Country Analysis Mongolia

Transition from the Second to the Third World?

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PREFACE

This report has been commissioned by the Swedish International Development Cooperation Agency (Sida) as a background paper for its work on a country strategy for Swedish development cooperation with Mongolia.

The transformation of the Mongolian society in the 1990s has been remarkable. The focus of the report is on trying to understand the linkages between political, institutional, social and economic transformation and development in Mongolia.

The report also discusses Mongolia's development in a more long term time perspective and tries to address the issues of sustainable development.

The report was written by Per Ronnås, Ole Bruun and Li Narangoa at the Nordic Institute of Asian Studies (NIAS).

I hope that this study can add to the understanding of the situation in Mongolia and I hope the reader will find it of interest.

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Mongolia: Transition from the Second to the Third World?

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Study undertaken for Sida, Stockholm

Content

Executive Summary

The transformation of the Mongolian society in the 1990s has been nothing short of remarkable. Politically, Mongolia has broken with a 70 year legacy of totalitarian rule in international isolation to become one of the most open societies in Asia, with a good human rights record and steady development and consolidation of political pluralism and democracy. The achievements in the field of economic transformation have also been impressive. Because of its extreme dependency the Soviet Union for trade and subsidies, Mongolia faced the prospect of economic catastrophe when the Soviet Union collapsed. Yet, although the subsequent economic transformation has been painful, Mongolia has not experienced the same disastrous economic decline as many of the CIS countries did.

Following a few years of uncontrolled inflation and rapid economic decline, the economy has registered modest, but sustained growth since 1994 and inflation has been brought down to manageable levels. The economic recovery was facilitated by a rapid re-orientation of foreign trade. A comprehensive economic reform package launched in 1991 included price liberalisation, decollectivisation of agricultural collectives and a voucher-based privatisation scheme of state enterprises.

There are several reasons behind the comparative success of the Mongolian transformation. Most importantly, the political reform process has been smooth, swift and thorough. and there has been a broad-based consensus behind the comprehensive and far-reaching reform programme. Dissatisfaction with the role as Soviet colony and the perceived external threat from the south made the establishment of genuine sovereignty and independence extremely important and has no doubt played a role in the consensus behind reform as well as in the positive attitude of the international community towards Mongolia. Other favourable circumstances have been the abundance of natural resources, which cushioned the impact of the trade shock, near-self sufficiency with energy and timely and substantial ODA.

A decade into the transition it may be concluded that Mongolia has overcome the initial economic crisis. GDP is back at approximately 90 per cent of the pre-transition level and growing and a reasonable macro-economic stability has been secured. The public sector has also fared reasonably well, largely thanks to forceful reforms and timely and substantial ODA. Public sector revenue amounts to roughly a quarter of GDP. However, rapid erosion of the fiscal base in the early 1990s has had a severe effect on social sector spending. Discoveries of large oil reserves open the prospects for substantially improved revenues in the future, but also for the risk of Dutch disease. However, despite the overall positive picture there are several reasons for concern.

- The crisis in the financial sector, which emerged in 1995, continues more or less unabated and is a severe impediment to economic restructuring and recovery. In particular, sorely needed small and medium scale enterprise development and enterprise restructuring is hamstrung by lack of long term credits and extremely high real interest rates.
- An economic crisis in 1998 has highlighted the vulnerability of the economy and not least public sector revenue to volatility of the world market prices

for Mongolia's main export commodities, that is copper. This is a reality which Mongolia will have to learn to live with.

- There has been a disempowerment of local communities and a *de facto* centralisation of power as the local self-sufficiency and local responsibility for schools, primary health care and other local services traditionally provided by the collective farms have disappeared and have not been replaced by any other effective local mechanism for mobilisation of resources for common use. Local governments have due to lack of resources, legal room to manoeuvre and general shortage of capacity and competence been unable to fill the void left behind by the *negdels*. As a result, local autonomy has been eroded and local communities have become increasingly dependent on hand outs from the centre to cover the cost of basic social services.
- The twin evils of corruption and a commercialisation of the nomenclature, with senior government officials and their offspring figuring among the nouveau riche, are emerging as threats to a sound societal transformation. However, by CIS standards these phenomena are still not all that severe and a vigilant and vocal mass media serves as a useful watchdog.
- A severe deterioration of the accessibility and affordability of basic social services such as education and health care and a dismantling of the public social safety net is causing severe hardship to large groups of the population and is rapidly eroding the quality of the country's human resources. This has largely been due to the crisis in public sector financing, brought about by the general economic crisis and the need to put the fiscal sector on an entirely new footing.

However, arguably the most serious threat to the country's long term development is posed by the nature of economic development since the country's transition to a market economy. In particular, there are reason for concern with regard to (i) the sectoral composition of economic development, (ii) the capacity of the economy to generate employment and incomes, and (iii) the regional aspects of development. Economic development in the 1990s has had an increasingly narrow base and has been concentrated to extraction of natural resources (mining), animal husbandry and the (largely informal) services sector in Ulaanbaatar. All other economic sectors have contracted sharply and manufacturing has nearly collapsed. Thus, Mongolia is rapidly being de-industrialised and is attaining the characteristics of a typical resource-rich developing country. This development has extremely serious implications on the capacity of the economy to generate employment and incomes and to make use of the highly educated and skilled human resources base. Unemployment and under-employment is rampant and employment opportunities are increasingly confined to livestock herding and informal sector services in Ulaanbaatar. The rapid increase in poverty is largely, but not exclusively, a consequence of this development and it will not be possible to alleviate poverty unless this root cause is effectively addressed.

The dramatic deterioration in the fields of transport and communications and the virtual collapse of the economic base of most provincial centres is resulting in extreme spatial inequalities in economic development. Recent economic growth has been highly concentrated to Ulaanbaatar and a few adjacent centres, while most of the rest of the country is sliding back into primitive subsistence animal husbandry. The geographic disintegration of the economy and the increasing isolation of large parts of the country and of the population pose a severe threat not only to long term economic development, but also to territorial integrity and to the long term survival of Mongolia as an integral, independent and sovereign nation. Similarly, an economic development that economically and socially marginalises large segments of the population poses the probably most important threat to the remarkable achievements made in the development of an open, pluralistic and democratic society.

As the acute, initial transition problems are overcome, time has come to put Mongolia's development in a slightly more long term time perspective and to address the issues of ensuring an economically, socially and politically sustainable and desirable development. This will require a much stronger focus on fostering a geographically and sectorally broad-based economic development, viz. a development that encompases the entire population and that emphasises employment and income generation.

Mongolia

Mongolia is a newly independent, democratic country in Central Asia. During the period of Soviet dominance it was known as the People's Republic of Mongolia and earlier as Outer Mongolia as opposed to the still Chinese dominated Inner Mongolia. In 1990 the country was released from Soviet dominance, which had lasted for nearly 70 years, and embarked on an ambitious program of reform and openness. The old Revolutionary Party remained in power until 1996, however, when the new Democratic Union was elected into government.

Mongolia's geographical location in Central Asia, landlocked between China and Russia, and its steppe, mountain and desert ecology with a harsh climate have framed much of her history and culture. Even today, one third of her population are nomadic pastoralists and many more people own private livestock.

A huge territory of 1,566,500 sq. km. (more than three times the size of Sweden) and a population of merely 2.5 million still set the parameters for the country's development; the country is rich in resources measured per capita, but distances are huge and infrastructure is sparse. The average altitude is 1589 m above sea level and almost 90 per cent of the land area is either pasture or desert wasteland of varying usefulness, while 9 per cent is forested and only 1 per cent is arable. The administrative division of the country comprises 4 autonomous cities (Ulaanbaatar, Darkhan, Erdenet and Choir) and 18 *aimags* (provinces), which again are divided into a total of 336 sums (townships).

The Mongolian population consists of 85 per cent Mongols (predominantly Khalkha), 7 per cent Turkic groups (primarily Kazakhs), 4.6 per cent Tungusic people, and 3.4 per cent others, including Chinese and Russians. The main language is Khalkha Mongolian, spoken by over 90 per cent of the population. The state religion is Lamaist (Tibetan) Buddhism, while approximately 4 per cent of the population are Moslems. Under Soviet dominance, the Mongolian population was customarily denoted as an indigenous people in the West.

Today, approximately 30 per cent of the population live in the capital of Ulaanbaatar and another 7 per cent in the two nearby cities of Darkhan and Erdenet. After the country became independent, but at the same time lost Soviet financial support and skilled manpower, an economic downturn has driven a large number of people away from particularly the smaller towns, either into the capital area or out onto the steppe to become nomadic livestock herders.

Mongolia has a comparatively well-educated population, today dominated by the younger age groups as about three fourths of the total population are under age 30. The present birth rate is estimated at 2.7 per cent.

1. Review of Political, Institutional, Social and Economic Developments

Mongolia's struggle for an open democratic society followed the dissolution of Communist regimes in Eastern Europe. In early 1990 mass demonstrations in the central square of Ulaanbaatar called for an end to Communist rule - the Mongolian People's Revolutionary Party (MPRP) had ruled the country persistently since its formation in 1924. The old party responded tactically and refrained from the use of power. Inspired by Gorbachev's glasnost movement the Mongolian leadership had already for several years experimented with more open political discussions and had also taken a clear stand against the Stalinist repression in Mongolia during the 1930s to 60s. Also in the economic field attempts at restructuring had been made, for instance by introducing a private contract system in the herding collectives (*negdels*).

The outcome of the demonstrations was a gradual and peaceful transfer of power. Within the party a new generation of reformers took over and the Parliament amended the constitution to delete the MPRP's leading role in society and began to set up a range of new political institutions.

The Politburo of the MPRP resigned and a reformed party called for quick democratic elections already in the summer of 1990, giving the opposition very little time to organise. Six parties participated, however, most of which were rapidly formed. A bicameral parliament was introduced: the Great Hural consisted of members elected on a district basis and was put in charge of creating an interim government and drafting a new constitution - this body became dominated by local MPRP leaders. The Little Hural was an interim 50-seat house of parliament constituted by proportional representation (abolished in 1992). Here the new opposition gained 35 per cent of the seats, with the Mongolian Democratic Party getting 13 seats and the National Progress Party and Social Democratic Party each getting six seats. A national unity government was formed under MPRP leadership with many key positions granted to the opposition.

Much attention was paid to the drafting of a new constitution, particularly by the opposition, who feared a comeback by the conservative forces of the MPRP. Already in 1990 a 20-member constitutional drafting commission was set up, headed by President Ochirbat and including many prominent lawyers and representatives of all parties. Many international agencies provided advice on the construction of a new constitution, including the International Commission of Jurists, Amnesty International, The UN Human Rights Centre and the Asia Foundation. Despite lengthy debate, primarily concerning human rights provisions, the division of power between the two houses of parliament and between president and government, the new constitution was adopted by the Little Hural in 1992. The final draft adopted a system of government with five branches: the President, State Great Hural, the Government heading by the Prime Minister, a Supreme Court and a Constitutional Court - of these the President and the Constitutional Court were new institutions, which proved important defenders of liberal democracy and human rights.

Another issue that produced controversy already then and continues to do so is land ownership. Since pastoral nomadism has been the dominant way of life in Mongolia for centuries and the national identity is closely linked to nomadic culture and open landscapes, there is hard-headed opposition to any idea of private ownership of land, particularly in rural areas. But also private economic interests and fear of purchase of land by foreigners have led the land issue into a deadlock.

At the second election in 1992 the MPRP won 71 out of the 76 parliamentary seats with only 56 per cent of the popular vote. Due to the electoral system's division of the country into 26 districts, where the party with the most votes gained all of the two to four members in each district, the MPRP's power was unchallenged. The opposition formed the Democratic Union coalition just before the election, but remained divided, and originally based in the capital it was unable to gain a firm foothold in the countryside. The MPRP particularly appealed to all state-dependent groups in society and promoted itself as a reform oriented party taking social responsibility in the difficult transition to a market economy.

