

Mongolian Privatization Process in Transition Economy

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Abstract

Privatization of state properties played important role in Mongolia's transition to democracy from communism and economic reform from centralized economy to market economy. It started in 1991 just after democratic movement and demonstration forced ruling communist party leaders resignation from the government and the coalition government formed in Mongolia. Both politicians and economists agreed privatization of state properties and formation of private sector was a key to democracy and market economy. Privatization carried out for sixteen years in three steps. First two steps were crucial. In the result, growth of economy reached 10.6 per cent in 2006 and private sector has produced more than 70 per cent of the GDP. The State Property Committee, a government agency, manages state properties and organizes privatization of state properties and assets.

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Introduction

Mongolia is a large, land-locked, lightly populated country sandwiched between Russian Federation and Chinese People's Republic. Almost half the population is engaged in agriculture, particularly the unique Mongolian herding industry. The urban population is primarily located in the capital city, Ulaanbaatar, and a few other towns. Transportation and communication services are limited. Major industries outside the agriculture are cashmere processing, copper and gold mining, food processing, and construction materials.

Mongolia had been a communist satellite state of the former Soviet Union and governed by its only political party, Mongolian People's Revolutionary Party (MPRP), for almost 70 years. Democratic revolution began following the first political demonstration organized by the Mongolian Democratic Union on Dec. 10th, 1989 in Ulaanbaatar. The social movement led to resignation of the cabinet solely formed by candidates from the ruling party and Mongolia's first free elections. The old MPRP won, but formed a coalition government with the new political parties.

The coalition government aimed to transform Mongolia from centralized economy to market economy and to set a policy toward open and transparent economy. To reform the economy, formation of private sectors and privatization of collective and state properties became the most important objective.

Development of private sector, which was an economic foundation of freedom and true democracy, with the aid of personal interest and activity of people to develop industry and economy was a social demand.

Mongolian politicians in early 90's viewed privatization as a path to democracy while economists asserted privatization as it was the first step toward to market economy. The identical views confirmed that privatization of state properties was essential.

Privatization

The Government started a preparation work for privatization in the end of 1990. A working group to draft a privatization guideline was organized. In three month the government made a decision to establish Privatization Commission of Mongolia consists of a chairman and 11 members including Minister of Finance, Minister of Labor, and

Minister of Trade and Industry, the First Deputy Minister of National Development, a head of National Statistics, and a director of newly founded Stock Exchange.

The Commission drafted a Law on Privatization of Properties and the parliament adopted it in May 1991. At the same time a Law on Commercial Entities was enabled. An amendment to Civil Code guaranteed a right for people to own unlimited amount of private assets and properties. The first time in more than a half century, people were given an opportunity to establish and operate their own commercial entities.

The purpose of privatization in Mongolia was to restructure the economy and to transform the country to democracy. By 1989, the government owned 96 percent of total assets and properties of the country. Less than 2 per cent of the properties considered as private properties. The rest belonged to communes of farmers, which operated directly under the government control.

Political transition happened relatively easily in the early 90's, but the transition of economy. After withdrawal of financial aid from the Soviet Union to Mongolia, the gross domestic production (GDP) dropped by 20 per cent, but almost all of the national industry were stopped. Without the sufficient funding resources from foreign countries, the success of private sector became only hope for the economic growth. Only in 1998, the economy reached back to the level of 1989.

Privatization Commission of the Government was to make a government policy on privatization of state properties, to reinforce implementation of the policy and to carry out privatization of state assets and properties. The Commission was given enough power to operate relatively independent. The Commission was headed by the Deputy Prime Minister, and ministries, agencies, local governments and citizens shall obey decisions made by the Commission.

Privatization began with retail sector and with the herding industry, which is the original basis for the Mongolian economy. But many larger industries that had been subsidized by the former Soviet Union quickly went bankrupt without subsidies or new investment. Several bank failures occurred in 1996, including the largest bank which had just completed a large new building in the capital.

First Period of Privatization (1991-1996)

Uniqueness of this period was that privatization was made by investment vouchers. This is statement can not clearly express true identity and the result of the work. This could be explained in the following way.

