

**MONGOLIA**

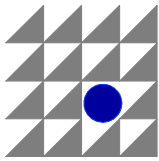
**THE ASIAN DEVELOPMENT BANK**

**TA 3948: CAPACITY BUILDING  
FOR INTEGRATED  
REGIONAL DEVELOPMENT**

**FINAL REPORT**

**8 April 2004**

**Prepared by**



P.D.P AUSTRALIA PTY LTD

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## ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
GOM	Government of Mongolia
IDA	International Development Association
IMF	International Monetary Fund
LRDMC	Law on Regionalized Development Management and Coordination
MFA	Ministry of Food and Agriculture
MOFE	Ministry of Finance and Economy
MTFF	Medium Term Fiscal Framework
MTRDS	Medium Term Regional Development Strategy
NGO	Non Government Organization
PARP	Public Administration Reform Project
PMC	Department of Prime Minister and Cabinet
PSMFA	Public Sector Management Finance Act
RDC	Regional Development Concept
TA	Technical Assistance
TOR	Terms of Reference

## PREFACE

This is the final report for TA 3948: *Capacity Building for Integrated Regional Development*. The Technical Assistance was supported by the Asian Development Bank for the 12 months April 2003 to April 2004.

The principal findings and recommendations of the work are summarized in this report. Importantly, those findings and recommendations are cast in the context of the terms of reference for the TA. The key written outputs arising from the TA are a series of seven Policy Advisory Papers that were prepared and widely distributed between December 2003 and April 2004. The findings and recommendations in this Final Report are predominantly taken from those Policy Advisory Papers. Consequently, thorough consideration of the findings and recommendations should not rest just on the summaries in this report. Rather, such consideration should also include a review of the Policy Advisory Paper that deals with the particular matter being considered. The relevant papers are cross-referenced in this Final Report.

Comments on the draft of this report were received from MOFE. Those comments are reproduced in Appendix 5, along with responses to the comments made.

All the documents produced under the TA are available on the Asian Development Banks' website: [www.adb.org/mnrm](http://www.adb.org/mnrm).

## KEY RECOMMENDATIONS

### INTRODUCTION

The recommendations included in this report are as listed below. It is important, however, that they are not read in isolation but that the reasoning that accompanies each recommendation is reviewed in the main text. The section and page number in which each recommendation is discussed, along with other documents where it is considered, are noted in brackets after each recommendation.

Most of the recommendations were developed in the Policy Advisory Papers prepared under TA 3948. The Policy Advisory Papers, along with the Occasional Papers prepared under the TA are listed in sections 2.4 and 2.5 of this report. The recommendations from those papers are summarized in Appendix 2.

### INTRODUCTORY NOTES

Two important background points are emphasized in relation to the work of the TA and to the key recommendations. These are as follows:

- The infrastructure of Mongolia is, quite obviously, poorly developed; but a strong premise of the TA work is that simply taking a supply-side approach and providing infrastructure will not ensure regional economic development. Rather, with limited resources, government must carefully target its infrastructure investments, with that targeting based on existing and/or forthcoming demand for infrastructure services (this point is discussed in section 1.1.2 of this report); and
- There is a strong commitment to the five-region model in Mongolian government agencies. Consequently, any reassessment of the approach to regionalization or related matters would involve consideration of those matters under the overall 'umbrella' of a five-region administrative model.

### KEY RECOMMENDATIONS

#### It is recommended that:

1. The purpose for regionalization is thoroughly revisited in the RDC with a focus on the definition of functional regions [3.2, p. 19; Policy Advisory Paper 4];
2. The purposes for regionalization relate particularly to coordination of regional policy and development activities, program and service delivery, and equitable access to services such as education, health and social welfare [3.2, p. 19; Policy Advisory Papers 4 and 5];
3. Regional policy development and planning activities take a bottom-up approach, involving a wide range of stakeholders. (Additionally, under the five-region model, the Regional Councils should take a leading, facilitative role). [3.2, p. 20; Policy Advisory Paper 1; the bottom-up methodology is outlined in Occasional Papers 1 and 2];

4. Active discussions are entered into with personnel of the PARP project, as soon as possible, to ascertain the likely implications of PARP's work for regional development [3.2, 3.4, pp. 20-21; Policy Advisory Papers 4 and 7];
5. In relation to regional development the Government focuses on its role as a facilitator and coordinator of economic development (3.3, p. 20; Policy Advisory Paper 6);
6. The National Committee, Regional Councils, and their respective professional support offices adopt a role of coordinating regional development activities, but implementation and management of those activities remain the role of the line ministries [3.4, p. 21; Policy Advisory Paper 6];
7. Active consideration is given to enhancing and formalizing deconcentration of the activities of key line ministries through the establishment of 'sectoral regions', thereby supporting the implementation of regional development policy [3.4, p. 21; Policy Advisory Papers 4 and 7];
8. A corporate plan is developed by those ministries that are to establish a regionalized, deconcentrated structure. Assistance with the preparation of such plans would need to be provided, perhaps by a donor agency [3.4, p. 21; Policy Advisory Paper 7];
9. All key regional policy proposals and strategies are reviewed in the light of important market economy principles (a considerable part of this work has been undertaken under TA 3948) [3.5, pp. 20-23; Policy Advisory Papers 2, 5 and 6];
10. The strategy of investing in capital infrastructure in an effort to underwrite economic development in identified pillar centers is abandoned or, at the least, that such investment in each proposed pillar center is subjected to thorough financial and economic analysis<sup>1</sup>. Conversely, investment by government in important social services such as health and education is highly appropriate and serves to support equity objectives [3.5, pp. 20-23; Policy Advisory Paper 5];
11. The identification of 'organic' growth centers is left to market forces and private sector identification of competitive advantage and, subsequently, strategic decisions in relation to infrastructure investments in those centers be considered [3.5, pp. 20-23; Policy Advisory Papers 2 and 5];
12. Government investments in capital infrastructure to underwrite economic development are based on demand, rather than on the supply-side emphasis that typifies the RDC and MTRDS. Conversely, social services such as health and education cannot be provided on a demand basis as market failure generally occurs in relation to the provision of such services; it is an important core function of government to provide such services [3.5, pp. 20-23; Policy Advisory Papers 5 and 6];

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<sup>1</sup> The distinction between financial and economic analysis is emphasized. Economic analysis goes further than simply considering the dollar costs and returns and includes consideration of social costs and benefits. Economic analysis uses measures such as opportunity costs as the true measure of economic costs [see Policy Advisory Paper 2].



13. The free economic zones proposed are subjected to detailed economic analysis<sup>2</sup>;
14. Proposed investments in transport infrastructure, particularly roads, are subjected to thorough financial and economic analysis [3.5, pp. 20-24; Policy Advisory Paper 6];
15. The Prime Minister's Economic Strategy and Planning Office, as indicated in Article 34 of the Law on Government, in the Law on Regionalized Development Management and Coordination, and in Government Resolution # 27 of 30 January, 2004, is established as soon as practicable. That office should be an appropriately staffed professional office, responsible for coordinating regional development activities and providing professional support to the National Committee [3.6. pp. 24-25; Policy Advisory Paper 7]. In the interim, until this office is established, it is recommended that responsibility for regional development matters be delegated to the Cabinet Secretariat [5.1.2, p. 30];
16. ADB considers providing professional TA support for the establishment and operation of this office [3.6. pp. 24-25; Policy Advisory Paper 7]; and
17. ADB provides support for the further development and implementation of regional policy in Mongolia, based on recommendations 15 and 16 above relating to the location for and focuses of such support [3.6, p.25].

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<sup>2</sup> The free economic zones were assessed under the USAID funded Economic Policy Reform and Competitiveness Project in February, 2004. A summary of the findings of that assessment is provided in Appendix 4.

# 1. INTRODUCTION

## 1.1 BACKGROUND

### 1.1.1 Need for Regional Development and the Technical Assistance

Several decades of work in Mongolia have resulted in widespread acceptance of the need to address issues surrounding regional development and planning, although there is continuing debate on the best way forward. Amongst the many considerations that arise are those concerned with the need for regional development; the context for regional development policy, planning and actions; the appropriate policy instruments to employ in implementing regional development programs; the appropriate role of government in regional development; and the central coordinating role of the national budget.

Based on concern about regional imbalances the Parliament of Mongolia adopted the Regional Development Concept (RDC) in June 2001 (Resolution No. 57).

Following a request from the Government of Mongolia (GOM), the Asian Development Bank (ADB) agreed to provide advisory Technical Assistance (TA) to support efforts to strengthen GOM's policy, planning and implementation strategies for the RDC. It was agreed that the TA (# 3948) would be based in the Ministry of Finance and Economy (MOFE), on the basis that, as stated in the Terms of Reference: "... the TA requires coordination with other line ministries and responsibilities to integrate all sector-specific plans into a unified social and economic development plan." This arrangement was, however, based on the requirement – discussed in section 1.2 below – that an integrated medium term [regional] development strategy would be prepared under the TA.

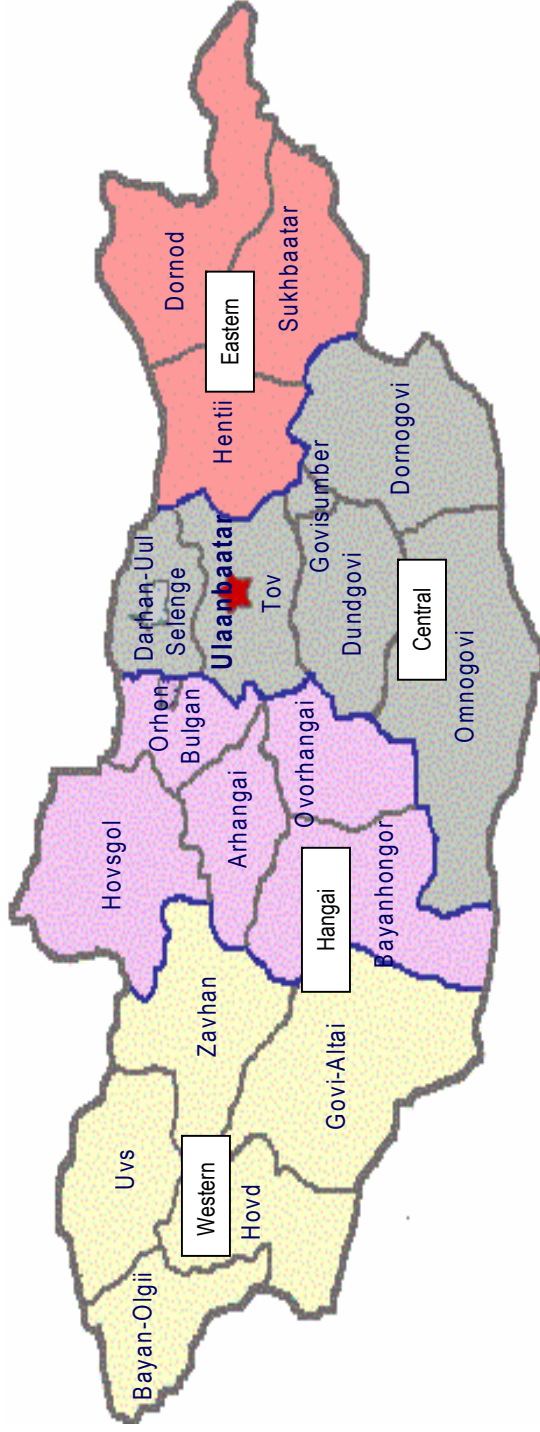
The original intent was that the TA would begin in January 2003, and take place during the 2003 calendar year. Unforeseen delays resulted in a commencement date of 14 April 2003, with a completion date of 8 April 2004.

