



# **LOCAL GOVERNMENT CONSTRAINTS TO RURAL BUSINESS DEVELOPMENT**

**Prepared By:**

Mercy Corps Mongolia  
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## Executive Summary

Mercy Corps Mongolia conducted a survey in six aimags - Umnugobi, Dundgobi, Gobi-Sumber, Uvurhangai, Bayanhongor and Gobi-Altai - in an effort to identify:

- The constraints facing rural businesses in becoming established, in operating on a daily basis and growing over the longer-term, and in complying with government regulations, and
- The capacity building needs of public officials, to enable them to provide better services and support to the rural business community.

Over the past several years, a significant effort has gone into supporting the growth of rural businesses through the provision of training and consulting services and assistance with linking the businesses to financial services and markets.

Some efforts have also been undertaken to create a better enabling environment for rural businesses, particularly with respect to the interaction between local governments and the local business community. These efforts have met with some success, but they have been largely driven by strong interest and motivation on the part of specific local governments and/or businesses, rather than a wider endorsement of a more standardized and comprehensive "enabling environment" strategy and plan.

It is generally recognized within Mongolia that an effective and productive partnership between the private sector and local government is crucial for realizing sustainable rural development. It is the businesses that create jobs, produce goods, pay taxes and boost economic growth, and it is the government's responsibility to create and maintain an enabling environment by formulating and properly implementing appropriate business support policies and regulations. The ability, however, of the local governments to properly undertake this responsibility is largely determined by a commitment at the highest level of both central and local government and by the capability and willingness of the staff to assume this responsibility.

A total of 337 randomly-selected businesses from thirty-five soums within the six aimags were interviewed during a three-week period in June 2006. The survey document, included in this report as Appendix 1, was developed using questions that had been voiced by participants of recent round-table meetings of businesses and government officials held in the six aimags. During these meetings, it was identified that the Tax Department, Professional Inspection Agency, Aimag and Soum Government Offices, and the Land Office are the government bodies that have the most interaction with rural businesses. The survey identifies what the respondents encountered as constraints when interacting with each of these government departments. The survey questions were mainly close-ended but respondents were encouraged to add comments and/or clarifications of their responses.

The survey results demonstrate a need for all the major stakeholders - government, businesses and NGOs - to work together to create a better environment for rural business development. Specifically, more emphasis needs to be placed on:

- Fostering a climate of greater trust and understanding between local governments and local businesses;
- Shifting government interaction with local businesses from a near-exclusive focus on "policing" and "punishment", to an appropriate balance of "oversight" and "customer service";
- Increasing the knowledge and understanding of local government officials concerning business laws and regulations, and the accessibility of that knowledge/understanding by the business community;
- Creating greater transparency concerning fines/penalties, product testing, and the availability and award of business support funds;
- Reducing bureaucratic impediments, and offering incentives, for starting new businesses; and
- Establishing *government-independent* institutions that can effectively advocate on issues related to business development.

More than anything else, the business community is asking for fast and efficient government service from officials who understand that their primary role is to assist and deliver quality services to the business community and the general public.

**Survey Respondents**

A total of 337 entrepreneurs and businesses operating in six aimags were surveyed. The respondents included Patent Holders, Limited Liability Companies, Cooperatives, Partnerships, and Shareholding Companies.

Table 1: Entities Surveyed

<i>Type of Entity</i>	<i>Number</i>	<i>Percentage</i>
Patent Holders	111	32.9%
Limited Liability Companies	99	29.4%
Cooperatives	67	19.9%
Partnerships	38	11.3%
Shareholding Companies	21	6.2%
<b>Other</b>	1	0.3%

Almost half of the businesses surveyed were involved in trading. There was an equal division between businesses operating for less than five years and those operating for more than five years.

