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**JARGALSAIKHAN Dambadarjaa***For weekly articles,
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STATE-POWERED **BUSINESS**

The peace and prosperity of a nation depend on the quality of democracy, the foundations of a market economy, and ability to innovate. People's livelihoods are most impacted by how strong the foundations of the market economy are. But the free market system is coming under stronger scrutiny and criticism today.

This criticism has asserted that the free market and capitalist economy fuel social disparity and push people to a consumer society, eventually causing climate change. There is a strongly emerging view that the free market cannot regulate economic relations adequately.

There are two types of capitalism today – 1) free market capitalism with fair competition, and 2) a state-powered economy with unfair competition. The latter is also referred to as 'crony capitalism'. Crony capitalism has been

spreading in most developing countries and is the reason why the reputation of the free market economy is being damaged. The Wall Street Journal reported in 2015 that crony capitalism causes people to withdraw their support for capitalism.

Crony capitalism means that the government or the authorities provide an unfair advantage to their close companions, including family members, friends, and associates, and eventually establish a monopoly in a given industry. This type of unfair advantage is given in the form of granting soft loans, issuing special permits, or restricting other companies from taking part in specific activities. It is not viewed as corruption because such decisions are made within legal boundaries. That's why it is often labelled to as 'legalised theft'.

CRONY-CAPITALISM INDEX

The term 'crony capitalism' was first coined during the Asian financial crisis in 1997-1998. University of California professor Andrew MacIntyre explained that the underlying cause of the crisis was crony capitalism, using the

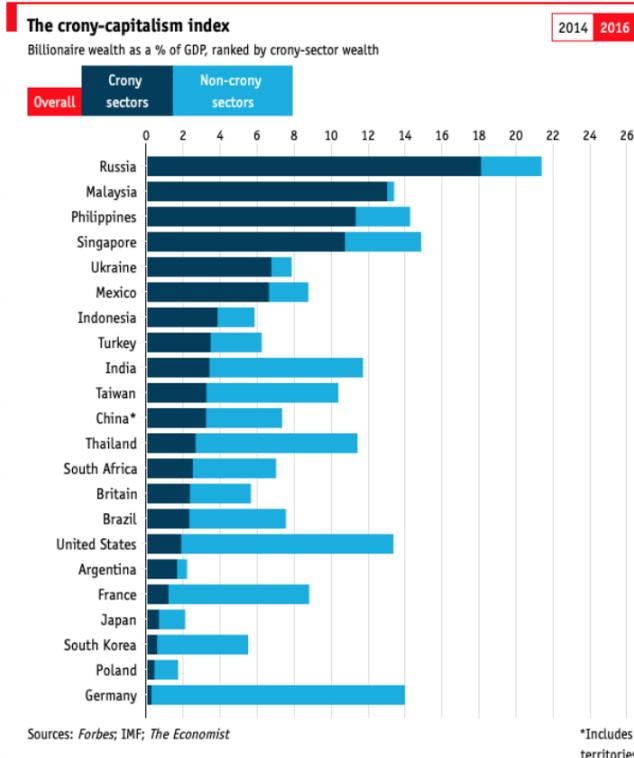
examples of Indonesia and Thailand. The crisis hit many Southeast Asian countries and was triggered by massive inflows of 'hot money' intended to generate short-term profits based on interest rate differences. This inflow of ►►

- ▶ foreign capital and movement of money was carried out by governments who did it together with their cronies – family members, friends, and close associates.

The Economist published a crony-capitalism index in 2014 and 2016. The index focuses on ten sectors that have the strongest likelihood of a monopoly and are highly dependent on the government and special permits. These sectors include casinos, coal and timber preparation, defence, deposit-taking banking, infrastructure, airports, real estate and construction, steel and metal processing, mining and commodities, and utilities and telecoms services. Then they use the wealth of billionaires in those sectors based on data published by Forbes. The premise is that the bigger the ratio between the billionaire wealth and national GDP, more the economy suffers from crony capitalism.

Russia led the 2016 index, which covered 23 countries, while the 2014 index had Hong Kong in first place with the 'croniest capitalism'.

In Russia, the billionaire wealth in the select sectors equalled 18 per cent of national GDP, while the billionaire wealth in other sectors equalled only 1.8 per cent.



CRONY-CAPITALIST BUSINESS FLOURISHING IN MONGOLIA

Mongolia is becoming more and more eligible for the crony-capitalism index. Our crony sectors include coal, deposit-taking banking, infrastructure, real estate and construction, mining and commodities, and telecoms services. It begs the question whether any of these sectors hasn't had involvement from the authorities and decision makers from the present and the past. We have many MPs who pass laws that are directly relevant to their own business activities, ministers who provide advantages to their own businesses using

funds from the public budget, and also MPs who have their own banks.

