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MONGOLIAN ECONOMY

SEPTEMBER 2016 №14 (116)

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FOUNDER, EDITOR-IN-CHIEF:
D. Bekhbayar / 9999-4248

FOUNDER, DEPUTY EDITOR:
I. Otgonjargal / 8800-6228

MARKETING MANAGER:
D. Barianjav / 9409-2904

EDITOR:
S. Otgontsetseg

ENGLISH EDITOR:
O. Tuvshin

TRANSLATOR:
B. Enkhmunkh

JOURNALISTS:
B. Enkhtsetseg
B. Uuriintuya
G.Orkhon
TS. Elbegsaikhan

DESIGNER:
Sh. Oyundari


Address:

Chingeltei district, 1st khoroo
Peace Avenue, Express Tower 1101
Ulaanbaatar, Mongolia

Central Post Office, P.O. Box 2762,
15160 Ulaanbaatar, Mongolia
URL: www.mongolianeconomy.mn
E-mail: info@mongolianeconomy.mn
Tel/Fax: 976 - 7011 5476

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Compromising with the truth

The truth is that balancing the budget is something the market has demanded for a long time now. *page 16*



Hello old friend

The tugrug has become the worst performing currency in August, plummeting to an all-time low of 2,200 per USD. *page 18*



Erdenes Mongol's renewed vision

The objective of Erdenes Mongol's Strategic Transformation Programme is to emulate [the Temasek Model] in Mongolia. *page 21*



Where does education reform begin?

Before 1990, the education sector received more investment than any other sector. *page 20*

Mongolia

Price of staple food products

As August 31, 2016, the price of staple foods decreased by seven percent compared to the previous month and 0.8 percent to the previous week.



Meat	Average Price	monthly % change	weekly
Mutton (with bone)	5070	-12.3	-1.4,
Beef	6375	-8.3	=
Beef steak meat	7900	-10.8	=
Horse meat	4405	-6.4	=
Goat meat	4505	-15.4	-8.9
Packed highest grade flour		-0.3	=
Packed high grade flour		+0.4	=
Packed grade II flour		+0.6	0.6
Unpacked grade I flour		=	=
Rice		+1.1	=
Sugar		+17.0	+6.3
Potato		-18.4	=
Carrot		-47.9	-17.4
Cabbage		-42.5	-1.4
Beet		-64.2	-10.3
Onion		-4.4	=

IMF ready to help

IMF spokesman Gerry Rice informed that the organisation is ready to assist Mongolia and that its experts came to Ulaanbaatar to discuss several issues with the new government in August. The IMF also established a new representative office in Mongolia. “We are observing Mongolia’s situation carefully. We are ready to support the government which is working to resolve the economic difficulties of Mongolia,” stated Rice.



Mortgage loans

This past July, commercial banks provided new mortgage loans of MNT 92.8 billion to around 1,600 borrowers. Outstanding mortgage loans reached MNT 3,856.3 billion, and the total number of borrowers reached approximately 85,000. Also in that month, 569 new borrowers were approved for five percent interest loans, with then-current 117 borrowers being allowed to switch to the lower interest rate loans. In July, commercial banks financed 20.7 percent of the outstanding mortgage loans, or MNT 800, billion from their own funds or sources.



The Minister of Construction and Urban Development, G.Munkhbayar, clarified that the state mortgage programme will continue. In addition, the possibility of reducing the interest rate on mortgage loans for rural areas down to five percent is being discussed. The minister relayed that continuing this programme will be one of the government’s main priorities. Experts are also looking into the possibility of changing the terms as well as raising the square-metage of homes covered by the five percent interest mortgage lending programme.

Lending

This past July, commercial banks provided a total of MNT 745 billion in loans. Total outstanding loans stand at MNT 12 trillion, of which MNT 9.3 trillion are tugrug-denominated. MNT 833 billion, or 6.9 percent, of total loans is classified as overdue. Out of that, MNT 431 billion, or 3.5 percent, is non-performing. The weighted average duration of total loans is 47.7 months and the annual interest rate is 16.6 percent. The highest reported interest rate was 42 percent, while the lowest was 3.8 percent.

Credit rating

Moody’s downgraded Mongolia’s sovereign credit rating from B2 to B3. Thus, Mongolia moves to the “speculative and high credit risk” category.

The agency’s key determiners for the downgrade were the fall in foreign exchange reserves, weakening liquidity of assets and high budget deficit.

According to the report published August 26, a review for further downgrading has been initiated and Mongolia’s credit rating may be cut again in the next 12-18 months. Furthermore, Moody’s experts estimated that Mongolia’s Government debt could rise to 71 percent of GDP in 2017. Government debt reached 63 percent of GDP in 2015.

On August 19, Standard & Poor’s and Fitch downgraded Mongolia’s long-term credit rating from B to B-. ■

World news

Dilma Rousseff ousted



Brazil's Federal Senate voted 61-20 on August 31 to remove President Dilma Rousseff from office, with Vice President Michel Temer being sworn in hours later. Temer will serve out the presidential term which ends on January 1, 2019.

The ordeal formally began on April 17, when the Chamber of Deputies (the lower house) voted to move forward with the impeachment process. Rousseff was found guilty by the Senate of breaking fiscal laws. More specifically, she was found guilty of moving funds between different government budgets, which is illegal in Brazil. Rousseff claims innocence and has called her impeachment and trial akin to a coup d'état, saying her enemies are ousting her from office so they do not have to wait for the next presidential election. Her detractors say she moved funds to offset deficits in popular social programmes to boost her chances of winning the 2014 election. Her removal from office marks an end to her 13 years as head of the left-wing Workers' Party.

Trudeau visits China



Canadian Prime Minister Justin Trudeau announced a new era in China-Canada relations during his first official visit. Chinese Premier Li Keqiang and Trudeau announced that the two countries will hold

annual meetings to discuss climate change, judicial training and gender equality, among other things. Meanwhile, Canada's Finance Minister Bill Morneau stated that Canada will apply to be a member of the China-backed Asian Infrastructure Development Bank, an institution which seeks to boost China's role in global finance. "Until now, the China-Canada relationship has somewhat lacked in stability and regularity," stated Trudeau. His father, former Canadian PM Pierre Trudeau, was one of the first Western leaders to establish diplomatic relations with communist China. The next stop for the Justin Trudeau will be to attend the G-20 summit in Hangzhou on September 4-5.

Smartphones for Pakistani Farmers



Starting from October, five million smartphones will be given to Pakistani farmers in order to improve knowledge of modern farming techniques, according to the chairman of the Punjab Information Technology Board Dr. Umar Saif. "The farmers will receive free alerts about the use of pesticides for their yields," he said. A similar project was implemented in India.

Apple back taxes

The European Commission ordered Apple to pay USD 1.5 billion in back taxes to Ireland, but Ireland says it does not want the money. Ireland was accused of giving favourable tax deals to Apple, which says it should not have to pay the sum. The European Commission is responsible for maintaining fairness between EU member states, and said that Ireland's preferential



tax treatment of Apple is illegal under EU law. Apple's on-paper subsidiary in Ireland, Apple Sales International, paid an effective tax rate of 0.0005 percent in 2014, according to the Commission. Ireland does not want to accept the money, because that would hurt Ireland's image as a country with low tax rates that are favourable for business. Ireland plans to appeal the ruling.

US-Cuba relations



The first commercial flight between the United States and Cuba took place on August 31. It is a landmark occasion in the process of the normalisation of relations between the two Cold War enemies. The flight was a short one, under an hour, from Fort Lauderdale, Florida to Santa Clara, Cuba. "This is just the beginning," said JetBlue CEO Robin Hayes. "I look forward to growing our service here in the years to come."

President Obama and Cuban President Raul Castro announced in December 2014 that the long-time foes would re-establish diplomatic relations. Since then, embassies have been reopened in Havana and Washington, DC, and US companies have signed business deals with Cuban counterparts. ■



Special report

J.Erdenebat's economic policy

BY I.OTGONJARGAL

The budget amendments are making experienced politicians of the ruling Mongolian People's Party (MPP) scratch their heads. Prime Minister J.Erdenebat, Finance Minister B.Choijilsuren and Majority Leader D.Khayankhyarvaa seem to be perplexed by their own party's quarreling and lack of unity.

Some MPs, led by Ch.Khurelbaatar, outright protested the submitted budget amendment proposals to raise taxes and cut wages of civil servants. Naturally, no one wants to see tax hikes in the midst of such dire economic straits. In addition, the Bank of Mongolia's (BoM) decision to sharply raise the policy interest rate to 15 percent will likely be damaging to the

private sector.

Furthermore, economists are concerned that the tighter fiscal and monetary policy will worsen an already sluggish economy. A significant portion of society agrees that the BoM as well as the government should administer a softer approach supportive of the private sector in the current situation. But on the other side, some politicians and the majority of citizens support the proposal to reduce the salary of the high-income class, raise taxes, reduce the number of civil servants and scale back welfare spending.

Although the government must conduct surgery on the economy in order to revitalise it, they have to put out the

house fire before tending to the wounds. They explain that there is no other way than to take tough action by raising taxes and reducing wages, which is true. It is always easy to criticise looking from the outside.

Over the last decade, previous governments always made optimistic forecasts regarding budget revenues, and budget expenditures were on average 20 percent higher than revenues, disregarding whether export revenues were rising or falling. This is how we got to where we are today.

The most worrying issue is that Mongolia must start paying loan interest payments starting from March of next year. In addition, there is an urgent need ▶

► to plug the budget deficit.

While the parliamentary quarrels carry on, our magazine looked into what policies the government intends to implement in the short, medium and long term.

Short term policy:

There are three issues that need to be urgently resolved: the budget, balance of payments and debt. The government has what they call a “special plan to overcome the crisis.” Of course, the first issue to resolve would be deciding whether to implement the IMF’s Stand-By Arrangement (SBA). The likelihood of implementing the IMF’s SBA is quite high after looking at recent foreign and domestic news. We have to keep in mind that the situation will worsen as time goes on.

Short term loans from international organisations generally have a term of 1-1.5 years. We have no right to waste time arguing whether it is appropriate to implement the SBA. What would have happened if Mongolia implemented this programme in 2015? Mongolia nearly did, but decided not to at the last minute, which some see as a mistake. It is not too late now. If we take the deal, at the very least it will give us some breathing room. If we apply the SBA at the start of next year, the state will start making payments in 2022. Also, the Oyu Tolgoi underground mine will start operating in 2021, and there would be little to worry about in repaying the IMF.