Table 2: Entity Sector and Numbers of Years in Business

<b>Sector</b>	<b>Number</b>	<b>Percentage</b>	<b>Years in Business</b>	<b>Number</b>	<b>Percentage</b>
Trade	154	45.7%	More than 8	107	31.7%
Service	97	28.8%	5-8	67	19.9%
Manufacturing	86	25.5%	3-5	92	27.3%
			1-3	71	21.1%

**Survey Results - Business Community Perceptions of Government Support**

As mentioned, during previous local government/business community meetings, it had been identified that the Tax Department, Professional Inspection Agency, Aimag and Soum Government Offices, and the Land Office are the government bodies that have the most interaction with rural businesses. When asked to list government agencies from "generates most constraints" to "generates least constraints" in terms of business support, the ranking was: Tax Department (most constraints), followed by Professional Inspection Agency, Land Office, and Aimag/Soum Governor's Office (least constraints).

The detailed survey results related to each of these government bodies are as follows:

**Tax Office**

The survey for the Tax Office listed constraints relating to (a) the tax system itself, as well as (b) the perceived deficiencies of the Tax Office and its staff.

Regarding the tax system, it is not surprising that most of the respondents felt that the current tax rate was too high. It is, however, somewhat surprising that the percentage of respondents noting this as an issue was not higher than 58%. The two other tax system constraints concerned lack of tax support for start-up businesses and for those engaged in local production; both were significant in the opinion of the respondents (53% and 44% respectively).

Regarding the Tax Office itself, the primary concerns were the inflexibility and lack of transparency concerning fines and penalties, the poor business and regulations knowledge of inspectors, and the unwillingness and/or inability of the inspectors to properly explain the regulations and how best to comply with them.

Table 3: Summary of Survey Findings Related to the Tax Office

<b>Constraints/Issues - Tax System</b>	<b>Number</b>	<b>Percentage</b>
Tax rate is too high	197	58.5%
No tax holiday/breaks for new businesses and start-ups	179	53.1%
No government support for businesses engaged in local production of goods and services	148	43.9%

<b>Constraints/Issues - Tax Office</b>	<b>Number</b>	<b>Percentage</b>
Tax inspectors impose fine/penalties, rather than providing other options such as working out tax payment schedules and/or mutual negotiation	116	34.4%
Tax department officials make very little effort to inform the general public on tax policies and regulations, and how to comply with the relevant laws	108	32.0%
Poor business knowledge of tax inspectors	86	25.5%
Difficult for business entrepreneurs to understand tax laws and regulations	82	24.3%
Poor communication skills of the tax inspectors; occasional unprofessional and rude behavior	73	21.7%
Inspectors request contributions and donations towards various celebrations (Tsaagan sar, Naadam, etc)	66	19.6%
Excessive bureaucratic process to register a new business	52	15.4%

The focus on fines and penalties rather than information dissemination and proactive compliance support is perceived as a serious deficiency in Tax Office operations. This issue is compounded by the perception that tax officials do not understand the regulations that they are being asked to enforce. This creates a climate of distrust on both sides and leads to accusations that "tax officials are corrupt and arbitrary" (business perception) and that "business owners are all tax-cheats" (government perception).

*Comments from Business Owners:*

*Tax officers do not explain the tax related laws and regulations. They don't provide sufficient information on taxation and how to comply with the laws. They sometimes explain the VAT regulations incorrectly.  
(Dundgobi business owner)*

*It is very difficult to deal with the tax office. Its staff members are bureaucratic and are not available during normal working hours.  
(Bayanhongor entrepreneur)*

**Professional Inspection Agency (PIA)**

It is alarming that more than half of the businesses interviewed stated that there is a lack of professional advice available to them from the PIA. One of the primary roles of the PIA is to provide advice and assistance to businesses on all regulations and standards related to conducting business in Mongolia, and to assist businesses in complying with the regulations. Many respondents noted the poor communication skills of the inspectors and that they are often threatened with having their businesses being closed down or having their licenses revoked. As with the Tax Office, the focus appears to be on punishment as opposed to support.

A small business owner in Dundgobi told the surveyors that, “The professional inspection agency inspectors are very authoritarian in the way they talk to us, taking advantage of their positions. If I run into an inspector on the street while I am driving around town, I would need to give him a ride home. Otherwise, this may affect my future relationship and eventually my business.”