### 1.1.2 Key Background Matters

The RDC redefines regional boundaries by re-grouping the 21 aimags (provinces) and Ulaanbaatar into five 'economic regions' (Map 1). The RDC provides a set of principles. A policy, strategies, and implementable plans are still under development, although decisions on establishing free economic zones – a key strategy in the RDC – have been taken (three such zones have been declared). A Medium-Term Regional Development Strategy – discussed in 1.3.3 below – was adopted in 2003 by the Government as a first step in the process of developing implementable plans.

As noted in the original TA paper from ADB, **"despite the RDC's supposed aim of developing a market economy, however, it is based on central planning, as evidenced by the emphasis it gives to a physical infrastructure blueprint and its lack of critical analysis or assessment of social and economic implications (emphasis added).** This is largely due to inadequate knowledge of market economy principles and the shortage of experienced staff in the Government for policy development and strategic planning – a significant constraint on Mongolia's ability to move its market economy forward." Work undertaken within TA 3948 serves to indicate that these comments remain valid.

### MAP 1: THE REGIONS DEFINED IN THE RDC



In the final meeting of the TA Steering Committee (29 March 2004) it was asserted that the TA and its work – and, therefore, presumably the previous reviews undertaken by ADB and by IDA/IMF – was undertaken on the basis of an assumption that Mongolia has well-developed infrastructure that can support economic development. Conversely, it was stated, the RDC and MTRDS were based on physical planning and an infrastructure blueprint because the nation's infrastructure is poorly developed and needs to be improved. The underlying assumption here is that if infrastructure is put in place then economic development will automatically follow.

This explanation of the tension between the work of the TA and the physical planning approach of the RDC and MTRDS is a misrepresentation of the TA and cannot go unchallenged. It is very clear that Mongolia is typified by poorly developed infrastructure, and that it is struggling to maintain what it does have. It has never, at any stage in the TA, been suggested that Mongolia's infrastructure is well-developed. The point made repeatedly in the TA, and previously outlined in the ADB's TA paper, however, is that a supply-side approach to infrastructure development ignores economic realities. In a situation of tight budgets, a small and sparsely settled population, and limited economic development opportunities it is critical that government investments in capital infrastructure are based on demand, thereby increasing the likelihood of positive economic and social returns from those investments.

One important distinction is made here between investments that will, supposedly, underwrite economic development, and those that support social services, such as investments in schools, hospitals and other social welfare institutions. Such investments support the government's equity objectives and comprise an important core function of government.

Also as noted in the TA paper, "before preparing the RDC in 1999 the Government had drawn up long term action programs with the help of multilateral and bilateral agencies. But the RDC made these obsolete. **What is needed is a more structured, organized, and rational approach to regional development that coordinates the various policy initiatives, plans, and sectoral studies, and adequately prioritizes development needs and areas of foreign assistance on the basis of a realistic assessment of their financial viability**" (emphasis added). Again, the work undertaken under TA 3948 serves to indicate that this is still the case, that these needs, while raised in the TA, have still not been addressed. The establishment of the National Committee (see 1.1.3 below) and the likely establishment of a professional working office to support the implementation of regional development policy will, however, at least address the matter of coordination of policies, plans and studies.

A third key point made in the TA paper was that "**the RDC currently stands as a statement of the Government's intent to achieve balanced regional development, but it needs to be based on a critical assessment of economic and financial realities toward market-orientated development**" (emphasis added). The TA will help make the shift from a central planning paradigm to an approach that reflected economic realities and the market demand for development investment, and give the Government a better understanding of its role as an enabler, not a controller, of the economy." This has been the central focus of the review work, training, and preparation of policy and other papers in the TA – i.e. improved understanding of regional development in a market economy setting and of the core roles of government. Additionally, considerable effort has gone into providing evidence of the successes and failures of regional development policy and strategies from other parts of the world.

A fourth key point in the TA paper was that "**The Government has confirmed that it will consider amending or adjusting the RDC if the TA shows it to be financially or**

**economically unviable**” (emphasis added). Despite advice and recommendations concerning the non-viability of both the RDC and the Medium-Term Strategy in the review of those documents<sup>3</sup>, however, neither document has been revised in any way. The fact that 2004 is a national election year in Mongolia may have been an important constraint on changing such documents.

In association with adoption of the RDC in 2001 four consequent tasks, to be implemented by Cabinet, were announced: (i) establishment of the legal framework in which to set the RDC; (ii) identification of the strategy for regional development in each of the zones identified in the RDC; (iii) formulation of the methodology or model of administration and management for each zone; and (iv) selection of the center for each zone.

At the beginning of 2004, item (i) had been undertaken (1.1.3 below), the preparation of Regional Development Programs for each of the zones had just commenced (item (ii)), the model of administration or management for each zone had not been finalized, although guidance is provided by the Law on Regionalized Management and Coordination (item (iii)); and two ‘pillar centers’ and the regional center had been selected for each region (item (iv)).

### **1.1.3 The Law on Regionalized Development Management and Coordination (LRDMC)**

The Law was passed on 30 May 2003 and sets out the administrative arrangements of the framework for implementing regional development. The Law puts in place a National Committee, Regional Councils, a professional office or secretariat to support the National Committee, and working offices to support the Regional Councils. The National Committee is chaired by the Prime Minister and was established in January 2004. Concomitantly, the chairmen of four Regional Councils were announced, although Council memberships were still to be decided. Furthermore, the establishment of a professional secretariat to support the National Committee was agreed to in January 2004 and the responsibilities of the secretariat outlined in Government Resolution # 27 of 30 January 2004. Responsibility for supporting any activities was given to the Cabinet Secretariat at this time. The working offices for the Regional Councils are to be established in the offices of the Governors who chair the Councils although, like the national office, these have not yet been formed.

Importantly, the Law is appropriate to the establishment of a structure that supports regional development policy and planning. It puts in place the structures that allow for consultation between the regions, line ministries and national government. It also provides for professional support for the National Committee, as well as for each of the Regional Councils through the establishment of working offices for each Council.

The regions, as defined in the RDC and the MTRDS, are not included in the Constitution as legal entities and, for this reason, the Law is considered to be a contributory part of the existing legislation of the state apparatus rather than legislation for new territorial units. The Law does not specify the number of regions to be formed, nor their boundaries.

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<sup>3</sup> Previous reviews of the RDC by agencies such as the IMF/IDA and ADB also indicated that it was considered to be non-viable.

## 1.2 GOAL AND OBJECTIVES OF THE TA

The overall goal of the TA was stated as being to support balanced and equitable regional development in Mongolia. The TA was to play an important role by helping to build the capacity in Government to formulate appropriate policies for regional development, along with realistic plans to achieve such an outcome. This is reflected in the stated aim, which is to “strengthen the capacity of the Government for policy analysis and development management, and to help establish systematic and structured development planning functions.”

The original objectives of the TA, as agreed between the ADB and GOM were to:

- Help the Government assess the economic rationale and financial viability of the RDC by preparing an integrated medium term [regional] development strategy;
- Strengthen the capacity of the regional policy and planning staff of the Government to undertake their work in the framework of market economy principles; and
- Prepare operating guidelines for the establishment of a Department (potentially within MOFE) that will function as a [regional] policy development unit.

Importantly, the Terms of Reference explicitly required review of the Regional Development Concept (2001) and the preparation of a strategic plan for regional development in Mongolia. Matters relating to the goal and objectives are discussed further in section 2.1.3 below.

## 1.3 APPROACH AND PREMISES OF THE TA

The work undertaken within the TA, at all times, rested on one very important question: is it in the best interests of Mongolia and its people; that is, will there be a net social and/or economic benefit associated with the strategy or proposal recommended? This also included consideration, where appropriate, of whether there is a better way to tackle the particular matter being addressed.

A second fundamental consideration was also taken into account. This related to the fact that, in the post World War II era, much has been learned about regional development. Considerable experience has been gained in relation to what might work but, perhaps more importantly, a great number of lessons have been learned about what does not work. Consequently, at all times efforts were made to draw on the experience with successes and failures. The work was also cast in the context of modern, accepted regional development theory and practice, including the methodologies that are now widely accepted internationally. As stated by Parr (2001, p. 23): “It would be disappointing, to say the least, if shortcomings of the past were not recognized and responded to in current planning practice.”

In summary, the work of the TA was based on:

- Whether or not there are net benefits to Mongolia;
- The principles of market economics;
- Modern regional development theory and practice;

- Lessons about successes and failures internationally;
- The training, experience and background of consultants; and
- Reference to recent and relevant literature on both theoretical and practical aspects of regional development.

## 2. COMPONENTS AND OUTPUTS OF THE TA

### 2.1 COMPONENTS OF THE TA

There were four components in the TA although these were, as specified in the Terms of Reference (TOR), implemented within three Phases. The individual components, and the activities undertaken to meet the requirements of each, were as follows:

#### 2.1.1 Component A

Component A was to be focused principally on enhancing the economic foundation for the RDC and supporting strengthened public policy analysis. It was also to establish the framework within which the later work, and particularly the preparation of an integrated medium term development strategy, would be undertaken.

The principal activities undertaken under Component A were the following:

- An analysis of the context within which regional development policy, planning and activities occur in Mongolia;
- A review of the RDC and the Medium-Term Regional Development Strategy (MTRDS);
- An analysis of the economic factors and policies that impact on regional development, and the subsequent preparation of a report entitled *An Economic Policy Framework that Supports Development of the Regions*<sup>4</sup>; and
- An initial assessment of the legal, organizational and institutional framework in which regional development policy would be implemented<sup>5</sup>.

A full list of reports arising from the TA is provided in Appendix 1.

#### 2.1.2 Component B

This component comprised training for Government officials in an overseas training institution. That training was undertaken at the University of Queensland, Brisbane, Australia. The process for selection involved: (i) an invitation to a number of institutions to register their interest in providing training; (ii) the undertaking of a training needs analysis in Mongolia by a local consultant employed under the TA; (iii) preparation of a terms of reference for the training, the provision of that TOR to interested institutions, and a competitive tendering process for the provision of training services; and (iv) the preparation and approval, by ADB, of training modules.