Medium term policy:

As for the medium term, the government will focus on keeping 2018 budget balanced, expanding the current tax base and supporting indebted sectors. The biggest issue is that Mongolia has to meet debt repayment obligations amounting to USD one billion in 2017 and again in 2018. This sum is not just government debt: it includes the debts of the Development Bank and external debts of the Mongolian Mining Corporation.

The government needs to address debt restructuring issues in the medium term. It is a critical issue that needs to be

We need to wean the economy from dependence on mining and commodity price cycles. The government would have to create a multi-pillar economy dependent on sectors such as mining, agriculture and manufacturing.

resolved independently of international organisations. In other words, it means to postpone payment of USD-denominated debts to 2022 from 2017. This is not unheard of when it comes to bonds.

The first option is to explain the current situation to the place where the bonds were raised. In this situation, the government will have to negotiate on interest rates. The interest rate will become higher as the repayment period gets postponed. Another option would be similar to the experience Mexico went through in the 90s. Mongolia would have to reach out to powerful economies such as Japan and Germany and exchange the due bonds with another long term bond programme with a maturity of more than 20 years. This is what we mean by debt restructuring.

Long-term policy:

The long term policy will also seek to resolve three issues. Firstly, economic diversification. We need to wean the economy from dependence on mining and commodity price cycles. The government would have to create a multi-pillar economy dependent on sectors such as mining, agriculture and manufacturing. We can learn from the Vietnamese experience of diversifying their economy and realising steady growth.

According to economists’ forecasts, Mongolia has the potential to experience 10 percent growth in 2021 and 2022. Before that happens, it would be more than alright if Mongolia can grow steadily at 4-6 percent.

The next issue to be resolved in the long-term is competitiveness and innovation. Mongolia will never develop just by importing obsolete equipment from China and used vehicles from South Korea. There would be a need to do something that inspires development. We must create something that can penetrate into international markets by 2020. Mongolia cannot duplicate technologies of other developed countries and cannot beat China or Taiwan price-wise. One area where this has true potential is in the agricultural sector, producing ecological products.

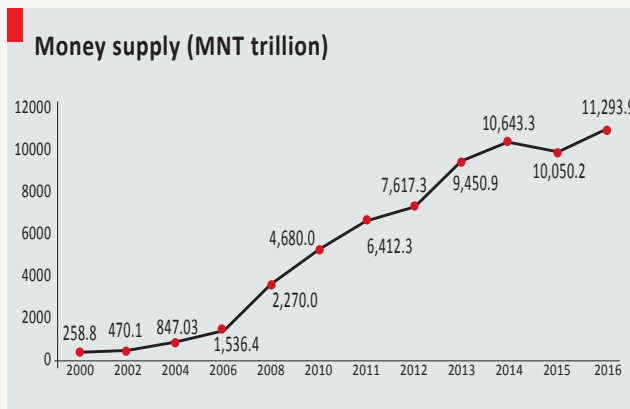
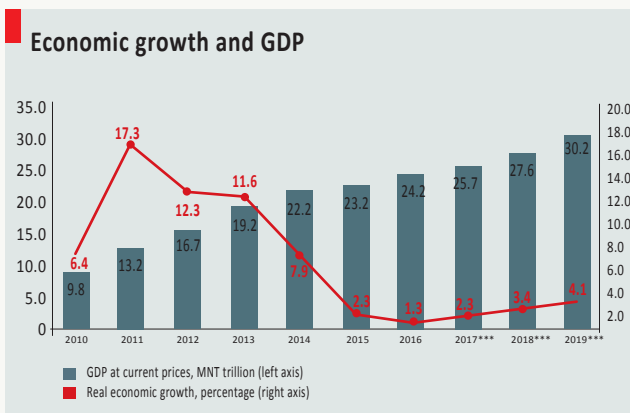
Thirdly, there is the issue of developing the future human capital of Mongolia. The government has to implement a state policy backed by science. The state cannot continue recklessly spending like it does today. Skilled personnel have certainly been developed over the past 20 years, but unfortunately, they remain in the shadows because they do not spout political rhetoric and make empty promises.

Given that the long term policy will have to go through more than two governments, Prime Minister J.Erdenebat’s government is responsible for developing the correct economic base today. There is opportunity out of defeat. Hopefully, the prime minister, an economist by trade, will use this opportunity wisely. His policy on taxes and wages are the weakest cards of his economic policy. He is going to have to make much tougher decisions in the midst of policy, budgetary and political debates. ■

Economic indicators

Finance Minister B.Choijilsuren’s statement on Mongolia’s current economic conditions

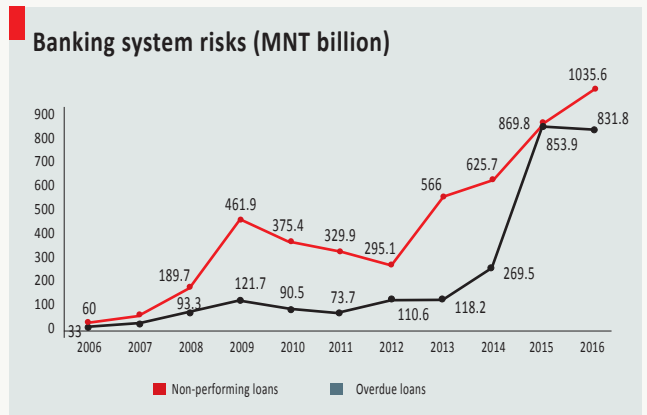
In July, Minister of Finance B.Choijilsuren delivered a televised speech to the public on socio-economic, budgetary and financial conditions. Below are some of the key points from his address.



From 2011-2013, cash in circulation increased by 18 percent, but began falling in 2014. As of February 2016, cash in circulation was MNT 655 billion, but it increased by MNT 183.7 billion, reaching MNT 839.2 billion within four months, creating a cash shortage and sudden cash increase in a short period of time.

RISKS IN THE BANKING SYSTEM:

As of the first six months of 2016, Mongolia’s domestic savings equalled MNT 7.9 trillion, while its debt stood at MNT 12 trillion. On the other hand, non-performing and overdue loans reached MNT 1.9 trillion, equal to 15.5 percent of all loans issued. The figure was 11.6 times higher than it was in 2011.



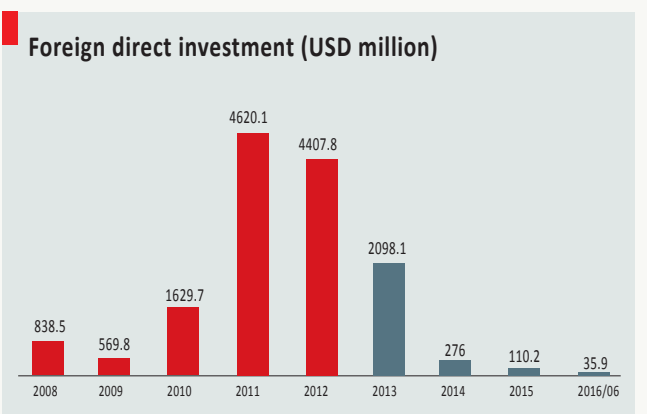
LOAN INTEREST RATES:

The average interest rate for MNT-denominated loans, which stood at 15.5 percent in 2011, rose by 5.7 percent, reaching 21.2 percent in June 2016. Risks in the banking system and interest rates for financial resources drawn by banks increased, following which, loan issuance is expected to decline and loan interest rates are expected to increase.

In order to mitigate rising loan interest rates, the cabinet and the Bank of Mongolia say they have no choice but to take out long-term and concessional loans from international organisations and partner countries.

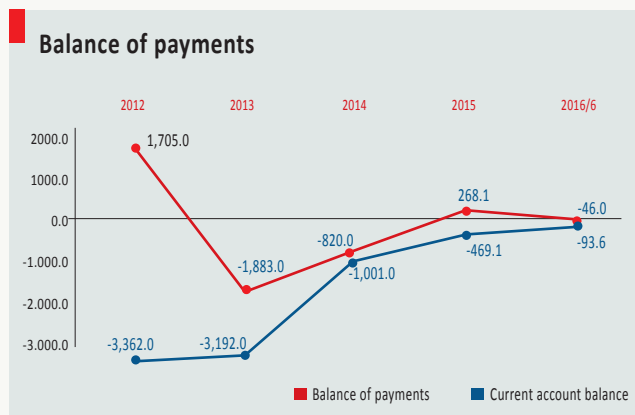
FOREIGN INVESTMENT:

In 2011, foreign direct investment (FDI) in Mongolia totalled USD 4.6 billion, but the figure has consistently fallen since then and reached USD 110 million in 2015. As of the first half of 2016, FDI dropped to USD 35 million. ▶



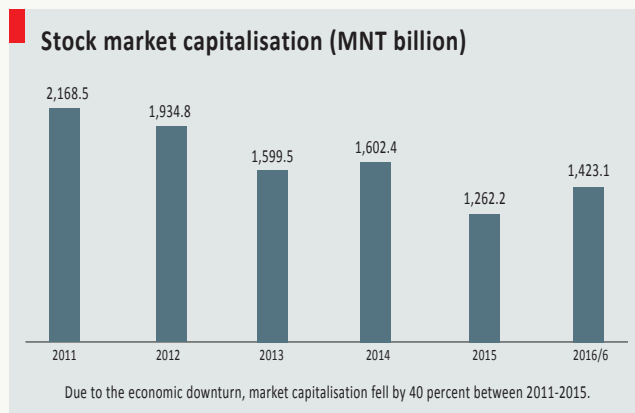
FOREIGN TRADE:

As of the end of 2015, Mongolia's foreign trade turnover dropped to USD 8.46 billion, down by USD 2.95 billion compared to 2011. As of the first half of 2016, exports amounted to USD 2.2 billion, and imports USD 1.5 billion, down by 13 percent compared to 2015.



FOREIGN CURRENCY RESERVES:

The nation's foreign currency reserves, which stood at USD 4.1 billion at the end of 2012, have consistently decreased over the past four years. As of June 2016, Mongolia's foreign currency reserves fell to USD 1.2 million. The new authorities at Bank of Mongolia reported that net foreign currency reserves dropped to USD -429 million.