Mongolia's crony capitalism is even growing in sectors that are less likely to suffer from a monopoly. It has become a difficult task to find a statesperson who doesn't have their own non-banking financial institution, hasn't founded a private university, hasn't taken ownership of an asset during privatisation, doesn't own a licence to a mineral deposit, hasn't bought land, or doesn't own their media outlet. They have all been making laws that ▶▶

- ▶ gave their business an advantage, receiving soft loans or grants to their own business activities, and providing business advantages to either themselves or their cronies.

The Mongolian state has established many different funds, founded its own bank, and funded its own companies by issuing bonds and raising external loans. All land surrounding Bogd Mountain is now sold, and so are all parks and any other valuable land in the capital city. Under the name of the price stabilisation program and housing mortgages, the authorities have also funded their own companies using public funds. As a result, prices went up and people's purchasing power has fallen to the floor. Due to enormous loans raised in foreign currencies, the tugrug has drastically weakened.

It has recently been revealed how 15 MPs misused the billions of tugrugs intended for SME development and laundered money through their own non-banking financial institutions. However, just like many other

corruption cases in the past, the SME scandal is also being quietly wiped away from the public's memory.

As crony capitalism and state-powered businesses flourish in Mongolia, it is becoming increasingly difficult for people to do business using their own skills, talent, and capital. Therefore, many people are choosing to go abroad seeking employment.

It is time to fight crony capitalism by mobilising private sector business associations and also the National Chamber of Commerce and Industry, which has legally binding responsibilities. It is time to create free competition. If we're too late, the same fate as Venezuela awaits us.

Mongolian businesses and companies now need to decide whether to complete a short distance quickly by mixing with the state or complete a long distance surely by creating free competition.

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**JAN ZIEKOW**

DIRECTOR OF THE GERMAN
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MONGOLIA'S PARLIAMENTARY SYSTEM IS PERHAPS ITS **BIGGEST STRENGTH**

Jan Ziekow is the General Director of the German Research Institute for Public Administration in Speyer. Dr. Jan Ziekow is a member of the UN Committee of experts on public administration and the president of the German chapter of the Institute of Public Administration. He is also a member of various governmental and parliamentary bodies. Dr. Jan Ziekow also serves as an editor and co-editor in numerous international journals and was bestowed an Honorary Doctorate by the National University of Mongolia in December of 2015.

Jargal Defacto: Please tell us about your visit to Mongolia

Jan Ziekow: This is my fifth time in Mongolia with my first time being in 2011 or 2012. This year, I gave two lectures, the first one being at a UNDP conference about Civil Service Reform and the second one being at a leadership conference at the National University of Mongolia regarding different approaches to improving public service delivery.

JD: You refer to public service, but it is called state service in Mongolia.

JZ: Yes. I learned about that. From a German perspective, it is difficult to draw comparisons because we have a very strong autonomy at the municipal and county levels. There are public service mechanisms even at the municipal level meaning that they are not encompassed in state services. There is no difference in the terms, but I share your concerns about the term state service being associated with serving the state rather than the people.

JD: What are the common features of socialist countries with respect to public service?

JZ: I think that they start in a similar manner, but you should not forget that even in the former Soviet Union, there were different regions with their own

cultures within it. It had a very strong command and control approach, a very rigid hierarchy with little respect for the decision-making capacity of the individual civil servant. While this was the starting point for socialist countries, it was my impression that the countries of the former Soviet Union that I visited such as Ukraine, Armenia, Georgia, Azerbaijan, Kazakhstan and Uzbekistan are pursuing different paths to development in their political system.

This is not astonishing however as the countries closer to the European Union are primarily concerned with meeting the standards of the European Union, but this is understandably less of a priority for Mongolia for example. Mongolia would be more concerned with establishing closer ties with Asian democracies such as Japan or Korea for example.

JD: Where does the difference lie?

JZ: One difference for example is in the interconnectedness of the administrative apparatus to the political mechanism. There are big variations in this metric, and it depends on the social structure within the country. For example, if you have a Central Asian country with a very traditional, tribal culture, you will have a political system designed to balance the interests of those tribes and its leadership. It would be a much

easier proposition to establish administrative systems independent of the political system in countries with homogenous social structures than in countries that fit the previous example.

JD: With the exception of Georgia, all former Soviet countries possess authoritarian systems. What would difficulties do our parliamentary democracy pose?

