CHAPTER 7

The Business Climate: Institutions and Governance

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Mongolia's governance indicators have long been an anomaly in Asia, viewed both in terms of the country's state socialist past and in its place in the world today. Since its political and economic transition started in the early 1990s, Mongolia has shown all the nominal and structural features of a capitalist democracy. But it is also a rare case among countries of the former Soviet bloc in that its democracy has been neither eroded nor reversed.

Mongolia's many features of a functioning democracy include the 1992 Constitution, which has popular legitimacy even as it is being amended in late 2019, and a Parliament that has been regularly elected and has seen a transfer of power between different parties. This achievement has been rooted in near universal literacy in a small population. The country is increasingly overcoming some of the challenges that its low population density poses by being very connected and active online. All these features are commonly used criteria to assess the extent to which a country is judged to be democratic. Freedom House, in its yearly Freedom of the World survey, has categorized Mongolia as a "free" country since 2014 on the basis of its popularly supported democratic decision-making processes.

In Freedom House's 2020 survey, Mongolia scored 84 on a scale ranging from 0, scored by Syria, to 100, scored by Finland, Norway, and Sweden (Freedom House 2020). The scoring suggests a fine-grained resolution of the scale that is probably somewhat illusory even when it is tied to the answers on specific questions that make up the index. Countries scoring 83–85 are Antigua and

Barbuda, Argentina, Croatia, Monaco, Panama, Poland, the Republic of Korea, Romania, and Sao Tome and Principe. That is not bad company to keep in such a ranking of governance. Note that the only Asian country in this range is the Republic of Korea, and only three former socialist states, Croatia, Poland, and Romania (now members of the European Union) are in the same range.

The only Asian economies assessed as more free than Mongolia in Freedom House's survey are Japan (96) and Taipei,China (93). The Republic of Korea, just below Mongolia with its score of 83, provides a good comparison because both countries broadly started on their democratic paths in the late 1980s—the Republic of Korea in 1987, when military control ended. Compared with other former state socialist countries, Mongolia scores well—it is only outdone by Estonia and Slovenia (both 94), the Czech Republic and Lithuania (both 91), Latvia (89), Slovakia (88), and Croatia (85).

Mongolia's civil rights have consistently scored 2 (7 = lowest, 1 = highest) on Freedom House's *Freedom in the World* report. For Freedom House's political rights subcategory, Mongolia consistently gets high scores for electoral process and extent of political pluralism. It scores less well for the subcategory of the functioning of government. For the civil liberties subcategory, Mongolia ranks well in extent of freedom of expression and association, but has a lower rank in the rule of law.

On the Bertelsmann Foundation's 2020 Transformation Index, which focuses on countries in transition, Mongolia ranks 28th of 137 countries for political transformation (Bertelsmann Foundation 2020). Unlike Freedom House, which focuses on political and civil rights, the measure of "political transformation" most closely approximates a measure of the institutionalization of democracy. Here, in a scoring system that ranges from lowest (0) to highest (10), Mongolia had a political transformation score of 7.30. That puts Mongolia into a similar category (+/− 0.1 in the score) with Ecuador, El Salvador, and North Macedonia (7.20), India (7.25), Montenegro (7.35), and Brazil (7.40). The Asian economies that rank above Mongolia for political transformation are Taipei,China (9.55), the Republic of Korea (8.60), and Timor-Leste (7.55). Many former state socialist countries in Europe rank ahead of Mongolia. In Central Asia, the Kyrgyz Republic (6.10) ranks below Mongolia and other countries are significantly lower.

Mongolia's democratization has been all the more remarkable because it happened in a context that was hardly conducive to this process, given poverty, regional politics, and democratic traditions. Until 1911, Mongolia was a feudal society focused entirely on pastoral herding to serve the nobility and Buddhist monasteries. During the state socialist period (1921–1990), Mongolia developed economically. Industries were built with Soviet support from the early 1920s on. Within the the Council for Mutual Economic Assistance (COMECON), Mongolia's contribution largely came through meat exports, but central planning placed industrial production in many of the provincial centers that were created through state socialist administrative reforms.

With the collectivization of animal husbandry, even this central sector was somewhat rationalized around economic targets in the 1960s. Mining projects helped underpin Mongolia's economic development during the Soviet era. The Erdenet copper mine was the largest of these, operating from the 1970s as a Soviet–Mongolian joint venture contributing significant copper production. The Mongolian economy collapsed in 1991 after the withdrawal of Soviet economic support.

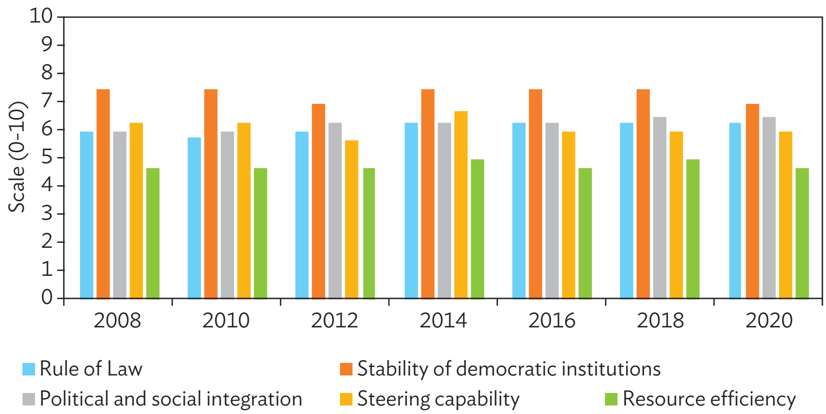
While Mongolia's nascent democracy was being designed and the first steps taken to institutionalize it, the country was mired in poverty. Throughout the 1990s, the economy underwent "shock therapy" experiments following international advice. The 1990s was the decade of Mongolia's initial institutionalization of democracy, and the first peaceful change of power followed an election in 1996. It was not, however, a period of economic security or comfort.

Mongolia's democracy developed without regional support. The former state socialist countries in Eastern Europe developed their democracies in close geographical proximity to the European Union, but Mongolia essentially had "to go it alone." And although Asia's democracies were regarded as "third neighbors" by Mongolia's foreign policy, they did not actively promote democracy in the way that the European Union did to the former state socialist countries of Eastern Europe. Mongolia's democratic credentials are attested by global surveys, the country's membership since 2012 in the Organization for Security and Co-operation in Europe, and its hosting of the annual meeting of the Community of Democracies in 2013.

