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Foreword

The World Bank's economic and sector work program on China is a very active one ranging over a wide spectrum of topics from macroeconomics to health and education. We have also very recently begun to analyze development and reform in Mongolia. Each year we publish a handful of our formal studies, but thus far most of the background papers and informal reports, many of them containing valuable analysis and information, have remained outside the public domain. Through the China and Mongolia Department Working Paper Series, we hope to make available to a broad readership among the China watchers and development communities a few of the papers which can contribute to a better understanding of modernization in these two countries.

This paper by Messrs. Shahid Yusuf and Shahid Javed Burki reviews Mongolia's current economic condition, analyzes the reform measures introduced in 1990-91 and assesses the country's longer term potential.

Shahid Javed Burki
Director
China and Mongolia Department
Asia Region

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This paper was prepared following a visit to Ulaan Baatar in July 1991. It draws upon the findings of the World Bank's economic mission led by Mr. Mete Durdag.

Mongolia

C3. Key economic indicators, 1985-91

	1985	1986	1987	1988	1989	1990	1991 Projection
			(Percentage change)				
Growth rates							
Real GDP	4.7	8.3	4.5	5.1	4.2	-2.1	-18.4
Nominal GDP	4.2	-0.7	4.3	6.1	4.2	-2.0	80.7
Prices							
Consumer	0.6	-1.0	--	--	--	--	..
GDP deflator	-0.5	-8.2	-0.2	0.9	0.0	0.0	121.4
Terms of trade (tugrik terms)	8.0	-14.5	6.3	0.7	-21.8	16.4	-9.1
Monetary							
Domestic credit	..	..	-1.6	6.5	2.0	11.4	74.4
Domestic liquidity	..	..	3.5	6.6	16.1	32.7	26.6
of which: currency in circulation	..	..	11.4	7.4	10.5	10.6	195.6
			(Percentage ratios to GDP)				
Budget							
Revenues	52.5	46.5	46.5	45.1	48.6	50.7	49.9
Expenditures	59.3	64.2	65.2	64.7	65.3	64.1	61.2
Overall balance	6.9	17.7	18.7	19.5	16.8	13.4	11.3
External financing	7.3	18.3	19.1	19.6	15.0	10.4	9.5
Domestic bank financing	..	-4.5	-0.5	2.2	1.5	5.7	0.2
Investment	49.4	51.2	46.9	44.1	44.8	32.1	11.1
Savings							
National	17.3	14.9	17.4	15.1	10.3	3.4	-8.7
Foreign	32.2	36.2	29.5	29.0	34.5	28.7	19.7
External 1/							
Exports of goods and services	25.3	28.2	27.0	25.9	23.5	23.2	64.1
Imports of goods and services 2/	57.5	64.4	56.4	54.9	57.9	51.9	83.9
Current account	-32.2	-36.2	-29.5	-29.0	-34.5	-28.7	-19.7
			(Millions of U.S. dollars)				
Exports of goods and services	638.6	825.1	906.0	923.6	839.7	521.2	471.2
Imports of goods and services 2/	1451.9	1885.6	1896.4	1956.4	2072.3	1168.5	616.3
Current account	-813.2	-1060.3	-990.0	-1032.5	-1232.7	-647.3	-145.1
Overall balance	30.8	-0.2	34.2	4.8	6.0	-53.1	-70.9
Change in net reserves (- increase)	-30.8	0.2	-34.2	-4.8	-6.0	53.1	39.6
Financing gap	--	--	--	--	--	--	31.3
Net international reserves	57.5	57.3	91.7	96.6	102.5	49.2	9.6
Net reserves (weeks of total imports)	2.1	1.6	2.5	2.6	2.6	2.2	0.8
			(Billions of transferable rubles)				
External debt CMEA only							
Outstanding at the end of year	6.4	7.2	7.9	8.6	9.9	10.4	10.4
Debt service (Percentage) 3/	13.0	2.2	3.1	5.6	9.4	13.2	--

Notes:
1/ Official exchange rates were used.
2/ Includes turnkey projects.
3/ As a proportion of exports of goods and services.

Sources: Mongolian authorities; IMF and World Bank staff calculations, estimates and projections.

Abbreviations

CMEA - Council for Mutual Economic Assistance

MDU - Mongolian Democratic Union

MIAT - Mongolia International Air Transport

MPRP - Mongolia People's Revolutionary Party

MPS - Material Product System

NMP - Net Material Product

Introduction and Overview

The objectives of this paper are threefold: To describe the main characteristics of the Mongolian economy; to delineate the reforms being introduced for the purposes of adjustment and structural change; and to define the nature of the assistance which the Mongolian authorities might need to overcome the current economic crisis and promote long-term development.

In many respects, Mongolia's economic circumstances are quite special. It is a landlocked country half the size of India but with a population of 2.1 million. Because of its location and attitude, the climate is unusually severe. The average temperature for the whole year is below freezing point. Rapid population growth during the past two decades has biased the age structure downwards. Nearly half of all Mongolians are under fifteen years of age, but as a result of the government's emphasis on education, they are relatively well educated. Literacy is virtually universal, thanks to the free provision of compulsory schooling. Nearly 90 percent of all children complete the 8th grade and 50 percent graduate from the 10th. Medical services are also available to the entire population, even those living in remote areas, at no charge. Emigration from the rural areas has been spurred by the low relative prices of agricultural products and subsidies for urban housing, transport and daily necessities. Half of the population now lives in cities.

From the 1950s until 1990, the Soviet Union, along with other CMEA countries, provided a generous volume of financial assistance to Mongolia in the form of grants and low interest loans. Over the second half of the eighties, for instance, foreign resource transfers averaged 30 per cent of GDP each year.

These helped finance Mongolia's imports of equipment, consumer goods and energy. All the petroleum products consumed came from the Soviet Union which was also the principal purchaser of Mongolia's exports of copper concentrate, wool, leather goods and meat. Between them the CMEA countries absorbed 97 per cent of Mongolia's exports and for much of this period, the main transport link with the outside world ran through Western Siberia into the Soviet Union. The rail link with China was used mostly for passenger transport.

The scale of foreign transfers, by augmenting domestically generated resources, enabled Mongolia to achieve respectable rates of growth almost continuously from 1970 to 1990 and levels of per capita consumption close to those of lower middle income countries. Net material product (NMP) rose at an annual average of 5.5 percent and this resulted in steady gains in living standards. But aside from increasing the economy's reliance on imports, the flow of resources from abroad has done little to enlarge or diversify the export base and may have discouraged domestic savings. All of these--a high import coefficient, the narrow range of exports, essentially to a single market, and a modest level of domestic savings--have left the economy exceedingly vulnerable to external shocks. Withdrawal of Soviet aid and the government's decision to fully embrace a market system in the space of two years, have been profoundly unsettling on the institutional plane as well as the plane of material supplies. The sudden interruption of imports, for instance, finds the economy unprepared and imperils the urban population, who have distanced themselves from the relatively frugal and self-contained lifestyles of the nomadic herdsmen.

Mongolia's current living standards could, potentially, be supported by its resource base of pastureland, minerals and educated manpower. But these have still to be fully harnessed by a development strategy. In the meantime, reduced budgetary assistance from the Soviet Union in 1990 and its cessation in 1991 has sharply curtailed government spending. The need to find hard currency to pay for some of its imports, even from the U.S.S.R, and the weakening of export demand for wool, hides, leather products and carpets in Mongolia's traditional markets, has worsened the situation and brought segments of the manufacturing sector to a virtual halt. Shortages of petroleum products, spare parts, certain intermediate products and various items of consumption, threaten Mongolia's cities with paralysis. In May 1991, the crisis appeared to be approaching a head: supplies of fuel and other material were running low; foreign exchange reserves were close to exhaustion; daily necessities were in short supply; trade had virtually ceased; and negotiations with the Soviet Union to resume at least barter transactions of Mongolian copper concentrate, molybdenum and livestock products for Russian fuel, spare parts and equipment, were stalled.