Table 4: Summary of Survey Findings Related to the PIA

Constraints/Issues	Number	Percentage
Absence of professional advice for businesses	185	54.9%
PIA does not promote and advise citizens and businesses on the services available from the PIA or standards with which each business must comply	148	43.9%
Threats to close and fine businesses and revoke licenses	134	39.8%
No support for local production and start-up businesses	117	34.7%
Overly bureaucratic and hard to obtain license/permits	112	33.2%
Poor communication skills of PIA officers	101	30.0%
Officers seize products as samples for testing and the procedure or reason is not transparent	87	25.8%
The actions of the inspectors sometimes creates tensions and stress for the business owners	79	23.4%

Also as with the Tax Office, there is a strong perception from the business community that the PIA does not do enough to inform businesses on the services available from the PIA or to provide detailed information on the standards with which each business must comply.

Other significant constraints include excessive bureaucracy and lack of transparency over the product testing process. A GTZ project coordinator recently commented that, "The PIA is a big agency; it is almost like a Ministry. Its main responsibility is to distribute permits. If you want to open a new restaurant you will need nine different permits from the PIA. This excessive bureaucracy is preventing people from starting and developing businesses".

The product testing process is also very unclear. Business owners state that PIA inspectors confiscate products and demand samples for laboratory testing. Once the products are taken, it is rare that the owners hear back on the results or what the agency did with the confiscated goods. These actions create an environment of suspicion in the business community, questioning the true motive of the PIA in confiscating and taking samples for testing. Coupled with this issue is the fact that very little information is available or known on the actual regulations related to taking samples for testing and/or confiscating goods.

*Comments from Business Owners:*

*Professional inspectors come and take away some of your products saying that a lab test is needed. But they never get back to us informing us of the result or if they did the test at all. Or much later they would say that your goods have been destroyed. (Bayanhongor trader)*

*The pressure from inspectors is fierce. They don't treat us fairly and openly. They threaten us under the name of rules and regulations which we have not heard of. (Gobi-Altai business woman.)*

*They come just to inspect and fine you. I heard they had a plan to collect fine money. (Dundgobi business owner)*

## Governor's Office

This office is responsible for a number of departments and agencies, all of which oversee policy and regulations for a variety of sectors and functions, including agriculture, health, education, labor, police, land, inspection, and disaster relief, (see the organizational chart included in this report as Appendix 2). When asked about services provided by, and difficulties encountered in interacting with, these agencies, the majority of the respondents said, "There is little support from these departments and agencies for local businesses." Many respondents believe that rural businesses, especially those producing local goods and services, should be treated differently in terms of government support (technical advice, tax incentives, ease of registration, assistance in complying with PIA standards, etc), in line with the central government's campaign to support rural economic development and job creation.

Table 5: Summary of Survey Findings Related to the Governor's Office

Constraints/Issues	Number	Percentage
No government support for local businesses and production of local goods and services	178	52.8%
Non-transparent selection and distribution of business support loans and grants	177	52.5%
GOM resolutions to support local industry are not implemented at aimag level	166	49.3%
Complicated and difficult bureaucratic process to obtain business permits and licenses	121	35.9%
The Governor's Office requests contributions and donations from local businesses for aimag celebrations e.g. Tsaagan sar, Naadam festivals, and aimag anniversary celebrations	107	31.8%

The respondents also commented that it is not very clear to the general public what the roles and responsibilities are of the individual departments and which department needs to be approached for which request. The departments also do not have clear working hours, making it difficult for the general public and business community in seeking assistance or trying to conduct business. One respondent commented, "...locked inside their rooms, they don't care about those who are waiting outside their office doors." Some said that local government employees spend a lot of their time traveling or attending seminars and workshops rather than dealing with the public. One person noted that, "...it is rare to find any of these officials at the office on Fridays."

From the survey responses it also became apparent that government officials, both at aimag and soum level, request that rural businesses make financial contributions for Naadam celebrations and other events such as Tsaagan sar and anniversary celebrations. Contributions can be in non-cash forms such as sheep, cashmere and dairy products. Some businesses paid up to MNT 300,000 towards the celebration of just one event. Almost one-third of the businesses surveyed stated that, "if we don't contribute when asked, we receive fines or unfair treatment." Also, there would be other types of public embarrassment, such as government officials publicly stating that a certain business owner "was the only one who did not follow the others." This activity is seen as an "informal tax" on all businesses.