The 1992 election nevertheless did not put an end to the widespread frustration with the MPRP government. On the political front, the government was accused of manipulating the media and maintaining control over vital functions such as information dissemination, printing facilities, distribution networks, transportation facilities and so forth. On the economic front a galloping inflation, unfulfilled promises and continued decline undermined the MPRP credibility. Again in 1994 and 1995 a number of anti-MPRP demonstrations were staged at the central square, for instance demanding greater openness and removal of restrictions in the right to demonstrate.

The 1996 elections became a landslide victory for the opposition, equally stunning for both sides, particularly because the government shortly before had abandoned the proportional representation of 24 seats in parliament which had been introduced in a new law the year before. The Democratic Union coalition won 50 out of 76 seats and the victory marked a new era in Mongolian history as it terminated 70 years of MPRP rule. Not only new parties, but also a new generation of young professionals, inexperienced in politics, entered the new government under Prime Minister M. Enkhsaihan.

Since 1996, however, the further liberalisation of the economy, removal of import restrictions and banking reform have not had the promised effects and apart from a boom in consumer goods available in the capital, in real life the democratic government has effected little change. On the other hand, the openness and rife political debate in Mongolia today is probably unsurpassed in East and Central Asia.

The murder of the Minister of Infrastructure, S. Zorig, who was one of the leading figures in Mongolia's democratic breakthrough, in October 1998 rocked the entire nation. Many people feared a return to political repression and intimidation, but it is still untold whether the murder was politically motivated.

Low growth and rising unemployment in many parts of the country, along with a series of corruption scandals among government, MPs and state bank executives have shattered the illusions of real change under democratic rule; wide segments of the population have lost their faith in the Democratic Coalition. Even worse, continued frustration over the country's poor economic performance has driven many talented young people out of the country and many more wish to follow.

The last couple of years have seen a series of political crises, resulting in the rapid change of cabinets and even long periods of deadlock without acting government. Contradiction between the MPRP, holding the presidency, and the Democratic Union-dominated parliament as well as infighting among the coalition parties have ravaged politics. In particular, government has been hampered by the lack of a credible candidate for the premier, while an uncompromising tone in parliament not has made it easier. Since government (as also the President) has a four year term, the next parliamentary elections are due in the summer of 2000.

Mongolia's geopolitical situation obviously sets the terms for a number of issues in relation to the country's development, security and foreign policy. While relations with China are scarred by historical antagonism and Russia has played big brother since the 1920s, the modern Mongolian state has embarked on a policy of third neighbour-relations with the industrialized world, including Japan, Korea, Europe and the US, of which the latter is an increasingly important player on security issues. During this century the Mongolian nation has been lifted out of an Asian context to the effect that many Mongolians today regard their country as a kind of "European state in Asia".

Economic Transformation

For almost seventy years, from 1924 until 1991, Mongolia developed as an economic and political 'colony' of the Soviet Union. Its economy was closely integrated with that of the Soviet Union and, more importantly, socialist central planning was imposed on the country and the development strategy followed was virtually a blueprint of that of the Soviet Union. The means of production were brought under state or collective ownership, the economy was as far as possible subjected to central planning and there was an emphasis on the development of mining and heavy industry. The industrial sector was dominated by a small number of large scale and capital intensive plants, while the development of consumer goods industries and small and medium sized enterprises was neglected. Agriculture, including rearing of livestock, was collectivised and there was, as elsewhere, an attempt to develop crop production, in particular the cultivation of cereals, with a certain disdain for the constraints imposed by nature. The development strategy was also characterised by a focus on physical production targets and a disregard for relative prices and efficiency aspects.

In return for political and economic subservience to the Soviet Union, Mongolia received considerable assistance, consisting of grants, concessional loans and very cheap energy. The Soviet Union also provided much technical assistance and large numbers of Soviet and East European advisers worked in Mongolia.

Despite the idiosyncrasies inherent in the traditional Stalinist development model followed, the achievements made during the socialist period were in many regards quite respectable. Literacy was virtually eradicated and by the late 1980s Mongolia had a highly educated labour force. Similarly, health care and other social services were comparatively well developed. There was virtually full employment and little if any abject poverty. Strategic military interests lay behind large Soviet investments in the transport infrastructure, thus reducing the isolation imposed by distance on much of the country.

As elsewhere in the Soviet bloc, the reforms initiated by Gorbachov had profound effects on Mongolia. On the one hand, the economic relations between the two countries were put on a much less comfortable footing as Gorbachov made it clear that subsidies would be cut. On the other hand, Moscow's tight grip was loosened, thus creating space for economic and political reforms.

In July 1990, immediately after the first multi-party elections, the Mongolian government launched far-reaching reforms aimed at creating a market-based economy. At the same time, Mongolia suffered three acute external shocks: an aid shock, a trade shock and a macro-economic shock.[1] Financial assistance from the Soviet Union was reduced from 1,233 million USD in 1989 to zero in 1991.[2] This aid shock, which is estimated to have been equivalent to as much as 30 per cent of the GDP, had a dramatic effect on the external accounts as well as on the government budget. The aid shock was made worse by a severe trade shock. Until 1990 approximately 90 per cent of Mongolia's external trade was with the Soviet Bloc countries, primarily the Soviet Union. The implosion of the Soviet Union caused a near collapse of the trade. The problem was aggravated by the centrally planned nature of trade, which had resulted in a lack of horizontal contacts between trading enterprises. The combined effect of these two factors was a fall in imports from 2,016 million USD in 1989 to 402 million USD in 1993.[3] Exports, too, fell, albeit less dramatically, from 832 million USD to 385 million USD in the same period. The macro-economic shock was a combination of several factors: a macro-economic crisis resulting from the aid and trade shocks and an acute lack of economic expertise in the country. In the past Soviet advisers had provided much of the economic expertise, which, in any case, was woefully inadequate for dealing with macro-economic management problems in the context of a market economy. The introduction of world market prices created a fourth shock with severe long-terms implications for the economy. The structure of the entire economy as well as the choice of production technology in all fields had been based on the assumption of unlimited supply of virtually free energy. Thus, enterprises not only lost their markets, but their production technology was overnight rendered hopelessly uneconomic.

The reforms launched in 1991 had two main components: liberalisation of prices and markets, including foreign trade and factor markets, and privatisation of state enterprises and other state property. In the rural areas, the collectives were dismantled.

The first few years of the 1990s were characterised by considerable economic turmoil. Consumer prices increased 18 times between 1989 and 1993, with an inflation peak of 325 per cent in 1992. During the same period GDP fell by approximately 22 per cent.

The economy turned around in 1993/94 as GDP began to grow again at a steady although not very high rate. By 1998 GDP was back at 93 per cent of its 1989 level, although in per capita terms it was still some 20 per cent below the 1989 level (Table 1). Other economic indicators, too, improved substantially. Inflation was gradually brought down from 66 per cent in 1994 to 6 per cent in

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[1] Griffin (1995: 3-4).

[2] World Bank (1994: 20).

[3] The figures for 1989 should not be taken at face value as it refers to trade under central planning with arbitrary prices.

1998. The collapse of the external trade was halted and both exports and imports began gradually to increase again. The improvement in the foreign trade was intimately linked to an impressive re-orientation of the trade pattern. By 1998 Russia accounted for only 12 per cent of the exports and 31 per cent of the imports, while China, Switzerland, Japan and South Korea had emerged as major trading partners. A sharp increase in the trade deficit in 1998, due to a drastic decline in copper prices, does not alter the positive picture with regard to trade but underscores the vulnerability of the external sector to price fluctuations of key raw materials. The fiscal sector, too, has by and large developed satisfactorily. The fiscal deficit has been kept within manageable proportions, except in 1998 when a mini-crisis due to the fall in copper prices affected the budget. Yet, Government expenditures stand at a respectable 37 per cent of GDP.

Table 1
Development of GDP

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
GDP										
Annual change %		-2.5	-9.2	-9.5	-3.0	2.3	6.3	2.4	4.0	3.5
Index: 1989=100	100	97.5	88.5	80.1	77.7	79.4	84.5	86.8	90.0	93.1
GDP/capita										
Annual change %		-5.2	-10.5	-10.6	-4.5	0.9	4.6	0.8	2.5	2.1
Index: 1989=100	100	94.8	84.8	75.8	72.4	73.1	76.4	77.0	79.0	80.6

Source: CG Meeting 1999a.

By and large, Mongolia's economy would appear to have survived the shocks and turmoil in the early 1990s better than might have been expected and its overall economic performance in the 1990s compares favourably with that of many, if not most, CIS countries. There are several reasons for this.

- The country is rich in natural resources, primarily copper, coal and gold. Export of raw materials and of cashmere, for which there is a ready world market, cushioned the impact of the trade shock and has greatly facilitated the restructuring of the trade pattern. At the same time, the domestic availability of coal has softened the impact, not least on the external account, of the dramatic increases of energy costs.
- The country has been very successful in attracting ODA and technical assistance. The replacement of Soviet advisers by Western advisers has mitigated the shortage of technical and economic expertise, while the inflow of ODA in the form of grants and long-term loans has eased the pressure on the government budget and the external accounts considerably.
- There has from the very beginning been a broad-based political and public support for the reform process as a whole, if not always for its details.

Yet, as discussed in Section Three below, a closer examination of the nature of the economic development reveals a somewhat disconcerting picture.

Social and Institutional Change

Soon after the democratic breakthrough in 1990, and highly important for the democratic process as such, an abundance of newspapers and magazines appeared in the streets of Ulaanbaatar, all with their own focus and perspective. Since then, the free press has been instrumental in maintaining an international perspective and attempting an institutional alignment with truly democratic countries. Asserting openness and co-operation with the Western world has the full backing of both population and government, although the increasing dependency on foreign aid causes dispute.

The development of a modern judiciary under democratic control has been one of the major achievements in Mongolia since independence. Foreign experts and international organisations are continuously consulted in this process and new issues such as escalating corruption are dealt with in accordance with international standards.

After the collapse of the old socialist institutions a range of services have deteriorated, including health care, education, transportation, sanitation and water supply. Still the most serious direct outcome has been the loss of employment for thousands of people and the loss of economic and social security for everyone (see section 3 and 4). Instead, livestock herding on the steppe now serves as the safety net for much of the Mongolian population, but not all the vulnerable groups and individuals are able to use this strategy for their survival.

Both education and health care are still free in principle, but the responsibility for them has been decentralised and in both fields the previous high standards are seriously threatened by dwindling budgets. A nation-wide system of primary schools secure eight-year minimum schooling for everyone, but in both country and city a soaring dropout rate presents a constant challenge to literacy. Presently, literacy is estimated at 87 per cent, dropping by 1 per cent per year. In the countryside, boarding facilities for children of nomadic families have been confined or abandoned and many schools are in a very bad condition. All over the country schools and clinics generally suffer from run-down buildings and equipment.

Higher education continues to function, but generally with poor facilities. University students now pay a tuition fee, which clearly restricts enrolment, but the overall admission into higher education is at a comparatively high level.

The medical system offers free visits to doctors or medical assistants, but medication as well as hospitalisation must now be paid for, as public expenditure on health has fallen dramatically since 1990. As a consequence, access to health care is extremely limited among especially the poor and the nomadic groups living in remote areas. State employees have a medical insurance that will cover all costs, but for other people especially hospitalisation may now be a heavy burden. Food as such is a problem for some in Mongolia, both the collapse of crop farming and the waning cash income opportunities have resulted in a simpler diet for large segments of the population, with declining intakes of vegetables, berries and fruit. At least one out of four children suffers from undernourishment or malnutrition and among other age groups a number of non-communicable diseases with some relation to dietary habits are on the rise, for instance cancer, circulation problems and lever and kidney diseases.

In the vast Mongolian countryside the abandonment of the herding co-operative (see section 3) in 1992 meant a large scale transfer from state to private responsibility of all productions and functions. The veterinary service is now fully privatised, state emergency fodder supply no longer exists, transportation at the seasonal moves are a private matter and marketing is in most localities left to outside traders passing through the area at irregular intervals. Since local governments in rural areas only maintain key activities, roads and bridges are no longer maintained and the road is most often the landscape itself, allowing only jeeps and trucks with light loads to pass.