7.1 Political Institutions, Risks, and Governance

Remarkable though Mongolia's democratization has been, concerns are growing about the quality of government and governance. As Figure 7.1 shows, key governance indicators, including rule of law (separation of powers, independent judiciary, and prosecution for abuse of office), have not been as high as Mongolia's commitment to democratization. Indeed, recent international and local surveys identify negative perceptions of Mongolia's political institutions and policy making as the largest impediments to the country's business and investment climate. The World Economic Forum's 2018 Global Competitiveness Index ranks policy instability and corruption as the biggest problems to doing business, and both have topped previous surveys (WEF 2018). A survey of 2,000 companies by the National University of Mongolia shows that the policy and the legal environment for doing business are problems for local businesses (Mongolian Chamber of Trade and Industry and NUM 2017).

Figure 7.1: Governance Indicators, Selected Years 2008–2020



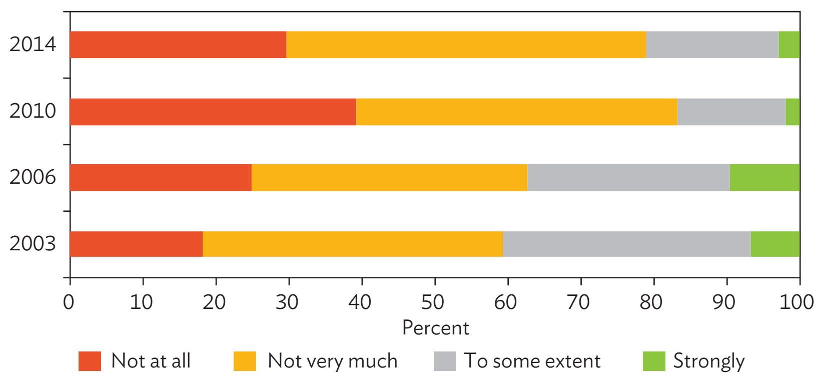
Source: BTI Transformation Indexes for the years shown (Bertelsmann Foundation 2020).

The following sections examine the performance of key political institutions and the challenges they face for implementing reforms.

Political parties

Asian Barometer surveys show that since the early 2000s public trust in political parties has fallen dramatically: see Figure 7.2 (Hu Fu Center for East Asia Democratic Studies 2019). Some observers attribute this to corruption in political parties. The Asia Foundation's survey on Perceptions and Knowledge of Corruption has, since 2015, ranked political parties in the top five institutions in Mongolia perceived to be most corrupt (Asia Foundation 2018b).

Figure 7.2: Public Trust in Political Parties, Selected Years 2003–2014



Source: Authors' analysis of survey data from Asian Barometer Surveys for the years shown (Hu Fu Center for East Asia Democratic Studies 2019.).

The Defacto Institute's 2018 Internal Democracy Index concluded that most political parties in Mongolia were "semi-democratic" in their internal processes, and that competition within political parties is increasingly dominated by financial capital and patronage networks (Defacto Institute 2018). The membership in political parties and activists' allegiance to these parties are very low, suggesting that "political parties are not considered to be the backbone of democracy even by their foot soldiers, but rather thought of 'at best' as an instrument for some other purpose" (Koo 2018: 375).

According to an International Institute for Democracy and Electoral Assistance report, Mongolia does not meet international guidelines and best-practice recommendations on party funding (Burcher and Bértoa 2018). The oversight and disclosure of party finances by a mandated authority especially fails to meet international standards. Current party finance regulations do not effectively deter parties or candidates from illegal funding. The Organization for Security and Co-operation in Europe noted that new requirements for Mongolia's political parties on financial reporting and auditing have been introduced into the election laws, but there are hurdles to their implementation (OSCE 2017). While the law requires political parties and candidates to submit reports on the donations they receive before elections to mandated authorities, it does not include clear requirements for public disclosure and access to information. By law, the Mongolian National Audit Office has a broad range of powers and responsibilities on pre- and post-election audits of election campaign financing, but implementation has been inadequate (Enkhtsetseg 2017). The Law on Political Parties, revised in 2005, requires parties to disclose annually their audited financial reports, but this has not been enforced. As a result, there has been little incentive for financial transparency among major parties.

Several proposals have been made to revise the Law on Political Parties to improve transparency and accountability. The National Plan for the Fight against Corruption approved by the government in November 2016 defined measures for ensuring the transparency of party finances. In 2017, a parliamentary task force began work on drafting an amendment of the law, regarding transparency. The focus of the reform is to eradicate the illegal private funding of political parties and other forms of corruption by introducing public funding and better oversight and disclosure mechanisms.[1] Previous attempts to reform the Law on Political Parties failed, suggesting the ongoing attempt may not be straightforward. For example, a 2016 draft law prohibiting political parties from setting up committees in small districts (*soums*) attracted a lot of criticism. Improving the oversight of public funding and the disclosure of private funding through better adjudication and judicial mechanisms in the law will be crucial for reforming political parties.

Mongolia's political parties' positions on socioeconomic development and well-being tend to be rather vague and inconsistent. Voters and party members often do not have the opportunity to decide on competing policy packages that reflect the core values that the parties proclaim. But it is important that political parties have clear, long-term perspectives on important economic issues, such as taxation, credit access, and pensions, which tend to be wrapped up in general pronouncements. Policy debates are not integrated into the party structures and processes. Youth initiatives within parties have tried to transform their parties into policy institutions, but no clear path forward to achieving this has been identified. Indeed, the party system incentivizes parties to state vague and less testable platforms, and it motivates individual politicians and factions within parties to aim at opportunistic electoral advantage.

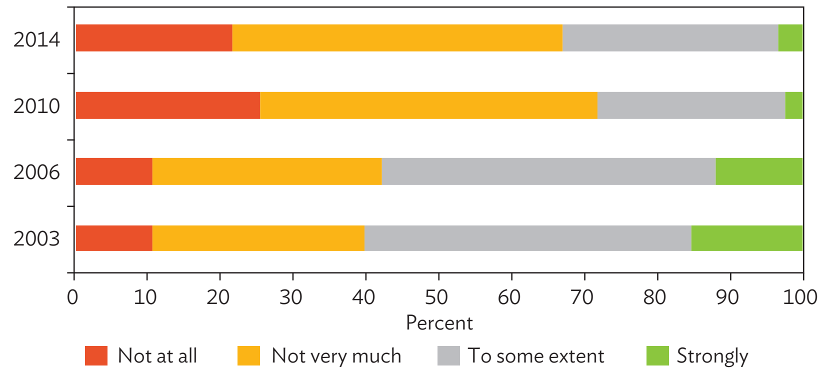
[1] By law, political parties receive MNT1,000 ($0.40) for each vote they receive and MNT10 million ($4,000) for each parliamentary seat they win.