But in the third quarter of 1991 the situation eased somewhat. Emergency food and medical supplies from abroad,1/ rising meat production and the promise of a good grain harvest took the edge off local shortages although the situation remains quite precarious.2/ Negotiations with the Soviet Union yielded promises as regards the supply of fuel during the balance of 1991

1/ In 1990-91, the U.S. provided 30,000 tons of wheat and flour and 14,000 tons have been received from Japan. Smaller amounts of milk, sugar and vegetable oil was also supplied by Japan. In the second half of 1991, Japan will complete the delivery of medical supplies valued at close to 500 million yen. Another 60 tons of Gulf War surplus medical supplies were flown in by the U.S. in July. The FRG has donated 60 tons each of sugar and vegetable oil, while S. Korea is providing 640 small computers as a part of technical assistance program.

2/ Current shortages are superimposed on seasonal cycles of scarcity. Vegetables such as carrots and onions are hard to find in spring and must be imported. Milk is not available in quantity until after July and few animals are slaughtered until September by which time they have had a chance to gain weight.

in exchange for mineral ores.3/ Coal production in the first five months of 1991, was close to that of last year and this has sustained power generation. The trickle of assistance from other countries and the promise of more to come has provided measure of reassurance. And many Mongolians are optimistic that a rapid liberalization of the economy will yield large dividends in terms of growth and exports after what may only be a brief spell of austerity.

To contain the crisis, Mongolia has initiated reforms in both the economic and political spheres. Their scope is impressively wide, but the attempted therapy will require time to take effect. During this period, the availability of foreign assistance will be decisive. How much hardship has to be endured and the willingness to persist with painful restructuring may depend on the degree of support forthcoming.

Three types of external support is required: (i) Emergency assistance to tide the country over the immediate problems and assure basic needs to the urban population during the winter of 1991-92; (ii) Provision of technical assistance to establish institutions for managing a modern economy; (iii) Assistance for realizing the long term potential of the economy.

Adjustment and the resumption of growth during the medium term is subject to an array of systemic constraints. Unless other donors are prepared to partially--or fully--substitute for Soviet assistance, the Mongolian economy is likely to experience a significant drop in GDP and urban consumption

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3/ Commitments made by the central government in Moscow no longer carry the weight they once did, given the increasing intransigence of the Republics. Hence, the Mongolian authorities have attempted to cement these agreements by opening separate channels of communication with the Russian and Kazakh republics.

will be sharply squeezed, which could be damaging politically and might redound against reform efforts so recently begun.

Reforms and Macropolicies During 1990-1991

Reformers in Mongolia responded to two stimuli: disenchantment with centralized socialism and the economic break with the Soviet Union. The initial phase of reforms was in response to the first impulse; the second was brought about by the inability of the Soviet Union to preserve its economic relations with Mongolia.

An awareness of Mongolia's systemic problems first surfaced in the mid eighties at about the same time as the first stirring of perestroika in the Soviet Union. During 1985-6, the bureaucracy was marginally trimmed, steps were taken to decentralize fiscal authority and enterprises were allowed greater autonomy over the use of retained earnings. Towards the close of the eighties this was followed by a cautious widening of reform horizons; planning and the required rigid adherence to a variety of indicators was scaled back; fiscal decentralization was pushed a stage further; a number of retail prices, which had remained frozen for decades, were raised and given a margin of flexibility; a few state enterprises were not only permitted to trade directly but also to retain a portion of foreign exchange so as to stimulate exports; last but not least, a law of cooperatives breathed new life into the private sector by allowing private participation in newly instituted cooperatives.

These early and hesitant moves were of limited consequence and had little effect on either the economic structure or on efficiency. Attempts at reform began in earnest only after developments in the Soviet Union gave warning of impending upheavals that were likely to sweep away long entrenched economic relationships between the CMEA and Mongolia.

The break with the Soviet Union encouraged the reformists to espouse a radical change in the country's economic and political systems. In early 1990, student protests and the possibility of a work stoppage induced the ruling Mongolian People's Revolutionary Party (MPRP) to espouse a strongly reformist position under the leadership of Mr. P. Orchirbat. Continuing political turbulence within Mongolia, a multiparty election in July 1990 and clear indications from the Soviet Union that it was unwilling to serve as the financial prop for Mongolian's economy, finally persuaded the authorities to embrace both the market system and a democratic form of government.

Thus, Mongolia, unlike most reforming socialist countries is embarked upon two radical changes: introduction of a pluralized democratic system and adoption of a market based economic system.

A. Price Adjustments and their Consequences

The program of economic reform puts emphasis on changing relative prices and reducing expenditures. With government revenues accounting for a little under half of GDP and spending equivalent to two thirds of gross product, correcting the budgetary deficit is a matter of priority. In 1990 the government sought to trim outlay by reducing employment and capital spending. It began talks with the Soviet authorities to reschedule payments on debt obligations of 9.8 billion transferable rubles, whose servicing since 1986 has absorbed about 5% of export earnings (69 million tugriks) annually.4/ To lessen the burden of subsidies, which exceed 15% of GDP and to reduce domestic absorption, the tugrik was devalued in July 1990

4/ Under the 1986-90 agreement, the Soviet Union allowed Mongolia to defer amortization charges on government to government debt. In mid 1991, negotiations were underway to extend this arrangement for several more years (Milne 1991, p. 28).

from Tug 4 to a US$ to Tug 5.63. Two subsequent adjustments of the rate, in March and June 1991, brought the parity to Tug 40. Farmgate prices for wool, skins and butter were increased by between 30 and 70 percent in January 1991 and simultaneously, the state procurement of meat and wool was sharply reduced. Although these moves diminished the claims of exporters and agricultural producers on the budget, their effects on the domestic supply response and on consumption were partially vitiated by a decree doubling both retail prices and wages, which also went into effect in January 1991 (prices of coal and electricity rose by lesser amounts).5/ As the government announced its intention to embark upon a further round of price and exchange adjustments in July 1991, the incentive to market agricultural products through state channels was seriously eroded. Meat production rose in the first half of 1991 but much less was available through state owned shops in the cities.6/ Exports were also affected. Although the bartering of minerals for Russian fuel continued, albeit fitfully,7/ export of other commodities through official channels fell in the first quarter of 1991 and virtually ceased in the second quarter partly because of production bottlenecks but partly also in anticipation of the next devaluation.

The process of adjustment was further complicated by the flight from tugriks to dollars as inflationary expectations took hold in response to the doubling of prices and the steep decline in the exchange rate. The suddenness of the devaluation

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5/ Prices of coal and electricity were increased by 75 per cent and 94 per cent respectively, Milne, (1991, p. 17).

6/ As producers diverted supplies to market channels in anticipation of further price adjustments anticipated in mid-year.

7/ Shipments of fuel in January and February 1991 were running below normal. Furthermore, although the Russians have been accepting deliveries of molybdenum these are being stockpiled and no goods are being offered in exchange.

as well as its magnitude also immediately jeopardized the finances of enterprises with significant foreign obligations, in particular the national airlines and the railway company, which are Mongolia's lifelines to the outside world. Inevitably the government has had to respond to the plight of these enterprises through an expansion of credit. In the first half of 1991, the net domestic bank credit rose by close to a 90 percent.

