

**Mongolia**  
**Manual for Action in the Private Sector (MAPS) Survey**  
**Findings**

**The Competitiveness Initiative**  
**USAID funded project**  
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# Mongolia

## Manual for Action in the Private Sector (MAPS) Survey

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### Part 2. Survey Results

## Preface

The Competitiveness Initiative, a USAID-funded project, and the faculty and students of the Department of Economics of the Mongolian National University carried out this survey of the private sector. It could not have been completed without the cooperation and assistance of the Government of Mongolia, the 375 companies who gave their time in survey interviews, the Economic Policy Support Project (USAID), the Mongolian Chamber of Commerce, and the Foreign Investment and Foreign Trade Agency (FIFTA).

This survey represents the collaborative efforts of three donor agencies, USAID, the World Bank, and the Asian Development Bank. The World Bank gave valuable assistance in designing the survey instrument. Survey data has been entered into a coded database so that the individual companies that were interviewed cannot be identified. The World Bank provided valuable input on the design of the survey instrument, which is based largely on the Bank's Private Sector Assessment survey. The Bank's experience in implementing similar surveys in over 100 other countries, including numerous transition economies, was drawn upon in order to refine the survey questions and format.

The survey findings and conclusions as represented in this summary document should be read with the following facts in mind. The survey sample consists primarily of formal businesses and was not designed to represent a comprehensive sample of the Mongolian private sector, which would include a much greater number of informal businesses. It was not within the scope of this survey to assess the business environment for informal businesses. Nor does this survey sample include banks and other financial service providers, whose business issues are quite different from other types of companies.

The survey data itself can be analyzed from many different perspectives. This summary document only provides an overview of the findings. The task of mining the survey data for all the information it contains and of interpreting this data in detail will be an ongoing one. All organizations interested in obtaining a copy of the database for analytical use are encouraged to contact TCI.

## Introduction and Purpose of the Survey

The Manual for Action for the Private Sector (MAPS) survey was undertaken in order to compile and rank ordered data on private sector perceptions of the current business environment in Mongolia. The companies surveyed were asked to provide their own assessment of how different "business environment" issues affected their business. This survey was conducted with the objective of setting an agenda for public-private discussion on ways of improving the business environment in support of continued economic growth.

The survey results can be used to identify priority areas in which both the public and private sectors can work to improve the competitiveness of the private sector. The MAPS survey instrument was originally designed to provide input to strategy and policy formulation in support of private sector growth. The MAPS survey presented several key aspects of the business environment and asked businesses to rate them in terms of their impact on the performance of the business. After the survey, a series of focus meetings were held with private sector representatives to discuss specific issues and further develop the findings. These discussions provided qualitative input that helped to interpret the survey findings. More information on how the survey was designed and implemented can be found under the section entitled Methodology.

Country competitiveness may be viewed in terms of the effective functioning of three key elements, all of which are necessary but not sufficient conditions for achieving economic growth: 1) the overall macroeconomic framework, 2) the microeconomic (or business) environment, and 3) business operations and strategy at the industry and firm level. This survey addresses only the second, the microeconomic environment, which can be considered the “platform” for business operations in a market economy.

Mongolia has made substantial progress in shaping a macroeconomic framework that provides the fundamental conditions in which economic growth may take place. Businesses have begun adapting to the demands of a market economy, and there is increased recognition of the fact that in market economies, businesses must be the primary drivers of economic growth. Achieving national competitiveness will now require the creation of a supportive microeconomic environment that facilitates increased investment and productivity.

The survey findings show areas where public and private sector initiative is required to address constraints to growth and to build a platform for increased competitiveness. More importantly, the findings allow us to rank the importance of different business environment issues and to set an agenda for discussions between the public and private sectors. The survey responses can also be used as benchmarks for setting near- term objectives in improving the business environment and later for measuring progress.

## **Survey Design**

The survey is organized in 11 sections. Section I., Company Profile, contains questions about the company being interviewed. The section was designed to help divide up responses from different types and sizes of companies in the subsequent analysis and to allow comparisons between different segments of the business community. Sections II through X look at different sub-issues within the business environment which can be roughly classified into the following categories:

- II. General Legal and Regulatory Issues
- III. Regulations, Licensing, Inspection
- IV. Role of Government
- V. Taxes
- VI. Customs
- VII. Judiciary System
- VIII. Bureaucracy
- IX. Financial Services
- X. Competition

The last section, XI. Business Confidence, includes a question designed to rank the relative importance of the business environment issues covered throughout the survey. It also contains a series of questions designed to collect business perceptions on government’s performance in supporting private sector growth and on the outlook for business performance.