Australia was deemed a suitable country in which to provide the training because of certain similarities to Mongolia, particularly: (i) a relatively small population spread over a vast area of land; (ii) a landscape and climate often typified by harshness; (iii) the importance of primary industries, particularly agriculture and mining; and (iv) concerns about rural-urban migration.

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<sup>4</sup> This work was undertaken by James Lamont, Macroeconomist and Public Finance Specialist, under a short-term international input.

<sup>5</sup> This component of the TA was undertaken by Simon Watt, Institutional and Legal Specialist, under a short-term international input, with assistance from local consultant Badamgarav Gantuya.



Furthermore, Australia has considerable experience in the formulation and implementation of regional development policies and activities and, consequently, guidance on both successes and failures in regional policy is available.

Following the competitive process described above the contract to provide training was awarded to the University of Queensland, through its commercial entity Uniquet Limited. Training was provided by the Center for Economic Policy Modeling. An important consideration in selecting the University of Queensland – apart from a competitive price – is the extensive experience within the Economics Department in regional analysis and policy development.

The training program and its outcomes were described in a report submitted to ADB in November 2003.

### **2.1.3 Component C**

Component C was to be the final major component of the TA, involving preparation of a medium term integrated regional development plan. It had been decided that a strategic planning approach would be taken to the preparation of the plan, supported by action plans and a reporting and monitoring framework. Consequently, a very specific and major element in the TOR was that the TA team would, over the course of the TA, prepare a regional development strategy. This strategy would be the key outcome, along with capacity building, from the TA. The original timing was that the TA would run through calendar year 2003, so that the Strategy would be available at the end of 2003. Delays in TA commencement, as previously noted, meant however that the Strategy would, ultimately, be completed in March 2004.

Approximately one month after TA commencement, however, and as a result of submitting the Inception Report, the Team Leader and Team Manager were informed that a Regional Development Strategy had already been prepared and was currently (in May, 2003) before Parliament. Despite the agreements laid out in the TA documents and contracts, the team had not previously been informed of this matter. Subsequently, at the final meeting of the Steering Committee on 29 March 2004, the Team Leader was informed that this had occurred because the Parliamentary Agenda had specified that the MTRDS was to be submitted to the Spring 2003 session of Parliament. In any case, this required that the TOR be revisited and, amongst other things, it was agreed that the review of the RDC would be extended to also include a review of the MTRDS. It is noted that, as laid out in the TA documents, the Government agreed to revise the RDC if the review showed it not to be viable. The subsequent review showed that it is not viable given the current economic situation confronted by Mongolia. It was also concluded that the MTRDS, which exactly follows the framework set out in the RDC, and which includes lists of several hundred proposed projects and activities, was also not viable, and it was recommended that it should also be revisited and revised.

In summary, Component C comprised a major source of tension between the TA paper and the TOR. The recommendations formulated as a result of the review of the RDC and the MTRDS, were passed on to the government via the Economic Policy and planning Department (EPPD) of MOFE in August, 2003.

The strategy adopted as a result of the situation with the MTRDS was to focus further on policy development. Additionally, it was agreed that, where appropriate, advice on methodological aspects of regional development would be provided. Amongst the outputs resulting were the Policy Advisory Papers and Occasional Papers, listed in Appendix 1 of this report.

### **2.1.4 Component D**

Component D was to include the conduct of workshops and a conference to promote wider participation in the formulation of regional development plans than might otherwise occur, and to also encourage ownership of the resultant plans. The workshops were also to facilitate the dissemination of public policy briefs and discussion papers. While Components A, B and C occurred sequentially over the period of the TA, Component D was carried out throughout the implementation of the TA as activities were completed under the other three components.

Importantly, and again largely in response to the situation described in 1.3.3 above, Component D was extended by planning and implementing three regional workshops in August and September 2003, thereby allowing consultation with, and input from regional communities. A Contract Variation was provided by ADB to support these workshops. Additionally, a national workshop was held in Ulaanbaatar in November 2003 to disseminate the results of the work of the TA to that point, and to also seek feedback from a range of stakeholders. Internal seminars in the Ministry of Finance and Economy (MOFE) were also organized but, despite widespread promotion, were not attended by government staff. Consequently, they were discontinued following completion of Component A of the TA.

The Policy Advisory papers, discussed in 2.4 below, were also a very important initiative that supported the outcomes sought under Component D.

Finally, a national conference was held in Ulaanbaatar on 17 and 18 March. The purposes of the workshop were to facilitate wider dissemination of the outcomes of the TA and to inform stakeholders about various activities underway in relation to regional development.

## **2.2 PRINCIPAL OUTPUTS**

As noted in 2.1.3 the principal output of the TA was to be the preparation of a Medium Term Regional Development Strategy for Mongolia, an output that was deemed by the TA Management Unit to be superfluous as such an output had already been prepared by the Government and was, at the commencement of the TA, before Parliament. Consequently, the TA had to be 'reinvented' to some extent, although it was clear that much needed to be done. The principal outputs, subsequently, were as follows.

### **2.2.1 Inception Report**

The Inception Report was an agreed milestone, which included details of the approach to the TA; management structures, particularly the Steering Committee, TA Management Unit (TAMU), and Working Groups; staffing; and the work program. The work program was reviewed, and subsequently accepted by the TAMU and Steering Committee. The major change to the first draft was the removal of reference to preparation of the medium-term strategic plan.

### **2.2.2 Review of the RDC**

The first major paper arising from the TA, released in July 2003, comprised a review of both the RDC and the MTRDS.

It was noted in the Review that the rationale for taking a regional planning and development approach in Mongolia was neither clear nor validated. A policy on rural and regional

development is almost certainly appropriate, but such a policy does not necessarily translate to a need to establish new administrative boundaries to establish four separate, large regions. A rural and regional policy and development strategy may be developed and implemented without changing or adding to administrative boundaries. The case for the establishment of five regions has not been clearly established. The RDC contains no evidence that efficiency or equity gains will be realized as a result of its implementation.

It was subsequently recommended that the RDC should be revised.

### **2.2.3 Review of the MTRDS**

The purpose of the MTRDS is to implement the RDC, although it is concluded that it, like the RDC, is too prescriptive in approach. There is, however, recognition that development has not been well planned and coordinated in Mongolia and, most importantly, not related closely to the budget. The Strategy serves to highlight the importance of coordination of the many regional development activities that are already underway or planned. This is one of the strongest arguments for a “[rural and] regional development strategy”: that such a strategy coordinates, schedules and prioritizes the many activities occurring or planned in rural and regional areas.

Further comments relating to the RDC and the MTRDS are provided in Chapter 3 below.

### **2.2.4 Institutional and Legal Structures Review (Working Paper 1)**

Simon Watt, Institutional and Legal Specialist prepared this paper. It was not a deliverable under the TA and has not been published separately. Rather, components of the Review were included in other documents, while also building a basis for a subsequent input on organizational and institutional structures.

### **2.2.5 Economic Policy Framework (Working Paper 2)**

This paper, entitled *Towards an Economic Policy Framework that Supports Development in the Regions* was prepared by James Lamont, Macroeconomic and Financial Specialist, and is considered to be well-focused and to provide a very important review of economic policy settings. Lamont drew out implications for regional development policy that arise from the current macroeconomic setting. The paper was published as Working Paper No. 2 and is focused on providing information and policy views about financial and economic aspects of regional development in Mongolia, including suggestions for the development of an appropriate policy framework for the future. Amongst the key conclusions are the following:

- The regional strategy relies heavily on the provision of adequate supplies of investment financing to the private sector at reasonable market rates of interest. This will not occur under current monetary policy settings. While there is a role for the Government in provision of public goods and well designed micro economic interventions in the regions, impacts will be limited to largely fiddling at the edges while macro economic settings are not conducive to growth. A focus on macroeconomic fundamentals is also important in relation to regional development. Monetary policy, particularly exchange rates, high interest rates and a fiscal stance that includes relatively high rates of company tax are all constraints on rural and regional development;

- The current integrated policy, planning and budgetary framework under the umbrella of the Public Sector Management Finance Act (PSMFA) has only recently been introduced. While not yet widely understood the framework potentially provides a coherent approach to the linking of policy, planning and budgeting in a medium term context. This framework, in principle, is adequately structured to absorb the additional focus being sought for regional development implementation. However, additional policy and planning resources and capacities are needed just to cope with existing responsibilities, let alone absorb new ones in policy, planning and budgeting for regional development;
- The effectiveness with which central Portfolio Ministers in future develop contracts (as provided for in the PSMFA) for the delivery of services and public investments in the regions will be critical for the future of regional development;
- Both the recurrent and development forward estimates to 2005 are currently heavily composed of ongoing and committed items and neither provide for major new government or foreign donor resources to finance the many initiatives in the regional development strategy paper. While there will be scope to introduce more programs and projects over time the competition for resources will remain tight given the focus on deficit reduction;
- There is potential scope to achieve efficiencies in administration and to facilitate regional management and development through rationalizing the size and numbers of aimags and soums. This will be a more fruitful approach in the medium-term than the declaration of five new, large regions; and
- Seven issues are put forward as being fundamental to improving development in the regions: (i) economic policies cannot be split into five different regions – a coherent national growth oriented approach is needed; (ii) there is a need to recognize the disappointing recent economic performance and the policy reasons underlying this<sup>6</sup>; (iii) the development of appropriate national economic policy settings is critical; (iv) there is a need for ongoing longer term development of the financial sector, matched by shorter term measures to make monetary policy less dysfunctional; (v) proactive agricultural and industry support programs are appropriate but they must be very well designed and implemented; (vi) the recently installed policy, planning and budgeting framework can be made to work to the benefit of the regions and should be supported for reasonable periods at least until institutional capacities improve; and (vii) it will be important to refine and prioritize the multitude of activities contained in the regional development strategy paper in the context of the Medium Term Fiscal Framework (MTFF).

### **2.2.6 The Context for Regional Development Policy, Planning and Capacity Development in Mongolia (Working Paper 3)**

This was a substantial paper on the setting for regional development in Mongolia. It comprises an internal and external assessment (environmental scan) of the situation in the country, a task that normally occurs as an early step in strategic planning. Amongst key findings reported in the paper were the following:

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<sup>6</sup> This point was made by Lamont in July 2003, but Mongolia's recent economic performance has improved considerably.

Social and economic indicators show that people living in rural and regional areas are disadvantaged in comparison to those living in Ulaanbaatar and the other major urban areas. Unemployment rates are higher and services and infrastructure poorer, with the disparities generally increasing with distance from Ulaanbaatar. Such disparities also encourage rural-urban migration. Regional employment generation can, however, only be addressed in a fundamental sense by the application of growth-oriented macroeconomic policies.