TOTAL FOREIGN DEBT OF MONGOLIA – USD 23.5 BILLION

Government – USD 5 billion
 Bank of Mongolia – USD 1.8 billion
 Development bank of Mongolia – USD 1.6 billion
 Commercial banks – USD 1.9 billion
 Private sector – USD 2.1 billion
 Loans received from investors – USD 11.1 billion

STATE BUDGET:

Over the past three years, Mongolia's state budget revenues fell short by over MNT one trillion, and two or three amendments to the budget were made every year. The finance minister said that the great budget deficit Mongolia has consistently faced over the last four years has been due to the economic crisis and inefficiently spending taxpayer money.

The Law on Budget Sustainability states that budget deficits should not exceed four percent of GDP, or MNT 975 billion. However, as of the first seven months of 2016, the nation's budget deficit had already reached MNT two trillion.

Minister Chojjilsuren said that if Mongolia does not make amendments to the budget immediately and mitigate budget expenses, the nation's budget expenditure will reach MNT 10.3 trillion with 5.1 trillion in deficits by the end of 2016, which would exceed the nation's GDP by 21.1 percent.

UNBUDGETED GOVERNMENT EXPENDITURE

Under their "Good" programmes, the former cabinet approved the spending of nearly MNT 1.14 trillion, and issued MNT 553.8 billion to fund the programs, taking out MNT 596 billion in loans.

Mongolia's 2016 state budget expected performance (MNT billion)

Indicator	2016 (approved)	2016 (expected performance)	Difference
Net budget revenue	7,013.9	5,213.4	-1,800.5
Net budget expenditure	7,954.4	10,326.8	2,372.4
Budget balance	-940.5	-5,113.5	-4,172.8
Budget balance as a percentage of GDP	-3.4%	-21.1%	17.7%

The Law on Budget Sustainability states budget deficits should not exceed four percent of GDP. However, this year it is expected to reach 21.1 percent of GDP.

GOVERNMENT DEBT SERVICE:

According to preliminary budget performance reports, Mongolia paid MNT 37.2 billion in loan interest in 2011, but the figure rose to MNT 1.8 trillion in 2016, which was 29 times higher than interest payments made in 2012.

"Because the previous cabinet financed many projects and programmes through loans, pressure on the budget and debt ceilings have increased, following which, loan interest payment is expected to rapidly increase in the future. Mongolia is going to start repaying bonds in 2017. We warn that: because prices of mineral products have fallen on the international market; because Mongolia's foreign currency reserves are not sufficient; and because Mongolia's lowered credit rating, when the budget deficit is over MNT one trillion in 2016, it will be very difficult to meet bond repayment obligations," said B. Chojjilsuren. ▶

Budget revenue disruptions (MNT billion):

The previously approved 2016 state budget of MNT 7,013 trillion experienced a shortage (disruption) of MNT 1.8 trillion and is expected to be less than last year's budget by MNT 760 billion.

Cause	Income disruption
Falling prices of mineral products, exports decline	362.8
Imports decline	515.9
Economic conditions	397.3
Other	524.5
Total	1,800.5

Outstanding government debt (MNT billion)

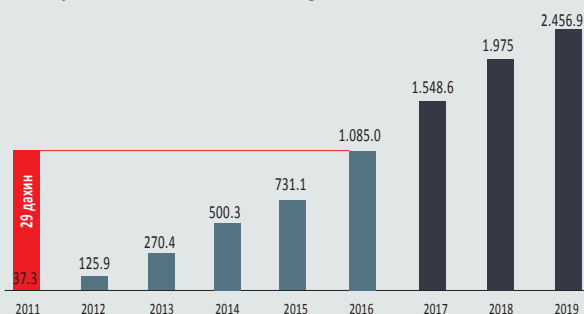
Indicator	2016 (approved)	2016 (expected performance)
Government debt (nominal)	17,310.8	21,284.4
Government debt (NPV)	15,174.4	18,913.6
Government debt (NPV) as a percentage of GDP	55%	78%

The Law on Budget Sustainability states that the net present value of government debt should not exceed 55 percent of GDP. However, government debt is expected to reach 78 percent of GDP by the expected budget performance of 2016. (calculated at the rate of USD 1 = MNT 2040)

GOVERNMENT DEBT:

Although the government debt was approved to be MNT 17.3 trillion this year, it is expected to reach MNT 21.3 trillion by the end of the year, which is equivalent to 78 percent of this year's forecasted GDP.

Interest rate payments for international and domestic loans paid from the state budget (MNT billion)



PROBLEMS ARISING FROM THE FINANCING OF STATE BUDGET EXPENDITURES:

“If we pay all of our debts in accordance with these graphs, and don't take out any additional loans, the government has only 1.3 trillion MNT to finance all of its operations. This is not sufficient to pay salaries to civil servants, and the cabinet would need 5.8 trillion MNT to conduct its operations,” the minister said.

Illegal financing not included in the state budget

When budget revenue fell short by MNT 1.8 trillion, the former cabinet raised budget expenditures by violating the Law on Budgets and other laws, increasing public debt.

Good property programme - MNT 300 billion
 Good herder programme - MNT 240 billion
 Good stock programme - MNT 495 billion
 Good student programme - MNT 100 billion

Total: MNT 1,135.0 billion

Of that amount, MNT 553.8 billion was issued

Because the previous government's financing of many projects and programmes through loans, pressure on the budget and the debt ceiling have been increased.

Challenges facing the financing of state budget expenditures (MNT billion)

	2016	2017	2018	2019
Budget revenue (not including grants revenue)	5,103.6	5,803.4	6,098.2	6,543.5
Loan service payments	3,973.0	6,197.4	6,236.4	5,337.4
Interest payments	1,085.0	1,548.6	1,975.0	2,456.9
Principal payments	2,888.0	4,648.8	4,261.4	2,880.5
Remaining sources	1,130.6	-394.0	-138.2	1,206.1
Required sources to finance the budget expenditures	-5,811.4	-7,938.7	-6,612.6	-5,202.7
Total -25,565.4				

Mongolian Economy magazine question

What needs to be done in order to improve the current economic situation?

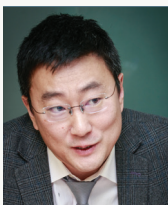
CH.KHASHCHULUUN (Economist):



I think more taxes will eventually bring negative side-effects. People will be more active in the shadow economy and the black market and will start hiding their income. Just recently the government was able to get something back from the shadow economy with quite a bit of difficulty, but we will go back to the previous situation again now. Why are we not using the resources that do not pay taxes at all? There would be nothing wrong with taking taxes from livestock owners, pine nuts businesses and merchants. Foreign tourists catch fish when they come to Mongolia. They can pay taxes. It would be correct to get creative on such things.

Of course we must work in order to compensate for the revenue and expenditure. For example, what would happen if thousands of people become unemployed, where will they go? Do we have any thoughts on that? What social welfare measures will be taken for those 20,000 people? Will the state conduct training and absorb them into other areas? We need to look from all the angles. Saving is good, but it cannot be purely mechanical. Economic policy should not be just an austerity policy.

B.ERDENEBAT (Economist):



People need to understand that our country will develop only if everyone strives towards it. In other words, construction manager A needs to compare today's work to his last year's productivity and increase it by X percent. Otherwise, we can increase the quality of a product by X percent. For example, a tailor brings growth by introducing new ideas and styles. As for civil servants, if they start to provide a service with X percent higher quality, accessibility and lower-costs, the economy will grow a certain percentage. So hypothetically, if everyone increased the performance of their works by five percent from the previous year, then the economy will grow by that percentage from the previous year. This year's economic growth is at 1.4 percent. So we would be able to estimate that economic growth will be 6.4 percent this year by adding the hypothetical five percent.

In addition, we need to have an end goal. Now everyone knows what people in other countries do by infusing scientific and technological processes into things. If we can

replicate that, the nation will develop much faster. Looking at the experiences of highly developed countries, they determine their goal and look for ways to reach the objective.

R.AMARJARGAL (former MP):



Frankly speaking, the dream scenario would be long-term foreign direct investment from third neighbours such as the UK, the US or Japan. As for short-term solutions, we must cooperate with our northern and southern neighbours. We need to allocate responsibility for tasks and determine the direction. Secondly, we need to regain investors' trust. Today, it seems like there is no desire to form trust. Are the professionals doing their job? Do they know what to do? Why are you being driven by politics? What is it you have planned for the future? Every Japanese investor that I have talked to says: "We want to invest in Mongolia; it is a beautiful country with lots of potential. However, your country needs only one thing: you need to make a contract with the IMF. If so, we will send everything we have." Investors from the US, the World Bank, Asian banks and all other investors are saying the same thing. Now when we try to reach out to China they say: "Of course we would support our neighbour, but the Asian Infrastructure Investment Bank has been established, so how about going through them?"

D.ANGAR (Economist):



- The majority of people are likely to oppose the tax hikes. However, people are misinformed. The tax policies introduced by the government are consistent with the MPP's platform. It is a left-wing policy that increases taxation. In other words, it is a system that takes more from higher-income groups and gives to lower-income groups. The high tax rates are set for high-income people and then distributed to the vulnerable class in form of pensions and welfare. It is a classic left-wing policy.

Two political parties have taken turns being in charge of Mongolia for the past 26 years. On paper, the Democratic Party has more right-wing ideology and the MPP more left-wing ideology. However, both of the parties have implemented leftist policies. For example, the DP has been implementing more leftist policies than the MPP. However, Prime Minister J.Erdenebat's tax policies are directed more towards luxury consumption. If we look at it more precisely, the taxes are increased for certain groups rather than across the board. ▶

► **B.MUNKHZAYA** (Provost at the Institute of Finance and Economics)



- I would say we are currently going through a transitional period seeing economic indicators with the past few years. Key economic indicators have shown a downward trend, but they have not reached disaster levels. Whether indicators go up or down is going to depend on the policies to be

implemented.

Personally, I don't think that we have reached such dangerous levels. Other countries have been in worse situations than this. If we compare the last decade of indicator movements to such nations, we are right in the middle. However, the worrying thing is that we are going downwards instead of upwards.

N.ENKHBAYAR (Economic policy adviser to the PM)



- There are several mistakes that occur during budget planning. For example, macroeconomic research must be conducted before planning budgets. The Bank of Mongolia must discuss the next year's and medium-term plans with the financial sector.

What we are seeing today is the result of inconsistent policies. Experts and researchers say that the necessary research before budget ratification tends to be incomplete, and international experts agree. No other country's parliament makes major principle changes to the draft budget submitted by the government during the approval process. There must be a requirement when submitting a budget: how monetary policy will be linked with external sectors must be reflected. Yet, none of our laws have such provisions.

