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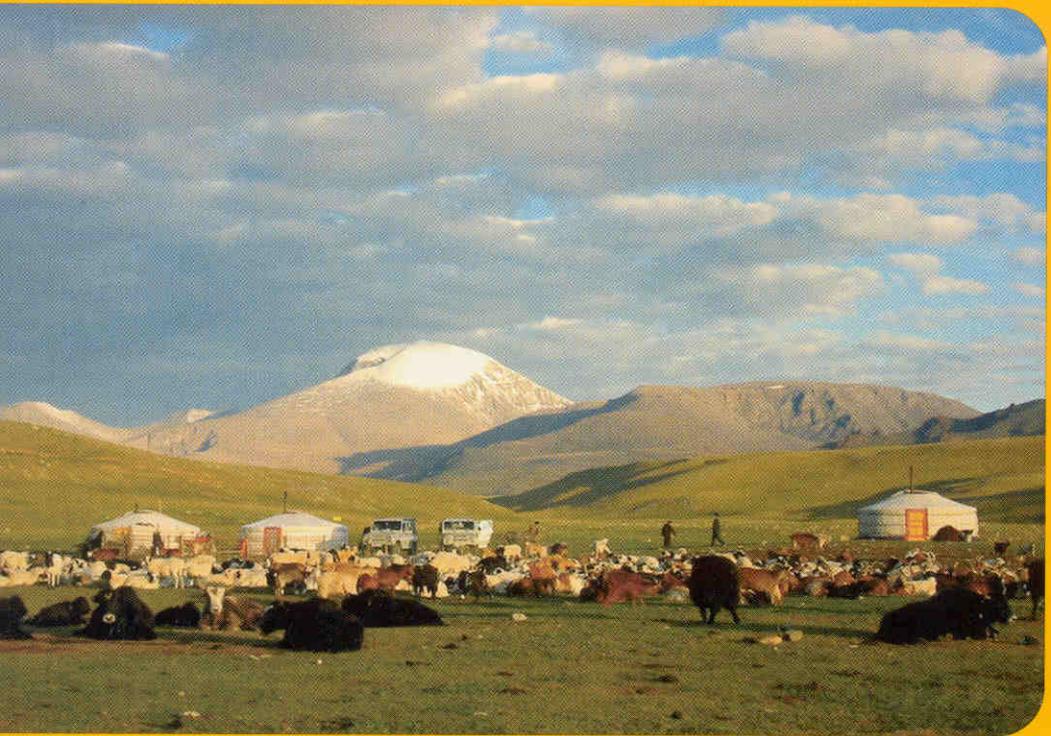
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## Between Yaks and Yurts

Perspectives for a Sustainable Regional  
Economic Development in Mongolia



SLE CENTRE FOR ADVANCED TRAINING IN RURAL DEVELOPMENT



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## Summary

After more than ten years of transition and despite considerable progress towards democracy and a market economy, Mongolia still faces enormous challenges in its attempt to raise income and create employment, particularly for those living in the rural areas. The German Government made the decision to support Mongolia's endeavours to strengthen regional economies, in accordance with their specific and to some extent unique potential and natural resources. The creation of a business-friendly environment for small and medium economic entities (i.e., a range of enterprises with various legal forms), start-ups, and investors lies at the centre of the joint strategy "Economic Reform and Build-up of Market Economy" (WiRAM). To implement this strategy, the Mongolian and German sides have agreed to launch a new programme entitled "Promotion of the Regional Economy" (see chapter A1). The programme will cover two regions in the Western and Central zone, the sub-regions of which will serve as programme pilot regions during the initial four-year phase, commencing in autumn 2004:

*Programme  
background*

*WiRAM  
strategy*

*Programme  
pilot regions*

- Zavkhan *aimag* (82,400 km<sup>2</sup>, 87,500 inhabitants) is located about 1,000 km west of the capital Ulaanbaatar and characterized by a low population density combined with a minor degree of urbanization (the largest settlement, the *aimag* centre Uliastay, has 16,000 inhabitants), a strong dominance of nomadic animal husbandry, and an infrastructure that is both technically and socially weak.
- The Darkhan-Uul and Selenge *aimags* (together 45,300 km<sup>2</sup>, 187,500 inhabitants) are located 250 km north of Ulaanbaatar. The region has a diversified economy and benefits from a reasonable transport infrastructure and energy supply, as well as from a number of educational and vocational training institutions in the regional centre Darkhan, which is the second largest city in Mongolia (70,000 inhabitants).

*Zavkhan  
aimag  
(province)*

*Darkhan-Uul  
and Selenge  
aimags*

The SLE team analysed both regions with regard to starting points, prospects, and constraints for entrepreneurial activities and the extension of value chains, relevant private and public

*Study  
topics*

*Methodological approach*

institutions for the promotion of regional economies, and the legal and institutional framework for participation of the local population in regional economic development (RED). The methodological approach and survey design followed the “Local and Regional Economic Development” concept of the German Agency for Technical Co-operation (GTZ) / the Federal Ministry of Economic Co-operation and Development (BMZ) and the principles of participatory diagnostic, i.e., Rapid Rural Appraisal (RRA) and Participatory Appraisal of Competitive Advantage (PACA<sup>®</sup>) (see chapter A2). The results of the study are based on interviews and workshops with local stakeholders, supplemented by various secondary sources.

*Challenging framework for regional economic development (RED)*

Although the Mongolian Government has gained substantial achievements in promoting economic growth (e.g., price stabilization, open trade regime, privatization, infrastructure development programmes), a number of unfavourable framework conditions still constitute a challenge to the economic development of the two pilot regions (see chapter A3):

*Poverty and unemployment*

- Poverty – reflected, e.g. in the low purchasing power of the rural population – is widespread. Bearing in mind the large unemployment (including underemployment, e.g., in herder households), economic development in the regions must first and foremost be labour-based and generate income and employment for young people in particular.

*Domestic and international markets*

- An extremely low population density, especially in the Western Region, means that regional markets are small and saturated quickly. At the same time, certain economic policies of Mongolia’s two large neighbours (Russia: import taxes and bans; China: subsidies for domestic investments and production) limit the scope for exports. The challenge for producers in regions such as Zavkhan is, therefore, to gain a market share in supra-regional markets (other *aimag* centres, Ulaanbaatar), to find niches in less competitive markets (e.g., products that cannot easily be copied by Chinese enterprises), and to establish connections with Asian, European and North American markets.

- The harsh continental climate makes agriculture (crop, vegetable, and animal production and processing) a seasonal business involving risks. Economic entities require risk-minimizing, income-stabilizing strategies, such as diversification of production, irrigation, greenhouses, breeding for resistance, storage, appropriate herd compositions, stabling in winter, etc. *Harsh climatic conditions*
- Mongolia's ecosystems are not only unique but also very fragile, which means that vital natural resources (especially pastures and forests), if not managed properly, are easily over-utilized and depleted. Finding a balance between economic utilization and ecological protection is a particularly challenging task for RED in both pilot regions. *Fragile ecosystems*
- Poor transport and communication infrastructures and the inadequate and unreliable supply of energy, especially in the Western Region, implies that transport and transaction costs are high, and only limited scope available for energy-intensive production and processing. In promoting the regional economy, therefore, it is essential to increase the value of transported goods, to support investment in the improvement of roads and communication systems (e.g., Internet facilities), and to find intelligent methods of substituting and producing electricity. *Poor infrastructure*
- In the course of transition, the supply of social services like schooling to people in the rural areas declined dramatically, both in quantity and quality, and has led to significant migration to the urban centres of the Central Region. Strengthening these 'soft' locational factors relevant to individuals will be a particular challenge to RED. *Decline in social services*

