4 Mongolia

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I. Introduction

A. Geography

Mongolia, covering an area of 1,564,100 square kilometers, lies in the heart of the Asian continent. It stretches about 2,400 km from west to east and about 1,260 km from north to south and bounded on the north by Russia and on the southeast and west by China. The total length of the country's boundary line is 8,158 km. Mongolia is mountainous country with an average altitude of 1,580 meters above the sea level. The lowest point Khokh-nuur in the east is 552 meters above sea level and the highest point is the mountain Nairamdal in the Mongolian Altai (in the west) which stands at 4,374 meters.

The geography of the country is characterized by great diversity. From north to south it can be divided into 4 areas, mountain-forest steppe, mountain steppe, semi-desert and the desert. In the west- north the mountain ranges and ridges are overgrown with wild forests, big lakes and tempestuous rivers. The vast grasslands of the Asian steppe stretch across the eastern part of the country. The Gobi Desert lies in the south occupying somewhat less than one-third of the Gobi Region, the rest being semi-desert grassland. The typical landscape, a nature-lover's paradise, is an undulating steppe land providing fine pastures. The country is dotted with hundreds of lakes, the largest being Uvs-Nuur (covering an area of 3,350 square km), Huvsgul-Nuur (2,760 square km). Lake Huvsgul being also the largest fresh water lake in Central Asia is unique with its natural beauty and is called as a "blue pearl of Mongolia".

B. Climate

The climate in Mongolia is full of extremes. Temperatures may fall by 30 degrees not only in a season but also within a fortnight. Distance from seas and considerable elevation over the sea level makes the climate very dry. Mongolia lies right between the southern edge of eternal glaciers and northernmost boundaries of deserts.

Winter lasts from November to March, with temperatures dropping down to – 30 Celsius. Mongols speak about ‘Nine nines” or 81 days when it is cold. The coldest period falls on middle “three nines” or from mid December to January. Mongolia is a sunny country with 260 days of sunlight.

C. People and population

The number of population have been increasing, however population growth rate has declined over the last few years. At the end of 2005, population of Mongolia was 2,562.4 thousand people. 49.6 percent of the total population is men and 50.4 percent is women in that year, giving a sex ratio at of 98.5 males per 100 females. Two thirds of the Mongolian population is below 30 years old, and two fifths of the population is 14 years or below. Much of the population growth of Mongolia has been absorbed in urban areas. The present urban population is about 60.2 percent of total population or 1543.3 thousand people. In Ulaanbaatar, the capital city, there are 846,500 inhabitants-one third of the total population of Mongolia. However, a significant part of the urban populations still live in ger (yurt) habitations on the town peripheries. While the average population density of Mongolia is just over 1.5 person per sq. km, the population density of South Gobi Province is only 0.3 per sq. km. More than 90 per cent of the country’s population constitutes Mongolian nationalities. The core Mongolian nationality, being Khalkha distributed all along the territory of the country, makes up 80 percent of its population. The other major group, the Kazakhs, makes up about 6 percent of the population and lives in western Mongolia, mainly in Bayan-Ulgii aimag. Many Kazakhs immigrated to Kazakhstan in the early 1990s, but many have since returned. As for the linguistic reference of the Mongolian population, it relates to the Mongolian group of the Altaic family except for Kazakhs. This group is composed of Khalkh, Durvud, Buryad, Bayad and Uriankhai. Mongolian is the official language and the Russian Cyrillic alphabet was introduced to write Mongolian in 1944. Literacy levels had reached 98.0 percent by 2000 - 98.5 percent among men and 97.5 percent among women.

D. Culture

Mongolians traditionally lead a pastoral, nomadic lifestyle. Because of the climate and short growing season, animal husbandry defines the nomadic lifestyle, with agriculture playing a secondary role. Nomads raise primarily five types of animals–goats, sheep, cattle (including yaks), camels, and horses–that provide food, dairy products, transportation, and wool. Of these animals, the horse holds the preeminent position in Mongolian hearts and legends. Outside the capital, Ulaanbaatar, the horse is still the main mode of transportation and children begin riding as young as three year’s old. The most prestigious tests of these superb animals are the horse races at the Naadam Festival, Mongolia’s national games, which takes place each July. Families will travel for days to be able to participate or just attend this grand event. Nomadic families follow a seasonal routine, moving their herds to new grazing land based on the time of year, rather than one of aimless wandering. Historically, each clan had various chosen grazing grounds that were used exclusively by the same clan year after year. This tradition carries on today and families return to the same locations at the same time each year, for example, traveling at the end of each winter from a specific sheltered valley to a particular area on the high plateau of the Steppes.

Tibetan Buddhism represents the most complete array of Buddhist teachings and in the past Mongolians were guided by Tibetan masters who began the process of educating Mongolians in the fundamentals of Tibetan Buddhism. This spiritual bond between Tibet and Mongolia continues into the present day- predominantly Yellow Sect of Tibetan Buddhism (Lamaism); about 4 percent Muslim (primarily in southwest), some shamanism. Limited religious activities are taken although freedom of religion was guaranteed in 1960 Constitution.

E. Brief History and Political Structure

Mongolia’s history spans 5,000 years. From nomads herding the Central Asian steppe to the formation of the powerful Mongol Empire and the gradual emergence of the Mongolian Republic, its history is steeped in conflict. The Mongolian steppe is one of most ancient places on the earth. The Mongols created the largest empire the world has ever seen. The Mongols gained fame in the 13th century when under CHINGGIS KHAN they conquered a huge Eurasian empire. After his death the empire was divided into several powerful Mongol states, but these broke apart in the 14th century. The Mongols eventually retired to their original steppe homelands and later came under Chinese rule. Mongolia won its independence in 1921 with Soviet backing. A Communist regime was installed in 1924. The ex-Communist Mongolian People's Revolutionary Party (MPRP) won elections in 1990 and 1992, but was defeated by the Democratic Union Coalition (DUC) in the 1996 parliamentary election. Since then, parliamentary elections returned the MPRP overwhelmingly to power in 2000 and produced a coalition government in 2004. In the early 1990s, Mongolia abolished the old political and social regime and started to establish a new democratic system. As the nation with 2200-year tradition of national statehood, Mongolia has steadily been paving its way towards a free market through these political changes. In spite of all this, Mongolia applied the model of the world's developed countries with democratic legislature, in compliance with its specific features and national traditions.

Power is shared between the President, the Parliament (State Great Khural), the Prime Ministers ten-member cabinet and the Supreme Court. The President and Parliamentary members are elected directly by the people at two different elections. The Prime Minister is nominated from the party with the largest number of seats in Parliament. The Constitution legalized the tenet that the **Government** is the highest executive body of the State. The Government is accountable for its work to the State Great Khural and the term of its mandate is four years. As a supreme government organ, the **State Great Khural** has a power to enact and amend laws, determine domestic and foreign policy, ratify international agreements, and declare a state of emergency. **The President** is the head of state, commander in chief of the armed forces, and head of the national's security council. He is popularly elected by a national majority for a 4-year term and limited to two terms. The constitution empowers the president to propose a prime minister, call for the government's dissolution, initiate legislation and issue decrees, which become effective with the prime minister's signature. The **Supreme Court** serves as appeals court for people's and provincial courts but rarely overturns verdicts of lower courts; judges are nominated by the General Council of Courts and approved by the president.

II. Overview of Macroeconomic Activity and Fiscal Position

Background

Traditionally the main economic activity in Mongolia has been based on agriculture and livestock with some minerals products. Until 1990, Soviet policies dominated the Mongolian economy but since then Mongolia has embarked on a set of political and economic reforms. Mongolia has made significant efforts in achieving macroeconomic stability and fundamental structural reforms since its transition to democracy and a market-based system in 1990. In 1991 Mongolia became a member of international financial institutions, such as the World Bank (WB) and the International Monetary Fund (IMF). Mongolia joined the World Trade Organization (WTO) in 1997. With the assistance of international financial institutions and the wider donor community, Mongolia has made substantial progress over the past decade of democratic restructuring in laying down sustainable macroeconomic foundations and creating a private sector-led open economy. The private sector now accounts for more than 75 percent of GDP, an impressive turn-around given that it accounted for virtually nothing at the beginning of the 1990s. As the same time, Mongolia made progress in laying the institutional and policy foundations for a market oriented economy, including price and trade liberalization, launching large-scale privatization (retail sector and livestock herding), curtailing budget transfers and lending to state enterprises, and setting-up a commercial banking system. Towards the end of the decade Mongolia also stopped inflationary financing of the public sector and has since then managed to keep inflation under control.

A. INTERNATIONAL ENVIRONMNET

1) International Trade and Trade balance

One of the world's largest landlocked countries, Mongolia previously depended heavily on both the Former Soviet Union (FSU) and the Council for Mutual Economic Assistance (COMECON) for trade. This organization was active between 1956 and 1991 and coordinated economic policy among the nations that were under Communist domination. These states accounted for over 90 percent of Mongolia's external trade. The fall of the FSU and subsequent dissolution of COMECON forced Mongolia to reassess and diversify its trading strategies. Throughout the transition, successive Mongolian governments have pursued various trade liberalization policies in hopes of strengthening and expanding international trade. As a part of measures to promote trade liberalization policies in an effort to improve upon recent economic reforms, in 1997 Mongolia abolished customs duties and excise taxes on all imported goods, with the exception of alcohol, tobacco, petroleum and motor vehicles. As the same time Mongolian trade suffered from sharp falls in the world prices for copper, gold and cashmere, earnings from these leading export products plunged. This caused a ripple effect that resulted in various budget problems, a decline in the national currency and a general disruption of macroeconomic stability giving rise to the largest deficit since the collapse of the FSU. In response to these problems, the Government of Mongolia several measures to increase budget revenues by introducing Value Added Tax Law in 1998 and reinstating a 5% uniform import tariff and an excise tax on beer.

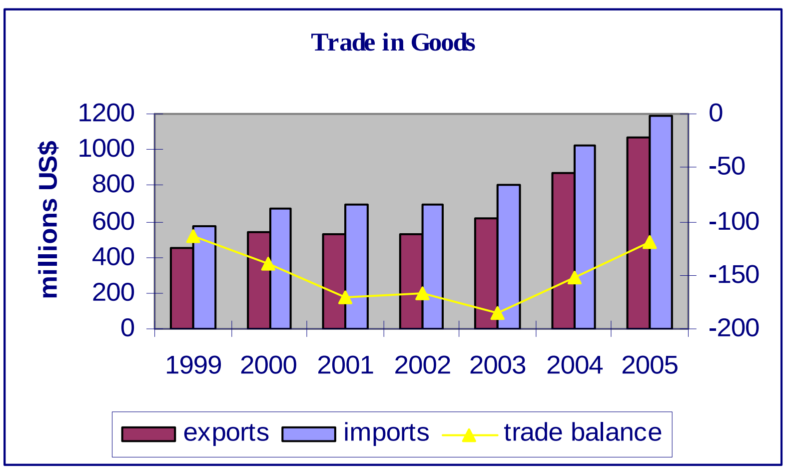
Currently Mongolia still heavily relies on international trade, but its export base is narrow and commodity-based. A large proportion of total exports consist of just a few products. Copper and molybdenum, copper and spar concentrates, animals and animal products, wool and wool products, cashmere and cashmere products represent the main export commodities. Some food items, diesel, petroleum products, and industrial equipment are imported. As Copper is the most important export product, Mongolia's export performance is highly sensitive to copper price fluctuations. Together with gold, these two products have accounted for more than half of Mongolia's total export. In addition, garments including cashmere have become a major export product. Although the total trade turnover increases each year, foreign trade balance remains negative, mainly due to the world price decrease of its key export products such as copper, gold and cashmere. However, given the favorable conditions in the mining and livestock sectors, total exports increased by 21% in 2005 while imports increased by 12.5%. Hence the trade deficit fell from 9.4% in 2004 to 5% of GDP in 2005.

Table 1 Trade balance, 1999-2005

(In millions of USD)

	1999	2000	2001	2002	2003	2004	2005
Trade balance	-113.1	-140.2	-169.9	-228.9	-199.6	-28.9	-9.2
Exports	457.2	535.8	523.2	523.9	627.3	872.1	1055.8
Imports	567.3	676.0	693.1	752.8	826.9	901.0	1065.0

Figure 1



In geographical terms, Mongolia has seen a constant and significant diversification of its trading partners. In recent years, Mongolia has become less dependent on Europe, specifically Russia, for its trade turnover while becoming increasingly active in trade with all other continents. While trade with the Russian Federation has consistently decreased since 1990, China has emerged as a major trading partner. Exports to G7 countries, mainly the United States, are also significant, at more than 30 percent of share in recent years. This partly reflects an increase in non-cashmere garment export to the United States. However, the Russian Federation remains a key trading partner even during the transitional period because of Mongolia's continued dependence of energy imports from Russia and the joint Mongolian and Russian ownership of the large Erdenet Copper mine.

