MONGOLIA:
THE FIRST PROVINCIAL COMPETITIVENESS REPORT
2012

ECONOMIC POLICY AND COMPETITIVENESS RESEARCH CENTER
ЭДИЙН ЗАСГИЙН БОДЛОГО, ӨРСӨӨДӨХ ЧАДВАРЫН СУДАЛГААНЫ ТӨВ

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THE FIRST PROVINCIAL COMPETITIVENESS REPORT 2012

ULAANBAATAR
2013

ECONOMIC POLICY AND COMPETITIVENESS RESEARCH CENTER

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HUMAN CENTERED POLICY

NATURE FRIENDLY DEVELOPMENT

COMPETITIVE MONGOLIA

President of Mongolia

Tsakhia ELBEGDORJ

FOREWORD

I am delighted to present you The First Provincial Competitiveness Report of Mongolia, which identifies and reflects the current stages of development in Mongolia's 21 provinces.

Despite the fact that our economy is expanding rapidly, not all Mongolians are benefiting. As professor Stephane Garelli pointed out, Mongolia is at risk of facing a three-tiered society: "The Mining Mongolia" (e.g. OyuTolgoi), the "Urban Mongolia" (Ulaanbaatar city) and the "Rural Mongolia" (Countryside). While Ulaanbaatar is struggling against the air pollution and overloaded traffic jams caused by the growing number of its population and vehicles, there is a risk that economic growth will not flow through to the provincial areas. Thus, migrants have continued to move from rural to urban areas, particularly to Ulaanbaatar city.

Rural development has been one of the main priorities for the Government. I would like to address that the parliament has recently amended the Budget Law of Mongolia, which will support decentralization and implementation of budget management with citizen`s participation and increase the involvement of local authorities. I hope that the implementation of this law will contribute to rural development.

However, in order to develop the provinces, it is vital for Mongolia to identify the current stage of development for each of the 21 provinces and define their strengths and weaknesses. Until now, we have assessed rural development using economic indicators such as GDP per capita, unemployment and poverty rate. But now, the Provincial Competitiveness Index provides us with a rich source of data based on 180 criteria derived from numerous statistical and survey-based data. This report will enable us to define each province's competitiveness in a more comprehensive way. It compares not only the main socio-economic indicators of provinces, but also considers the opinions of entrepreneurs working there creating the most unbiased database about rural development.

I would like to thank the EPCRC team, who have carried out such an important project and analyzed the competitiveness of all 21 provinces using internationally accepted methodologies. I do hope that the Provincial Competitiveness Report will be an important source of information for policymakers to find reliable and comprehensive information. Since it reflects the overall development situation in each province publication and widespread distribution of the annual report would make it possible, to figure out why each province's competitiveness has improved or worsened. We therefore believe that this report would serve as a "guidebook" that supports policy formulation and implementation.

Puntsag TSAGAAN

Chairman of the Board

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January 2013

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It is my pleasure to acknowledge that the Economic Policy and Competitiveness Research Center (EPCRC) is expanding its operational frameworks.

Since 2010 we have been managing in conjunction with the Swiss based Institute for Management Development (IMD) the annual publication of the Mongolia in World Competitiveness Report, which became a reliable source of information for decision makers. Now we are presenting the Provincial Competitiveness Report, which analyzes the competitiveness of Mongolia's 21 provinces using internationally-accepted research methodology.

I would like to sincerely thank German International Cooperation (GIZ) and its Regional Economic Development Programme for their valuable investment in producing and printing this report and the Mongolian National Chamber of Commerce and Industry and its regional branches, who supported us in studying the opinions of entrepreneurs. I would also like to send my special word of thanks to our partner organizations, especially the IMD`s World Competitiveness Center and Mongolian Development Institute.

I hope that the report, which shows key socio-economic indicators of provinces as well as local entrepreneurs` opinions and expectations, shall serve as a useful reference for policymakers, researchers and businessmen.

On behalf of the EPCRC team, I would like to thank you for taking a look at this report, and wish you success and prosperity.