## **Overview of Survey Results**

In general, the survey responses revealed that very few issues generally accepted as obstacles to doing business were rated as significant issues by businesses, defined by a ranking of “significant” or “major” obstacles or their equivalence on a similar scale. To the overwhelming majority of ranking-type questions where companies were asked to specify the degree of obstacle posed by separate business issues, the *majority* (over 50%) of companies responded with “don’t know”, “no

obstacle”, or “minor obstacle”. The majority of companies responded with a negative rating to only two categories of issues: taxes and the judiciary system.

Over half of all firms indicated that it is difficult to obtain information on laws and regulations, and almost half believed that changes were highly or completely unpredictable. Companies did not think that their opinions were taken into account when there were important changes being made to the laws or policies affecting their businesses. A large number of respondents believed that government officials or agencies often misinterpreted laws and regulations, set their own rules, or imposed additional rules on top of those actually required.

Of ten categories of issues affecting the business environment, the general survey population ranked taxes and corruption/cronyism as the top “major obstacles”, followed closely by licensing and infrastructure. Exporters, however, ranked financing as the top issue posing a major obstacle to business growth.

Business registration, which is often cited as a problem issue, was not highly rated as a “major” obstacle to doing business. According to most companies, registration is relatively trouble-free compared with other licensing and regulation obstacles encountered once a business begins operation. The most difficult areas of regulation, licensing, and inspection were identified as tax regulations, tax administration, and dealing with the customs service. Companies also ranked tax and customs departments as the most bureaucratic agencies.

Although most respondents viewed government as being responsible for the shortcomings of the business environment, the majority of respondents could not state a clear role for government in a free market economy. Responses to this question were highly varied, and showed that there was little consensus within the business community about what government should be doing or what steps should be taken to improve the business environment or the performance of the economy. “*Government doesn’t listen to us*” is a complaint expressed by virtually all of the survey respondents in answering this question. Since this comment cannot be categorized as a “role” for government it was left out of the survey scoring, but it should be noted that this perception is a widely held one.

Inspections also ranked highly among the leading obstacles to business operations, but not as “major” obstacles. Companies complain less about the need for inspections themselves, than about the liberal interpretation of regulations and rules and the behavior of inspectors. This is reflected in the relatively high ranking given to corruption in the summary ranking question. Inspections are viewed as a way for inspectors to extract unofficial payments from companies.

Business confidence questions revealed mixed feelings or pessimism as to whether government actions would improve the business environment in the next two years. However, the majority of businesses were optimistic about their growth prospects and other measures of business productivity.

## **Conclusions**

The overall findings of the MAPS survey indicate that policy-related constraints to growth in Mongolia are not grave; on average they fall in the low to mid range in terms of explaining the country’s economic situation. The exception to this finding is in the area of tax policy. Business perceptions of tax policy and implementation are heavily influenced by the fact that companies feel taxes to be inefficiently spent and that the burden is disproportionate to the benefits received in the

form of infrastructure and services. Specific business environment issues and policy implementation appear to pose a greater problem for businesses.

The judiciary system was not rated as a significant obstacle in the summary ranking question to responses to which are presented above. However, the sub-section of the survey dealing with the judiciary system had the highest number of negative rankings out of all the sections of the survey with the possible exception of taxes. This response pattern would indicate that while firms do not come into contact with the judiciary system often enough to rank it as a major overall obstacle, their experience with the system has not been a positive one. Further, the lack of frequent contact with the judiciary system likely means that respondents formed their views from indirect knowledge, such as their understanding of experiences of other businesses with the judiciary.

According to the survey, small firms faced more regulatory problems than did large firms, were subjected to higher levels of bureaucratic procedures, corruption, and harassment, and had less access to financial services and to government services. As Mongolia's commercial sector is comprised mainly of small and medium sized firms, these problems merit special attention. These findings, not unusual, were consistent with the results of an earlier informal survey of the business environment.

The survey further revealed that of the six economic sectors represented in the survey, the views of larger companies in the "industry" sector represented the consensus view of all businesses on most issues. This finding is not surprising because small firms dominate the economy numerically, but they do not account for a major share of foreign exchange earnings and are less likely to encounter the range of problems a large firm does. However, because large firms are more likely to have financial and political assets to address problems, the prevalent complaint from small business, that "government doesn't listen to our concerns," is readily understandable. The survey responses indicate that government services are often not made available to small business. This finding is not surprising since, in lower income countries such as Mongolia where government services are limited in reach, the needs of small business tend to be addressed, if at all, from the standpoint of social policy rather than commercial policy.