Figure 2

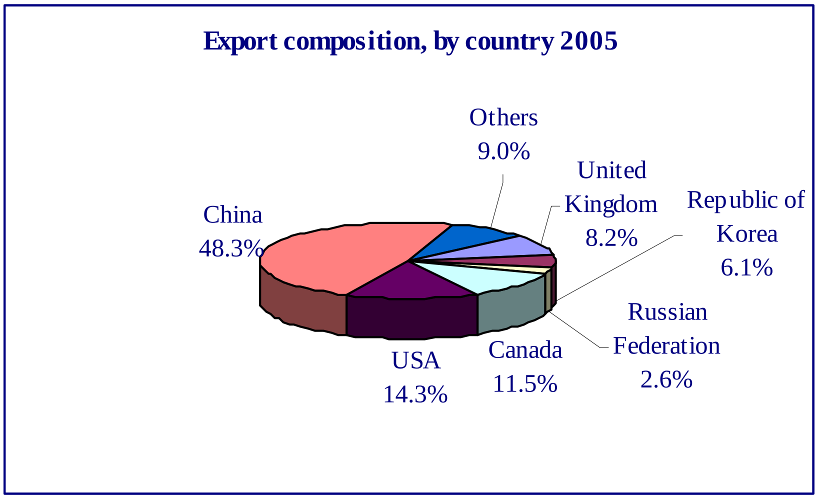
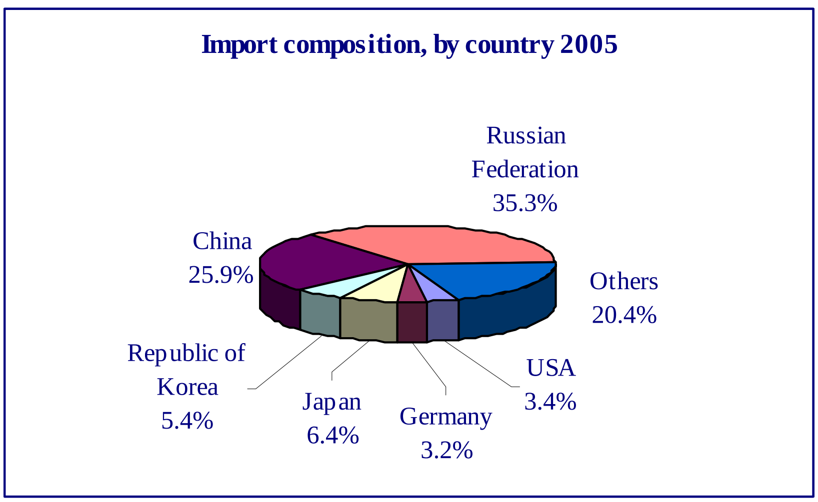


Figure 3



2) Balance of Payment

In 2005 the current account balance showed a surplus of USD 170.4 million. The trade deficit improved three-fold compared with the previous year, reaching USD 9.2 million. This substantial increase in the current account surplus was mainly due to favorable balances of the goods and services accounts in the third and fourth quarters and inclusion of the current transfers: in particular, remittances from Mongolians working abroad and the significant amount of foreign grants received. In 2005, the service account deficit stood at USD 28.8 million. The significant increase in service receipts resulted mainly from tourism, increased freight transportation receipts and receipts from services related to transportation due to increased activity and coverage of road, air, and railroad transportation services as well as increased transit and charter flight charges.

The inflow of private remittances declined by 10.8 percent on last year alongside the reduced volume of transfers through banks and other official channels from countries such as Great Britain and Germany, as well as from South Korea where the transfer services run by five Mongolian commercial banks were closed due to illegalities in their operations. There was no change in the value of irrevocable aid received from international institutions and foreign governments by the Mongolian government, thus positively affecting the surplus in current transfers.

The Capital and Financial account showed a surplus of USD 29.9 million. In sum, it can be said that Mongolia's overall balance of payments has recently been relatively favorable and stable. This performance largely reflected a thriving service sector, a sharp increase in unrequited private transfer and donor support through loans and grants. Loans are mostly provided by the World Bank, the Asian Development Bank, and Japan with concessional terms, while grants are largely from other bilateral donors.

Table 2 Balance of payments, 1999-2005

In millions of USD

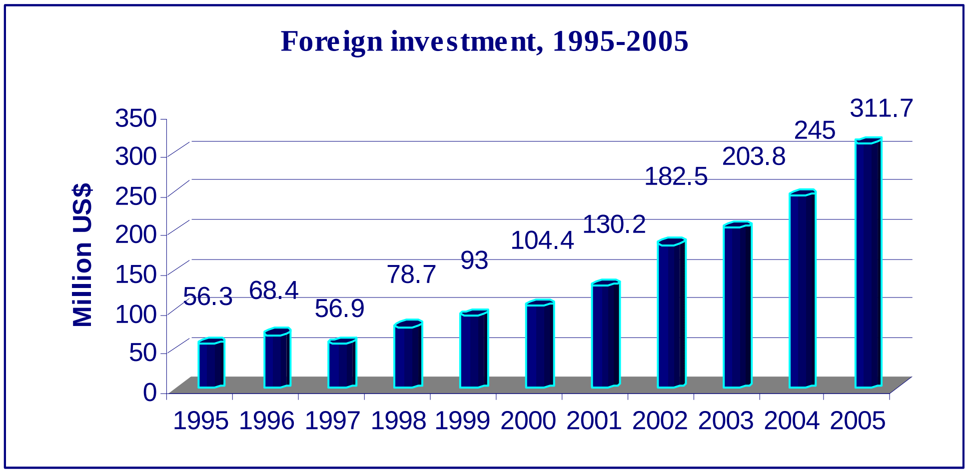
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Trade balance	-113.1	-140.2	-169.9	-228.9	-199.6	-28.9	-9.2
Services, net	-7.3	-8.4	-22.2	-9.3	-49.1	-165.3	-28.8
Income, net	-12.8	-12.4	2.9	-4.5	-11.5	-11.1	-16.8
Private transfers, net	5.9	8.0	25.0	64.4	74.3	146.3	133.8
Official grants	60.2	86.2	72.1	53.0	49.4	86.9	88.0
Other grants	6.9	12.4	15.3	20.2	37.8	35.5	3.4
Current account balance, including official transfers	**-60.3**	**-54.3**	**-76.8**	**105.2**	**-98.7**	**63.4**	**170.4**
Financial and capital account	**62.4**	**68.3**	**79.0**	**157.4**	**4.9**	**-23.1**	**-29.9**
Direct Investment	34.2	40.0	43.0	77.8	131.5	92.9	97.3
Portfolio investment	0.0	0.0	0.0	0.0	50.0	-52.5	0.0
Other investment	28.2	28.3	36.0	79.6	-176.6	-63.5	-127.2
Errors and omissions	12.7	20.1	12.5	14.2	-3.1	-5.7	-6.0
Overall balance	**14.7**	**34.1**	**14.7**	**66.5**	**-96.8**	**34.6**	**134.5**
Increase in net official reserves (-)	-30.5	-35.2	-19.5	-66.5	96.8	-34.6	-134.5

3) Foreign Direct Investment (FDI)

Prior to 1990, no private investments were possible in Mongolia; much of the country's investment capital was derived from government loans and grants provided by the FSU and allied countries. New government policy and laws since 1990's, including the Foreign Investment Law of 1993, provide the legal basis and incentive for foreign investments. In 1994, Mongolia concluded a Bilateral Trade and Investment Agreement (BTIA) with the US, in 1997 accessed to the WTO, and in 1999 was granted normal trade relations (NTR) status by the US. *Mongolia has signed "Convention for Avoidance of Double Taxation" with 35 countries and the "Investment protection and Mutual protection Agreement" with 31 countries. Mongolia has joined the "1965 year's Washington Convention on Settlement of Disputes" in 1996 and the "1985 year's Seoul Convention on establishing of multilateral investment insurance agency" in 1999. Mongolia is also* a full member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group since January 1999; investors will thus be eligible for risk insurance through MIGA.

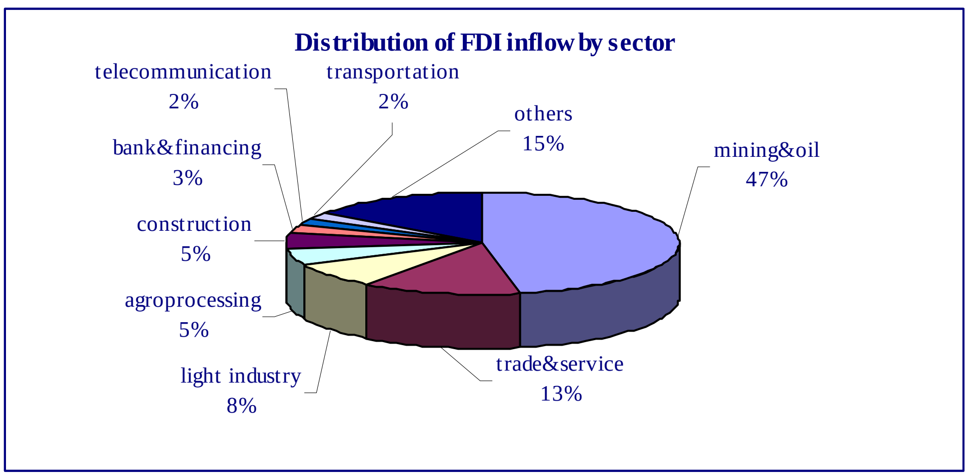
According to the Foreign Investment and Foreign Trade Agency, 988 foreign and joint venture companies registered to invest a total of more than USD 300 million in Mongolia in 2005. 93.2 percent of total investment was accounted for by companies from China, South Korea, Russia, Great Britain, the USA, Japan, Italy and the Ukraine. Foreign direct investment increased continuously from US$93.0 million in 1999 to US$311.7 million in 2005, an average annual rise of 28%. FDI inflows as a percentage of GDP increased from 9.5% to 14.7% in 2005. Cumulative FDI inflows (1990-2005) stood at US$1.5 billion, of which US$1.2 billion occurred after 2000. Some two thirds of total investment is foreign.

Figure 4



FDI is found mainly in mining, including exploration and petroleum (47.3%), trade and foodstuffs (15.6%), light industry (8.0%), and processing of animal-originated raw materials (5%). FDI has come mainly from China (47.6%), followed by Canada (12.1%), Korea (7.3%), and Japan (4.9%). The FDI inflows into Mongolia are moderate compared to other transition economies because of geographic position and small market size. However, the majority of the existing FDI inflows are natural resource seeking (mining and quarrying); benefit seeking or to gain privileged access of Mongolian entities to the developed countries' market (textile); the scare raw material oriented (cashmere); and catering services. In recent years the FDI inflows into financial institutions has increased.

Figure 5



4) Public External Debt

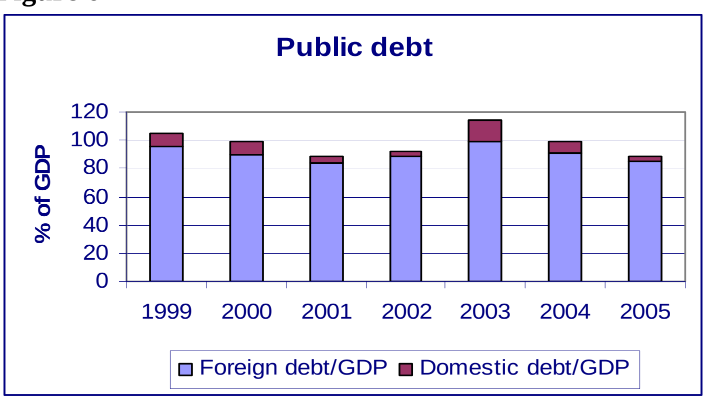
Mongolia has a high stock of public debt even after the settlement of pre-1991 transferable ruble (TR) debt to Russia. At end-2004, Mongolia's stock of total public debt amounted to 91 percent of GDP—almost all external loans from multilateral and bilateral donors. Most of the Mongolia's public external debt is concessional. Three creditors (the World Bank, the Asian Development Bank, and JBIC) account for 80 percent of total public external debt. Public domestic debt remains very limited about 4.5 percent of GDP at end of 2005.

Table 3 External debt stock by Creditors, 1999-2005

(In millions of USD)

	1999	2000	2001	2002	2003	2004
External debt	827.8	837.0	853.5	978.1	1237.0	1360.1
Medium-and long-term	776.4	786.7	806.6	936.1	1138.1	1315.9
Multilateral	412.5	437.1	476.5	548.0	668.8	796.1
ADB	281.6	298.8	319.3	366.1	439.1	502.6
WB	129.6	136.9	155.1	179.0	225.0	287.3
IMF	51.4	50.3	46.8	42.0	48.9	44.2
IFAD	1.3	1.5	2.1	2.9	4.7	6.2
Bilateral official	350.9	336.5	317.1	375.1	456.3	506.8
Paris club	322.3	306.6	283.5	322.2	395.7	444.1
Japan	214.8	208.4	193.6	219.3	261.8	293.4
Russia	51.5	43.2	26.4	24.5	22.1	16.7
Germany	37.6	37.5	46.5	59.9	77.9	90.3
Finland	6.2	6.1	6.0	5.9	7.9	8.8
Norway	12.1	11.5	11.1	12.5	17.1	21.9
Spain	0.0	0.0	0.0	0.0	8.8	12.9
Non-Paris club	28.6	29.9	33.5	52.9	60.6	62.8
China	15.5	15.5	15.5	15.0	15.0	15.0
Korea	8.7	8.1	7.9	24.5	30.2	31.7
India	1.2	1.0	0.9	0.7	0.6	0.4
Kuwait	3.3	5.3	9.2	12.7	14.8	15.6
Treasury bill in US$ to nonresidents	0.0	0.0	0.0	0.0	50.0	0.0
Commercial	13.0	13.0	13.0	13.0	13.0	13.0
Short-term	0.0	0.0	0.0	0.0	0.0	0.0

Figure 6



4) Official Development Assistance

Mongolia receives more than $300 million in foreign aid each year, one of the highest per capita assistance levels in the world. The Asian Development Bank (ADB) is the single largest multilateral donor. Other multilateral donors include the World Bank, International Finance Corporation, European Union, UN agencies and USAID. Japan is Mongolia's major bilateral source of loan as well as grant assistance. Both the United States and Germany provide substantial grant assistance to the country. A number of other donors provide modest amounts of additional support. These other donors include Sweden (governance); Netherlands (energy conservation); Canada (rural and urban development); Korea (energy and health); the Czech Republic (health); Russia (humanitarian aid); China (housing); and India (information technology). Another possible and relatively unusual donor nation is the United Arab Emirates (UAE), which recently offered to help finance a hydroelectric plant in the countryside.