*Comments from Business Owners:*

*It is common that local governments take unofficial taxes for celebrations such as Naadam, aimag anniversaries etc. I had to pay MNT 300,000 for the aimag's 60th Anniversary, MNT 250,000 for the soum's 80th anniversary and MNT 30,000-50,000 for other celebrations this year (Dundgovi businessman)*

*There is no policy to support new businesses at soum and aimag levels. Government officials do not care whether a business succeeds or fails. (Bayanhongor business)*

**Land and Cadastre Office**

Surprisingly, less than half of the people made complaints or revealed problems concerning the services of the Land and Cadastre Office in the aimags. This is probably due to the fact that, unlike in Ulaanbaatar, land ownership and distribution have not yet become a major issue in the aimags and soums. However, one-third of the respondents stated that the land titling and registration process is very slow, requiring a lot of paper work, and that they believe that land ownership and use permits are not being distributed in a just and transparent manner. A Govi-Sumber resident said, "I have visited three different government officials to make an application for obtaining a land use permit. It has taken me one year now and I am still waiting for the permit. The officials never give me clear information or explain the status of my application".

**Survey Results - Business Community Expectations from Government**

The businesses that were surveyed were also asked what they most expected from government agencies and their employees in order for them (the businesses) to operate with the least number of constraints. More than half of the respondents said that they would like to receive fast and efficient services from officials who understand that their primary role is to "assist", rather than "police", businesses. This indicates that they are currently dissatisfied with the role and actions of the various government bodies.

The respondents also commented that they would like the government employees and inspectors to have a better understanding of businesses and business needs, as well as better communication skills and attitudes in dealing with business owners. The respondents also felt that local government officials need to be more proactive in promoting and explaining their activities, and be more engaged in providing advice on how to comply with regulations. The near-exclusive use of fines and penalties is not seen as constructive in establishing an environment that is conducive to the development and growth of rural businesses.

Table 6: Summary of Survey Findings Related to Business Community Expectations

<p><b>What would you expect from government and the regulatory agencies in order for you to run your business successfully and smoothly?</b></p> <ol style="list-style-type: none"> <li>1. Fast, efficient service and an understanding of their role in serving the business community</li> <li>2. Professional Inspection Agency that assists businesses to prevent problems and comply with standards, not just to 'police' businesses and impose fines</li> <li>3. Open and transparent policy for the advertisement, selection, and award of business support loans and grants to rural businesses</li> <li>4. Provision of tax and other incentives for new and start-up businesses</li> <li>5. Good communications skill and professional behavior of local government employees</li> <li>6. Government agencies that promote and inform the general public and business community about their services and relevant regulations and policies</li> <li>7. Government employees that have a better understanding of businesses and business needs</li> <li>8. Government employees that have a clear knowledge and understanding of the laws and regulations and how to apply them</li> <li>9. No forced donations/contributions for any types of celebrations</li> </ol>
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**Survey Results - Conclusions and Recommendations**

The following conclusions and recommendations for creating a more business-friendly environment in the rural aimags have been drawn from the results of the survey:

1. Local governments need to proactively disseminate information to the public on the services and activities of the various government departments. The Tax Office needs to improve the quality of its interaction with the business community and provide a much more "consumer-friendly" advisory service on tax laws and regulations. The Professional Inspection Agency should improve its efforts to provide information on standards and requirements for all businesses and widely disseminate that information so that it is available to all who are interested.
2. Local government agencies need to shift their emphasis from a near-exclusive focus on regulating business operations to formulating policies, providing advice, and creating supportive conditions for rural businesses to establish and grow.
3. Tax and Professional Inspection Agency inspectors need to change their attitude and approach toward businesses. Communication should reflect a supportive and "problem resolution" objective as opposed to one focused on punishment. The inspectors need to better understand their role as providers of advice and assistance to rural business owners.
4. The procedure used by the Professional Inspection Agency for taking samples for laboratory testing and confiscation of products needs to be made more transparent. The Agency should consider initiating a public awareness campaign to inform rural businesses of the existing standards, the ways in which businesses can best comply with these standards, and the procedures that are implemented when businesses do not comply with the standards. An open and transparent mechanism for businesses to obtain information, and submit complaints and appeals, should be established.
5. Government agencies should cease soliciting "voluntary" donations from businesses for government-sponsored Naadams, horse races, anniversary celebrations and other events.
6. Government employees within certain departments need to improve their general business knowledge and understanding of business needs. This will help them better understand and support rural businesses.
7. There is a lack of support and/or incentives for the local production of goods and services. The government should consider developing and promoting a strategy that supports local production of goods and services and creates and/or sustains rural employment.
8. The Governors' Offices should provide transparent and easily accessible information on local business support and loan/grant-making programs and how local businesses can participate in these programs.
9. Aimag and soum governments need to proactively support and fully implement the Parliament's 2002 resolution on tax exemption and relief for rural start-up businesses.