The main reason the privatization made by investment vouchers was to redistribute state assets and properties which were monopoly by creating of private sector and allowing private sector participation growth and raised from the objective to establish economic foundation for transition from socialism to market based system. Unless restructuring of

economy, transition process to democracy and market economy would not be possible to accomplish.

At the moment, the whole economy did not have purchasing power to support the demand. Total savings of the private citizens were equal to only 1.9 per cent of assets and properties planned to be privatized. There was lack of information in the western and south Asian countries and investment environment was not created at all. This is called as lack of demand which was the same for other transition countries as a main obstacle.

On the other hand the government issues investment voucher and distributes state assets evenly to its citizens could be an honorable way. Involvement of society in this process minimized the risks and failures and unwanted outcomes.

Russian Federation, Czech Republic, Poland and Kyrgyzstan and several other countries began privatization with issuance of vouchers. This proves that Mongolia is not the only case.

Mongolian government classified its assets and properties into three sections. The first was properties and assets not to privatize, the second was properties and assets to keep under the state control and to be partially privatized, and the last is to privatize.

Strategic important companies and properties are included in the lists of not to privatize. For instances Ulaanbaatar Railway, Mongolian Airlines, medical industry, and entities of which operation relates to national reserves and intellectual properties funds, and some special government protected farms, roads, bridges etc.

In the lists of partially privatized included 42 entities mainly from infrastructure, governments supply chains, distribution centers and some farms.

Others such as trade and service companies, centers, tourist, forestry, construction, press and printing, small and medium size transportation companies whose operation can be regulated by the market itself.

Due to political and economic situation and social expectation, the government issued investment vouchers to be given every citizen with free of charge to provide them an equal opportunity to have their own shares from the privatization. 1,989,900 vouchers with the total value of 19.8 billion Mongolian Tugrugs were issued and used in the early years of privatization history.

The entities needed to be restructured before the privatization to make them compatible on the free market. For this purpose, privatization by investment voucher classified into 3 types: large privatization, small privatization and agriculture sector privatization.

By large privatization, first large enterprises restructured into stock companies or limited liability companies. Then their interests and shares traded on the stock exchange by blue investment vouchers.

In the framework of this work, 344 state enterprises planned to be privatized, but in fact interests and shares of 916 entities value of 10.9 billion tugrugs were traded by blue investment vouchers, and 475 stock companies and 369 limited liability companies formed newly in the result. Almost 70 per cent of the total population or 1.3 million people had ownership in these newly established companies.

By small privatization, trade, service companies, big assets, apartment buildings, small commercial entities were traded by pink investment vouchers. In the framework of small privatization, 1593 department and grocery stores, restaurants, service centers were planned to be privatized, and 2451 small entities were covered. In the result 3176 commercial entities formed. Out of which 3046 entities value of 2.1 billion tugrugs, assets value of 385 million tugrugs were sold by pink investment vouchers and transferred to private sector.

Privatization of communal properties, which were mainly farm animals, agricultural equipments, rights and licenses was a unique. From 1959 to 1960, a political campaign forced 100 per cent of private farmers merge into communes by donating the most of their farm animals. With the establishment of communes ownership rights of commune members were not recognized. There was misleading understanding among people that communal assets were same as state assets although its operation was ruled by designated own law. The government did not attempt to make corrections to such kind of misleading statements.

In the privatization, its uniqueness was respected and the government set the main principles. For instances, a privatization method was chosen by commune members, investment voucher was secured by commune assets, and the government involvement was limited up to providing assistance to technical work and organization.

In July, 1991 eighth convention of the Union of Agricultural Communes approved a directive for privatization of commune assets. The directive secured initial commune members right to participate in the privatization of commune assets with investment vouchers and to own up to 30 per cent of the total shares of the commune.

Privatization process of communes carried out intensively and completed in a year. Methods used in the privatization of communes were varied from one place to another. In some provinces, in the result of the privatization, many private individual farmers were born. In other places, communes restructured to stock companies. The total of 230 communes existed in Mongolia in 1990 all of them privatized by the investment vouchers. In a few years the number of farm animals increased dramatically from 20 millions to 30 millions.