Declining trade and the slowing down of industrial activity have cut government revenues severely, while the decentralization of expenditures has diminished the ability to control spending. Plans to broaden the tax base, to introduce new direct taxes, impose customs duties and to supplement the financing of social services with user charges are under active consideration. However, until these are instituted, domestic savings, one of the critical determinants of adjustment, will continue falling. In 1990, national savings were estimated to be about 3 percent of GDP, mostly generated by the public sector. Budgetary difficulties, falling household incomes, worsening unemployment and the general uncertainty, suggest that in 1991 Mongolia might be headed towards a zero savings rate,8/ whereas investment is likely to decline more slowly to 11 percent of GDP from 32 percent in 1990. In effect, the adjustment problem will remain acute in 1991 as the current account (BOP) deficit will decline only a few points from 30 percent of GDP in 1990 to 26 percent of GDP.9/

8/ Savings are likely to be negative after decumulation of inventories and reserves are factored in.

9/ This assumes, of course, that foreign financing is forthcoming to cover the gap. Estimates of Mongolia's GDP have been crudely constructed from MPS based data and the accuracy is suspect. Because inventories of food , some intermediates and foreign exchange reserves have been run down, savings could be negative. But to an unknown degree this is offset by the accumulation of raw material and finished product stocks.

Measures taken to liberalize the economy and to introduce market prices have, so far, done little for the cause of adjustment and price stability, but they have begun to put in place the foundations of a market economy. The withdrawal of controls on a wide range of retail prices has allowed approximately 60 percent of trade to be conducted at market prices. Although export licensing remains in effect, the right to export is no longer restricted to state enterprises and trading corporations.

B. Privatization

The passage of the privatization law in June has accelerated a process that began in 1988 with the legalization of private cooperatives. There are now 2000 active cooperatives with 30,000 members. In addition nearly 4000 small private ventures have registered over the past few months to produce retail and construction services as well as light manufactures. By mid 1991, estimates of employment generated by these ranged from 17,000 to 30,000.10/ Nearly one third of state owned herds are in private hands and 30 shops were auctioned off in mid 1991. The next step, to be completed by the summer of 1992, is the privatization of small and medium sized enterprises. The company law of June 1991 established the governments' ownership rights over state enterprises and allows it to dispose of shares through the recently established State Privatization Commission: starting in July 1991 the commission began distributing green vouchers to each citizen, which will be used to acquire small and medium sized enterprises as they are auctioned through mid 1992. It also planned to supply blue vouchers which will enable individuals to become shareholders in some 700 larger enterprises

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10/ The emergence of petty trading, as in Poland, is not necessarily the makings of an efficient small scale manufacturing sector. Without entrepreneurship of a particular kind, institutions and incentives it need not progress to higher stages.

to be privatized in batches starting in September 1991 and extending over a 2-3 year period.11/ The total book value of assets in the Mongolian economy was set at Tugrik 51 billion in mid 1991. Of these Tugrik 24 billion will pass into private hands with the government retaining Tugrik 13 billion worth of shares in large enterprises. The face value of vouchers to be distributed is expected to be Tugrik 20 billion, so that the transfer of assets can occur without households having to significantly drawdown their Tug 1.5 billion in financial holdings. To facilitate trading, the state statistical office has made available to the Commission detailed information on all the enterprises to be auctioned or transferred to new owners. It has begun establishing countrywide telecommunication links so that a large number of voucher holders can participate in the bidding. The creation of a stock exchange later in 1991, will allow the trading of newly acquired shares and give foreigners an opportunity to participate.

Privatization by voucher on an accelerated schedule in a country with no tradition of private ownership and one threatened by serious macroeconomic instability raises a number of questions.12/ But it represents a determined effort by the Mongolian reformers to seek the institutional precondition for efficiency gains and growth over the longer term. A successful transition which must also grapple simultaneously with adjustment must come to teams with numerous constraints and short term supply inelasticities. These factors and their implications for policy are discussed below.

11/ Far Eastern Economic Review (1991).

12/ See Blanchard, et. al. (1991, Ch. 2), and Borensztein and Kumar (1991, pp. 308-9). The latter note the problems posed by information gaps concerning enterprises; the scale of the auction; the implications of the resulting ownership structure for managerial supervision; and the transitional possibility that vouchers would be traded as money and thereby generate inflationary pressures.

C. Resource Mobilization

Responsibility for mobilizing domestic resources has resided, primarily with the public sector - household savings have rarely exceeded 1 per cent of GDP, which is fairly typical of low income socialist economies. Because of the severe contraction in economic activity and concomitantly of public revenues, the outlook for public savings looks exceedingly bleak over the medium run. As most enterprises are incurring losses, the profits tax, which generated nearly 45 per cent of budgetary income in 1989 has ceased to be a fiscal pillar. Likewise, the returns from markups on import prices as well as turnover taxes have been drastically reduced. In 1989, the ratio of revenue to GDP was 49 per cent and national savings about 10 per cent of GDP. The ratio of revenues to GDP projected for 1991 will remain approximately constant, with the economy actually dissaving as inventories and reserves are run down. Sustaining revenues deserves priority. Investable capital will be sorely needed to revive growth and in the absence of a coherent fiscal policy, macroeconomic stability will prove to be elusive. Initially, at least, the authorities must utilize the existing tax system as fully as they can, but as economic circumstances improve and administrative capabilities are strengthened, they will need to introduce broad based taxes adapted to a market economy.

Over the medium term, it is likely that expenditure management will exert a decisive influence on macroeconomic functioning. Cushioned by Soviet financial assistance, Mongolia was able to create an infrastructure of social services far more elaborate than countries at comparable income levels. In recent years, education absorbed over 10 per cent of GDP or a fifth of the budget. Another 5 per cent of GDP has been channelled into health. Employment in these two sectors accounted for 19 per cent of the total in 1989. Repeating a pattern encountered in other socialist countries, Mongolia has generally subsidized urban consumption of food, transport and housing. State enterprises that have exploited soft budget constraints to the full, have also balanced their books by means of budgetary hand outs. About 35 per cent of expenditures (15-17 per cent of GDP in 1985-90) have been annexed by subsidies, mainly for energy, family support and agriculture.

If cuts are to be imposed, the choices are few and difficult. For a year or two consumption can be protected by bearing down on capital spending, but this would be highly injurious for long term development. Pruning subsidies, enforcing economies in the spheres of health and education and minimizing defence costs are among the narrow range of possibilities. If Mongolia were to half the subsidies through price reform and privatization; bring expenditure on health and education down to the average for lower middle income countries - 5 per cent and 3 per cent of GDP respectively;13/ and limit defence spending to 1 per cent of GDP, approaching a semblance of equilibrium in fiscal accounts will begin to appear feasible.14/

Clearly, burdens will have to be shifted from the government onto the shoulders of private households along with significant adjustments in incomes. The numbers on the public payroll will also have to be reduced and many will go through a transient period of hardship until employment can be found in the private sector. To try and husband public sector jobs on the slender finances currently available would be courting hyper-inflation in the short term and prolonging the unavoidable process of adjustment.

13/ Expenditure on education is 7 per cent of GDP in Thailand and 3 per cent apiece in S. Korea and China.

14/ A little over 7 per cent of GDP was absorbed by administration and defense in 1989.