The lack of substantial policy debates in party politics and election campaigns partly reflects the country's majoritarian electoral system. Elections campaigns are centered on electoral districts, and candidates narrowly focus their campaigns on local issues. The 2012 introduction of proportional representation for 28 of the 76 seats in Parliament was important for motivating political parties to develop policies of substance, but this was cancelled by amendments to election laws in 2016.

Parliament

Parliament has been a crucial support to the country's political and economic transition. As a forum for collective decision-making and inter- and intra-party competition for power and influence, Parliament has in many ways prevented a reversal of democratization in Mongolia, as has happened in many post-Soviet countries that chose presidential systems. Public trust in Parliament has, however, plummeted since about 2010, as well as in the country's political parties (Figure 7.3).

Figure 7.3: Public Trust in Parliament, Selected Years 2003–2014



Sources: Asian Barometer Surveys for the years shown (Hu Fu Center for East Asia Democratic Studies 2019).

Parliamentary debates are frequently derogatory. An Asia Foundation survey found that members of Parliament (MPs) are widely seen as corrupt or belonging to business–political groupings (Asia Foundation 2018b). The owners and shareholders of many large companies are also MPs. And many MPs have direct and indirect beneficial business ownerships, according to their assets and income statements submitted to the Independent Authority Against Corruption (Ikon.mn 2017).

The disclosure by Mongolian investigative journalists of the names of 49 MPs allegedly connected to companies or their beneficial owners that received low-interest loans from the state-run Fund for the Development of Small and Medium-Sized Enterprises showed the depth of conflict of interests in Parliament (Transparency International 2019b). The government's approval of an obscure, interim regulation for allocating loans to small and medium-sized enterprise (SME) projects from the fund in 2016 increased the influence the government and politicians had on decisions affecting the fund.[2] Although the head of the fund, the state auditor, and the minister overseeing the fund have been dismissed, efforts to hold MPs accountable were constrained by their parliamentary immunity.

The number of new laws and amendments passed by Parliament since about 2010 has steadily increased (Enkhbaatar et al. 2016), suggesting that the workload of MPs has increased. By law, Parliament can pass laws and regulations by a majority vote of no less than 50% of all 76 MPs who are present. Thus, the attendance of a minimum of 38 MPs allows Parliament to hold a session and their majority (a minimum of 20) can pass laws and regulations.

The Law on Legislation, passed in 2015, is based on lessons learned from ill-prepared laws, and aims to integrate research, stakeholder consultation, and analysis into lawmaking. However, strong research and advisory bodies still need to be developed for Parliament. Although this is broadly acknowledged, efforts and political backing to accomplish it have been inconsistent.

Government

International investors cite political instability as a big cloud in Mongolia's business climate. Foreign mining and mineral exploration companies have expressed concerns about the country's lack of political certainty and unwelcome surprises from cyclical instability. The *Annual Survey of Mining Companies* (Fraser Institute 2018) show that political instability has affected Mongolia's attractiveness as an investment destination (Table 7.1).

Mongolia has had 14 governments since 1992 (Table 7.2). The average term in office of Prime Ministers is 2 years, a pattern that has been well-established since 2004. The Constitution states that Parliament is the "highest organ of state power." The Prime Minister does not have discretionary power of dissolution, which is common in many traditional parliamentary democracies.

[2] The interim regulation allowed the fund to provide business loans of up to MNT2 billion ($750,000) with an interest rate of 3%, which is extremely low compared with bank rates of up to 20%.

Table 7.1: Mining Companies Business Climate Perception, 2008–2017
(%)

Indicator	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Mineral potential assuming current regulations and land use restrictions	64	53	45	25	59	68	82	76	82	90
Uncertainty concerning the administration, interpretation, and enforcement of existing regulations	93	87	78	75	80	82	85	100	82	70
Regulatory duplication and Inconsistencies (includes federal/provincial, federal/state, interdepartmental overlap, etc.)	84	69	76	48	58	75	84	89	82	82
Legal System (legal processes that are fair, transparent, non-corrupt, timely, efficiently administered, etc.)				71	88	92	94	89	73	91
Taxation regime (includes personal, corporate, payroll, capital and other taxes, and complexity of tax compliance)	84	33	79	67	81	84	89	76	82	73
Socioeconomic agreements/community development conditions (includes local purchasing, processing requirements, etc.)	57	72	76	71	66	64	77	75	82	60
Political stability	97	88	70	73	94	86	88	87	64	90

Note: Numbers indicate % of negative ratings. Orange cells indicate consistent risks.
Source: Authors' analysis of Fraser Institute (2018) data.

Table 7.2: Mongolian Prime Ministers and Their Governments Since 1992

Prime Minister	Time in office	Composition of the government	Reason for termination
Puntsag Jasrai	21 July 1992–19 July 1996	MPP (former MPRP)	General election
Mendsaikhain Enkhsaikhan	19 July 1996–23 April 1998	Coalition of MNDP and MSDP	Ousted by opposition and own party
Tsakhia Elbegdorj	23 April 1998–9 Dec 1998	Coalition of MNDP and MSDP	Ousted by own party
Janlav Narantsatsralt	9 Dec 1998–22 July 1999	Coalition of MNDP and MSDP	Ousted by opposition and own party
Renchinnyam Amarjargal	30 July 1999–26 July 2000	Coalition of MNDP and MSDP	General election
Nambar Enkhbayar	26 July 2000–20 Aug 2004	MPP	General election
Tsakhia Elbegdorj	20 Aug 2004–13 Jan 2006	Coalition of DP and MPP	Resignation of cabinet members
Miegombo Enkhbold	26 Jan 2006–7 Nov 2007	Coalition of MPP and other parties	Ousted by own party
Sanj Bayar	22 Nov 2007–29 Oct 2009	Coalition of MPP and other parties	Resigned due to declining health
Sukhbaatar Batbold	29 Oct 2009–10 Aug 2012	Coalition of MPP and other parties	General election
Norov Altankhuyag	10 Aug 2012–21 Nov 21 2014	Coalition of DP and other parties	Ousted by own party
Chimid Saikhanbileg	21 Nov 2014–8 July 2016	Coalition of DP and other parties	General election
Jargaltulga Erdenebat	8 July 2016–4 Oct 2018	MPP	Ousted by own party
Ukhnaa Khurelsukh	4 Oct 4 2018–present	MPP	

DP = Democratic Party, MPP = Mongolian People's Party, MPRP = Mongolian People's Revolutionary Party.
Sources: Enkhbaatar et al. (2016) and authors' analysis of various sources.