There is substantial internal migration momentum in Mongolia at present, leaving rural areas even more sparsely populated and urban areas more heavily populated. Concomitantly, the unit costs of service provision in rural areas will be increasing, while urban areas are likely to experience further difficulties in the provision of housing and certain services such as sanitation.

There is a strong case for an appropriate and robust rural and regional development policy. Similarly, there is a need to specifically consider the needs of those living in rural and regional areas when development interventions are planned and implemented. Importantly, however, regional development can be facilitated but generally it cannot be forced, while taking a prescriptive approach – as is taken in both the RDC and MTRDS – runs the risk of expensive failure. Furthermore, the approach of government or its agencies in taking the lead in identifying competitive advantage (see section 3.4 below), again as taken in the RDC and MTRDS, ignores market economy realities and is also very likely to fail.

The case for establishing five new regions has not been demonstrated in either the RDC or the MTRDS. There is no evidence that such a definition of new regions will facilitate the efficiency in use of scarce development resources, that it will contribute to improved equity in access to opportunities and services in rural and regional areas, or that it will meet goals such as slowing or preventing rural-urban migration. Planning development interventions within the framework defined by the five-region model – or attempting to force various development programs into a regionalized planning and implementation framework – is unlikely to enhance development and accelerate economic growth.

The desire to present the MTRDS on the basis of five regions result in it being repetitive, while also leading to confusion between what are or should be local, regional or national actions. Many of the proposals for development interventions in the MTRDS are already encapsulated in national programs in sectors such as health, education, agriculture and infrastructure. With a population of less than 2.5 million, national programs – on a sectoral basis – remain appropriate. There is substantial potential for wasteful duplication and inefficient use of scarce resources because of the efforts to redefine national needs and programs in a regional framework. As noted above, however, there is a case for ensuring that development programs take specific account of rural and regional needs.

There is considerable duplication in planning and related activities in respect of regional development. The Medium-Term Regional Development Strategy, the Poverty Reduction Strategy Paper and the Rural Development Strategy each cover the same matters and recommend similar responses. Furthermore, as noted above, the Medium-Term Regional Development Strategy includes long lists of initiatives that are included in various sectoral programs already underway, initiatives that should be considered in those programs, not in the MTRDS. This serves to indicate a lack of coordination in policy and planning activities.

The approach to formulation of both the RDC and the MTRDS is one of central planning in a command economy setting, with physical planning emphasized. Proposals such as that to plan the development of the Ulaanbaatar region on the basis of three circles, based on socioeconomic status, highlight the reliance on physical planning. Little account is taken of market economy principles or of the role of the private sector in development.

Microeconomic policy analysis requires strengthening in the documents that have been prepared. For example, the proposals to establish free economic zones (in an already very open economy) and industrial parks in each of the proposed regions, along with the proposals on pillar centers, have not been analyzed in an effort to assess if they will provide net economic and social benefits to Mongolia. Furthermore, the capacity and organizational and institutional structures to support regional policy and planning activities remain weak and under-resourced.

Specific regional development projects are not included in the Medium-Term Fiscal Framework, while the matter of budgetary capacity to support new regional initiatives has not been addressed in the RDC or the MTRDS.

Certain policy inconsistencies occur, including the commitments made by the government under the Poverty Reduction and Growth Facility (PRGF), which are contradictory to the policy stance of the regional development strategy paper. Conversely, as previously noted, the budget framework under the PSMFA and MTFP provides an appropriate and robust structure under which regional development policy can be implemented.

There is potential scope to achieve efficiencies in administration and to facilitate regional management and development through rationalizing the size and numbers of aimags and soums. This will be a more fruitful approach in the medium-term.

### **2.2.7 Organizational and Institutional Structures to Support Regional Development (Working Paper 4)**

Similarly to Working Paper No. 1, this paper was prepared as an internal paper and not published for wider circulation. Rather, it was used to inform subsequent work and recommendations on the institutional and organizational structures that most suit regional development work in Mongolia. Included in the subsequent outcomes from this work is Policy Advisory Paper No. 77.

### **2.2.8 Training Report**

A report on the training undertaken at the University of Queensland, Australia, was a milestone under the TA and was delivered to ADB by the due date of 26 November 2003.

## **2.3 SEMINARS, WORKSHOPS AND CONFERENCE**

The requirement, under Component D, to disseminate information, elicit feedback and involve various stakeholders in the work of the TA, was described briefly in section 2.1.4 above. Activities included seminars in the Ministry of Finance and Economy, three regional workshops, which were beyond the original TOR, a national workshop attended by more than 80 participants in November, 2003, and a national conference in March 2004.

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<sup>7</sup> This Policy Advisory Paper was still under preparation at the time of preparing the Final Report.



Apart from the internal seminars in the Ministry, all activities were extremely successful and were keenly attended. Substantial feedback was gained, while the national workshop and the regional workshops resulted in approaches to the TA management for further information and/or assistance on certain matters (e.g. the methodological matters described in 2.5 below). The national workshop was also the main source of a mailing list of more than 90 people and organizations interested in knowing more about the work being undertaken within the TA. Again, information prepared in the TA was distributed widely and well received by a range of stakeholders.

The regional workshops also showed that people living in and managing regional areas and local government are vitally concerned about regional development and particularly about an apparent lack of consultation on many occasions from the central government. Furthermore, it is clear that those who attended the regional workshops have substantial knowledge about the needs of regional development, along with views about the priorities for such development.

A special seminar was also conducted at the request of agencies responsible for the preparation of the General Plans for the pillar centers, including the Ulaanbaatar City Government Urban Planning, Research and Design Institute. This seminar, presented by the Team Leader, provided information on the background to regional development and the TA, along with advice on methodological aspects of preparing the General Plans. Consequently, like the other seminar, workshop and conference activities, it was an important activity in relation to capacity building.

The final conference, held in Ulaanbaatar on March 17-18 drew together a range of organizations with an active involvement in regional development and played an important role in facilitating communication amongst many of the stakeholders involved in this area of policy and planning.

Finally, the Team Leader participated in various other conference and workshop activities, including those run by other ADB projects such as the Public Administration Reform Project (PARP). Again, such involvement indicated the relevance of and interest in regional development in Mongolia.

## **2.4 POLICY ADVISORY PAPERS**

A series of Policy Advisory papers were produced, beginning in December 2003. While such papers were not a deliverable under the TA, it was decided that a medium for delivering TA conclusions and recommendations to a wide stakeholder group was desirable. Consequently, these papers, which are generally brief, were prepared and distributed to approximately 100 stakeholder organizations and individuals. This again resulted in feedback from various groups, along with requests for further information and assistance.

The Recommendations page from each Policy Advisory Paper is included in Appendix 2 to this report, while key conclusions and recommendations are discussed in Section 3 below.

The Policy Advisory Papers produced were the following:

No. 1: A Process Approach to Regional Development Programs. December 2003;

- No. 2: Important Concepts and Definitions for Regional Development Policy and Planning. December 2003;
- No. 3: Mongolian Regional Development Indicators and Indexes. January 2004;
- No. 4: Defining Functional Regions. February 2004;
- No. 5: Pillar Centers, Enterprise Clusters and Regional Development. March 2004;
- No. 6: The Role of Government in Regional Development. March 2004; and
- No. 7: Institutional and Organizational Aspects of Regional Development in Mongolia. March 2004.

## **2.5 OCCASIONAL PAPERS**

Two 'Occasional Papers' were produced under the TA. These papers arose from specific requests for assistance with the preparation of Regional Development Programs and the General Plans for the Development of the Pillar Centers. In both cases the work is to be undertaken by private or statutory agencies under contract to the government. While prepared at the request of such organizations, the papers have much wider applicability in relation to approaches to planning both inside and outside of government in Mongolia.

In each case the methodology is based largely on a 'bottom-up' approach, which is in some contrast to the approach taken in the development of the RDC and the MTRDS, both of which are prescriptive, top-down documents.

The Occasional papers produced were the following:

- No. 1: Methodological Framework for Preparation of Regional Development Programs; and
- No. 2: Methodological Framework for Preparation of General Plans for Pillar Centers.



## 3. PRINCIPAL FINDINGS AND RECOMMENDATIONS

### 3.1 INTRODUCTION

The conclusions and recommendations from the TA are described in the various reports prepared since April 2003. The discussion below is not designed to be exhaustive but to summarize the principal conclusions and recommendations, which, subsequently, serve to help identify future possible support from ADB and other development agencies.

### 3.2 REGIONALIZATION

Regionalization and the approach to defining regions were discussed in Policy Advisory Paper No. 4: *Defining Functional Regions*. There is a strong case for an appropriate and robust rural and regional development policy in Mongolia. Similarly, there is a need to specifically consider the needs of those living in rural and regional areas when development interventions are planned and implemented. The RDC, MTRDS and the Law on Regionalized Management and Coordination serve to emphasize these needs and, especially, the need for coordination of regional development activities in the nation. There are, however, some general principles that apply, and lessons that have been learned, and it is important that these are applied in Mongolia.

First, and as argued repeatedly during the TA, it is critical to clarify the purpose for regionalization and, subsequently, to define regions that are functional in relation to that purpose. Unfortunately, it is concluded that the five region model is not robust in terms of the criteria that normally apply to defining regional groupings of local government areas and that the regions defined in the RDC are, consequently, not functional. It is therefore recommended that:

- ➔ The purpose for regionalization is thoroughly revisited in the RDC with a focus on the definition of functional regions;
- ➔ The five region model is independently reassessed in light of valid purposes for regionalization in Mongolia, with specific consideration of the number and structure of regions and the potential of 'sectoral regions' based on a deconcentrated governance model (see also Recommendations 8 and 9 below)<sup>8</sup>; and
- ➔ The purposes for regionalization relate particularly to coordination of regional policy and development activities, program and service delivery, and equitable access to services such as education, health and social welfare.

[Definition: deconcentration is the simplest form of decentralization, and occurs when a central government ministry disperses its program delivery – and some decision-making – to regional offices of the ministry. Elements of deconcentration occur already in Mongolia, while it is a policy actively pursued in other parts of the world. For example, most Australian states operate deconcentrated systems in areas such as agriculture, health, education, planning, and industry development.]

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<sup>8</sup> There is a strong commitment in Mongolia to the five region model and it is accepted that that model will remain. Consequently, any reassessment would involve consideration of appropriate changes under the overall 'umbrella' of the five region model.

Second, it is concluded that the approach to regional policy and planning, as described in the RDC and MTRDS, needs to be far less prescriptive. Conversely, the LRDMC provides an appropriate framework for undertaking policy development and planning activities. Therefore, it is recommended that:

- ➔ Regional policy development and planning activities take a bottom-up approach, involving a wide range of stakeholders. (Additionally, under the five-region model, the Regional Councils should take a leading, facilitative role).