Even more acute, communication has dwindled in the countryside, leaving rural families totally disconnected without even radios or printed media. While previously every family owned a Russian transistor and radio programmes were important in rural life, very few radios operate today, since there are only Chinese batteries of poor quality available and most people are short of cash. Difficult living conditions in the countryside and especially in the outer provinces have led a mass influx of people into the capital, to which the government has responded by introducing severe restrictions for settling down in the capital.

A considerable religious revival since 1990 has brought back the Lamaist Buddhist church as an important institution in society, though with great local variation. A whole range of monasteries and temples have been restored or rebuilt, catering to the local population's spiritual, magical, medical and educational needs. In many cases religious institutions develop in areas where public institutions have dwindled, for instance by offering Lamaist medicine to nomadic people.

Rising Differentiation

Country and city, or more precisely Ulaanbaatar and the rest, have drifted apart since 1990. A very significant demographic process has been the gradual depopulation of particularly the *sum* centres, built as complex, self-supporting social and economic entities during the 1950s to 70s. Today, mass unemployment, abandoned buildings and lack of any activity in many such centres are testimony to the de-industrialisation of the countryside and stand in odd contrast to the increasingly metropolitan atmosphere in the capital, where both unemployment and poverty have been moderate.

A considerable spatial differentiation has been accompanied by a great social differentiation in most localities. A wealthy political and commercial elite has risen out of the opportunities of political and economic change, while common state employees earn only approximately 30-50 US dollars per month. Many pensioners from state units, some being only in their early fifties as their unit was closed down during the 1990s, are supported by the government, being paid 10-25 US dollars per month. Still these groups are privileged compared to the thousands of jobless, who may support themselves on occasional odd jobs, petty trading in the markets or depend on the income of family members. A large 'informal sector' has developed in Ulaanbaatar, where it is estimated to support 30-40 per cent of the population.

Poverty now looms large in Mongolia, although its appropriate measurement and true nature continues to be debated (see section 4) According to the Mongolian government's 1998 Living Standards Measurement Survey, one third of the population now live below the poverty line, of which particularly *aimag* and *sum* centre populations are much affected. Also among herding families poverty serious poverty is found, particularly in the Gobi area, but also in the remaining *aimag*s out of the centre.

A declining number of new jobs direct the attention to Mongolia's large population of young, who, defined as 16-to-32-year-olds, make up on third of the population. The lack of career opportunities already backfires on the educational system, threatening motivation to study. Jobless and restless youth present a major problem all over the country, as their despair often leads to heavy drinking and fighting as well as damages their social relations. Thus employment, education and healthy lifestyles for the young are crucial issues.

Everywhere in Mongolia large population segments live in *ger* (traditional felt tent) accommodation on the fringes of cities and towns, where special areas are set aside for this purpose. Each household has a small fenced-in compound, allowing some livestock to be kept, but facilities are simple, without piped water and with poor sanitation. These urban *ger* areas have become centres for poverty, out of sight and easily forgotten in the development process. In Ulaanbaatar an estimated 40 per cent of the population live in *ger*-type accommodation or small wooden houses and a large influx of settlers in recent years have strained all resources, services and income opportunities.

In the social field, major challenges for the Mongolian government are to keep both old and new lifestyles integrated into the Mongolian society and to maintain the social integrity of the Mongolian nation.

2. Political and Institutional Transformation

Mongolia has over the past two years experienced rapid changes in government and overt political scandals. While this has caused frustration among donor agencies, whose representatives are continuously confronted with new counterparts and changes in the political agenda, and while this may have negatively affected the economic reforms, it is hardly a sign of shortcomings in the political reform process. By any standard, political reform and democratisation have been remarkably swift, smooth and thorough. Almost seventy years of totalitarian rule in virtual isolation from the outside world (except for the Comecon countries) would have suggested that prospects for democracy were bleak. Yet, ten years down the road of reform Mongolia stands out as one of the front-runners with regard to political and institutional reform, in the same league as Poland, Hungary and the Baltic countries and far ahead of any of the CIS-countries.

In the 1998 Freedom House survey of political rights and civil liberties, only the Czech Republic, Hungary, Poland, Slovenia and the three Baltic countries scored higher than Mongolia among the former socialist countries. Within Asia, Mongolia ranked at par with India, the Philippines and Thailand while only Japan and South Korea scored better.[4] An open and democratic society has been established and is being consolidated on all fronts. A modern constitution guaranteeing human rights and civil liberties within a democratic political system is in place and respected in all quarters. The constitutional court has already proved to be an effective guard of the constitution and there have been several free and fair elections to both Parliament and Presidency, the results of which have been respected and have led to peaceful hand-over of political power. There is civilian control over the military. Mass media is free and political debate and public protest are alive. An independent judiciary has been established and is

[4] http://freedomhouse.org/. Mongolia received the score of 2.75 on a scale of decreasing freedom from 1 to 7.

being consolidated. The political turbulence in the past two years should be seen in the light of these remarkable achievements. Several factors have contributed to this positive development.[5]

- A domestic consensus on the direction of development is coupled with a spirit of tolerance and willingness to compromise.
- The new constitution emerged as the result of an intensive process of genuine and intense deliberation in the legislature, which greatly contributed to its legitimacy.
- Political violence has been avoided and both rulers and opposition have shown a respect for the basic rules of democracy.
- The new constitution paved the way for a dispersed power structure with a judicious balance between the legislature and the President, not unlike the Polish system.
- Democratisation in Mongolia has not been associated with any single 'father figure' as for instance in Russia. Thus the inherent weakness of a dependency on a single person has been avoided.
- A civic society developed rapidly, including strong NGOs and a free and vocal press.

The political consensus that carried Mongolia peacefully through the "dual transition" to democracy and a market economy has also formed the background of the continued reform process. A great many aspects of both political and economic reform enjoy general support. In the political sphere this concerns openness, democracy and press freedom, while only premises such as the voting system and the accountability of the press are discussed. In general principle the continued modernization of both economy, society and government is unchallenged. Similarly there is full support to building up relations with both Asia, CIS and the West, based on peaceful, independent diplomacy and market relations.

The continued privatization of state assets is also supported by all sides, despite an ongoing debate on its appropriate scale and speed. A devotion to sustainable economic development with due respect to environmental protection is shared by all political parties and form part of the Mongolian national identity.[6]

In the social field the common goals pertain to creating full employment and maintaining high standards of literacy, health and social development, although the shrinking social sector budgets cause controversy over priorities between government and opposition.[7]

Yet, there are some clouds on the horizon.

- Corruption has emerged. According to a recent survey, 63 per cent of the Mongolian population believe that corruption is widespread and 53 per cent consider it to be widespread at all levels.[8] High-level corruption has featured prominently in recent political scandals (resulting in several MPs losing their

[5] Fish (1998: 127-141).
[6] Government of Mongolia (1998).
[7] CG Meeting (1999a).
[8] Sociological Survey (1997).

positions and privileges and facing gaol), while corruption at lower levels is fuelled by dismally low wages. However, the high visibility of corruption in Mongolia is also a positive sign, as it reflects the strength and independence of the press and others who defend an open society.

- The former nomenclature and, not least, the children of these are emerging as key players in the economic arena and feature prominently among the nouveau riche. A sweeping privatisation has failed to create strong new owners and lingering ties between the political apparatus and the economic agents have paved the way for a commercialisation of parts of the nomenclature (and its relatives), much as in other former socialist countries.
- The civil society that has emerged is largely confined to Ulaanbaatar and some other urban centres. Particularly the media has difficulty in reaching out beyond the main cities.
- Although impressive achievements have been made in the establishment of an independent and effective judiciary, this is inevitably a long-term process. The capacity and juridical competence of the judiciary is still inadequate and the prison and detention system for economic reasons remains below standard.
- In the long term perspective rising inequality probably poses the main threat to the achievements in the political field. Dropping educational levels and growing segments of the population being debarred from the social and economic developments in mainstream society may provide fertile ground for political populism in the future. In a sense, the socialist system paved the way for rapid democratisation by ensuring universally high levels of education and participation in the economic life. It is ironic that the transition to democracy and market relations is jeopardising these achievements.

Decentralisation and Local Governance

Establishing a system of capable and efficient local-level government is one of the most important, but also most difficult, institutional challenges in the democratisation of former socialist countries. Local governments play a key role in translating reform policies into practical realities, as much as they bear the burden of interpreting and explaining reforms to the local population. They are also the primary contact - and often the only contact - between citizens and state during the period of transition. The ability of local authorities to translate lofty concepts of democracy into everyday realities thus is reflected in the general public's view of the success of the reform process.

Local governments in Mongolia are particularly ill-equipped to assume this role. In the past they functioned merely as extensions of the central power and their main function was to execute orders from above and report back. They were responsible for providing local services, such as education, housing and basic health care, but joint leadership and economic responsibility among all institutions in the *negdel*, including local enterprises eased this task. By contrast, they are now expected to assume much greater decision-making power and at the same time to be fully accountable both to the local electorate and to higher level government. As the agricultural collectives were dismantled and local enterprises tended to collapse, they were forced to assume the full burden of providing services to the population.

The present administrative system divides Mongolia into 22 *aimags* (regions) and autonomous cities, 342 *sums* (communes) and (urban) districts , and 1,681 *bags* (rural settlements) and *horoos* (urban quarters). The political and administrative power at each level is shared between an elected local *hural* (council) and a governor. Governors are proposed by the local *hural* and appointed by the governor at the level immediately above. The 1992 constitution provides the foundation for far-reaching local autonomy, but to date developments in this direction have been rather disappointing. Despite considerable technical assistance in this field, *inter alia* funded by Sida, effective and autonomous local governance remains a distant target. Three main reasons for this unsatisfactory state of affairs can be identified.

- The local resource bases are most places sorely inadequate. With the disintegration of the agricultural collectives (*negdels*) and the collapse of many local enterprises the capacity of the local communities to generate and mobilise resources for common use (education, health care, local roads etc.) has been severely undermined. The general economic decline, particularly in rural areas, has contributed to this negative development. Moreover, an efficient system of local taxation is not everywhere in place.
- The legislation does not reflect the spirit of decentralisation in the constitution, but still makes for a rigid and centralised mode of governing. The ability of the local authorities, including the *aimag* governments, to decide on their own structure and mode of operation is severely curtailed. Detailed regulations from the centre on most aspects pertaining to local administration (including the size and composition of the staff), stifles local initiatives, ties the hands of the local governments and provides for gross inefficiencies. Similarly, the fiscal legislation virtually precludes local self-financing. As a consequence local governments depend on the centre for subsidies and handouts, which are given in a seemingly arbitrary manner. There has also not been any clear distinction between state assets and local assets, precluding effective use of local assets by the local authorities.
- Local governments remain weak in terms of capacity and competence. It is partly a question of shortage of technical and professional skills and equipment, but also a problem of mentality and commitment. The socialist system fostered passivity and expectations that all problems had to be solved from above. Many find it difficult to break out of this pattern. Low salaries, often paid with long delays, provide little incentives for commitment and high work ethics.

It is paradoxical that with the economic and political reforms in the 1990s local communities have in many respects suffered a disempowerment, despite rhetoric to the contrary. This has been the result of, one the one hand, a *de facto* centralisation of decisions regarding local communities and the way they manage their own affairs, and on the other hand, dwindling budgets and decreasing economic self-sufficiency. Political freedom provides the main, if not sole, exception to this trend.

The Deterioration of Transportation

With a land area three and a half times that of Sweden, but with only a third of its population and a mere fraction of its GDP, it is a daunting task to ensure adequate transport and communication infrastructure throughout the country. In the past, massive Soviet assistance to the transport sector, provided not least for military purposes, and virtually free energy facilitated transport in all corners of the country. In addition, the centrally planned economy provided institutional mechanisms for the distribution of raw materials and manufactured goods throughout the country without regard to costs. The withdrawal of subsidies as well as of military personnel and equipment and the introduction of world market prices for energy have devastated the transport sector, making it unable to fulfil the objective of stimulating economic growth and national integration.

Over the past decade the low priority of maintenance has resulted in a rapid deterioration of transport infrastructure in all fields. The situation with regard to road transportation is particularly precarious. Apart from some major highways, which are now reconstructed with foreign assistance, roads are generally in a very poor condition; in the countryside they mostly consist of tracks across the landscape. Most of the bridges that were constructed to carry the traffic across Mongolia's thousands of rivers and streams have collapsed, making all transportation entirely dependant on the water level in the water courses and periodically cutting off entire regions. Most rural areas can only be reached by four-wheel-drives and trucks carrying light loads. Local governments have been utterly inactive in this field, claiming to lack the capital and equipment for maintenance works.