JZ: Mongolia's parliamentary system is perhaps its biggest strength and its biggest flaw given that it is the only system of its kind for thousands of miles. This is why Mongolia is so important for the future of democracy. The starting point is the stability of the political system as Mongolia has gone through an alarming number of regime changes, but I believe this is characteristic of post-Soviet countries in the first 10 – 20 years of their lifetime.

It is possible that those systems may begin to stabilize in the near future. We will have to see what happens, especially in Armenia. Of course, Germany is far away, and I may not be privy to all the current information, but it seems like there is more continuity in Mongolia's political discussion compared to 10 years ago. It is normal for political power to change following elections, but this change should not affect the stability of the governing system.

JD: How do we ensure that public officers are not replaced following changes in government?

JZ: It is a matter of culture, but this problem is not characteristic to Mongolia as even the US goes through major shifts in the composition of its administration following elections. From a Central European perspective, it weakens the administrative system because it is an indication of its reliance on the political system. As civil servants have to be constantly mindful of the impact of their decisions on politicians and the political parties through which they got their job, the administrative system is severely weakened.

JD: One of the causes of this is the constant name changes of and creation of new ministries. Please

elaborate on whether this is forbidden by law in Germany.

JZ: We don't have fixed names. The constitution establishes the core ministries: Ministry of the Interior, Ministry of Finance, Ministry of External Affairs and Federal Chancellery but these are just the core ministries and the names of other ministries are often changed with changes in political parties but this amounts to little more than semantics.

JD: Is there a differentiation between core and auxiliary ministries in Germany?

JZ: There is no such differentiation in Germany and all ministries are on the same legal standing. With this said, obviously, the Ministry of the Interior will possess more prerogative than the Ministry of Family Policy for example but they all possess a single vote each within the cabinet.

JD: Are ministers in Germany legislators?

JZ: It depends because we have the federation and 16 states. One approach bans legislators from concurrently serving as Ministers while this is not relevant in other approaches. In any case, there is no requirement for Ministers to be legislators.

JD: How many legislators and ministries do you have in Germany?

JZ: The number of federal legislators varies but it is usually in the region of 700. Our second chamber consists of the Prime Ministers of the 16 states with the remaining seats being allocated based on the population of the states. I believe there are now 16 ministries in Germany.

JD: One aspect of the Mongolian system is that all 18 or so Ministers are now chosen from among the 76 Members of Parliament. This creates a situation where the Minister who is obviously invested in acquiring a larger budget for their departments also votes on the budget. This creates a situation where the budget is constantly blown out of proportion. Have you noticed this phenomenon in your time studying Mongolia?

JZ: I am not aware of this particular phenomenon in Mongolia, but I would agree that if one-fourth of Parliament is invested in the votes taking place, the remainder of parliament would not be strong enough to place effective checks on the government.

JD: Do you include police, teachers, and analogous professionals in the ranks of public servants and are their salaries reflected in the budget.

JZ: Those professions have the status of public servants and their salaries are financed by the entity under whose authority they operate whether this is the municipal or state government. The salary of public servants is set by federal or state legislation. Our constitution requires adequate compensation for public servant and to this end, we have a complicated system of determining the salary of public servants. There are several precedents of the Federal Constitutional Court deeming the salaries of public servants inadequate forcing the government to increase them. Our institute has created a database for making those determinations easier in the future.

JD: How many private schools do you have in Germany?

JZ: The vast majority of schools are public schools. We have what we call European schools which are private but 80 – 90% of our private schools are operated by the Church. I would hazard to guess that 5% of our schools are private.

JD: How many private health care providers are in Germany

JZ: There has been a shift in the last 20 years. 20 years ago, most health care providers were public, but I would say most health care providers are private now even though they receive government subsidies. Nowadays, only the elite hospitals that operate under the auspices of Universities are public. However, the state takes a significant part in the planning of the healthcare system determining how many hospitals and doctors must operate in a given region based on the needs of the population. If there is no interest from the private sector to build

a hospital in a region where it is deemed necessary, a public hospital is created and in case of multiple interested parties, a tender is held.

JD: Do you recall any corruption in Germany involving procurement?

JZ: Not involving procurement because of the stringent European legislation governing the process. Obviously if you want to find a way to get bribed, you will but you will be entrapped then because of the formal, strict systems such as 4i, 6i where you have to meticulously record every stage of the process.

JD: In our country public officials are bribed in one form or another, sometimes for things they should have been doing in the first place. Is there a way out of this system?

JZ: The first step is to establish adequate salaries. If someone does not make enough money for themselves and their families, they will seek to bridge the gap between their salary and their need through other sources. Maybe they have to get a second job that in turn has a negative impact on their performance or they may simply pursue illegal ventures. Secondly, you have to create an atmosphere of appreciation of the work that civil servants do so that they feel they are doing an important job rather than simply slaves to their superiors.