Revenue maintenance and expenditure reduction should begin to benefit public savings, but there is also an urgent need for measures to encourage accumulation in the private sector. To an extent this will materialize on its own accord as individuals react to uncertainty over future housing and social security benefits that were such a large part of socialism's appeal, and begin building up precautionary balances. Saving will also be stimulated by widening opportunities for private investment in activities long placed off limits, such as manufacturing and retail services. Eventually, there will be scope for purchasing urban housing. These tendencies could be reinforced by monetary policy that promoted price stability and assured positive real returns on financial assets, together with systemic reforms unlocking the door to sustained development. There is no reason why private savings in Mongolia should not spiral upwards as they did in China if adjustment can be telescoped into two or three years and growth is restored to 4-5 per cent per annum rates by the mid nineties.

One part of adjustment depends on restraining domestic absorption through fiscal measures that enlarge public savings and financial ones that motivate those of individuals. Such actions must be complemented by political initiative and labor policies which ensure that the cost of adjustment in terms of falling real incomes is widely and equitably distributed. Where public sector employees are able to orchestrate an effective resistance to the sharing of wages, the entire effort of mobilizing consensus on macro strategy of shrinking expenditures on public services, of decreasing consumption, and of improving the competitiveness of locally produced goods, can be vitiated.

The Labor Market and Real Wages

In most socialist countries with sizable urban sectors, the labor force is well-organized and embedded within it are focii for determined resistance to unpalatable policy medicine. Mongolia with its large agricultural sector, which employs thirty per cent of the labor force, is on the borderline and to a degree insulated from labor militancy. Nevertheless, half the populace lives in urban centers, some 600,000 in the three principal cities and a third of the workforce is concentrated in industry, transportation and construction. Thus, urban-industrial workers are in a position to undermine adjustment unless they are neutralized through political persuasion, a wages policy and for those who are unemployed, the hope that reforms now being implemented will bring resources together into much more fruitful combinations.

Unemployment at the end of 1990 was 40,000 (6 per cent of the labor force). By mid 1991, it had risen to 70,000 (11 per cent) as construction activity declined yet further, manufacturing industry faltered and some public sector employees were laid off.15/ However, many of those newly out of work are guaranteed full pay for six months and in theory at least can claim social security benefits on the basis of past contributions. Prices were doubled in January 1991, but so were wages so that the forthcoming squeeze on real wages has been felt only indirectly as a result of queues and empty shelves. The real trial will come in the winter of 1991 and in the early part of 1992. It is during this period that a combination of joblessness, shortages, declining real wages and industrial dislocation could test the patience of the relatively privileged urban labor and the political skills of reformers, who must carry this critical element of the electorate with them if the reform program is to be carried more or less intact into 1992 and beyond. How much hardship must be endured and hence the severity of the political challenge lying ahead depends in part on the

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15/ Mid year unemployment figures are biased upwards by the entry of school leavers into the job market.

volume of assistance forthcoming from abroad to buffer urban consumption. Equally, it will be a function of relative price movements favoring the strategic agricultural and energy sectors as well as the irrevocableness of enterprise reform in pressing hard budget constraints to the point of closure.

The Real Sectors

A. Agriculture

Foodgrain Production. Mongolia's dry climate and thin soils permit low yield, extensive farming on some 1.3 million hectares. The seventy state-owned collective farms account for much of 635,000 tons of grain produced in 1990. They are also responsible for the supplies of potatoes (130,000 tons), vegetables, hay and fodder. Over the past year, the system has been under pressure from three sides: imports of spares for tractors, fuel, fertilizer and chemicals, distributed to the farms through state channels have been reduced; uncertainties regarding prices have led to interruptions in supplies to the state flour mills; and administrative reorganization, together with the spread of privatization, have begun undermining state orders without there being, as yet, markets to take over allocative and distributive functions. Each of these will require attention in the immediate future.

The Livestock Industry. Mongolia's 26 million (1990) head of livestock, mainly sheep (14.5 million), goats (5 million) and cattle (3 million) 16/ provide meat and dairy products, the principal constituents of the diet; hair, hides, wool, felt and other intermediate products for the main industries; and about 50 per cent of total exports in the form of raw materials,

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16/ There are, in addition, 2.2 million horses, 0.6 million camels and smaller numbers of yaks. Milne (1991, p. 13).

live animals, food products and processed goods. Growth in the number of animals averaged 3-4 per cent per annum during 1986-90, because of good weather, but unfavorable meat and dairy prices have impeded the increase in output.

Price reform and the spread of privatization, by stimulating the pastoral economy, could erase the shortages of basic food items on the domestic market but the development of a internationally competitive livestock industry, will require a many pronged effort.

Although 70 per cent of Mongolia's 1.6 million square kilometers of land is usable for pasture, the ecology of the dry steppe grasslands with their thin salty soil is inherently fragile. Fertilization, attention to grass species, and controlled cropping are necessary in order to maximize returns and prevent ecological degradation. Scientific pasture management and intensive farming guided by economic criteria has barely commenced. Alongside improvements in pastures, there is a need to upgrade the quality of livestock through crossbreeding with higher yielding foreign strains. Through more efficient utilization of pasture and herds, a smaller stock of animal could be made to yield a larger volume of output with less strain on the ecosystem.

Any pastoral system and especially one faced with climatic extremes, must give special attention to the supply of fodder and feed. Adequate provision of protein and nitrogen is critical for growth. Depending on the type of animal, various kinds of additives and antibiotics are also necessary. Cattle, in particular, must have coarse fodder along with grain and protein supplements for healthy development.17/ Seasonal feed and fodder constraints in Mongolia are fairly acute. They limit the degree to which the number of animals can be multiplied as well as the production of quality meat and dairy products. Domestic output of fodder is half a million tons, or 40 per cent of current needs. Facilities for drying hay so as to preserve soluble carbohydrates, protein's and vitamins are inadequate or nonexistent. Hay is stored in the open without weather proof covering, which results in deterioration and, in the event of unseasonable rains as in 1990, leads to spoilage. Scarcity of protein and supplements is even more serious. While this does not constrain the growth in numbers, it is certainly a factor in the productivity of the herds and Mongolia's ability to meet quality standards in international markets.

These are not the only impediments on supply. An efficient dairy industry must possess refrigerated trucking facilities for the collection of liquid milk from dispersed farms and its delivery to processing units. Dairy farms of an economic scale, equipment for milking and storage, a system of feeder roads, container trucks of a suitable size, factories where the milk can be processed and packaged, and refrigerated transport facilities for distributing these items to distant markets, are the various essential links in the production chain. These are either at a rudimentary stage of development (processing stations) or nonexistent; feeder roads, cold chains, and container trucks. A dairy industry operating on a commercial scale also must possess an institutional infrastructure to facilitate collection, to absorb seasonal fluctuations in supply, to minimize damaging cycles in output as well as in prices. Producer co-ops, government price supports, strong linkages with

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17/ Concentrated feed, containing protein and other additives, can only be fully utilized by cattle when their complex digestive tract is filled with long chain, cellulose fibre from coarse fodder.

final markets, are some of the institutional steps leading from a cottage industry to a commercial operation which has some prospect of becoming a player in the world market.

Similarly, the meat packing industry has its own long chain leading from the supplier of animals, through mechanized slaughter houses, where the meat is dressed, to meat packing factories by way of refrigerated trucks or railway wagons. Meat packing must be closely linked with the needs of retailers, which makes for constant experimentation with various kinds of packaging and processing techniques. In developed countries, meat packing is frequently a vertically integrated, capital intensive industry in which the government plays a major role in enforcing quality standards and regulating the activities of oligopolistic suppliers.