In the first period of privatization, some trade and service entities, assets, unfinished buildings were sold for cash through open-bidding. Before 1996, 119 properties and assets were sold for 1.8 billion tugrugs.

More than 20 companies of agriculture and infrastructure sectors and hotels were privatized by tender with special requirements. One of the example is the privatization of Mongolia Telecom, which was only telecom operator at the time. Korea Telecom won the tender and bought 44.7 per cent of the total shares of the company. Mongolia Telecom has been operating successfully nowadays competitive market.

Advantage of this period was that laws, regulations and some institutions were formed well in relatively short time. An amendment to Civil Code was the beginning of setting new legal environment for transition to market economy. The amendment was about to approve private properties and assets in Mongolia. This was a basic concept of the government policy on privatization. Following this Laws on Privatization, Legal entities, Banking, Tax and Customs and Bankruptcy were passed by the parliament. These laws allowed to regulate and carry out government plan to privatize state properties and develop private sector in Mongolia, further transition to democracy, and relations and operations of post-privatized entities. Specially, Laws on Privatization and Legal Entities gave the government an advantage to control over various privatization types, methods and form of privatizing entities.

Having development of new legal framework, old State enterprise law and Commune law were getting less in use and finally they were disabled. Rules and regulations related to these laws also went out of use.

In the beginning of this period of renovation of legal framework, some issues left unregulated.

Although Privatization law was relatively transparent, clearly defined and it was useful to resolve many disputes, problems rose during first few years of privatization.

As privatization continues further, advantages and disadvantages of privatization processes were cleared up. Renovation of a policy, policy implementation and legal framework became a necessity. Transferring assets and properties to private sector by small privatization and liberation of the market has executed important role in money accumulation of the private sector and the government overcome obstacles like period of low supply-high demand of consumer products in the early 90's.

Along the advantages, there were some disadvantages need to be corrected during the privatization. Due to late opening of the second market for securities and poor corporate governance and institutions, government control on financial operations of state owned and state shared companies were weakened. Corruptions and misconducts of executive personal were common in strategic companies in state ownership, which were in the list of not to be privatized.

Large numbers of shareholders located in vast area around Mongolia were unable to participate in decision making processes of privatized companies. In some instances, executives who were responsible for safekeeping and utilization of state properties lost state properties, and some even used state properties for their personal businesses.

There also was a lack of control in privatization processes. About 700 government and local government organizations were making decisions and organization of privatization. Plenty of misconducts were noticed from privatization practice such as incorrect use of law, making wrong decision intentionally or unintentionally, making mistakes, poor organization of privatization, etc. Many arguments and disputes were raised due to these misconducts and mistakes.

Corrections were required by filling imperfections and adding new articles and clauses for uncovered and unregulated issues. On the other hand privatization by investment voucher was getting close to end. The Privatization law was replaced by the State and local property law in 1996 by the parliament.

Second Period of Privatization (1997-2000)

In accordance with State and local property law, the Government established an agency, State Property Committee in 1996 and approved Privatization guideline in 1997. The government goal was to speed-up transition process and economy reform and to get additional financial resources for state budget. It had been six years since the beginning of transition and reform, people were having some savings, and private sector was having money accumulations. The SPC determined auction is a preferable method for privatization of state properties in this period of time.

The government approved lists of legal entities and assets to privatize for 1997 to 2000 with privatization methods to be used for each entities and assets. The list was publicly announced in order to give investors give time for preparation for auction or tender and encourage their participation.

Properties and assets to be privatized were divided into several groups: small entities, large entities, valuable entities, buildings, unfinished buildings and apartments.

Legal entities with fewer than 50 employee determined as small. Small entities privatized by public auction and sold to the winner, who offered the highest bid. The total of 448 entities were sold for 23.5 billion tugrugs.

Legal entities with more than 50 employee considered as large. 258 large entities were in the plan to be privatized, but shares and interests of only 80 entities sold for 16.0 billion tugrugs.

200 rent buildings and 218 unfinished buildings were sold during this period of time.