The railways are largely confined to the trans-Mongolian trunk line, connected to the transsibirian railway line, and although they are in a somewhat better state than the roads they suffer from lack of profitability.

The domestic air transport network includes 20 airports, 15 of which have only earth runways and all of which need to be modernised. A fleet of old AN-24 and YAK-42 planes serves the airports. The domestic air service is running at a considerable loss and safety standards are low, which has resulted in a number of accidents. There is an urgent need for improved maintenance and modernisation of air traffic.

The consequence of these shortcomings has been a sharp increase in the cost of transportation, both in terms of money and time, and decreasing reliability of both public and private transport. Rural areas have been progressively separated from urban centres, causing isolation in many parts of the country. This again leads to a geographic fragmentation of the economy, posing a major threat to the efforts of transforming the country into a modern market economy. During the past decade economic activity has been concentrated in the space around Ulaanbaatar and the adjacent urban centres, while more remote urban centres suffer rapid decline and much of the countryside slides back into subsistence herding.

The deteriorating state of transport has other detrimental effects. It increases the difficulties of providing social services outside the main urban centres, reduces mobility in general and is highly detrimental to national integration and consolidation.

The greatest need is for improved road maintenance and construction of new low-cost all-weather roads connecting major towns and regions to the centre.

Another key objective is to bring the domestic air traffic up to modern safety standards and expand the present service network to cover all regions. Mongolia will require continued foreign assistance to these ends, but Mongolian governments at all levels must also be activated where possible. The desire of obtaining an economically viable, if not profitable, transport sector will need to be weighted against the strategic national interests of fostering integration of all parts of the country and securing regional development. Both from an economic, a social and a political perspective a strong case can be made for subsidising domestic long distance transport, but presently Mongolia is hardly in a position to permit itself such a luxury.

The Human Rights Situation

The Mongolian Government generally respects the human rights of the citizenry. As reported by international human rights organisations certain problems remain, however, including occasional beatings of detainees and prisoners by members of the security forces, poor prison conditions, restrictions on due process for detainees, occasional government manipulation of the media, and violence against women.

Before 1989 the constitution also guaranteed an extensive set of rights to Mongolian citizens, while in practice these took a back seat to ideology, particularly when it concerned religion, media and public expression. Since 1990, politicians and NGOs have rallied attention to human rights issues and have won important victories. International human rights norms played an important role in shaping the final text of the new constitution in 1992. A Constitutional Court, called the *Tsets*, has emerged as a powerful force for individual liberties and governmental accountability, while a vigorous press ensures a lively and uncensored political debate. Another important human rights victory was when the Government engaged in a major rehabilitation action and within two years rehabilitated 22,000 persons who were executed or imprisoned on political grounds during period of Stalinist repression (1930–1950).

Democratisation has minimised governmental abuse of civil and political rights, but at the same the economic collapse has weakened the social safety net and challenged positive rights such as education and health care. Unemployment causes rising crime and serious alcoholism.

Mongolia continues to employ the death penalty, although its actual application is infrequent. Crime rates have increased with the introduction of a market economy, leading to overcrowded prisons, while budgets have declined, resulting in dramatically worsening prison conditions. Insufficient food and heating as well as a shortage of medical supplies constantly threaten the health of detainees: 15-30 prisoners have apparently died from starvation.

The Government now respects and supports Buddhism, but notes that there is no barrier to citizens exercising other faiths and explicitly recognises the separation of church and state.

Women's participation in most professions is good, e.g., more than 50 per cent of judges in Mongolia are women. However, women's role in public affairs has been significantly reduced since democratisation. The serious problems caused by extremely high rates of alcohol consumption, have led to increased instances of family abuse and abandonment and have added to the number of single-parent families, most of which are headed by women. Although women's groups advocate new statutes to cope with domestic violence, there is no known police or government intervention in cases involving violence against women beyond prosecution under existing assault laws after formal charges have been filed. Rape is illegal, and offenders can be prosecuted and convicted, but there is no law specifically prohibiting spousal rape.

A number of human rights groups operate without government restriction, investigating and publishing their findings on human rights-cases. Government officials are generally co-operative and responsive to their views.

The law specifically prohibits forced or compulsory labour. The Government enforces this law, but a minor breach is that members of the military forces are required to help with the fall harvest.

Despite these problems the human rights situation in Mongolia must be viewed positively, particularly when compared to Mongolia's big neighbours. Many Mongolians see a strong system of international law as a guarantee of their national security. Taking international human rights obligations seriously is one important aspect of this.

3 Economic Reform Issues

The Quality of Growth

A closer examination of the economic development in the past decade reveals a rather disquieting picture. In particular, there are concerns with regard to (i) the sectoral composition of the development, (ii) the capacity of the economy to generate employment and incomes and (iii) the regional pattern of the development.

A review of the development of the main economic sectors in the 1990s (Table 2-4) suggests that agriculture (together with the residual category 'other services') has fared the best. By 1998 agricultural production was up 14 per cent over the 1989 level. Industrial production declined only marginally over the period, while construction, transport and communications declined by 50 per cent or more. Trade, too, registered a substantial decline. As a consequence, the share of agriculture in GDP increased from 30 to 37 per cent, while that of industry remained almost constant at 32 per cent at constant 1993 prices.[9] However, a more detailed analysis of the industrial sector development reveals a disconcerting picture. Output from mining more than doubled between 1989 and 1998, while manufacturing production all but collapsed (Table 5). By 1998 manufacturing production was at little more than a quarter of its 1989 level. Within the agricultural sector development has largely been confined to livestock, while crop production has declined sharply. In short, mining and animal husbandry have emerged as the main pillars of the economy, while virtually all other sectors have declined sharply.

[9] If measured at current prices, the increase of agriculture was much more dramatic; from 15.5 per cent in 1989 to 32.8 per cent in 1998, while the share of industry fell from 33 to 24 per cent in the same period. This is accounted for by a sharp increase in the relative prices of agricultural products from an very low level.

Thus, 'transition' has reversed the industrialisation pursued under socialism and the economy is rapidly attaining the structure of a resource-rich, but

Table 2
Sector Development of GDP at 1993 Constant Prices. 1989=100.

	1989	1990	1995	1996	1997	1998
Agriculture	100	98.7	101.1	105.9	110.9	114.3
Industry	100	100.3	88.6	86.8	90.7	94.7
Construction	100	75.4	35.1	36.9	35.0	33.2
Transport & Com.	100	94.4	43.7	47.4	49.6	52.3
Trade	100	98.6	70.5	72.3	75.3	78.6
Services	100	94.5	129.3	136.5	138.3	144.9
All sectors	100	97.5	84.5	86.5	89.9	93.1

Source: Statistical Yearbook, p. 54

Table 3
Sector Distribution of GDP at 1993 constant prices

	1989	1990	1995	1996	1997	1998
Agriculture	30.3	30.7	36.3	37.1	37.4	37.3
Industry	32.3	33.2	33.9	32.4	32.6	32.5
Construction	4.4	3.4	1.8	1.9	1.7	1.6
Transport & Communication.	8.0	7.7	4.1	4.4	4.4	4.5
Trade	17.6	17.8	14.7	14.7	14.7	14.9
Services	6.0	5.8	9.2	9.5	9.2	9.3

Table 4
Sector Distribution of GDP at current prices

	1989	1990	1995	1996	1997	1998
Agriculture	15.5	15.2	36.8	36.8	33.5	32.8
Industry	32.7	35.6	32.5	20.6	24.1	24.1
Construction	6.1	5.0	2.7	3.8	3.3	3.4
Transport & Com.	12.0	12.0	4.6	5.8	6.6	6.7
Trade	19.0	19.4	12.3	18.3	18.4	18.9
Services	13.4	11.5	11.2	14.7	13.9	14.0

Source: Statistical Yearbook, pp. 54.59.

Table 5
Development of Gross Production in the Secondary Sector at Constant Prices of 1995. 1989=100.

	1989	1990	1995	1996	1997	1998
Energy	100	99.1	120.5	118.1	119.6	121.1
Mining	100	95.9	157.1	168.8	193.2	205.1
Manufacturing	100	93.3	35.2	30.5	28.4	28.4
All secondary sectors	100	94.3	64.7	63.1	65.9	68.0

Source: Statistical Yearbook, pp. 116-117.

traditional, third world economy. Although this transformation of the economy has so far resulted in modest growth, the question must be raised if this is the kind of transformation Mongolia has envisioned and if it is sustainable. There are reasons to believe that the answer to both of these questions is negative.

A main disadvantage of this pattern of development is that it makes very poor use of the country's human resources: mining creates few jobs, while herding sheep and goats hardly provides attractive career prospects for university and secondary school graduates in rural towns and *aimags*.

A review of the available employment data provides a grim picture and confirms the suspicion that the current pattern of development precludes efficient and full use of the country's human resources (Table 6). Between 1991 and 1998 the population in the active age groups in Mongolia increased by about 200,000 persons. Given a participation rate in the labour force of 80 per cent, which has been typical for Mongolia in the past, some 160,000 new jobs would have needed to be created in this period. Yet, total employment increased by a mere 15,000. In other words, the economy has only been able to absorb a small fraction of the young entrants into the labour force and the vast majority of the school leavers remain outside the formal sector labour force. While unemployment in the early years of the transition primarily was a problem of displaced wage workers from state industries, youth unemployment has in recent years emerged as the key issue. The latter is typically not registered in the statistics, but is reflected in a sharp decline in the labour force participation rate from 80 per cent in 1991 to 68 per cent in 1998.[10] This picture is aggravated by the fact that agriculture, that is animal husbandry, is the only sector in which employment has increased. Employment in the agricultural sector increased from 274,500 in 1991 to 402,300, that is by 53 per cent, while total employment in the non-agricultural sectors declined from 521,200 to 407,200, or 22 per cent, in the same period. It can safely be assumed that this shift in the industrial structure of the labour force does not reflect changes in employment preferences, but that agriculture has assumed the role of an employment buffer. Facing the stark choice of unemployment or going into animal husbandry, school leavers and others opt for the latter, as it offers the sole avenue for securing a living.

The development path followed by Mongolia in the past decade is clearly not sustainable, not even in the short run. It is a main reason behind the sharp increase in poverty (discussed in Section Four) as there is a close link between employment, incomes and poverty. It will also inevitably result in increasing social tension (and most probably also crime) as increasing numbers of primarily young people are left outside the development process. It furthermore implies a terrible waste of Mongolia's human resources, which the country can ill afford.

Although public works programmes and various labour market and employment programmes can provide useful immediate relief, a long term solution to the problem will inevitably require a fundamental change in the nature of economic development and a diversification of the economic base. This will require a development of agro-processing, manufacturing in areas where Mongolia has a comparative advantage (such as up-market textiles) and services

[10] The fall may in reality be somewhat smaller than indicated by official statistics as people working in the informal sector may often declare that they are not employed (Anderson, 1997).

in general. Such development will mainly have to rely on the development of small- and medium scale enterprise.

Table 6
Population and Labour Force

	1990	1991	1992	1993	1994	1995	1996	1997	1998
(1000)									
Total population		2187.2	2215.0	2250.0	2280.0	2317.5	2353.3	2387.0	2420.0
Active age groups		1069.2	1148.2	1133.8	1165.6	1186.2	1212.0	1229.4	1263.7
Labour force		851.1	860.0	844.7	861.4	839.8	847.2	852.0	859.3
Employed		795.7	806.0	772.8	786.5	794.7	791.8	788.3	809.5
Unemployed		55.4	54.0	71.9	74.9	45.1	55.4	63.7	49.8
Employed in:									
- agriculture	258.6	274.5	294.2	302.2	335.8	354,4	357.9	377.6	402.3
- industry	131.6	132.1	133.8	124.4	100.7	108.1	104.5	100.1	100.4
- other	393.4	389.1	378.0	346.2	350.0	332.2	329.4	310.6	306.8
LFP rate		79.6	74.9	74.5	73.9	70.8	69.9	69.3	68.0
employed as % active age groups		74.4	70.2	86.2	67.5	67.0	65.3	64.1	64.1
Growth rates:									
- active age groups			7.3	-1.3	2.8	1.8	2.2	1.4	2.8
- labour force			1.0	-1.8	2.0	-2.5	0.9	0.6	0.9

Sources: CG 1999a; Women and men in Mongolia p. 85.