By world standards, the Mongolian meat and dairy industry is in its infancy. In 1990, about a half million tons of meat and about 30 million liters of milk were produced. Quality is indifferent, facilities are antiquated and standards of hygiene low. Exports, thus far, have been restricted to the Soviet Union and East Europe. Countries with a broader range of choice are unlikely to accept Mongolian meat and dairy products, unless quality, packaging, price competitiveness and delivery are brought closer to world standards. No doubt, Mongolia is in a position to enlarge the domestic output of animal products, but a sustained and expensive effort of industrial modernization will be required before many of these find their way into exports. Over the medium term only the Soviet Union might be prepared to purchase these. If transport difficulties can be overcome, there may be a market for live animals in the Mid-East but this could take years to develop.

Animal byproducts--hides, wool, hair, blood, bones, horn and natural casing for sausages--can support a variety of industries.18/ Some of these already exist and Mongolia has exported wool (including cashmere), woolen fabrics, woolen carpets, hair, hides, leather and sheepskin coats, sausage and shoes. Unfortunately, almost all of these items are a quality which has hitherto been acceptable only in CMEA countries. Even Mongolian cashmere, an item earning hard currency, is inferior in quality to that sold by China, the dominant supplier.

During 1990-91 production has been falling in all these lines partly because industrial chemicals, spare parts for machinery and energy supplies have been scarce. But more important is the sharp reduction in demand from traditional CMEA buyers, who either cannot raise the funds to purchase Mongolian products or prefer to earn hard currency from the commodities they once traded with Mongolia. Factories are producing at a fraction of their rated capacity and have accumulated voluminous inventories of what are virtually unsalable products. Thus, industrial supply is highly elastic but there are no buyers. To

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18/ Animal byproducts can serve as the basis for a wide range of manufacturing activities which can be conducted on a small scale, and if necessary, with limited capital and rudimentary technology. For domestic purposes and to service regional markets, low capital intensity and small scale might be adequate for Mongolia's purposes in the medium run. Quality conscious manufacturing on a larger scale would be justified once it is decided to enter more competitive markets farther afield. This will require a collection network with supporting transport facilities; research and extension; standards and quality monitoring; training; and attention to marketing. The byproducts of interest and the manufactured items that might be obtained from them are as follows: converting animal offal, through rendering that removes moisture and fat, into protein feed for animals; refining and drying animal fat for cooking purposes; tallow, glue crushed and dried bone meal and phosphorous for use as fertilizer from bones with varying amounts of water and organic content (green, table and desert); blood can yield protein usable for animal feed, amino acids that can serve as vegetable supplements, binders, fibrin usable for preparing medical sheets and powders, haemotonics (iron supplements) and blood albumin used for finishing leather; animal intestines yield natural casing that is excellent for sausages; horns and hoofs yield material for knife handles and buttons. The meal can also be used as cattle feed and fertilizer. Hair and bristles are the raw material for brushes. Finally, collagen from bones, tannery stock and killing floor stock can be processed into glue and gelatine. FAO (1989).

revive output using newly available assistance from bilateral or multilateral sources to make up for deficiencies of intermediate materials would be an exceedingly wasteful approach to sustaining employment in urban manufacturing facilities. Before production is resumed for other than the domestic market, it is vital that the product mix is changed and the design as well as the quality of manufacture be enhanced to satisfy tastes in foreign markets.

B. Mining

Adjustment has other dimensions as well: supply elasticities of products which can be exported are of importance because they help to delineate the economy's potential for efficient growth and its capacity for correcting disequilibrium in the balance of payments. Forcing aside the constraints impinging upon its export oriented subsectors will preoccupy Mongolian policymakers for years into the future.

Copper. Mongolia is richly endowed with minerals but so far, only a single deposit of copper ore has been extensively developed and a beginning made at exploiting the reserves of low sulphur coal. In 1990, the country exported about 350,000 tons (120,000 tons of metallic content) of copper concentrate, mostly to the Soviet Union.19/ The Erdenet 20/ copper mine also yielded as byproducts, molybdenum, silver, and gold in that order. These, too, were exported to CMEA countries. Currently about 16 millon tons of rock are ground and milled to extract the copper sulphide ore which is then processed into concentrate.

19/ The excavation crushing and concentration of copper sulphide ores is extremely electricity intensive and requires large quantities of water (silicate ores are harder to separate and call for ever higher inputs of electricity). In addition, the disposal of tailings imposes much punishment on both the surrounding land and eventually, through leaching of chemicals, on the groundwater, Gordon (1987, pp. 42-49).

20/ Erdenet is the Mongolian word for treasure mountain.

Within the next three years, the mine will have to handle 20 million tons of rock to maintain the production of concentrate as ore quality is declining. This will entail investment in trucks, crushing and processing facilities and it will raise the demand for energy from the domestic grid or from the Soviet Union. While there may be scope for selling a larger proportion of the concentrate to other countries in exchange for hard currency, several years and much investment would be needed to appreciably augment production from the Erdenet mine.

Coal. Several open pit and two underground mines produce a little over 8 million tons of coal, of which 0.8 million is exported and the balance consumed in five power stations, three in Ulaan Baatar and one each in Erdenet and Darhan. Coal production doubled between 1980 and 1988, but the potential for further increase is large as Mongolia has barely dented its huge reserves of anthracite estimated at 16 billion tons. However, the prospects for rapidly expanding coal output and finding overseas buyers are small. The underground mines are old, substantially depleted expensive to operate and dangerous to work in. Both they and the existing open pit mines will need significant amounts of capital in order to raise the volume mined. To exploit major new anthracite deposits in the southern part of the country will require not just capital for developing mines and the associated infrastructure including washeries but also the building of a railway line to transport the coal to Mongolia's borders. As neither the Soviet Union nor China possess the capacity to handle Mongolian coal, additional investment would be needed in railway lines and port handling facilities before the coal would become accessible to foreign buyers. Given the availability of the low sulphur coal from Chinese and Australian sources at competitive prices, the economics of developing Mongolia's coal reserves for export as distinct from domestic use, are uncertain. Virtually all the capital would have to come from overseas. Investors would have to be persuaded that the expense of diversifying sources of supply was meaningful given other options. Furthermore, even if such interest is aroused, the Mongolian economy would reap few benefits until the very end of the decade as developmental lead times are long, investment is capital and import intensive and foreign companies will absorb much of the income from the first few years after production starts.

Other Minerals. Mongolia's copper and coal deposits have been partially surveyed and are ready for development. Other prospects still await careful geophysical exploration and they are unlikely to contribute to the country's GDP--or exports--much before the late 1990s. A small oilfield in the central Gobi Aimag deemed uneconomic when cheap Soviet oil was available and capped in the early sixties might be reopened. Meanwhile, U.S., Soviet and Mongolian companies have stepped up the pace of exploration in an attempt to validate the government's claim that there are reserves of 400 million tons waiting to be tapped. As Mongolia lies within the Boreal realm containing a quarter of the world's oil,21/ the likelihood of finds in Western Mongolia is fairly high, but the rigors of developing a field under unusually inhospitable conditions and the costs of piping the oil beyond Mongolia's borders, is bound to dilute foreign interest in the country. As with coal, it is unlikely that oil could contribute much to Mongolia's adjustment or growth over the coming 5-8 years. At best, a trickle of supplies from the one known field could offset imports of refined products from one of the neighboring countries.