Industry's current dialogue with government tends to be about problems, and not about problem solving. While companies individually offer criticism, industry is not organized to develop internal consensus on priorities or possible solutions, or to propose constructive strategies. As a result, the number one complaint of businesses has been that "government isn't listening". This complaint surfaced during the survey and in focus group discussions. A plausible and objective explanation is that government is unable to identify a view that reflects the consensus of any one interest group, or of interested parties on any one issue.

The range of responses given to the question "what is the role of government in a free market economy" and the split between positive and negative answers to other business constraint questions indicate that it is possible that government *is listening*, but government officials are not hearing anything particularly useful from "industry." If government's actions reflect the demands of the business community, it is not surprising that the private sector senses a lack of cohesion or direction in economic development strategy. Within the current, limited discussions between government and the business community, industry is not providing constructive proposals that government can support. Absent a mandate to identify a consensus or the skills and resources to develop one, government agencies use an *ad hoc* way to measure industry reaction – informal information gathering or listening to whichever company "speaks loudest" or speaks last. Since there is little industry leadership to develop or advocate business-friendly strategies, government

becomes the master strategist by default. This results either in government attempting to “pick winners,” or in strategies *for* and not *by* the private sector.

The action plans or sub-programs developed for different industries by various government ministries are examples of the failure in dialogue. Action plans and sub-programs often contain numerous suggestions that reflect the interests of different segments of industry. However, the plans are a patchwork of ideas that are un-prioritized, sometimes contradictory, and reflect an overall lack of strategic focus. Industry either finds the plans objectionable and impractical, or of little use in improving industry competitiveness. Likewise, industry standards and regulations developed by government agencies are meant to improve the levels of product or service quality, but are the object of much industry complaint because they are directive, top-down, and are inconsistent with the demands of the markets or the way in which industry generally works to meet these demands. However, industry has rarely if ever come together to propose industry developed targets or voluntary standards for achieving efficiency or competitiveness. When business and government have met in the past, the discussion has been characterized by complaints from business citing a long list of problems that obstruct growth. Industry has not come prepared with its own consensus vision of how problems might be solved or with constructive suggestions for moving forward. If industry has no strategy, it is not possible to have a productive public-private dialogue on growth. The dialogue then falls apart and no follow-up action is taken.

## **Recommendations**

The survey shows that some issues that businesses perceive to be major obstacles to doing business or major weaknesses in the business environment need fixing. Tax implementation and petty corruption are the leading obstacles as defined by the survey responses. Along with these, access to finance must be improved in order to address the major constraint perceived by export-oriented businesses, which account for a large share of employment. Government and the private sector need to begin a dialogue so that explicit agreement is reached on priorities and both sides can commit to an “outcome”. If an outcome is not clearly defined, it will not be possible for both sides to track progress toward an object or agree that an objective has been reached.

As this survey was designed specifically to provide a basis for discussion and a tool for facilitating public-private discussion on ways of improving the business environment, the following discussion is limited to guidelines for joint action by the public and private sectors. Specific business environment issues need to be addressed, and solutions found, by those who have the biggest stake in building a better business environment in support of economic growth.

In seeking ways to improve the business environment, cross-cutting solutions that have a positive impact on several problems give a relatively large return on the resources devoted to implementing them. Let us take tax implementation and corruption as an example. In both areas, better information dissemination and increased transparency, and giving a clear set of rules and guidelines to both public officials and to the business community, would help to address multiple concerns. This action would make it easier for companies to obtain information on laws and regulations, assure more accurate and uniform interpretation, and reduce the incidence of additional requirements being imposed. A government-wide effort to increase information dissemination and transparency would also resolve many of the issues perceived as obstacles in the areas of taxes, licensing and inspections, customs, and bureaucracy. Tax implementation could be used as a pilot program or test case.

The chances of any such initiative being successful are greatly increased if all interested parties agree on the strategy used for solving the problem and have a shared responsibility for making it

work. While tax implementation is presented as an example here, the actions for improvement of the business environment which have the greatest chance of succeeding will be those that are demand driven. Rather than choosing a focus for action and trying to rally a team of stakeholders around it, issues that are “self selected” by business provide better starting points. Responsibility for the process should be shared both by business leaders who are willing to actively participate and key government officials who will support change. Initial attempts at building better communication and closer cooperation between the public and private sectors should not focus on highly controversial issues. Initially, taking on highly controversial issues risks discouraging both sides if a consensus strategy cannot be reached, and is more likely to result in increased mistrust. Remember, *success breeds success*.