Nongovernmental organizations (NGOs) such as the Soros Foundation and World Vision make important contributions to Mongolia, each managing annual development programs valued at around $3 million. Numerous other NGOs from the United States, Japan, Europe, and elsewhere also provide important support, especially in the social sectors.

B. DOMESTIC ENVIRONMENT

1) Economic growth

After 1994 the economic downturn stopped and henceforth Mongolia's macro economic environment has held comparatively stable in recent years. However, the growth slowed to 2.6% in 1996, essentially because of the drop of international copper and cashmere prices. Moreover, in 1999/2000 and 2000/2001 Mongolia suffered from extremely harsh winters. Known as 'dzuds', these disasters killed about a fifth of the country's livestock which decreased to 25 million head, down from 32 million in 1999. Livestock recovered to 30.4 million heads in 2005, but adverse weather conditions continue to be a serious risk for animal husbandry which is still a vital sector of the country's economy. Although the prices of fuel, electricity, thermal energy and foodstuffs increased in recent years, annual inflation was maintained at a single-digit level. In 2004 the Mongolian economy grew by a record 10.6%, up from 5.6% in 2003 and 3.9% in 2002. 2005 growth was 6.2%, less than in the preceding year, but around 2.0 percentage points higher than average growth over the last 5 years, again fostered by high prices for Mongolia's main export products (copper, gold) and favorable weather conditions. In 2005, CPI inflation reached 9.5 percent. The Bank of Mongolia successfully raised official foreign currency reserves back to the level prior to the debt payment to Russia. Moreover, the general government fiscal balance recorded a surplus. All these factors have facilitated the economic development of the country.

Figure 7

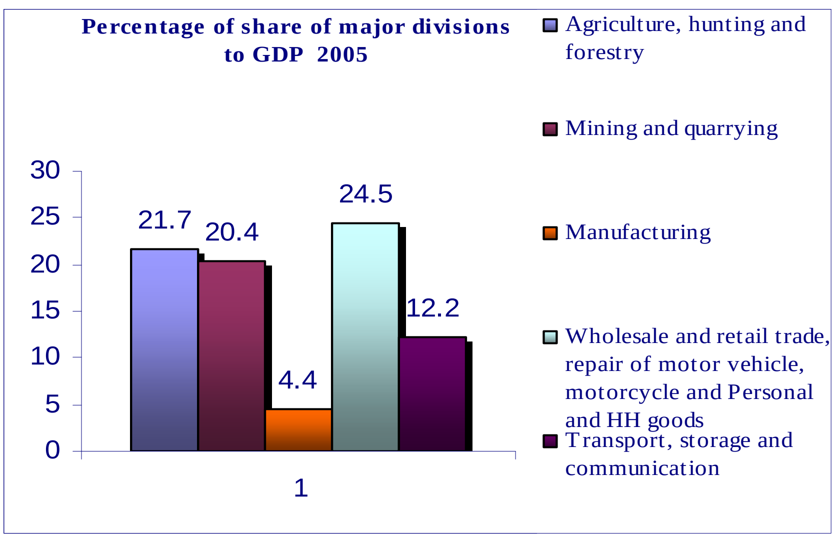
As mentioned above, the agricultural sector, including livestock was the main engine of growth for Mongolia during the second half of the 1990's although its share in GDP has been declining. The share of agriculture in total GDP has declined from 38 percent in 1995 to 21.7 percent in 2005. Over half of the population relies on agriculture for some part of their income. Agriculture exports account for over 12 percent of total exports. The **secondary sector**, dominated by mining, manufacturing and construction has played a substantial role in generating growth. The mining sector is a major contributor to the economy, accounting for about 20.4 percent of GDP and 43 percent of export earnings. The formal mining industry sector employs over 12,000 people and the informal mining sector may involve more than twice this number.

The **tertiary sector** dominated by wholesale trade and retail trade as well as transport and communication has been the other main source of growth and it has grown considerably since 1997 surpassing agriculture as the primary source of growth in Mongolia. The share of the tertiary sector in total GDP has grown from 35 percent in 1995 to 48 percent in 2005.

Table 4 Gross Domestic Product, by Divisions, at Current Prices, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
					(In billions of togrogs)		
Gross domestic product	**925.3**	**1018.9**	**1115.6**	**1240.8**	**1461.2**	**1910.9**	**2266.5**
Industry	168.5	204.3	223.9	250.7	325.5	525.2	631.5
Agriculture	342.1	296.5	277.6	256.6	293.4	399.0	491.1
Construction	23.0	19.3	21.9	29.0	44.8	46.5	52.5
Transport&communication	84.7	112.2	144.4	182.8	202.7	240.9	275.5
Trade	191.7	244.6	297.8	344.0	387.1	465.1	561.1
Services	115.4	142.0	149.4	177.7	207.7	234.2	254.8
Net factor income from abroad	-4.0	-5.6	31.7	66.5	72.0	160.2	190.0
Gross national product	921.3	1013.3	1147.4	1307.3	1533.2	2071.1	2456.5
						(In percent of GDP)	
GDP	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Industry	18.2	20.1	20.1	20.2	22.3	27.5	27.8
Agriculture	37.0	29.1	24.9	20.7	20.1	20.9	21.7
Construction	2.5	1.8	2.0	2.3	3.1	2.4	2.3
Transportation and communication	9.1	11.1	12.9	14.7	13.9	12.6	12.2
Trade	20.7	24.0	26.7	27.7	26.5	24.3	24.8
Services	12.5	13.9	13.4	14.3	14.2	12.3	11.2

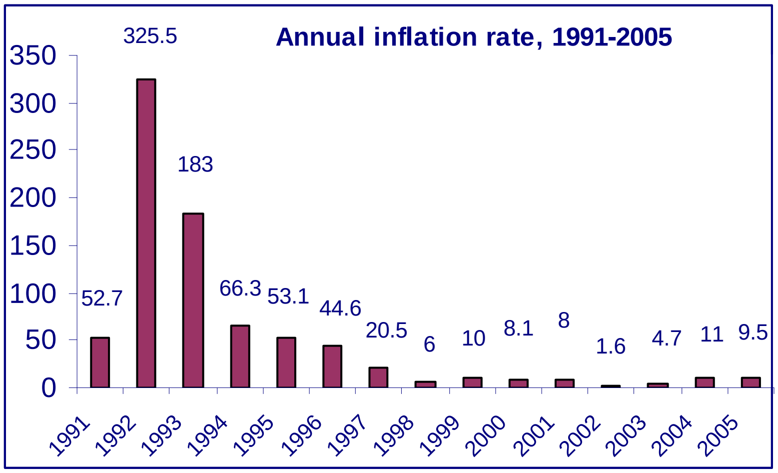
Figure 8



2) Inflation

The average annual rate of inflation has been reduced from peak levels of 325.5% in 1992 to 44.6% in 1996, 20.5% in 1997 and 6% in 1998. In 1999 it accelerated to a level of 10% mainly due to external price shocks. Since 2000, inflation has remained moderate, but accelerated to 11% in 2004 and 9.5 % in 2005, partly due to higher energy prices. Domestic prices of petroleum products rose due to sustained high oil prices on the world market and increased taxes on oil product exports from Russia (Mongolia's main supplier). This rise in prices translated into higher consumer product prices, especially those of meat and meat products, and strengthened inflationary pressures. Inflation, spurred to double digits by higher prices for fuel, utilities, and food, eased later in the year as food price inflation slowed. Imports of lower-priced consumer goods from China reduced prices of clothing and footwear.

Figure 9



Meanwhile, core inflation was estimated at a modest 3.5 percent. Core inflation measures the change in average consumer prices excluding 28 items in the CPI basket prone to volatile price movements such as meat, dairy products and vegetables. In 2005, prices of meat and meat products rose 32.2 percent, the highest rise in any single category of goods. The Mongolian government has been making efforts to regulate and manage factors influencing the supply of meat and petroleum products that have a significant impact on CPI, in order to maintain control over inflation.

3) Financial market

With the economic transition of the early 1990s, Mongolia launched ambitious reforms to restructure the banking system for participation in a free-market economy. However, the rapid nature of the transition, and low financial literacy among Mongolian clients led to a mid-1990s banking crisis with the rate of non-performing loans reaching 47% and a wave of major bank insolvencies. In the years that followed, the banking system was dramatically reformed with critical revisions to the legal environment as well as substantial assistance from international organizations. The State Monetary Policy Guideline, carried out during the banking crisis was focused on ensuring stability in the financial sector and improving the sophistication of bank infrastructure rather than promoting competition in the banking sector. As a result of these operations, the banking environment is gradually stabilizing and so profitability and the ability of banks to bear various types of risks is improving.

As of the end of 2005, 17 banks were carrying out an activity in Mongolia and 732 subsidiaries of these banks across the country (including 107 branches, 590 payment and settlement centers and 31 cash offices) were providing banking service to customers. In 2005, of 17 commercial banks 1 was state-owned, 2 had minor state participation and the remaining 14 banks were under full private ownership. Of the 14

Privately-owned banks, 6 had participation of foreign ownership (of which, the controlling interest of 5 banks is owned by foreign investors). As of 2002, state-owned and state-participated banks held 28 percent of deposits and 10 percent of current accounts in the domestic banking sector, but in 2005 these indicators fell to 10.8 percent and 8.5 percent respectively.

The number of financial institutions other than banks has grown dramatically. For instance, at the end of 2001 there were 24 non-bank financial institutions and 78 savings and credit unions. By the end of 2005, those figures had grown to 150 and 700 respectively. In parallel with restoration of banking sector the microfinance in Mongolia was developed. Both as a direct financing methodology for poor people and as an alternative to traditional banking strategies, microfinance has quickly become one of the leading approaches for reducing the considerable national poverty rate of 36%. According to the most recent Sub-Sector Review of Microfinance in Mongolia published by the United Nations Development Programme (UNDP), the past seven years have seen significant growth in the microfinance sector. There are now over 1,600 formal financial intermediaries in Mongolia, which is approximately one for every 366 families. Loan outreach has increased, with 26% of all households now accessing some form of microcredit, up from only 1% in 1998. Likewise, savings has also increased, with an increase in the Deposit-to-GDP ratio from 19.9% to 42.0% in just the last four years. There have also been noticeable improvements in credit discipline, product demand, and consumer confidence in the finance sector.

4) Money supply

In 2005, money supply in the economy rose by 38.1 percent, or 323.1 billion togrogs from the beginning of the year, reaching 1.17 trillion togrogs for the first time in Mongolian economic history. The majority, 85.2 percent, of the money supply growth was provided by quasi money growth even though it fell 8.9 percentage points from its level the previous year. The contribution of money M1 (currency outside the banks and demand deposits) to money supply growth increased 8.9 percentage points from the previous year to 14.8 percent. In comparison with the previous year, money supply growth increased by 179.4 billion, or 17.7 percentage points.

It could be said that growth in money supply has basically met demand for money since credit in the economy has rapidly increased. Total outstanding credit issued by banks to individuals and enterprises, which accounted for 78.3 percent of money supply growth, rose 253.1 billion togrogs, or 41.7 percent in 2005. On the other hand, this was also influenced by a steady drop in the inflation rate from the second half of the year onward.