Without this power, which can be an important incentive for MPs to support the cabinet, the Prime Minister and the cabinet frequently face no-confidence votes. The Prime Minister has to carefully navigate competing interests of individuals and factions within their political parties and other parliamentary parties to avoid obstructions. Importantly, factional politics and their effects on cabinet composition and performance inhibit the government's effective treatment of complex whole-of-government issues. Because providing the Prime Minister with the power to dissolve Parliament is unlikely to be widely accepted in Mongolia, it is crucial that changes are made to find a balance between politics and policy.

Amendments to the Constitution in 2000 lifted the prohibition on MPs holding concurrent posts, allowing MPs to become ministers. Boldbaatar (2017) and others argue that this change may have created a strong motivation for backbenchers to oust the government and become cabinet members during a Parliament's term. As Table 7.2 shows, backbenchers or MPs of their own party have frequently used votes of no confidence to cause the resignation of a government.

In November 2019, Parliament passed several constitutional amendments. Public discussion of the amendments had started in June 2019 and was extensive, with several of the proposals evolving. Some of the amendments will only have an impact if followed up on by specific laws, but others have nudged Mongolia from its hybrid presidential–parliamentary constitutional system in the direction of more parliamentary power. For example, the Prime Minister, elected by Parliament, will be able to appoint cabinet members without requiring approval from the President. As O. Munkhsaikhan, who was a member of the constitutional working group, notes, "With a view to addressing problems of government instability... the amendments require an absolute majority for the dismissal of the Prime Minister, instead of a simple majority as is currently the case, and an obligation to appoint a new Prime Minister within 30 days, failing which the President is obliged to dissolve Parliament" (Munkhsaikhan 2020). While Parliament has been restrained in terms of individual MPs' ability to add items to the budget vote, MPs have also been given greater powers to initiate investigations.

In established democracies, the negative effects of frequent government changes on the business climate are often minimized by long-term policies and politically impartial and independent civil services. However, new governments in Mongolia often make significant policy shifts. When the Altankhuyag administration stepped down in 2017, the new minister of justice reversed justice reforms initiated by the previous minister. The frequent government changes do not provide sufficient time for new policies to be designed and implemented.

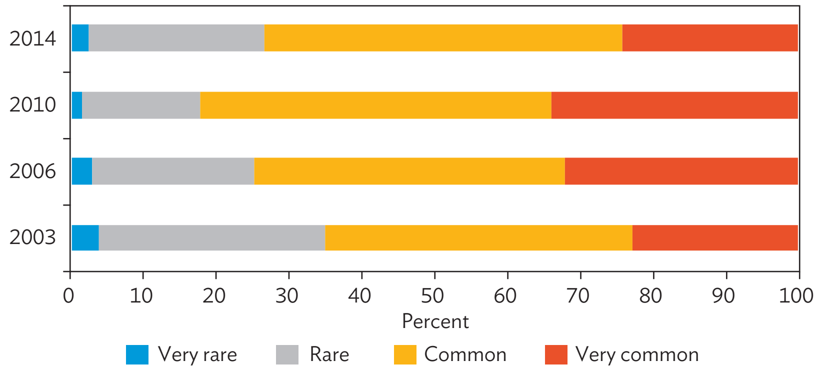
Mongolia's Constitution and Civil Service Law prohibits the removal of civil servants because of political discrimination or election outcomes. Government changes have, however, led to the replacement of large parts of the civil service. According to a World Bank report, turnover rose from 5% of the civil service in 2007 to 14% in 2014, weakening morale, reducing accumulated experience, and diminishing its effectiveness and capabilities (Forneris et al. 2018: 12).

The Civil Service Law, passed in 2019, aims to protect public administration from political influence, and improve professional capabilities in the civil service and enhance its accountability. The government is expected to draw up about 40 supplementary procedures or guidelines to the law and to submit a bill on the conduct and responsibilities of civil servants to implement the law. However, a long-term government policy or substantial policy debate on the size, competency, and performance of the civil service is still lacking and will be vital for implementing the law effectively.

Recent assessments of Mongolia's investment climate have sent a clear message to the government that, despite the imperfections of existing laws, more effort is needed to properly implement them and to give investors time to become familiar with them before they are changed again. As the International Finance Corporation, commenting on Mongolia's Investment Reform Map, puts it, the "costs of launching yet another revision process of the investment law in a country where it has changed so often have to be balanced against the benefits of these changes" (IFC 2018: 5). Bruckner and Danielson (2017), in an assessment of Mongolia's mining policy, conclude that frequent revisions of laws that affect mining risk lowering investor confidence and are a source of stakeholders' lack of clarity on the current rule of law. More independent reviews and multistakeholder efforts are needed to tackle the duplications and contradictions in Mongolia's laws. A 2017 media report found numerous examples of this in the minerals sector (News.mn 2017). The inconsistencies appear to deter mining and exploration companies from operating in Mongolia (Table 7.1).

Public perceptions of the scale of the abuse of power by government officials have historically been negative in Mongolia (Figure 7.4), but have been particularly noticeable since the mid-2000s, especially during the mining boom.

Figure 7.4: Perceptions of Corruption and Bribe-Taking in National Government, Selected Years 2003–2014



Note: The question asked in the surveys was, "How widespread do you think corruption and bribe-taking are in the national government?"
Sources: Asian Barometer Surveys for the years shown (Hu Fu Center for East Asia Democratic Studies, 2019).