### **A Different Kind of Discussion**

It is necessary to build a new type of public-private dialogue that is “opportunity-driven”, and which would address the private sector’s complaint that government isn’t listening. Again, it is quite probable that government is listening, or attempting to listen, but that the input and advice reflects such diversity of demands and of differing viewpoints that government officials find it difficult to make sense of the comments they receive. For example, a common complaint of the surveyed respondents is that there is little cohesion or consistency between different policies and lack of communication between different government agencies. It is quite likely that this is true, but that these different agencies are also reflecting, in some part, the general confusion about the role of government and of the development strategy to be taken that is evident within the private sector itself.

In meetings with government agencies and officials, it is apparent that some part of government *is* focused on the identified barriers and is seeking solutions to them. Additionally, significant donor support is being applied to restructuring parts of the economy or specific policies in order to support accelerated economic growth. Still, an acceleration of private sector growth is not occurring. This review concludes that accelerated growth is not occurring in large part because effective public-private dialogue on the subject is not occurring and business support activities are absent. The survey responses show that companies do not consistently rank any one specific business environment issue as a constraint, except perhaps taxes. To almost all of the questions posed, the majority of companies responded with “don’t know”, “no obstacle” or “minor obstacles”. This pattern of responses leaves unanswered the question of the respondents’ identification of the constraints that *do* explain the poor living standards and the lack of economic growth in Mongolia.

### **Organizing the Dialogue**

The MAPS survey results may be used as a tool for helping to focus the public-private dialogue on issues of most concern to industry. That dialogue should be driven by identifying specific opportunities for growth rather than by focusing on general obstacles to it and by re-playing the problems of the past. In shifting the tone from obstacle to opportunity, the discussion should also focus on practical micro-concerns, on implementation rather than restructuring and changing policies again. This would involve moving from a process-oriented exercise dominated by issues of restructuring the economy, to one focused more on repositioning the commercial sector to produce higher value products, generate higher wages, and contribute to improved standards of living. Rather than challenging government to come up with a strategy or plan for addressing a particular business constraint that either succeeds or fails, this would require the private sector to become actively involved in the process and share the responsibility of making the process work. Government’s role would become one of *enabling* the private sector to achieve these targets.

An *ad hoc* task force (mixed public private sector body) approach has been used successfully in Mongolia and in other developing countries for achieving action and results. A good example of such a task force in Mongolia is in the tourism sector. Although relatively new, this task force is taking positive steps to improve the platform for competitiveness in the tourism industry. It has been the conduit for constructive communication between private sector companies and the government agencies responsible for regulating or promoting tourism.

There are two requirements for making progress in organizing the communication between government and the private sector. The first requirement is that the private sector must organize itself so that it can speak on different topics with one voice. This requires businesses to meet and prepare for discussions by identifying priorities for improving the business environment and by developing *practical* solutions to propose to government. Critically important, private sector groups must include key players from all parties that have a stake in the result. An outside catalyst or facilitator may help organize and run these sessions more effectively, but should be a resource and a mediator, not a participant.

The second requirement is that once government and the private sector do engage in dialogue, ground rules must be set to ensure that outcomes are pursued and progress made. A clear objective or goal must be agreed upon so that both sides know when it has been reached. Responsibility for implementing actions must be assigned, and someone must monitor progress and ensure that there is accountability.

Improved public-private dialogue can be created if both industry and government share the responsibility for identifying and solving problems that limit growth. Private enterprises must take initiative and accept greater responsibility for offering realistic proposals for solving the problems they articulate. Government agencies must be prepared to let others influence the policy agenda or strategy. Discussions on obstacles and opportunities can then effectively indicate the specific public policy mechanisms that are needed, define the support that would be required to implement them, and bring to the task force leaders from the government who can legitimize the process and sponsor regulatory changes.

## **Summary of Survey Findings**

### **I. Company Profile (questions 1-11)**

The majority (74%) of firms surveyed had 100 employees fewer, or with 51% having less than 25 full-time (year round) employees. “Light industry” (especially garments/cashmere), “agro-processing” (including food processing), and “trading” comprised about half of all firms surveyed. Twenty-five percent of the firms were export enterprises. Export firms tended to have twice the number of employees as compared with firms from the general survey population.