Table 5 Main ratios of the financial sector

(in percent)

	2000	2001	2002	2003	2004	2005
M2/GDP	25.4	29.7	37.9	48.1	44.3	51.6
Loans	6.6	12.1	18.7	30.3	31.8	37.9
Deposits/GDP	9.1	12.1	17.6	24.9	27.0	30.6
Currency outside banks/M2	39.0	33.0	25.7	18.7	16.9	13.0
Loans outstanding (billion togrogs)	66.8	135.1	231.4	442.1	606.8	858.9

5) Exchange rate

Mongolia moved from a fixed U.S. dollar exchange rate to a floating system in May 1993.The BOM's 2004 State Monetary Policy Guideline states that the exchange rate will be free and depend on market demand and supply. However, it has at times intervened over prolonged periods beyond that needed to smooth out fluctuations, in order to maintain a stable nominal US$ exchange rate. There is no target exchange rate, and the market sets the togrog's value. With large trade and current account deficits, Mongolia's external balance depends on capital inflows, especially aid and other official transfers. In 2005, the nominal effective exchange rate index was 86.51, showing a depreciation of the togrog by 2.3 percent compared to 2004. In 2005 the nominal effective exchange rate of the togrog depreciated by 1.7 percent against RMB, by 1.1 percent against the South Korean Won, by 0.9 percent against RUB and by 0.1 per cent against

USD but it appreciated against the foreign currencies of the UK, Germany, Japan, Switzerland and Singapore. The depreciation in Togrog was influenced by oil prices on the world market which increased dramatically, pushing up import prices. The RMB also appreciated by 2.3 percent because one of Mongolia's biggest trading partners, China has revalued their currency in July 2005, in a step towards a free floating exchange rate system. Togrog's real effective exchange rate index was 92.27 in 2005, showing a fall in togrog's purchasing power by 7.73 percent since 2000. In 2005 domestic inflation declined from its previous year level, also leading to depreciation in togrog's real exchange rate. Mongolia's export product competitiveness has improved on the world market as a result of the exchange rate depreciation. As a result of this, supply of foreign currency also increased and foreign exchange reserves improved. Hence, the current account showed a surplus.

Table 6 Exchange rate

	2004	**2005**	**change**
Nominal effective exchange rate	88.6	86.5	-2.3
Real effective exchange rate	95.2	92.3	-3.1
CPI (change)	11.0	9.5	

6) Labor market

At the end of 2005, the total population of Mongolia was 2,562,400, of whom 1,577,000 were of working age, 1,001,200 were in the labor force and 968,300 were employed. Unemployment rate is less than 4 percent.

Figure 10

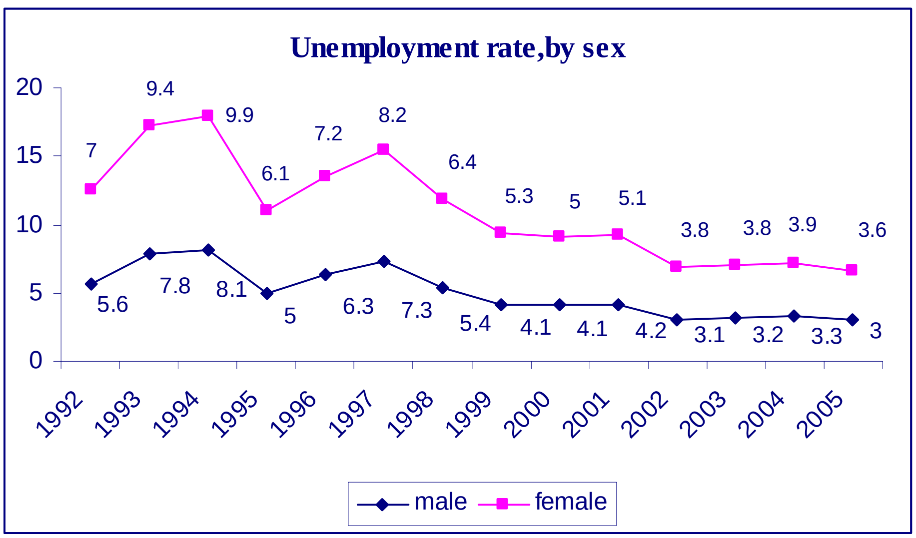
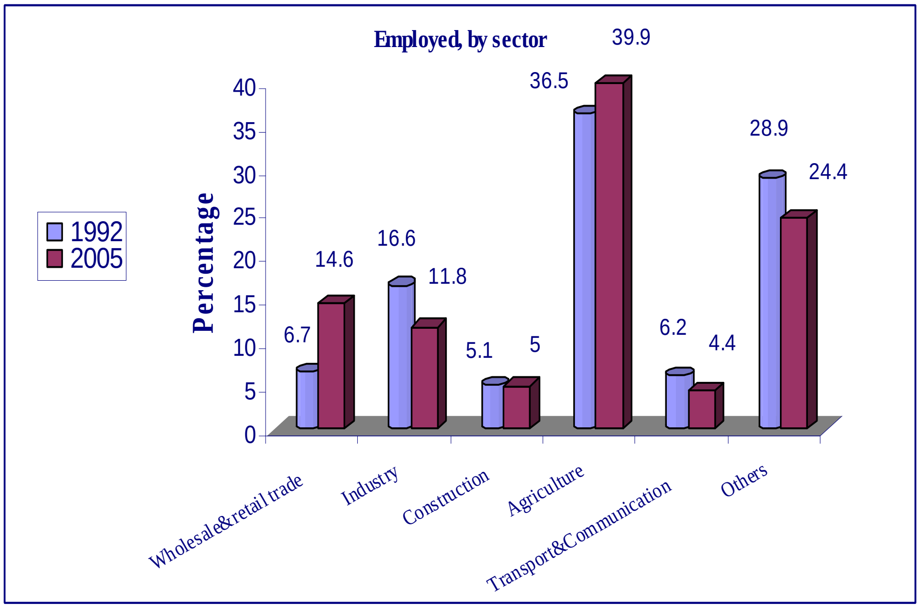


Figure 11



While much of the value of the economy is in larger agricultural and industrial sectors, a large portion of the population 96.1% of all registered businesses are microenterprises and small- and medium sized enterprises (SMEs), which provide over 80% of national employment.

C. FISCAL POSITION

1) Public finance

In recent years, progress has been made stabilizing macroeconomic conditions and implementing medium-term fiscal reforms. Mongolia's fiscal policy has been directed toward strengthening these achievements, sustaining economic growth, reducing the state budget deficit and public debt. In compliance to the Law on Management and Finance of State Organizations, measures taken to improve accountability of the budget administrative bodies and planning of the budget, along with improved financial and tax policies to support economic growth, has resulted in stable and strong fiscal performance in Mongolia and the budget deficit has declined over the last three years. According to preliminary results, budget revenue in 2005 stood at 837.9 billion togrogs (36.9 percent of GDP) and budget expenditure at togrogs 764.6 billion (33.7 percent of GDP); thus, the current account finished the year in surplus by togrogs 240.2 billion (10.6 percent of GDP) and the overall budget surplus ended the year 73.3 (3.2 percent of GDP). The general government budget recorded a surplus for the first time. Much of it was achieved by increasing revenues, with new taxes (especially the VAT) being introduced or replacing old ones, an increase in foreign trade, and an overall broadening of the tax base. In the period of 1997-2000 revenues averaged 29 percent of GDP, but by 2005, at 37 percent of GDP. This high and increasing revenue productivity stems in part from the broadness of the tax base and from improvement in tax administration, but it also reflects a high cascading under the VAT, low income tax thresholds, and discretionary enforcement practices in the enterprise tax. Thus, the burden and distortions of taxation are significant, and both tax reform and tax administration strengthening remain high on the agenda.

Public spending has increased faster than GDP. Overall expenditure increased substantially, by close to 4 percentage points of GDP in the 2001-04 average compared with 1997-2000. Much of the growth reflects the interplay of political pressures and promises for new spending programs and agencies, and lack of progress on restructuring existing ones. At over 40 percent of GDP, public spending in Mongolia is high in comparison with other transition or developing countries.

The improvement in the fiscal position is robust to alternative definitions of fiscal balance. The extent of fiscal consolidation was significant, even after correcting for transitory increases in revenues in the mining sector. Mongolia's vulnerability to terms-of-trade shocks and natural disasters remains high, with clear risks to the fiscal stance. A large decline in commodity prices, especially gold and copper prices, would undermine Mongolia's fiscal position, as royalties and corporate income tax contributions from the private mining sector, and dividend payments from major mining sector State owned enterprises could begin to dry up. The fiscal stance is also sensitive to weather-related shocks.

Figure 12

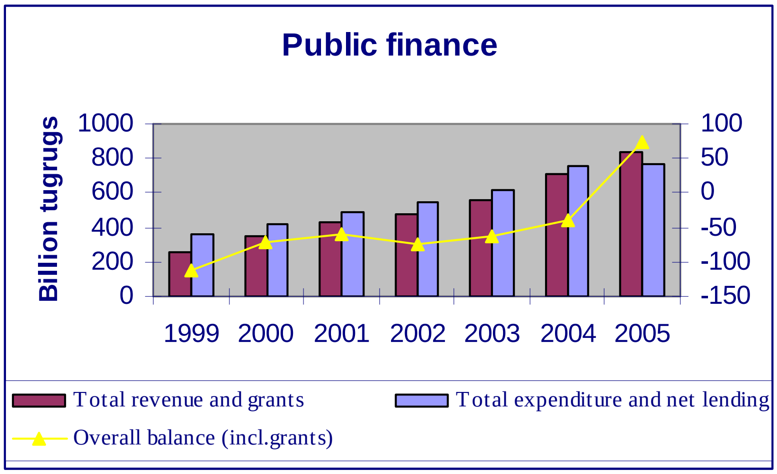


Table 7 Summary Operations of the General Government, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
Total revenue and grants	251.7	351.4	429.5	477.0	553.9	713.1	837.9
Total expenditure and net lending	364.6	422.6	489.7	550.5	615.8	753.7	764.6
Overall balance (incl.grants)	-112.9	-71.3	-60.2	-73.4	-61.9	-40.6	73.3
Financing	112.9	71.3	60.2	73.4	61.9	40.6	
Foreign financing	105.8	66.6	72.8	81.8	-115.8	68.1	
Domestic financing	7.0	4.7	-12.6	-8.3	177.7	-27.6	
(In percent of GDP)							
Total revenue and grants	27.2	34.5	38.5	38.4	37.9	39.4	37.1
Current revenue	26.5	34.0	37.7	37.9	37.3	39.1	36.7
Tax revenue and social security contributions	19.7	25.6	29.4	28.9	28.8	32.3	30.5
Income taxes	4.2	6.2	5.8	5.8	6.7	8.0	7.9
Enterprise income tax	2.9	4.7	3.9	3.7	4.7	5.5	5.3
Personal income tax	1.4	1.5	1.9	2.1	2.0	2.5	2.6
Social security contributions	3.3	3.9	4.8	4.4	4.5	4.5	4.2
Sales tax and VAT	6.5	7.5	9.3	9.6	8.3	9.0	8.0
Excise taxes	2.9	4.0	4.8	4.1	4.0	3.9	3.5
Customs duties and export taxes	1.0	2.2	2.4	2.0	2.2	2.5	2.5
Other taxes	1.8	1.9	2.3	3.0	3.1	4.4	4.2
Non-tax revenue	6.8	8.4	8.2	8.9	8.5	6.8	6.2
Capital revenue and grants	0.7	0.5	0.8	0.6	0.6	0.4	0.2
Total expenditure and net lending	39.4	41.5	43.9	44.4	42.1	41.7	33.7
Current expenditure	26.7	30.8	32.9	33.5	29.8	29.9	17.1
Wages and salaries	6.9	8.5	8.3	8.5	8.0	7.7	6.3
Purchase of goods and services	10.9	12.2	14.6	14.6	12.0	12.0	10.8
Subsidies to public enterprises	0.1	0.0	0.5	0.7	0.7	0.6	0.6
Transfers	7.0	8.3	8.0	8.2	7.9	8.2	8.1
Interest payments	1.9	1.8	1.5	1.6	1.2	1.3	0.9
Contingency allocation	--	--	--	--	--	--	--
Capital expenditure and net lending	12.7	10.6	11.0	10.9	12.4	11.8	7.2
Capital expenditure	4.0	5.1	5.3	5.5	6.2	5.8	3.8
Domestically financed	3.1	4.3	4.4	4.2	4.6	4.6	3.4
Foreign financed	0.9	0.8	0.9	1.3	1.6	1.2	0.4
Net lending	8.7	5.5	5.7	5.4	6.2	6.0	3.4
On-lent foreign project loans (net)	8.3	5.3	5.3	5.4	5.8	5.9	3.9
Domestic lending minus repayments	0.4	0.2	0.5	0.1	0.4	0.2	-
Current balance (excl. privatization receipt)	-0.2	3.2	4.8	4.4	7.6	9.2	10.2
Primary balance	-10.3	-5.2	-3.9	-4.3	-3.0	-1.0	?
Overall balance (incl. grants)	-12.2	-7.0	-5.4	-5.9	-4.2	-2.2	3.2
Financing	12.2	7.0	5.4	5.9	4.2	2.2	
Foreign Financing (net)	11.4	6.5	6.5	6.6	-7.9	3.8	
Project loans	9.4	6.2	6.2	6.5	7.3	7.1	
Program loans	1.8	1.3	2.1	1.3	1.9	1.5	
Short-term external debt	0	0	0	0	4.0	-3.3	
Amortization	1.1	1.0	1.8	1.2	21.1	1.5	
Arrears	0	0	0	0	0	0.7	
Privatization receipts	1.3	0.7	0.5	1.4	1.5	0.9	
Domestic Bank financing (net)	0.0	-0.7	-1.7	-2.2	9.5	-3.2	
Domestic Non-Bank financing (net)	-0.5	0.4	0.0	0.2	1.2	0.1	
Total public debt/GDP	104.7	98.8	89.1	91.7	113.9	99.0	
Foreign debt/GDP	95.9	90.1	84.3	88.7	99.1	90.9	
Domestic debt/GDP	8.7	8.7	4.8	3.0	14.9	8.1	
NPV of total public debt	74.8	67.0	62.8	62.7	80.2	60.2	
Nominal GDP	925.3	1018.9	1115.6	1240.8	1461.2	1808.0	

