

DeFacto **INTERVIEW**

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ARE THE BASIC FOUNDATIONS FOR
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economic observer, columnist



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**CORRUPT GOVERNMENT,
STATE OWNERSHIP, AND POVERTY**



JARGALSAIKHAN Dambadarjaa

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CORRUPT GOVERNMENT, STATE OWNERSHIP, AND POVERTY

Thirty years ago Mongolians chose the irreversible path of building a democracy and a free market economy, and enshrined this commitment in the constitution. We made this decision because history had shown that other countries were able to significantly improve the livelihood of their people within a short period of time by putting these political and economic systems in place. But today, instead of maintaining our perseverance on this path, we have been feeling confused and lost with increasing regularity.

The governing power has transitioned from the people to an oligarchy, while our economy declines and livelihoods deteriorate. Being desperate, Mongolians are continuously migrating from the countryside to urban areas. Half of our population is working in the capital city, and 6 per cent are living abroad.

The reason why we are unable to strengthen our democracy directly relates to the fact that our three branches of government – legislative, executive, and judicial – are not strong enough as institutions. The stagnating growth in these institutions comes from

their ever-changing organizational structures and the appointment system that looks at connections and donations to a political party instead of talent and merit. Mongolian political parties have become used to raising their finance by trading positions and fixing tenders. Subsequently their members have also grown used to these hidden wrongdoings. As a result, our state is mired in bribery and corruption.

State ownership is expanding, and the government is setting the prices of food products, fuel, electricity, housing and construction materials. In addition, they are increasingly trading land in secret. This is driving our economy further away from free market principles. As the government grants more soft loans, provides discretionary tax reductions, and hands out cash to people, they are further damaging free competition in the market.

With increasing state and government involvement, corruption is growing and our private sector is shrinking. This is what suspends the natural growth of our economy and causes more unemployment and poverty.

WHY DO STATE-OWNED COMPANIES RUN DEFICITS?

Mongolia has 101 state-owned companies that are currently operating. Twelve of those companies are governed by Erdenes Mongol, 5 by the Ministry of Finance, and 84 by the Government Agency for Policy Coordination on State Property. In the first half of 2016, 70 per cent of these companies ran deficits.

The deficits run by state-owned companies are made up from the public budget. In other words, the deficits are paid for by revenue collected from taxes. This means state-owned companies use taxpayers' money to compete with the same

taxpayers. However, they always keep their budgetary and financial information undisclosed. They have a vested interest to keep it secret and to not report on their financial performance. If there is a mistake made in or by a state-owned company, no one is held accountable. The director might get replaced, but it is the only thing that may happen. The executives of these companies make donations to aimags and soums, and use the public funds to prepare for elections. It was recently revealed that Ts. Nyam-Osor, who was the head of the policy regulation department in the State Property

- ▶ Committee, acquired 500 million tugrugs from the SME fund via his company named 'Khos Erkhes'. After it made the news, he was removed from his position.

The state even acquired a commercial bank. State Bank, which is fully under state ownership, now has more than 500 branches across the country and has financial liabilities of 3 trillion tugrugs. This bank had 70 highly paid executives and directors. In addition, the state has its own railway and airline companies, but they all operate with losses. The total debt owed by state-owned companies stood at 3 trillion tugrugs in 2012, but the number grew more than threefold to 10.5 trillion in 2016. Within the same timeframe, the executives of state-owned companies spent 19 billion tugrugs to purchase 42

luxurious 4WD vehicles.

The government always talks about privatizing state-owned entities, but they never rush to the cause. This is because the more state-owned companies there are, the more advantageous it is for the corrupt. In 2017, Mongolia scored 64 points out of 100 in the resource governance index, while the score was only 40 in the state-owned enterprise governance index. The board of directors of the state-owned Erdenes Mongol company are completely dependent on the government. They are operating without sufficient scrutiny and are not transparent in their financial reporting. Yet, they are the company that manages a dozen of Mongolia's strategic deposits.

DIFFERENCES BETWEEN A POLITICAL DECISION AND AN ECONOMIC DECISION

In a democracy, political decisions are made by the majority or by the principles of majoritarianism. But you could argue that market or economic decisions are made by the principles of proportionalism. Let's pick a simple example to illustrate the difference and say all 76 MPs are having lunch together. They discuss how they will pay the bill and the majority agrees, making a political decision that everyone pays an equal amount. Once this decision is made, individuals don't find a large difference between ordering an expensive steak and a bottle of wine and going for a smaller meal. No matter what they order, they will end up paying one seventy sixth of whatever the whole bill might come to.