In Mongolia, the budget approval process is regulated by the Law on Parliamentary Procedure. The budget gets discussed over four sessions. Voting takes place during the second and third sessions, and although there are some good proposals, many proposals that damage the budget have started to be put forth in recent times. The expenditures planned by the government rises due to those bad proposals. Therefore, we need to change the legal process of budget approval. In other words, the Law on Parliamentary Procedure must include exactly what those proposals may entail.

YOLANDA FERNANDEZ LOMMEN

Country Director, Mongolia Resident Mission
Asian Development Bank



The Mongolian economy is entering into a phase of adjustment following expansionary monetary and fiscal policies that have created fiscal stress largely from off-budget expenditures. Negative net foreign exchange reserves and large external debt repayments due in 2017-2018 exert pressure on the balance of payments. These trends are unfolding in the context of slowing economic growth triggered by adverse external factors, including low mineral prices and less economic dynamism in the People's Republic of China, Mongolia's main trading partner.

The new government has reacted swiftly to the challenges by undertaking policy actions to address the implications of the deteriorating outlook. An amended budget containing fiscal consolidation measures has been submitted to parliament. The central bank has raised the policy rate in August by 4.5 percentage points to 15.0 percent to arrest currency depreciation. A new Government Action Plan has been prepared focusing on short-term actions to arrest the major challenges combined with longer term strategies to support Mongolia's development needs.

Against this good start, a more comprehensive and systematic adjustment plan is needed. Determined policy actions are essential to contain the growing fiscal and balance of payments pressures and restore macro-economic stability. It would also be important to strengthen macro-prudential regulations to reduce systemic risk over time and across sectors.

The economic slowdown and the government's commitment to structural reforms underscore the importance of strengthening social protection in Mongolia. The economic adjustment plan could have a short-term contractionary effect. Reductions in the welfare budget will reverse poverty reduction gains by creating new poor and bringing those that crossed the poverty line back into poverty. Given the positive impact of social welfare programs on poverty reduction in Mongolia, continued support for them is vital during the economic adjustment.

Looking ahead, Mongolia's long-term prospects are promising. Large on-going mining projects are expected to turn the balance of the fiscal budget and the balance of payments into surpluses in the years ahead. While successfully managing this mineral wealth is a key for Mongolia's future, more is needed. Ensuring macroeconomic stability and making mining-led growth sustainable and inclusive are among the greatest development challenges, in addition to economic diversification and higher productivity growth.

Productivity growth is the key to long-term growth sustainability. International experiences suggest that climbing the value-added chain in the production process increases productivity and growth. However, as production becomes more sophisticated, the technical and vocational skills of the workforce are increasingly important as high literacy rates and universal primary education are necessary but not sufficient for countries to move up to higher income levels. Human capital development ►

► helps to absorb technology and knowledge. Higher education, and technical and vocational education and training should, therefore, be fully integrated in the country's development strategy and supported by public and private initiatives.

It is also critical to ensure equal opportunities, as imperfect access to education is an obstacle for the rural population to develop the skills demanded by economic progress and modernisation. In this regard, given the high labour-intensive nature of services and its employment generation potential, matching skills and opportunities in the service sector will help to absorb the rural-urban migration. This will, in turn, increase the living standards of the more than 800,000 migrants settled in the ger districts on the fringes of Ulaanbaatar.

Public and private initiatives should join efforts in this endeavour. International experience shows that the private sector is a fundamental engine of long-term growth. Greater public sector participation requires a favourable investment climate to attract both foreign and domestic private investment, an item that features prominently in the government's agenda. Moreover, private sector participation could be boosted by further developing public-private partnerships and widening companies' access to financial resources. The latter is particularly relevant to support small- and medium-sized enterprises' (SMEs) access to credit. SMEs in Mongolia, which generate most of the new employment opportunities and are critical to developing a vibrant services-based economy, need better support.

LEE CASHELL Founder and CEO, Asia Pacific Investment Partners



The Mongolian economy is currently very challenging. On the one hand with the commencement of phase two of the OT project, we should expect a reasonable recovery in the economy and increasing employment across a number of sectors. Unfortunately, however, the current government has inherited a large debt burden which has tied their hands and given them some difficult financial problems that need to be dealt with urgently. I feel therefore that we are at an inflection point and if the current government can come up with a good solution for the debt issues then we should be well on our way to a full recovery.

The most important thing that needs to be focused on is increasing the credit profile of the government. This can only be done by rapidly increasing revenues and decreasing expenses. Only doing one of these items by themselves simply will not be enough. In order to achieve this, the revenue generating parts of the government need to be enhanced. New taxes on services, alcohol, parking, importing, cars, hotels, income tax and most importantly tolls on roads need to be increased.

Many roads were built in a country that doesn't have a large population which means that collecting tolls will take a long time to payback these road construction projects. What amazes me is that the tolls collection has been given away to pensioners and the tolls are not high enough. I think these toll concessions need to be taken back from companies and

persons who have received them for one reason or another and put back into the hands of the government. Taking this lack of focus on revenue generation I feel the government needs more participation from the private sector. I would suggest doing revenue sharing schemes with landowners in the city. If all of the empty land was turned into government run parking lots taking fees for parking it would help with city finances in a quick and inexpensive way.

Also, foreign direct investment needs to be boosted immediately, and this cannot be done by just sitting here in Mongolia and expecting foreign investors to show up at the front door. The old Foreign Investment and Foreign Trade Organization needs to be rejuvenated and elevated to at least a deputy ministerial position if not a fully ministerial position and sit firmly under the Ministry of Finance. This organization needs funding and to cooperate with the Mongolian embassies around the world to engage in investment promotion in a persistent and determined effort.

There are many additional suggestions, but in summary, lower government expenditure and better revenue generating activities to increase the governments credit profile and ability to pay back all of the money it has borrowed over the last four or five years. Furthermore, increasing foreign investment will add a much needed boost to the recovery. These are the main fundamentals ways to get the economy back on track.

HARRIS KUPPERMAN Chairman and CEO
Mongolia Growth Group



The economy is clearly in a very difficult situation caused by the government's mistakes in scaring foreign investors and interfering with domestic businesses. This has been compounded by low commodity prices and high borrowing costs. I suspect that the economy will continue to deteriorate for at least another year or two, unless a number of mega-projects are fast-tracked and begin to move forward.

The government needs to take dramatic action to restart a number of stalled mega-projects that already have investors and funding. These include the Gatsuurt mine, Combined Heating and Thermal Power Plant 5 and even more importantly, the reinstatement of the prior agreement to bring an international consortium to mine the Erdenes Tavan Tolgoi deposit along with using local firms with expertise at that deposit. The previous government obstructed these projects from moving forward, which meant that Mongolia missed out on future growth, and now the country is paying the price. If these projects can move forward, other international firms will see that progress and also invest in Mongolia, starting a new positive trend – as opposed to the current trend of declining economic growth.

In the long term, Mongolia needs to create an image of a country that is a stable and attractive to invest in and do business. ■

Budget

Compromising with the truth

BY TS.BUYAN

Eggs can be considered luxurious consumption. Three years ago, anyone who said this would have been laughed at. Today, that statement does not sound so ridiculous anymore. With the current state of monetary policy, more and more people are being squeezed into cutting back on certain types of consumption that they can go without.

Quite resolute measures were reflected in draft amendments to this year's budget submitted to the parliament. In a nutshell, the state does not want "artificial" growth. The central bank will not supply money, investments will not be made from the budget, some taxes are to be increased, and the salaries and bonuses of higher-up civil servants as well as welfare benefits are to be cut. The truth is that balancing the budget is something the market has demanded for a long time now.

Economists had continually warned about the need to implement better fiscal discipline. However, there will be some difficulty and resistance. Cutting salaries and welfare spending never sounds good, but it sounds especially bad when the average family or individual is struggling to get by.

It is unlikely that citizens will support the decision to increase the personal income tax, savings interest income tax and excise taxes on vehicles, alcohol and tobacco. There will also be taxes imposed on apartments with an area of more than 150 square metres.

Unfortunately, it seems like there is no other way. Policy-makers claim that Mongolia would have no other choice than to declare bankruptcy if the nation chooses to fool itself for another year without accepting the cold hard truth.

If it could, the government would have approved the budget amendment



as it is without any changes. But it is impossible to predict the thoughts of the policy-makers in advance.

Proposals and requirements

The budget approval process of the Mongolian government features an oddity that most other nations do not have: the budget is developed by the proposals of the members of parliament. In other countries with parliamentary institutions, development of a budget is considered work for experts, with parliament having the power to approve or reject a proposed budget. There are instances of parliaments being dissolved because they could not agree on a proposed budget or sent a proposed budget back too many times. Yet, in Mongolia, parliament directly handles the budget.

This standard is related to the legal environment. According to the discussion procedures concerning the budget, MPs submit proposals starting from the second day of the session during a meeting of the standing committee. The budget gets changed mostly due

to proposals such as for the need to renovate the roof of a school in a rural area. In doing so, MPs do not even give experts a chance to give their thoughts.

Due to such an ill-fit standard, budget revenues have been forecasted to be 20 percent more than the amount that actually came in for the past many years. It is also why the budget gets amended several times a year and why

government debt reached today's levels. It is estimated that the government debt-to-GDP ratio will reach 81.3 percent by the end of the year.

The actual situation

In recent years, the budget's investment expenditures have been declining. Forget budget investments – the situation has become so severe that the salaries and pensions of civil servants are at jeopardy. Some state organisations fear being unable to pay for heating in the winter. According to the statement made by the Finance Minister B. Chojjilsuren, the budget deficit is expected to reach MNT four trillion.

The proposal developed to tackle these issues is designed to set a ceiling on civil servants' salaries, provide child benefit money depending on the household's standard of living, and to stop monthly stipends for college students. In addition, officials will not go abroad under assignments, pay their phone bills out of their own pocket, not buy any new furniture, not make office renovations and not have as many vehicles starting from next year. ▶

► MNT 558 million can be saved just by reducing the payroll of state executives. On top of this, there is a proposal on the table to reduce payroll funds by MNT 1.5 trillion by cutting the salaries of public administration officials. There are also plans to cut back on expenditures for assignments.

Moreover, cost cutting steps such as reducing pensions and sudden job loss benefits, equalising the salaries of judges with those of higher government officials and reducing bonuses and incentives are reflected in the draft budget.