The majority of the economic entities under review suffer from low competitive and bargaining power and low income stability (see chapter B1). Their capacity for efficiency and success in increasingly competitive and dynamic markets is constrained by:

- high vertical integration of production, i.e., little outsourcing of certain stages in the value chain, mainly due to unreliable suppliers or their complete absence;

*Low competitiveness of economic entities*

*Little outsourcing*

- Little specialization*
  - highly diversified production, i.e., very little specialization on 'core' businesses, mainly due to external risks (e.g., climatic conditions);
- Low product variation*
  - low product variation (e.g., production of a single natural yoghurt instead of a variety of fruit yoghurts) due to lack of market information combined with general risk aversion;
- Low processing depth and standard*
  - low processing depth, particularly of animal products in Zavkhan, and, despite good quality of raw materials, low standard of processed goods (e.g., perishability), mainly due to lack of information on appropriate processing technologies and quality standards and insufficient investment capital;
- Poor product design*
  - poor product design (containers, labels, etc.), largely due to a lack of marketing know-how and of suppliers;
- Insufficient know-how*
  - insufficient technical and managerial know-how due to inadequate education during the socialist era and the current scarcity of educational and vocational training opportunities, especially in Zavkhan.

*Planning insecurity and low bargaining power*

Most economic entities do not have fixed buyer contracts and – as in the case of herders – depend on unreliable domestic and foreign middlemen and their price calculations. The resultant planning insecurity and income instability is aggravated by seasonal constraints on production. Bargaining power is also low as a result of bad organization (e.g., in co-operatives, associations, chambers) and poor networking among the various interest groups.

*Economic potential in both regions*

In both regions, core products such as raw and processed meat, hides, milk, and vegetables could satisfy local and national demand and substitute for imports, provided that these products – sausages, leather, cheese, vegetable salads, etc. – match foreign products in quality (e.g., taste) and price. There is also an unmet demand for a variety of services such as repairs, transport, sewing, etc.

*Zavkhan*

The unique characteristics of Zavkhan *aimag* to be marketed in the long-term include:

- first-class export quality wool and cashmere for primary processing in the region and final processing in Ulaanbaatar or abroad, provided that pasture management and herd composition is optimized and quality is sustained by improved veterinary services, fodder production, and possibly breeding for quality; *Wool and cashmere*
- an extraordinarily beautiful landscape that could attract national and foreign tourists, provided the quality of current facilities and services and co-operation with tour agencies and other *aimags* is improved; *Tourism*
- wild fruits and plants for the production of berry jams and pharmaceutical products to serve national and international markets, provided these non-timber forest products are carefully exploited and reforestation measures take place; *Wild fruits and plants*
- certain niche products, such as marmot oil and fur, red garlic, and yak and camel milk, for supra-regional and international markets.

The outstanding economic potential of Darkhan-Uul and Selenge *aimags* includes: *Darkhan-Uul / Selenge*

- production and processing of cereals and vegetables to serve regional and national markets and to substitute for imports, provided quality seeds are made available and cultivation risks are minimized through appropriate irrigation and greenhouse technologies combined with diversification of crops; *Cereals and vegetables*
- availability of a variety of raw materials for construction (cement, lime, clay, etc.) and a processing industry in Darkhan to serve a booming market both inside and outside the region; *Construction materials*
- certain niche products such as honey or wild plant products for national markets as well as for export.

