

For a green development

MONGOLIAN ECONOMY



Juggling Funds

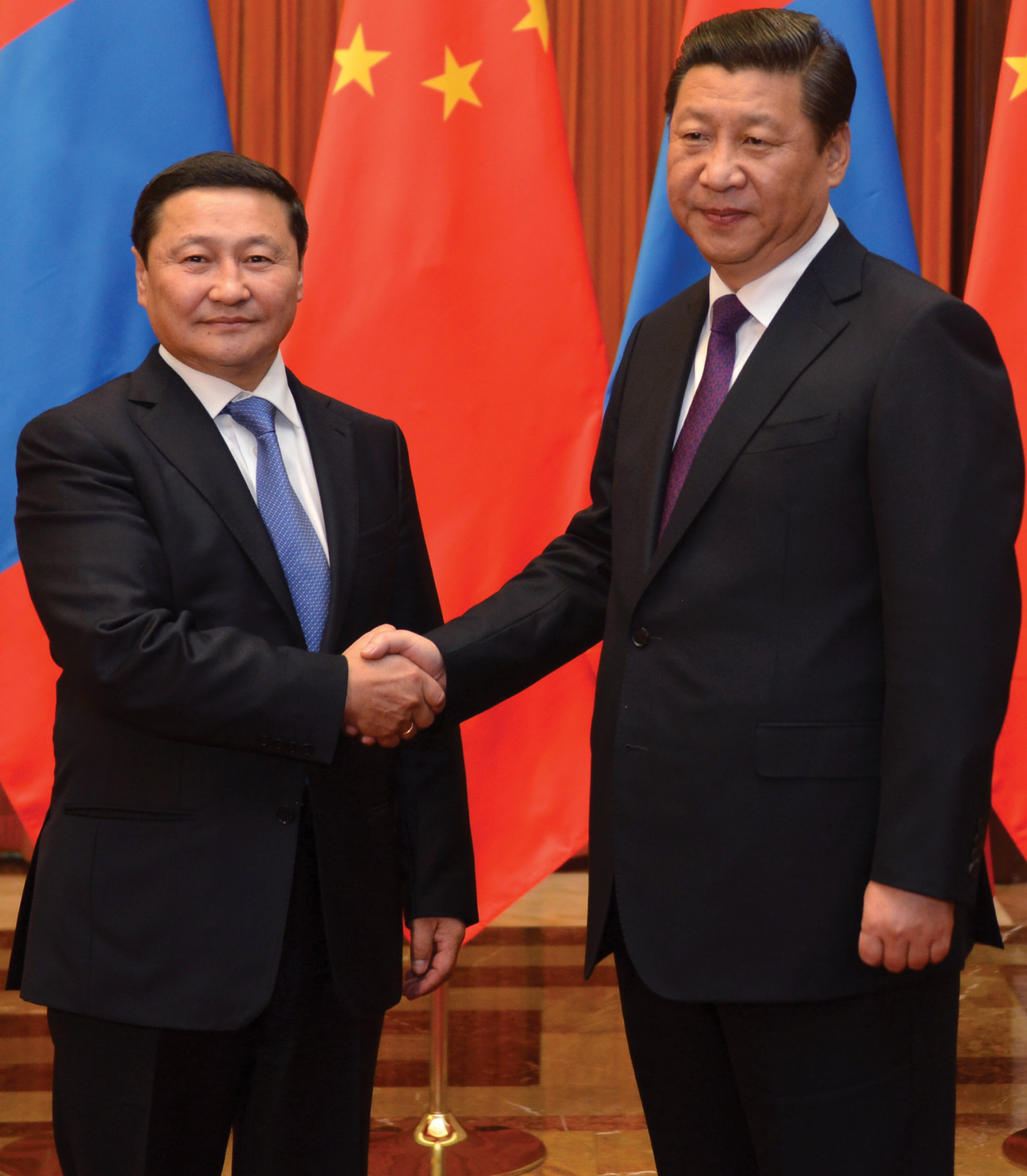
Signs that Mongolia's
Economy is Regaining
Stability

Mongolia's Economy and Business Magazine

November, 2013. №21 (055)

www.mongolianeconomy.mn

A NEW STEP FORWARD



act. worldwide.



create. health. manage. care. enjoy. vitality.

As a developer, planner, contractor and operator, VAMED offers a complete portfolio of health care projects and services. VAMED has already successfully implemented 500 hospitals, rehabilitation centers, health resorts and thermal spas worldwide.

www.vamed.com



Since the establishment of VAMED in 1982, with the aim to build and equip the biggest hospital in Austria (Vienna General Hospital – University Clinics with 2,200 beds), we have developed into an international leading company for health care and medical wellness with over 13,000 employees. In the last three decades, we have successfully implemented over 600 healthcare projects in 70 countries worldwide.

With the professional focus solely on the healthcare sector, VAMED offers a very unique approach by providing all services throughout the complete value chain of a healthcare project, starting with the project development, professional consulting, engineering, project management and construction, as well as different services for technical and/or commercial perspectives of a hospital including total operational management of the entire facility.

Today, besides the large number of projects we have completed worldwide, VAMED is the Austrian market leader in health tourism with over 28% market share and also the biggest Austrian private rehabilitation service provider. As a pioneer, we have developed and completed 18 projects with public partners (PPP) in Europe. Furthermore, it is also our priority to gain more experience by providing services to and working with 355 hospitals and that's more than 100,000 beds all over the world. Our cooperation with 5 leading European medical universities helps us to maintain our leading position and keep our know-how to the highest international level.

In Mongolia, VAMED has established a representative office with the aim of providing innovative, comprehensive and reliable integrated solutions this year. However, already since 2011 we have been working with the MCS Group for the Intermed Hospital in Ulan Bator. Using this experience and knowledge we gained from the local healthcare market, we are looking forward to develop and complete more projects in the future.



11th Coal Deep Processing Forum 2013

Asia's Premier Coal Event
Nov. 21-22 2013 | Beijing China

QUICK FACTS from CDPF 2012

- Total of **239** participants, including speakers, delegates, sponsors and exhibitors
- Generated **18%** of overall attendance from coal producers and **23%** from project owners
- 79** companies represented
- 23** countries participated
- 14** sponsors and exhibitors

Media Partners



www.mongolianeconomy.com 决策者会议策划集团

主办方: **CDMC EVENTS**

联系人: Eric Fan

+86 186 2180 9722

cdpf@cdmc.org.cn

Mongolian Economy NOVEMBER 2013

www.cdmc.org.cn/2013/CDPF

For a green development

MONGOLIAN ECONOMY

MONGOLIAN ECONOMY'S PROFESSIONAL COUNCIL



B. Byambasaikhan,
Chairman at the Business
Council of Mongolia, Chairman of the
Professional Council at Mongolian
Economy



B. Bold, President of
Copper International
at RioTinto



D. Jargalsaikhan,
President at
MIH Group



Ts. Batsukh, PhD,
Professor and Dean
of the Economic
Faculty at the Institute
of Finance and
Economics



S. Bekhbat,
Director General of
Innovation and PPP
Department at the
Ministry of Economic
Development



J. Sunjidmaa, Manager
for Corporate and Public
Affairs at Peabody
Energy Mongolia



B. Tuvshintugs,
PhD and Dean of the
Economic Research
Institute

FOUNDER, EDITOR:

D. Bekhbayar /9999-4248/

FOUNDER, DEPUTY EDITOR:

I. Otgonjargal /8800-6228/

ENGLISH EDITOR:

Terrence Edwards

TRANSLATOR:

R. Gantulga

JOURNALISTS:

B. Bayartogtokh
B. Enkhtsetseg
E. Zorigt
Kh. Khulan

DESIGNER:

Sh. Oyundari

WEB MASTER:

N. Gal

MARKETING MANAGER:

D. Barianjav /9409-2904/
D. Battulga /9409-2905
M. Khishigtogtokh /9409-2906/

"ECONOMY" TV STUDIO

EDITOR:

B. Uuriintuya

ADDRESS:

AB centre-503, Ikh surguulyn Street, 6th Khoroo,
Sukhbaatar District, Ulaanbaatar, Mongolia

Central Post Office, P.O.B 2762,
Ulaanbaatar 15160, Mongolia

URL: www.mongolianeconomy.mn
E-MAIL: info@mongolianeconomy.mn
TEL/FAX: +976 70115476

Printed at Ulaanbaatar Print Co., LTD
www.ubprint.mn

MONGOLIAN ECONOMY SUBSCRIBE ONLINE

www.mongolianeconomy.mn

SELLING POINTS:

Internom bookstore
Flower center
Minj plaza
Altantulkhuur bookstore
Nomin supermarkets
Max supermarkets
Fresko supermarket
BTSI supermarket
Zig Zag autoservice
Az orchlon bookstore
Bileg store
Grand Plaza supermarket

MIR BOOKSTORE:

Grand plaza
Metro Mall
Sky supermarket
Ulaanbaatar department store
Max mall

JUGGLING FUNDS



...Mongolia has a total of 37 special funds. The Law on the Special Funds of Government has 30 of those funds fall under the scope of 16 different ministries while another seven funds, including the Human Development Fund and Fiscal Stability Fund, are regulated by other laws.

13

A Budget to Learn From

...The government plans to generate MNT 6.8 trillion next year amid economic instability while spending has been estimated at MNT 7.2 trillion.

10

Future Tax Policy

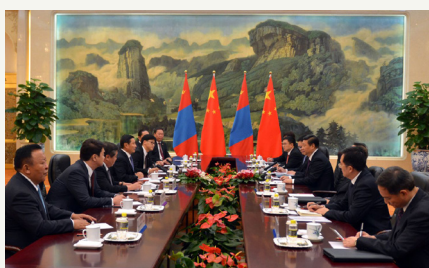
...It has been 21 years since the formation of a new tax system in Mongolia. That included five major new taxes for the taxation of corporations, personal income, trade, and transport.

11

A New Step Forward

...During Altankhuyag's visit, the two national leaders approved mid-term and long-term programmes for developing their countries' strategic partnership for the next two decades to ensure no deviations occur in their continued economic relations.

8



ECONOMY

8 A New Step Forward

10 A Budget to Learn From

11 Future Tax Policy

13 Juggling Funds

14 Point of Contact

16 EBRD: Helping companies build the economy

18 The Northern Neighbour Struggles for Continued Growth

20 Mongolia's Construction Industry Outlook for 2014

23 Oyu Tolgoi troubles add to Fiscal Strains

24 Improvement of Medical Equipment is Vital

26 Signs that Mongolia's Economy is Regaining Stability

28 Gobi Benefits

MONGOLIA:

MINING



The Ministries of Mining, Economic Development and Industry and Agriculture have established a working group to implement the Mongol Tumor (tr: Mongolian Metal) and Mongol Zes (tr: Mongolian Copper) programmes. The government will direct USD 50 million from the Chinggis bond to fund the programmes.

CHINGGIS BOND



The Chinggis bond is set to provide MNT 1.7 trillion to fund projects in 2013. From January to the end of August this year, some MNT 625 billion was withdrawn from the bond proceeds. For 2014, projects for the construction of roads, a new power plant and infrastructure will receive MNT 413 billion to be repaid by the state. Another MNT 100.5 billion will be spent on the construction of apartment buildings and a new iron ore processing plant, also to be repaid by the state.

ECONOMY



Oyu Tolgoi this year received a USD 1.155 billion loan from Rio Tinto and expects to receive another loan this year of USD 1.236 billion. Although Oyu Tolgoi completed phase one of the mine last year, including construction of an open-cut mine and copper concentrate plant, construction of the underground mine as part of phase two is now on hold while it waits to resolve issues concerning USD 4 billion project financing to fund further development.

