in Mongolia Telecom.

¹⁰ Chiefly with the European Bank for Reconstruction and Development (EBRD).

¹¹ Note the permitted premium on one-way MIAT fares has been quoted as being MNT 5,000, equivalent to less than USD 5. The capture of the tourist traffic is therefore the more significant factor at work.

¹² As suggested in interviews with donors operating in this sector.

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