Figure 13

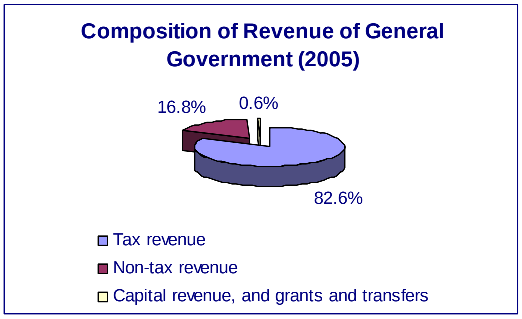
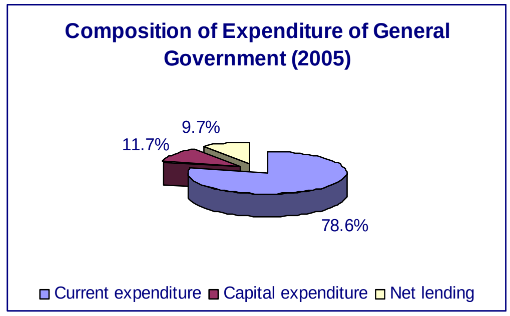


Figure 14



III. Tax Syatem

A. DEVELOPMENT OF MODERN TAX SYSTEM

Mongolia's transformation towards a market-oriented economy in the 1990's was accompanied with a parallel transformation of its tax system. To this end, the General Law of Taxation, which established the legal framework for tax system, was introduced in 1993. As the same time, all modern taxes have been put in place; the Corporate Income Tax (CIT), the Personal Income Tax (PIT), the Sales and Excises, Stamp duties, Vehicle tax were introduced in 1993. The Gasoline and Diesel fuel tax was introduced in 1995; Land fees were introduced in 1997; the Value Added Tax (VAT) replaced the former Sales tax in 1998; and the Immovable Property Tax was introduced in 2001. A Law on Supervision of Tax Levy, Tax Payment and Collection, originally introduced in 1997, was revised in 2002. The Customs duties were raised in 1991 and the Harmonized System implemented in 1993. In addition to these taxes, some other charges such as royalties, forest income, fees or payment for natural resources are levied as taxes in Mongolia.

Sweeping reforms in the tax system and tax administration had taken place during 1998 to 2003 mainly focusing on changing rate structure of taxes, but radical reforms in the package of the tax laws adopted in 2006. *Bearing in mind the need to reduce the tax burden on labor and businesses, encourage private sector growth, and strengthen Mongolia's competitiveness in the global market Mongolia is making greater efforts to improve its tax system by undertaking further reforms of their tax policies and clarifying and simplifying the tax laws. One example is the comprehensive tax reform package to main tax laws including CIT, PIT, VAT and Excise tax laws. In case of PIT, Mongolia adopted a Flat income tax system under which labor income above 84 thousand togrogs is taxed at single rate of 10 percent and some specific rates on certain types of income including dividend and other capital income. Likewise, VAT rate was lowered from 15 percent to 10 percent in an effort of creating favorable business environments for taxpayers to grow and save on the consumption expenses. Thus, Mongolia has become one of the low- tax countries with favorable environment induced production and investment.*

B. TAX LAWS OF MONGOLIA

Under the current tax system in Mongolia, the taxes consist of National and Local taxes.
National taxes include:

- Legal entity income tax (CIT)
- Customs duties
- Value-added tax (VAT)
- Excise duties
- Tax on auto fuel and diesel fuel

- Payment for use of mineral resources
- Personal income tax
- Presumptive income tax

Local taxes include:

- Gun tax
- City tax
- Dog tax
- Inheritance and gift taxes
- Real estate tax
- State stamp tax
- Payment for use of water and springs
- Tax on auto vehicles and self-propelled means
- License fee for use of natural resources, except minerals resources
- Payment for use of natural plants
- Payment for use of widely spread mineral resources
- Payment for use of hunting resources
- License fee for animal hunting and catching
- Land payment
- Payment for procurement and use of wood fuel and timber from forest

1) Income taxes

Income taxes are the second largest source of tax revenue in Mongolia. They provide about 26 percent of total tax revenue, 17 percent of total revenue and about 8 percent of GDP. However, Corporate Income Tax and Personal Income tax are treated separately under the Legal Entity Income Tax Law, Individual Income Tax Law and Presumptive Income Tax Law respectively.

Table 8 Revenue contribution

Sources	2000	2001	2002	2003	2004	2005
Amount (in millions of togrogs)	62826.1	64504.5	72433.9	97564.7	144132.2	178539.2
In percent of total taxes	24.1	19.7	20.2	23.2	24.7	25.8

a) Corporate Income tax

General

The law literally was called “Economic entity and organization income tax law”, but recently has been changed to “Legal entity income tax law” (hereinafter abbreviated as CIT). The CIT is the second most important source of tax revenue, yielding some more 18 percent of the total tax revenue. Mongolia levies progressive rates of which the upper rate was 40 percent until 2003, which was very high and detrimental to economic growth. As the difference between the lower rate and higher rate was very wide, any business would be tempted to split to avoid paying the higher rate of CIT, thus the law itself discouraged companies to grow. That is why the CIT rate has been lowered to 30 percent and then significantly lowered from dual rate of 15 and 30 to lower rate of 10 and higher rate of 25 percent in 2006 in order to minimize costs of taxation to the economy and encourage the investment and growth in the size of the companies. *As the same time, taxable threshold was much increased from 100 million togrogs of annual taxable income to 3 billion togrogs. According to this change, only 0.4 percent of registered entities have become liable for 25 percent whereas remaining 99.6 percent has to pay at 10 percent. The new law also includes many desirable features that allowed deduction to all business expenses and loss carry-forward system and put domestic and foreign investors on the same treatment and competition by* *abolishing various preferences previously granted to only foreign investors. Thus Mongolia can be said as having modified classical system of the CIT.*

Table 9 Revenue contribution

Sources	2000	2001	2002	2003	2004	2005
Amount (in millions of togrogs)	47996.1	43828.7	46268.8	68781.4	98613.9	120552.6
In percent of total taxes	18.4	13.4	12.9	16.3	16.9	17.4

Taxable person

Taxpayers with respect to CIT are divided into **Residents** and **Non-residents**. **Resident taxpayers** are Corporations incorporated under the laws of Mongolia and Foreign corporations having their head office in Mongolia. For the purpose of the CIT, "corporation" includes juridical persons listed in state registration as engaged in business activities, such as companies, cooperatives, partnerships, state or locally –owned enterprieses and other persons liable to pay CIT. Resident taxpayers are liable to tax for their income from sources within or outside Mongolia.

Non-resident taxpayers are Foreign entities running business through their Permanent establishments in Mongolia, or those earning income in Mongolia through activities other than Pernanent establishments. Non-resident taxpayers are liable to tax for their income from sources within Mongolia

Tax base

Following types of income are subject to CIT:

- Business income
- Capital income
- Capital gains

The Law provides for the itemized list of all income categorized under this main headings.

Deductible expenses

Mongolia adopts an itemized system of allowable deductions for the purpose of CIT. Under this system, deductible expenses are specified in the law and any expenses that are not specified are not allowed. However, before adopting changes to the CIT this year, the law denied many legitimate Business or Research and Development expenses, but now it allows deduction for almost all expenses incurred wholly for the purposes of the business, except where expressly provided otherwise. For instance, all direct expenses such as all kinds of material expenses; wages, salaries and benefits; social and health insurance premiums; rewards, remuneration and accommodation, transportation and food allowances granted to employees; depreciation and amortization; repair and maintenance; loan interest; currency exchange loss; acquisition cost of shares or part of owner's equity applicable to the share; salaries paid to individual part-time employees; rent, interest on financial leasing; subscription of professional periodicals; compulsory and voluntary insurance installments, excise duties, immovable property taxes, windfall profit tax, customs duties levied on imported assets except fixed assets, transport facility and self-propelled means tax, payment for use of land and natural resources; bad debt reserve for banks, non-banking financial institutions, saving and credit unions; and reserves for reclamation cost for other cooperatives; advertising and promotion; training and re-training of employees; business trip; cost of seed, fertilizer, fodder, vaccination and plant care, transportation; labor safety; communication and stationary; cleaning and maintenance; security; disaster loss etc. Also reserves for natural restoration by special license holder of mineral resources are deductible.

Non-deductible expenses and Limitations on deduction

No deduction is allowed unless a particular expense is specifically included in the list of deductible expenses. For example, payment for financial leasing, fine and loss indemnification for damages caused to third parties etc.

No deduction is allowed for following expenses incurred by Non-residents running business through their permanent establishment:

- Costs incurred outside Mongolia
- Managerial or administrative expenses not related with earning the income concerned

Also maximum limit has been fixed for certain expenses. For example, total combined payment of voluntary insurance should not exceed 15 percent of gross taxable income. Maximum ceiling of Business trip expense should not exceed twice the amount of that of the civil servants. Deduction for Repair and maintenance cost is limited to 2 percent of residual value of real estates and 5 percent of other assets. Exceeding amount is treated as Capital repairing expense.

Depreciation

The law fixes the useful life of depreciable assets and depreciation rate for each asset separately. Straight line method of deprecation is specified.

Table 10 Depreciation Rates

Fixed assets	Useful life
12.2.1. Building &Construction	40
12.2.2. Machinery &Equipment	10
12.2.3. Computer, hardware and software	3
12.2.4. Intangible assets with undefinite useful life	10
12.2.5. Intangible assets with definite useful life. This applies to Lisence for exploiting and prospecting mineral resources	License period
12.2.6. Other fixed assets	10

Computation of taxable income and Tax rates

Regular rates apply to following taxable income arrived at deducting legitimate expenses:

Annual taxable income	Tax rate
0-3 000 000 000 togrogs	**10 %**
Over 3 000 000 000 togrogs	300 000 000 togrogs plus **25%** of taxable income in excess of 3 000 000 000 togrogs

- Sales income from Main or auxilary production, work and service;
- Income from goods, work and service received with no consideration;
- Income from disposal of intangible assets;
- Income from technical, managerial, advisory or other service;
- Interest, fine and loss indemnification payment received from third parties failed to fulfil contractual responsibilities;
- Gain from Foreign currency exchange ;
- Other income identical to above described
- Rental income of movable and immovable properties;
- Interest income
- Income from sale of shares and securities calculated as sale thereof less acquisition cost;
- Income from sale of movable property calculated as gross sale less residual value

Special rates apply to the following types of income computed as their gross receipts:

Type of income	Special rates
Dividend	**15%**
Royalties	**10%**

▪ Income from disposal of immovable property	**2%**
▪ Interest income	
▪ Income from sale of right	**15%**
▪ Income from sale of, payments of any kind received as consideration for the use of erotica, video tapes; and for rendering erotic performance	**30%** **40%**
▪ Taxable income from conducting quiz, wagering or betting and lottery calculated as gross income less legitimate expenses and costs of any kind paid for winnings	**40%**
▪ Profit of Permanent establishment of foreign corporations distributed abroad	**20%**

Following types of Income of Non-residents earned in Mongolia – **20%**:

- Dividend received from domestic corporation
- Loan interest and payment for underwriting
- Royalties, interest income from financial leasing, managerial costs, rent, income from leasing tangible and intangible assets
- Income from production, work and services performed within Mongolia

Dividend received upon liquidation of corporation is calculated as distribution based on number and type of shares or contributed capital owned by the shareholders less acquisition cost of shares or capital

Repayment of loan previously deducted as bad loan reserve by Banks, non-banking financial institutions and deposit and credit unions is subject to tax

Income of Insurance corporations is calculated as gross insurance income less insurance reserve and operation costs

Exemption and Credit

Tax incentives under the CIT are provided in the form of exemption and credit.

Exemptions:

- Income from interest on the Government bond;
- Income, derived from sale of share products by a non-resident corporation, which is carrying out business in Mongolia in accordance with product sharing contract concluded with the Government of Mongolia in oil sector, and its transfer abroad after tax deduction
- Income derived from intermediary service for selling member's share products by a cooperative

Credits:

Tax credit of 50% to the corporations engaged in production of cereals, potato, vegetables and milk, and plantation of fruits and forage plants, for only share of these products

Tax credit equal to 10% of invested capital to a corporation investing in priority sectors of Mongolia after January 1, 2007

Tax credit to a corporation where the disabled work, calculated as number of the disabled in total number of employees

Investment- related tax credits - Tax credit equal to 10 percent of invested capital exceeds amount of tax payable of the year concerned, the exceed can be carried-forward for next profitable 3 years.

Loss carry-forward

There was no provision for the set off of business losses under the previous law, but the revised law introduced liberal rules relating to the tax treatment of losses in order not to discourage more risky investment and to make the tax system growth oriented. To this end, taxpayers are now allowed to carry over the loss to offset it against profits of future consecutive 2 years. However, amount of loss declared by annual tax return should not exceed 50 percent of the taxable income of the year concerned.

Payment and Filing

Taxpayer is required to declare the basis of his assessment and submit a calculation of the tax due with payment of the amount he regards as due based on quarter or annual tax return prepared in accordance with accrual basis of accounting.