However, the numbers still suggest all this is not going to be enough. The finance minister informed that approximately MNT 200 billion is being slashed by the budget amendments. This number seems tiny compared to the anticipated deficit of MNT four trillion. On the other hand, the opposition criticises that there is room for more cost savings. They say there is no need for deputy ministers, for instance.

In addition, expenditures are rising due to a one-time allowance for job cuts in relation to the reshuffling of ministries and agencies and creation of new positions. A total of MNT 3.4 billion is to be spent on 905 employees who are losing jobs as a result of the structural changes, and 496 new positions are expected to be created.

The issue of increasing the budget investment expenditure of MNT 500 billion on top of operating expenses was raised by Ch.Khurelbaatar MP. Finance Minister B.Choijilsuren answered that the government must fulfil payment obligations in relation to MNT 670 billion in works carried out under a promissory note agreement in 2014-2015. The government explained that they are adhering to a policy to fulfil the payment obligations within 2016-2017.

Mongolia's state budget deficit is expected to reach 18.2 percent of GDP, much higher than the four percent allowed by the Law on Budget Sustainability. However, the Government has openly expressed their intention to make amendments to the law, as there is no real possibility for the deficit to be brought under four percent.

This is simply how Mongolians solve problems. ■

Tax

Golden lessons

BY TS.BUNIA

This time around, amendments to the state budget are not just about addressing this year's issues, but also about determining the landscape of the budgets for the coming years. The issue of raising taxes still remains a hot topic. The government has to find a way to increase budget revenue, and it has no option other than increasing taxes, but it is facing tough opposition from the public as well as parliament. However, the most important question is "how?"

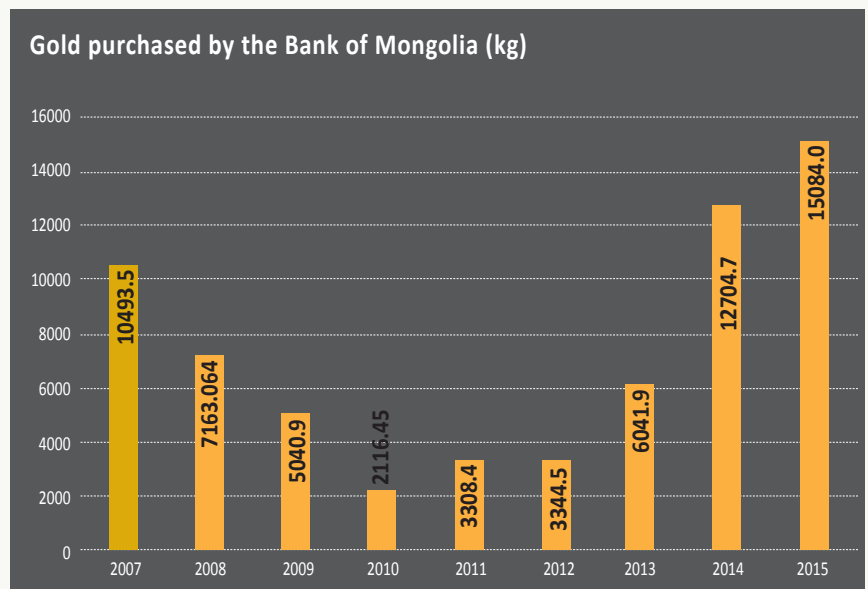
The need to raise taxes is unquestionable, but what taxes and by how much? Let's take a good look at gold. There is a proposal to increase mining royalty fees for gold starting next year, which raises the concern that the budget will stifle monetary policy again.

Gold has always been a key aspect of monetary policy, even though nations no longer adhere to a fixed gold standard. However, during its heyday, its main weakness was that a central bank had to increase its gold reserves in order to print money. After the World War I, the system came to its end, albeit briefly, as

central banks were not able to guarantee that all the bills in circulation could be backed by gold due to the economic damage of the war.

Near the end of World War II in 1944, the US dollar replaced gold after 730 representatives of the 44 Allied nations gathered in Bretton Woods, New Hampshire to establish the Bretton Woods system and usher in a new era of global finance. As for the dollar, it was backed by gold. However, US gold reserves could not completely back the US dollar reserves of other countries. Finally in 1971, the United States unilaterally terminated convertibility of the US dollar to gold, effectively bringing the Bretton Woods system to an end in what the history books call the Nixon Shock.

The weakness of today's system is the risk of losses in foreign trades due to exchange rate fluctuations. On the other hand, it is possible to realise profits from these fluctuations. Even so, gold still plays an important role in determining exchange rate. A country's currency ►



Source: The Bank of Mongolia

► exchange rate fluctuates depending on other exchange reserves on the market. As for gold, it is an important metal that brings currency reserves into markets.

In a nutshell, gold producers sell their gold to the Bank of Mongolia (BoM), and the BoM sells gold held in its reserves to increase their foreign exchange reserves. The more currency reserves there are, the more stable the domestic currency's exchange rate will be through intervention. Today, the BoM with its 1.8 tonnes of gold reserves ranks 98th in the world behind Haiti, according to World Gold Council rankings. The United States tops the list with 8,133.5 tonnes of gold reserves. That is equal to 76 percent of US foreign exchange reserves, while Mongolia's is 5.2 percent.

Looking from here, the BoM clearly needs to boost its gold reserves given that the proposed budget amendments include selling gold reserves. According to the current Law on Minerals, gold producers have a 50 percent exemption from mineral reserves usage fees and are 100 percent exempt from additional mineral charges until 2019. The government has found that they can add MNT 38.7 billion in revenue to the state budget by terminating this provision. It might help to plug the hole in the budget deficit counted in trillions, but it might create an even bigger hole in the market.

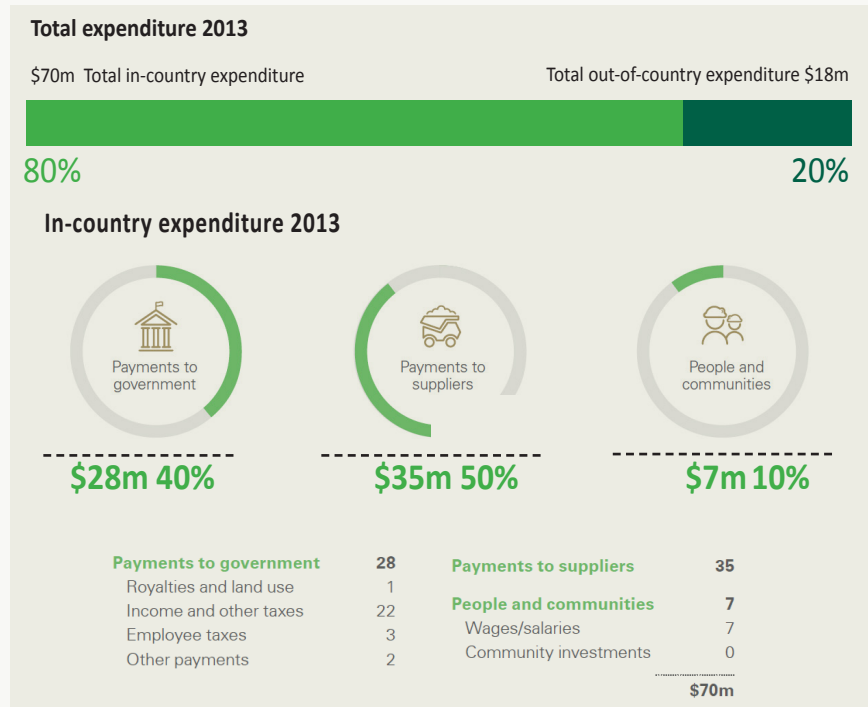
There is a reason why gold producers were exempted from these fees. Gold most strongly felt the negative effects of the 68 percent windfall profits tax. In 2006, 15 tonnes of gold was deposited at the BoM, while it fell to just two tonnes in 2010. However, gold extraction has not slowed. In other words, economists and researchers came to the conclusion that the gold went to the black market.

Although gold deposits have slowly recovered after the tax was done away with in 2011, only six tonnes have been deposited over a three year period. Thus, policymakers have decided to give the aforementioned discounts, considering underground trades have not been subdued enough. After the discounts were implemented, gold deposits doubled as the BoM purchased 12.7 tonnes of gold in 2014 and 15 tonnes in 2015.

Today, we may see history repeat. If parliament ratifies the government's proposal, gold producers will have to pay mineral resource usage fees and other additional payments starting from next year. As these payments are not considered taxes, they get deducted directly from sales income. Hence, such a change will affect businesses' profits greatly. On the other hand, G.Munkh-Erdene, a gold dealer at Golomt Bank,

warned that this move may cause companies to leave the gold business as their profits will fall in an already risky mining sector. There is the risk of many business shutting their doors indefinitely.

If history repeats itself due to all these reasons, the planned budget cannot be realised, the central bank will fall into a gold deficit, and there will be even less breathing space to implement monetary policy. ■



Standby

Hello old friend

BY TS.ELBEGSAIKHAN

Last year in February, a text message from the government of Mongolia was received on my phone as well as that of every citizen with a mobile phone. The message said: "Let's choose our development path together! 1. Determine the exchange rate by resolving Oyu Tolgoi and other major developments. 2. Determine the exchange rate by reducing consumption and expenditures to boost economic discipline."

Although it was far from a standard referendum, it was a new experience for the government which had never tried something like that before. The majority of responders chose option one: to move forward with OT and other major projects.

Looking back at the decision we made, there seems to have been little success, as nothing significant has been done to this day. The tugrug has become the worst performing currency in ►

- ▶ August, plummeting to an all-time low of 2,200 per USD. Investment has still not recovered.

The Tavan Tolgoi deposit's investment agreement, which was discussed around the same time as the referendum, has vanished into thin air. Now our only remaining hope is Oyu Tolgoi. At the time, people saw the first option as the easiest and most effective option.

Mongolia became acquainted with the International Monetary Fund's Stand-By Arrangement (SBA) about ten years ago. Today, the IMF is once again extending a helping hand. However, Mongolians do not have such a positive memory about the arrangement.