The government were very cautious about privatization of housing and apartments and studied privatization of housing since 1991 when privatization begin. The government considered that housing is an essential part of people's lives, should not be sold like other state properties. Finally the government made a decision to privatize houses and

apartments to family where living in for free of charge after having adopted a special law only for this purpose. Currently more than 90 per cent of the houses and apartments are privatized so far.

Social sector privatization was new to Mongolia and it has began in 1997. With the aid of World bank technical assistance, the SPC started privatizing hospitals, colleges and universities.

In the second period from 1996 to 2000, all of the small legal entities and most of the large entities were privatized. In the result, now private sector is producing more than 70 per cent of the Gross Domestic Product and it shows success of privatization work.

One of the disadvantages of privatization through public auction was that owners with no experience or insufficient experience in the sector bought the entities and had trouble to continue its operation. Some of the entities stopped its operation after the privatization and some of which never operated again. Most of them experienced post privatization shock and the recovery took long time.

The government and SPC more concentrated on transition of state properties to private sector and less on restructuring of entities after privatization relying on the new owners. Also government regulations and restructuring processes in other areas which supposed to be implemented along the privatization were not done timely. Therefore, outcomes of privatization for overall economy was not good enough as expected.

Third period of privatization (2001-2007)

In the result of privatization program of ten years, indicators showed slight growth in 2000 and following years the growth rate increased more and more up to 10.6 per cent in 2006. This was the outcome of intensive privatization and economic reform made in the first and second period.

The Government started more concentrating on privatization of large enterprises and restructuring and preparation of entities before and after privatization. Preparation of state owned entities for privatization to increasing its value became crucial task. Law on Ministries and Agencies prohibited direct involvement of Ministries to state owned companies and let them only make policies for sectors where the companies operating in. State Property Committee reserved ownership rights of government interests and shares in the companies. Along separation of government power to make policy and utilization of ownership rights, cooperation between agency and the ministries improved dramatically.

New Company law of 2002 promoted restructuring of commercial entities to stock or limited liability companies. With restructuring of companies, basis of corporate governance came into reality and both ministries and the agency appointed their representatives to Board of Directors of state owned companies.

The government attempted to resolve deep problems between state owned companies which were accumulated during 90's. Several decisions made by the government and some of debts between state owned companies were written off from balance sheets.

Amount of supervision and control on companies operations, specially their financial activities, and their executive personal has improved in these years. Number of misdeeds or corruption in the state owned companies has been decreasing.

In the third period, several big entities were privatized. Foreign relations of Mongolia improved and Mongolian mining started attracting foreign investors. Gobi, the biggest cashmere processing company, NIC, the petroleum company, Trade and Development bank and Savings bank were the biggest entities privatized in this period through international tenders. All of them were sold to foreign invested companies or foreign participated consortiums. Other small entities, and assets privatized through different privatization methods.

Social sector privatization has been continuing still today. Society is very sensitive about social sector privatization and this can not be carried out as mass privatization done in 90's.

Sixteen years of privatization of state properties played important role in Mongolia's transition to democracy from communism and economic reform from centralized economy to market economy. Privatization will continue in the future, but in different a way.

The State Property Committee

The SPC is a government agency established in 1996 following the State and Local Property Law enacted by the Parliament.

The SPC is responsible for

1. organization and supervision of work to improve state properties and assets utilization, safekeeping and protection,
2. organization and supervision of bookkeeping, counting of state assets, preparation of balance sheet, control, utilization and efficiency improvement of state assets,
3. Setting standards and norm for planning, distribution of dividend and pay rates for state owned legal entities,
4. organization of privatization of state properties and assets in accordance with privatization lists approved by the Government and reporting,
5. providing support on management of local properties to local governments,
6. appointing state representatives to the Board of Directorships of state owned entities, and controlling of their actions,
7. Analyzing of state owned legal entities requests to write off capital and current assets from the balance sheets, to purchase new assets and approving them.

The Committee consists of 9 members including a chairman and members. The chairman appointed by and reports directly reports to the Prime Minister. Member are representatives of main ministries. The chairman also leads the agency employee of 65.

The agency has three departments in it: Administration department, State property management and privatization department and State property accounting, controlling and supervision department.