Tax is paid on the current year basis. Taxpayers are required to pay advance tax within 25th of each month on the basis of monthly tax payment schedule prepared on the basis of budget submitted last year and submit a quarter tax return within 20th of first month of the next quarter and a final tax return on or before February 10 of the subsequent year.

b) Personal Income tax

General

Although Personal Income tax accounts for small portion in total taxes, tax burden on labor is too high when one takes into account the combined burden of PIT and social security contributions. Like CIT higher rate, top marginal rate of PIT was 40 percent until 2003. It was lowered down to 30 percent in January 2004 and then to 10 percent in 2006 effective from January 2007. Previous big differentiation in the CIT rate and top marginal PIT rate generated many distortions like taxpayers were encouraged to create companies instead of proprietorship firms, not for economic reasons but to lower the tax liability and kept their savings in the form of profits retained in the corporate sector because CIT rate remained much below the top marginal rate of PIT. However, this problem has now been solved by adopting same or almost single rate for both CIT and PIT.

Table 11 Revenue contribution

Sources	2000	2001	2002	2003	2004	2005
Amount (in millions of togrogs)	14830.0	20675.8	26126.1	28803.3	45518.3	57986.6
In percent of total taxes	5.7	6.3	7.3	6.8	7.8	8.4

Taxable person

Taxpayers, for PIT purpose, are classified as “residents” or “non-residents”. Resident taxpayers are those having domicile in Mongolia, residing for 183 days or more in any tax year, and public servants with official assignment abroad. Non-residents are those having no domicile in Mongolia and staying for 183 days or less in Mongolia. Whereas Resident taxpayers are taxed on their worldwide, Non-resident taxpayers are taxed only on income derived from Mongolian sources.

Tax base

Following types of income are subject to PIT:

- Salary, wages, remuneration, benefits and any labor income identical thereto;
- Business income
- Capital income
- Income from disposal of properties
- Income earned by cattle-breeder households or persons with private livestock
- Income from scientific, literary and art work, invention and design of advanced products, organizing sport competition and artistic performance;
- Remuneration from artistic performance and sport competition, bonuses for Naadam festival;
- Income from laying a wager, quiz and lottery games;

- Any indirect income

Non-deductibles
No deduction is allowed for illegitimate or personal expenses

Tax rate
A single rate of 10% apples to following taxable income computed as following ways:

- Salary, wages, remuneration, benefits and any identical labor income computed as gross receipts less social and health insurance premiums
- Gross receipts of any allowance and gifts granted by employers to employees and their family members; salary, compensation and benefits of the Board of Directors and Supervisory board, or other non-permanent board or committee members, members of assigned working group; any bonus and benefits granted by foreign and domestic persons
- Net receipts of Business or self-employment income
- Net receipts of Rent
- Gross receipts of royalties
- Gross receipts of dividends
- Gross receipts of Interest
- Gross receipts from leasing of assets
- Net receipt of share income distributed upon liquidation of a corporation
- Net receipts of income from disposal of shares
- Net receipts of income from disposal of securities
- Net receipts of income from disposal of movable assets
- Any indirect income

Specific rates apply to the following types of income computed as their gross receipts:

▪ Income from sale of immovable properties	**2%**
▪ Income from scientific, literary and art work, invention and design of advanced products, organizing sport competition and artistic performance, and any income identical to them	**5%**
▪ Remuneration from artistic performance and sport competition, bonuses for Naadam festival	**5%**
▪ Income from laying a wager, quiz and lottery games	**40%**

Different **lump sum** taxes are levied on cattle-breeder households or persons with private livestock based on head of livestock and locality.

Exemption and Credit

- Tax credit of 84000 togrogs is provided against Salary, wages, remuneration, benefits and any identical labor income
- 20 bog animal (sheep and goat) for each member of cattle-breeder household is exempt.
- Legitimate costs incurred by cattle-breeder household for sink well is credited against annual taxes due.
- Income of a resident taxpayer from producing cereals, potatoes, vegetables, fruits and fodder plants only shall be waived 50% for taxation;
- Tuition paid for natural or adopted child studying at domestic or foreign universities or vocational schools is also waived for taxation.

Foreign tax credit is provided only on the basis of the Convention for avoidance of double taxation concluded with foreign countries.

Payment and Filing

Tax is paid on the current year basis. They have to submit return on a quarterly and an annual basis.

c) Presumptive Income tax

General

Mongolia has been making maximum use of presumptive taxation, particularly in the case of those businesses where it is administratively difficult to calculate net income. Under this system, specified businesses are required to pay lump sum amount, depending upon their location. For example, handmade printings, smith service, repairers of radio, TV, watch, shoes, cloths etc., photo service, car washing, small trading etc. are subject to presumptive tax.

Tax rates are fixed on a lump sum basis, as per the geographical areas, which are divided into three groups. For example, rates fixed for Ulaanbaatar are the highest and while lowest for the least developed area. In addition to simplicity, these rates provide incentive to generate more income since effective tax rate decrease with the increase in productivity.

2) Domestic Trade Taxes

In Mongolia, domestic trade taxes are prime revenue raisers as these taxes reach the large section of population, including lower income group, on whom it is difficult to impose income taxes, they are broad-based. VAT and excise duties are major domestic trade taxes. These taxes provide about 40 percent of total tax revenue in Mongolia.

a) Value added tax

General

The VAT was introduced in 1998 replacing former Sales tax, with a single rate of 10 percent which was raised to **15** percent in 2001. A **Zero** rate applies for exports. In 2006, the VAT rate was lowered 15 to 10 percent with effective from January 2007. VAT is currently the single most important tax in Mongolia. In recent years its yield has averaged about 9 percent of GDP or about 30 percent of total taxes. Productivity of VAT is 60 percent, which is quite high. If classify by industry types: about 50 percent of VAT is from Fuel, 19 percent from Trading (whole and retail), 13 percent from Telecommunication, 10 percent from Power and electricity supply, and 8 percent from Catering etc.

The number of registered VAT-payers is around **5200.**

Table 12 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Amount (in million of togrogs)							
Domestic	28941.6	30182.1	43798.3	40696.0	47927.1	57417.2	70645.1
Imports	31418.6	46036.5	60395.5	77992.2	94331.1	136923.6	157504.2
Refund	0	0	0	0	20387.6	31260.5	47110.2
Total	60360.2	76218.6	104193.8	118688.2	121870.6	163080.3	181039.0
Percent of total							
Domestic	47.9	39.6	42.0	34.3	39.3	35.2	39.0
Imports	52.1	60.4	58.0	65.7	77.4	84.0	87.0
Refund					-16.7	19.2	26.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
VAT as percent of							
Tax revenue	33.3	29.2	31.7	33.0	29.0	28.0	26.2
Total revenue	24.4	22.0	24.2	25.3	22.4	23.1	21.7
GDP	6.5	7.5	9.3	9.6	8.3	8.5	8.0

Taxable items
Principally, all goods and services provided and consumed shall be liable for VAT. VAT is imposed on both domestic sales and imports.

Taxable threshold and tax rates
It has a threshold of Togrogs 10 million (US$ 8532) taxable sales and permits businesses below the threshold to be registered voluntarily provided they satisfy proper bookkeeping requirements and have taxable sales of at least 80 percent of the threshold in their main line of business or have made investment of more than two million USD to Mongolia. Group registration is also allowed.

Exemptions
Currently, various goods and services or transactions are exempted from VAT for various reasons as follows.
Social reasons:

- Educational services;
- Medical services;
- Services by a religious organization;
- Special purpose appliances for handicapped people;
- Humanitarian and grant aid goods bought through the grant aid provided by the governments and non-governmental organizations of foreign countries, international and charity organizations;
- Blood, blood products and organs to be used for treatment purposes
- Sale of apartment and or part of it.
- The renting of accommodation in a building as a place of residence or abode;
- Public transportation

For the development of industry:

- Imported machinery, equipment, materials, raw materials, spare parts, gasoline, diesel fuel, food and personal items for employee needs, in support of activities related to crude oils provided in an Agreement entered with the Government based on principles of products sharing in crude oil industry
- Tour operating activities to foreign tourists.

Administrative reasons:

- Financial services:

Other exemptions:

- Passengers baggage for personal use;
- Goods imported for use of diplomatic missions or international organizations residing permanently in the territory of Mongolia;
- Goods, jobs and services purchased in the territory of Mongolia for work needs of diplomatic missions and consular offices residing in Mongolia, if goods, jobs and services purchased for the needs of diplomatic missions and consular offices of Mongolia in foreign countries are exempted from tax in respective countries;
- Service by government organizations
- Any weapons, technical appliances imported for needs of defense, police, and state security, labor correction institutions, and law enforcement;
- Sold gold
- Sold newspapers
- Bank notes of Mongolia produced abroad by order
- Container, equipment, special appliances, machinery and their parts for the use of gas fuel
- Passenger aircraft and its parts

Non-deductible inputs

- Car, its components and spare parts (exceptions to those who are line of car-selling business
- Goods and services purchased for personal or employees' needs
- Goods and services imported or purchased for purpose of producing VAT exempt goods and services

Filing and Payment

All taxpayers, regardless of size, are required to submit monthly VAT return and pay taxes. Excess VAT is either offset against next VAT or against other taxes due, or refunded.

b) Excise Duties

Excise duties generate about 12 percent of total tax revenue, 10 percent of total revenue and 4 percent of GDP. Of the excise revenue, traditional excise careers viz. alcoholic beverages and tobacco products provide about half of the total excise revenue while gasoline and vehicle generate rest of the excise revenue.

Table 13 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Total (in million togrogs)	26731.2	41011.8	53330.0	51321.3	58575.3	70283.2	78959.2
Percent of total							
Tax revenue	14.7	15.7	16.2	14.3	13.9	12.1	11.4
Total revenue	10.8	11.8	12.4	10.9	10.7	10.0	9.5
GDP	2.9	4.0	4.8	4.1	4.0	3.7	3.0

Tax base and exemptions

Excise duties can be levied on both imported as well as domestically produced goods.
Currently, they are levied on the following items:

- All kinds of alcohol
- All kinds of tobacco
- Gasoline and diesel fuels
- Passenger's vehicles and
- Special purpose appliances and equipment for the use of laying a wager, quiz and lottery games, and operation of persons engaged in such activities

However the following goods are exempted from excise duties:

- Exported goods produced within the territory of Mongolia;
- Domestically produced beer and home-made liquor distilled from milk;
- Snuff tobacco
- Duty free alcohol and tobacco imported for personal use under the permission of
- Customs Administration;
- Vehicles using dual type fuel

Excise rates

Excise duties are levied basically with the specific rates on administrative ground since these rates are relatively easier to apply than advalorem rates.

3) Taxes for special purposes

a) Transport facilities and vehicle tax

Transport facilities and vehicle tax is levied on trucks, buses, passenger vehicles, motor cycles, special purpose automobiles (such as cranes, auto-service and repairing automobiles, laboratory vehicles, etc); tractors and other vehicles and auto trailers. This tax is paid during state inspection of auto-techniques.

Table 14 Revenue Contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Total (in million togrogs)	2515.3	2927.7	3437.5	37345.3	3983.6	4826.0	5059.7
Percent of total Tax revenue	0.7	0.8	0.8	1.0	0.9	0.8	0.7

Tax rates

Tax rates are fixed on a lump sum basis, as per the geographical areas divided into urban and rural areas, depending on engine capacity in case of passenger automobile, the number of seats in case of bus, and loading capacity in case of trucks.

Assessment and Payment

The tax is levied on vehicle registered with the State Registration office irrespective of whether the transport facilities and vehicles are used or not. Once the State Registration Office is notified that a transport facility or vehicle is no longer in use, the tax will not be levied from the next quarter. Similarly, if a taxpayer transfers ownership of vehicle, he will not be obliged to pay tax from the next quarter. The citizen will have to pay the tax during national technical fitness inspection. In case when a vehicle is imported after the national inspection, the tax for the remaining period of the respective year will have to be paid to the tax authority of affiliation.

A part of the revenue generated from this tax is deposited to the respective local road development fund, as determined by the Government. Business entities and organizations will have to transfer to the state budget, a proportionate amount of annual motor vehicle tax within 25 of the last month of each quarter and submit annual tax report to the tax authority within February 15 of consequent year. The taxpayer may pay quarterly or annual motor vehicle tax in advance.

b) Gasoline and diesel tax

Table 15 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Total (in million togrogs)	4316.8	4189.3	5454.5	4850.3	5703.1	6107.4	5939.7
Percent of total Tax revenue	1.2	1.0	1.2	1.4	1.4	1.0	0.9

Tax rates

Gasoline and diesel tax is levied on lump sum basis on the production and imports of gasoline and diesel depending on octane in case of gasoline and per ton in case of diesel oil at the following rates:

Gasoline and diesel tax is collected by the national tax administration on domestic products of gasoline and diesel while it is collected by the customs administration on the imports of these products.

c) Windfall profit tax

This is a special tax that has recently approved by the Parliament. The law calls for a 68% tax on gold when the international price is above USD$500/oz and on copper on prices above $2,600 per ton.

4) International Trade Taxes

International trade taxes provide about 8 percent of total tax revenue, 6 percent of total revenue and 3 of GDP. Of the total customs revenue the import duties provided almost 95 percent in the recent years.