BUSINESS ENVIRONMENT

The following is a portion of the 2013 Consumer Confidence Index conducted by the Mongolian National Chamber of Commerce and Industry. The study shows the current and perspective conditions of the business environment in Mongolia and the tasks that need to be made as priorities.

	2010	2011	2012	2013	2014
Business Index	60	73	86	76	-
Index of Economic Freedom	88	94	81	75	-
Competitiveness Index	117	99	96	93	107
Corruption Perception Index	116	120	94	-	-

Source: Mongolian National Chamber of Commerce and Industry

MANUFACTURING

Mongolia's manufacturing industry has grown 11.5 percent, or by MNT 185.6 billion, this year compared with the year before. As of September this year, the sum total for products sold reached MNT 4.4 trillion, of which 57.1 percent has been sold as export.

Product	Хэмжээ	2012.I-IX		2013.I-IX		2012.I-IX 2013.I-IX	
		Quantity	Amount	Quantity	Amount	Quantity	Amount
Horse meat	gram	350.1	990.0	706.0	2130.8	201.6	215.2
Derivative animal products	gram	820.2	501.8	381.2	327.3	46.5	65.2
Processed cow and horse hide	million/s of decimetre	26.0	3305.4	30.0	3455.3	115.3	104.5
Processed sheep and goat skin	million/s of decimetre	124.2	10975.9	113.7	10786.6	91.6	98.3
Unprocessed cow and horse hide	million/s of decimetre	44.2	4456.4	81.1	8186.3	183.6	183.7
Unprocessed sheep and goat skin	thousand/s of pieces	101.5	1132.5	261.2	3207.0	2.6*	2.8*
Uncombed sheep wool	gram	2655,3	3045,2	2008,9	2487,9	75,7	81,7
Raw cashmere	gram	3486.1	140031.7	3922.9	180827.1	112.5	129.1
Combed cashmere	gram	384.4	34291.6	402.4	39314.1	104.7	114.6

Source: the Ministry of Industry and Agriculture

WORLD:

APPLE



Apple has reported a fourth quarter profit of USD 7.5 billion, beating analysts' expectations. Although iPhone sales surged 26 percent to 33.8 million, profits slid for a third consecutive quarter as margins fell. On an annual basis, Apple ended its fiscal year with its first earnings decline in 11 years as net profit slipped to USD 37 billion.

SAMSUNG

Samsung Electronics has reported a 26



percent jump in profit in the third quarter driven by strong smartphone sales and a recovery in its memory chip business. It made a net profit of 8.24 trillion won (USD 7.6 billion) in the July-to-September quarter, up from 6.56 trillion won during the same period a year earlier. Operating profit rose to a record 10.2 trillion won during the quarter.

RIO TINTO

Rio Tinto is to sell its 50.1 percent share in Australia's Clermont thermal coal mine to Swiss commodities giant Glencore Xstrata and Japan's Sumitomo. Anglo-Australian mining giant Rio will receive USD 1.02 billion from the sale of the facility in Queensland



state. This summer Rio reported a 71 percent fall in half-year profits, partly due to reduced demand from China.

ISLAMIC BOND

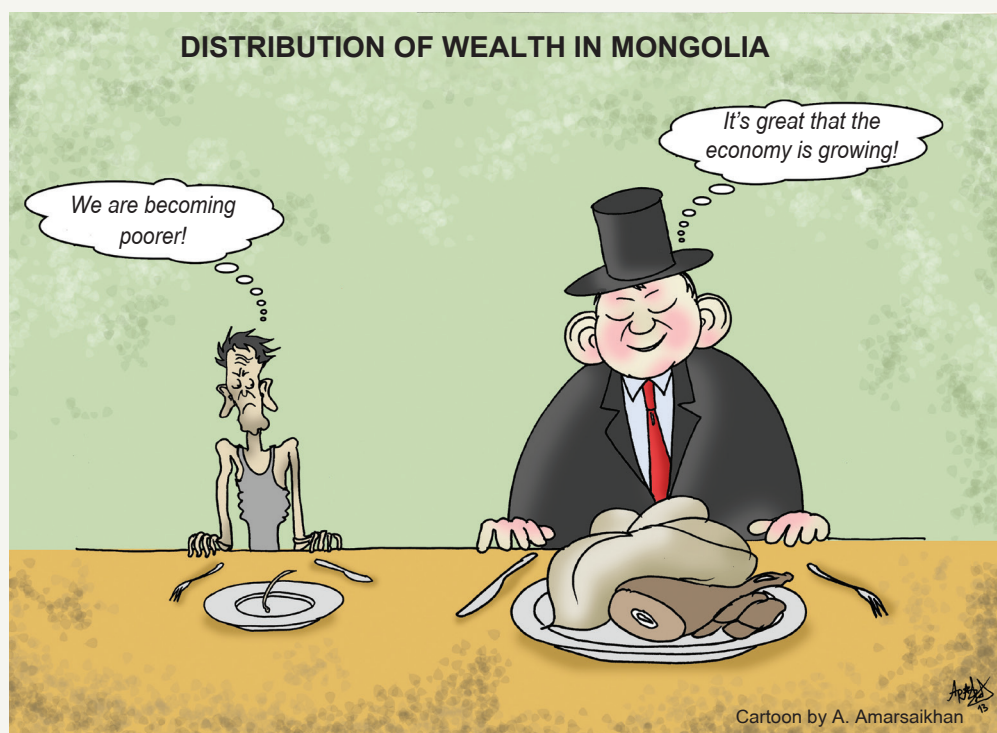
Prime Minister David Cameron is set to announce that the UK will become the first non-Muslim country to issue an Islamic bond. At the World Islamic Economic Forum (WEIF) in London, he will also announce plans for a new Islamic index on the London Stock Exchange. It is intended to attract more Islamic investors by making it clearer which companies match their criteria. It will be structured to bring in a fixed return from a tangible asset or service, and without charging interest, in accordance with Islamic financial principles.

TWITTER



Twitter has unveiled the price range for its shares when the company lists on the stock exchange. Twitter said it planned to sell 70 million shares priced between USD 17 and USD 20 to raise up to USD 1.4 billion. The offering represents 13 percent of Twitter and values it at as much as USD 11 billion.

A. AMARSAIKHAN'S COLUMN



OFFICIAL VISIT



Prime Minister Norovyn Altankhuyag paid an official visit to China to meet with Xi in Beijing.

A NEW STEP FORWARD

B. ALTAI

The top three high-ranking of Mongolia have met China's new leadership this year. Parliament Speaker Zandaakhuugiin Enkhbold in March met with Chinese President Xi Jinping during the Baaia Forum for Asia held in Hainan Island. President Tsakhiagiin Elbegdorj also met Xi in Kyrgyzstan in September. Most recently, in October, Prime Minister Norovyn Altankhuyag paid an official

visit to China to meet with Xi in Beijing.

This was the second official visit abroad by the prime minister since he took the office last year. During the visit, both sides agreed that the agreement made during the visit would be to the benefit of both Mongolia and China.

China has been the leading foreign trade and investment partner for Mongolia over the last decade. Since 2011, they have continued to work towards reaching the level of a strategic partnership with the implementation of projects

for the construction of vital infrastructure in the mining and energy sectors of the economy. China's recent development policy to reform its economy gave the meeting great significance, and occurred during some economic hardship experienced in Mongolia.

China is the main importer of coal from Mongolia and one of the main investors. China is an open market where huge volumes of coal will someday be exported from Mongolia. Mutually beneficial cooperation will be essential to ►



maintaining this relationship.

During Altankhuyag's visit, the two national leaders approved mid-term and long-term programmes for developing their countries' strategic partnership for the next two decades to ensure no deviations occur in their continued economic relations. They also made a deal on foreign trade and their economic ties that will see the prime minister and the minister of economic development meet with China's officials to discuss the results of the programme each year.

Coal, Oil and Gas

The first issue for Mongolia will be supplying China with one billion tonnes of coking coal for an estimated USD 50 billion over the next 20 years. The Ministry of Mining predicts that some 10 companies, including Erdenes Tavan Tolgoi, Energy Resource and Mongolia-listed Tavan Tolgoi will cooperate with China's Xinhua Group for the export of 50 million tonnes of coking coal to China a year. There are also plans for the production of USD 20 billion worth of coal-to-liquid fuels made from brown coal in the next 20 years. All told, that 20-year plan has Mongolia looking to export USD 70 billion tonnes worth of coal products to China.

Mongolia's Ministry of Mining and China's Petrochemical Corporation (Sinopec Group) have signed a memorandum of understanding for the construction of a coal and gas plant. The plant would be able to supply domestic demand for fuel with its production of coal-to-liquid gas as well as export to China. A preliminary estimate projects that the plant would have the capacity for 15 billion cubic metres of gas from 50 million tonnes of brown coal after the first phase of development. Production is expected to create more than 20,000 jobs and supply Ulaanbaatar's ger districts with 10 percent of its fuel by 2016.

For petroleum, the volume of crude oil pumped out of Mongolia is likely to grow each year.

Mongolia and China have agreed to increase the supply of the MGL-93 petroleum fuel it introduced last summer as much as four times, up to 40,000 tonnes a month. They also plan to finish work constructing facilities at Zamyn Uud for the transport of liquid fuel by mid-December. Zamyn Uud would eventually be able to deliver the full 40,000 tonnes of monthly fuel arrivals.

Current export of MGL-93 petroleum made from crude oil extracted from Mongolia and exported to China for refinement is up to 10,000 tonnes a month.

New Ports and Travel

Currently, Zamyn-Uud is the only border point for rail between Mongolia and China, but Mongolia hopes to establish ports in the provinces of Sukhbaatar, Dornogobi, and two in Umnugobi. Mongolia has already sent official letters to both China and Russia on the extension of the current railway network. There is also discussion over access to the Tianjin seaport via rail.

During Altankhuyag's visit a consortium led by Xinhua Group negotiated with Mongolian officials for rights to construction of the railway that would connect Gashuun Sukhait in Mongolia

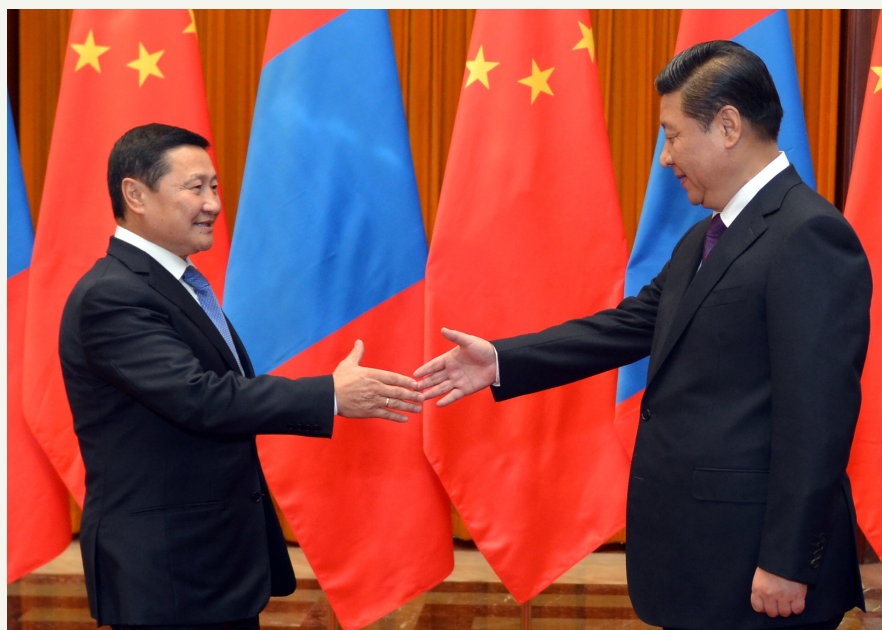
and China's Gants Mod border points. The deal would have Xinhua commissioning the construction to state-owned Mongolian Railway.