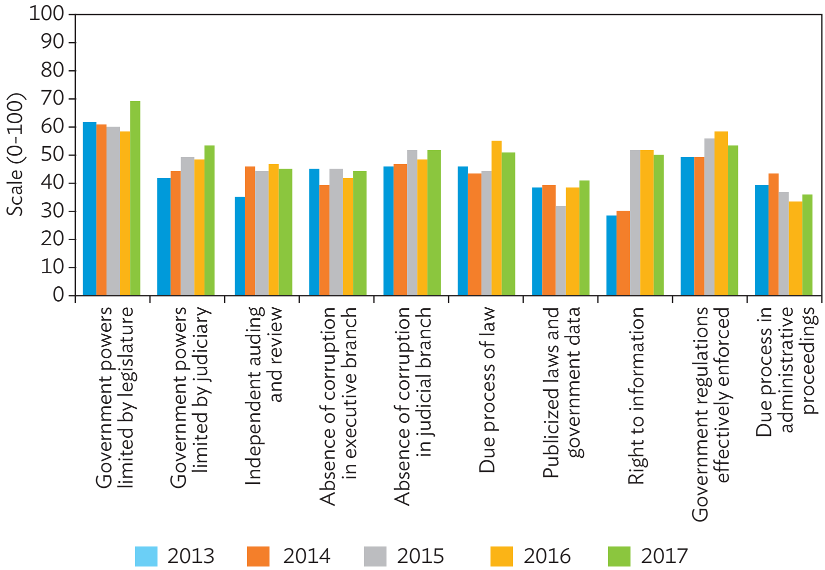
The local business community perceives corruption by government officials as high. Nearly 80% of respondents in an Asia Foundation survey on private sector perceptions of corruption in Mongolia rated such corruption as a "a lot" or "some." The top five government agencies seen to be the most affected by corruption are the Tax Office, the Specialized Inspection Agency, the Customs Agency, the Land Administration, and the Government Trade Authority (Asia Foundation 2018a).

The number of cases the Independent Authority Against Corruption has investigated and submitted to the courts has increased, including cases against cabinet members and provincial (*aimag*) governors. But 25% of these cases in recent years were terminated by prosecutors and only 9.5% led to convictions (OECD 2019). Courts have also dropped corruption charges because of limitation periods in the Criminal Law, passed in 2017. While limitation periods on corruption and the embezzlement of public funds are long enough or nonexistent in many countries, such limitations are not integrated into relevant laws in Mongolia (Transparency International 2010). In 2018, the local media alleged that politicians, civil servants, and businesses used the prosecution limitation periods to avoid criminal and civil liabilities for themselves and their associates (Mongolian National Broadcasting 2018; *UB Post* 2018).

Judicial system

Mongolia ranked 53rd of 129 countries in the 2019 World Justice Project's Rule of Law Index; it scored 0.55, where 1.0 is the highest score and 0, the lowest (Figure 7.5). The country scored very well for absence of civil conflict, and very poorly for absence of government interference in criminal justice and absence of corruption in Parliament. Central Asian countries that ranked below Mongolia in the index were Kazakhstan, 65th (0.52), and the Kyrgyz Republic, 85th (0.48). Mongolia ranked 8th of 15 countries in East Asia and the Pacific and 3rd of 30 lower-middle-income countries. Countries with similar scores to Mongolia include Bulgaria, Macedonia, and Trinidad and Tobago, (0.54); Malaysia and Senegal (0.55); and Jamaica (0.56).

Figure 7.5: Rule of Law Indicators, 2013–2017



Source: Authors' analysis of World Justice Project (2019) data.

Mongolia's judiciary has a poor reputation among domestic and foreign investors for impartial decisions in legal disputes, as indicated by the US Department of State's annual Mongolian Investment Climate Statements. As regularly noted in these statements, foreign investors report that, in resolving disputes, a Mongolian private party exploited contacts in government, the judiciary, law enforcement, or prosecutor's office to coerce a foreign private party to accede to some demand (US Department of State 2018). By contrast, investment agreements and contracts that specify international arbitration to resolve disputes have a higher level of confidence.

Experience and prominent cases are behind the foregoing negative assessments. One case involved Khan Resources Inc., a Canadian uranium miner that had its Mongolian mining license revoked in 2009. Despite receiving judgments against this decision in the Mongolian courts, Khan Resources ultimately had to turn to arbitration to win a $100 million settlement (Dierkes 2015). As Zhang (2015) notes, an international arbitration tribunal under the United Nations Commission on International Trade devoted a large portion of their analysis of the merits to the claims of unlawful expropriation. That is, whether the invalidation of the mining licenses and failure to reregister them constituted an unlawful expropriation under Mongolia's Foreign Investment Law of 2013. Government officials argued at the time that investors should consider that it is better to invest in a country where it is possible to sue the government against decisions like this, than in a country where such decisions cannot be disputed. But the lack of enforcement of domestic decisions remains a stain on confidence in the judicial system.

Transparency International (2019b) indicates that doubts about the independence of Mongolia's judiciary intensified after a March 2019 law gave the National Security council the power to dismiss judges, arguing that the wrongdoing of judges required sanctions. But this has also undermined the ability of judges to act, if needed, against the state or political actors.

The independence and accountability of the Judicial General Council—which has the power to select, nominate, and appoint judges—has been endangered by a series of failed judicial reforms since about 2000 (Munkhsaikhan 2014). The council was set up in 1993 under the Law on Court Administration with 12 members and a chair (incumbent for 3 years and appointed by council members). The chief justice of the Supreme Court was the first chair. The law was amended in 1996 to allow the minister of justice to chair the council. In 2002 the law was again amended to enable the chief justice become the chair. While this gave judges a key role in court administration, it eroded internal checks and balances within the judicial system. In 2012 the Law on Court Administration allowed the President to appoint the chair, who should be nominated by the members of the Judicial General Council.

One of the areas of the recent constitutional amendments where follow-up legislation will be crucial is judicial appointments and dismissals. The composition of the Judicial General Council is set to be balanced and representative. The amendments also create a new constitutional body, the Judicial Disciplinary Council, and determine its composition. This body is envisioned to be tasked and staffed to review cases of misbehavior by judges, but until new legislation is passed, power rests with the National Security Council since the 2019 March legislation that created that power.

Policies for judicial reform in Mongolia have been a focus of support from development partners. White (2009) argues that their approach has been institution-building to improve the capacity and resources of judicial institutions, and that priorities for reform have been defined with the consent of the leadership of these institutions. This top-down approach focusing on capacity building, professionalism, and resources failed to address deep-seated concerns over institutional corruption and popular demands and popular movements for judicial reform.