A majority of the firms (75%) in the general survey population had no foreign ownership or equity. However, half of the export firms had foreign ownership. This may suggest that firms with foreign ownership are more likely to be export oriented and manufacture products or offer services that can compete in world markets. Industries with export potential are also more attractive to foreign investors, given the limited size of the Mongolian market.

66% of the surveyed firms were private from the time of start-up, and 17% were initially formed as joint ventures between domestic and foreign partners. Privatized firms represented 14% of the sample size and 4% were still state owned or had state held shares. Up to 30% of surveyed firms were family-run businesses, as defined by the management or a family member also being the

largest or the majority shareholder. This is not surprising given the fact that the private sector is largely composed of small and medium sized businesses that are self-financed.

## **II. General Legal and Regulatory Issues (questions 12 – 17)**

The survey responses indicate that most respondents agree that information on laws and regulations affecting their businesses has become easier to obtain now than it was two years ago. However, 18% of respondents still mostly disagree that information is easy to obtain and another 36% only somewhat agree. This would indicate that over half of all firms have difficulties obtaining information on laws and regulations.

The predictability of changes in laws and regulations also poses a constraint. 48% of all respondents believed that changes were highly or completely unpredictable. Tourism companies as a group seem to experience more difficulty with unpredictability. 70% of tour companies answered that changes were highly or completely unpredictable. Unpredictability of laws and regulations discourages investment and increases the costs of compliance. The largest share of respondents said they had seen no change in predictability over the last two years, although more respondents believed that changes were becoming more predictable than less so.

The large majority of companies believed that their opinions or those of their business associations were either seldom or never taken into account when there were important changes being made to the laws or policies affecting their businesses.

A large number of respondents believed that government officials or agencies often misinterpreted laws and regulations, set their own rules, or imposed additional rules on top of those actually required. 36% of the general survey population believed that this situation occurred, while in certain sectors, the response was much more negative. The percentage of firms that believed officials or agencies often or always misinterpreted laws and regulations, set their own rules, or imposed additional rules was 74% in tourism, 68% in trade of consumer goods, 64% in food processing, and 60% in light industry. Incorrect implementation or willful manipulation of laws and regulations by government agencies reduces business confidence in government integrity, and increases the costs to firms of compliance, licensing and permissions *outside of those required by law*, particularly as businesses report that legal recourse is not a practical option.

Focus group discussions revealed that businesses believed laws and regulations changed frequently and that inconsistency in policy and lack of coordination between agencies was as much of a burden as the lack predictability of laws and regulation.

## **III. Regulations, Licensing, Inspection (questions 18 – 40)**

In ranking the most commonly cited regulatory issues, the survey shows that tax regulations and administration, customs, and licensing and permits created the most problems for businesses. 49% percent of all respondents estimated that the procedures, rules, and regulations for obtaining licenses and permissions caused either significant or major financial or time losses for their firms. Regulations and licensing were most troublesome to agro-processing, food processing, and tourism companies where the percentage of firms that rated them as causing significant or major losses was 90%, 80%, and 85% respectively.

Of the most commonly implemented inspections, hygiene and sanitation inspections were ranked as the most problem-creating, with electrical, production and technology standards, and plumbing inspections ranked as distant seconds. Compared to the general survey population, 20% of whom ranked hygiene and sanitation inspections as significant or major problems, the percentage of companies that gave hygiene and sanitation inspections as significant or major obstacles was 95% for restaurants and 61% for food processors. In several restaurants and food processing firms, the owners complained of massive samples of foods being taken “for testing” on a repeated basis, although none of the food products ever failed to pass inspection.

In focus group discussions, companies agreed that such inspections are necessary but are haphazardly and unfairly conducted. The most cited objection to such inspections is that they are more often used to extract unofficial payments from companies rather than to enforce regulations. Companies complained that regulations are often widely interpreted by inspectors in order to impose fines. Many companies cited that they regularly gave gifts, meals and drinks to inspectors in order to obtain a clean bill of inspection. As an example, one firm said fire inspectors receive daily meals at the company’s expense. The survey responses indicate that it is not inspections per-se that companies object to, it is the corruption that accompanies them. This finding becomes more evident in the last section of the survey on business confidence, where corruption was ranked as a much greater problem than inspections.