A working group that included Economic Development Minister Nyamjavyn Batbayar, Road and Transport Minister Amarjargalyn Gansukh, and China's National Development and Reform Commission's chairman and transport minister was established to tackle issues on how to cooperate in the area of rail and auto roads, and whether or not to construct rail with China's narrow gauge.

Also agreed upon was an initiative to increase the number of scholarships granted to Mongolian students as well as the construction of a joint research centre for science. China has 1,000 Mongolian students studying in Beijing with as many as 800 more students throughout the country.

The China Development Bank is also set to lend the Development Bank of Mongolia USD 240 million to further fund the initiatives prompted by the Chinggis bond. Interest on the loan would likely be in line with the Chinggis bond.

Mongolian Prime Minister's official visit to China was a large step forward to expand the economic relations between China and Mongolia. ■



BUDGET

A BUDGET TO LEARN FROM

B. ALTAI

It has been one year since the Fiscal Stability Law took effect. The law put in place a ceiling so that the state budget under no circumstances exceeds 2 percent of GDP. The law aims to bring greater discipline to the budget as well as greater efficiency.

The break-neck speed for growth seen in Mongolia has brought expanded revenue to the government as well as spending. But some criticise that spending has grown too big. The World Bank warned last January that this year's budget is not in compliance with Mongolian law and that the deficit would likely reach 6 percent of GDP this year. The Ministry of Finance has come under criticism for including too-optimistic projections for exports and commodity prices to circumvent the limitations of the law. So far this year revenue generation has fallen MNT 1.5 trillion short of projections, and many are expecting budget amendments to soon come forward.

Spending and revenue generation have been reduced slightly in the 2014 draft budget, but it does not give much of an impression of restraint. The government plans to generate MNT 6.8 trillion next year amid economic instability while spending has been estimated at MNT 7.2 trillion. That would mean a budget deficit for the year of MNT 410.1 billion with the gap in the deficit expected to be fulfilled by the sovereign bond.

The 2014 budget proposal projects GDP to grow to MNT 20.4 trillion, with total revenue representing 33 percent of GDP. Any delays to the operations of Oyu Tolgoi and Tavan Tolgoi, how-

ever, would make amendments for next year necessary as well. State-owned Erdenes Tavan Tolgoi plans to ramp up production to 13 million tonnes in 2014. Meanwhile Oyu Tolgoi plans to produce 692,000 tonnes of copper concentrate, which, according to the proposed budget, would amount to 40 percent of mine production in Mongolia.

Prudent Spending

Looking at the figures presented in past budgets suggests that budget makers have long been in need of a heavy dose of reality. Spending has grown from MNT 430 billion in 2000 to MNT 7.4 trillion in 2014. Since 2000, the cost of products and services has grown nine times, furniture costs has grown five times, routine maintenance costs have grown 2.7 times, business trip expenses have grown eight times, and meeting and conference expenses have grown 15.3 times.

"The fact that external debt in the draft budget is MNT 10 trillion is in violation of the Fiscal Stability Law", said Ch. Khurelbaatar, a member of the State Great Khural for the Mongolian People's Party. He said spending was still too high and that operating costs were 73 percent of the proposed budget while capital costs were 27 percent.

"In the past three years, spending has increased from 20 to 23 percent compared with the year before. For the draft budget, there seems to be an attempt to correlate the economic outlook more with reality", said Ts. Davaasuren, an independent parliamentarian and chairman of the Standing Committee on Economy.



There is some MNT 200 billion in the draft budget for increases to salaries, pensions, and allowances included in the 2014 budget. The draft has also increased the monthly allowance for students at vocational training centres from MNT 40,000 to MNT 70,000, in addition to an extra MNT 44 billion for healthcare and MNT 34 billion for education. Operating expenses are down, however.

Another inclusion in the draft budget is MNT 31 billion for more than 70,000 people's pensions and employment compensations.

"We cannot be so optimistic for the draft budget. We have planned it in terms of basic revenue", said B. Battsetseg, director of the budgetary control and risk management department at the Ministry of Finance.

Revenues

The draft budget for 2014 expects a large volume of coal for export to make up for the current deficit. The Ministry of Finance, which felt the backlash of severe criticism from its too-optimistic projection for 2013, kept revenue projections to just MNT 6.8 trillion for next year. The proposed budget expects MNT 161.5 billion from Oyu Tolgoi and MNT 187.7 billion from Erdenet Mining ►►

Corporation. In 2014, Erdenet expects to produce 502,000 tonnes of copper concentrate and 3.274 million tonnes of molybdenum with a price of copper of USD 6,242 per tonne. Coal is projected to range between USD 81.6 and USD 115.9 per tonne, depending on the type and quality. The proposed budget projects MNT 1.4 trillion in revenue from the mining industry, of which 41 percent is coal and 27 percent is copper.

Tax revenue is projected at 90.7 percent of total revenue in 2014, or MNT 6.2 trillion. Capital income is projected at 9.3 percent, or MNT 637 billion. The General Department of Taxation expects to receive MNT 3.3 trillion in taxes next year, or 48.4 percent of the state budget. The Customs General Administration expects to collect another MNT 1.9 trillion.

Macroeconomic Indicators

	2012	2013*	2014**	2015**	2016**
Annual GDP growth (billion/s of MNT)	14,013	17,000.3	20,503.1	24,494.8	29,317.0
GDP growth compared with 2005 (billion/s of MNT)	5,498.5	6,310.6	7,244.4	8,405.2	9,650.0
Real economic growth	12.4	14.8	14.8	16.02	14.81
Agriculture	21.6	16.5	6.2	9.1	12.1
Manufacturing	9.9	26.8	26.3	29.2	26.2
Service	16.3	9.8	13.5	13.3	10.5
Mining	8.0	22.3	40.0	38.0	28.7
Non-mining industries	13.2	13.4	9.8	10.5	10.4
Annual average USD exchange rate	1,359.2	1,450.0	1,384.0	1,279.0	1,251.9
Balance of foreign trade	(2,354.2)	(1,660.8)	507.0	1,155.2	1,370.2
Export (million/s of USD)	4,384.6	4,686.3	7,237.0	8,502.5	8,806.8
Import (million/s of USD)	6,738.8	6,347.2	7,383.0	7,347.3	7,436.6
Changes in consumer price by end of year	14.0	8.0	6.0	6.0	6.0

Mongolia expects to export 31.4 million tonnes of coal to China, the main consumer of Mongolia's minerals. That figure would meet 41.9 percent of China's coking coal import demand, according to the Ministry of finance. Imports of coking coal would mainly come from Erdenes Tavan Tolgoi and SouthGobi Sands.

For next year, royalties are projected to represent 60 percent of total revenue from the mining industry.

If lawmakers can stick to the rules they put upon themselves and learn from the mistakes of 2013, perhaps 2014 can pass without any amendments to that year's budget. ■

The 2014 Balance of Revenues (billion/s of MNT)

Revenue	2012	2013	2014
	Performance	Plan	Draft
Budget and grants balance	4,881.2	7,088.2	6,865.0
1 Tax revenue	4,203.3	6,461.5	6,227.1
1.1. Income tax	871.4	1,261.5	1,283.6
1.2. Revenue from social insurance	674.2	732.0	1,085.9
1.3. Property tax	21.9	23.7	33.3
1.4. Value-added tax	1,296.5	1,940.2	1,702.4
1.5. Excise tax	312.4	595.2	597.7
1.6. Special purpose revenue	34.0	37.3	46.0
1.7. External revenue	327.4	575.3	426.2
1.8. Other taxes (payment and fees)	665.6	1,296.3	1,051.9
2 Non-tax revenue	642.7	625.8	637.4
Assets/Property revenue	10.4	0.8	0.5
Revenue from grants	24.7	0.0	0.0

Source: the Ministry of Finance

TAX

FUTURE TAX POLICY

BY B. BAYARTOGTOKH

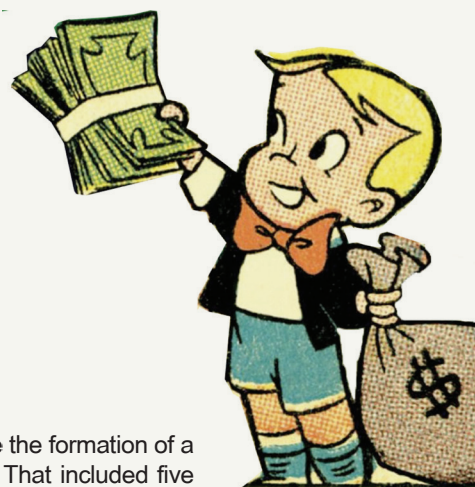
"In this world nothing can be said to be certain, except death and taxes" -

Benjamin Franklin

Mongolia has 23 types of taxes, of which four types have not yet been introduced, including an endowment tax, city tax, dog tax and mining tax. Although the dog tax is unlikely to ever be rolled out, the other three have already been drafted by the Ministry of Finance.

It has been 21 years since the formation of a new tax system in Mongolia. That included five major new taxes for the taxation of corporations, personal income, trade, and transport. Now the State Great Khural is preparing to receive a package of 17 new tax laws to decide on.

Mongolia first adopted its tax system in 1997, ►



► basing it on a commonly used international taxation structure. The system included value-added and speciality taxes. The first major tax reform following its introduction occurred in 2007, reducing the number of taxes, and a second major reform is now under way.

“There have been constant tax incentives and exemptions so far, but some disputes over tax issues have been on the rise every year”, said E. Batbayar, head of the revenue division at the Ministry of Finance.

One measure of the tax reform will be putting in place a threshold for value-added tax. The new tax policy will also remove ambiguity and create tax incentives.

“According to a study, the shadow economy in Mongolia makes up 40 percent of GDP. We expect this to be reduced as a result of the second phase of reform”, said S. Purev, Vice Finance Minister.

The vice minister thinks that the reform will bring a portion of returns from value-added tax to citizens while shrinking the size of the shadow economy—which refers to the business activity hidden from the government where no tax is paid. Next year, the government will bring its Internet-based tax services department online, which would allow individuals and companies to attain all types of online reports on tax. Mongolia has saved MNT 6.4 billion by removing paper-based reports.

The online service delivers an integrated and independent data network for tax payers. The system will record and process tax transactions while delivering receipts, all online.

“We will implement a policy for contributions to small and medium enterprises,” said Kh. Gantsogt, state secretary at the Ministry of Finance. “According to the government’s action plan, the taxed income of corporations with sales revenue of up to MNT 1.5 billion a year will be subject to 90 percent tax incentives”.

The companies currently paying 10 percent tax will have to pay a mere 1 percent with the incentives, said Gantsogt. The changes to the tax structure would recover some investment costs of companies while extending the due date for tax payments, he said. Also, the limit on

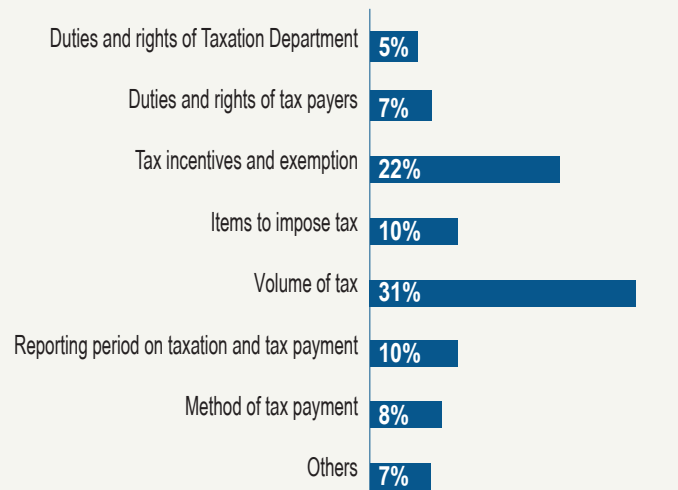
personal income for tax incentives will likely be increased along with the increase to minimum wage.