A supportive institutional business environment is slowly evolving in the pilot regions. Most of the public and private service providers, however, are still in an early phase of development, defining missions, shaping profiles, and improving customer-orientation (see chapter B2):

- Business development services*
- At present, non-financial business development services (BDS) such as training, counselling, contact brokering, and lobbying are provided by membership organizations (chambers, employers' federations, co-operative associations) and certain public administration departments (e.g., employment office), while private consultancy firms have not yet entered the service market. The BDS providers under review are largely committed to increasing the competitiveness of economic entities but have difficulty in attracting new members and are not yet capable of satisfying client needs completely, especially in relation to advice on technology, management, and marketing. This is mainly due to insufficient qualification of personnel, lack of technical equipment (e.g., computers) and limited financial means (e.g., for advertising).
- Finance institutions*
- Institutional finance in the two pilot regions comprises banks, non-bank finance institutions (NBFIs), savings and credit co-operatives (SCCs), government / donor schemes and non-governmental organizations (NGOs). Notwithstanding a tremendous improvement in diversity and outreach of the financial sector in recent years, the demand of many economic entities for medium and long-term loans (3-5 years) at reasonable lending rates (10-15% per annum) is largely unmet. In addition, start-up entrepreneurs find it particularly hard to access loans, mainly because of high demands by banks, NBFIs and government / donor schemes for security.
- Public administration departments*
- Trade supervisory boards, tax offices, and insurance departments are the core public administration departments that economic entities in Mongolia have to deal with. Although the administrative assistants interviewed are aware of transaction costs caused by registration and licensing procedures, they do not see much scope for a reduction. Their positive self-assessment of customer orientation, however, is in contrast to the entrepreneurs' view: small economic entities, in particular, complain of slow processing of applications, insufficient explanation of delays, poor counselling standards, and official forms that are sometimes hard to comprehend. Cases of corruption were also reported.

Difficult access of the population and economic entities to politically and economically relevant information (whether general, such as market prices, or specific, such as certain production technologies) is a major obstacle for RED in the pilot regions, particularly in Zavkhan (see chapter B3). Internet facilities and local newspapers are largely absent, local radio and TV stations are either non-existent or out of operation. Local BDS providers face similar difficulties and are, thus, not yet able to fill the gap.

*Access to  
information*

As a result of financial constraints, the educational situation is unsatisfactory, above all in Zavkhan. Teaching facilities and equipment are in bad condition, teaching materials are either outdated or non-existent, and the teaching staff lacks practical experience and opportunities for advanced training. As a result, many parents prefer sending their children to schools and colleges in the Central Region, qualified teachers prefer to stay in the capital or other larger cities (not least because of huge wage differences between Ulaanbaatar and the rural regions), and graduates from existing local educational and vocational training institutions have difficulty in matching the demands of potential employers.

*Educational  
situation*

Mongolia's democratic constitution and federal structure, combined with the political will of the ruling party to promote balanced regional development, forms the basis for local participation in RED. Yet, recent laws strengthening the power of the central government, insufficient information on government regulations and programmes, and widespread political inactivity and disinterest limit the involvement of various stakeholders, including the local population, in relevant decisions concerning the regional economy (see chapter B4):

*Political and  
institutional  
framework for  
participation in  
RED*

- All local projects that cost money (e.g., introducing a new subject to a college curriculum or installing a transmitter for mobile phones) have to be approved at higher administrative levels, usually in Ulaanbaatar. Local governors have to lobby at the *aimag* government or in the central ministries, where implementation of local initiatives is either rejected or delayed.

*Decision-  
making*

- Budgeting*
- The lower the administrative level, the less budget sovereignty lies with local governments. While *aimags* (provinces) have to pay most of their income tax directly to the capital, *soums* (districts) can only keep income tax that exceeds the target amount set in Ulaanbaatar. *Bags* (communities) have no budget of their own.
- Information policy*
- Information on laws, regulations and government programmes is seldom available to the public, not only due to the absence of media (especially in Zavkhan) but also to a restrictive government information policy. Public notices are rare and meetings where relevant information is shared only take place at long intervals.
- Political disinterest*
- Many local people do not exercise their legal right to participate (also reflected in a drop in polls), either because they are unaware of them or because they do not perceive them as an opportunity for change.
- Non-compliance with laws and corruption*
- Non-compliance with laws (e.g. forestry regulations, labour laws) as well as corruption and nepotism were reported in several interviews. The negative consequences are over-exploitation of natural resources and difficulty of local entrepreneurs to develop their business ideas.
- Recommendations on the programme concept*
- In order to support economic development in both pilot regions and the participation of local stakeholders, the new programme should assist existing public and private institutions in improving access of economic entities and the population to information dealing with politics, technology, and the market, and to credit, education and advanced training. Lowering administrative hurdles would also be worthy of support. More specific recommendations in this respect include (see chapter C2):
- Improve information flows*
- To improve information flows, the programme should support local initiatives to put local media such as newspapers, television, and radio back into operation, to establish versatile information centres open to everyone, to intensify the organization of exhibitions and trade fairs, and to provide start-up entrepreneurs with tailored information.