Finally, you have to establish a control mechanism. There are different paths that can be taking in establishing this mechanism. For example, in Singapore, all public servants have to provide their private banking information and this is not a system Germany would pursue.

*This interview originally aired in December, 2018.
It has been edited here for space and clarity.*

*You can watch the full 30-minute interview at
www.jargaldefacto.com*

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MONGOLIANS ARE STILL SPENDING MORE THAN THEY EARN DESPITE THE GROWTH OF THE ECONOMY

The National Statistics office reported that the economy grew by 6.9% but inflation increased to 8.1%. These indexes are not directly connected but there are some interconnections. Inflation is influenced by 329 products that Mongolians utilize that are divided into 12 groups. Different groups have different roles on inflation depending on their utility. The largest group is food and non-alcoholic beverages which constitutes 30 % of consumption with rent and utilities following suit with 14%. Public transportation accounts for 12.6% of expenditure while clothing makes up 12.2%. The remaining 8 groups are not that substantial but are included in the consumption metric.

It only takes an increase in the price of food and non-alcoholic for inflation to increase. Overall, the inflation counteracts the economic growth as it is of a higher percentage. In Western democracies, an annual economic growth of 2.2-3% is looked at favorably. This is regarded as good growth as inflation rarely rises above 2% and it causes big concerns when it does. In normal economies, inflation is a mechanism through which a lot of market failures are corrected. It is meant to increase in correlation with the increase in the productivity of a society.

It is promising that the Mongolian National Statistics Office is now providing sound statistics which allows them to generate estimates of family earnings and expenditures. A good explanation of why households spend on average 1.1 million MNT despite the average earning of 1 million MNT is the national credit balance which has risen by 27% compared to last year. The hundred thousand MNT discrepancy between their earnings and expenditure is most likely money that they are borrowing. This even led the Central Bank to issue a directive that the amount of money being directed towards loan repayments shall not exceed 70% of a family's earnings.

Another intriguing statistic was that the earnings



of 8.5% of households were lower than 300,000 MNT. It was also determined that only 9% of households earn over 2.1 million MNT and that 20% of households earn between 1.1 million and 1.6 million MNT. The remaining 60% of households earn between 1.6 – 2.1 million MNT. Therefore, this last bracket can be set as a reference point for the Mongolian middle class. There is also a minimum living wage of 187,000 MNT with individuals earning less than it being considered destitute.

The World Bank considers individuals making less than 2 USD as destitute and if you do the calculations for our minimum living wage, it equates to 2.6 USD a day. This is disheartening as according to our latest statistics, 30% of Mongolians live under our minimum living wage threshold. This means that there is a lot to do in order to improve the living standards of Mongolians. There are some encouraging signs however with private consumption decreasing from 50% to 48% of GDP from 2017 to 2018 with investment rising from 34% to 43% of GDP in the same time span.

Moreover, government purchase decreased from 13% to 11% of GDP. It is an intriguing prospect to contemplate on why government purchase decreased despite our State Budget containing

a surplus for the first time in 10 or so years. This seems to have been as a result of a 35% increase in our VAT tax, 45% increase in our excise tax and 33% increase in our customs tax revenues compared to the previous year.

The increase in the VAT tax in turn can be attributed to the introduction of the E-barimt system whereby individuals receive a certain percentage of their expenditure as a refund and are also enrolled in a lottery. This in turn incentivizes individuals to demand their E-barimt, allowing the state to more effectively monitor the compliance

of companies with tax regulations, decimating the underground economy in the process. A thriving underground economy posits a tremendous issue in that businesses would pay taxes in accordance with their wishes and conscience rather than the tax regulations.

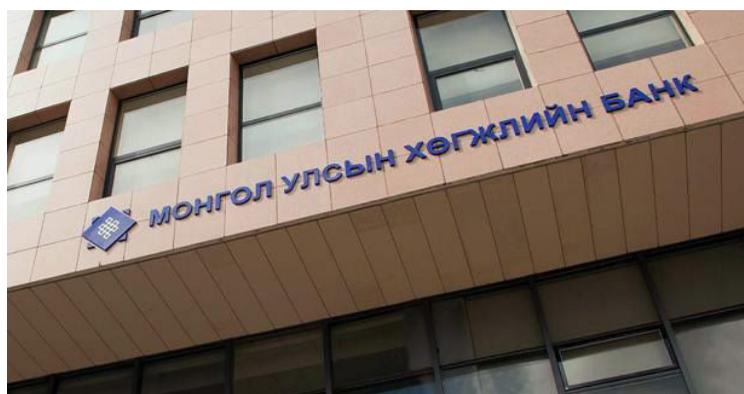
I am however not entirely optimistic about the prospects of a sustained policy of increased taxation given that it hinders the ability of companies to extend its operations and develop as a large portion of their resources are directed towards taxes.