**Suggested activities that might be undertaken in order to implement these recommendations are contained in Appendix 3 of this report.**

This concludes the report on "Local Government Constraints to Rural Business Development". Appendices to this report are as follows:

Appendix 1 - Survey Questionnaire

Appendix 2 - Local Government Organizational Chart

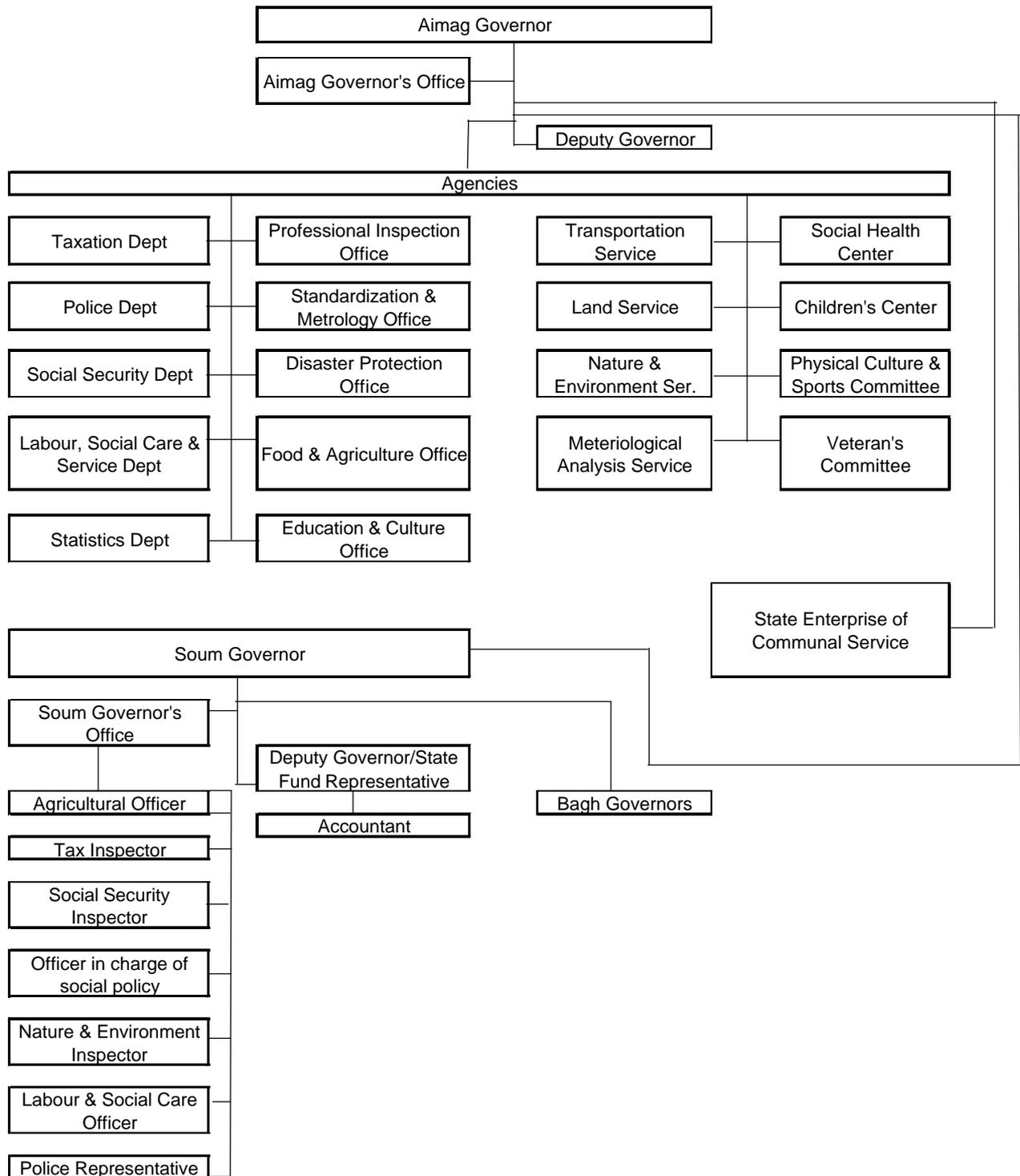
Appendix 3 - Suggested Activities for Creating a More Business-Friendly Environment