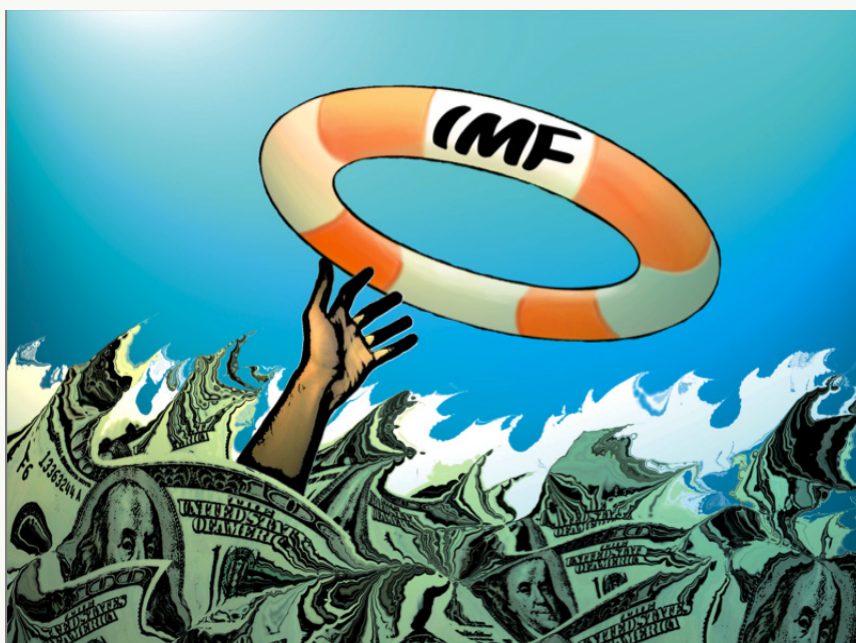
An economy growing at nine percent slowed to 1.3 percent growth in the year the arrangement began implementation. Mongolians started to negatively dub it as a programme that dries the economy.

At the same time when the government sent the SMS referendum to its citizens, the discussion on whether to implement the SBA was also heating up. But the government refused to take up the offer as the people chose to move forward with the mega projects. In addition, the Bank of Mongolia also wanted to implement policies independently.

The IMF is one of the main partners of developing countries. It is sometimes the last hope for countries such as Greece and Mongolia. The SBA provides low interest loans to unreliable borrowers. However, the arrangement's strict terms demand that the borrower tighten its monetary policy. In a nutshell, they get involved in internal matters of the borrower in order to ensure repayment of the risky loan.

In 2009, the IMF demanded that Mongolia get its balance of payments to equilibrium, implement prudent monetary policy, reduce the budget deficit's share of GDP and reduce loans. Let's look back at what it looked like back then.

The budget balance was MNT 300 billion, the balance of payments had a USD 232 million deficit, inflation was at its peak (nearly 30 percent), and the MNT reached 1,600 per USD from 1,100 in just half a year. At that time, the



high level of inflation was because of the depletion of foreign exchange reserves due to budget and balance of payments deficits as well as an increase in the USD exchange rate in a small market in which the majority of its consumption is satisfied through imports.

However, the truth is that the implementation of the SBA brought positive results as the balance of payments became healthier and foreign exchange reserves increased eight-fold by the end of 2012. Unfortunately, this success was overshadowed by an economic downturn, giving people the impression that the SBA was a destroyer of economies.

We need to correct this misunderstanding about the SBA. The IMF cannot work with every country using the same methods. Economist B.Tuvshintugs sees that the IMF will take different measures from the last time if Mongolia decides to take this deal. Economic conditions are much different from the way they were in 2009.

The GDP growth rate and inflation are at 1.4 and 0.9 percent, respectively. Tight monetary policy in a contracting economy will exacerbate the situation. The IMF knows all this, so the expectation is that it will supply money to the market and will implement supportive policies.

Why economists hold varying views about the SBA and why some are wary about the approach are not without

reason. Not every country that undertook the arrangement saw success. The most recent example is Greece, which is still in the midst of a financial crisis.

In 2005, Robert J. Barro and Jong Wha Lee published in *Journal of Monetary Economics* a paper titled "Who is Chosen and What are the Effects?" The research looked into the implementation and results of the Stand-By arrangement.

According to their conclusions, the higher the involvement of the IMF loan programme, the slower a nation's economic growth becomes. The higher the arrangement's investment is, the weaker the rule of law and democracy becomes. If states were not involved in the programme and worked things out on their own, their economy could have arguably come out better, according to their findings.

In any case, the national conversation on whether to accept the loan programme offered by the IMF is taking place for the second time within just a year. This time, however, the likelihood of taking the deal is much higher. Some economists did not deny that the hike in the policy interest rate to boost the MNT's exchange rate may have been done to satisfy the pre-conditions of the programme.

The dream that major projects will rescue the economy has vanished. Now, only the second option remains. Hello old friend. ■

Financial regulation

S.Davaasuren: Interests of investors must be protected

BY I.OTGON

Mongolian Economy magazine sat down with S.Davaasuren, Head of the Financial Regulatory Commission (FRC), to talk about the financial market development strategies and how to attract investment during this economic downturn.



- Business loans are likely to decrease due to the higher policy interest rate of the central bank. This may provide opportunities for major domestic companies interested in the stock market. In general, what strategies can be implemented in order to shield the financial markets during this crisis and overcome the crisis by changing today's single-pillar financial system?

- There is the need to develop and implement specific policies and programmes in order to overcome our present situation, develop the financial market in the long-term and enhance its role in the economy. Regarding capital markets, we believe that we have the internal resources and opportunities to boost market supply and demand. Supply tools – such as benchmark interest rates and trading of government bonds, shares of SOEs and companies owning strategic deposits through the stock exchange – can be utilised. We need to make securities markets friendly, open and active for citizens, and we need to instil confidence in foreign and domestic investors by creating a favourable tax environment for investors. In doing so, the market will expand by guaranteeing ownership rights, upgrading payment options to international standards, by developing custodian banks, professional mediation and dealer services and by

establishing an integrated infrastructure.

Most importantly, the interests of investors must be protected. We will prioritise improving corporate governance, creating a transparent information environment and establishing a system to reduce losses due to exchange rate fluctuations. In addition, we will shift to a risk-based inspection and monitoring system oriented to facilitating access to markets. In order to implement all of these, the legal status of the FRC and other relevant laws need to be amended, which is something we are currently working on.

- There is word that the potential to attract investment into Mongolia's capital market has been improved within the framework of the Law on Investment and other legal regulations. In relation to this, permissions to establish a couple investment funds have been granted. Are the investment funds ready to begin operations? How is the overall investment climate?

- Investment funds make up a new sub-sector in finance. Understanding about such organisations is relatively new not just for the public, but professional organisations as well. The FRC has approved rules and regulations within the Law on Investment Funds and is organising trainings for market participants and the public. As of today, about ten companies have received permissions to operate in investment management. However, only four companies have established investment funds, which was a bit disappointing. We are planning to do step-by-step works to promote the law and regulations and raise the awareness among the public in cooperation with relevant organisations.

- What will be done to improve the citizenry's level of financial education? The economic crisis could be exacerbated due to the poor economic and financial knowledge of the masses. As a professional economist and professor, what substantial measures can you take?

- Of course, financial institutions regulated by our committee and their customers all are our customers in a way. Our main objective is to create appropriate regulations for relations

between participants of the non-banking finance sector. There are mostly experts in finance and economics working at institutions regulated by our committee. We advise such organisations to practice good customer service and to teach and advise their customers. The number of savings and credit cooperative members has reached 41,000, policyholders of insurance companies around 600,000, clients of non-banking financial institutions 650,000, and shareholders and customers of securities companies have surpassed 850,000.

-Experts criticise that the 2016-2020 government action plan includes just one conventional sentence used by the previous government: "Will developed the capital market." There are expectations that the new government will come out with a plan to develop the capital market. What plans do you have regarding this?

- The capital market is directly dependent on economic growth and thus follows cycles looking at the current economic structure and developmental indicator trends. In 2011, the government updated the Mongolian Stock Exchange's (MSE) trade, savings and monitoring programme in accordance with international standards, and participation in Mongolia's stock market increased as a result of the free distribution of 1072 shares of Erdenes Tavan Togloi JSC to citizens. At the time, stocks of major mining companies rose sharply in value due to the high commodity prices on the global market and the increased interest of foreign investors.

However, the stock market's capitalisation, index and trading volume have fallen since 2012 as a direct result of the commodity price slump and sluggish economic growth. The committee will focus on developing policies surrounding the capital market to counter the cyclical nature of markets and coordinate it with fiscal and monetary policies.

The FRC has developed a plan to adjust the regulation system of the securities market and bring it up to international standards, restore confidence in the financial sector and create a fair and secure market.

- Some experts announced that they are uniting to establish an open stock market association as the question of privatising the MSE is unclear. What is your opinion on this matter?

- It is a good thing that a new, professional and open association is being established on the securities market. With the amendment of laws governing the sector in 2013, experts and regulated entities became able to voluntarily establish self-regulatory organisations. Our committee closely cooperates with professional stock and financial associations and will continue to do so in the future. ■

TECHNICAL ASSISTANCE PROJECT LOAN AGREEMENT SIGNING CEREMONY



Corporate governance

Erdenes Mongol's renewed vision

BY TS.BADRAL

The vision of Erdenes Mongol LLC, the parent company of Erdenes Oyu Tolgoi, Erdenes Tavan Tolgoi and state-owned coal mines such as Baganuur and Shivee Ovoo, is to become the Mongolian version of Temasek, Singapore's state-owned investment company and sovereign wealth fund.

Much needs to be done in order to realise this goal, and the company is working to implement its "Strategic Transformation Programme" developed in 2015 and expiring in 2017. There are high expectations of the programme as Erdenes Mongol is set to become a national investment company that works in accordance with business principles independently of politics.

A widely held view is that state-owned enterprises (SOEs) are notorious for poor management, large debt, always running under a deficit, corruption and nepotism. Many people believe that SOEs need to be privatised, as there is no worse manager than the state.

However, there are SOEs that

are very strong players in markets throughout the world. In particular, many countries' minerals sector and the oil and natural gas industry are completely state-managed or owned. In addition, almost all the major companies of China and Russia are state-owned and interact with Mongolia through one voice and policy.

Today, global trends are shifting. Although the state may not be the best manager, that does not mean it should not own any property. There is the trend where business experts take care of the business end while the state remains the owner. This model of corporate governance is epitomised by Singapore's Temasek Holdings.

The objective of Erdenes Mongol's Strategic Transformation Programme is to emulate this model in Mongolia and improve the corporate governance and efficiency of Mongolian SOEs. The one tasked with this ambitious undertaking is none other than B.Byambasaikhan, Executive Director of Erdenes Mongol.