Table 16 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Amount (in million of togrogs)							
Import duties	5852.0	17152.9	25991.4	23767.3	31058.6	40783.3	53170.0
Export duties	3161.4	5153.1	1027.3	825.2	1588.1	3936.0	3804.3
Total	9013.4	22305.9	27018.7	24592.5	32646.7	44719.3	56974.3
Percent of total							
Import duties	64.9	76.9	96.2	96.6	95.1	91.2	93.3
Export duties	35.1	23.1	3.8	3.4	4.9	8.8	6.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Percent of							
Tax revenue	5.0	8.6	8.2	6.8	7.8	7.7	8.2
Total revenue	3.6	6.4	6.3	5.2	6.0	6.3	6.8
GDP	0.97	2.41	2.92	2.66	2.2	2.3	2.5

Mongolia joined World Trade Organization (WTO) in 1997and under WTO arrangements Mongolia has adopted a uniform tariff rate at a very low level, i.e. 5 percent, except 15 percent on a few specified vegetables. Tariffs have already brought down to zero on automatic data processing machines etc. and are planned to bring down to zero on medicine in 2005. Tariff reform has been carried out due also to the agreement with International Monetary Fund. There are two customs laws: Customs Law, and Law on Customs Tariff. As per the WTO requirements, necessary arrangement has been made in the laws regarding valuation, appeal, rule of origin, post clearance audit etc.

Export duties are levied on a few items such as live stock wool (non processed camel wool and cashmere), non-processed goat or baby goat skins, rough logs, square logs (beams) and woolen materials, scrap black and chromatic metal such as iron, steel, copper, zinc, and aluminum. The rates of export duties are fixed on specific basis.

5) Property Taxes

Property taxes account for small portion in the revenue. They currently provide about 1 percent of total tax revenue. Of the property taxes, immovable property tax is a new tax and the revenue from this tax has been increasing. Gun tax also provides a minor portion in the tax revenue. Property taxes are classified as local taxes in Mongolia. As the privatization of land has begun recently, base of immovable property tax will be expanded in the future and this tax may develop as an important source of revenue of local government. Immovable property tax was introduced on January 1, 2001.

a) Immovable property tax

Tax base and rate

This tax is levied on the immovable property, basically land and buildings. Immovable property tax is levied on the value of the immovable property. The base of the tax is the value registered with immovable property state registry. In the absence of such a value, the value is determined by the valuation of insurance on the property. In the absence of both such values, the value that is written in accounting books will be considered as the value of immovable property for the purpose of this tax.

The annual tax rate of the tax is <u>0.6 percent</u> of the value of taxable property.

Following properties are exempt from this tax:

- Immovable property of persons, who are financed by central and local budget
- Dwellings houses
- Buildings of public use.

Tax is paid on quarter installments and filed once annually.

b) Gun tax

Gun tax is levied on all kinds of guns save the guns which are used by personnel's arms in state defense, state security, policy and prison at the specific on lump sum basis. Revenue from this tax goes to the local budget.

6) Social Security Contributions

Social security contributions are significant sources of tax revenue. They generate about 16 percent of total tax revenue. Social security contributions are broadly divided into two groups: social insurance and health insurance. The former constitutes roughly three fourth while the latter roughly one fourth of total contributions. Mongolia implements an extensive system of social security contributions. It covers benefits relating to retirement, loss of the ability to work, sickness, unemployment and death. Social insurance can be either compulsory or voluntary. Employers and government servants are subject to compulsory insurance while citizens engaged in any production or services can decide themselves whether to register with social insurance and which types of insurance to choose. Military, police, intelligence personnel, and fire fighters are not required to contribute. Foreigners and entities residing in Mongolia and employed by any Mongolian organization, and citizens of Mongolia employed by foreign organizations or business entities carrying out their activities in Mongolia will have to register with the social insurance legislation.

Table 17 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Amount (in million of togrogs)							
Total contribution	29784.9	39272.7	53956.7	54397.6	65205.2	82089.3	95596.7
As percent of							
Tax revenue	16.4	15.1	16.4	15.1	15.5	14.1	13.8
Total revenue	12.0	11.3	12.5	11.6	12.0	11.6	11.5
GDP	3.2	3.9	4.8	4.4	4.5	4.3	4.2

Rates

The Mongolian social security contribution system is a flat system. Rates are flat for all sort of income, there is no minimum threshold, and rate is 10 percent on employees up to 400,000 togrogs gross monthly salary. Social insurance premiums for employers and employees (insures) are fixed at the following rates:

Insurance type	**Premium amount (as a percentage)**	
	Employer's payroll and similar revenue	Insured's salary and similar income
Pension insurance	13.5	5.5
Benefit insurance	1.0	1.0
Industrial accident and occupational disease insurance	1.0, 2.0 or 3.0	-
Unemployment insurance	0.5	0.5
Health insurance	3.0	3.0
Total	19.0, 20.0 or 21.0	10.0

Rate structure of the social insurance premium for voluntary contributors is as follows:

Pension insurance: 9.5%
Benefit insurance: 1.0%
Industrial accident and Occupation disease insurance 1.0%
Voluntary contributors can choose any one, two or all of the above insurances.

Assessment and Payment
Premiums are calculated according to the premium report or the employer's payroll and similar revenue, the employees' wages and similar income, and premium identifying sheet. Social insurance premiums are paid on a monthly basis. Employers are required to retain social insurance premium due to be paid by employees from their wages and other similar income at each pay, and have to transfer it to the central bank account of the insurance authority in the same month. The monthly premiums to be paid by employees and employers will have to be paid by the 5th of the following month.

7) Local Taxes
Local level taxes are specified in the General Taxation Law according to which the rates of (a) fees for use of hunting resources, animal hunting and catching license fee, (b) land fees, and (c) fees for cutting and use of wood fuel and timber from forest shall be fixed by the government within the limits approved by the Parliament.

Rates of other taxes shall be fixed by the Aimag and Capital City Hurals of Citizen's Representatives, within the minimum and maximum rates given in the tax acts. Budget law specifies the revenue to be deposited to the local budget. As per this law, revenue is allocated among various governments as follows:

<u>Central budget revenue:</u>
- VAT
- Customs tax
- Excise tax
- Income tax
- Gasoline and diesel fuel tax
- Fee for use of mineral resource

<u>Local budget revenue</u>
(a) Aimag/City budget revenue
- City tax
- Fee for use of mineral resource
- Land fee
- Payment for use of water and springs
- Licensing fee for mineral exploitation and usage
- Immovable property tax

(b) Soum/District budget revenue
- Tax on auto and self-moving vehicles
- Inheritance and gift tax
- Gun tax
- Dog tax
- State stamp duty
- Payment for use of hunting resources, licensing fee for animal hunting and catching
- License fee for use of natural resources other than minerals
- Payment for use of natural plants
- Fees for use of wood fuel and timber from forest
- Fees for use of widely spread mineral resources
- Payment for use of water and springs

While several taxes have been specified as local taxes not all of them are being implemented. For example, no law has been enacted yet in the case of capital city tax, dog tax, and inheritance and gift tax, meaning that these taxes are not implemented yet.

8) Non-Tax sources

Non-tax revenue constitutes about one-fourth of the total revenue. Non-tax revenue is about six to nine percent of GDP. Non-tax revenue includes dividend, income earned by budgetary organizations, interest and fines, rent, oil income, navigations income and central Bank's profit.

Table 18 Revenue contribution

Sources	1999	2000	2001	2002	2003	2004	2005
Non-tax revenue as percent of							
Total revenue	26.9	24.7	23.7	23.5	22.8	17.4	16.9
GDP	7.2	8.4	9.1	8.9	8.5	6.4	6.2

C. TAX ADMINISTRATION

1) General

The Mongolian tax administration was created as the government agency in 1991. It reports to the Minister of Finance, who, in turn, informs to the Ministry of Finance and Economy. The main objective of tax administration is to implement tax policy and tax laws of the government. It collects both national and local taxes and deposits to the national and local tax budgets respectively. It also gives inputs to the tax policy division of Ministry of Finance and Economy, which is responsible for formulating tax policy.

2) Organizational structure

There are 31 tax offices nationwide, 21 Aimag and 1 Ulaanbaatar City Tax Office. There are 9 district tax offices under the Ulaanbaatar tax office while Soum tax inspectors under the Aimag tax offices. As the country is geographically very big, it is difficult to control Soum inspectors from the centre. So Sums tax inspectors are located at Soum Governor's office for the local supervision and control, of course, over all control remains in the hand of GDNT. There are about 1200 employees in the whole tax administration.

Head Quarter of the tax administration was initially created as the General Department of State Taxation which was later renamed as General Department of National Taxation (GDNT). The GDNT has five divisions: Tax Administration and Methodology Division, Collection Division, Auditing Division, Data Processing and Automation Division and Resource Management and Internal Auditing Division. There are three sub-ordinate units under this department. They are: Large Taxpayers Office (LTO), Training and Service Centre and State Registration Office.

State Registration Office carries out registration of entities.

A LTO (Central Budget Revenue and Control Department) was created in 2001 in order to deal with the large taxpayers scattered all over the nation. But the scope of work of this office was expanded in 2002, when it was made responsible for the collection of CIT, PIT, VAT, Excises, and withholding taxes, relating to all taxpayers through local tax offices. It also deals with all kinds of refunds (refunds to taxpayers, foreign aided projects and diplomats). LTO also supervises local tax offices. There are three divisions of the LTO. They are: collection division, audit division and local tax collection/revenue division. The collection division is responsible for the collection of revenue from about 100 large taxpayers that pay revenue directly to this office. Audit division is responsible for the audit of large taxpayers while local tax collection division is responsible for monitoring and providing guideline to the local tax offices.

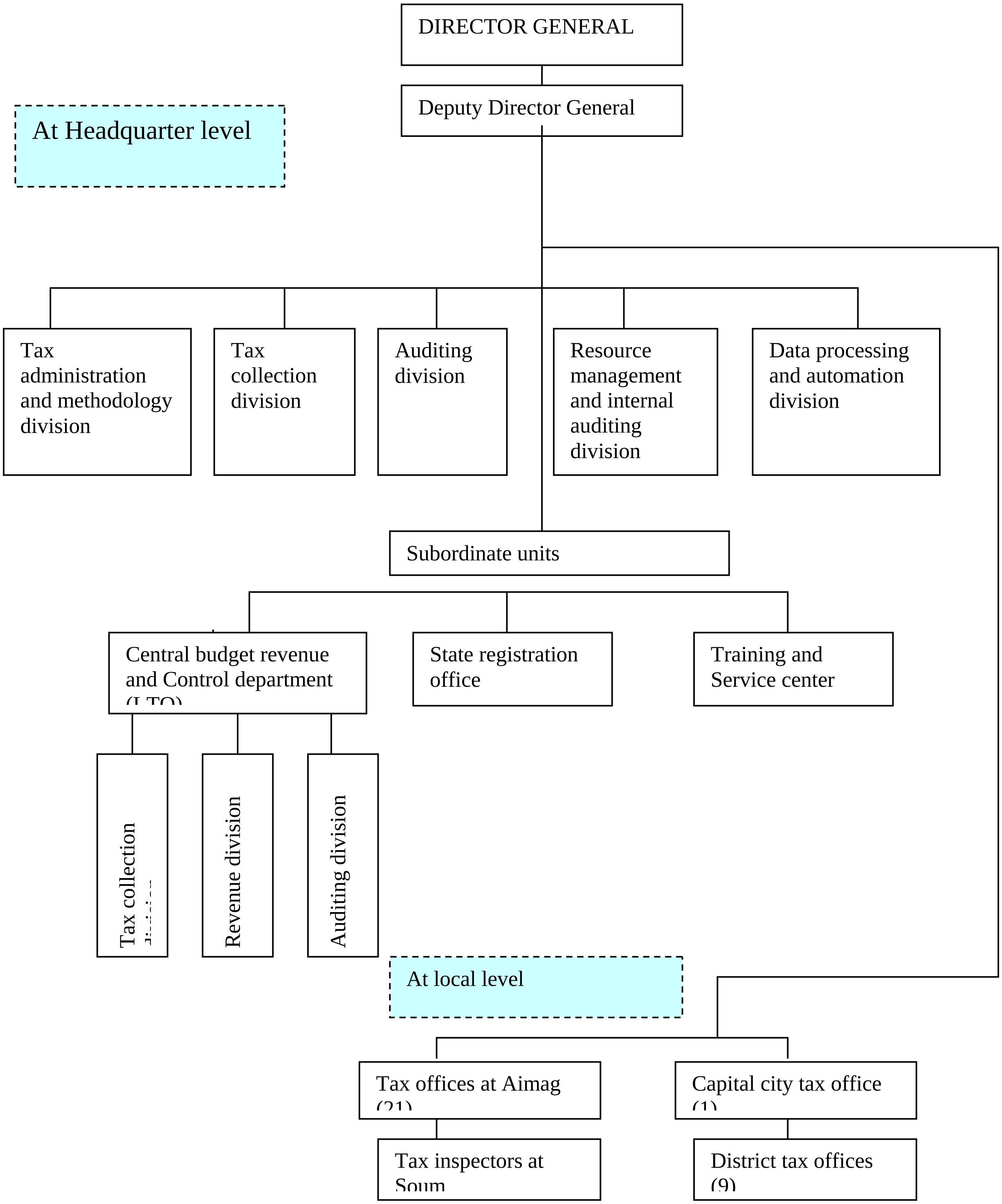
There is a training centre, which organizes training programs for tax officials and tax education programs for the taxpayers. It has three instructors responsible for training, one official responsible for tax education and one director. The centre organizes three levels of training programs. Training centre also compiles the problems of taxpayers and circulates to each tax offices.