#### **IV. Role of Government (question 41)**

After almost a decade of transition to a market economy, survey respondents clearly had difficulties defining the role of government in a market economy. Sixty companies, or almost one-in-four, answered they don’t know what the role of government in a market economy should be.

Of the remaining respondents, many companies gave more than one answer. In characterizing the overall answers from respondents, it is clear that almost a quarter of the surveyed companies gave a definition that would characterize the role of government in either a command economy or in a closed or import substitution economy. Examples include “*direct the private sector, tell companies how to react to a market economy, or give directed credit.*” Only a little over half of the respondents replied with a definition which could be considered to reflect the role of governments in open market economies or moderately market-oriented economies.

Out of a total of 530 different statements given by the respondents that answered the question (excluding “don’t know” responses), 183 could be characterized as “*support the private sector by providing a good business environment or by creating favorable conditions*” or “*to serve industry*”, with some responses being given as “*if not to support private businesses, then at least to stay out of their way or not interfere with them*”.

152 responses reflected the respondents’ belief that the government’s role was primarily that of policymaker and administrator, for example, to make policies, collect taxes, and provide social services. Some respondents complained that Mongolia did not have a development strategy and with every new government another plan is developed, so there is a lack of continuity or linkage between governments. In the words of one respondent: “*It makes us think that we don’t know where we are going.*” Many companies complained about the lack of working linkages between the central government and implementing agencies. “*There should be a system through which the central government can get feedback on the implementation of the policies or laws in real life. Laws should not contradict each other.*” Some 10 companies said that there should be closer cooperation between the government and the private sector.

A large number of the companies used this question as an opportunity to complain about tax policies and administration, and about corruption and bureaucracy in the customs service or in public agencies.

The survey respondents tended to use the terms “control” and “regulate” interchangeably when referring to government’s relation to industry. This choice of wording indicates that the respondents made little or no distinction between control and regulation, and reflects the fact that ministries and government agencies often do not draw a clear line between directing business decisions versus ensuring fair competition, the health and safety of the consumer, and the protection of the environment. In most market economies, industry regulation confines itself to the latter.

About 50% of the responses reflect the outlook of firms that see government in a supporting role consistent with building a competitive economy. Up to 30% of the responses are confined to complaints about specific issues, reflecting the inability of respondents to distinguish a role for government while wanting the government to “*do something*”. Another 20% of responses reflect attitudes inconsistent with achieving competitiveness in an open market economy. These indicate a lingering focus on government as protector, director, and strategizer.

## **V. Taxes (questions 42 through 49)**

Among a number of tax issues presented, respondents ranked “high tax rates” and “large number of taxes” as being the most problem-creating for their businesses, with the instability of tax legislation ranking third, although tax inspections were more often cited as “major” obstacles than instability. The average company paid more than six types of taxes.

Focus group discussions revealed that most companies were unaware of the business or corporate tax rates in effect in other countries. While businesses around the world will complain of high tax rates given the opportunity, there may be some validity to the complaint when an effective rate of taxation is calculated for Mongolian businesses. The inability to deduct some business expenses and limitations on others, unrealistic schedules for depreciation (10 years for computers, as compared to 3 to 5 years generally accepted elsewhere), and excessive valuation of assets probably contribute to a higher *effective rate* of taxation in Mongolia than the nominal rates would imply.

The perception of taxes being unduly high also stems from the fact that companies feel they pay an inordinately large share of taxes compared to informal businesses, private citizens, and small merchants who pay a flat tax. It is often said that tax collectors focus on businesses they know will pay taxes and ignore businesses that are difficult to collect from. This creates an unfair situation where responsible firms in the business community make up the shortfall for businesses that avoid taxes. This is an example given by a cashmere company: *“A formal cashmere company pays business taxes on profits, plus procurement taxes on raw cashmere, which is a substitute for the herder tax. Government can’t collect taxes from herders so they require cashmere companies to pay a procurement tax, saying we can collect it from the herders. Of course, herders will sell at market rates and not accept any deduction for the procurement tax, so this tax payment comes out of our pockets. Changers (traders) who buy and sell large amounts of cashmere every day in the markets from their containers don’t have to pay full taxes, they may pay just a small tax even though they make lots of money. Then, when we export cashmere customs applies its own valuation regardless of what is on our bill of sale, and they always value the cashmere at some unrealistic high price. They have no idea what the cashmere is selling for on world markets, and they don’t care. Also, when we export raw cashmere we pay the export tax, while changers smuggle cashmere or bribe*

*the border people and they don't pay any taxes on these illegal exports. Its the year of industry but the types of companies the government wants to see growing are punished."*

Only 4% of respondents believed that taxes paid to the government were spent efficiently. Another 13% believed they were spent inefficiently, while fully 67% believed that tax spending was highly inefficient and 16% did not know if tax money was spent wisely or not. The perception that government's use of revenue from taxation did not provide proportionately useful benefits to the economy and that taxes were wastefully spent also contributes to the level of complaint about high taxes.