It should be noted that this company has become Mongolia's largest enterprise and taxpayer today, providing more than 10,000 people with jobs. Between 2012 and 2015, the corporation contributed a total of MNT 1.8 trillion to the state budget in the form of taxes and fees. It is estimated that the company will contribute MNT 3.3 trillion to the state budget over the next six years.

One of the key changes expected from the reforms is high-skilled professionals being guaranteed jobs. "People are the most important resource," said Byambasaikhan. The primary objective is to provide citizens with jobs, increase employees' productivity and incomes and train internationally competitive Mongolian professionals. In the past, the company has launched practical tasks in training experts cooperating with many international organisations and corporations.

Making sure the benefits of the transformation reaches the citizenry as well as its staff is another important goal.

One big change seen relatively recently is the legal environment. In February of this year, parliament ratified amendments to the Law on the Human Development Fund, making it more in-line with the Law on Corporate Governance. Erdenes Mongol will not have special privileges over private companies and will compete on a level playing field with the private sector. ▶

► Furthermore, the company has started publicly announcing the selection of independent members of the board of directors. In order to further improve its governance, implement sensible management and become Mongolia's Temasek, the company is implementing a guideline programme of the International Finance Corporation as well as a technical assistance project with the Asian Development Bank. After implementation, the company will create an integrated management system covering financial management, supply, investment and project management.

Audited financial statements are required in order to attract investment and financing from international markets. The auditor firm must be reputable and trustworthy. Erdenes Mongol LLC and its subsidiaries were audited by one of the world's four largest auditing firms, Ernst and Young. By doing so, the company was able to introduce international financial reporting standards as a corporation and began preparing reports in multiple languages.

On top of securing financing for the OT underground mine project, the company has established partnerships with international investors, lenders and businesses. B.Byambasaikhan mentioned that they are worked with representatives of more than 50 organisations, including 20 investment banks and financial institutions, in establishing the underground mine's financing agreement.

The strategic transformation has already begun and is going well so far. Shivee Ovoo JSC, which had operated in the red for many years, has worked profitably for the past two years: MNT 1.7 trillion in 2014 and MNT 580 million in 2015. The company has even begun distributing dividends to its shareholders. It happened only after a newly organised board of directors and management stepped in.

The strategic transformation will enable the company to maintain its position as the biggest tax contributor and manager of a low-cost mining business. Further down the road, Erdenes Mongol LLC has the potential to implement major projects not only in mining, but can very well expand into infrastructure and energy. ■



Corporate governance

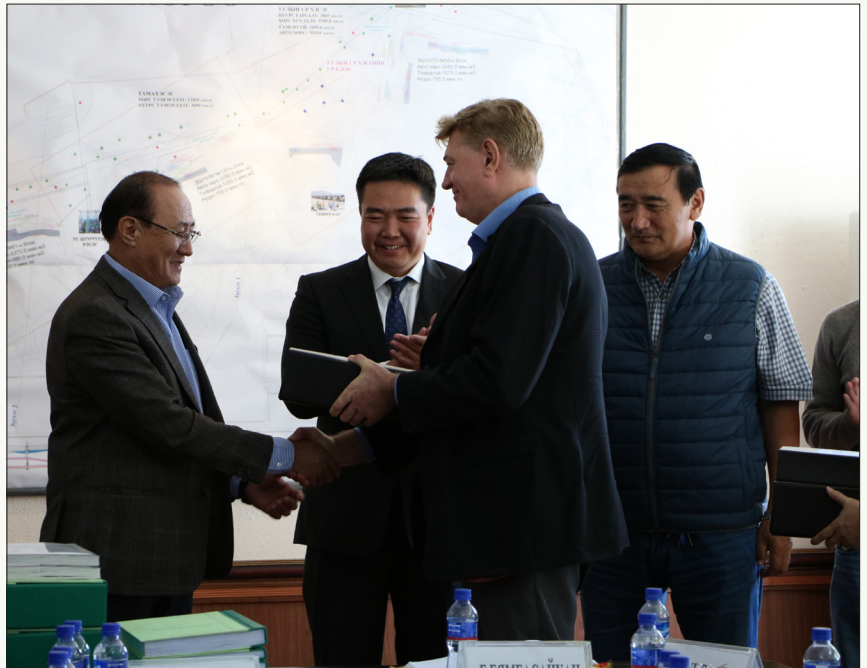
Baganuur mine: top marks on homework assignment

BY D.BEKHEE

The time for the Baganuur mine to step onto the international arena has come, as the fundraising document of the company is now ready. The technical and economic feasibility study to attract global investment and offer proposals to investors has been completed. Over the past two years, the company conducted additional geological surveys and explorations and increased their coal reserves by 274 million tonnes. Now the Minerals Council has recorded the mine's total reserves at 812 million tonnes. If the mine can operate for approximately 60 years (according to estimates) without

interruption, 10 million tonnes of coal can be extracted annually.

The Baganuur mine is Mongolia's largest coal mine and supplies about 60 percent of total domestic consumption. The first feasibility study of the deposit was developed by the Giproskhakt Institute of the Soviet Union about 40 years ago, while a consortium made up of Australia's Runge Pincock Minarco and Mongolia's Bal Chuluu LLC developed the new feasibility study this time around. Issue concerning the mine's expansion, increase of reserves and operational period have much significance as Mongolia's energy consumption is ►



► increasing year by year. Coal miners and the entire energy sector are more than glad about an additional 60 years of operation during this period when establishment of new power stations and sources are being discussed. Expansion, modernisation and investment into the mine will proceed in accordance with

international standards, representing the beginning of new era for Mongolia’s mining sector.

The exploration and feasibility study of Mongolia’s largest coal mine was developed in accordance with international standards. In addition, a globally respected auditing firm handles the company’s financial reporting. By doing so, the investment proposal for the mine’s expansion and modernisation can be offered to international investors. “We have done our homework in accordance with international standards. Now the work to raise mining investment remains

to be completed by Erdenes Mongol LLC,” stated CEO B.Byambasaikhan. Erdenes Mongol is the parent company of Baganuur JSC and is working to strengthen corporate governance at the company. A handover ceremony was held at Baganuur mine where the Executive Director of Baganuur JSC, M.Otgonbayar, thanked the World Bank, Baganuur JSC’s staff and foreign and domestic companies that developed the feasibility study.

According to the new feasibility study, it is estimated that USD 160 million will be required for the expansion. B.Byambasaikhan said that this sum will be raised from the global market within the coming years. Today, the mine is capable of producing 3.8 million tonnes per year, while it will be able to produce up to 10 million tonnes per year after the expansion.

Baganuur District in Ulaanbatar has population of 30,000. Many of the residents work at the mine, and many more are affected directly. Approximately 1,000 people work at the Baganuur mine, and the company plans to hire 300 additional personnel, according to the new feasibility study. This major player in the Mongolian energy sector produced its 100 millionth tonne of coal last year and has determined its next half-century of plans and goals. ■





Education

Where does education reform begin?

BY S. OTGONTSETSEG

Schools across the nation held welcome ceremonies to kick off the 2016-17 school year on September 1. This academic year also marks the first year of the new government's 2016-2020 programme set forth by the Mongolian People's Party (MPP), which includes reforms on education.

In terms of the new government's reforms, responsibility of the sports sector was transferred to the Ministry of Education. In fact, the new Minister of Education, Culture, Science and Sports (MECSS) J. Batsuuri informed that the ministry will focus on two areas in particular:

Firstly, refraining from raising university tuitions during these times of economic crisis.

Secondly, increasing accessibility to kindergartens.

Mongolia is a country of young people. As the majority of the population is youths, early childhood education is a vital issue. The minister is giving special attention to the overcrowded kindergartens of the capital. Rural areas with a sparse population density do not face this problem.

The increasing child birth rate, excessive migration to the capital city and

growth of new, poorly-planned micro-districts are the main reasons behind the shortage of kindergarten space. Even though today public kindergartens' class sizes are already over capacity, there are still around 43,000 children who are unable to attend kindergarten.

Although the public had positive expectations of the new government's resolutions on the issue, 80 percent of new kindergarten students were selected by lottery, just as they were last year, which leaves parents hoping to get lucky in the lottery or having to consider private, overpriced kindergartens.

In the 2016-17 academic year, the government planned to raise nationwide enrolment in pre-school education to 79 percent and elementary and secondary education to 97 percent. As of this academic year, a total of 1,288 kindergartens will operate nationwide, with about a third of them being private. In total, approximately 62,000 thousand children will enrol in pre-school education.

This year, 39 new kindergartens, 22 schools, five kindergarten-elementary school complexes, six sports facilities and eight dormitories will be commissioned, and another 34 buildings of kindergartens, schools, complexes and sports facilities

will be renovated. The government is also instituting a policy such that any new residential apartment complexes have to resolve kindergarten and school issues in their proposals.

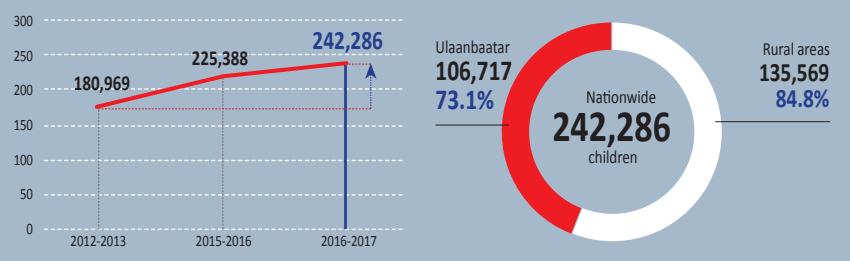
According to estimates, 69,100 children are entering first grade this year, which is a 7.7 percent increase from the previous year. It is evident that there is a necessity to increase the capacity of schools and kindergartens every year.

"This year, a total of 768 public and private schools will receive half a million students," said Minister Batsuuri. "The buildings of many current schools were built between 1950-1960, so many of them were taken down, making 1.2 percent of the total students, or 6,300 students comprising 24 schools, have no choice other than going to classes in the late afternoons and evenings. We will focus on constructing schools and dormitories over the next four years. Twenty schools are going to be built with funds from a donation by China, and the construction works of the first seven schools have begun in Ulaanbaatar. In the future, we will maintain classroom size standards and will work to return two shifts (morning and afternoon). This issue was submitted to be reflected in the new government's action plan."