While legal reform can have indirect benefits on an economy, any changes to the tax structure will have direct impacts. For corporate tax, some positive changes will include tax exemptions for startups’ first one and a half years of operation. There will also be tax incentives put in place for introducing new technology and innovations for up to five years. Personal income tax will be better targeted, and a MNT 50 million threshold will be put in place for value-added tax.

Other improvements include tax refund delivery, and incentives and controls over value-added tax payments. The government also plans to come down on tax avoidance, specifically targeting tax dodgers who simply transfer assets to new titleholders. Taxes will be imposed on the recipients of assets valued over MNT 100 million.

A tax for residency in Ulaanbaatar is also expected, as well as on amenities such as roads, plumbing and a sales tax of up to 0.3 percent. For the mining industry, taxes will be imposed for every cubic metre of damaged soil. ■

Amendments in laws by percentage



Tax ratings

Country	By simplicity of tax payment (integrated index)			By number of tax payment			By period of time to spend for tax payment			By average tax amount		
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Armenia	153	159	153	152	156	120	179	169	160	69	94	100
Azerbaijan	108	103	77	76	60	63	151	128	96	89	95	91
Belarus	183	183	156	181	181	63	177	178	172	177	173	157
China	125	114	121	9	9	11	165	154	155	160	158	166
Estonia	38	30	47	30	9	17	16	14	16	131	134	154
Georgia	64	61	39	59	60	4	154	152	152	9	10	14
Kazakhstan	52	39	17	21	24	11	114	115	68	66	38	41
Kyrgyzstan	156	150	162	178	152	163	79	77	83	153	152	171
Latvia	45	59	62	9	9	11	121	125	128	54	81	86
Lithuania	51	44	57	37	35	40	63	62	61	99	83	115
Moldavia	101	106	109	150	152	158	93	95	98	42	44	47
Mongolia	69	66	65	141	140	138	70	67	69	20	21	25
Russia	103	105	102	35	35	29	131	132	128	129	123	132
Uzbekistan	178	154	157	180	142	138	145	78	79	176	176	178

Source: the Ministry of Finance



ISSUE

JUGGLING FUNDS

B. BAYARTOGTOKH

Mongolia has a total of 37 special funds. The Law on the Special Funds of Government has 30 of those funds fall under the scope of 16 different ministries while another seven funds, including the Human Development Fund and Fiscal Stability Fund, are regulated by other laws. In 2013, the state budget has funded between MNT 2.1 and MNT 2.3 trillion to some 22 special funds, of which 14 funds are managed by working groups. The total operating costs for these funds is MNT 40.2 billion a year.

The government plans to introduce reform that would reduce spending. All funds but the Risk Fund and Securities Fund are partially funded by government grants, donations and elsewhere. Only eight funds, however, comply with the rule that a fund must be jointly supervised over by the Ministry of Finance and the Mongolian National Audit Office.

Mongolia still has some special funds that have their own sets of rules to follow as well. The Standing Committee on Budget held several discussions on possibly amending fund

laws, but it is not certain if they will pass successfully.

A working group was established via a resolution by Prime Minister Norovyn Altankhuyag to reevaluate the number of special funds that exist. The working group, which was chaired by Finance Minister Chultemiin Ulaan, was tasked with deciding whether the special funds needed reorganisation, if the funds should be transferred into another account, or if funding should continue forward as it had been.

“There needs to be regulation over the integration of the special funds of ▶

▶ the government and their inclusion in the budget as well as limits for the foundation of new funds”, said parliamentarian S. Bayartsogt.

He said the current costs for special funds could be substantially reduced. For instance, the Crop Production Support Fund, Employment Support Fund, Small and Medium Enterprise Development Fund, and Investment Fund could be integrated into a single development fund for agriculture. He also argued that the State Training Fund could be turned into a fund for higher education.

Bayartsogt argued that the reorganisations of funds would bring compliance with the Fiscal Stability Law through more efficient spending. The budget guidance for 2014 has some 26 special funds that are likely to function next year, four of which are new. The new funds are the Science and Technology Fund, Children’s Fund and Criminal Victims Compensation Fund, as well as the Mongolian Study Support Fund initiated by the President Tsakhiagiin Elbegdorj

In 2009, the government established its funds to better target its objectives in the budget. But the finance minister argues that these funds have been misused and that politicians were treating them as a means of competitions to see who could bring about the most prestige projects. Ulaan argues that the growing number of funds has become a greater burden on the budget and that the funds themselves lack proper oversight. His suggestion is to replace the current system using funds with specific programmes that have goals.

One possibility for reform is to take all the funds and divide them to see which need to be changed, which should go unchanged, and which should be financed by sources other than taxpayer money. It would also be in the interest of the budget to remove some of the special privileges granted to some funds, said Ulaan.

“The special funds of the government are less than efficient, financially,” reads a report from the Open So-

ciety Forum in Mongolia. “The funds need to be assessed on whether they should become independent”. The study argues that there is high risk because of a lack of transparency and oversight. It also warned that the relationship between the

funds and the budget is often unclear, and that there is a lack of sufficient controls.

The reformed policy will hopefully address these issues, otherwise they may become an unnecessary burden on an already strained budget. ■

LOAN GUARANTEE FUND

POINT OF CONTACT

E. ZORIGT

Mongolia’s Loan Guarantee Fund is in its early stages of development, though similar institutions been developed for more than 100 years in Europe. The following is an overview of the basic concepts behind the fund and how it should be implemented.

The State Great Khural passed a resolution in 2012 to found the Loan Guarantee Fund. The fund addresses the main complaints of small and medium enterprise (SME)’s about the lack of sources of credit available in Mongolia.

For the banking sector, a fund benefits as follows:

1. Enables banks to provide credit to potential borrowers with strong qualification yet lack assets for collateral
2. Reduces risk in lending
3. Increases the number of loans issued and revenue generated from loan interest
4. Increases the number of banks’ clients and creates opportunity for using other financial services provided by banks
5. Improves SMEs’ financial capabilities and expands their opera-

tions, which ultimately make banks more profitable

6. Contributes to SMEs’ activities and improves their operations, ultimately to the benefit of the economy

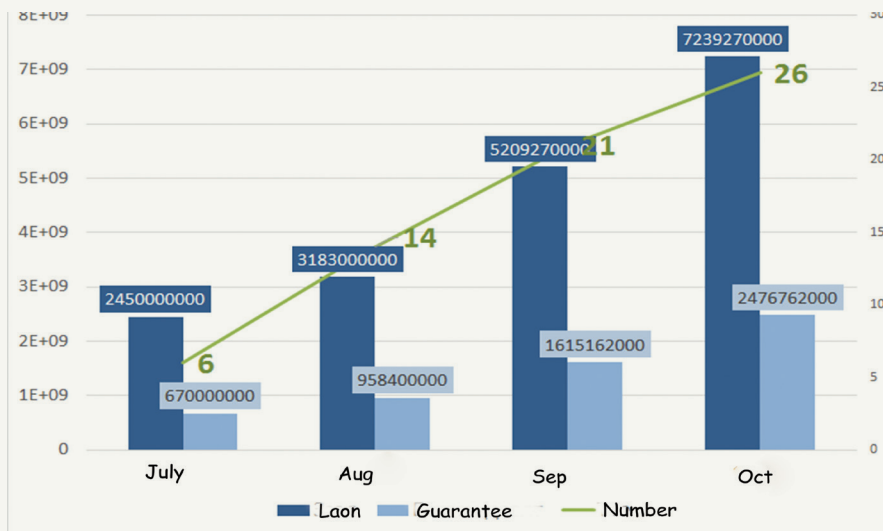
For SMES, a fund benefits as follows:

1. Increases SMEs’ likelihood of attaining credit
2. Increases capital
3. Builds savings and creates jobs
4. Expands the operations of SMEs
5. Increases household income, ultimately to the benefit of the economy

There are currently many similar programmes to the Loan Guarantee Funds in more than 170 countries. In Europe, a special law was passed by the parliament to support its own fund. In Asia, in countries such as Japan or South Korea, a fund of this nature has also been employed along with legal protections.

If a fund is implemented with the necessary regulations it can be a ▶▶

Loan Guarantee Indicator



► strong source of support for SMEs while combatting poverty in a society. A fund can help reduce unemployment, create new jobs and reduce poverty, said Z. Shagdarsuren, a board member at the Development Bank of Mongolia. When SMEs can develop they can form new industries. They can also create employment opportunities for those who are not qualified to work at large companies because of a lack of formal knowledge or skills. SMEs also provide jobs for those who have no or little work experience and can provide opportunities for the most vulnerable segments of the population.

The fund in Mongolia is less than a year old. Since its introduction, there have been 33 requests from urban and rural small businesses, of which 26 requests have been fulfilled.

One limitation, however, is the fund can only guarantee up to 60 percent of a loan. Anyone who lacks the assets to hold up as collateral is considered a risk, and that risk must be shared. The one taking out the loan must have some asset equivalent to 40 percent of the loan sum total being requested while the remaining 60 percent can be guaranteed by the fund.

The Mongolian fund is new and there is a lack of experience in its use, meaning there are plenty of problems that need to be worked out. For instance, if an SME received a loan for billions of tugrug but could not repay its debt, the burden would be left to tax payers. Included in the budget is an allotment of MNT 5 billion for the launch of the fund's operations this year.

Start-up businesses are risky and the failure of many would have a negative impact on society and the future of the fund.

Japan's Experience

Japan has gained a great deal of experience in devising ways to make contributions to SMEs from which Mongolia can learn. Japan's fund is a non-profit that operates independently from the government. Most importantly, its sources for capital are the Japanese government and Japan's commercial banks because a diverse portfolio of assets is necessary to hedge risks. Furthermore, the fund is insured by another guarantee fund.

The budget for Mongolia's fund comes from tax payers and is granted by the government. Many criticize

this point, arguing that the state is bearing all the risks. Thus, focus needs to be placed on creating the financial infrastructure to spread the risks along with regular supervision to ensure that the loans being given out are healthy and valid.

"Banks will very soon conduct a study on the quality of loan guarantees for SMEs", said Sh. Gankhuyag, chief executive at the Loan Guarantee Fund. "The fund's operation has just begun. There is a lot to be done and improved on".

She said the fund had sent a group of ten personnel to Japan for training and that the Loan Guarantee Fund had signed agreements with funds in South Korea, Malaysia, and Russia to learn from them as well.

The fund gives a chance for banks and SMEs to cooperate. If some of the initial issues with the fund can be resolved, Mongolia can develop its SMEs for the good of the economy. ■



GUEST

EBRD: HELPING COMPANIES BUILD THE ECONOMY

BY B. ENKHTSETSEG

Paul Vlaanderen is Director for the Netherlands, Mongolia, FYR Macedonia and Armenia at European Bank for Reconstruction and Development, London. Prior to that he was the financial action task force president at OECD and international tax director at Ministry of Finance of the Netherlands, director at Energy Charter and programme officer at Food and Agriculture Organisation of the United Nations. He joined OECD in 2011. Mongolian Economy met with Vlaanderen at his London office for the European Bank for Reconstruction and Development.

What are some of the projects the European Bank of Reconstruction and Development is working on in Mongolia?

Maybe one or two sentences of introduction of the EBRD would be necessary. The EBRD—that is the European Bank for Reconstruction and Development—is a reconstruction and development bank. So, it has a very specific mandate. It started in 1991 and it has 66 or 67 shareholders; the owners of the bank are those 66 to 67 governors. It is public-sector owned, and Mongolia is one of the co-owners of the bank.

Although the bank started in 1991, the real operations started in Mongolia started much later in 2006, so Mongolia joined later.