Deposits of gold and silver could be exploited more quickly if overseas interest can be aroused. Placer mining of gold yields small amounts. The next step would be the processing of large ore bodies containing tiny quantities of gold. This is

21/ C.D. Masters (1991), p. 147.

a capital and energy intensive operation whose viability still needs to be assessed under Mongolian conditions. Even if financial returns attract resources and expertise, the benefits, if any, to the economy will accrue over the long run.

Development of the mining sector, along with the associated transport and energy infrastructure with foreign assistance must be an integral part of Mongolia's strategy, but in its early stages the mining industry will spawn few industrial linkages, or employment. It will begin to generate exports late in the decade and revenues for the government even farther into the future. Over the next five years, at the very least, it is the livestock sector and affiliated industries that will support adjustment and growth.

C. Infrastructure

The outcome of measures to build a more trade oriented manufacturing sector on inherited foundations and exploit Mongolia's potential as an exporter of minerals and animal products will be paced by the parallel, facilitative expansion of infrastructure.

The transport system has a number of shortcomings. Only 27,000 trucks are available to meet intercity transport demand and the needs of dispersed rural communities. The costs of operating these vehicles, mostly Soviet Russian in origin, is high because of their age--half have covered in excess of 500,000 km--and because of the poor quality of Mongolia's largely unpaved roads.22/ Between them Mongolia's road vehicles, haul just a quarter of the freight in terms of ton kilometers, but consume

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22/ The nation's total stock of vehicles is 40,000. There are 42,000 km of roadways, 1300 km paved. In total, 870,000 tons of fuel was imported in 1990, 364,000 tons of gasoline, 360,000 tons of diesel and lesser amounts of fuel oil and aviation kerosene.

360,000 tons of gasoline, approximately 40 per cent of the annual imports of petroleum products. Since 1990, shortages of spares of fuels have begun hampering vehicular movement which has tightened the noose around economic activity.

The main north south rail link 1100 km in length links Ulaan Baatar with the Soviet Union and with China. It is heavily utilized, carrying 75 per cent of all freight in ton kilometers, mainly copper ore to Russia, coal to the power stations and construction material between the three principal cities. Fresh investment is badly needed to extend the network so as to push some of the country's promising mineral deposits across the economic threshold; the rolling stock signalling system and tracks must be modernized; and a means found to integrate Mongolian railways more closely with the Chinese system, which uses a narrower gauge.23/ Transhipment of Mongolian goods to the Chinese port of Tianjin, 1000 km from the border, is far quicker and less costly than the cross Siberian passage to the distant Russian ports of Vladivostok or Nokhodka. Several transhipment options through China are feasible with a joint venture to augment rail capacity along the corridor leading to Tianjin being among the most attractive.

For such a large and thinly populated country, the returns on investment in transport facilities lie far in the future, but they are essential for unlocking the mineral wealth and bringing the rural economy within the ambit of international trade. In this context, air transport cannot be ignored. To attract foreign investment, Mongolia must establish aviation links with East Asia and Europe not just to expedite passenger movement but also to pave the way for the eventual shipment of high value exports to distant markets. While the existing fleet

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23/ Mongolian gauge is 1520 mm, the same as in the Soviet Union. Chinese railways use 1435 mm gauge.

of some 70 aging prop powered aircraft may be adequate for domestic purposes, transnational routes are serviced by a single medium sized jet aircraft leased from Aeroflot. Resources permitting,24/ it will be necessary to upgrade the runway and facilities at Ulaan Baatar to accommodate large wide bodies,25/ expand MIATs fleet and persuade other carriers to incorporate Mongolia into their network. The latter may be difficult as traffic is bound to be sparse. Hence, MIAT will, over the foreseeable future, shoulder much of the burden.

In spite of the difficulties posed by geography and a population thinly scattered over 18 aimags, internal telephone services are adequate, albeit of low quality. There are 4 lines per 100 people for the country as a whole for a total of 76,000 lines routed through 322 exchanges. The main deficiency arises from the neglect of international connections, a legacy of Mongolia's long isolation. Direct links are with Beijing and a few neighboring cities in the U.S.S.R. only. In addition, there is a telex connection with Hong Kong. International calls must be routed through the Soviet Intersputnik network, a cause of serious delays. For Mongolia to diversify its trade links and sources of capital direct dialing, fax, telex and data links of suitable standards are a must and can be acquired at modest cost. Foreign interest in a country, so remote and so austere in its attractions, will bloom only if businessmen can find some of the

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24/ MIAT, the national airline, has ordered two Boeing 757s to operate on its international routes.

25/ Ulaan Baatar's international airport with its 3500 meter runways is the only one of five with asphalt-concrete landing strips that can accommodate widebody jets short of the 747. But navaids' and ground handling equipment are inadequate. The Asian Development Bank is reviewing the possibility of providing assistance for modernizing the airport.

conveniences which other countries in East and South-East Asia provide in abundance.26/

Electricity is the remaining item on the list of vital infrastructure needs. Five large power stations with an installed capacity of 680 Mwh (75 per cent of total) feed a national grid that draws supplementary power from the Soviet system as well. Sixty per cent of the power, along with much of what is obtained through barter from the U.S.S.R., is consumed by the Erdenet copper mine. Residential use accounts for 10 percent, the balance is utilized by industry.

Generating plant is old. It is inefficient in its use of fuel and profligate in the own consumption of electricity - close to 20 per cent.27/ It is vulnerable to any interruption in the supply of spare parts as became painfully evident in the first quarter of 1991. The system, including the 150 Mwh of diesel powered capacity, has little slack and barely accommodates the current needs of industry. Any increase in demand from newly established private industries or mining ventures will require additions to capacity or economies in current usage. One small 80 MW facility is under construction in Ulaan Baatar, but this will provide little relief. At the same time, the two large stations in the capital are scheduled for major refurbishment. Although power from the Russian grid is expected to compensate for the overhaul of the first plant by C. Itoh of Japan in the fall of 1991, the agreement with the Russians does not involve a

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26/ A telephone link through Hong Kong was installed in 1990 for £ 750,000 by Cable and Wireless. It uses an earth station to route telephone and telex traffic through Asiasat. Euromoney, (1991), p. 18.

27/ Very probably, electricity is being siphoned off for use in workers' housing or other plant on the premises of power stations.

shift in the medium run power supply curve.28/ As the planning and construction of even a turbine generator takes in excess of eighteen months, additions to industrial capacity over the next two years will have to be balanced against the success of measures to conserve power. Alternatively, Mongolia may have to seek additional power, should the need arise, from the Soviet grid. As the Soviet market may be one of the few still prepared to accept Mongolian manufactures, there is scope for the continuation of barter trade - Mongolian leather products and carpets for Russian energy.

Foreign Assistance

Mongolia's economic crisis has many dimensions: first, macromanagement is unsure and it is if any thing compounding the problems caused by the withdrawal of Soviet aid; second, reforms are being introduced with reference to political imperatives and at a rate which far exceeds the absorptivity of an economy lacking even the most basic market institutions; third, the sharp reduction in imports is beginning to affect industrial employment but more damagingly for public morale, it is leading to shortages of daily necessities; fourth, there is as yet no strategy for mobilizing domestic resources, strengthening the productive sectors, developing infrastructure and diversifying exports. Instead of striving after greater self reliance, the current thinking has not evolved beyond seeking alternative sources of financing to maintain consumption standards and support a variety of still quite nebulous projects. Foreign assistance to Mongolia might concentrate on each of these deficiencies.

28/ Surplus electric power availability in Eastern Russia and the Kazakh republic may be insufficient to support major mineral sector developments in Mongolia over the medium term is uncertain. Undoubtedly, marginal needs can and should be met from the Soviet grid, but Mongolia might need to undertake a major generating project such as the 600 MW plant planned near the coal deposits at Baganur.