Such a development is already taking place in Ulaanbaatar in the form of a mushrooming informal sector. A recent survey suggests that the informal sector presently employs 30-35 per cent of the city's labour force, that is 105,000 to 130,000 people.[11] Incomes in the formal sector vary widely, since this sector covers a range of activities that only have non-wage earnings in common. In some instances they are much higher than salaried incomes (viz. taxi drivers), but there are also cases of very low income, for instance petty traders. The border between formal and informal sector activities is vague. Many, but far from all, informal sector enterprises are registered with the authorities and pay some taxes and fees. The development of the informal sector in Mongolia may be seen as the embryo of a small-scale private sector development. As such it is very encouraging. However, it is so far largely confined to services and concentrated to Ulaanbaatar. A main policy issue must be to promote the diversification, formalisation and development in size and strength of the embryonic private sector. The preconditions would seem to be more favourable than in most of the CIS countries, mainly because criminal rent-seeking (in the form of protection money etc.) and other organised crime pose less of a problem. However, a cohesive strategy aimed at promoting a diversification of the economy through small- and medium scale enterprise development will be needed to revert the development pattern of the 1990s. This will need to include the development of a supportive institutional environment, sanitising the financial sector and sound macro-economic policies, including, not least, skilful exchange rate management.

[11] Anderson (1997: 1, 8). Of these, 70,000 – 100,000 are engaged in the informal sector as their primary means of earning a living.

The gradual depopulation of several of the outer regions of Mongolia and the massive influx of herding families and their animals into the central province should cause serious concern, as it strains both natural and other resources. The Ulaanbaatar city government has imposed severe restrictions on settlement in the capital. Mongolian government representatives, on the other hand, tend to regard migration as a natural phenomenon and compare with 19th-century Western Europe. A rebuttal is that during Europe's industrialization the farming population primarily moved to the cities because of new employment opportunities, whereas the Mongolian herders are first of all moving away from deteriorating terms of trade, usually without a pre-known option where they move.

The geopolitical consequences of depopulation, however, can become even more acute. In an aggravated political conflict situation it may be hard to defend national sovereignty in the face of illegal Chinese immigration when Mongolia cannot guard or even populate its huge hinterland territories.

Reform of the Collective Herding Economy

Until reform of the rural herding economy was launched in 1987, every herding household was member of local herding collective, the *negdel*, in most cases synonymous with a *sum* administrative unit. Livestock production was managed by the *negdel* leadership, among whom Russian specialists were prominent, in line with state planning. The *negdel* was a comprehensive unit meeting every aspect of the herding households' social and economic needs. It offered free education, health care and pensions. It provided veterinary services, animal shelters, hay and transportation for people and equipment. It marketed all livestock products jointly and supplied consumer goods in return. Still a pragmatic component remained as every herding family owned private livestock in addition to those herded for the collective.

A gradual reform process was launched in 1987, when a system of "mutual agreement" between herder and *negdel* administration was introduced to increase production. At this point the herders still received a salary for herding. In 1989 this was replaced by a livestock lease system, under which the herders were responsible for generating their own income. In 1990 *negdel* and local *sum* administration were separated, getting ready for the final abandonment of the collective and privatisation of animals. This was carried out in two phases in 1991 and 1992. This step by step introduction of market relations in the livestock sector aimed at making herders self-supporting, increasing productivity and, not least, freeing public authorities from their social and economic responsibilities.

At the final privatisation of the *negdel* livestock was allocated to the herders according to length of membership and number of family members, while former drivers and mechanics in many cases got possession of trucks or tractors. Key assets such as buildings, agro-machinery, trucks and camels typically remained under the control of the old leadership, who formed new semi-private companies in the *negdel* centres with undefined responsibilities towards the herders. These companies were thought to continue a range of activities from the *negdel*, such as farming, fodder production, marketing of livestock products and transportation, but in most localities they were fairly short-lived or gradually changed into easier business such as selective trade with Ulaanbaatar or running local shops; in other cases both leadership and assets disappeared from the local area.

The number of animals distributed to the *negdel* members was generally far below the minimum for self-supporting family herding and most families were faced with the difficult task of supporting themselves on a small herd and at the same time build it up to secure their survival in the future. Moreover, since wage employment in general became scarce in the sum centres, a large segment of the population had to move out on the steppe to take up herding from scratch.

Table 7
Approximate Prices of Selected Goods by Location in Relation to Ulaanbaatar, 1999. Tugriks.

	Ulaanbaatar	200 km from UB	400 km from UB
Live sheep, piece	15,000	12,000	10,000
Wool, kg	220	200	180
Flour, kg	230	250	280
Petrol	200	230	275

Source: Ole Bruun, field notes.

Today, herding is entirely private, with average livestock holdings between 100 and 200 animals per family. Local economic differentiation is large, with some herders owning 1000 animals and other surviving on 30-50 animals. Since 1993 the total number of livestock in Mongolia has grown rapidly, yet with a generally falling productivity due to the collapse of local marketing facilities and transportation. Today, most families rely on traditional herding practices, with as many of the five traditional animal types as possible represented in the herd to maximise security. Everywhere in the country, however, livestock herding is threatened by poor infrastructure, high transportation costs and bad marketing conditions, usually only permitting the sale of live animals, wool and cashmere whereas meat and milk products are unsaleable. For instance, while a live sheep will buy 65 kilograms of flour in Ulaanbaatar, it will only buy 35 kilograms of flour some 400 kilometres away from Ulaanbaatar (Table 7). To make matters worse the private 'occasional traders' that roam the countryside tend to refuse paying cash and instead exchange a sheep for one bag of flour or a pair of boots. The sharply deteriorating terms of trade for livestock products with increasing distance from Ulaanbaatar is a main factor behind the geographic concentration of economic growth and the decline into subsistence economy of large parts of the country. Only along major roads and trade routes has some specialisation occurred, for instance based on *airag* production, milk, cashmere or live sheep.

The Financial Sector

Mongolia's fledging financial sector has had a very rocky start. The establishment of a two-tier banking sector was initiated already in 1990/91, as the former State Bank was divided into a central bank (Mongolbank) and five commercial banks. One year later nine other small commercial banks were established. In 1995 yet another bank (Golomt Bank), this time with foreign equity participation, was established. The rapid proliferation of the number of banks was not accompanied by any strengthening of the banking sector. Many of the banks inherited a troublesome portfolio of loans from the State Bank and were thus handicapped from the start. More importantly, a number of factors combined to result in a rapid deterioration of the loan portfolios of the banks:

- A volatile and generally negative external environment in which many of large enterprises and borrowers got into acute financial problems. Furthermore, rapidly growing inter-enterprise arrears resulted in liquidity problems for many enterprises.
- A lack of a sound legislative and regulatory framework, which severely undermined the banks' ability to enforce payments.
- Continued Government lending on non-commercial criteria through the banks and other unsound lending practices, such as insider lending to the owners of the banks.
- An acute shortage of banking skills, which was made worse by the large number of banks.
- A weak central bank, both in terms of authority and capacity, resulting in poor supervision and monitoring of the commercial banks.

In late 1996 a full-fledged financial crisis broke out. By then, half of the outstanding loans of the banking sector were non-performing and only one of the 16 banks was solvent. There was a run on the banks as depositors tried to rescue their savings and the Government and the Central Bank were forced to make large infusions of money into the banks to keep them afloat. Still, Mongolia's largest and fourth largest bank collapsed and were forced to closed down.

A comprehensive restructuring programme was launched to put the banking sector on a sound footing. A new Central Bank and Banking Law was passed to tighten the legislative framework of the financial sector. Three successor institutions were created out of the two collapsed banks: a savings bank, which inherited household deposits from the collapsed banks and was to serve as a 'safe' bank investing only in safe assets; a reconstruction bank, which retained the performing loans of the two banks; and the Mongolian Asset Recovery Agency (MARA), created to recover as much as possible of the non-performing loans. A central register of defaulting borrowers was established and all banks were forbidden to extend new credits to those on this register. The cost to the Government of the bank restructuring amounted to roughly 9 per cent of GDP, making it slightly more costly in relative terms than the financial crisis in Sweden in 1991.

Despite its ambitious approach the restructuring was incomplete and failed to establish a firm basis for a sound financial system. The political crisis in 1997 stalled the financial reform and the restructuring. The sanitising of the surviving banks was very incomplete and a much needed merger of the many small banks has not taken place. The Government control of the banking sector remained strong, as half of the banks, accounting for about 80 per cent of the total bank assets, remain fully or partially government owned.

After registering some improvement in 1997, the banking sector slid into crisis again in 1998, as the share of non-performing loans increased from 30 to 40 per cent and three large banks became deeply insolvent. The immediate reason behind the renewed crisis appears to have been the sharp fall in copper prices, which set in motion a process of accumulating inter-enterprise arrears as the copper mines could no longer fulfil their financial obligations to the energy companies etc. However, the heart of the problem remains the same as before: a weak Central Bank, unsound lending practices (partly induced by the Government) and an inability or unwillingness to enforce sanctions and bankruptcy on defaulting borrowers. ADB and IMF are providing technical assistance to the restructuring of the financial sector. However, the problem is as much of a political as of a technical financial nature. A firm political will to enforce discipline and hard budget constraints on both banks and borrowers and to put an end to politically motivated lending is needed to create a sound financial system. Privatisation *per se* may ameliorate the situation, but will not solve the problem. A recent survey shows that privatised enterprises are almost as prone as public enterprises to seek Government help if they run into trouble.[12] A deep reform, which effectively establishes clear and new roles of the main actors (the enterprises, the banks and the Government) and releases the Government and the banks from their role as patrons of economic enterprises, is needed to solve the crisis. This will require not only political commitment, but also a stronger government than the past two years have brought witness of.

The cost to the economy of the prolonged financial crisis is very high. By late 1998 interest rates for short term commercial loans ranged from 36-72 per cent at a time when inflation was a mere 6 per cent.[13] The fledging private enterprise sector is starved of capital. Long term credit is not available at all, while short term loans come at an exorbitant real interest rate. In the absence of alternative sources of funding, such as the stock market, insurance or leasing businesses, this implies that most private enterprises have to rely exclusively on internally generated capital.

The Public Sector

The loss of the large Soviet subsidies and the subsequent dramatic economic transformation have subjected the public sector to an extreme shock. Yet, by and large the impact on the public sector has been less than one might have feared and certainly less than in many CIS countries. A forceful reform of the public sector and timely and substantial foreign aid have helped to mitigate the impact of the shocks on the public sector. Public expenditure has fallen from over 50 per cent of GDP in the early 1990s to 37 per cent in 1998. The decline partly reflects reduced public sector involvement in the economy and reduced subsidies, but social expenditures, too, have fallen considerably. Expenditures on education have fallen from 10 per cent of GDP in 1991 to 5.5 per cent in 1998, while the decline in expenditures on health care and social security has been smaller.[14] Both current expenditures and current revenues now appear to have stabilised at about 25 per cent of GDP (Table 8). The fall in social sector expenditure does not reflect any change in Government priorities or spending patterns, but is solely the result of the reduction of the public cake as a whole. Indeed, social sector expenditures amounted to 52 per cent of total government expenditures (excluding foreign funded investments) in 1998, up from 43 per cent in 1994.

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[12] A majority of the private enterprises perceived lobbying at the ministry level as important or very important. A quarter of the private enterprises had accumulated more than one year of unpaid taxes and 16 per cent had social insurance payment liabilities that were more than one year old (Anderdson *et. al.*, 1998).

[13] World Bank (1999: 4).

[14] World Bank (1977; 44-47).