An important activity funded by ADB is the Public Administration Reform Project (PARP). Amongst its activities PARP has responsibility for designing revised approaches to local government. This work may have significant implications for the implementation of regional development policy. For example, if there are recommendations about the amalgamation of aimags to enhance the efficiency of resource use – a proposal that has been aired at various times – then the new groupings of aimags might comprise a basis for regionalization with a purpose of effective delivery of local services. It is recommended that:

- ➔ Active discussions are entered into with personnel of the PARP project, as soon as possible, to ascertain the likely implications of PARP's work for regional development.

### **3.3 ROLE OF GOVERNMENT**

In all development activity in market economies it is normally agreed that Government has a range of 'core functions' and that it is critical for government to focus on those functions. Core functions include matters such as law and order, appropriate regulation, establishing a suitable enabling environment for investment and growth, macro and micro economic policy, the provision of social services and support for disadvantaged groups in society and, when appropriate, the provision of physical infrastructure. In the case of physical infrastructure, however, it is important that avenues for private sector provision of such facilities are fully explored prior to government committing to provide expensive capital infrastructure.

The government's particular emphasis, whether on equity or efficiency of resource use, will influence its policy approach. But whichever criterion is most emphasized, it is clear that the role of Government is to facilitate economic activity in all areas by establishing an appropriate enabling environment for private sector investment and risk taking.

Importantly, the framework provided by the LRDMC provides a suitable structure for government to take a facilitating role in regional development. Consequently, it is recommended that:

- ➔ In relation to regional development the Government focus on its role as a facilitator and coordinator of economic development.

### **3.4 Line Ministries**

Allied to the question of the role of government is the role of individual line agencies within government. As noted above, the LRDMC provides the framework for policy development and planning. Under the Law, the National Committee and the Regional Councils, and their respective professional offices, will have important roles in facilitating and coordinating regional development policy and activities. It will, however, be the line ministries that continue to have

the lead role in the implementation and management of development activities: the Ministry of Food and Agriculture will remain responsible for implementing agricultural programs, the Ministry of Education, Culture and Science will continue to be responsible for education development and service provision, and so on. This situation needs to be recognized if the National Committee and Regional Councils are to be effective and if policy and planning are to be cohesive. Therefore, it is recommended that:

- ➔ The National Committee, Regional Councils, and their respective professional support offices adopt a role of coordinating regional development activities, but that implementation and management of those activities remain the role of the line ministries.

Under the Public Sector Management and Finance Act (PSMFA) the line ministries have increased responsibilities in relation to the management and allocation of budget resources. The line ministries have responsibilities that spread across the nation, and most have a considerable presence in regional areas.

Consequently, the question of the management structure of line ministries is one that is worth addressing – perhaps under the Public Administration Reform Project (PARP) – although the proposed professional office for the National Committee for Regional Development could also play a role. For example, the Ministry of Food and Agriculture (MFA) has a network of veterinary and animal breeding services (in all aimag Governor's offices) and agricultural officers (in many soum Governor's offices) and plays a crucial role in rural and regional development. It might be the case that, as in many other countries, a deconcentrated regional management structure would facilitate the effectiveness of MFA's work and also the efficiency of use of its budgetary, human and other resources. Related to the recommendations in section 3.2 above, it is recommended that:

- ➔ Active consideration is given to enhancing and formalizing deconcentration of the activities of key line ministries through the establishment of 'sectoral regions', thereby supporting the implementation of regional development policy; and
- ➔ A corporate plan should be developed by those ministries that are to establish a regionalized, deconcentrated structure. Assistance with the preparation of such plans would need to be provided, perhaps by a donor agency.

### 3.5 MARKET ECONOMY PRINCIPLES

The discussion in the foregoing sections relates closely to a number of important economic principles that, in a market economy, should be explicitly taken into account (these and other economic principles are defined in Policy Advisory Paper No. 2: *Important Concepts and Definitions for Regional Development Policy and Planning*). Amongst those principles are the following.

**Deadweight loss:** simply put, this applies to the situation where government invests in some activity or development that could or would have been provided by the private sector. The amount of the government expenditure is a 'deadweight loss' to the economy and its citizens. The prescriptive nature of the RDC and MTRDS indicate that government will invest in a number of areas and that, consequently, there will be substantial deadweight losses.

**Opportunity cost:** relates to deadweight loss, to the establishment of priorities for the use of scarce government resources, and to government remaining focused on its core functions. Sometimes known as economic cost, opportunity cost is a measure of the true costs of using a scarce resource in some production process, and is measured as the alternatives (or opportunities) foregone by so doing. It is the measure of cost used by economists in economic analysis such as occurs in social benefit-cost analysis. An investment in any one area means that funds are no longer available for investing in another area. For example, government spending on capital infrastructure for transport means that less money is available to spend on, say, education services.

Consideration of opportunity costs drives home the constraints on development activities imposed by the budget, and also supports priority setting in relation to these and other activities.

**Market failure:** the market-economy framework is often taken as a position to “leave it to the market”. Economists, however, recognize that the market does not always work and that market failure will occur in many instances. When market failure is occurring – or is highly likely to occur – government has a role to intervene to correct that failure. This relates closely to the core functions of government.

Market failure occurs when markets fail to achieve an optimum allocation of resources. Market failure is almost certain to occur in small, narrow economies such as that of Mongolia. It is, therefore, valid for government to intervene in appropriate but carefully identified ways. Market failure is likely to occur in relation to environmental management, social services and public goods. For example, the efficient level of education is unlikely to be provided by the market, so government has a role to intervene in support of such services. That is, private investors are unlikely to respond to the demand for education services because they cannot make a profit from providing those services and, consequently, they are unlikely to build schools and provide education services, particularly in more remote locations. A core function of government is to provide such services, which support policy objectives relating to equity by building and equipping schools, hospitals and other social services, and supporting the provision of education, health and other social services in those facilities.

The potential for market failure must be recognized in regional policy and, importantly, government remain focused on its core functions and refrain from becoming involved in areas where such failure is not occurring.

**Competitive Advantage:** is the basis of the market system, and emphasizes the role of competition in reducing costs and increasing resource use efficiency. It is clear that competitive advantage is not something that can easily be created artificially and attempts to do so are both risky and likely to be very costly. Unfortunately, the RDC and MTRDS place substantial emphasis on identifying the competitive advantages supposedly held by each region; but this is the role of private investors who will invest in areas and industries where they believe they can minimize production costs and obtain a competitive advantage. Government attempts to ‘pick winners’ should be strongly resisted.

**Economic Analysis:** proposed investments by government, particularly in infrastructure and similar capital structures, should always be subjected to thorough economic analysis. By employing realistic assumptions about costs (opportunity costs) and social and economic benefits, analysts can make well-guided decisions and recommendations about particular

investments. Many of the proposals in the RDC and MTRDS should be subjected to such analyses, including the pillar centers, free economic zones, transport and other infrastructure. Only then can the government make sound judgments about the best use of its scarce resources.

Consideration of the small number of economic principles listed above serves to emphasize the flaws in many aspects of the RDC and MTRDS. Two of the key aspects of the approach to regional development are the development of the so-called pillar centers (which are growth centers: see Policy Advisory Papers No. 2 and No. 5) and the Free Economic Zones. The Free Economic Zones have recently been the subject of an investigation by the USAID-funded Economic Policy Reform and Competitiveness Project (see Appendix 4). Additionally, an important premise in the RDC is that of the ‘vertical and horizontal axes’, implying substantial investment in road infrastructure. The opportunity costs associated with such investments, especially given that they are not based on any market or other assessment, are almost certainly extremely high.

In the case of the pillar centers, the international evidence is very strongly that such a strategy is doomed to fail; so much so that it has been abandoned virtually everywhere it has been tried. Again, the opportunity costs of investing in infrastructure in instances where the returns are likely to be negligible – as in some of the pillar centers – are almost certain to be high. Furthermore, such investments disregard the precepts of market failure and of competitive advantage.

In each of the cases referred to, the deadweight losses are also likely to be substantial, something that no government can afford, particularly in a situation of tight budgets.

Based on the foregoing discussion it is recommended that:

- ➔ All key regional policy proposals and strategies are reviewed in the light of important market economy principles (a considerable part of this work has been undertaken under TA 3948);
- ➔ The strategy of investing in capital infrastructure in an effort to underwrite economic development in identified pillar centers is abandoned or, at the least, that such investment in each proposed pillar center be subjected to thorough financial and economic analysis<sup>9</sup>. Conversely, investment by government in important social services such as health and education is highly appropriate, serves to support equity objectives and should be undertaken;
- ➔ The identification of ‘organic’ growth centers be left to market forces and private sector identification of competitive advantage and that, subsequently, strategic decisions in relation to infrastructure investments in those centers be considered (see Policy Advisory Paper No. 5);
- ➔ Government investments in capital infrastructure to underwrite economic development are based on demand, rather than on the supply-side emphasis that typifies the RDC and

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<sup>9</sup> The distinction between financial and economic analysis is emphasized. Economic analysis goes further than simply considering the dollar costs and returns and includes consideration of social costs and benefits. Economic analysis uses measures such as opportunity costs as the true measure of economic costs [see Policy Advisory Paper 2].

MTRDS. Conversely, social services such as health and education cannot be provided on a demand basis because market failure occurs in relation to the provision of such services; it remains an important core function of government to provide such services;

- ➔ The free economic zones proposed be subjected to detailed economic analysis<sup>10</sup>; and
- ➔ Proposed investments in transport infrastructure, particularly roads, are subjected to thorough financial and economic analysis.

### **3.6 INSTITUTIONAL AND ORGANIZATIONAL ISSUES**

A number of institutional and organizational matters remain to be resolved. While the LRDMC provides the basic underpinning legislation for the establishment of a framework for regional policy development and planning, the locations, roles, responsibilities and powers of the professional bodies that support the National Committee and the Regional Councils remain to be finalized.

At the beginning of the TA it was made clear that the expectation, within the Ministry of Finance and Economy, was that a regional development 'project implementation unit' or similar body – perhaps the professional secretariat to the National Committee – would be established within MOFE. Furthermore, it was made clear to the local consultants employed under the TA that there was an expectation that, beyond the life of the TA, they would seek to contribute further to regional development by taking employment in an appropriate arm of government (on the assumption that such employment was available).

It is concluded, however, that the appropriate location for a professional regional development body is within the Cabinet Secretariat. This conclusion is based on the following considerations.

- The Prime Minister is the Chairman of the National Committee and it makes sense to have professional support nearby to his office;
- The members of the National Committee comprise the Ministers of various line ministries and the Chief of the Cabinet Secretariat;
- The recommended coordinating role of the professional body means that it needs to have a status above that of a line ministry and be seen to be separate from such a ministry;
- There is a real danger of duplication of activity and piecemeal management of policy development and planning if a professional office is established within MOFE given the responsibilities of the Cabinet Secretariat for local government and territorial administration, both of which relate closely to regional development; and
- MOFE is responsible for financial aspects of national management and its activities should be focused in such areas, not in the area of regional development policy and planning.