Boojoo LAKSHMI

Director Interim

PARTNER ORGANISATIONS

IMD REAL WORLD REAL LEARNING	International Institute for Management Development World Competitiveness Center
giz Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH	Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH Regional Economic Development Programme
MONGOLIAN NATIONAL CHAMBER OF COMMERCE AND INDUSTRY	Mongolian National Chamber of Commerce and Industry
MDI	Mongolian Development Institute
MONGOLIA ECONOMIC FORUM	Mongolia Economic Forum

STATISTICAL DATA SOURCES

УНДЭСНИЙ СТАТИСТИК	National Statistical Office
Монгол Банк	Bank of Mongolia

GREETINGS

Dear readers,

Mongolia overcame its transition process and stepped into the era of growth and development. However, there are still many obstacles to development, particularly in rural areas. Rural development remains weak, the business community lacks a competitive edge and poverty persists due to many shortfalls, among them weak infrastructure and a lack of financial services. We are pleased that the EPCRC took a note of such an important issue and produced the Provincial Competitiveness Report.

The Regional Economic Development Programme of the GIZ aims to support regional economic processes by assisting the local communities in enabling the conditions for the sustainable use of local resources in the programme regions of Darkhan-Uul, Orkhon and Zavkhan provinces since 2006. We believe that our financial support at realizing this report makes a valuable contribution to the rural development.

The report, which defines the competitiveness of provinces based on a large scale research, will assist decision makers, whose main responsibility is to improve the development policies, by introducing the facts and data of rural economic development.

Sanjjav BAIGALMAA

German International Cooperation
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ABOUT THE ECONOMIC POLICY AND COMPETITIVENESS RESEARCH CENTER

The Economic Policy and Competitiveness Research Center (EPCRC) aims to enhance Mongolia`s competitiveness by identifying the most efficient development paths. In doing so, we aspire to define and research the country`s competitiveness and economic policy using globally accepted methodologies and to create a wide range of reliable information database. EPCRC was established in 2010 and has since continually expanded its operational range.

Since 2010 the EPCRC has been managing the annual publication of the special Mongolia in World Competitiveness Report produced in conjunction with the Swiss based Institute for Management Development (IMD) and its World Competitiveness Yearbook publication. We also established Mongolia`s first ever Provincial Competitiveness Report, which identifies the current stage of development in the country`s 21 provinces. We produce reliable and regular 'knowledge products' such as the "Monthly macroeconomic overveiw" and "Quarterly review on Banking Sector's competition".

The EPCRC is committed to delivering factual knowledge about the Mongolian economy and competitiveness both domestically and internationally by producing reliable sources of information. Furthermore, the EPCRC implements development projects and organizes discussions, workshops and seminars in order to address challenges facing the country`s development. For instance, we developed the "Mongolia`s Competitiveness and Business Enabling Environment Roadmap" in conjunction with the Office of the President, USAID funded project Business Plus Initiative, Asian Development Bank, Business Council of Mongolia and the Mongolian National Chamber of Commerce and Industry. The roadmap was handed to the New Government for Changes in September 2012.

The EPCRC has been collaborating with the Mongolia Economic Forum (MEF) since its establishment.

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ABBREVIATIONS

ADB	Asian Development Bank
BoM	Bank of Mongolia
EPCRC	Economic Policy and Competitiveness Research Center
GDP	Gross domestic product
IMD	International Institute for Management Development
NSO	National Statistical Office
PCI	Provincial Competitiveness Index
VAT	Value added tax
WCC	World Competitiveness Center

UNLOCKING THE FORGOTTEN COUNTRYSIDE

Mongolia is one of the world's fastest growing economies. In 2011, economic growth was 17.5 percent. Although the growth fell to 12.3 in 2012, it remained in double-digits. However, there are grounds for questioning whether all Mongolians are benefiting from this growth in the same way. There are certainly many positive and negative effects visible in skyscrapers in the city and numerous traffic jams pointing-out to changes occurred. Nevertheless, even though in Ulaanbaatar city the rapid economic expansion can be perceived, in the countryside there are no signs that the economy is about to improve.

While up to 65 percent of gross domestic product (GDP) is produced in Ulaanbaatar city, and 10 percent is produced in Orkhon province where the "Erdenet" joint venture is located, the remaining 25 percent is allocated amongst the other 20 provinces. GDP per capita is 3 times lower in the countryside than in the city. There are low levels of job offer and the business environment is unfavorable due to poor infrastructure and low market potential amongst other problems. Almost 70 percent of enterprises are located in Ulaanbaatar city.