Macromanagement

Combining major systemic reforms with efficient macropolicies requires some ingenuity. Price liberalization, when linked with attempts to rationalize industry in the face of persisting real wage rigidities and impediments to factor mobility, subjects the economy to unusual stresses. A freeing of prices not only permits much needed realignment, it also allows repressed demand to initiate inflationary tendencies. Meanwhile,enterprise reform initially precipitates a decline in production, employment and tax payments. In an effort to cushion the real effects, check the spread of unemployment induced discontent, and contain the fall in revenues, governments' are inclined to accommodate the pressures released through monetary expansion. An easy credit policy augments public finances, while rising prices imposes an inflation tax and temporarily increases the resources at the state's disposal. A moderately expansionary policy under conditions of gradual reform may not be injurious. However, attempts to neutralize the shock wave released by overnight price adjustments can push the economy towards hyperinflation, vitiating the benefits of reform and inculcating price expectations with deleterious consequences for the longer term.

Mongolia's actions with respect to price and the exchange rate during 1990-91, in the face of unusually stringent import constraints, have enormously complicated macromanagement. A doubling of prices, a sixfold devaluation of the exchange rate, alongside a 90 per cent increase in credit, all within the first five months of 1991, means that the economy is primed for an inflationary spiral even as it lurches into the worst depression in Mongolia's recent history. Virtually, at a stroke, the conservative price expectations accumulated over decades have been erased. There is incipient "dollarization" of the economy.29/ Voucher based privatization could have wealth effects on consumption, which will raise consumption propensities. And the future efficacy of monetary policy has been substantially impaired.

Clearly, the next, more meaningful steps in the reform of prices and of the industrial system must be defined with a closer eye to complementary macroeconomic goals of growth and stability. Now that the contrasting experience of Eastern Europe and China has helped clarify approaches to macromanagement during the transition to a market economy, the first item on the agenda of foreign assistance should be advice with regard to:

a) the pace of systemic reform so as to take full account of factor rigidities, industrial supply elasticities, and the flow of resources form abroad.

b) the use of monetary policy so as to balance accommodation to price adjustments with the objective of medium term price stability. Recent trends in credit expansion to government and enterprises are not sustainable and only store problems for the future.

c) a phased enlargement of the revenue base plus changes in expenditure policies concerning subsidies, health and education to name the most significant items.

29/ Dollarization shrinks the base of the inflation tax and raises the velocity of circulation, both of which worsen future inflation. Dollarization also increases the influence of high black rate on the domestic price level.

d) the selective application of wages policy so as to reinforce other actions seeking expenditure reduction and the moderating of future price expectations.30/

e) continuation of trade reform with the gradual removal of export licensing, improved provision of financing for exporters, especially new entrants, and attention to the marketing of Mongolia's exports overseas. Underpinning these moves must be an exchange rate policy that balances domestic macro goals and supply possibilities with external competitiveness.

In short, the Mongolian authorities must appreciate the interplay between reform and macro management. The limits of reform in any given period must be set with reference to the capacity for managing change using policy instruments within the given supply and institutional parameters.

Institutions

The speed of transition to the market is closely linked with the appearance of institutions which regulate the flow of information and make possible the efficient functioning of a decentralized system with a multiplicity of autonomous interactants.31/ As state controls are removed, a different set of rules mediated by market institutions must ensure that competitive forces are allowed full play and lead to socially desirable outcomes. Accelerated reforms allows little time for institution building and pushes enterprises poorly equipped with

30/ The degree to which wages are indexed to prices, whether formally or tacitly, is a critical determinant of macrostability (Calvo and Frenkel, 1991).

31/ These include legal, accounting and financial institutions. Macro, price and sectoral data is also scarce and will have to be made good by strengthening the statistical apparatus.

managerial resources into an environment lacking most of the props taken for granted in a developed market economy.

As a start, advice to the Mongolian authorities might be directed towards three areas:

a) Privatization. This must balance a political timetable against realistic assessments of absorptive capacity. Too much haste would push a large number of unprepared state firms into a quasi-market milieu. East European experience suggests unequivocally that hurried privatization of long protected and inefficiently run enterprises poses serious difficulties. Many of them do not have the entrepreneurial capabilities, financial skills and work discipline to survive without the crutch of subsidies. Should a sizable number of firms run the risk of going under when the public sector umbrella is folded, it is most improbable that the Mongolian state could stand aside and allow the markets' will to prevail. The country does not have the institutional structure to absorb the shock of labor redundancy on a large scale. Budgetary obligations, the state is trying to relinquish will have to be resumed. More importantly from the long term standpoint, a situation where enterprises are selectively salvaged by the government after privatization is sure to seem inequitable to individuals left holding worthless shares in bankrupt enterprises. Instead of ushering in a new dawn, privatization will come to be associated with some of the principal flaws of market capitalism. A more cautious timetable, which concentrates in the early stages on rural assets and smaller enterprises to be followed by the privatization of industrial and commerical enterprises, might be the way to proceed. What such an approach must guard against is the de facto takeover by workers of larger enterprises during the period of uncertainty when ownership rights have yet to be defined. In East Europe, such takeovers have started a process of decapitalization.

b) The need to devise institutional mechanisms so as to coordinate macroeconomic and development policies between ministries no longer subjected to centralized direction, is also a matter of priority especially during transition. Economic agencies must be induced to share information fully and cooperate in implementing policy. This is the only way to ensure that the skills of Mongolia's limited cadre of able decisionmakers is fully harnessed.

c) A nation in acute distress will seek help from all quarters and at times enter into unnecessary contracts with foreign parties. Many other socialist countries treading the road to the market have entered into deals which neither side has much hope of consummating. Eventually many of these arrangements must be voided or worse reneged upon, which leaves a strong residue of suspicion and ill will. Over the past year, various Mongolian agencies have approached foreign governments, corporations and banks with requests for financing. They have also entertained proposals from foreign investors, acting independently, seeking to develop Mongolia's mineral resources or the infrastructure.

The usefulness of assistance from overseas would be maximized if the various government agencies acted in concert and with reference to a mutually acceptable as well as an economically meaningful hierarchy of needs. Similarly, it may be desirable to enter into developmental contracts once a strategy has been defined, the economy's absorptive capacity during transition better appreciated and domestic finances are on a firmer footing. There is now a wealth of experience on how to coordinate foreign borrowing and how to orchestrate an opening of the economy to foreign private investors. Some of this could be usefully reviewed by the Mongolian authorities.

Imports. Foremost in the minds of Mongolian officials is the need to finance "critical imports" during the short term, but managing imports and their financing will remain a major policy concern for some time. Mongolia is self sufficient in grain but not rice, in certain vegetables (although not items such as carrots, onions, garlic, beans, etc.), in meat, and many dairy products (although there are seasonal shortages). It is dependent on imports of vegetable oil, sugar, plus a variety of additives and processed goods. The country has an exceedingly narrow industrial base for consumer goods and food products and has relied on imports to make good its needs. Only a handful of countries such as PNG and Paraguay are quite as dependent for basic consumer items.

When Mongolia's imports are compared with a number of roughly comparable market and socialist economies, its import/GDP ratio is the highest by a significant margin - 46 per cent as against 30 per cent on average for the others. A breakdown of imports into broad categories indicates a similarity with PNG and Paraguay on virtually all counts, although PNG imports much less fuel. The other socialist countries, Romania, Bulgaria and Vietnam also share certain common features, but they are much more self sufficient in industrial consumer goods (see Tables 1-3).