Businesses believed that while they paid in large amounts of taxes, they did not benefit from infrastructure improvements (roads and other) nor were there any publicly financed services to businesses that they found useful. Some businesses stated that their tax money was being used to fund public agencies that were more often obstructionist than helpful.

## **VI. Customs (questions 50 through 57)**

"Treatment by customs officers" was most often cited as the worst obstacle in dealing with customs, closely followed by paperwork and valuation.

A majority of respondents reported that their goods generally cleared customs in less than 7 days, which is relatively good for developing countries. Some respondents, generally larger firms and firms importing or exporting higher value goods, reported more significant delays. These firms appear to experience more problems with paperwork and and valuation, and are more likely to have difficulties with customs officers. Many firms insist that it is necessary to make unofficial payments to customs on a regular basis to avoid problems.

## **VII. Judiciary System (questions 58 through 63)**

Survey responses indicated that almost one half of companies believed that the country's court systems were seldom or never fair or consistent, or that decisions were rarely enforced. A slightly larger number of respondents believed that the court system was seldom or never quick or affordable. Fewer than one fourth of the respondents gave favorable ratings of "usually" or "always" when asked whether they believed the courts to be fair, quick, affordable, or consistent, although 23% believed that decisions were usually or always enforced.

## **VIII. Bureaucracy (questions 63 through 66)**

In order of problems encountered, respondents ranked customs, tax authorities, sanitary and hygiene inspectors, courts, and district governments to be the most bureaucratic and trouble-making agencies. Some 22% of respondents indicated that private firms in their line of business "usually" or "always" had to pay irregular additional payments to get things done. Another 24% responded that private firms in their line of business sometimes had to make irregular payments. 55% of respondents believed that firms in their types of business seldom or never had to make irregular payments.

Respondents were asked “If you had paid all of the unofficial payments requested of you by government officials in the last year, what amount would it have cost you?” 247 of the 375 surveyed respondents gave no response. Of the 128 that did respond, 58 firms “would have paid” between 100,000 and 1,000,000 tugriks, 53 firms between 2,000,000 and 10,000,000 tugriks, and 17 firms responded with an amount of over 10,000,000 tugriks. Several companies were able to respond with exact amounts, as they had kept fairly detailed accounting of unofficial payments.

Only 8% of respondents believed the easiest or quickest way to get licenses or permissions was through official channels. 66% believed that going through friends or relatives was the most expedient route, with a much smaller number relying on unofficial payments or favors. These responses indicate that most companies use unofficial or informal means of obtaining licenses and permits.

### **IX. Financial Services (questions 67 through 76)**

The majority of the surveyed businesses are financed largely through retained earnings or internal sources of funds. The second largest source of financing among respondents (for about 25% of companies) was bank lending, followed closely by loans from family and friends and from private moneylenders. The survey responses indicate that almost 30% of surveyed firms obtained some share of financing through banks. Other sources of funding were negligible. Since almost all of the companies surveyed were formal businesses, the proportion of financing derived from banks and other formal lending sources is sure to be higher than in the economy at large. Surprisingly, leasing seems to be a source of financing for almost 20% of the businesses surveyed, even though formal leasing is not a widely available financial service. Further investigation may reveal that companies considered *renting*, or revenues from renting assets, as equivalent to *leasing* when responding to this question.

In ranking financing issues, respondents indicated that high interest rates and lack of access to long term financing caused the greatest problems, followed by bureaucracy, lack of access to foreign banks, and collateral requirements. Over 40% of firms perceived competition against other businesses receiving subsidized loans to be an obstacle. Corruption and cronyism were not ranked that negatively, but almost one quarter of respondents ranked these as significant or major obstacles. Interestingly, between 20% and 41% of firms answered “don’t know” to each of the questions, indicating that they did not know how these financing issues affected their business. This is not too surprising given that most businesses are financed through internal funds or through informal loans, but indicates a general lack of awareness about financing options and their requirements although only 25% of companies ranked “lack of information” as significant or major obstacles.