Table 8
Summary of the Government Budget

	1993	1994	1995	1996	1997	1998
Total Revenue	33.3	28.3	33.7	27.8	29.5	25.9
Current revenue	33.3	27.2	31.6	26.6	27.3	23.3
Capital revenue	0.0	1.1	2.1	1.2	2.2	2.6
Total Expenditures	49.4	51.1	37.8	36.0	38.1	37.1
Current expenditure	31.2	25.9	24.5	22.1	25.5	24.5
Capital expenditure	18.2	25.2	13.3	13.9	12.6	12.6
Current balance	2.1	1.3	7.1	4.5	1.8	-1.2
Overall balance	-16.1	-22.8	-4.1	-8.2	-8.6	-11.2
Financing	16.1	22.8	4.1	8.2	8.6	11.2
Foreign, net	17.2	15.5	6.9	5.9	12.3	7.7
Domestic	-1.1	7.3	-2.9	2.3	-3.7	3.5

Remarks: Capital expenditure includes net lending. Foreign funding includes grants.

Source: World Bank (1999c).

The rather high level of public domestic revenue (Table 8) is a testimony to success in reforming and developing the fiscal system, although it also reflects revenues from mineral resources. A value added tax of 13 per cent, up from 10 per cent in 1998, and enterprise income tax are the main sources of fiscal revenue. A uniform 5 per cent import tariff, various excise duties and export taxes on gold and unprocessed cashmere are other sources of tax revenue. Still, much remains to be done to develop an efficient fiscal system. The large second economy in Ulaanbaatar reflects the inability to effectively and fairly tax the emerging private sector and smuggling is legendary.

ODA and other forms of foreign funding have to a large extent compensated for the loss of Soviet subsidies. In 1993 and 1994 it amounted to over 15 per cent of GDP, but has subsequently fallen somewhat. It has been and remains instrumental to permitting a rather high level of public capital expenditures and to fund large budget deficits with non-inflationary means. The budget deficit has increased in recent years from 4.1 per cent of GDP in 1995 to 8.6 per cent in 1997 to 11 per cent in 1998. The large deficit in 1998 is largely attributed to the sharp fall in copper prices in 1997-98, which has severe repercussions not only on the economy as a whole but also on public revenues. With copper prices now picking up again this problem should be over (for the time being).[15]

The current situation of the public sector can be summed up by highlighting three main problems.

- At the present, the public sector is too small and too weak to meet the needs and safe-guard previous achievements in the fields of education, health care and social services and to maintain transport and other physical infrastructure throughout the country at a desired level.
- The public sector is highly dependent on foreign assistance and will continue to be so in the short to medium term future.

[15] Copper prices on the world market have increased by 24 per cent in the past three months alone.

- The high dependence of the economy on a few commodities will inevitably result in large and unpredictable fluctuations in public revenue.

In the coming years the public revenue situation may improve substantially if the on-going oil explorations yield fruit. According to a recent study,[16] oil related revenues[17] may well result in 300 – 400 million USD in income earnings in a decade's time, to be compared with total government revenues of 270 million USD in 1998.

The Energy Sector

Huge distances and an exceptionally harsh climate make Mongolia highly dependent on energy for heating and transport. Heating alone accounts for 40 per cent of the gross energy consumption.[18] During the socialist period the physical infrastructure in Mongolia was developed on the assumption of limitless availability of virtually free energy. The transition to world market prices for energy after 1991 have therefore imposed a severe shock on the country. Many industrial plants were rendered hopelessly uneconomical and were closed down. A more lasting problem with far reaching consequences has been the sharply increased costs of heating and transport. However, in contrast to the situation in many of the former CIS countries, Mongolia is on the whole self-sufficient in energy and the sky-rocketing energy prices have therefore not had any major detrimental effect on the trade balance.

Mongolia has very large deposits of coal. However, most of the deposits are in the form of lignite with a rather low calorie content. Although coal prices will need to be increased by 25 – 50 per cent to ensure long term viability of this sector, the per calorie cost to the consumer (who are mainly found in Ulaanbaatar) will still be well below world market prices.[19] The long term outlook for coal production therefore looks bright. The problems of energy supply that have plagued Mongolia in the past few years can largely be ascribed to (i) antiquated, inefficient and poorly maintained power generation and transmission facilities with very large conversion and transmission losses; (ii) poor cost-recovery in the energy sector due to artificially low prices and poor enforcement of payments; (iii) erratic supplies of oil products from Russia, and (iv) erratic payments by Mongolian buyers. Modernisation of the energy sector will gradually reduce these problems and large investments and foreign assistance is being directed to this end. The implications of the transition to world market prices for energy on the cost of transport and on heating will be of a lasting nature and will need to be addressed accordingly. High costs of transport are a main factor behind the rapid concentration of economic activities and population to Ulaanbaatar and the surrounding area and the depopulation of the periphery, while rapidly increasing costs of heating risk imposing an unbearable burden on the urban poor.

Oil exploration is still in its infancy in Mongolia, but there are strong indications that oil may become Mongolia's most important natural resource in the coming two decades. Potentially exploitable resources are estimated to be

[16] Johnson (1997).
[17] Incomes from actual production as well as licence fees.
[18] World Bank (1995: 3).
[19] Johnson (1997).

between four and eight million barrels. A recent analysis suggests that a conservative forecast would be a production of 30 to 60 million barrels per year in less than ten years time.[20] If this scenario materialises it would fundamentally alter the economic prospects for Mongolia. Assuming a price of 18 USD per barrel, oil sales alone would generate around 500 – 1000 million USD in revenue per year, that is the equivalent of 50 to 100 per cent of the present GDP. Although estimates about future revenues from oil are still little more than informed guesses and vary widely, there is enough evidence to suggest that oil production will have a major impact on the development of the Mongolian economy in the medium to long term future. It is important to take note of this, because it highlights the issue of the kind of development path Mongolia has embarked upon. It underscores the need to safeguard the quality of the country's human resources and for policies aimed at a broad-based development with a high content of employment and incomes.

Environmental Issues

As a result of rapid urbanisation and industrial growth under Communism, localised environmental degradation has been a major concern. Ulaanbaatar's population has increased six times its size in the early 1950s, resulting in the emergence of a range of environmental problems. Of these the most immediate problem is air pollution, particularly from the burning of lignite for heating in private homes coupled with smoke from factories and thermal stations. In the winter season the emission of toxic gasses vastly exceeds safety limits and provokes respiratory diseases and increased mortality.

Also the disposal of increasing volumes of solid waste in the city poses a danger to public health. Insufficiently regulated waste disposal from private households, unprotected public dumpsites, new dumpsites emerging spontaneously in populated areas and uncontrolled dumping of hazardous waste all contribute to solid waste becoming a major challenge to Mongolian authorities. Also water pollution is rapidly increasing around Ulaanbaatar and much of the water supplied to private households is now sub-standard with both bacteriological and chemical contamination.

In the countryside efforts to increase grain and hay production by ploughing up virgin land previously caused soil erosion, but as crop farming has shrunk to a mere 23 per cent of its 1989 level this is no longer a major concern. Instead, the gradual building up of private herds during the 1990s has increased the total number of livestock by 30 per cent, while at the same time public regulation of pasture was discontinued in the market society (except that herders in principle are required to graze their animals within sum borders). The total carrying capacity of Mongolia's pastures remain much debated, not least because of the country's highly unpredictable weather conditions, but it generally recognised that some pasture regulation must be reinstalled for sustainable use of resources. As infrastructure problems in general encroach on the herders terms of trade, many herding families in poorly served areas are attracted to pastures near urban markets and major traffic routes. Particularly the most recent years have seen the uprooting of herding families in remote *aimags* and a heavily increasing

[20] Johnson (1997).

pressure on the pastures in the central parts of the country, changing grass composition and decimating the margin between grazing and carrying capacity. Overgrazing has become a serious issue in these areas and loss of livestock in severe winters hurl many families into poverty. The land law that was outlined in the early 1990s is continuously met with political opposition.

Other environmental issues are deforestation and loss of biodiversity due to economic exploitation, just as the emission of toxic wastes from hundreds of small gold mines across the country has caused concern, but Mongolia's enormous, undeveloped land mass still places the country among the most pristine regions of the world.

4 Poverty, Inequality and Deteriorating Social Services and Protection

The Pattern and Determinants of Poverty

Poverty has emerged on a large scale in the 1990s as a consequence of the structural transformation of the economy, at the same time as differences in incomes have increased. Two living standard measurement surveys undertaken in 1995 and in 1998, according to the standardised World Bank methodology, provide a good picture on the pattern of poverty. The incidence of poverty was found to be almost the same in 1995 and 1998, 36.3 and 36.2 per cent respectively, confirming the impression that the sharp increase in poverty took place during the first few years of transition. However, the depth of poverty was greater in 1998 than in 1995, suggesting an increase in extreme poverty.[21] This is also reflected in increasing income inequality. The Gini coefficient increased from 0.31 in 1995 to 0.34 in 1998. Although income inequality is still not very high by regional standards, the trend towards a deterioration is cause for concern.

The Government has identified six groups as being most vulnerable to poverty: households with more than four children, unemployed, small-scale herders in remote areas, female-headed households, elderly without family support, handicapped and orphans. Thus, the poor households may be divided into three broad categories:

- Those who lack the means to support themselves and depend on support from society. The elderly stand out as main losers in the past decade. Whatever savings they had accumulated to provide for their old age were wiped out by inflation at the same time as the real value of pensions have fallen but are still very important as a source of cash income. Elderly who are not supported by next-of-kins are therefore very exposed to poverty. People with various handicaps and, arguably, orphans fall into the same category.
- Households with sufficient labour force, but who are unable to put this labour to sufficiently productive use in the new economic environment. The unemployed, small-scale herders and others who have been forced into distress employment at the margins of the economy belong to this group.

[21] FIDE International (1999).

- Households with high dependency rations, that is with few providers and many mouths to feed. Households with many children and female-headed households are the main examples of this category.

Two main causes of poverty can be identified. Firstly, the virtual collapse of the social safety net provided by the state or its proxies in the form of state enterprises and agricultural collectives. This primarily affects those who lack the means to support themselves. Secondly, as discussed in section three above, the economic transformation has resulted in a marginalisation of large segments of the labour force and has resulted in a gross underutilisation of labour and skills, which is wasteful for society and obviously very harmful for the individuals concerned. The de-industrialisation and the emergence of a narrow-based growth concentrated to Ulaanbaatar and its immediate vicinity and to extraction of mineral resources suggest that no easy remedy to this problem is in sight.

Table 9
Incidence of Poverty 1995 and 1998. Per cent

	1995	1998
All urban areas	38.5	39.4
- Ulaanbaatar	35.1	34.1
- Other urban areas	41.9	45.2
Rural areas	33.1	32.6
All Mongolia	36.3	36.2

Source: FIDE International 1999.

The pattern of poverty is quite distinct from that of most other developing countries, but bears resemblance with that of some other transition economies. The highest and most rapidly increasing rates of poverty are found in the provincial towns, while poverty in Ulaanbaatar and in the rural areas is lower and shows no sign of increasing (Table 9). The economic transition has hit the provincial towns particularly hard. These artificially constructed towns located at strategic points across the country to serve as centres for rural communities have in most instances seen their economic base severely eroded as few of the enterprises on which they depended have survived the transition. Massive unemployment and lack of alternative employment opportunities has resulted in a flight back to the rural areas and to livestock herding and in rapidly increasing and severe poverty among the population that remains.

In comparison to the situation in the smaller towns and cities, the unemployed in the major cities, especially Ulaanbaatar, have far better access to alternative income opportunities, such as simple manufacturing, petty trade, various formal and informal sector services and as a last resort, begging or crime. The emergence of a buoyant informal sector in Ulaanbaatar, which is estimated to engage 30 – 40 per cent of the cities population, is without doubt the main reason behind the comparatively low rate of poverty in the city. However, there is a large population in the *ger* areas and in the vicinity of the capital consisting of recent migrants, who are not officially registered as urban dwellers. Many of these newcomers are desperately poor, having been driven away from their native areas by deteriorating terms of trade and perhaps loss of livestock.

The vast availability of land implies that there is no shortage of land or pasture resources, only accessibility sets the limits to their use. Rural poverty in Mongolia is therefore not correlated to landlessness and is distinct from rural poverty in most other countries as well as from urban poverty.