On the other hand, if everyone agreed to pay for their own bill (making an economic decision), they will consider the value for their money before making an order. Therefore, the bill in the first scenario is likely to be greater than the second scenario.

The public budget is allocated on the same principles as the first scenario, therefore – regardless of how much revenue was generated, the expenditure always exceeds the revenue. Hence, our public budget always runs a deficit. Once there is a deficit, the government starts increasing taxes, which triggers companies to increase the prices of their goods and services. It means the burden from running a deficit eventually goes to the customers.

As a result, people end up paying more for the value they receive from goods and services. When state ownership grows and the government has more power, it gives more room for corruption. Political parties understand this connection very well and take advantage by stealing from public funds. This is why the constitution restricts the government's power over public funds, and it requires over 75 per cent of the parliament to make a constitutional amendment.

Mongolian political parties have forgotten their duty to be the bridge between the governing power and the people, and have turned into a bridge that allows individuals take advantage of public funds for their personal interests. Corruption is destroying all of our public governance institutions. In order to eradicate corruption, we need to make political party financing transparent and set up an institution that provides strong scrutiny over the financing. In addition, we need to privatize most of the deficit-running state-owned companies and allow the public to own shares. Technically the government should only focus on areas that aren't pursued by the private sector, which includes defense and infrastructure. Some social services, including education and medical services, can be managed by the state in conjunction with the private sector.

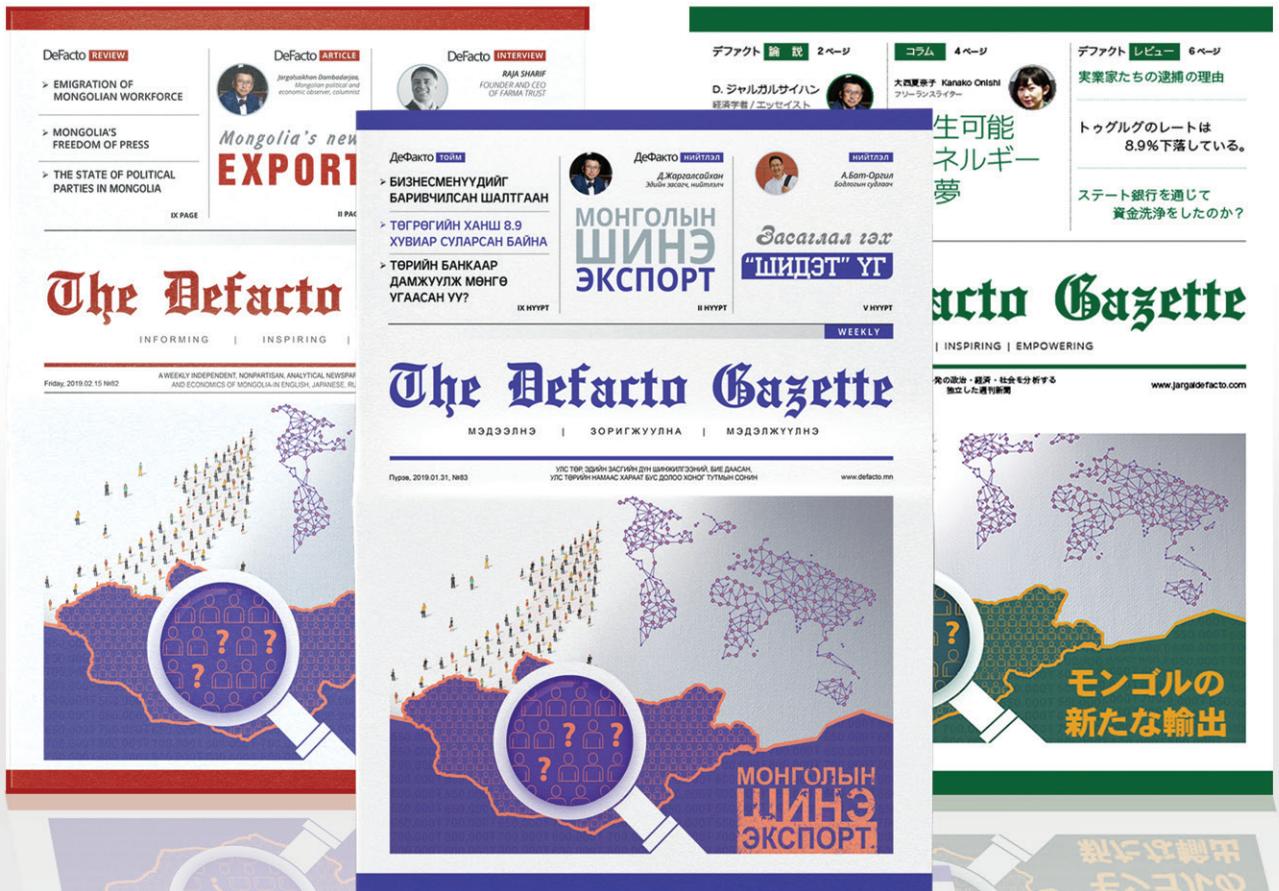
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**TAN SRI ABU
KASSIM MOHAMED**