I should maybe also say something about what the bank tries to do. By the way, you're talking to me here because I'm not only the director for the Netherlands but I'm also the director of representing Mongolia on the board of directors. The bank has a couple of very distinct objectives. One of them, and probably one of the most important ones, is the bank wants to promote the role of the private sector in the economies in the countries it operates in. So, it wants to promote private activities and therefore it selects its project very much accord-

ing to that leading principle and objective. It also tries to assist governments in improving their governance structure, in improving their rules, laws and regulations that belong to an economy that is by and large governed by private-sector activities. And the third main objective (and that is very different from other institutions), the bank also tries to promote multi-party democracy, and also it tries to promote functioning civil society. That is, if you like, a political objective that the bank has and that most other international organizations do not have.

That is a general introduction of the bank. On what the bank is in Mongolia, I think the short story is that it started in 2006, and by now it has invested about [USD] 1 billion in Mongolia, which is one with nine zeros (if I'm not wrong), in an economy that at present is not more than 10 times that figure. So the EBRD is a major player of the past seven years it's been operational in Mongolia. It has done a little bit less than 60 projects throughout the economy but also and notably in the sector of manufacturing—so the private sector.

Does that mean small-and medium-sized businesses?

Also big businesses but also medium-sized and smaller businesses. The

next question might be what would the bank do, and the answer would probably evolve more in that particular sector of small-and medium-sized businesses.

How does the EBRD manage the effectiveness of its activities in Mongolia and analyse the results?

The EBRD is a bank and one of the leading principles of any bank is that we want our money bank at some stage.

And how well is that going?

It's going very well, thank you. [laughs]

And therefore one of the objectives is, as I said, promoting the private sector. Another objective, which of course is a banking principle, is good-sound banking, and that means that all the bankers at this bank when developing their projects are to do it in such a way that ultimately the money is coming back to the bank. And therefore there are risk controls, accountant controls, financial controls. The normal activities the bank is doing if it provides a loan or participates in equity structures to be a co-owner of a company, we have to try to maximize the possibility that the money comes back.

Would you say that, in the long run, supporting small-and medium- ▶▶

▶ **sized businesses is a major priority?**

Yeah. We believe that specifically in Mongolia the situation that is agreed upon with the government for a fairly recent strategy for Mongolia is we believe one of the key objectives of the Mongolia economy is reciprocation.

That reciprocation meaning adding to the now so-big mining sector in Mongolia. The banks believe the sustainable development of the economy necessitates that other sectors in the economy also are developed. One is the financial sector. Another is maybe infrastructure, roads, rail, electricity, that kind of thing—but also that the bank assists the Mongolian government in developing some more medium-sized enterprises which create economic activity at a level of private-sector companies, and experience shows that they will not all be successful but a couple of them will grow into larger businesses, which helps the economy, too.

How strongly concentrated is investment in the mining sector?

I think the mining sector is not excluded, but we believe that in addition to the mining sector other activities in the economy have to be developed and the bank should also assist that.

Having said that, I think a lot of diversification could and probably will come from companies that do in fact relate to the mining sector. I can imagine there is a lot of supply necessary to the mining sector; be it finance, equipment, human needs such as transport, food supply or clothing supply. All these supply activities can be provided by Mongolian companies over time. Then, they don't have to be imported. The economy of Mongolia will benefit from providing these goods and services. That kind of development bank will actively try to promote this.

Is there any particular sector in Mongolia the EBRD is concentrating its focus on?

I think what I tried to indicate is that the financial sector is important. Today the Mongolian financial sector is still relatively small, and if the national activities evolves it would be helpful if the financial sector evolves with it in order to be able to supply the banking services to those

growing companies.

The financial sector is a key part of society that we will concentrate on. Another is infrastructure and you know much better about the traffic situation than I do. The infrastructure is also roads outside the city, the electricity supply, and that kind of larger investment the bank might be interested in.

In the past seven years the EBRD has invested some USD 7 billion. Do you have any financial goals for Mongolia for the next few years?

I think in Mongolia it depends on how you measure but when you look at the size of the economy then Mongolia is a big country for the bank in percentage. So, in fact you may argue today the bank does more in Mongolia than many other countries, relatively. I think what I'm trying to say is we have no absolute number and we certainly try to find projects that help the economy of Mongolia and that are in the limits of the objectives of the bank. The bank is actively engaged with Mongolia, both in the government and also in the private sector, to find those good projects.

I have full confidence that the bank will continue to be able to find these bankable and useful projects for the economy of Mongolia.

Can you describe some of the success stories the EBRD has achieved in Mongolia?

I think a fairly recent example is that the air quality of Ulaanbaatar is an issue, a very severe problem sometimes in winter. And the bank is now participating in the construction of a wind farm, I think 70 kilometers outside of Ulaanbaatar [the Salkhit wind farm]. That is within our objectives, not only to help the private sector (because it is the private sector) but also our more soft goals of improving the fate of the people of Ulaanbaatar by decreasing the level of pollution in the city while still keeping the lights on.

How is the EBRD helping small-business entrepreneurs?

One thing I like very much is one of the programs of EBRD in fact is specifically designed for very small companies. I have visited some of the companies

the bank is supporting and the bank is supporting with a little bit of money, but notably with know how. A lot of these companies are always short of money but because they are short of know how they first need to know better what they do and then get organised, and grow a little bit better. For that the EBRD is doing for expanding local expertise, so we hire consultants in Ulaanbaatar. And there is the next phase for the programme that larger companies offer the same companies, if they've grown a little bit, and then we can even bring in a related party programme foreign consultants.

There are very interesting examples of this in Mongolia and outside Mongolia where you really see these companies learn the ropes, as they say, start to grow and then become developers for real investment because then they can handle it and process it. Of course not all activities are equally successful, but the programme as such is really, I think, a very nice element in the work of this development bank.

How does EBRD addressing its goals for promoting democracy?

For instance we have a legal transition team that is able to assist governments improve their rules, laws, and regulations in order to be able to run a country with a growing private sector. So it is good governance at the side of the government with the rules, regulations and laws it requires, and then, on the other hand, promote private sector activities with good governance, corporate governance, that is needed on that side. The bank is willing and able to support both sides.

How does the EBRD see the challenge of adapting legislation to Mongolia?

This is a process of cooperation, and I don't believe the bank is in the world of templates; to say, "why don't you just copy this from the Netherlands or any other country because you'll be fine". No, I think the bank is different. Because we've worked for many years in Mongolia, we have an office now in Ulaanbaatar, Mongolia and we have a network of contacts in your country, and therefore the bank can be much more sensitive to trying to adapt its advice to your circumstances. ■

RUSSIA

THE NORTHERN NEIGHBOUR STRUGGLES FOR CONTINUED GROWTH

BY B. BYAMBADORJ

Since the collapse of the Soviet Union in 1991, Russia has made a successful yet bumpy transition from an isolated, centrally planned economy to a global free market. The country had a steady economic growth from that time until 2008, when it faced economic recession. With the economy now in recovery, Russia's economy is once again growing, albeit at a slower pace.

Naturally Rich

Although Russia is considered developing by both the International Monetary Fund and World Bank, it is rich in natural resources—possessing one-fifth of the world's forests, and one of the largest coal reserves in the world.

Russia has abundant reserves of oil and natural gas, being one of the top oil and gas producers along with Saudi Arabia. It was only this month, according to US data, that the United States for the first time exceeded it in production. Russia also has ample reserves of iron ore, chromium, nickel, platinum, titanium, copper, lead, tungsten, gold and diamonds, among others, making it self-sufficient for most raw materials. Tin, tungsten, bauxite, and mercury were among the few raw materials Russia imported during the Soviet regime.



Russia's trade partners are located mostly in Europe, and its major trade partners are China, Germany and Italy. Over 50 percent of Russia's total export revenue is generated from oil and natural gas, transported via a large system of pipelines. Other main mineral exports are nickel, palladium and iron.

In a 2012 study, the Russian government acknowledges that its forests in Russia is underutilised. Despite possessing the largest forest reserve in the world, Russia's market share in the timber industry is less than 4 percent. Both foreign and domestic analysts cite various reasons for this problem such as low

demand and counterproductive policies and tariffs.

Blessing and a Curse

Russia is widely known for its dependency on oil and gas exports. In an interview with Voice of Russia, economist Valery Makarov noted that this problem had persisted and the growth of the Russian economy is directly linked with the demand (and thus the prices) of oil and gas. Makarov pointed out that there are various ideas to cut Russia's dependence on natural resource, one possible example being Russia's machine engineering industry, but it »

► was “in a very poor condition”.

The biggest customer of Russian oil and gas is the European Union. The 2008 global recession hit the Russian economy hard after oil and gas prices plummeted.

There are a number of countries, especially in Eastern Europe, experiencing the reverse situation. They, including Mongolia, are dependent on Russia for oil and gas. As a result of Russia’s geopolitical advantages, it has powerful leverage over European countries, politically and economically. Austria, Greece, Bulgaria, and Serbia all import more than 50 percent of their gas demand directly from Russian pipelines.

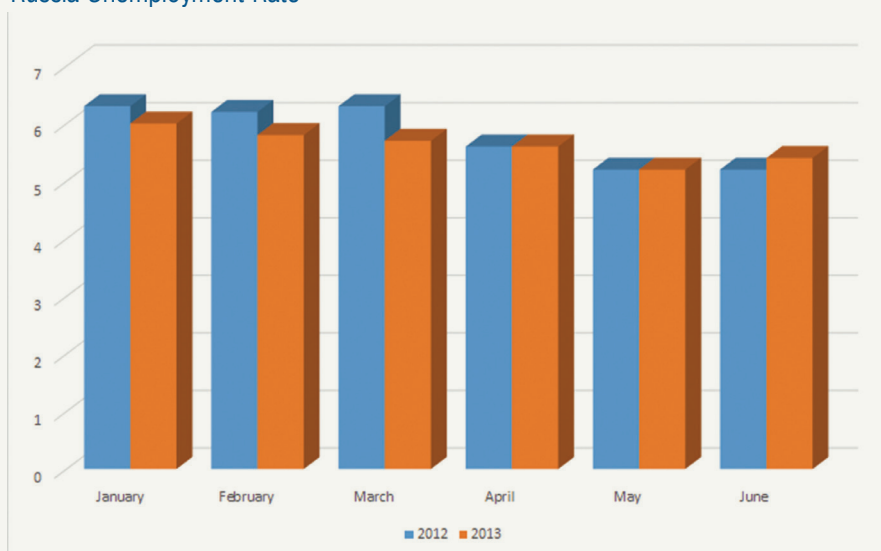
The Russian oil-and gas-dependent countries have long since recognised the need to seek out other sources of energy, and as a result Russia’s grip on them might soon loosen. For example, the European Commission is currently planning to build a regional liquid natural gas terminal so the Baltic countries can have access to global gas pipelines, eliminating Russian gas dominance in the area.

President Vladimir Putin outlined his long-term economic policy after he was elected into office in May 2012, aiming to “step up the rate of stable and consistent economic growth, increase people’s real incomes, and make Russia’s economy a technological leader”. The main focus was on improving internal economic efficiency, structure and policies, transparency, infrastructure and social care.