Estimates of rural poverty tend to be made entirely on the basis of the number of animals owned by each family and therefore do not take into account the dramatic economic effects of collapsing infrastructure and the rising significance of distance. Despite steadily growing numbers of livestock at the national level the total production from animal husbandry is not increasing. Furthermore, herders are subject to very disadvantageous terms of trade as they depend on businessmen with private trucks passing through their area. Since these commonly refuse to pay cash for the herders products, but only barter with flour and a few other items, herders have gradually been cut off from a range of consumer goods that previously were available to them. Therefore, even though the intake of calories may be high in rural areas as herders have almost unlimited access to milk products, the dietary variation is insufficient and the state of health often poor. Generally speaking, the rural areas are neglected in the development strategies of the Mongolian government, just as they have been difficult to reach for foreign donors. But also social inertia inherited from the old system, diminishing flows of information and massive drinking in rural areas as essential to customary socialising prevent many herders from improving their own life situation.

The other aspect of poverty in Mongolia, which makes it distinct from poverty in most other developing countries, is that it is by and large a new phenomenon. This means that the bulk of the poor are individuals and households that were not badly off in the past. Not only are they used to leading a better life than they do at the present, but their level of education and skills also reflect a higher economic and social status. A fundamental challenge facing Mongolia is to ensure that the newly poor are given a chance to improve their lot and return to the mainstream of society. If not, temporary poverty will soon become endemic and will be transmitted from one generation to the next, as the children of the poor will have reduced access to education and health care. Once poverty has become endemic and entrenched it will become much more difficult to eradicate. At the present combating poverty will require action in three broad areas:

- Embarking on a developing strategy that puts employment and income generation as well as regional development considerations in focus.
- Re-establishing a safety net that is specifically targeted on the poor and taking measures to ensure equal access to education and health care.
- Temporary public works programmes as a means to immediate alleviation of unemployment, particularly in the provincial towns. Such programmes could be designed as integrated parts of infrastructure investment programmes, for instance road building and maintenance.

Education, Health Care and Social Security

Education

At the time when Mongolia ceased to be a Soviet satellite all young Mongolians went to school for at least eight to ten years. Vocational and boarding schools provided suitable education to nomads and their children. Literacy was virtually universal, as was primary school attendance. At the post-primary level there were 41 vocational schools, 32 post-secondary technical schools and nine institutions of higher education. In addition, many students received their higher education abroad, especially in the former socialist countries. Indeed, Mongolia's achievements in the field of education were *at par* with those of middle to high income countries. The educational sector has been severely battered in the past decade. Per capita government expenditure on education declined by more than 50 per cent between 1991 and 1996, as its share of the GDP fell from 10.8 to 5.6 per cent. This sharp decline partly reflected a decline of the public sector as a whole. The share of total government expenditure allocated to education declined from 22.9 to 17.2 per cent in the same period.[22] The cuts have resulted in reduced access to education as well as to reduced quality. The number of teaching staff has fallen, wages and salaries have been eroded, hurting staff morale, the availability of pedagogic material has diminished and capital investments have halted. At the same time, closure of boarding schools for lack of heating, the deterioration of transport, the introduction of cost-recovery schemes in the form of fees in kindergarten, boarding schools etc. and an increasingly prevalent habit of charging informal fees has resulted in reduced accessibility to education. The consequence has been a sharp increase in dropout rates. The number of children dropping out of primary and secondary school increased form 6,133 in 1989 to a peak of 48,446 in 1992 before falling back to 10,954 in 1998. The total number of drop-outs between 1989 and 1998 was 193,000. Drop-outs are more common in *aimags* and rural areas than in the cities. According to UNDP's Human Development Report there are three main reasons for the rise in drop-outs: (i) increased direct and in-kind costs of schooling, (ii) increasing livestock herd sizes following privatisation and an ensuing need for family labour, and (iii) remoteness of schools and the closure and lack of heating of boarding schools.

However, in the past two years the situation has improved somewhat. The number of pupils and students has increased and the number of dropouts has become much lower than at the first few years of transition. It is a big challenge for Mongolia to recuperate the levels of formal education and to give adequate attention to vocational education and re-training of the unemployed. Vocational schools offer three main areas of training: agriculture, construction and industry. Enrolment rates have fallen sharply in vocational education and in post-secondary technical and specialised education. Between 1990 and 1998 the number of students in these institutes fell from 29,000 to 11,650.

The demand for tertiary education remains high, but places are limited. In 1991 higher education was restructured. The government has sought to supplement the public educational system with private non-profit tertiary educational institutions. As a result, the number of private tertiary schools has proliferated rapidly. In 1996 there were 46 such institutions specialising in

[22] UNDP (1999: 60).

economics, law and foreign languages. However, the quality of the teaching staff in these institutions is often poor, they tend to lack equipment and their financial base is often weak. The Ministry of Science and Education is planning to set up a rating system for private institutions and to publish their performance score regularly.

Health Care and Social Security

As in the case of education, health care has suffered from the declining financial resources available to the public sector. In per capita terms government expenditure on health care has fallen by approximately 40 per cent between 1991 and 1996, although its share in total government expenditure has remained virtually unchanged. Free health care, albeit not always of the highest quality, was one of the luxuries offered by the socialist system. The financial crunch has forced the government to seek new ways of delivering health services. One aspect of the new strategy is a greater emphasis on preventive rather than curative health care and a shift of support from large hospitals and to primary health care. The private sector is also invited to play a large role in health care. Private clinics are appearing and the government is also contracting health care to private operators on an experimental basis. Universal free health care is being replaced by a health insurance scheme. Those unable to pay the insurance premiums will ostensibly still qualify for free health care. However, there is little doubt that increasing costs are making health care unaffordable to the poor. A World Bank study in 1995 found that inability to pay was the most frequent reason among the poorest 40 per cent of the population for not consulting health facility when in need.

Apart from high costs, the precarious state of the transport sector and of the roads implies that large parts of the rural population have severe difficulties in physically accessing health care when they need it. As a consequence, lay doctors (often lamas) dispensing traditional medicine and treatment are increasingly being solicited. The increased focus on primary health care is welcome, but it will be difficult to implement, given that only 40 per cent of the physicians are practising outside Ulaanbaatar and that the infrastructure in many *aimag* and *sum* centres has virtually collapsed.

Demographic indicators provide a mixed picture of the development in the 1990s. Average life expectancy has remained virtually unchanged at 63 years. The average life expectancy for men is lower than for women – 62.1 versus 65.4 years in 1995 – but the difference is smaller than in many other CIS countries. Infant mortality has fallen sharply from 76 per thousand in 1985 to 44 per thousand in 1995, no doubt partly due to the sharp fall in fertility. However, maternal mortality has risen somewhat. Nutrition has emerged as a main concern, as has access to drinking water and sanitation. The average daily energy intake fell dramatically from 2,621 calories in 1989 to 1,963 in 1993, but has since risen to 2,278 in 1996. However, the diet tends to be unbalanced, containing too little fruit and vegetables and cereals. Excessive consumption of alcohol in many cases aggravates the problem.

Gender Equality

The transition has imposed a hard burden on the women. Unemployment and financial problems contribute to alcoholism, which in its turn erodes the stability of the families. The result is increasing divorce rates and a large number of street children. The number of female-headed households has steadily increased from 37,800 in 1993 to 54,500, that is more than 10 per cent, in 1998. Similarly, the number of single women with children has doubled between 1990 and 1998.[23]

Women traditionally play a very active role in the economy. Their rate of participation in the labour force has been almost as high as the male rate. Women appear to have been somewhat more affected than the men by the contracting labour market. Female unemployment is slightly higher than for men and their participation rate in the labour force has fallen slightly more than it has for men. However, working women have been hurt in other ways. In the past free day care centres and kindergartens made it possible for, in particular urban, women to combine work with child rearing. Today, combining work with family responsibilities has become much more difficult as most day care centres and kindergartens have either closed down or charge high fees. At the same time harsher economic circumstances make it imperative that there are two breadwinners in the family. The consequence of this dilemma is amply reflected in the sharply declining birth rates.

The Constitution provides men and women with equal rights in all areas and, both by law and in practice, women receive equal pay for equal work and have equal access to education. There are no legal impediments to the participation of women or representatives of minorities in government and politics. Although many women occupy mid-level positions in government and business, their participation in at the top of the political and business hierarchies remains poor. For instance, women make up 11 per cent of the members of the Parliament.

5. Overseas Development Assistance

Mongolia benefits from substantial ODA and technical assistance from large multinational institutions as well as from bilateral donors. Total ODA increased sharply from a mere 21 million USD in 1990 to 262 million USD in 1991 and reached 322 million USD in 1997.[24] Official grants peaked in 1995 at 71 million USD and has since declined to 41 million USD in 1998. At the same time medium and long-term lending has increased from virtually zero in 1994 to 105 million USD in 1998.[25] The total external debt has risen to 71 per cent of GDP, but debt

[23] Mongolia Statistical Yearbook (1998: 30-32).
[24] Including all government guaranteed long term loans and grants. Figures according to ADB. These figures suggest that total ODA in 1997, broadly defined, amounted to over 30 per cent of Mongolia's GDP. That seems to be rather on the high side. Furthermore, official statistics on the receiving end suggest much lower figures.
[25] World Bank (1999c).

servicing remains very modest as most of the lending has been on very favourable terms.

Mongolia is member of the Bretton Wood Institutions since 1991. A three year ESAF (Enhanced Structural Adjustment Facility) package of 45 million was approved by IMF in 1997 and the second disbursement under this programme was recently made. The World Bank has embarked on 12 projects since 1991, four of which have been completed. At the end of December, 1998, their total accumulated disbursements stood at 114 million USD. The focus of the their activities has been on rehabilitation of the physical infrastructure, the energy sector and on financial reform. A 'Transport Rehabilitation Credit' and a 'Coal Project' have been the largest single projects to date, with committed amounts of 35 and 30 million USD, respectively. The World Bank has played a major role in the restructuring of the financial sector, but progress to date (as discussed in Section Three) has been mixed at best. More recently, the World Bank has approved technical assistance to the fiscal sector, a credit to promote the private sector development is in the pipeline and a project aimed at water supply, sanitation and other infrastructure in the *ger* areas around Ulaanbaatar was recently approved.

The Asian Development Bank is the largest single lender to Mongolia. By the end of 1998 their total lending stood at 378 million USD. Altogether 19 loans have been given, of which 15 are still active.[26] ADB's portofolio in Mongolia is very broad. The transport and communications sector and the energy sector have received 110 and 94 million, respectively, industry 60 million, while social infrastructure, agriculture and the financial sector have been allocated 38 million each.

UNDP has a large number of projects in four core areas: Human development, governance and economic transition, and environment and natural resources management. Most of the projects in the field of human development focus on poverty alleviation. The Government launched together with UNDP a National Poverty Alleviation Programme (NPAP) in 1994. This programme serves as an umbrella for a large number of programmes and activities and benefits from the participation of a large number of actors, including the World Bank, ADB, ILO and various NGOs. Strengthening local decision-making through decentralisation and promotion of good governance are in the focus in the field of governance. The latter include an interesting project aimed at exposing and combating corruption. In the field of environment, UNDP helps the Government to implement the UN conventions on biological diversity, climate change, combating desertification and on ozone depletion. A Mongolian Action Programme for the 21st century (MAP 21) aims to define a sustainable development strategy for Mongolia in the coming century.

Japan is by far the largest of the bilateral donors. Between 1993 and 1997 (inclusive) 1997 Japan disbursed a total of 507 million USD in assistance, of which 389 million in the form of grants and 119 million as loans. The main focus has been on modernising physical infrastructure as a foundation for economic development. Rehabilitation of the railways, a large thermal power plant in Ulaanbaatar and of one of the major coal mines have been the largest loan-based activities in this field. The grants have typically been for smaller projects in a

[26] ADB (1999: 91-93)

wide range of areas. Apart from infrastructure, human development, agriculture and livestock and basic human needs are the main target areas.