Chief commissioner to the
International Anti-Corruption
Academy

TRANSPARENCY AND ACCOUNTABILITY ARE THE BASIC FOUNDATIONS FOR ADDRESSING CORRUPTION

After his studies in Bachelor in Social Science at Malaysia Science University, Penang, in 1984 he began his career as Investigation Officer at the Malaysian Anti-Corruption Agency (ACA) and in the year 1989 he continues his studies in Criminal Justice at the Michigan State University, United States. He made his way up from an Investigation officer in 1984 to the Director of the Planning and Policy Coordination Division in 1999. He then moved on to become the Director of Anti-Corruption Agency for the state of Perak in the year 2000 and state of Penang in the year of 2003. In 2005 he was appointed as Director of the newly establish Malaysian Anti Corruption Academy (MACA).

Defacto: Good evening, sir. Welcome to the show. Let's begin with what brought you here to Mongolia.

TS: Yes, I am representing the International Anti-Corruption Academy. I am here to share my experiences and give a broad view of what role the IACA can play in helping Mongolia's own anti-corruption agency. We provide training. We also conduct a Masters program in anti-corruption studies, which uniquely provides knowledge and expertise to the international community on anti-corruption issues.

Defacto: Has anyone from Mongolia participated in the anti-corruption Masters program?

TS: Mongolia has been involved in our summer program, I think, three times. We have invited respected professors who have vast knowledge on studying and fighting corruption. They share this knowledge with the participants—who are themselves practitioners, professionals, academicians—on how they can effectively address problems of corruption in their countries.

Defacto: Where is the Academy located?

TS: It is in Laxenburg, Austria, near Vienna.

Defacto: The UN has an anti-corruption convention, does it not? How is the Academy connected to this?

TS: The convention is something that members of the United Nations have agreed upon, principles that they have agreed to uphold, in fighting corruption. This Academy was initiated by the UNODC (United Nations Office on Drugs and Crime) and OLAF (European Anti-Fraud Office) to "fill in the gaps" regarding the understanding of the UN Convention against Corruption, as well as the study of corruption. This anti-corruption agency is meant to ensure the UN convention is given priority in many countries, and that knowledge and skills are shared among countries.

Defacto: The police is itself an institution of security. There should be a specific approach to control the corruption inside of it. How does that work?

TS: Police organizations first have to accept and recognize that corruption is a problem. Many police organizations regard corruption as the acts of a few “bad apples”. So when they deny the problem its significance, that is the biggest issue. When they recognize the problem, then things are much easier. For example, they must have a risk assessment to look at the issue of corruption in a broader perspective and holistic manner. They cannot be like, “Oh, corruption? We must catch the perpetrators and put them in jail.” No, this is but one of the elements. They need a macro perspective that looks at the issue of corruption in law enforcement as a national agenda.

Defacto: I would like to know more about what’s happening with Mongolia’s police force, but this might be a separate issue. Right now, let’s return to the corruption issue: Why can’t we stop it?

TS: Because we are human. As long as the world and its countries have been managed by humans—if you look at the research done by Professor Robert Klitgaard, he talks about how corruption exists in virtually every country and culture because of greed. It exists also because of conducive environments within organizations for corrupt opportunities. For some it is a moral issue, a problem of integrity. When there is an opportunity to become involved in corruption, they would take it.

So a conducive environment for corruption is one that is less transparent, which is why Transparency International came into being. They say that in order to reduce corruption, we need to make practices more transparent. Decisions need to be accountable to the public. Transparency and accountability are the basic foundations for addressing corruption.