Poverty is also much more prevalent in Mongolia's countryside. The poverty rate is 33.3 percent in the countryside, compared to 26.6 percent in the city. In other words, 1 out of 4 people are poor in the city while 1 out of 3 people are poor in the countryside. In 2011, the official unemployment rate was 5.6 percent in the city, whereas 6.8 percent in the Central region, 8.3 percent in the Khangai region, 10.8 percent in the Western region and 11.1 percent in the Eastern region.

Besides the positive effects of mining driven socio-economic growth, the new "old" phenomenon *rural-urban disparities* has been growing. Inequality between the city and countryside can be clearly seen from the following situation in the countryside:

- It's common that roads, heating and energy, waste and sewage management system, and water supply in the countryside are still in poor condition;
- People who live in the countryside have limited and poor quality access to various social and public services including health, education and cultural services;
- Due to the poor overall economic development as well as low market potential and access to information, the business environment is unfavorable and it is difficult to find jobs; and
- The standard of living is low, while the quality of life and conditions are considerably different from those in the city.

There is a trend whereby the more remote the province is, the more inequal living condition is from that in the city. As a result, flows of migration path towards the center are increasing: from "bags[1]" to soums, from soums to provinces, and from provinces to Ulaanbaatar city. According to the 2010 Population and Housing Census net migration into Ulaanbaatar city in 2010 exceeded over 40,000 people. All of a sudden, almost half of the nation's population is residing in Ulaanbaatar city which occupies only 0.3 percent of the total land area of Mongolia. Current estimates show that the population of Ulaanbaatar city is over 1.2 million. The capital city is facing many problems such as air pollution, traffic jams and electricity limitations due to the increase in population and an overwhelming number of buildings and vehicles, while the countryside is left abandoned. All that deepens the gap between rural - urban development.

If this situation persists, poor provincial development will drag the overall national development down. Overpopulation and over-expansion of the city will cause socio-economic problems such as ecological imbalances, deteriorating living conditions, unemployment, poverty and the gap between poor and rich. Many of these problems are already prevalent. Therefore, attention should be paid more to rural areas by developing provinces in accordance with their growth opportunities and characteristics, reducing the discrepancy in development and inequality

1 *Bag is the lowest administrative unit in the provinces in Mongolia.*

through a policy, and distributing development equally using the economic advantages and benefits provided by the mining sector.

Rural development is dependent on various factors such as socio-economic development, governance and environmental situations. In order to improve these conditions, the current development stage of each province should be assessed and the strengths and weaknesses should be defined on the basis of research findings. By doing so, we will be able to find solutions for each province and improve their competitiveness.

For these reasons, the EPCRC produces the Provincial Competitiveness Report which is aimed at improving the competitiveness of provinces and contributing to the equitable distribution of the fruits of growth amongst Mongolian citizens. After analyzing each province according to 180 criteria we were able to define the most impending five challenges that should be addressed urgently.

1. Improving roads and infrastructure

Vast land, low population density and harsh weather are the basic reasons behind poor infrastructure. Statistics show that only 0.01 km of road and 0.001 km of railroad are built per 1 square km area, indicating poor infrastructure development[2].

A good road network is the key to development. This is also a reason why the development is not promoted outside Ulaanbaatar city. In short, if provincial capitals are connected to Ulaanbaatar city via pared roads, there will be "new blood" for renewal and the fruits of development can be spread. Although Mongolia annually spends 1.5-2.0 per cent of its GDP on road sector, which is a satisfying amount compared to international benchmarks, 100 km of road development per year on average is relatively low figure as noted in a research done by the Asian Development Bank[3].

In the past, we were not able to make adequate investments in infrastructure due to a modest budget. But in 2012, the Government successfully placed bonds for USD 1.5 billion in the international capital markets setting a benchmark (in total, the New Government for Changes plans to issue bonds in the amount of USD 5 billion). The money raised through these bonds is planned to be invested into infrastructure development such as railway system, paved road and energy supply. According to the Government Action Plan, besides connecting provincial capitals to Ulaanbaatar city via paved road, a motorway along Altanbulag – Ulaanbaatar – Zamyn-Uud should be also built in the coming 4 years increasing the road transit traffic. However, to achieve these goals it is necessary to promote good investment climate and improvements in technology as well as in human resources.

According to our survey, many local businessmen are eager to have new roads. It is important to build the roads as soon as possible ensuring a high standard of quality under the supervision of local people. Moreover, good maintenance of the newly built roads is equally important.