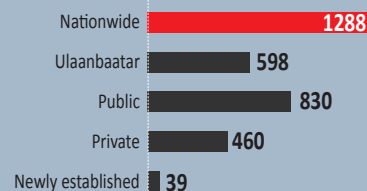
During the past four years in power, the Democratic Party implemented several programmes, introduced an integrated education sector electronic information system and changed the transformed the concept behind schooling from studying to learning. Minister Batsuuri stated: "We will strengthen the progress created so far and will fix and improve its errors. The structure, system and organisation of our education system are similar to those of global standards. We have transferred the secondary school system to 12 years, adhering to the global standard. Naturally, schooling should still be consistent with Mongolia's unique features."

A country's approach to its education sector can be determined by how much funding the sector receives as a percentage of state investment. This indicator is more than 30 percent in the world's most developed countries. Before 1990, the education sector received more investment than any other and was in special care of the state as it accounted for 25 percent of the state budget and 64 percent of GNP. But during transition to a market economy, vital aspects of social sectors were left behind, and investment in education plummeted. ▶

The number of children attending pre-school education (nationwide)



Number of kindergartens to operate this academic year



► Education researchers have confirmed that “Although governments of the last 25 years would seem like they administered policies that are competition supportive and of international standards on one hand, on the other hand, the policies were fickle. They were nothing more than declarations and election populism.”

They have warned in their research: “Therefore, experts of this sector must actively take part in the parties’ processes of action plan development based on substantial assessments and research in the future.”

Mongolians, once proud of being a nation with a 100 percent literacy rate that focuses on all levels of education access until recently, have now begun to emphasise quality of education and its benefits to society.

“Today, the main indicator measuring development of the education system is the employment rate of graduates, their social status and whether their education and profession fosters financial security, rather than the amount of capital spent on the sector, its personnel and number of graduates,” education researchers reiterated.

Today, more than 100 universities and colleges are operating nationwide, and more than 40 thousand students enrol at these schools annually. But this year, 37,500 thousand new students enrolled at universities and colleges, with 22,000 being admitted from rural areas.

Although the decreasing higher education enrolment over the past two years is related to tuition hikes, education sector experts believe that the sector’s structure itself is ineffective. Experts criticised that higher education tuition levels are around MNT 900,000 to 2.6 million. The Ministry of Education ordered that they not be increased further, which in turn limits the independent operations of educational institutions and forces them to find revenue by admitting more students.

The number of pre-school age children in the capital city

144,000

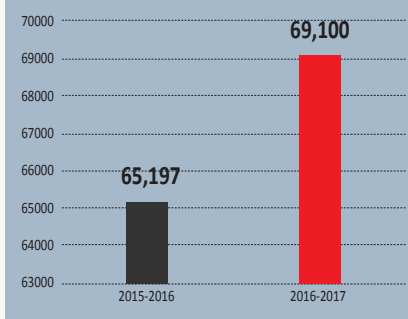
Attending kindergartens

106,717

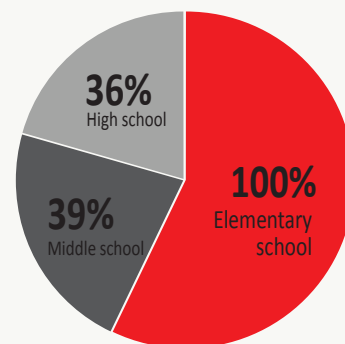
Not attending kindergartens

43,000

The number of children enrolled in first grade this year nationwide



How much of the learning materials are supplied by the state?



“Higher education is a sector in which it is impossible to reduce costs,” said B.Buynzaya, Secretary of the Consortium of Mongolian Universities and Colleges, during open discussion about education. “The value of higher education, the driving force of human and social development, will decrease if its expenditures can be lowered. University graduates account for 31 percent of the unemployed. In other words, it means a tenth of university graduates are unemployed. But this indicator does not reach double digits numbers internationally. Today, Mongolia has 101 universities and colleges and more than 170,000 students, which means that the education sector is in a glut.”

Today, schools have lower expenditures and higher income, develop more social and humanitarian sector

graduates rather than professional sectors such as engineering and technology, and the concept of threshold score has almost disappeared.

Technical and vocational training centres that prepare highly skilled workers, the true creators of wealth, have been left behind for some time. As the system that prepares teachers and professors itself is distorted, the “Core” programme is being implemented not only at middle schools, but also at universities and colleges that prepare teachers.

All in all, there is a dire need to harmonise market principles with national development policies and priorities in these times when the imbalance in labour market demand and oversupply in the education sector are being felt more and more throughout society. ■

Government

Meet the new government

BY S. OTGONTSETSEG

The Mongolian People's Party (MPP), having secured a landslide victory in the seventh parliamentary elections held on June 29, 2016, has been working at full composition since June 30. During the first session of

parliament held on 21 June, a bill on government structure and other relevant acts were approved, with the new government starting operations with 13 ministries and 16 ministers, including the prime minister.

STRUCTURE OF THE GOVERNMENT

No	Members of the Cabinet	Name
1.	Prime Minister	J.Erdenebat
2.	Deputy Prime Minister	U.Khurelsukh
3.	Head of the Cabinet Secretariat of the Government	J.Munkhbat
4.	Minister of Construction and Urban Development	G.Munkbayar
5.	Minister of Foreign Relations	Ts.Munkh-Orgil
6.	Minister of Justice and Domestic Affairs	S.Byambatsogt
7.	Minister of Finance	B.Choijilsuren
8.	Minister of Environment and Tourism	D.Oyunkhorol
9.	Minister of Labour and Social Welfare	N.Nomtoibayar
10.	Minister of Defense	B.Bat-Erdene
11.	Minister of Education, Culture, Science and Sports	J.Batsuuri
12.	Minister of Roads and Transportation	D.Ganbat
13.	Minister of Mining and Heavy Industry	Ts.Dashdorj
14.	Minister of Food, Agriculture and Light Industry	P.Sergelen
15.	Minister of Energy	P.Gankhuu
16.	Minister of Health	A.Tsogtsetseg

The new cabinet structure will consist of six principal ministries: the Ministry of Foreign Relations, Ministry of Finance, Ministry of Justice and Domestic Affairs, Ministry of Labour and Social Welfare and Ministry of Defense; and seven supporting ministries: the Ministry of Construction and Urban Development, Ministry of Education, Culture, Science and Sports, Ministry of Roads and Transportation, Ministry of Mining and Heavy Industry, Ministry of Food, Agriculture and Light Industry, Ministry of Energy and the Ministry of Health.

The new government's changes to the previous structure separated and consolidated certain ministries. For example, the former Ministry of Justice was changed to the Ministry of Justice and Domestic Affairs, the former Ministry of Labour and Ministry of Population Development and Social Welfare was consolidated to become the Ministry of Labour and Social Welfare and operates on a principal status.

As for the former Ministry of Infrastructure, it was separated into heavy and light industry, as the Ministry of Heavy Industry was consolidated with the Ministry of Mining. The Ministry of Food, Agriculture and Light Industry was established on the base of the former Ministry of Food and Agriculture, and its minister is now going to be responsible for light industry. In other words, the new government sees that the development policy of the mining industry, the key economic sector, must be consistent with the policy to industrialise and develop heavy industry.

In addition, the Ministry of Health and Sports was separated as its public physical activity culture and sports development function was transferred to the Ministry of Education, Culture and Science to become the Ministry of Education, Culture, Science and Sports. ▶

GOVERNMENT AGENCIES

► In accordance with the law on government structure, the new government decided to keep the number of government agencies unchanged with 27. Ten agencies are going to be regulatory agencies while the remaining 17 implementation bodies.

Some agencies whose operations were dependent on integrated administration were separated. For example, the National Authority for Children was changed to the Child and Youth Development Authority; the Customs and Taxation General Department was separated; the General Authority for Social Insurance was changed into the General Authority for Health and Social Insurance; the National Registration and Statistics Office was changed to the National

Statistics, Registration and Intellectual Property Office; the Petroleum Authority of Mongolia and Minerals Authority was consolidated to become the Minerals and Petroleum Authority; and the State Property Policy and Regulatory Authority was newly established. The Marshal Authority of Marshal, in charge of witness and victim protection among other things, was dissolved, and its duties were transferred to the National Police Department.

With this reshuffling, the new government believes they can eliminate agencies' overlap of functions, properly allocate resources and effectively ensure the development and implementation of policies. ■

No	Scope and jurisdiction	No	Regulatory agency	No	Implementation agency
1.	Within the jurisdiction of the Prime Minister	1.	General Intelligence Agency	1.	State Property Policy and Regulation Authority
		2.	Information and Communication Technology Authority		
		3.	National Development Authority		
2.	Within jurisdiction of the Deputy Prime Minister	4.	Professional Inspection Agency		
		5.	National Emergency Management Agency		
		6.	Authority for Fair Competition and Consumer Protection		
		7.	Agency for Standardisation and Metrology		
3.	Within the jurisdiction of the Head of the Cabinet Secretariat				
4.	Within the jurisdiction of the Minister of Environment and Tourism			2.	National Agency for Meteorology and Environmental Monitoring
5.	Within the jurisdiction of the Minister of Foreign Relations				
6.	Within the jurisdiction of the Minister of Finance			3.	Customs General Office
				4.	Taxation General Office
7.	Within the jurisdiction of the Minister of Justice and Domestic Affairs	8.	National Police Department	5.	State Registration and Intellectual Property Office
		9.	General Authority for Border Protection	6.	National Central Archives
8.	Within the jurisdiction of the Minister of Labour and Social Welfare			7.	Court Decisions Enforcement Agency
				8.	Immigration (Agency) of Mongolia
				9.	General Authority for Health and Social Insurance
9.	Within the jurisdiction of the Minister of Construction and Urban Development			10.	General Authority for Labour and General Welfare
				11.	Children and Youth Development Agency
10.	Within the jurisdiction of the Minister of Defence	10.	General Staff of the Mongolian Armed Forces	12.	Land Management, Geodesy and Cartography Agency
11.	Within the jurisdiction of the Minister of ECSS			13.	Authority of Physical Education and Sports
				14.	Arts and Culture Department
12.	Within the jurisdiction of the Minister of Roads and Transportation			15.	Civil Aviation Authority
13.	Within the jurisdiction of the Minister of Mining and Heavy Industry			16.	Minerals and Petroleum Authority
14.	Within the jurisdiction of the Minister of Food, Agriculture and Light Industry			17.	Department of Veterinary and Animal Breeding
15.	Within the jurisdiction of the Minister of Energy				
16.	Within the jurisdiction of the Minister of Health				