As Lord Acton said, “Absolute power corrupts absolutely”. It is an issue of too much discretion and too much power. You must reduce discretion by increasing transparency and inserting more accountability.

Defacto: Accountability meaning reporting, yes?

TS: Yes. For example, when I was appointed Chief Commissioner of Malaysia’s Anti-Corruption Commission back in 2010, we had a big issue with public confidence. Upon analysis, we found that we need to be more accountable to the public and more transparent about it. Accountable, meaning that we must bring the public together in the anti-corruption work. In 2009, we introduced five committee members, representing the public, to monitor the Anti-Corruption Commission. The committee is under parliament, and the previous chairman was the speaker of the upper house. Every year, the chief commissioner has to submit a report to them with comment from other committee members.

Defacto: Organization is one thing, but even now in your country cases are still happening involving, for example, your prime minister and the 1Malaysia Development Berhad (1MDB) organization. As such, there is big resentment by the people. How can you reconcile these?

TS: For me, we have to understand the whole process. The responsibility of the Anti-Corruption Commission is to investigate. In the criminal justice system, there are three components: the investigators, the prosecutors, and the judiciary. Investigators have to have a principle to investigate without fear and favor. So as an investigation institution—I should say, my former institution—the values that we uphold is that regardless of who they are, we have to investigate whenever there

is a complaint against anybody. We proved to the public that, look, we are investigating. Indeed, if the prime minister is involved, we will investigate. And we submit our investigation to the prosecutor. The prosecution is another entity, and they have their own discretion and own power.

Defacto: When we talk about Malaysia, we cannot dismiss the case of a young Mongolian lady who was unfortunately killed in a very bad way, and whose case was allegedly connected somehow to the Malaysian prime minister (who was defense minister at the time) and his assistant. How familiar are you with the case?

TS: On this issue, the investigation had been done by the police. And of course for everybody in Malaysia the rule of law is important and justice must prevail. However, the Anti-Corruption Commission does not have the power to look into the matter. But we did look into the issues regarding the purchasing of the equipment involved. We investigated and proposed action to be taken against the person involved in the Altantuya case. If I'm not mistaken, the company was charged with some income tax problem because we discovered he had committed some income tax offense. We recommended it to the public prosecutor and they agreed with us that yes, there was action to be taken within our jurisdiction. With regard to the role of the police, I know only what I saw in the media.

Defacto: In Indonesia, in Malaysia, in Mongolia, the investigators such as the police or the anti-corruption agencies each seem to be under different authorities. For example, one is under the authority of the president, while another might be under the judiciary's authority. What is the most effective authority structure for these institutions?

TS: It depends on each country. Let's take, for example, Indonesia, Malaysia, Singapore, or Hong Kong, etc. Malaysia has exactly the same system as Hong Kong, with one difference: before 2009, Malaysia did not have an oversight committee. When I was appointed deputy-chief commissioner, I met with the prime minister and said, "Look we want to revamp the Anti-Corruption Agency", as it was called at that time. We wanted to make sure that it was more transparent and more effective, and also accountable to the public, because that's what was happening in Hong Kong. Hong Kong had the same system as we did, but their people had oversight of the operations via the oversight committee.

Let's take another example. When an investigative organization investigates, they may face a lot of problems: getting witnesses, documents, cooperation, and so on. We cannot share these difficulties with the public because most investigations are secret. We cannot reveal the details of the investigations, so there must be a forum whereby we can inform the public what really transpired. That's why we need an oversight committee—independent people representing the public to monitor our work.

*This interview originally aired in January, 2017.
It has been edited here for space and clarity.*

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

**CHRIS MELVILLE**

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DEVELOPING ETT

Developing the vast Erdenes Tavan Tolgoi coal deposit has been one of the biggest strategic challenges that Mongolia has faced over the past ten years, with various different unsuccessful attempts having been made. These range from the failed auction of 2010, the abortive international IPO in 2012-

13, the blocked deal with Shenhua in 2015, and on the operational side, a difficult contract with Chalco that has kept the business locked down to onerous long-term obligations, and the shift of operations from Macmahon to the mysterious TTJVCo. Meanwhile, the 1072 citizens shares issue remains unresolved and confusing.