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<sup>10</sup> The free economic zones were assessed under the USAID funded Economic Policy Reform and Competitiveness Project in February, 2004. A summary of the findings of that assessment is provided in Appendix 4.

Additionally, in other countries it is normal that the coordinating role in relation to policy coordination and implementation is based in a 'senior' office of the government. For example, it is often the case that a Department of the Prime Minister and Cabinet (PMC) is responsible for the coordination of all policy initiatives. All policy proposals from line ministries are referred to the PMC where they are checked for consistency with existing and proposed policies, laws, regulations, legislation and the budget, along with any duplication of existing statutes. Importantly, they are also examined to ensure that they are consistent with the government's policy stance on particular issues.

It is recommended that:

- ➔ The Prime Minister's Economic Strategy and Planning Office, as indicated in Article 34 of the Law on Government, in the Law on Regionalized Development management and Coordination, and in Government Resolution # 27 of 30 January, 2004, is established as soon as practicable. That office should be an appropriately staffed professional office, responsible for coordinating regional development activities and providing professional support to the National Committee. In the interim until this office is established it is recommended that responsibility for regional development matters be delegated to the Cabinet Secretariat;
- ➔ ADB consider providing professional TA support for the establishment and operation of this office; and
- ➔ ADB provides support for the further development and implementation of regional policy in Mongolia, based on the above two recommendations relating to the location for and focus of such support.



## **4. GOVERNMENT RESPONSE TO THE FINDINGS AND RECOMMENDATIONS**

### **4.1 INTRODUCTION**

The main findings and recommendations of the TA were reviewed by government personnel just prior to the conference that was held on 17-18 March, 2004. Subsequently, the Government's response to those findings and recommendations were reported by Ch. Khurelbaatar, State Secretary, Ministry of Finance and Economy, at the conference. The main points from the response are summarized below and, where appropriate, discussed briefly, while a copy of the complete paper presented by the State Secretary is provided in Appendix 3.

### **4.2 MAIN POINTS FROM THE GOVERNMENT'S RESPONSE**

The first specific point made in the government's response was that:

- It was agreed that regional development policy needs to be considered within a national development planning framework, and that such policy take account of macroeconomic policy along with coordination with this and other policy matters.

This was not a major concern raised in the TA, although the need to strengthen coordination of planning and development activities was raised on a number of occasions. The point on macroeconomic policy made in the response paper is a little unclear, but may refer to the issue, raised in Working Paper No. 2: *Towards an Economic Policy Framework that Supports Development in the Regions*, that regional economic development will best be supported by growth-oriented macroeconomic policies. Currently, the Government is constrained in this respect by its commitments to the IMF under the Poverty Reduction Growth Facility (PRGF), which places emphasis on stability rather than growth. As noted in Working Paper No. 2, microeconomic interventions in the regions will have little impact under current macroeconomic, fiscal and monetary settings.

It is noted in the Government's response that:

- There is a need to immediately consider the TA recommendations on the important economic questions relating to opportunity costs, competitive advantage and selecting the most cost-effective approaches to various development activities;
- The roles and structure of the pillar centers need also to be considered immediately;
- Cost-benefit analyses on project activities under the Free Economic Zones (FEZ) need to be undertaken; and
- The organizations involved in preparing the Regional Development Programs, the General Plans for the Pillar Centers, and the plans for FEZ investments, have been advised to consider the above recommendations from the TA in their work.

These are positive responses to the work and recommendations of the TA, and follow-through by the Government and its agencies will result in improved analysis and decision-making in relation to proposed and actual investments in various infrastructure developments.



An important theme in the work of the TA was the importance of Government focusing on its core roles, which, in relation to regional development, include facilitation and coordination. It was concluded in the Government's response that this recommendation is being catered for through:

- Current government activities and the operational guidelines for the National Committee and Regional Councils, which were developed and approved in January 2004.

Again, this is a positive response from the Government and, as noted in documents prepared within the TA, and previously in this report, the structure that has been put in place under the LRDMC is a robust one that supports a facilitation and coordination role of government, while also facilitating local involvement and a bottom-up approach to planning. The institutional and legal structures that are now in place, as previously acknowledged, provide a sound basis for regional development planning and implementation.

The Spring Session of Parliament will be reading proposals relating to aimag 'internal regionalization', inter-soum centers, and the structure of town groupings. Consequently, it is suggested in the Government's response that this would be the most appropriate time to shift towards bottom-up planning. While there seems little relationship between the forthcoming discussions in Parliament and the recommendations from the TA about a bottom-up approach to planning, this response, at the least, indicates that the general idea of an approach to planning that is other than prescriptive and centrally-based is being heard.

The matter of the five-region model is a vexed issue and one that, during the course of the TA, has often overshadowed far more important matters. It is noted that:

- It is accepted that the five region model can be revisited in order to make further improvements.

Again, this is a positive response to the work of the TA, although it is very important that the reasons for revisiting the model are clearly understood. The most important reason is that, as has been emphasized repeatedly in the TA, the purpose for regionalization must be clear. This is the main problem with the model, and the associated RDC and MTRDS, at present. If the model, with its historical significance to Mongolia, is intended to provide a regionalized administrative structure then it is not a major concern as to whether it is the 'correct' model. If, however, it is one that is meant to support regional and national economic growth, improve equity between rural and urban populations, and reverse – or at least reduce – rural-urban migration, then it is unlikely to have any appreciable impact on any of these matters.

Importantly, the Government has a strong commitment to the five region model as presently constructed. Consequently, it is accepted that the current lines on the national map that demarcate the five regions will remain. It is, however, recommended that within this structure the potential for deconcentrated regional structures for individual line ministries (sometimes referred to as 'sectoral ministries') is carefully assessed. Given that the line ministries have responsibility for the planning, implementation and management of regional development activities, and given the recent introduction of the PSMFA, a deconcentrated approach seems a rational approach in Mongolia. It is also an approach that will enhance service delivery, assist in regional economic growth and development, and facilitate greater equity in access to services and opportunities. The fact that such an approach might be considered seriously by the Government is indicated by the comment that:

- We understand that the goal to accelerate regional development can be achieved through better coordination of sectoral programs and projects, thus we support the idea to consider potential sectoral regions in the planning process;

In the response to the work of the TA the government also noted:

- The links between the regional development strategy, the MTFP and the Public Investment Program need to be identified to ensure that the resources needed to implement the strategy are available.

Again, the TA has brought a greater level of understanding to some of the key budgetary issues faced by the many regional development proposals and there has been a positive response as a result of that improved understanding.

Finally, in the Government's response there is some discussion of the need to finalize organizational arrangements, particularly in relation to a professional unit or secretariat to coordinate regional development policy and planning. This is a matter that is covered in the LRDMC, although as noted in the Government's response:

- The recommendations made in relation to such a unit need to take into account the experience of other countries and the recommendations of other international organizations. It will also depend heavily on the initiatives of central and local government staff, and particularly the leadership ability of managerial staff.

This is a response that, again, is totally in agreement with the ideas and recommendations from the TA. The need for the Government to establish a professional unit, and the further need for international support from an agency such as ADB for the work of such a unit, has been expressed in the outputs of the TA.

In summary, the response of the Government, as presented by the State Secretary of MOFE at the final TA conference, indicates a level of agreement with the main TA conclusions and recommendations that suggest that the TA has had several important outcomes. It also indicates a willingness by government to take on new ideas and to actively seek ways to ensure successful outcomes in their regional development efforts.

## **5. TA OUTCOMES AND FUTURE ADB SUPPORT FOR REGIONAL DEVELOPMENT POLICY AND PLANNING**

### **5.1 TA OUTCOMES**

Notwithstanding the positive outcomes reported in section 4 above, it is difficult to fully assess the outcomes of the TA at this point in time. Capacity building was the main outcome sought. Capacity building involves consideration of organizational, institutional and system structures and the strengthening of each of these elements of capacity. It also involves attention to the human resources and capabilities within an organization, and normally involves participatory processes in building overall capacity. It is generally agreed that there are four levels of capacity: (i) the enabling environment; (ii) the sector/network level; (iii) the organizational level; and (iv) the individual level.

Capacity building is fundamentally about change and transformation at the individual, organizational and societal levels. In the context of regional development in Mongolia, capacity building relates to strengthening the organizational structure, further developing the institutional components, and enhancing the capabilities of the personnel involved in regional development policy and planning. It will also have an objective of ensuring effective links between the various organizations, at various levels, that are involved in regional development, including the Government, its ministries and agencies, along with aimag, soum and bagh management personnel.

The results of the capacity building focus of the TA were as follows.

#### **5.1.1 Enabling Environment**

The establishment of a suitable enabling environment for investment has been stressed throughout the TA as a key element of capacity building for regional development. This includes consideration of such matters as the macroeconomic setting which, as noted in Working Paper No. 2: *Towards an Economic Policy Framework that Supports Development in the Regions*, is presently not conducive to regional development. There is little that a TA can do about this situation other than bring it to the attention of policy-makers.

Elements of the enabling environment for regional development, in the minds of various policy-makers, include the proposals for free economic zones and the development of the pillar centers. As previously noted, such strategies are based on a supposition that the provision of infrastructure will catalyze significant levels of investment. It has been pointed out repeatedly that such strategies are flawed in the Mongolian context and should be reviewed. If a review of the pillar center strategy resulted in a move to a more strategic approach with a focus on industry clusters and organic growth centers, then this would be a strong outcome from the TA.

A very important aspect of the enabling environment for regional development is that of the structure of regions under the five-region model of the RDC and MTRDS. It was observed early in the TA that the declaration of new regions is not a requirement for regional development and

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<sup>11</sup> Despite repeated recommendations on such matters, a presentation by a government official at a conference in late February indicated that the ideas outlined in the RDC and MTRDS had not been reviewed or varied in any way.

that the purpose for declaring particular regions must be very clear. Under the TA it has been recommended repeatedly that the five-region model should be reviewed, particularly as it is not seen as a robust model for regional development: the regions defined do not, apart from the Ulaanbaatar region, comprise functional regions (see Policy Advisory Paper No. 4). It is noted that previous reviews of the RDC, such as those undertaken by the IMF/IDA and ADB, also recommended a revision of the RDC and particularly of the five-region model. Agreement to support an independent review and revision of the RDC would, again, be a significant outcome of the TA. As noted earlier in this report, however, the Government is committed to the five region model, so the focuses of further review work should be on the purpose of regionalization and the potential for deconcentrated governance approaches.

### **5.1.2 Organizational Structure and Institutional Aspects**

The organizational structure for implementing regional development policy has not yet been finalized, but is heavily influenced by the Law on Regionalized Development Management and Coordination. The structure provided for in the Law is generally appropriate to the development and coordination of regional policy and planning activities. Organizationally, it has been recommended that overall responsibility for regional development reside within the Prime Minister's Economic Strategy and Planning Office (which is yet to be established), with suitable staffing to undertake needed policy, planning and coordination work. In the interim until this office is established it is recommended that responsibility for regional development matters be delegated to the Cabinet Secretariat.