USAID is the second largest bilateral donor in Mongolia. Between 1991 and 1998 USAID disbursed approximately 85 million USD in grant funded assistance. The largest single project to date has been the supply of spare parts and equipment to upgrade one of the power plants in Ulaanbaatar. At the present, assistance is focussed on promoting the growth of the private sector and consolidating the democratic transition. Within the former area, USAID provides technical assistance to the privatisation of state economic units, the restructuring of the financial sector and to improving the business environment. A project aimed at promoting economic development in two *aimags* in the Gobi desert was also recently launched. Promotion of a rural civil society and technical assistance to the Parliament and the judiciary are main examples of support in the latter area.

6. Summary Conclusions and Recommendations

The transformation of the Mongolian society in the 1990s has been nothing short of remarkable. Politically, Mongolia has broken with a 70 year legacy of totalitarian rule in international isolation to become one of the most open societies in Asia, with a good human rights record and steady development and consolidation of political pluralism and democracy. The achievements in the field of economic transformation have also been impressive. Because of its extreme dependency the Soviet Union for trade and subsidies, Mongolia faced the prospect of economic catastrophe when the Soviet Union collapsed. Yet, although the subsequent economic transformation has been painful, Mongolia has not experienced the same disastrous economic decline as many of the CIS countries did.

There are several reasons behind the comparative success of the Mongolian transformation. Most importantly, the political reform process has been smooth, swift and thorough. and there has been a broad-based consensus behind the comprehensive and far-reaching reform programme. Dissatisfaction with the role as Soviet colony and the perceived external threat from the south made the establishment of genuine sovereignty and independence extremely important and has no doubt played a role in the consensus behind reform as well as in the positive attitude of the international community towards Mongolia. Other favourable circumstances have been the abundance of natural resources, which cushioned the impact of the trade shock, near-self sufficiency with energy and timely and substantial ODA.

However, there are clouds on the horizon.

- The twin evils of corruption and a commercialisation of the nomenclature, with senior government officials and their offspring figuring prominently the nouveau riche, are emerging as threats to a sound societal transformation. However. by CIS standards these phenomenon are still not all that severe and a vigilant and vocal mass media serves as a useful watchdog.
- The crisis in the financial sector continues more or less unabated and is a severe impediment to economic restructuring and recovery. In particular, sorely needed small and medium scale enterprise development and enterprise

restructuring is hamstrung by lack of long term credits and extremely high real interest rates.

- The economic crisis in 1998 has highlighted the vulnerability of the economy and not least public sector revenue to volatility of the world market prices for Mongolia's main export commodities, that is copper. This is a reality which Mongolia will have to learn to live with.
- There has been a disempowerment of local communities and a *de facto* centralisation of power as the local self-sufficiency and local responsibility for schools, primary health care and other local services traditionally provided by the collective farms have disappeared and have not been replaced by any other effective local mechanism for mobilisation of resources for common use. Local governments have due to lack of resources, legal room to manoeuvre and general shortage of capacity and competence been unable to fill the void left behind by the *negdels*. As a result, local autonomy has been eroded and local communities have become increasingly dependent on hand outs from the centre to cover the cost of basic social services.
- A severe deterioration of the accessibility and affordability of basic social services such as education and health care and a dismantling of the public social safety net is causing severe hardship to large groups of the population and is rapidly eroding the quality of the country's human resources. This has largely been due to the crisis in public sector financing, brought about by the general economic crisis and the need to put the fiscal sector on an entirely new footing. However, short-sighted and ill-advised policies, inspired by all to dogmatic prescriptions given by the Bretton Wood institutions have in all likelihood aggravated the situation. These problems deserve serious and immediate attention as they pose a threat to the country's long term recovery.

However, arguably the most serious threat to the country's long term development is posed by the nature of economic development since the country's transition to a market economy. In particular, there are reason for concern with regard to (i) the sectoral composition of economic development, (ii) the capacity of the economy to generate employment and incomes, and (iii) the regional aspects of development. Economic development in the 1990s has had an increasingly narrow base and has been concentrated to extraction of natural resources (mining), animal husbandry and the (largely informal) services sector in Ulaanbaatar. All other economic sectors have contracted sharply and manufacturing has nearly collapsed. Thus, Mongolia is rapidly being de-industrialised and is attaining the characteristics of a typical resource-rich developing country. This development has extremely serious implications on the capacity of the economy to generate employment and incomes and to make use of the highly educated and skilled human resources base. Unemployment and under-employment is rampant and employment opportunities are increasingly confined to livestock herding and informal sector services in Ulaanbaatar. The rapid increase in poverty is largely, but not exclusively, a consequence of this development and it will not be possible to alleviate poverty unless this root cause is effectively addressed.

The dramatic deterioration in the fields of transport and communications and the virtual collapse of the economic base of most provincial centres is resulting in extreme spatial inequalities in economic development. Economic growth has been highly concentrated to Ulaanbaatar and a few adjacent centres, while most of the rest of the country is sliding back into primitive subsistence animal husbandry. The geographic disintegration of the economy and the increasing isolation of large parts of the country and of the population pose a severe threat not only to long term economic development, but also to territorial integrity and to the long term survival of Mongolia as an integral, independent and sovereign nation. Similarly, an economic development that economically and socially marginalises large segments of the population poses the probably most important threat to the remarkable achievements made in the development of an open, pluralistic and democratic society.

Previously designated as an indigenous people under foreign economic, politic and cultural domination, the Mongolian nation of today is faced with the tremendous task of building a new independent identity, embracing both historical nomadic roots and contemporary aspirations for social and economic development. The opening towards the Asian markets and intensified cultural exchange with Asian countries have sharpened the Mongolians awareness of their unsure position between East and West - as well as of the Soviet and European roots of their economy, administration and, in particular, their educational system including the cyrillic alphabet. After independence, heated debates have occurred over cultural issues such as the possible reintroduction of pre-cyrillic classical writing, whether modern education should be universally imposed on Mongolian herding children, the relevance for urban dwellers of ger-type accommodation, the rising prominence of the Lamaist Buddhist church and the choice of national symbols to be adopted.

Guarding the national integrity forces the Mongolian government to weigh nationalism against international politics. In a sense, Mongolia's present dilemma is expressive of a transitional plight affecting much of Central Asia after the break-up of the Soviet Union and the country cannot be blamed for a pragmatic balance-act between well-known historical players in the region. A traditional antagonism towards China does not preclude the rising significance of Chinese capital and the Chinese market, while, on the other hand, the undeniable Western and Japanese influence resulting from international aid causes scepticism. Further, a certain loyalty towards Russia, reminiscent of the time when all where fed, clothed, educated and cared for by the state, remains in all echelons of the Mongolian society.

How Can Sweden Help?

Sida would appear to be in a good position to provide meaningful assistance to Mongolia during the present critical period of its development. Mongolia is not an entirely new country on Sida's map, as Sida is already providing assistance in key areas such as governance and poverty alleviation. More importantly, Sida has considerable experience with assisting the difficult transformation of former socialist countries into democratic and pluralistic market economies. The lessons from the massive and successful assistance provided to the Baltic countries are perhaps particularly valuable in this context, but the considerable experience from the long-standing support to the reform process in Vietnam also deserves to be mentioned. Furthermore, as a country that has only recently broken out of seventy years of international isolation, Mongolia needs bilateral contacts and support from other countries.

The review above highlights a number of areas where Swedish assistance would be relevant.

- Reforming and strengthening local governments remain one of the most crucial areas in the field of governance. Local governments play a critical role in both the economic and political reform process, yet they are singularly ill-equipped to assume it. In the case of Mongolia there has arguably been *de facto* disempowerment of local communities. This is a trend which needs to be broken in the interest of sound economic and political development. Sida is providing assistance through a UNDP programme in this field. However, alongside assistance to enhance the capacity and competence of local authorities the broader issue of recreating a local economic and fiscal base also needs to be addressed.
- The regional aimag centres have suffered the worst economic decline of all areas and are in most cases in severe crisis. Support to rebuilding regional/local economies is of key importance both for poverty alleviation and for sustainable economic development. While this is an area where Swedish assistance can perhaps only play a limited role, the importance of reconstructing the transport infrastructure should be underscored. Assistance with road rehabilitation deserves very high priority. In view of the very high unemployment in the urban areas outside Ulaanbaatar and the shortage of cash, the possibility of funding public works programmes in connection with road rehabilitation deserves attention.
- The vast distances imply that Mongolia can benefit greatly from modern means of communication. Along with a rehabilitation of the transport sector, primarily roads, development of a modern system of communications would go a long way towards reducing 'the tyranny of distance'.
- Cushioning the social impact of the transition is crucial for both humanitarian reasons as well as to strengthen the viability and durability of the reforms. The main cause of the increase in poverty is no doubt the decline in employment and income opportunities and a stronger emphasis on employment-oriented economic development must therefore be a key ingredient in any attempt to alleviate poverty. However, education, health care and social security have also suffered as a consequence of the rapid decline of the fiscal base. Assistance to mitigate the social consequences of the transition is of crucial importance to Mongolia and is also in line with Swedish priorities. It is not only a question of money, but also of mentality and practices. Material support as well as technical assistance and training is needed to rehabilitate as well as to modernise in particular health care and social security. Sida has considerable experience in this field from assistance provided to CIS countries in the past decade.
- Sida may or may not consider to provide temporary budget/balance of payment support to Mongolia. Arguments in favour of such support are (i) proven government priority to key social sectors, (ii) the need to cushion the impact of the sharp decline in the fiscal base, and (iii) the prospects of increased government revenue in the medium term future as a result of exploitation of natural resources, in particular oil (which suggests that the need for support would be temporary). However, the public sector finances still suffer from lack of transparency and unambiguous accountancy practices. In any case, assistance to the reform and modernisation of the fiscal sector is much needed and is an area where Sweden has considerable experience.

- Mongolia needs to diversify its economy and, not least, to rebuild a manufacturing sector. This requires links and collaboration with foreign firms. Sida might therefore consider extending its StartEast and/or StartSouth Programme to Mongolia as well as actively assist the forging of economic links between Sweden and Mongolia.
- The rather large number of highly educated people in Mongolia is not only due to the domestic emphasis on education in the past, but also the generous opportunities that existed for Mongolian youth to attend higher education in the Soviet Union or in Eastern Europe until ten years ago. Sweden could make a contribution towards recreating this important window of opportunity to develop and maintain high-quality domestic Mongolian expertise by offering scholarships for talented Mongolians with a basic university degree from home to pursue further studies to a Masters' level in Sweden.

As Mongolia after seventy years of involuntary international isolation embarks on the extremely difficult task of transforming the entire society after a Western political and economic model it desperately needs strong bilateral contacts with other countries and with people from other countries. Its precarious geopolitical position further underscores this need. It needs exposure to the best foreign practices in all social, economic and political fields, it needs dialogue and exchange of experiences and it needs understanding for its own aspirations and problems and for the particularities of the Mongolian society. In short, it needs genuine partners in development. As a small democratic country with no vested interests or hidden agendas, Sweden is well-placed to play the role of such a partner.

Whatever the area of assistance, the importance of exposure and personal contact and dialogue deserve a prominent role. Study tours, internships, scholarships and a generally high content of personal interaction are crucial to help create a vision of the road ahead and to promote genuine reform. There needs to be a basis of trust if assistance that aims not only at development, but to fundamentally change entrenched structures, mores and perceptions (which after all is at the heart of the so called reform process) is to be effective. This requires intense personal interaction, insight into each others cultures and a genuine feeling of partnership and assistance needs to be designed accordingly.

In line with the above, Sweden can also play an important role in supplying Mongolia with critical expertise. The absence of high caliber domestic economic and other expertise combined with the overwhelming negotiating power of the World Bank and other large multi-national agencies puts Mongolia strictly on the receiving end as far as policy-making is concerned. Mongolia would no doubt benefit from access to impartial and disinterested expertise in key areas. Sida could play a constructive role by recruiting such expertise and putting it to Mongolia's disposal.

Lastly, the possibility of three-party co-operation should be explored. The Baltic countries have advance quite far on basically the same road that Mongolia has embarked upon. Their experiences are in many instances highly relevant for Mongolia. There is also a common language in the form of Russian. There are many areas where a three party constellation, involving a Baltic as well as a Swedish partner in the assistance would be opportune.

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