## Appendix 1 - Survey Questionnaire

General Questions	
How many years have you been running your business? 1-3 years; 3-5 years; 5-8 years; more than 8 years Type of business you are running? Trade Service Production Other What is your business legal status? Patent Coop Partnership LLC LC What date did your business formally register? ..... year .....month .....day	
<p><b>1. Indicate constraints faced in interacting with these government agencies</b> (Mark by v where appropriate)</p> <p>? ) Tax Department</p> <ul style="list-style-type: none"> <li><input type="radio"/> Requests donations for naadams and celebrations</li> <li><input type="radio"/> High tax rate</li> <li><input type="radio"/> Difficult to understand tax law and regulations</li> <li><input type="radio"/> Weak business related knowledge of tax officers</li> <li><input type="radio"/> Poor communication skills of tax officials</li> <li><input type="radio"/> Inspectors prefer to fine and penalize</li> <li><input type="radio"/> No support for local production</li> <li><input type="radio"/> No tax relief for start-up businesses</li> <li><input type="radio"/> Red tape/ bureaucracy slows down new business registration procedure</li> <li><input type="radio"/> No promotion of Department's activities/services</li> </ul> <p>B) Professional Inspection Agency</p> <ul style="list-style-type: none"> <li><input type="radio"/> PIA inspectors lack communication skills</li> <li><input type="radio"/> Does not provide professional advice to business</li> <li><input type="radio"/> Closes and fines businesses, revokes licenses/permissions</li> <li><input type="radio"/> Imposes psychological pressures on business</li> <li><input type="radio"/> Confiscates goods in a non-transparent way</li> <li><input type="radio"/> Red tape/bureaucracy in obtaining licenses/permissions</li> <li><input type="radio"/> Does not support local and new businesses</li> <li><input type="radio"/> No promotion of Agency's activities/services</li> </ul> <p>C) Aimag/Soum Governor's Office</p> <ul style="list-style-type: none"> <li><input type="radio"/> No local production support policy formulated</li> <li><input type="radio"/> GOM resolutions on support of domestic industry not implemented</li> <li><input type="radio"/> Non-transparent distribution of business support loans, grants and budget</li> <li><input type="radio"/> Demands informal donations for naadams and other celebrations</li> <li><input type="radio"/> Imposes constraints in getting licenses/permissions</li> </ul> <p>D) Land Office</p> <ul style="list-style-type: none"> <li><input type="radio"/> Slow registration process</li> <li><input type="radio"/> Excessive paper work</li> <li><input type="radio"/> Non-transparent distribution of land use permissions</li> <li><input type="radio"/> Bribery</li> </ul>	<p><b>Include detailed comments:</b></p>
<p><b>2. Rank these government organizations in terms of generating constraints to business support ("1" indicates most, "5" indicates least)</b></p> <ul style="list-style-type: none"> <li><input type="radio"/> Professional Inspection Agency</li> <li><input type="radio"/> Tax Department</li> <li><input type="radio"/> Land Office</li> <li><input type="radio"/> Aimag Governor's Office</li> <li><input type="radio"/> Soum Governor's Office</li> </ul>	<p><b>Include detailed comments:</b></p>