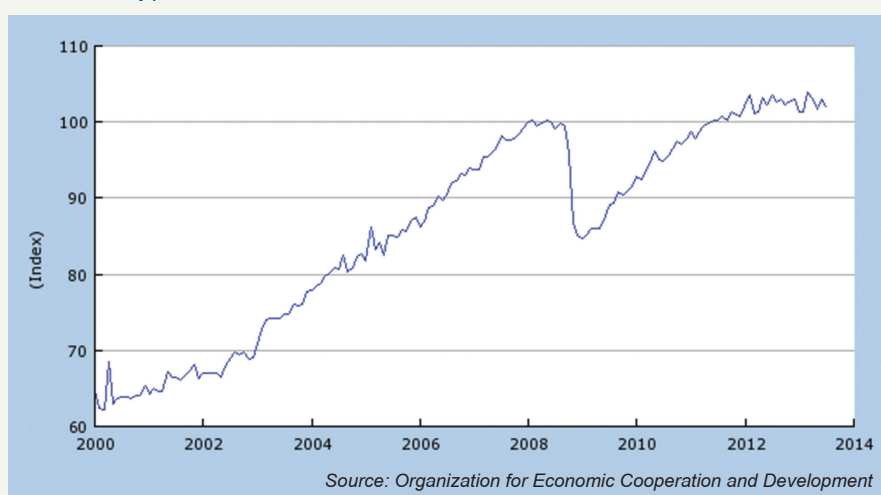
Russia has a to-do list for goals to meet by 2018, when Putin’s term ends. That includes pushing the ratio of investment to GDP five points to 27 percent. He also hopes to increase the economic activity in the tech sector 1.3 times from the 2011 level as well as move the country’s position on the World Bank’s Doing Business index 100 places to the 20th position.

Current standings

Russia Unemployment Rate



Total industry production in Russia



As of the first two quarters of 2013, Russia’s economy is in a state of slow-down. As the symptoms of decelerating economic growth continued to linger in the third quarter the World Bank, the International Monetary Fund and the US credit rating agency Standard & Poor’s all reduced their projections and estimates of Russia’s economic growth this year. The organisations warned of the lingering structural issues in Russia and that the country needs further investment.

“Slowdown in consumption, stalled investment demand, and a continuing

weak external environment led to the downward revision”, reads the World Bank report. The bank cut its growth projection for Russia to 1.8 percent from 2.3 percent.

“The country is experiencing large private capital outflows as the business environment deters both domestic and foreign investment”, said S&P economist Sophie Tahirion in a press release in September. S&P estimates that Russian economic growth will slow down to 2 percent, from 3.4 percent in 2012 and 4.3 percent in 2011.

The IMF also reduced its estimate to 1.5 percent from 3.7. ■

REAL ESTATE

MONGOLIA'S CONSTRUCTION INDUSTRY OUTLOOK FOR 2014



N. Monsor is the chief executive officer at UMC Alpha

According to a study by Mongolia's real estate agencies, the price for new apartments has risen from 15 to 25 percent since the introduction of the 8 percent mortgage loan programme. Demand, too, is on the rise, according to data from Mandal Assets Management.

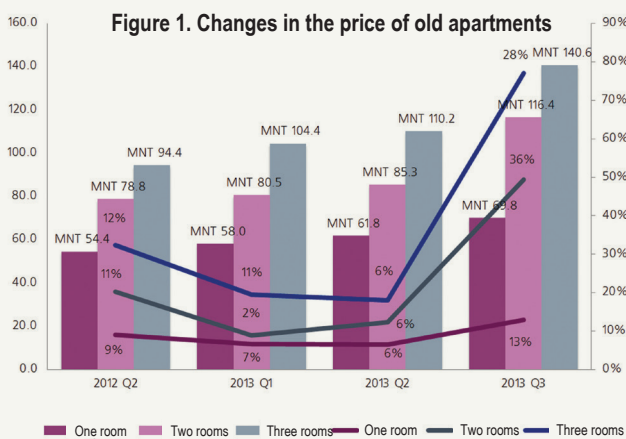
With young people under the age of 35 comprising more than 60 percent of the total population, demand is likely to grow further.

The current situation

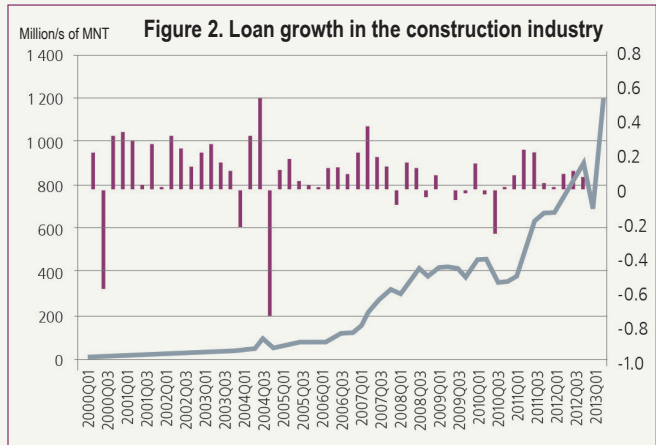
The price for the order of new apartments has not increased as the 8 percent mortgage loan is only dedicated to new apartments.

Production in the Construction Industry

The value of construction work totalled MNT 35.2 billion in the first half of this year, growing 153 percent from the same period last year.

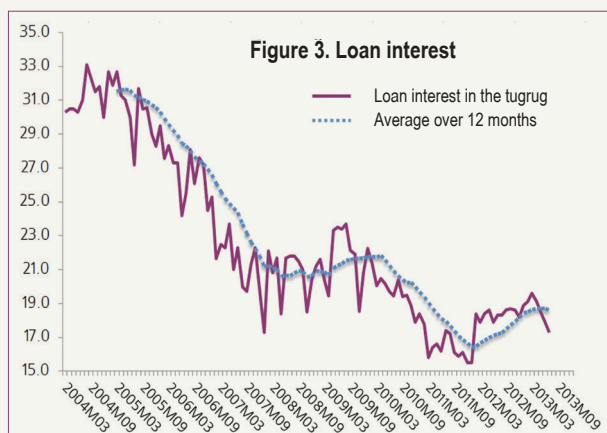


The highest growth in prices was seen in Khan-Uul district, with a 21.7 percent annual increase (with a monthly increase of 10 percent) and 24.4 percent (with a monthly increase of 11.5 percent) in Bayanzurkh district. But in Songinokhairkhan district, there was 4.3 percent growth (with a monthly increase of 0.3 percent) as well as growth from 10 to 20 percent in other districts (with monthly increases ranging between zero and 10 percent).



Debt within the construction sector declined 6 percent in the first quarter of this year compared with the same period last year. The second quarter, however, saw the loan total grow 62 percent from the same period as the year before due to the introduction of the Price Stabilisation Programme. »

Construction market



Commercial banks began reducing the interests on loans in the first quarter of 2013, allowing for short-term growth in the demand for apartments as well as their prices. Next, demand sharply rose 15 to 20 percent after the government set mortgage interest at 8 percent. The demand for apartments is closely linked to mortgage interest. Commercial banks saw a 4.7 percent rise by MNT 46 billion in the sum total of loans in June compared with May and a 40 percent increase by MNT 249 billion compared with 2012. The total debt held by commercial banks was MNT 1.03 trillion as of June 2013.

The number of debt holders has grown 6 percentage points to 16 percent since June, after the weighted average interest rate was cut from 16.6 percent to 12.9 percent and the government rolled out its 8 percent mortgage programme.

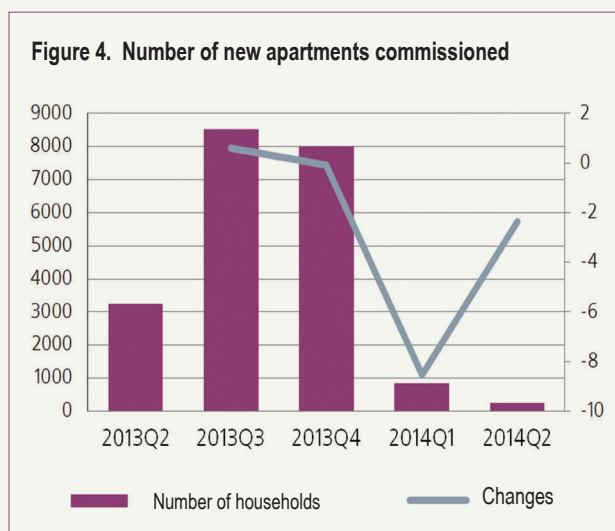
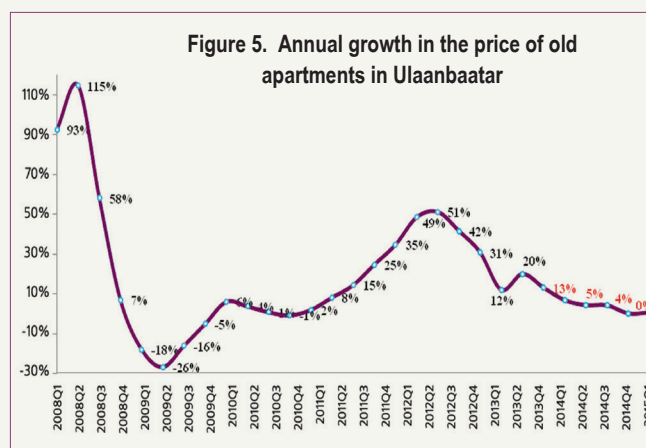


Figure 4 shows that the number of new apartments opening is quickly outpacing infrastructural capacity development.

Date	Demand		Supply	Difference	Percentage
	Total Ulaanbaatar households	Number of potential households	Number of commissioned new apartments		
End of 2012	312,00	228,000	117,000	111,000	51.3
End of 2013	331,00	241,000	144,000	97,000	59.8

The table shows that 111,000 households expressed interest in buying apartments by the end of 2012. This number is likely to fall to 97,000 households by end of this year. By the end of 2012, 51.3 percent of households that were able to buy an apartment had their own apartments.

The re-planning of the ger districts in Ulaanbaatar and growth in the supply of new apartments should reduce the demand for apartments and stabilise the prices for the long term.



Ulaanbaatar is expected to implement its redevelopment plans for the ger districts between 2013 and 2014. According to a statement by the Ministry of Urban Development, construction companies could meet 2014 consumer demand with the completed construction of 30,000 additional apartments this year out of the 60,000 new apartments that companies began building this year.

Mandal Assets Management expects that Mongolian citizens' income will grow by 15 percent and the economy will be recovering from the beginning of 2014.

Consequently, as of the second quarter of next year the price of apartments is expected to decline 4.6 percent followed by a rise between 0.4 and 1 percent in the third quarter.

The Price for building materials

The prices of cement, roof shingles and windows have fallen while the prices for light cement blocks, bricks, vacuum windows, and roof shingle imported from Russia have increased from 1.5 to 5.9 percent from 2012 to 2013.

The Prices of some Building Materials (MNT)

Manufacturer	Description	June 2012	May 2013	June 2013	Annual growth	Monthly growth
Mongolia	Cement M-500	9,075	9,400	8,500	-6.3%	-9.6%
	Light block 700	148,500	150,700	150,700	1.5%	0.0%
	Brick M-100 (thousand/s of pieces)	286,000	318,000	298,500	4.4%	-6.1%
	Timber (15x15), dry	28,000	28,000	28,000	0.0%	0.0%
	Vacuum window (15x15)	85,000	90,000	90,000	5.9%	0.0%
Russia	Roof shingle 1x10 m	22,000	21,500	22,500	2.3%	4.7%
	Cement M-500	8,500	7,500	6,500	-23.5%	-13.3%
	Roof shingle 1x15	9,000	8,000	8,000	-11.1%	0.0%
China	Window 5 mm	13,000	12,000	12,000	-7.7%	0.0%

► The programmes to support construction have allowed for lower interest loans. These loans effected declines of 6.3 percent and 23.5 percent in the prices of cement manufactured in Mongolia and China, respectively.