2. Supporting small and medium enterprises

Countries often promote small and medium enterprises, since these contribute to the increasement of employment offer and poverty reduction.

According to the executive opinion survey, high lending rates and high tax rates negatively affect local businesses. High interest rates of banks that provide 95 percent of Mongolia's financial services hamper the situation for business start-ups and expansion. Current interest rate is around 1.0 to 2.5 percent per month and around 20 percent per year which is a considerable barrier for local businesses. Therefore, there is a high demand by local people for loans on favorable terms.

In 2009 and 2010, up to MNT 30 billion a year were allocated to the development of small and medium enterprises. In 2011, the government issued MNT 280 billion in government bonds with the intention of supporting small and medium enterprises. The New Government for Changes promised that they would lower the interest rates to a one-digit figure. However, in order to achieve this goal there should be sound and well-defined fiscal policy which is aimed at keeping inflation low that in turn enables to lower interest rates.

The government promise to introduce second level tax reforms has created an expectation among local entrepreneurs. As at the end of 2011,

2 *In terms of road network density, Mongolia is ranked 15th out of 15 countries and in terms of the railroad network ranked 14th. "Mongolia in World Competitiveness", EPCRC, 2011*

3 *"Mongolia: Road Sector Development-2016", Asian Development Bank, 2012*

there are 48 thousand enterprises operating in Mongolia and almost 80 percent of them are small and medium enterprises employing 1-9 staff. Only 30 percent of these enterprises pay taxes regularly. As the 350 big enterprises pay almost 90 percent of the total income tax, favorable tax terms for small and medium enterprises would not immensely affect the state budget. Indeed, it would support job creation through small and medium enterprises.

3. Fighting against corruption and bureaucracy

In 2012 Mongolia is ranked in the annual Transparency International's Corruption Perceptions Index 94th least corrupt country among 174 moving up 26 places from the previous year which is a huge leap. Despite these improvements, bureaucracy and corruption in the public sector continue to affect Mongolia's social development negatively. The survey results show that local people especially of Bayankhongor, Arkhangai and Khuvsgul provinces are confronted with bureaucracy at most. Moreover, huge investment inflows resulting from mining related activities have accelerated the demand for better transparency and justice.

Former socialist countries like as Mongolia also face problems such as, for example, an overly complicated government apparatus, inefficient infrastructure and subsequent uncertainty of duties and responsibilities, bureaucracy and corruption. Our policy makers are learning from the Georgian experience of successfully improving its Governance processes within a relatively short span of time. However, this requires bold decision making and reform actions.

At the provincial level, political ideologies of local governments should be abolished. Businessmen in all provinces also plead for transparent and fair budget allocation and tender processes. It is no secret that only those who have "close" connections to local authorities often win tenders and get other kinds of state support. This persisting situation must be eliminated.

4. Improving education and health sectors

Mongolians say that "Clear mind is being in healthy body". Currently, the health service supply is concentrated in the city, while in the countryside there is an uncovered demand for medical experts and facilities. A simple example is the statistics on the number of patients per doctor. In Ulaanbaatar city there are 240 patients per doctor on average, whereas in the provinces there are 496 patients per doctor - almost twice the number of patients per doctor than in the city. There are 668 patients per doctor in Khuvsgul province and 450 patients per nurse in Umnugobi province.

A similar picture can be shown in terms of the education sector. Provincial school facilities do not meet the requirements, human resource demand is not covered and teachers' qualifications are low etc.

Mongolia can only prosper, only if when the people are healthy and educated. Therefore, the government has been taking responsibility for health and education services. Unfortunately, the state has proven to be a poor manager, apparent from the fact that there are not enough doctors and teachers in the provinces. Moreover, these tend to offer poor quality services ridden by bureaucracy. Consequently, it is crucial to reform health and education sectors in an appropriate way and improve ethics and skills of doctors and teachers. At the same time, there should be a well-organized framework where doctors and teachers are assigned on the basis of their knowledge and skills and get sufficient salary and bonuses.

5. Efficient allocation of mining income

Expectations are given that mining driven rapid economic growth would also bring development in the provinces. Certainly, Orkhon province is more competitive than other provinces, because the "Erdenet" mine is located there, the project which has kept Mongolia's budget and economy afloat for many years. Similarly, developments in Umnugobi province come from the single large project, "Oyutolgoi". As soon as the mine begins producing output and exporting its products on international markets, it will definitely speed up Mongolia's economy. As such, we should properly monitor and efficiently allocate revenues generated from the mining sector. This will ultimately support long-term provincial development.