<p><b>3. What in your opinion is the most common constraint to business support?</b></p> <ul style="list-style-type: none"> <li>○ Government agencies demand too many documents</li> <li>○ Excessive requirements imposed on starting a business</li> <li>○ Red tape / bureaucratic process</li> <li>○ Excessive control and inspection</li> <li>○ Intimidation</li> <li>○ Demands by local governments for donations</li> <li>○ Attempts by government to impose high taxes</li> <li>○ Forced to give a bribe</li> <li>○ Poor communication skills and rude behavior of government employees</li> <li>○ Other constraint – please explain</li> </ul>	<p><b>Include detailed comments:</b></p>
<p><b>4. What do you expect from government organizations?</b></p> <ul style="list-style-type: none"> <li>○ Fast, efficient service delivery - and to be aware of services provided by each agency/department</li> <li>○ Improved knowledge / understanding of laws and regulations by government employees</li> <li>○ Improved business related knowledge of government officials</li> <li>○ Duties and responsibilities that are consistent with government agency/ department mandate</li> <li>○ Good communication skills, polite and friendly service</li> <li>○ Provision of tax relief/incentives to local start-up businesses</li> <li>○ Cease requesting / demanding informal donations for celebrations etc.</li> <li>○ Transparent distribution of business support loans and grants from government and donor programs</li> <li>○ PIA should provide advice and information on relevant standards and how to comply rather than only imposing penalties and fines</li> <li>○ Improved information available on services provided by local government</li> <li>○ Other expectation - please explain</li> </ul>	<p><b>Include detailed comments:</b></p>
<p><b>5. In which areas do government employees need to improve their work performance / knowledge?</b></p> <ul style="list-style-type: none"> <li>○ Improved knowledge of business operations</li> <li>○ Ability to deliver quality services</li> <li>○ Improved knowledge of current business related laws and regulations</li> <li>○ Good communication skills</li> <li>○ Fair and transparent decision-making skills</li> <li>○ Have no conflict of interest</li> <li>○ Ability to advocate for and promote the amendment of relevant laws and legislation</li> <li>○ Other area - please explain</li> </ul>	<p><b>Include detailed comments:</b></p>

## Appendix 2 - Local Government Organizational Chart



### Appendix 3 - Suggested Activities for Creating a More Business-Friendly Environment

Areas / Topics	Activities	Government Agency
Promotion of government services	<p>Assist selected agencies to publicize and promote activities and services, and relevant laws and legislation, through:</p> <ul style="list-style-type: none"> <li>▪ Facilitating required training activities, and</li> <li>▪ Assisting with design of promotional materials, posters, and information campaigns</li> </ul>	Tax Office, Professional Inspection Agency, Governor's Office, Land and Cadastre Office
Capacity building of government staff	<p>Develop, organize, and provide training on:</p> <ul style="list-style-type: none"> <li>▪ The role of the private sector and general business principles and operations,</li> <li>▪ Communication skills and information dissemination methods, and</li> <li>▪ Ways to support local economic development</li> </ul>	Tax Office, Professional Inspection Agency, Governor's Office, Land and Cadastre Office
Policy development	<ul style="list-style-type: none"> <li>▪ Provide advice and assistance in the formulation of policies to create an enabling business environment in the aimags.</li> <li>▪ Assist local governments to implement policies to support local businesses and new start-ups.</li> </ul>	Aimag Hural, Tax Office, Governor's Office
Compliance with PIA standards	<ul style="list-style-type: none"> <li>▪ Assist the PIA to develop and launch a public awareness campaign to inform rural businesses of existing standards and provide information on procedures implemented to ensure compliance with standards.</li> <li>▪ Support the establishment of an open and transparent mechanism for businesses to obtain information and submit complaints and appeals.</li> </ul>	Professional Inspection Agency
Inappropriate solicitations	<ul style="list-style-type: none"> <li>▪ Work with Governors and Local Hurals to end the practice of inappropriate solicitations from businesses to finance government-organized festivals and celebrations.</li> </ul>	Aimag/soum Governors Offices and Hurals
Building relations between private and public sectors	<ul style="list-style-type: none"> <li>▪ Facilitate regular forums and round-table meetings between government and rural business representatives to discuss issues relevant to local business development.</li> <li>▪ Assist with the development of government-independent business associations which advocate on behalf of the business community.</li> </ul>	Local government and its agencies and rural businesses