Anticorruption institutions and initiatives

As Figure 7.5 shows, access to information has improved noticeably. Important publicly accessible information databases and sources now include the State Registration Information Database, the Digital Information Database of Courts, and the online database of the Extractive Industries Transparency Initiative (EITI). In 2018, independent media used publicly available data to expose the companies that had received loans from the Small and Medium-Sized Enterprise Fund. When the names of such companies were disclosed, open databases and other sources, such as Statement of Assets and Income submitted by government office holders to the Independent Authority Against Corruption, were useful for journalists to identify their owners and connection to politicians. The Law on State Registration, passed in 2018, requires the government to set up a public database containing the registration- and ownership-related information of legal entities.

In 2019, the government approved a new regulation of the Small and Medium-Sized Enterprise Fund that aims to improve transparency and fair competition in the selection for allocating loans. The fund is one of 29 special funds financed by the government budget—and there are concerns about governance and accountability. As in case of judicial reform, development partners have tended to focus on capacity building and the training of key stakeholders (including government officials) on their support for SMEs, rather than on the distribution and accountability of government loans to the sector.

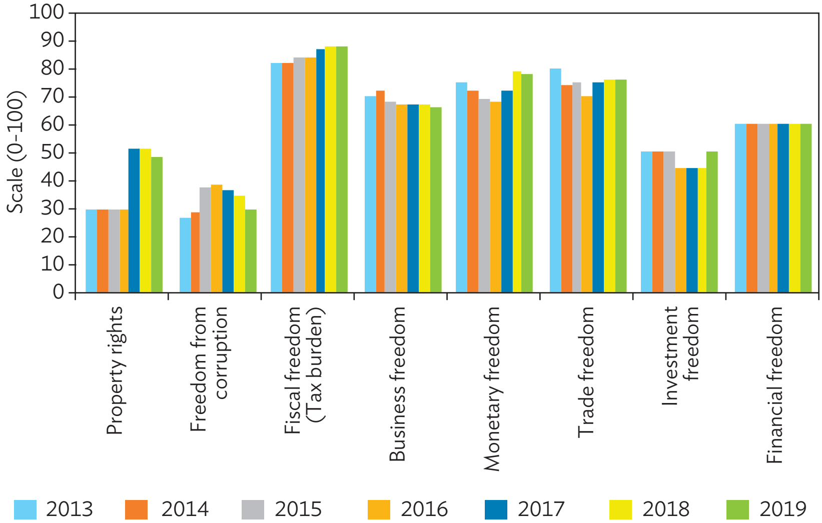
The development partner community can put pressure on governments to carry out reforms—as the International Monetary Fund did during the Asian financial crisis for Indonesia in an assistance program that was conditional on setting up an independent anticorruption agency, among other things. One of the most prominent international anticorruption efforts is the EITI, which is funded by the World Bank and others (World Bank 2018f). The Asian Development Bank is the main external funder of the EITI Secretariat in Mongolia since 2019. The EITI has been working in Mongolia since 2006, but its efforts are undermined by the lack of a long-term legal and financial basis. An attempt to embed the EITI into a government-backed draft law promoting transparency in the minerals sector failed to progress. Even so, the EITI has been producing detailed reconciliation reports that seek to match the reports on payments by the extractive industry to government receipts. The first report was issued in 2008 and 12 have been done as 2017.

Under the EITI, national and regional civil society councils have been set up. Along with other international efforts, the EITI in Mongolia does project reporting and, more recently, has added contract transparency to its work. While reporting is extensive and structures for civil society engagement have been created, the EITI's ultimate ambition—to arm civil society actors with information to demand accountability from politicians and administrators—remains largely unfulfilled due to a lack of engagement on the part of civil society with the evidence provided by reports by media and civil society. As was clear from the 2018 scandal over the Small and Medium-Sized Enterprise Fund, when public attention was focused on a particular issue, evidence can be crucial to introducing a public debate on government accountability. The EITI is therefore an important transparency and anticorruption tool that Mongolia can use.

Market institutions and business climate

The private sector constitutes about 80% of GDP and 75% of employment in Mongolia (ADB 2017a). The important role that the private sector plays in the economy is widely recognized in Mongolia and property rights for domestic and international investors are acknowledged in laws and regulations as an important element of economic freedom (Figure 7.6) that spurs entrepreneurialism (Bertelsmann Foundation 2020).

Figure 7.6: Indicators of Economic Freedom, 2013–2019



Source: Authors' analysis of the Heritage Foundation's 2019 Index of Economic Freedom data (Heritage Foundation 2019).

The government publicly endorses a policy of improving market competition and easing government bureaucracy, including e-governance initiatives. A 2015 Independent Authority Against Corruption survey found that business registration agencies were seen as the least corrupt among government agencies, and the easiest to access (IAAC 2016). The Law on Value-Added Tax, passed in 2016, introduced an incentive mechanism through which taxpayers can recover up to 20% of taxes paid; this reform helped develop a better registration system.

Market competition in many sectors of the economy is increasing, including in agriculture, textiles, telecommunications, food processing, tourism, and health and education (or will do so again when the effects of the coronavirus disease [COVID-19] pandemic recede). All these sectors are dominated by a few big companies. Banking, civil aviation, and petroleum are controlled by oligopolies (Bertelsmann Foundation 2018). The results of a 2015 Authority for Fair Competition and Consumer Protection (AFCCP) survey found that local companies, especially medium and large ones, view the government as a major contributor to unfair competition (AFCCP 2017). The government has a monopoly in some sectors, and develops quasi-competitive criteria for government support, such as concession agreements, subsidies, low-interest loans, and unequal access for businesses to essential facilities and supplies (UNCTAD 2012). The Law on Restricting Unfair Competition was revised in 2010 to cover all types of legal and illegal business entities, and to combat monopolistic or cartelistic structures (such as mergers, dominant market positions, and concentration) and practices (such as collusion, price fixing, and predatory pricing).

The AFCCP's regulatory board, its highest governing body, comprising a chairperson and eight members, has the power to define the agency's competition policy priorities, monitor the enforcement of competition law, and resolve disputes between inspectors and violators. The Prime Minister nominates the chair, the two staff members, and three nonstaff members; the remaining three nonstaff members are nominated by the National Chamber of Commerce and Industry, the Mongolian Trade Union, and a nongovernment organization engaged in protecting consumer rights. All the members are appointed for 4 years, renewable for a further 4 years. The AFCCP's authority is subordinated directly to the first deputy Prime Minister.