Financial services should be improved by providing funds that match the capital stocks of savings and credit co-operatives and non-bank finance institutions, by promoting the formation of SCCs, by giving start-up entrepreneurs access to special credit programmes, and by inviting bank representatives to RED-related informative local meetings or consultations.

*Improve  
finance  
services*

Support to business development service providers should include procurement and financing of technical equipment and training courses on selected subjects, assistance in creating awareness among potential clients of the possible utilization and advantages of business development services, support in forming co-operatives and co-operative associations, and assistance in networking among different national service providers and establishing contacts with foreign institutions.

*Support BDS  
providers*

Local stakeholders in Zavkhan suggested a variety of measures to improve educational and vocational training that should be supported: creation of incentives for teaching staff to stay and work in the region, provision of up-to-date teaching materials and equipment; focus on practice-oriented education, and strengthening of co-operation between educational institutions and economic entities.

*Improve  
education  
and training*

To improve the competitiveness of economic entities it is recommended to

- support and train herders and farmers to motivate them and enable them to produce high quality raw materials;
- assist local actors in marketing the characteristics of the *aimags* and the uniqueness of its people and products;
- improve producer know-how in handling new and more suitable equipment through (re-)qualification measures;
- assist SME, vegetable farmers, herders etc. to collect, process, and market their goods in groups and co-operatives;
- support methods to expand plant cultivation and material processing time spans;
- focus on programme support to small and medium economic entities, as they are in most need and can create jobs and income for the local population,

*Strengthen  
competiti-  
veness of  
economic  
entities*

- promote environmentally sound production and processing that focuses on sustainable utilization of natural resources.
- Enable participation in RED* To improve the framework for participation of local stakeholders in the programme – and in RED in general – the following measures are suggested:
- Reconcile interests*
- In order to reconcile regional and national interests, programme measures and objectives and the responsibilities at various levels should be clearly defined from the outset, and local and regional authorities actively involved throughout the planning and implementation process.
- Strengthen regional autonomy*
- GTZ should support and actively demand measures that strengthen the autonomy and power of regional authorities; they should also conduct or support legal advice to national and regional governments on matters of regionalization (particularly budgeting) and law enforcement.
- Organize information activities*
- The programme should promote and organize information activities (e.g., workshops, publications, and TV and radio programmes) about current possibilities for citizens to participate in RED; each citizen has the legal right to attend *bag*, *soum* and *aimag* parliament meetings, to make requests and proposals to state organs, to form citizen groups, co-operatives, and associations, etc.
- Support compliance with the law*
- To support compliance with the law, the programme should not only install effective supervision and control mechanisms for planned activities but also support groups and organizations that are committed to law reinforcement and the fight against corruption and nepotism.
- Use a participatory learning approach* In the planning and implementation of regional economy promotion measures in the pilot regions, the programme should use a participatory learning approach geared to existing concepts of Local and Regional Economic Development (LRED) (see chapter C3).
- Seek synergy* The programme should seek synergy with other donors and organizations promoting regional development. As already envisaged, the programme should also closely co-operate with – if not integrate – existing GTZ-supported projects.