On the other hand, as the mining sector is booming, many of the policy responses have been inappropriate. Policy makers have responded to pressure from society by making uncertain decisions for investors. In contrast, countries like Australia and Canada, which also have mining

driven economies, have ensured that companies act in a socially responsible way. Companies must be aware of their social responsibility and contribute to provincial development through focusing on nature protection and conservation, and remediation. Consequently, misunderstanding among society would decrease, so that grounds of sustainable development will be given.

In conclusion

Life is a choice. We make choices everyday such as, for example, what profession to choose, where to study, where to work after graduation, when to start a family, where to send our children to school etc. It is literally impossible for everyone to benefit from the socio-economic developments the same way. Nevertheless, it is important to open the door of opportunities to make choices. Today, rural people barely have opportunities to improve their life and do not have proper access to health and education services. This is the reason why they head for the city. Unless there are good opportunities to work and live in rural areas, the migration to Ulaanbaatar city will not ease.

In order to facilitate rural development, the five challenges mentioned above need to be solved and special policies aimed at each province should be made.

Each of the 21 provinces that make up Mongolia have their own strengths and weaknesses. We believe that this report will contribute for improving competitiveness and fortifying the strengths that each province has.

PRINCIPLES OF ANALYSIS AND METHODOLOGY

THE PURPOSE AND IMPORTANCE OF THE RESEARCH

The purpose of Provincial Competitiveness Research is to make a comparative evaluation of the current competitiveness of 21 provinces in Mongolia and to define their competitiveness holistically. This study identifies the strengths and weaknesses of each province and evaluates their potential to compete, thereby creating a database that is useful for developing a stable, long-term development policy.

Until recently, we used to take account of macro economic criteria such as GDP per capita and the unemployment rate only when we spoke about provincial competitiveness in Mongolia and provincial development. But these criteria alone cannot show real competitiveness and economic status. This research is unique as it defines competitiveness of provinces through a more broad and holistic approach by taking account of 180 criteria in economic performance, governance, business efficiency and infrastructure.

The provincial competitiveness index would give us an opportunity to observe any improvement and changes in provincial competitiveness, because this study will be conducted every year according to the same set of methodologies.

Besides comparing the competitiveness of the provinces, this research helps to identify factors that influence the provincial competitiveness either positively or negatively and evaluate the competitiveness strengths and weaknesses. Moreover, this becomes an important source of ammunition to determine which province is more competitive and which is not by addressing factors that drags down the provincial competitiveness.

For policy makers, the report on provincial competitiveness will be an important source of knowledge and handbook which would help them evaluate the current situation and level of provincial development and to make more effective policies to develop rural areas. Also, it makes for provincial administrators it possible to estimate the results of their implemented policies, to make comparisons with other provinces and learn from their experiences. Likewise, businessmen can get reliable and holistic information from this report when making business or investment decisions.

UNIQUENESS OF THE RESEARCH

This study on the competitiveness of provinces, conducted by EPCRC, is special as it is the first ever comprehensive research conducted on the provincial competitiveness in Mongolia. This is to contribute to the provincial development and draw public attention to eliminating existing differences between urban and rural areas and overcoming inequality. The report will provide reliable data to decision makers hence commencing our work towards promoting the provincial competitiveness.

The concept of provincial competitiveness is a relatively new notion and aims to investigate how efficiently a particular province is allocating its resources and potentials, thereby creating its own competitiveness and enabling a favorable business environment rather than merely studying its dominance. For these reasons, we ranked the provinces by comparing a particular province against others questioning, whether they could create a favorable environment for preserving their competitiveness edges and supplement the existing advantages. In other words, this report pursues the question of whether a certain province enables local business efficiency and prosperous life for its residents through effective allocation of resources and by exploiting its advantages.

Since this research is designed to compare the provincial competitiveness, those that are ranked top in the list should not necessarily be the best performers. Although they are more competitive than the others, those provinces should promote their incompetency by using its resources effectively and exploiting its advantages. Likewise, those ranked lower in the list should not consider themselves to have poor competitiveness, but rather, they should see themselves as having lower competitiveness than the other provinces and should learn from other provinces and address the factors that are lowering their competitiveness.