Institutional aspects include the various laws and regulations that have an influence on regional development. These include, although are not limited to, the PSMFA and the MTRDS, which are seen as appropriate institutional arrangements that are still to be fully 'bedded down'. These institutional arrangements have important influences on organizational arrangements, particularly those relating to the structure and mode of operation of the line ministries. It has been recommended that formalization of deconcentration of line ministry responsibilities would comprise an appropriate organizational structure under the PSMFA. Further work will need to be done on this recommendation but, if adopted, this would again be a significant TA outcome.

### **5.1.3 Enhancing the Capabilities of Personnel**

While this is just one aspect of capacity building it is often seen as the most critical. In general, it is concluded that the capabilities of many personnel in government, as well as in non-government, have been enhanced by the TA. The training undertaken in Australia, the seminars and workshops, and the distribution of documents such as the Policy Advisory and Occasional Papers, have been influential in enhancing the knowledge and capabilities of many individuals. Clearly, not all individuals involved in regional development work have been influenced by the activities of the TA and it remains the case that some influential personnel have clung to their views about the approach to regional development and the validity of the RDC and MTRDS. Given the high levels of ownership of ideas and documents this is perhaps not surprising.

One important lesson from the TA relates to the question of counterpart staff. Following requests from the Team Leader for counterpart staff, it was decided that the main working group would comprise the "counterpart". This was an arrangement that was never likely to work, particularly as the personnel nominated for the working group were mostly senior, very busy people, located in a range of agencies. Furthermore, successful counterparting requires

that local staff members are available to work closely on a day-to-day basis with international staff. The lack of counterpart staff impeded the capacity building outcomes of the TA.

Overall, however, feedback from a range of people in Mongolia suggests that the TA has made a substantial contribution to knowledge about the principles of and approaches to regional development in a market economy setting.

## **5.2 FURTHER ADB INVOLVEMENT IN REGIONAL DEVELOPMENT POLICY AND PLANNING**

ADB, particularly through TA 3948, has provided leadership amongst the development community in Mongolia in relation to regional development. This is evidenced by the requests from virtually all donor agencies for copies of documents produced under the TA, along with requests for supplementary information. Additionally, of course, the Bank is actively involved in various projects with regional development components.

The evidence from the TA leads to a conclusion that the focus of future support should be in the area of implementation of regional development, again with an emphasis on capacity building, rather than on policy and planning. Furthermore, as recommended, the location of support for regional development should be carefully assessed. If, as recommended, responsibility for regional development activities is placed initially within the Cabinet Secretariat, and subsequently in the Prime Minister's Economic Strategy and Planning Office, then that will be the appropriate place for the provision of Bank support.

➔ It is recommended that the ADB provide support for the further development and implementation of regional policy in Mongolia, based on the previous recommendations relating to the location for and focus of such support.

Future support by ADB for regional development could occur under the following goals, objectives and activities/inputs.

### ***Goal:***

Support the further development and implementation of regional policy in Mongolia

### ***Objectives:***

1. Support the establishment of a regional policy implementation unit in the Prime Minister's Economic Strategy and Planning Office. This would require agreement by GOM to establish and staff such a unit;
2. Increase capacity in the design of microeconomic policy interventions, including those of relevance to regional development;
3. Enhance capacity to undertake social and economic analysis of programs and projects within the policy implementation unit and in line ministries;
4. Facilitate improved coordination of regional development initiatives, including consistency with national economic policies and management systems;

5. Support capacity building in key line ministries, including Food and Agriculture, Education, Culture and Science, and Health, in project planning and analysis, strategic planning and corporate planning; and
6. Support capacity building in similar professional undertakings in regional areas, focusing on the Regional Councils and their professional support staff.

### *Activities and Inputs*

1. Provision of an international adviser with skills in the areas noted in the objectives above, perhaps for a period of two years;
2. Short-term specialist inputs in areas such as microeconomic policy formulation, training in benefit-cost analysis and other relevant in-country training;
3. Undertake a comprehensive review of the five-region model with a focus on functional regions and also taking into account previous ADB-supported activities in local government and decentralization, along with activities under the Public Administration Reform Project (PARP);
4. Provide support for the development of deconcentrated regional management structures within the line ministries, including the preparation of corporate plans in which matters such as the regional delivery of programs are addressed;
5. Assist line ministries in the preparation of annual budget submissions, based on the PSMFA and MTFP, that are supported by annual action plans and monitoring procedures and related to their corporate plans;
6. Arrange one or more short-medium term attachments for Mongolian staff with a regional planning and development agency in a country with similar regional development challenges to those faced in Mongolia; and
7. Assist the Regional Councils in developing protocols and approaches to their work that facilitate regional development and a bottom-up approach to regional planning and policy development.

**APPENDIX 1:  
REPORTS ARISING FROM TA  
3948**

## **GENERAL REPORTS**

1. Inception Report;
2. Review of the Regional Development Concept and the Medium-Term Regional Development Strategy;
3. Working Paper No. 1: Institutional and Legal Structures Review;
4. Working Paper No. 2: Towards an Economic Policy Framework that Supports Development in the Regions;
5. Working Paper No. 3: The Context for Regional Development Policy, Planning and Capacity Building in Mongolia;
6. Working Paper No. 4: Organizational and Institutional Structures to Support Regional Development;
7. Report on Training Held at the University of Queensland, Australia; and
8. Final Report.

## **POLICY ADVISORY PAPERS**

- No. 1: A Process Approach to Regional Development Programs. December 2003;
- No. 2: Important Concepts and Definitions for Regional Development Policy and Planning December 2003;
- No. 3: Mongolian Regional Development Indicators and Indexes. January 2004;
- No. 4: Defining Functional Regions. February 2004;
- No. 5: Pillar Centers, Enterprise Clusters and Regional Development. March 2004;
- No. 6: The Role of Government in Regional Development. March 2004; and
- No. 7: Institutional and Organizational Aspects of Regional Development in Mongolia. March 2004

## **OCCASIONAL PAPERS**

- No. 1: Methodological Framework for Preparation of Regional Development Programs; and
- No. 2: Methodological Framework for Preparation of General Plans for Pillar Centers.



## **DISCUSSION PAPERS**

- No. 1: The Health Sector and Regional Development. Prepared by Yo. Dingu, Social and Community Consultation Specialist; and
- No. 2: The Identification of Regions for Educational Services. Prepared by D. Namsrai, Sectoral Specialist, and D. Otgonchimeg, Social and Community Consultation Specialist.

**APPENDIX 2:  
RECOMMENDATIONS FROM  
THE POLICY ADVISORY  
PAPERS**

# **POLICY ADVISORY PAPER NO. 1: A PROCESS APPROACH TO REGIONAL DEVELOPMENT PROGRAMS**

## **KEY RECOMMENDATIONS**

It is **recommended** that the Regional Development Programs (RDPs) are focused on a process approach, thereby laying out a planning system that is flexible, that allows government at all levels to set clear future directions, and that results in strategies that inform the preparation of local, regional and national plans that support regional development.

It is **recommended** that preparation of the RDPs takes a bottom-up approach with participatory processes, through community consultation, afforded considerable importance.

It is **recommended** that the planning framework for the RDPs contain three different levels of planning documents (shown in Figure 1). Key features of this planning framework include that it:

- Is based on a bottom-up approach with community consultation (participation) emphasized;
- Involves each level of government/administration in the formulation of the program, thereby ensuring a level of ownership by all levels;
- Takes account of existing government policies, laws and administrative systems, thereby ensuring that RDPs are consistent with those policies, laws and systems;
- Takes account of existing and planned regional development activities, whether implemented by local authorities, NGOs, national government agencies, international development agencies or the private sector;
- Involves a dynamic system of feedback between the levels of planning to keep all levels involved throughout the process;
- Results in a realistic and sustainable approach to regional development; and
- Supports regular monitoring and review.

## **POLICY ADVISORY PAPER NO. 2: IMPORTANT CONCEPTS AND DEFINITIONS FOR REGIONAL DEVELOPMENT POLICY AND PLANNING**

### **KEY RECOMMENDATIONS**

It is recommended that the Government of Mongolia ensures that thorough social and economic analyses are undertaken of the proposed **pillar centers**, particularly given the high opportunity costs associated with investments in those centers. Such analyses should consider potential *organic growth poles* in Mongolia. This is an area of analysis that might be supported by one or more development agencies (See items 2.3 and 2.4 in the text below).

It is recommended that thorough economic analyses of the proposals to establish a number of **free economic zones**, including those already commenced at Zamyn-Uud and Altanbulag, be undertaken. This is again an activity that is likely to be supported by a development agency (Item 2.7).

It is recommended that policy initiatives that support further development of existing industry **clusters** be researched and, potentially, implemented. Such policy initiatives should be included in regional development policy (Item 2.8).

It is recommended that the planning and construction of **industrial zone** is allowed to be demand-driven, with private-sector investment underpinning such initiatives (Item 2.11).

It is recommended that foreshadowed proposals to establish **technology parks** in Mongolia be preceded by the development of an *innovation strategy* and that, subsequently, the technology park proposal is subjected to thorough economic analysis (Item 2.12).

Skills in **microeconomic policy** formulation appear to be relatively limited in the government sector of Mongolia. It is recommended that support from a donor agency be sought to strengthen this area of policy development (Item 3.6).

## **POLICY ADVISORY PAPER NO. 3: MONGOLIAN REGIONAL DEVELOPMENT INDICATORS AND INDEXES**

### **KEY RECOMMENDATIONS**

Development indexes are employed to compare and define comparative development levels and, thereby, assist in the identification of those countries or regions that are lagging in development terms. Consequently, guidance is available on where the greatest level of need occurs and resources may be directed to such areas. However, the problem of aggregation is highlighted by the development indexes estimated for Mongolia. Consequently, it is **recommended** that the presently proposed regions be reviewed, with the potential for reducing the level of aggregation.

It is **recommended** that regional development indicators and indexes for Mongolia are utilized as monitoring tools when monitoring regional development impacts from year-to-year, as well as in the medium-term.

It is **recommended** that, in the formulation of regional development policies and programs for Mongolia, the indicators and indexes are taken into account.

It is **recommended** that the regional development indicators and indexes outlined in this paper are utilized in the formulation of regional development planning models in Mongolia.

It is **recommended** that the regional and aimag-level development indicators (Table 1) and indexes (Tables 2, 3 and 4) for Mongolia are used as one guide for the allocation of state investments.

It is **recommended** that policy-makers make use of the development indexes to explicitly consider whether the regional development focus is more on equity or efficiency – some elements of both will occur, but it is a question of where the emphasis is placed. This also requires policy-makers to assess the opportunity costs associated with the decisions on equity and efficiency.