Foreign Investment

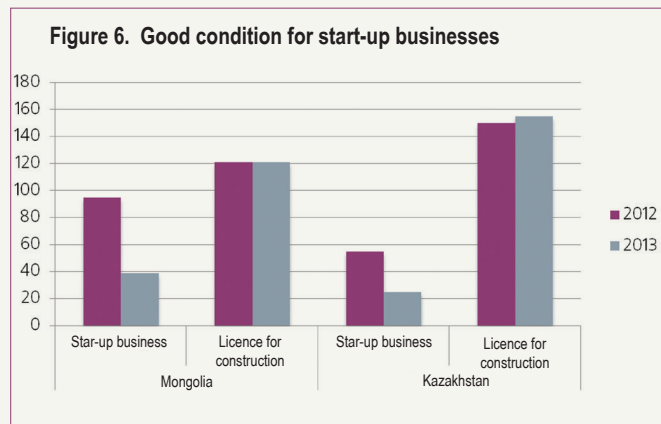


Figure 6 shows that the environment for businesses start-ups in Mongolia is not much worse off from that of Kazakhstan. There is no policy for introducing advanced technology and the number of domestic companies may need to grow in Mongolia.

Conclusion

The government has spent MNT 266.2 billion for the manufacturing and trade of building materials, MNT 385 billion on yet unfinished construction projects and MNT 900 billion on the 8 percent mortgage loan.

Construction is projected to grow between 2013 and 2016. The reduced mortgage loan interest rate to 8 percent pushed dramatic growth in demand for apartments, which resulted in the 20 percent growth in prices between the first and second quarters of this year.

However, the state-owned company the Ulaanbaatar Heating Network recently made a statement that it lacks the technical capacities to link up 4,800 new apartments to the central grid.

Power Plant No. 4 supplies 73.1 percent of total electricity demand and 63 percent of total heat demand to Ulaanbaatar residents. There will likely be a gap in the supply unless construction of Power Plant No. 5 begins very soon. ■

Source: <http://www.pmis.gov.mn/>
<http://www.mongolbank.mn/>
<http://www.doingbusiness.org>
<http://www.economy.news.mn/content/154026.shtml>



TAX

OYU TOLGOI TROUBLES ADD TO FISCAL STRAINS

BY TERRENCE EDWARDS

After four years of development and anticipation Mongolia's USD 6.5 billion Oyu Tolgoi copper mine has opened with a sputter rather than a giant kaboom. Faced with a growing budget deficit, Mongolia is scrambling to set things right to ensure the arrival of expected revenue from the mine.

Mongolia must somehow resolve the major issues that hold back a USD 4 billion financing package that would have the mine reach its full potential before a mid-December deadline expires. The State Great Khural is also likely to soon amend the 2013 budget while expected income remains tied up. That means Mongolia is unlikely to abide by the restriction that prevents the deficit from exceeding 2 percent of GDP, without major spending cuts.

"Because actual revenue is far below the overly optimistic projected revenue for the 2013 budget—mainly due to lower mining prices and output—the government had to propose an amendment to decrease revenue from MNT 7.3 trillion to MNT 6.3 trillion and expenses from MNT 7.4 trillion to MNT 6.6 trillion, accordingly", said Lkhagvasuren Amar, an economic officer at the Asian Development Bank in Mongolia.

He added that the less-than-expected revenue inflow this year necessitated spending be cut by 82 percent for the year to October 2013.

Revenue lost from the Oyu Tolgoi mine factors largely in the revenue shortfall. Rio last year rejected a new royalties scheme introduced in the 2013 budget that would have granted Mongolia an additional MNT 445 billion for 2013. The investment agreement signed for the project in 2009

requires consensus among all stakeholders.

The sore point for the government is what it sees as the mystifying costs to the project. The main priority of the government is keeping costs low because the 2009 investment agreement they both signed prevents Mongolia from collecting dividends for its 34 percent shares until after investors have recuperated their initial investment costs.

Mongolia is currently waiting on the final results for an audit into phase one development of the mine, when construction took place from March 2010 until the end of last June. Oyu Tolgoi maintains the initial phase of project development was just 13.8 percent over its USD 5.7 billion estimate from 2009, which is "well within the accuracy threshold typically assigned to a feasibility study estimate," according to a cost analysis on Oyu Tolgoi's website. Mongolia, however, remains unconvinced.

Less than expected

Mongolia waited out a 15-week delay at customs that delayed royalty payments while revenue earned remained unrecognised by the Oyu Tolgoi mining unit. Stockpiles of copper concentrate piled up at a bonded warehouse in China, near the border until withdrawals by Chinese smelters began October 19.

"With already at least 38,000 tonnes of copper concentrate worth [a market price of] \$7,181 a ton at the Chinese border and 160,000 tonnes already produced at OT [Oyu Tolgoi] the revenues will be substantial", said Surenjav Odbayar, head of research for Ulaanbaatar-based broker Na-

tional Securities. "Since commencement of OT, commercial production has increased Rio Tinto's overall copper output by 23 percent, compared to the same period of last year. At full capacity OT is estimated to boost the economy by a third".

In addition to a 25 percent corporate tax, value-added tax, customs, and a host of other taxes and fees, this year Mongolia can expect revenue from 5 percent royalties on a year-end production and export target of between 75,000 and 85,000 tonnes of copper in concentrate. Any lingering legal issues for China, however, would make it unlikely that total export would go recorded as recognised sales.

A more pressing challenge will be re-launching further development at Oyu Tolgoi. Before commercial operations even began at the copper mine, it was already one of Mongolia's largest sources of tax revenue during construction. According to the Rio Tinto website, Oyu Tolgoi had paid more than USD 1.1 billion to the Mongolian government for the project by the end of June 2013, about a week before shipments launched. Rio disclosed payments to the government of USD 280 million in 2012, when it was the second-largest taxpayer for the year.

Tax revenue from construction would have continued with the construction of an underground mine shaft to complement the open-cut mine already producing copper ore. But Rio put construction on hold after it received notice from the Mongolian government it would need parliamentary approval for Turquoise Hill's USD 4 billion financing package, sourced from 15 banks including the Interna- ▶

▸tional Finance Corporation and the European Bank for Reconstruction and Development.

The delay creates concern for some that Mongolia may miss the wave of rising demand for copper from China. Although Chinese demand reached an all time high in July, according to the International Copper Study Group, with a deficit of 150,000 tonnes, many are predicting a surplus as soon as next year. But while the *Financial Times* reports that copper surplus could reach 800,000 tonnes by the end of 2014, Oyu Tolgoi won't likely be a main contributor—not until it opens the underground shaft, which Rio says is the key to unlocking 80

percent of the wealth.

Recapturing investment

The Khural thrust itself into action after the curtailment of development at Oyu Tolgoi with the recall of lawmakers from recess two weeks ahead of schedule for an emergency session.

“Parliament members were called back due to the economic circumstances, such as constant falls in FDI and a sharp depreciation of the tugrik between September and August”, said Odbayar.

Foreign investment figures for the first half of the year showed a 43 per-

cent decline from the same period a year before as well as a sudden depreciation in the local currency against the dollar. The tugrug was down 21 percent when the emergency session commenced on September 16, on-year, and 7 percent compared to the month before.

It's encouraging to see Rio and Tinto come to a more cooperative note, and the steps taken to cater to investors gives hope that the economy will pick up again. But how soon these quick actions can put Mongolia on top again is anyone's guess. ■

INTERVIEW

IMPROVEMENT OF MEDICAL EQUIPMENT IS VITAL

BY KH. KHULAN

Robert Buerger is managing director at the Vamed health care company. He is specialised in Hospital and Medical Equipment planning. Buerger is responsible for the company's operations in Beijing and Ulaanbaatar.

Please tell us about the projects you have in Mongolia.

We are currently implementing a 100-bed private Hospital IMC, Intermed International Medical Center, with the company MCS as our client. After we were contracted with the hospital two years ago, we completed the functional planning and the mechanical and electrical design of the hospital. At the moment the process of medical equipment procurement and delivery; installation and testing and commissioning; and training are ongoing. MCS is planning to open the hospital by the end ▸



▸ of this year.

In addition to this project we are planning to upgrade the medical equipment at the National Cancer Center of Mongolia (NCC) with a soft loan from Austria. Included in this program is an extensive training program for the hospital staff in Austria.

Similar to the Cancer Center project, we are also developing the upgrading of the facilities at the National Center for Maternity and Children's Health (NC-MCH).

How long do this projects run?

We like to call our value chain the life cycle for health care facilities. We start from project development and come via a turn-key realisation through our support for the financing by providing financing to the engineering. After the start-up phase and the operational management of the health care facility we enter a phase of reconstruction and refurbishment where the whole circle would start again.

All these services can be provided to one project but there are often situations where only parts of these services are provided.

In your opinion, what types of health care services are vital to Mongolia and why?

Looking at the current situation, the provisions for primary care has to be improved so that all people can be reached and provided with at least basic health care. Also, existing facilities need to be refurbished and upgraded so that the population can get diagnostics and adequate treatments for illnesses. With a reasonable, small amount of investment, the improvement of medical equipment would be significant and the quality can be increased a lot. That's why we are very passionate about the two projects, where for one diagnostics would be more reliable, less harmful to patients, and the treatment would be more effective.

Along with all this, the private facilities should be expanded so that people who can pay above their basic insurance level could stay in Mongolia for regular health checkups as well as diagnostics and treatment. If the private health care landscape improved, the whole system would develop to a better standard.

The next step for Mongolia will be to look into provisions for prevention, like checkups and also into rehabilitation.

As Vamed who has been in China for long time, what kinds of treatments are most popular there?

Vamed has been in China since 1985. China is much more diversified and it is difficult to make a general statement about it. We started to provide improvements to health care facilities, similar to what we plan to do in Mongolia, by upgrading medical equipment with loans from Austrian government. Cur-

rently there is strong emphasis on provisions for private health care facilities. This includes rehabilitation and senior living projects

Although it's not the vast majority of the Chinese population, but a significant portion of the young generation is unable to support the elder generation after retirement. Also the healthier portion of the population chooses professional nursing care during retirement.

Vamed projects are being realised with support from the Austrian government. What incentives does the government provide?

The Austrian government, over the past 30 years, has provided loans to the foreign governments of developing countries for projects in infrastructure and health care. The emphasis has been on development aid and, therefore, the start of repayment, the duration of repayments and the interest rate on these loans are very favorable. At the time when a country is developing to increase its GDP, this is a facility which is taken up by many countries around the world.

What are advantages of a soft loan for health care projects?

In addition, the Austrian government wants to ensure the positive outcome of these projects and select only companies which are capable of conducting these somewhat complex projects. Only with a reliable track record in the field of hospital care, medical equipment and training can a company qualify to conduct these programs.

What are the most essential criteria for medical technical infrastructure?

In principal we see four areas which need to be looked at and optimised to provide the best quality and economic health care services. This is the architectural part of the hospital which ensures a good work flow for patients, staff, and goods, as well as providing good hygiene.

Next the quality of the facility, like the mechanical, electrical and medical equipment, needs to be at an adequate standard. There is also the staff, including doctors, nurses and supporting personnel. Only with their professional capabilities a facility can be used as intended.

Last and for sure not least is the hospital management, who coordinates everything and everyone. If one or more of these components are not functioning well then the outcome is compromised.

What do you hope to achieve within health care in Mongolia.

We would like to be the preferred reliable partner in the Mongolian health sector. This shall be valid for government and private projects. ■

OPINION

SIGNS THAT MONGOLIA'S ECONOMY IS REGAINING STABILITY



JAN HANSEN
Senior Country Economist,
Asian Development Bank

Economic growth in developed countries is gradually strengthening, while emerging market economies are slowing down. Lowering of the growth targets by the People's Republic of China (PRC), softer than expected economic activity in India and concerns about the Federal Reserve's quantitative easing program have affected emerging economies' financial markets, including in Mongolia. Emerging markets are facing the dual challenges of financial market vulnerability in the short term and moderating growth over the medium term, but are nevertheless expected to continue to account for a major part of global economic growth. The fragile global economic outlook continues to create uncertainties for the Mongolian economy. This outlook for the global economy is based on the Asian Development Bank's 2013 Asian Development Outlook Update, published on October 2.