DEVELOPMENT BANK OF MONGOLIA

Development Bank of Mongolia was established in 2011 as a for-profit government entity designed to finance ambitious development projects. Unfortunately, 7 years on, we struggle to find positives in the operation of the Development Bank of Mongolia as recently appointed Cabinet Chancellor, Mr. L.Oyun-Erdene determined that 85% of the bank's loans are bad loans. The very next day, Development Bank of Mongolia CEO, stated that their bad loans are within a single digit percentage point.

Development Bank of Mongolia was initially created as a vehicle to finance state projects, but the government also raised 1.5 billion USD through the Chinggis Bond. The first year, the government could not decide on how best to utilize the funds, so they were essentially paying interest rates to keep the funds in a safe. Large amounts of moneys were also paid to international consulting firms with one even receiving a duplicate payments of 5 million USD from both the government and the Development Bank of Mongolia as far as I understand it.

There are oversight proceedings that have begun in order to determine whether there was any conflict of interests within those proceedings. We must also not overlook that the government aided multiple entities in getting loans from Development Bank of Mongolia through their guarantees only for both the organization/entity in question to default on the loan with the government also refusing to pay the balance. The situation is also exasperated by the fact that there are changes in the Mongolian administration every 1.5 years or so.



For example, a so-called State Mortgage Corporation who received a 230 billion MNT loan from the Development Bank of Mongolia that has never been paid. They point to the state guarantee for the loan, but the state does not have the funds to pay the balance given that the guarantee was never reflected in the budget. The loan was meant to finance a construction project in the vicinity of the airport but it has only been halfway finished as the Development Bank of Mongolia issued a stop order to the loan given that there were no repayments being made.

Another example is Erdenes Mongol, the umbrella company of the 15 or so Strategic Deposit Companies receiving a 170 billion MNT loan from the Development Bank of Mongolia that was used to pave a road from Tavan Tolgoi to the border and repayments on the loan are also not being made. Another case involves the Ministry of Defense receiving a 30 million USD loan for the purchase of state-of-the-art equipment under the understanding that the loan shall be repaid from

the budget. However, no loan repayment plan is reflected in the budget.

Development Bank of Mongolia is still serving as a cashier for politicians and as much as I would like to close it due to the sheer amount of bad loans and assets, we need to find a way to start collecting on those loans or their collaterals. In 2017, the Minister of Finance, Mr. B.Choijilsuren even wrote off some of the bank's assets. Once companies

default on the loans, the state simply writes them off, trimming the balance sheet from over 4 billion MNT to 3.6 million MNT. The lingering question is who will finish the projects that were initiated and pay back the loans. It is ultimately the taxpayers that are on the hook as this contributes to our foreign debt which we pay on time but through a process of taking out new loans at higher interest rates to repay old ones.

BONE PROCESSING PLANT



The construction of the new bone processing plant in Emeelt cost 20.5 billion MNT, 16 billion of which was loaned through Development Bank of Mongolia. The plant uses Italian technology to process bones into protein given that we used to waste a large amount of bones and import a substantial amount of protein. The company seems to have conducted sound feasibility studies and is aware of the market in which it operates. On the other hand, there were questions raised as to whether feeding livestock their own bones will contribute to a vast array of diseases.

As it happens, this would not be the case as the process is an organic one and serves as a feed

supplement. Following the outbreak of mad cow disease, it was determined that the process was not responsible for the outbreak but contributed to its transmission through unsafe storage practices and lack of standards. It is therefore my hope that the company will follow all the relevant international regulations and the plant will significantly decrease our protein imports and its product can also be utilized as a makeshift fertilizer for our harvest. This demonstrates that when politicians don't get involved with Development Bank of Mongolia loans, there is a potential for a successful venture.

This review has been edited here for space and clarity. You can watch the full 30-minute review on the Defacto website [\[HERE\]](#).

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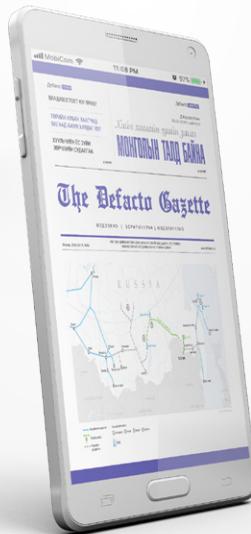
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