TRADING ETT SHARES

The government's latest proposals include a domestic and international listing of up to thirty per cent of the shares on the MSE and foreign exchanges. This is definitely a positive measure, that would give access to ETT for a number of different stakeholders, encourage positive and improved standards of corporate governance and hopefully at the same time resolve the 1072 shares issue. Certainly, as a first step, it would make sense to list ETT domestically on the MSE, giving

the MSE itself a significant boost, following on from the encouraging Erdene Resources dual listing earlier this month.

“ A domestic listing would also enable ETT to build up a track record of public accountability and corporate governance, and work to improve its operational and financial position before seeking an international listing. ”

INTERNATIONAL LISTING

For various reasons, it will be more difficult for ETT to list internationally.

There needs to be some convergence of the listing rules and legislation between Mongolia and those international exchanges where ETT shares might be traded. Taking Hong Kong as an example, the Hong Kong Listing Rules require an overseas company to demonstrate that its jurisdiction of incorporation there are shareholder protection standards at least equivalent to those of Hong Kong. These rules may be eased somewhat by the ongoing Innovative Companies Consultation launched by the Hong Kong Stock Exchange in February 2018 aimed at broadening the existing listing regime to facilitate the listing of emerging and innovative companies. However, it will be a significant challenge for Mongolia to demonstrate that its corporate governance and shareholder protection standards are at least as strong as those in Hong Kong.

An alternative would be for ETT to incorporate a special purpose company in one of the approved jurisdictions for listing, such as the Cayman Islands (where Mongolian Mining Corporation is incorporated). However, given the recent political furore over offshore jurisdictions, it would be a major stretch for a state-owned enterprise to attempt to list its shares from offshore.

Secondly, on the operational side, ETT remains tied into certain long-term contracts, such as the one entered into with Chalco. While the principal debt has now been paid off, according to media reports the contract terms remain substantially the same for a period of time, including pricing being tied to a Chinese based index. ETT has clearly benefited from an upturn in commodity prices, enabling it to pay off the debt associated with the contract and improving its financial position, but if this is correct, its freedom of manoeuvre may remain somewhat limited.

DEPOSITARY RECEIPTS

Another potential option for ETT would be to tap the international capital markets by issuing depositary receipts based on underlying MSE listed shares. This is a route that has been adopted by many Russian companies whose corporate governance was

traditionally not robust enough to obtain a primary or secondary listing on international stock exchanges. This is worth investigating if a full international listing is too much of a short-term challenge.

LINK TO RAILWAY INFRASTRUCTURE

Another issue for ETT derives from the blocked Shenhua transaction in 2015. One of the reasons this transaction was rejected, not necessarily a bad decision for Mongolia in my opinion, was linking development of ETT with development of the railway network. If the government proposes to continue to develop these as one project, there is a risk of there being too many political and other stakeholders to make meaningful progress. The capital expenditure required to develop

railway infrastructure is enormous and needs to be considered from a strategic perspective in the interests of the country as a whole.

“ It may be preferable to de-link ETT and railway if politically feasible and concentrate on the development of ETT and the Gashuunsukhait border railway link as two entirely separate projects, but proceeding on a parallel timetable. ”

POWER INFRASTRUCTURE

While the power solution for Oyu Tolgoi remains a hot topic of discussion, the development of the Tavan Tolgoi Power Project (TTPP) remains a good option for Mongolia. The plant is designed primarily to support Oyu Tolgoi, but if developed independently, could be expanded by including additional units to support the national grid. This would enable TTPP to act as a power hub, supporting regional development over the long term. On the other hand, if OT is required to develop its own power solution, the Mongolian government would effectively be paying for 34% of the project through its

shareholding in OT.

The main issues with developing TTPP are a shortage of available finance, due to the fact that commercial lenders and IFIs are no longer supporting projects based on coal. Secondly, political risk associated with OT is a concern for potential lenders and investors. The more OT is pressured, or perceived to be pressured, the more difficult it is to progress with ancillary projects such as TTPP which depend on the stability of the OT project.

CONCLUSIONS

As one of the largest coal deposits by reserves in the world, Mongolia needs to find a good solution for the development of ETT. A domestic listing in the first instance would be a positive step, may resolve the long-standing 1072 shares matter, and improve corporate

governance. While an international listing may be a challenge, it is a worthy aspiration. As for power, pursuing TTPP with ETT as the primary source of coal for the power plant remains the better option for both Mongolia and Oyu Tolgoi.

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