From these comparisons, it would appear that the scale of Mongolia's imports might be somewhat exaggerated, possibly because of distortions in the valuation of products originating in the CMEA countries. When Mongolia's exports are adjusted downwards to conform--as a proportion of GDP--to those of the comparators, the figure for 1990 in Tug 3286 m or approximately $650 million at an average exchange rate of Tug 5=$1. Of these $140 million comprise industrial consumer and other products.

A good deal of uncertainty remains over the near term barter arrangements with the Soviet Union. After a brief hiatus in January-February of 1991, the U.S.S.R., in spite of its internal difficulties, has been delivering contracted amounts of fuel, electricity and parts in exchange for Mongolian ore and goods. Work on some turnkey projects financed by the Soviet Union, has also, apparently, continued. Maintenance of these flows between the U.S.S.R. and Mongolia for the balance of 1991 and possibly into the future, assures, at the minimum, that Mongolia's mining sector will be able to function as will the transport system and power generating facilities. The various Soviet republics might also remain willing to supply a variety of wage goods as they did in the past.

Projecting the Longer Term

The immediate goal in 1991 was to find the financing for essential imports needed in the rigorous winter months. This has been largely secured from bilateral as well as multilateral sources. But over the medium term, Mongolia will need to trim its import dependence and raise export earnings so as to avoid recurrent foreign exchange crunches.

Once the immediate ameliorative purpose of foreign assistance has been served, it is the longer term goal of reform and development which must guide the flow of resources from overseas. It is difficult to say how much capital Mongolia will need from bilateral and multilateral sources over the next five years. Much depends on the speed with which the economy revives and the mobilization of domestic resources. The public sector will retain much of the responsibility for infrastructure building and this could bias resource needs over the medium term. Similarly, a part of the cost of surveying Mongolia's mineral potential is likely to rest with the government, but the future development of minerals must draw primarily upon foreign financing from private corporations. The state might own a share - as is the case in PNG.

Leather goods, woolen textiles and the processing of agricultural byproducts are the manufacturing activities with immediate promise. These might require seed capital from the state but the rest could come from private individuals. The government could assist directly through research and extension. More indirectly it could expand Mongolia's tertiary level manpower. Here, again, foreign assistance financial as well as technical, would be invaluable. Mongolia's longer term demand for foreign capital is likely to be modest even if mineral resources prove to be scanty. If the country happens to be generously endowed, these could gradually be whittled to nothingness. However, for the foreseeable future, Mongolia will benefit from the transfer of knowledge and skills. It has a strong base of human capital from which to start but there is catching up to be done if industry is to be modernized and the composition of exports diversified.

Concluding Observations

Managing a transition from a fairly radical form of socialism to a market economy is a complex and little understood task. Reforms cannot depend on tested rules and familiar landmarks. They must continuously be skirting a precipice. Relative prices must be realigned with reference to underlying market conditions which initially register weak and confusing signals. A sudden liberalization of prices unrestrained by firm macropolicies and which does not evoke a rapid supply response can, in the face of excess demand, rapidly degenerate into hyperinflation. Enterprise restructuring, which attempts to introduce hard budget constraints and the discipline of market competition, can be highly disruptive for an industrial system that for decades has marched to the beat of a plan. For many enterprises exit from the public sector can mean bankruptcy. When enough enterprises find themselves in such a predicament, unemployment becomes a serious concern and along with spiralling prices it tests a public unaccustomed to such circumstances and to coping with uncertainty. Once the macroeconomic situation begins to look tenuous, the methodical pursuit of critical reforms to develop market institutions, enlarge productive capacity, enhance efficiency and expand trade becomes increasingly problematic. Firefighting on a daily basis absorbs so much of the government's energies that the effort of engineering institutions from the recalcitrant material left over from socialist days; of persuading a worried and resentful labor force to accept changes, which over the near team promise only hardship, is often beyond the political and managerial capabilities of those tasked with realizing the promise of reforms. For a country wholly bereft of any capitalist traditions or experience with free markets, Mongolia has shown unusual alacrity in grasping the nettle of reforms. The economy is subject to constraints physical, institutional and managerial few other socialist countries are having to contend with. Our review of these constraints suggests that Mongolia which is at an early stage of development might, with the help of suitable policies, make the transaction in a shorter period than some of the East European countries. During this period, Mongolia will be very dependent on external sources of financing to achieve a decent economic performance.

Table 1: THE COMPOSITION OF IMPORTS BY COUNTRY

	Mongolia /a	Bulgaria /b	Papa New Guinea /c	Paraguay /d	Romania /e
Investment goods	31.2	38.7	37.1	32.0	26.4
Fuel, mineral & metals	30.7	48.6	9.6	22.9	54.7
Fertilizer & rubber	5.9	-	8.1	9.4	5.6
Building materials	1.9	-	-	-	0.9
Raw materials for food ind.	0.4	-	-	-	2.4
Food and agriculture	8.2	4.4	16.7	2.1	1.3
Industrial consumer goods	21.3	8.7	25.9	24.0	4.0
Other	-	-	2.2	9.1	4.7
Total	100.0	100.0	100.0	100.0	100.0

/a Average of years 1988, 1989 and 1990.
/b Average of years 1988, 1989, and 1990.
/c Average of Years 1986, 1987 and 1988.
/d Average of years 1986, 1987 and 1989.
/e Average of years 1987, 1988 and 1989.
/f Average of years from 1985/86 to 1987/88.

Table 2: THE RATIO OF IMPORTS TO GDP BY COUNTRY
(unit: in percentages)

	1986	1987	1988	1989	1990
Mongolia /a	65.3	58.0	53.0	46.3	-
Bulgaria /b	41.4	40.2	43.1	39.9	38.1
Nepal /c	21.2/d	21.9/e	23.7/f		
Lao PDR	9.2	17.0	27.5	27.6	30.0
Papua New Guinea /g	35.5	35.2	38.3	38.5	36.4
Paraguay /h	31.7	35.9	36.9	40.4	-
Romania /i	14.7	14.1	12.8	15.8	25.1/l
Vietnam /j	12.7	15.8	17.4	20.5	25.8

/a Net factor services are excluded from total imports.
/b Net factor services are excluded from total imports.
/c Net factor services are excluded from total imports.
/d The figure is for 1985/86.
/e The figure is for 1986/87.
/f The figure is for 1987/88.
/g Net factor services are excluded from total imports.
/h The high imports to GDP ratio of Paraguay can be explained by two factors: first, the country imposes no restriction and low tariffs on imports; and second, substantial amount of the country's imports are consumed in neighboring non-free trade countries, Brazil and Argentina, through smuggling.
/i Net factor services are excluded from total imports.
/j Figures from 1986-89 are unofficial.
/k Estimates
/l Estimates

Table 3: ADJUSTED IMPORTS BY SECTOR
(million tugriks)

	1990	70% of 1990
Investment goods	1,470.7	1,029.5
Fuel, mineral & metals	1,447.1	1,013.0
Fertilizer & rubber	278.1	194.7
Building materials	89.6	62.7
Raw materials for food ind.	18.9	13.2
Food & agriculture	386.5	270.6
Industrial consumer goods	1,004.0	702.8
Total	4,694.8	3,286.4

Note: (1) Mongolia GDP in 1990: 10,180.7 million Tugriks
Imports to GDP Ratio in 1989: 0.463

(2) If import composition remains as in 1989 but imports are scaled down to 70 percent so as to make them comparable to the average for other countries, then the outcome is shown in column 2.

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