### **X. Competition (questions 100 through 106)**

When asked to identify their competitors, most firms indicated that their competition was from other domestic companies. Next in line as competitors were micro-enterprises and the informal sector, then smuggled imported goods. Only 20% of firms saw foreign firms producing in domestic markets as competitors, and only 16% of firms perceived legal imports as competition. 13% stated that their firms had no competitors. State owned enterprises presented the least competition to the surveyed firms, only 11% of whom cited them as competitors.

The worst practices of competitors as defined by survey respondents were “unfairly selling at lower prices” and tax avoidance. A surprisingly high number of companies indicated copyright and trademark infringement as an unfair competition practice. The complaints were primarily directed at small companies using the trademark names or brands of more well-known companies. Firms in the largest, traditional industries identified as “major or significant” obstacles the fact that other companies received subsidies or favored access to services. These firms tend to be in competition with at least one state owned enterprise or shareholding company receiving soft loans or directed credit.

## **XI. Business Confidence (questions 107 through 130)**

In rating the efficiency of government in delivering services, 45% of respondents gave a rating of “somewhat efficient”, 35% as “inefficient or very inefficient”, and 20% as “efficient or very efficient”. While there was an almost equal split between the number of firms who believed that the business environment had either improved or deteriorated over the last two years (24% to 28%), the largest share of respondents (48%) believed that the business environment has remained the same over the last two years.

Only 7% of respondents were confident that government activities would improve the business environment in the next two years. 39% were somewhat confident, while 38% believed that government actions would not improve the business environment and 7% did not know.

In a summary question asking respondents to rank the relative importance of the major business environment issues, the leading issues (ranked as major obstacles) were taxes and corruption/cronysim. When we look at combined scores for “major” and “significant” obstacles, the top issues seen as significant or major obstacles to business operations and growth are ranked as follows:

1) Taxes (68%), 2) Corruption/cronyism (44%), 3) Infrastructure (40%), Licensing (39%)

Although respondents complained about inspections when answering the questions under the licensing and inspection section, it would seem that most businesses consider them less significant as an obstacle because it is possible to resolve inspection issues with favors or unofficial payments.

As another measure of business confidence, we asked respondents to estimate their firm’s growth in sales, investment, exports, employment, and debt in the past year and in the next year. A comparison of the two annual estimate provides another perspective on business confidence based on how well respondents believe their firms will perform next year relative to last year.

The responses indicate that most businesses are confident that sales next year will increase, with less than 20% of companies expecting a decline. At the same time, 53% of companies expect an increase in investment. 42% of the respondents reported significant decline in the firm’s investment last year while only 29% expect a significant decline next year. The outlook is similar for exports and employment. Most companies also expect to reduce their debt burden.

Overall, business confidence seems to be positive despite the relative dissatisfaction respondents expressed regarding government support in creating favorable business conditions. This seems to indicate that the private sector believes government does not have much positive impact on the business environment, but that companies can find ways to achieve continued growth with or without government support. In other words, the private sector gives little credit to government

policies or administration for achieving business growth in the private sector, which is perhaps contributing to the perception that the tax burden is unduly high.

## **Methodology**

A pre-selected sample of companies was chosen, representing business communities in Ulaanbaatar, Darkhan, Erdenet and Sainshand. 15-20 companies were interviewed in each of the locations outside of Ulaanbaatar. Companies were also selected in order to achieve good distribution according to size of operation, area of activity and type of company, better reflecting the composition of the Mongolian private sector than random sampling of companies.

3 groups of interviewers, each comprised of 6 enumerators and 1 supervisor, carried out the interview. The supervisors provided supervision of the enumerators and gave an advance phone call to the companies to arrange a time for interview. Supervisors contacted a decision maker or someone having good knowledge about the company's operations, and requested that the interviewee choose a suitable time for the interview. Training was carried out for enumerators before the interviews, giving enumerators detailed instructions on how the interviews should be carried out, explaining the purpose of each question and how it should be asked, and rules for how answers should be recorded. A copy of the survey instrument was also given to each interviewee, so that they could follow along during the interview, and see the scales used for different multiple choice questions where they were required to rank answers. In order for the survey results to be useful, it was necessary for respondents to give careful thought to ratings so the results would yield clear priorities. In other words, the survey was designed so that respondents could not assign a rating of "major obstacle" to all the questions. In each category of question where a number of issues were ranked, the respondents were instructed that no more than 3 items could be classified as a "major obstacle".