The AFCCP's lack of independence from the government leads to substantial difficulties in its ability to enforce competition (UNCTAD 2012). Political appointments have led to instability in competition policies and high employee turnover at the AFCCP. The Law on Competition lacks clarity on important legal terms, such as dominance and mergers. Furthermore, according to a review document prepared for revising the Law on Restricting Unfair Competition, passed in 2010, stakeholder consultations and the AFCCPs performance show that its power and procedural mechanisms are not up to adequately reviewing and investigating cases of unfair competition (AFCCP 2017). For example, anticompetition cases should be reviewed and investigated by the AFCCP within 14 days to 2 months, which is not enough time in many cases, especially those involving sophisticated commercial and financial analyses and investigations. The limitation periods for competition law actions in many market economies range from 1 to 5 years (Baker McKenzie 2016).

Most private companies in Mongolia are at an early stage of maturity. USAID (2008) noted that lack of transparency is one of the weakest areas of corporate governance in Mongolia. And a 2015 report by the National Council on Corporate Governance noted that information on the ownership, management structure, and performance was not consistently disclosed by Mongolian companies (National Council on Corporate Governance 2015).

Trade and financial liberalization

Since the start of Mongolia's economic transition, the government has promoted foreign trade and investment and achieved tangible results in trade liberalization. The country joined the World Trade Organization in 1997, which was the start of an ongoing effort to integrate the economy into world trade; align its trade agenda to its major trading partners in industrialized economies; and overcome some of the challenges linked to this, such as being a small, landlocked country. To this end, Mongolia has adopted international economic and trade standards to an extent that makes it stand out from many other transition economies. The US and Mongolia signed a Trade and Investment Framework Agreement in 2004 and an Agreement on Transparency in Matters Related to International Trade and Investment in 2013. In 2016, Mongolia signed a Foreign Investment Protection Agreement with Canada and an Economic Partnership Agreement with Japan. An intention to establish free trade agreements with the People's Republic of China and the Russian Federation has been expressed, but this is likely to be a lengthy process.

Although Mongolia's level of trade liberalization gets high scores in international surveys, as Figure 7.6 shows, local companies face challenges to exporting their products and services. A nationally representative sample of over 1,500 SMEs showed that only 5.3% of small businesses export their products (Narantuya and Empson 2018), because of the low level of economies of scale that affect many businesses and the moderate level of income.

Many local businesses and foreign investors complain about ambiguous export and import licensing procedures of government organizations (Mongolian Chamber of Trade and Industry and NUM 2017). In 2019, the Independent Authority Against Corruption released documents relating to the bribery of senior officers at the General Agency for Specialized Inspection, which clearly indicate serious costs and risks for businesses caused by the ambiguity and discretionary powers of government agencies over operational permits and sanctions (*Daily News* 2019). The Asia Foundation's Study of Private Sector Perception of Corruption has consistently shown that, in the view of survey respondents, the General Agency for Specialized Inspection and the Customs Authority has created risks and obstacles for businesses (Table 7.3).

Table 7.3: Survey Results of Government Agencies Most Affected by Corruption
(% of respondents)

Agency	2016	2017	2018
Specialized Inspection Agency	28	25	29
Tax Office	29	19	25
Customs	26	23	19

Source: Data from Asia Foundation (2018a).

The Mongolian financial system has undergone sweeping modernization reforms. Banking reforms in the late 1990s led to a modern, stable banking system that generally meets international standards (Bertelsmann Foundation 2018). The legal compliance of banks and the protection of the rights of investors and clients improved with the Financial Regulatory Commission being set up in 2006. Despite this progress, bank lending is concentrated in just a few sectors, reflecting a similar concentration in the economy, which increases the risk for the banking system. As of 2016, 60.7% of past-due banking loans were from mining, manufacturing, construction, real estate, and trading companies. In 2014, Savings Bank, Mongolia's fifth-largest lender, was declared insolvent by the Bank of Mongolia (BOM)—the central bank. The BOM declared Savings Bank insolvent after its controlling shareholder companies, which run oil and construction businesses, defaulted on loans.

In 2017, one of the International Monetary Fund's conditions for an Extended Fund Facility was comprehensive banking sector reforms, including ensuring the BOM's independence. As a result, Parliament amended the Banking Law in 2018 to introduce disclosure requirements for the owners of Mongolian commercial banks; new restrictions on banking activities, including a prohibition on establishing subsidiaries or affiliates; clarifications of corporate governance rules; and comprehensive measures to prevent bank failures and provide solutions to rescue troubled banks. The Law on the Central Bank was also amended by Parliament in 2018 to include provisions aimed at ensuring independent and professional management of the BOM through accountability mechanisms, and limiting the funding of government deficits and expenditure. The amended law limited the powers of the BOM's governor, who is appointed by Parliament, and required that specialized, collective decision-making committees and councils be set up to improve the BOM's management and independence.

Doing business

While many governance indicators capture the formal structures that are in place, measures of the business climate offer a broader assessment that also includes perceptions. Given the broader aim, indexes of business climate are commonly some variant of a meta-index combined with survey data. That is also the case for the World Bank's Doing Business project.

In the 2018 Doing Business project, Mongolia ranked 74th of 190 countries for ease of doing business (World Bank 2019b). It had a high rank for the ease of getting a construction permit (23rd), and a low one for getting electricity for a business (148th). Countries clustered around Mongolia include Greece, India, Indonesia, Jamaica, the Ukraine, and Uzbekistan. Mongolia is ranked 10th among 47 lower-middle-income countries, and 10th among 25 countries in East Asia and the Pacific (World Bank 2019b). The 2019 survey indicates that registering a property in Mongolia requires five procedures, takes 10.5 days, and costs 2.1% of the property value, which ranks Mongolia 49th out of the 190 countries. Contract enforcement takes 374 days and costs 22.9% of the value of the claim, ranking Mongolia 66th for the ease of enforcing contracts. Compared with the People's Republic of China, Kazakhstan, and the Russian Federation, Mongolia has ineffective judicial processes. In Mongolia, all contested foreclosure actions require court reviews and are subject to appeal to the Supreme Court; a final resolution can take up to 36 months.