The advanced economies are finally showing signs of recovery, but the outlook remains uncertain. The US economy is expected to experience gradual growth, and the euro area recession seems to be ending. Japan began 2013 quite strongly after the introduction of its new economic policy, or "Abenom-

ics". In emerging economies across the world, financial volatility has intensified in response to the prospective unwinding of quantitative easing by the US Federal Reserve. Asian financial markets have come under pressure, with stock markets falling and currencies depreciating, most notably in India and Indonesia, but also in Mongolia. The current turbulences reflect reversals of earlier asset price increases and currency appreciation that partly resulted from large capital inflows following expansionary monetary policy in the US and the euro area in response to the global financial crisis.

Sound macroeconomic positions

Growth rates in emerging markets are projected to remain much above those of the advanced economies, but below the elevated levels seen in recent years. Macroeconomic positions of developing Asia are generally strong, as many regional economies run current account surpluses and hold large foreign exchange reserves which makes them well positioned to weather further financial turbulences that may occur

when the Federal Reserve begins winding back its quantitative easing programme in the coming months. Developing Asia's pace of growth is expected to remain broadly stable at around 6 percent in 2013 and 2014.

PRC shifts to moderate and sustainable growth

In the PRC, in line with government policies, growth is expected to moderate further (albeit marginally) to 7.6 percent in 2013 from 7.7 percent last year and to slow further to 7.4 percent next year as structural reforms will take time to gain traction. This compares to an average annual growth rate of about 10.5 percent over the past decade. The recent moderation of growth in the PRC stems from the authorities' policy of "rebalancing" to accomplish a medium-term transition to a more sustainable growth path, based on private consumption and improved social services, rather than led by exports and investment.

The PRC's more moderate growth rates and shift away from material-intensive growth pattern however has clear implications for the growth prospects »

¹ The ADO and the ADO Update - the flagship economic publication of the Asian Development Bank - provide a comprehensive analysis of economic performance for the past year and offers forecasts for the next 2 years for the 45 economies in Asia and Pacific which make up developing Asia.

▶ of Asia, in particular for commodity exporters, including Mongolia as the PRC absorbs almost all of Mongolia's exports (92.6 percent in 2012). International prices for coal and copper, Mongolia's major export commodities, have trended downward since early 2011. Copper prices have fallen by about 20 percent and the price for coking coal by about 35 percent.

Recovery of major developed countries strengthens

The major industrialised economies continue to recover, albeit slowly, with the group expected to grow by 0.9 percent in 2013 and 1.8 percent in 2014. Subdued demand from developed countries continues to hold back growth in developing Asia, including Mongolia. The biggest drag is still originating from the euro area which emerged from recession in the second quarter of 2013. While the hope now is that the second quarter will be confirmed as a turning point, recent mixed signals from various leading indicators keep down expectations for further pickup in economic activity in the second half of 2013. Euro area GDP is expected to fall by 0.5 percent this year and to increase by 1.2 percent next year. Fiscal burdens will continue to drag down growth, and credit will remain constrained in several euro area economies, reflecting high credit risk and unresolved balance sheet problems in the

banking sector.

The US has now seen several quarters of solid private demand, despite significant fiscal tightening. The economy expanded moderately in the first half of 2013 as private consumption, investment and exports picked up. Unemployment, while still relatively high, has been on the downtrend, and inflation has remained under 2 percent, allowing monetary policy to remain accommodative. The Federal Reserve is widely expected to have put off scaling down of quantitative easing until early next year. Economic growth is expected at 1.7 percent in 2013 and 2.4 percent next year.

The Japanese economy is enjoying a vigorous rebound, boosted by a package of expansionary fiscal and monetary reforms or "Abenomics" and is expected to expand by 1.9 percent in 2013 before moderating to 1.4 percent next year due to tighter fiscal policy.

Global financial unrest hits Mongolia

Economic growth in the first half of 2013 was 11.3 percent year on year, down from a revised 12.4 percent in 2012, because of a lowering of the growth target in the PRC and falling commodity prices. Agriculture was the main driver of growth, increasing by 20.6 percent, while mining output fell by 18.5 percent.

In line with currencies of other emerging markets, the Mongolian tugrug has depreciated significantly since the beginning of the third quarter, in combi-

nation with substantial losses of foreign exchanges (FX) reserves, reflecting a deficit in the balance-of-payment (BOP). FX reserves fell by USD 1.4 billion to USD 2.7 billion so far this year, but remain at a comfortable level corresponding to four to five months of imports. The tugrug slid by 17.3 percent against the US dollar from early July and by 22 percent since the beginning of the year

Outlook expected to improve despite FDI falls

External trade continued to slow in 2013. The value of merchandise exports (mainly minerals) fell by 4.1 percent and imports by 8 percent during the period January to September 2013 compared to the same period in 2012. Exports of copper concentrate increased by 8.4 percent, but those of coal plunged by 44.8 percent as demand in the PRC waned. The current account deficit (32.6 percent of GDP in 2012) increased by 2.3 percent to USD 2.4 billion during the January-August 2013 period year-on-year. Exports however, are expected to pick up significantly, following the start of commercial production at the Oyu Tolgoi copper and gold mine in July, while imports of in particular consumption goods will be further kept down by the tugrug depreciation.

FDI plunged by 46.8 percent during the period January to August 2013 because of uncertainties arising from changes to the legislation governing it, a lowering of the growth target in the PRC, and the completion of the first phase of the Oyu Tolgoi mine which made up a significant part of FDI inflows in the past two years. The outlook for FDI is expected to improve with the enactment of a new Investment Law which is replacing the Strategic Entities Foreign Investment Law. In summary, a pick-up in exports, contained imports and some recovery in FDI are expected to start relieving pressure on the BOP.

Budget deficit falls, while off-budget spending grows

Fiscal policy in 2012 continued to be pro-cyclical, with the overall cash budget deficit rising to 8.3 percent of GDP from ▶▶



4.8 percent in 2011² and the structural budget deficit rising to 8.9 percent from 6.9 percent in 2011. This year Government revenue increased by 13.2 percent during the first nine months year on year, mainly because lower mining prices and output reduced royalty and tax receipts. Revenue shortages and implementation challenges tamped down public investment, keeping government expenditure flat. The budget deficit was MNT 93 billion, in September a fraction of the MNT 531 billion shortfall in 2012, but it excludes off-budget expenditure of about USD 1 billion financed by the Development Bank of Mongolia. The proposed supplementary budget for 2013 cuts the revenue estimate by MNT 1 trillion to MNT 6.3 trillion and expenditure by MNT 800 billion to MNT 6.6 trillion.

Credit growth and tugrug depreciation trigger inflationary pressure

Liquidity injections by the Bank of Mongolia, mainly through implementation of the price stabilisation program are often regarded as contributing factors to the recent currency depreciation by increasing the supply of tugrug in circulation. Bank lending to the general public increased by 35.8 percent during the first nine months of 2013 and 48 percent in September. While consumer inflation slowed to 10.1 percent year on year in the first nine months of 2013 from 14.2 percent a year earlier, inflation picked up again in August, rising to 9.9 percent in September from 8.3 percent in July. Economic policy needs to stay vigilant to ensure that inflation remains in single digits.

Signs that Mongolia's economy is regaining stability

With the modest global recovery and the recent start of commercial production at the Oyu Tolgoi mine, economic

growth is projected at 12 percent in 2013 and 13 percent in 2014. In accordance with the above mentioned positive developments (i.e., improved economic performance; expected reductions in

the current account deficit; strengthened investment climate, comfortable level of FX reserves and controlled depreciation), the Mongolian economy is expected to regain macroeconomic stability. ■

OYU TOLGOI

GOBI BENEFITS

BY B. ALTAI

All of Mongolia's 21 provinces need to be developed at the same speed as Ulaanbaatar. The distribution of development throughout Mongolia has been quite varied. There is wide disparity between the city and rural areas in the development of areas such as living standards, employment, education and health. Those who live and work outside the capital suffer physically and spiritually.

In the remote provinces and towns throughout the country, development is strongly staggered. The lack of opportunities forces young people to migrate from the countryside to the city. Rural towns have become sad places to live and the provinces have heavy unemployment.

Although the countryside has lagged behind the city in terms of development, Umnugobi province has been an exception. And the town of Khanbogd faces some of the greatest opportunities in the region.

September 18: Khanbogd hosted a special market event for the sale of produce for the first time this year.

Organised by the Governor's Office of Khanbogd, more than 100 business people from the towns of Khanbogd itself as well as Bayan-Ovoo, Mandalai, and Dalanzadgad came in for the event. The Gobiin Shim (translation: Gobi Benefits) programme was initiated by Oyu Tolgoi to contribute to local business. The programme has run since 2011, with participants selling their products for a total of over MNT 10 million each day the event is held.

September the 26th: Ivan Vella, vice president of procurement and infrastructure development at Oyu Tolgoi, signed a cooperation agreement with Kh. Nekhiit, chairman of the Citizens' Representative Khural of Khanbogd, and T. Buyan-Ulzii, Khanbogd's governor, for a series of development initiatives.

"This is our first agreement. In the future, I hope that a number of investment issues and other related problems will be resolved", said T. Buyan-Ulzii, governor of Khanbogd after the signing ceremony.

The agreement commits Oyu Tolgoi to providing financial support for projects including five kilometres ▶▶

² The structural budget balance represents what government revenues and expenditure would be if GDP were at its potential level.



Oyu Tolgoi signed a cooperation agreement with Khanbogd's governor's office

of paved road, a playground, and a waste-management system.

During the event officials announced the completion of construction to a 45-kilometre, 35-kilowatt electricity transmission line between Oyu Tolgoi and Khanbogd. Some of Khanbogd's households are already receiving electricity from the power lines.

October 2: It is quite rare for a rural town to have paved roads, especially in the remote Gobi. In addition to the five kilometres of road construction that has begun in Khanbod, last year Oyu Tolgoi built 10 kilometres of paved road in the town centre. The company leading road construction is state-owned Road Construction Equipments Leasing, which hired some eight local employees to do the work.

October 11 and 12: An experience exchange forum held at Oyu Tolgoi brought together local relations officers from various mining companies operating in Umnugobi. The meeting,

organised by the Regional Development and Social Performance Department at Oyu Tolgoi, had in attendance some 40 officers from the Mongolian National Mining Association, Erdenes Tavan Tolgoi, Energy Resource, Tavan Tolgoi, Umniiin Gobiin Els, Mongolyn Alt, Hunnu Coal, and Khuree Del. At the meeting's conclusion miners agreed to cooperate on local development and establishing an integrated network for those aims.

Competitiveness

This year the Economic Policy and Competitiveness Research Center has released its first report on the competitiveness of Mongolia's provinces. The report has four chapters on each province's economic strength, social governance, infrastructure, and business efficiency. Orkhon province leads the pack, according to the report, while Umnugobi placed second and Darkhan-Uul third.

To keep up with these frontrunners,

the report makes the following recommendations to the remaining provinces:

- infrastructure development, including the construction of roads;
- contributions to small and medium enterprises;
- active anti-corruption efforts and reduced bureaucracy;
- improvement of the health and education systems; and
- proper use of revenue generated from the mining industry.

A fourth of the urban population lives under the poverty line compared with a third in rural areas. The disparity in living conditions has encouraged the continuous migration of people from the countryside to the city. Currently, almost half of Mongolia's population lives in a mere 0.3 percent of Mongolia's territory, in the capital city of Ulaanbaatar. Data from the National Statistics Office shows that the registered population in Ulaanbaatar has exceeded 1.2 million.

Why is Ulaanbaatar the only choice? ■