Field tax offices are established in each Aimag and in Ulaanbaatar city. There are 22 (21 Aimag and 1 UB City) tax offices. They directly report to the GDNT. As Ulaanbaatar city is divided into 9 districts one district tax office is created in each district, which report to the Ulaanbaatar city tax office. Under the Aimag tax offices, there are Soum tax inspectors.

Another organization responsible for collecting taxes is the customs administration. The central level organization is called Mongolian Customs General Administration. Field offices are called customs offices, which are 27 in number. Of them, 16 are permanent offices while 11 are seasonal offices. These offices are located not only at the border but also inside the country. Inland customs office located in Ulaanbaatar is the largest customs office that collects about 70 percent of total import revenue. Largest seven offices collect about 95 percent of total import revenue. This administration collects import duties, export duties, VAT on imports and excise duties on imports.

Tax administration is organized in functional line. Since the central and field level organizational structure follows the same pattern, line of communication is easy. Responsibilities are well defined. Performance standards have been developed. There is a system of evaluating performance each quarter. Further, e ch year they have tests for each tax inspector on tax law, auditing, accounting, which tax inspectors are required to know to carryout their activities. As the country is geographically very big, it is difficult to control Soum inspectors from the centre. So Soum tax inspectors are located at Governor’s office for the local supervision and control, but over all control remains in the hand of GDNT.

Figure 15 Organizational structure of Mongolian Tax administration



3) Tax compliance and enforcement

Mongolia has a modern tax history of about only a decade and therefore the level of tax compliance among the people is not high. Voluntary compliance has been one of the challenges confronting our tax administration. In the effort of enhancing level of tax compliance among citizenry and bringing all potential taxpayers into the tax net, the tax administration has been making greater effort by establishing taxpayer service centers in each tax offices, conducting a survey of potential taxpayers every year, enforcing the issuance of invoice on those who do not issue invoices, ensuring proper and accurate accounting among those who do not maintain proper accounting and also confirming that all taxpayers submit the income statement/tax return through continuous reminders and tax is paid by those who do not pay tax, conducting tax audit and investigation, increasing the activities related to tax collection and punishing tax defaulters.

Table 19 Number of taxpayers

Type of corporations		2004	2005
Corporations	Stock company	389	382
	Limited liability company	24793	29709
	Partnership	3532	3705
	Cooperative	2370	2197
	Savings and credit union	556	835
	State enterprises	208	199
	Enterprises with local ownership	146	152
	Subsidiaries	1299	1356
	Permanent establishment	18	24
	Total	*33311*	*38361*
Budgetary and nongovernmental organizations	Budgetary organizations	4170	4219
	Non-Government organizations	805	1189
	Religious organizations	182	211
	Funds	117	135
	Public institutions	1352	1392
	Total	*6626*	*7146*
Individuals		456304	478011
Total		**496241**	**523518**

Figure 16

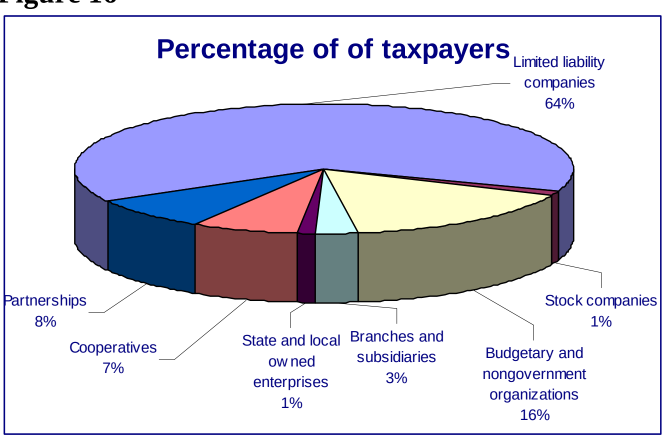
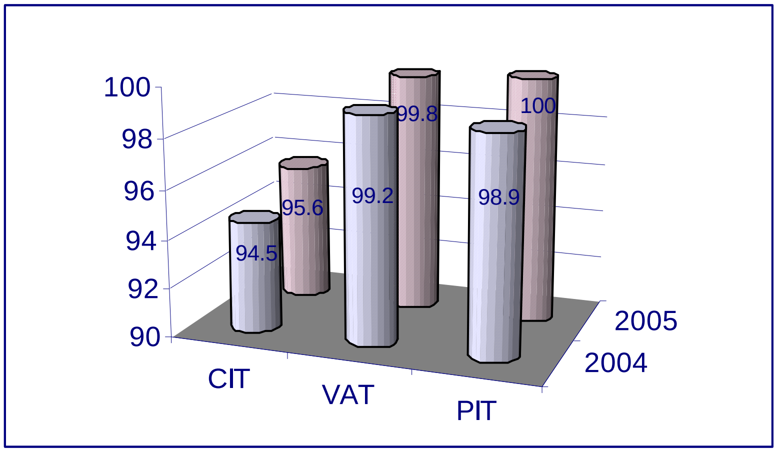


Figure 17 Ratio of submission of tax return



4) Information technology

The current organization of information technology/data processing in Mongolian Tax Administration is decentralized of its nature. In practice this means that there are 32 regional tax offices that collect data offline (independently). The collected data are transmitted periodically to the central database server, located in the central tax office, GDNT. The present IT-architecture at Mongolian Tax Administration is Client/Server-based. Concerning software, Windows 2000 is being used as operating system, and Oracle 9i as database management system. Using Oracle developer developed application programs. The WAN works on dial-up mode using telecommunication wired line and is used for example when transferring files created at local offices, through e-mail to the GDNT. The modem installed at every tax office provides facilities for the WAN.

Besides the WAN, there is also a LAN (Local Area Network) established at the central level (GDNT) as well as at each regional tax office. The LANs being used at the regional offices are based on HUB-equipment organizing client computers as workstations, while the GDNT-LAN is structured as administrating client computers from the domain server.

Currently, all application programs that are being used at GDNT have been developed in-house, by the IT-staff. These application programs cover the processing of main taxes as well as the basic tasks for a typical regional tax administration. All regional tax offices throughout the country use the same application programs, working towards a dedicated local database.

There are working the following systems:

- Tax compliance monitoring information system
- Third party information's system:
- Taxpayer service system
- Legal entity registration system
- Tax management information system

5) International cooperation

The Mongolian tax administration has a good system of cooperation with international organizations such as the WB, IMF, OECD, JICA of Japan, TICA of Turkey, KOICA of South Korea as well as for ign tax authorities such as of Russia, China, Japan, Turkey, Hungary and Malaysia in the field of exchange of tax compliance-related information, training of tax officials and technical assistance. Mongolia has entered into the "Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital". At present there are 35 tax treaties with developed and developing countries like Austria, Arabian Emirate, Belgium, Byelorussia, Bulgaria, Canada, China, Czech Republic, Egypt, France, Germany, Hungary, India, Indonesia Italy, Kazakhstan, Kuwait, Kyrgyzstan, Latvia, Luxemburg, Malaysia, the Netherlands, the North Korea, Poland, Romania, the Russian Federation, Singapore, the South Korea, Switzerland, Thailand, Turkey, Vietnam, Ukraine, the United Kingdom, and Uzbekistan.

IV. Country- Specific Issues

Since Mongolia embarked on the economic and political reform, Mongolia has achieved much success in many areas of social and economic development. Despite the economic recovery especially in recent years, large segments of Mongolia's social, economic and political sectors remain vulnerable and insecure. There are some aspects requiring further careful consideration:

- **Mongolia's large territory, its landlocked position, the small size of domestic market, and often harsh weather conditions all pose particular challenges-** Mongolia is a landlocked country sandwiched between Russia and China. Nearly two-thirds of the country's 2.5 million are scattered over a vast terrain. Remoteness and distance add substantially to costs of transportation and human hardships. Mongolia experiences extreme climatic conditions including long snowstorms, short growing seasons, dust storms and droughts. The harsh weather directly affects a third of the country's nomadic population who as herders depend for their livelihood and survival on some 30 million heads of cattle.
- **Depth and severity of poverty has increased-** about 36 percent of the population lives below the income poverty line. One fourth of the poor live in capital city of Ulaanbaatar which accounts for one-third of the population. The urban poor are especially vulnerable, given the higher cost of housing and food in this city. Being homeless in Ulaanbaatar, the coldest capital city in the world, unimaginable as winter temperatures can fall to 40 degrees Celsius below zero.
- **Imbalances in the distribution of population across the country have increased-** increasing internal migration to urban cities results imbalances in the spatial distribution of population with the concentration of population in a few towns and unequal level of regional development.
- **Outbound migration of talented and educated young people-** there has also been a sizeable migration of a large proportion of talented and educated people to countries outside Mongolia in search of better employment and living conditions.
- **The economy and the standard of living of the population heavily rely on its livestock base-** Mongolia will continue rely on the traditional agriculture which in turn is very sensitive to weather conditions.
- **Economy still remains heavily dependent upon overseas development assistance-** Attracted by the onset of economic transition, abundant ODA flowed to Mongolia, elevating it to one of the ten most aid-dependant countries in the world. However, this high level of international support has not resulted in an overall reduction in poverty levels.
- **Mongolia's growth performance remains vulnerable to fluctuations in the world prices of oil, copper and gold-** Growth has also relied heavily on external factors, particularly high minerals prices and weather, as the structure of the economy remains relatively concentrated around a few activities and few export- oriented commodities.
- **Recent and proposed fiscal policy changes put Mongolia in a more vulnerable position and can undermine future macroeconomic stability-** Specifically, recent and planned expansions of social welfare entitlements, large increases in civil service salaries without accompanying civil service reform measures, and reductions in the non-mineral tax base and major tax rates that will increase the government's dependency on volatile copper and gold prices make Mongolia's budget more vulnerable to shocks in the future.

- **The FDI inflows into Mongolia are moderate compared to other transition economies -** because of geographic position and small market size. A landlocked nation that must trade through either China or Russia, the difficulty in attracting investors is compounded by Mongolia's low population density and underdeveloped infrastructure However, the majority of the existing FDI inflows are natural resource seeking (mining and quarrying); benefit seeking or to gain privileged access of Mongolian entities to the developed countries' market (textile); the scare raw material oriented (cashmere); and catering services. Challenges for Mongolia are how to attract FDI into more value-added creative sectors.
- **There is serious concern on environmental degradation-** as Mongolia's economic performance is closely linked to environmental factors, in recent years neglect of the environment has led to serious problems of land and pasture degradation, desertification, green mass degradation, biodiversity loss, water degradation and air pollution particularly in urban areas. It has increased the risks if natural disasters and adversely affected the earnings and livelihoods of the poor.
- **Corruption identified as top issue hindering the development of the country-** According to surveys conducted by various institutions during the period through 1999 to 2005, highest responses saying "a lot of time and money" is required to achieve a goal: 1) getting medical treatment; 2) "obtain a license or permission"; 3) "obtain a land license"; 4) study at a school or university. 97% of surveyed business people believe there is corruption in the business sector. Largest response to question about what corruption is: 38% said it is a tool for bringing relevant government officials under their control. Corruption mainly exists as a monetary exchange (78% of respondents), but can also include giving presents (27%), appointment to high positions, and providing apartments or other living facilities (14.5% each). Around 90% of respondents (both general and those with experience in the courts) believed wealthy people, influential officials, and friends/relatives of court officials would get somewhat or far better treatment in the courts.

V. Conclusion: Where we stand and where we go

With the assistance of international financial institutions and the wider donor community, Mongolia has made substantial progress over the past decade of democratic restructuring in laying down sustainable macroeconomic foundations and creating a private sector-led open economy. The country has put in place a framework of laws, policies, and institutions to support a market-based system, and continued to implement structural reforms. However, major challenges remain. Despite strong growth and a slight decline in the unemployment rate, about a third of the population remains below the country's poverty line. Inequality remains high. Growth has also relied heavily on external factors.

From now on Mongolia has to start next fundamental reforms to progressively reduce poverty and improve living standards for all Mongolians, while maintaining overall economic growth. The Government recognizes that in order to increase economic growth, further reforms are needed, for example the continued privatization of major industries such as cashmere processing, and copper mining because Mongolia has to improve the quality of economic growth by making it less dependent upon the mining sector and world prices of copper and gold. Public sector reform and improved public services need to contribute to an enabling environment for the private sector.

The Government's Economic Growth Support and Poverty Reduction Strategy (EGSPRS) aims at 1) ensuring macroeconomic stability and enhancing public sector effectiveness; 2) enabling private sector-led growth through a sound institutional and regulatory environment; 3) enhancing balanced and environmentally sustainable development; 4) fostering sustainable human development and an equitable distribution of the fruits of economic growth through improved service delivery in education, health and social welfare; and 5) promoting good governance reform and gender equality.

Now achieving the set targets and implementing above strategies would be next challenges facin g Mongolia.

In addition Mongolia has also been chosen as an eligible country for the US Millennium Challenge Account.

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