Difficulties in accessing financing are one of the main barriers to doing business. Mongolia ranked 109th of 140 countries for financial market development in the World Economic Forum's *Global Competitiveness Report 2018* (WEF 2018). The banking system provides 97% of total lending and 93% of lending to SMEs. Alternative sources of financing in Mongolia are very limited (OECD 2016). Mongolian banks offer business loans with interest rates ranging from 16.2% to 22.2% (Economic Policy and Competitiveness Research Center 2017). Small businesses struggle to deal with banks' high rates and short tenures. Commercial banks view lending to SMEs as risky largely because they lack collateral (Narantuya and Empson 2018). The high rates have been criticized for inhibiting the growth of businesses. Initiatives to allow foreign banks to operate in Mongolia, which could result in better access to affordable financing, have been opposed by domestic banks.

Discussions with Mongolian entrepreneurs suggest that some seek foreign partners and foreign investment not only as a source of financing and expertise but also for the security that having international links can provide local businesses. For some businesses, having recourse to international arbitration provides much greater certainty than the prospect of domestic dispute litigation. Further, having a foreign partner can be used as an excuse (a quasi-moral element) for refusing to engage in corrupt practices. Such strategies, however, cannot be a long-term solution for Mongolian businesses. Foreign partnerships are only generally an option for a certain scale of business operations, and ultimately economic development will have to be driven by local factors.

7.2 Policy Recommendations and Conclusions

Mongolia's consistent commitment to building a democracy and a market economy has been remarkable in comparative perspective. Important governance structures and institutions beneficial for a strong business environment have been either created or reformed since the transition process started in 1990. The role of the private sector in the national economy has been widely acknowledged and property rights for domestic and international investors have been enshrined in laws and regulations. Mongolia has also aligned many structures, plans, proposals, and standards with international practice.

While broad indicators on governance look good by international comparisons, especially as such indicators largely measure the form and structure of compliance, many doubts have been raised about actual compliance. Governance indicators for political institutions and policy making have been the most problematic, and have been highlighted in international and domestic assessments of Mongolia's business and investment climate.

Transparency and accountability mechanisms are not adequately integrated into Mongolia's political party system. The lack of such mechanisms disincentivizes parties from competing by testable policy propositions, and it motivates politicians and factions within parties to aim at populist or opportunistic point scoring, causing policy uncertainty. Parliament's ability to develop and scrutinize laws and regulations is adversely affected by the lack of substantive policy debates within and between political parties, and a widespread conflict of interests in political institutions.

Political instability is a serious impediment to Mongolia's business climate. New governments often make significant shifts in public policy priorities, including policy reversals. Frequent government changes do not provide enough time for decision makers to implement new policies. Without a long-term development policy and a politically impartial and independent civil service, the frequent changes in government will continue to have negative effects on the business climate. More effort is needed to implement the laws, despite their implications—and to allow time for international and domestic investors and businesses to become familiar with the laws before they change again.

The government publicly endorses a policy of improving market competition. It has implemented policy programs to ease government bureaucracy, including e-governance initiatives. The business community has a highly negative perception of corruption by government officials, especially in the Tax Office, Specialized Inspection Agency, and the Customs, Land, and Trade Authority. Businesses see important obstacles to doing business resulting from the ambiguity of licensing procedures implemented by government organizations, the discretionary powers of officials, and taxation policies. The judiciary's ability to pursue wrongdoing by government officials and political figures needs to be strengthened.

Market competition is increasing in many key sectors of the economy, including agriculture, textile, telecommunications, food processing, tourism, and health and education. But these sectors are often dominated by a few big companies and the government. The businesses community views the government as a major contributor to unfair competition by having a monopoly in some sectors; developing quasi-competitive criteria for government support, such as concession agreements, subsidies, and low-interest loans; and setting unequal terms of access for businesses to essential facilities and supplies.

International financial institutions and development partners have devoted significant resources to helping the country implement broader institutional reforms. They can put pressure on the government to carry out reforms, such as the needed banking sector regulations. Avoiding state capture and the assuring rule of law will be essential for improving Mongolia's business climate and future development. Without the rule of law, corruption cannot be combated, investors will increasingly turn away from the country as an investment destination, and economic development momentum will be lost.
The following recommendations are offered to the government, international organizations, and business associations:

Promote the disclosure of political party and election funding and combat corruption. The government should introduce clear guidelines and procedures for implementing the relevant laws. Because the government has recently gained experience in implementing open data policies, it could improve the practice of election finance disclosure and information accessibility by enhancing the capacity of the state audit agency, and through participatory and digital methods, such as real-time donation reporting and the integration of government databases. The Independent Authority Against Corruption and the Mongolian National Audit Office could increase their role in reducing political corruption by increasing their focus and investing more resources on political party and election campaign finance.

Open up participation in elections. The 2020 parliamentary election will be particularly important because it offers opportunities for independent and new political movements. It is essential that these parties and their candidates are able to register to take part in the election without hindrance.

Strengthen the democratic quality of the justice system. To restore the confidence of the public and the business community in the country's political and economic institutions, the independence and legitimacy of the courts should be improved by enhancing the court system's transparency and through independent and carefully balanced self-governance mechanisms, specifically, the Judicial General Council and the Ethics Commission.

Increase access to business financing through better market competition and incentive mechanisms, which will require a broad-based dialogue.

Significantly improve the transparency and clarity of licensing and permitting procedures in the Specialized Inspection Agency and the customs authority. This urgently requires putting relevant policies in place. Development partners should avoid project capture by institutional elites, recruit a diversity of actors, and the public.

Strengthen independent decision-making, institutional capacity, and the procedural regulations of the fair competition authority to improve government performance.

The government and business associations should seek opportunities to collaborate on implementing laws and policies. Industry and business associations need to be proactive and leading voices for improving business practices in health and safety, the environment, social and community participation, and corporate accountability and ethics.

Develop and expand systems for public access to information. Government action on this is essential, especially for disclosure of and accessibility to corporate information on beneficial ownership, tenders, and conflict of interests.

Secure permanent funding for EITI work in Mongolia. To ensure that information about resource revenue will continue to be available, secure the EITI's funding by international development partners or by institutionalizing the funding through legislation. The Multi-Stakeholder Group of the EITI should consider the pros and cons of both models and decide which to adopt based on what is best for the future of the EITI.