## **POLICY ADVISORY PAPER NO. 4: DEFINING FUNCTIONAL REGIONS**

### **KEY RECOMMENDATIONS**

The principle for selecting regions is that regions must be defined on the basis of the **PURPOSE** for which they are to be used.

It is **recommended** that the overall goal for regional development in Mongolia, as specified in the Regional Development Concept, be shortened slightly to read:

“The overall goal of regional development is to create a favorable environment for narrowing the disparities in urban and rural development within regions, accelerate economic growth, and support social progress throughout Mongolia.”

Such a goal emphasizes the role of government, and it is **recommended** that government and its policy-makers focus their work on policies and strategies that facilitate, rather than prescribe or direct, regional development.

It is **recommended** that regionalization be focused on coordination, management and effective delivery of human services, along with efficient use of scarce public resources. (The agreed structure of a National Committee and Regional Councils, under the Law on Regional Development Management and Coordination, supports such an approach).

It is **recommended** that the current groupings of aimags, as specified for Western, Khangai, Central and Eastern regions, be reviewed urgently, with a view to reducing the size of regions and increasing their number. Such a review should include consideration of sectoral regions and criteria for their selection.

It is **recommended** that relevant criteria for regionalization in Mongolia be adopted, with those criteria being: (i) reducing rural-urban disparities; (ii) reducing poverty; (iii) reducing unemployment in areas where this is a problem; and (iv) improving the provision of human services in rural and regional areas.

Reference to the Human Development Report (UNDP, 2003) emphasizes the importance of these criteria. As noted by Bazarghur (2003) regions should be allowed to emerge based on existing infrastructure and industrialization, and the market forces of supply and demand.

It is **recommended** that the above matters be brought to the attention of the Public Administration Reform Project (PARP) for consideration under that reform program.

## **POLICY ADVISORY PAPER NO. 5: PILLAR CENTERS, ENTERPRISE CLUSTERS AND REGIONAL DEVELOPMENT**

### **KEY RECOMMENDATIONS**

It is **recommended** that the objective for developing pillar centers is carefully reviewed.

The principal conclusion is that a policy and strategy based on the development of eight growth poles (pillar centers) is one that will not represent an efficient or effective use of scarce government resources. Therefore, it is **recommended** that the Government of Mongolia not pursue this strategy. At the very least it should be subjected to rigorous economic analysis.

Concomitantly, it is **recommended** that government focuses on its core roles, including establishment of a suitable enabling environment for the private sector to establish in locations chosen by private investors on the basis of competitive advantage.

It is also **recommended** that government remain focused on its core roles of mitigating market failure in the provision of important social services throughout the nation (i.e. focus on equity).

The key **recommendation** is to shift the focus from pillar center development to facilitating the development of potential industrial and enterprise clusters.

It is also **recommended** that government policy makers engage with the USAID Economic Policy and Competitiveness Project, particularly in relation to clusters.

## **POLICY ADVISORY PAPER NO. 6: REGIONAL DEVELOPMENT: THE ROLE OF GOVERNMENT IN A MARKET ECONOMY SETTING**

### **KEY RECOMMENDATIONS**

It is universally accepted, in market economies, that governments have a number of core functions. In relation to regional development these include formulating macro and micro economic policy; establishing a suitable enabling environment for private sector investment to facilitate regional development; mitigating market failure, particularly for social services; promulgating appropriate laws and regulations in a transparent setting; and coordinating policy and planning.

It is, therefore, **recommended** that the Government of Mongolia focus on its role as a facilitator and coordinator of regional development, along with its role of addressing market failure, rather than prescribing how regional development shall occur.

It is **recommended** that the RDC and MTRDS are revised, taking account of market economy principles and the core roles of government.

It is **recommended** that any government investments in infrastructure are demand driven, as distinct from the supply-side emphasis of the RDC and MTRDS.

It is **recommended** that regional policy development and planning activities take a bottom-up approach, involving a wide range of stakeholders.

Skills in microeconomic policy appear to be relatively limited in the government sector of Mongolia. It is, therefore, **recommended** that support from a donor agency is sought to strengthen this area of policy development, possibly located in the Economic Policy and Planning Department of MOFE.

It is **recommended** that the National Committee, Regional Councils, and their respective professional support offices adopt a role of coordinating regional development activities, but that implementation and management of those activities remain the role of the line ministries.

It is **recommended** that an appropriately staffed professional office, with responsibility for coordinating policy development, planning and implementation of regional development, and providing professional support for the National Committee, is established within the Cabinet Secretariat.

It is **recommended** that ADB considers providing professional TA support for the establishment and operation of this office.

It is **recommended** that ADB provides support for the further development and implementation of regional policy in Mongolia, based on the previous recommendations relating to the location for and focus of such support.



## **POLICY ADVISORY PAPER NO. 7: ADMINISTRATIVE AND PLANNING FRAMEWORK FOR REGIONALIZED DEVELOPMENT**

### **KEY RECOMMENDATIONS**

It is **recommended** that the Prime Minister's Economic Strategy and Planning Office, as indicated in Article 34 of the Law on Government, is established as soon as practicable.

It is **recommended** that this office comprises the Secretariat for the National Committee, which is responsible for coordinating regional development activities and providing professional support to the National Committee, as specified in the LRDMC and Government resolution # 27 of 30 January, 2004.

It is **recommended** that the existing unit of the EPPD that is responsible for regional development issues be transferred to that Office.

It is **recommended** that the memberships of the National Committee and the Regional Councils are extended to include private sector, NGO and other relevant stakeholders.

It is **recommended** that the organizational arrangements that specify how the National Committee, its Secretariat and the Regional Councils will be involved in the preparation of the Annual Guidelines and MTFF are drafted by the Secretariat to the National Committee, considered by the National Committee, and provided to MOFE in the form of a recommendation.

It is **recommended** that active consideration is given to enhancing and formalizing deconcentration of the activities of key line ministries through the establishment of 'sectoral regions', thereby supporting the implementation of regional development policy.

**APPENDIX 3:  
GOVERNMENT RESPONSE TO  
TA CONCLUSIONS AND  
RECOMMENDATIONS: PAPER  
PRESENTED AT THE  
CONFERENCE OF 17-18 MARCH**

March 17-18, 2004

Ulaanbaatar

**“SOME ISSUES RELATED TO IMPLICATION OF PROJECT OUTPUTS”<sup>12</sup>**

Presenter: Ch. Khurelbaatar, State Secretary, MoFE

Good morning Ladies/Gentlemen,

Government of Mongolia has implementing “Capacity Building for Regional Development Integrated Planning” Technical Assistance Project under the ADB financial support since April 2003. Ministry of Finance and Economy and Ministry of Infrastructure were the main government bodies responsible for providing timely support to the TA day to day activities. We expect to receive final TA report by April, May this year.

Main objectives of the TA were identified as to improve planning features or methodology and organizational and institutional structure for implementation of Regional Development Concept (RDC) and Medium Term Regional Development Strategy (MTRDS) that have been approved by Parliament of Mongolia as well as strengthen skills and capacity of government staff to develop planning process considering regional development issues.

Project team has taken this goal as a guideline for its activities and has carried out studies of existing regional development policy documents and produced number of important assessments, suggestions, and recommendations to increase policy documents value, improve their scientific approach, identify market economy features that support regional development.

These TA outputs are presented in more detail in the TA project team Leader Dr Derrin Davis’s presentations.

I would like now more focus on the issues how MoFE sees further implication or implementation of these suggestions and recommendations raised by the project.

First of all we agree with the project main conclusion that Regional development policy should be considered as main component of the National development planning and be implemented within the macro economic integrated policy, coordination framework in order of sequences.

Main recommendations that are related to consideration of opportunity costs, identifying competitive advantage, selecting the most cost effective approaches while developing priority areas, pillar center duties and structure are needed to be considered immediately. It is significantly important also to carry out cost benefit analysis for any projects activities going to be implemented for FEZ establishment.

Those organizations already involved in development of Regional development programs, Master plans for pillar centers as well as investment projects for the FEZ have been advised to consider related recommendations and suggestions and its interim monitoring is underway.

Project recommendation regarding the core role of the government to focus more on facilitation of the regional development, providing market information, professional advices and through

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<sup>12</sup> This paper has not been edited prior to its inclusion in this Final Report. It is presented in the form, which was distributed and presented at the conference. The main reason for not editing the English expression in the paper was a concern that such editing might result in reinterpretation of some of the points made.

implementing programs and projects to coordinate activities across the sectors, urban and rural areas is in line with current government activities and subsequently operational guidelines for National committee and Regional councils to support regional development were developed and approved recently.

Spring Parliament session is going to read proposed aimag internal regionalization, inter soum centers, town groupings structure and it would be more appropriate time to shift more towards to bottom up planning approach, as frequently have been highlighted in project documents, to achieve regional development goals after its approval by Parliament.

“ Five economic region” model adopted by Mongolia, as you understand, has been developed based on the specific peculiarities of the nation to ensure socio-ecological balance, appropriate connection to the international trade network and infrastructure considering transport and geographic locations, maintain unitary national economy and state administration conditions.

Within each of this region development centers, pillar centers are to be developed in conformity of the local capacity of in terms of natural and raw material resources, intellectual property and subsequently manufacturing, service providing, inter soum, aimag, city, town cooperation, specialization are to be developed attracted by their markets.

Based on the above, possibilities to create geographic “groupings” or “clusters” of firms, individuals, organizations willing to support each other, be closely interrelated and be relatively independent do exist and what is important is needed. Taking this approach it is accepted that “5 region model” can be revisited in order for further improvement.

We understand that goal to accelerate regional development can be achieved through better coordination of sectoral program and projects, thus we support the idea to consider potential regional sectors in planning process. Using this regionalizing, identification and development of industrial parks, specialized intensive cropping and livestock areas as well as potential tourism and mining industries in pillar centers and in its spillover areas is given more focus. These areas are meant to be growth poles to accelerate national economy and increase efficiency, so policy is taken towards to increase investment and financial support into these areas. Doing so conditions to apply the recommendation drawn from the TA documents to rationally allocate scarce resources and achieve effective results would be available.

Another very important recommendation has been raised by the project is that planning should be further improved towards to link closely RDS to MTF, PIP to ensure financial resources available for its implementation and we support it.

There is need to improve the strategy considering more closely regions and sectors programs, projects and funds required for financing can be allocated in the annual budget package of the Member of Government responsible for the sector. Further, stable fund is needed to be established to finance implementation of common arrangements and achieve common goals, use these resources for identified priority areas in most cost effective way, set up proper management for monitoring, reporting outputs. It is suggested that this issue can be solved within the planned activities to develop guideline for performing “Regional development support fund”.

Regarding the institutions to support regional development, along with to activate activities of the recently established RCs it is needed to improve organizational structure that would support

RCs. With this relation, “professional unit” or agency that would direct inter ministry and sectors, inter aimag and regions cooperation to address common issues of the regions is proposed to be established within the Government structure is needed to be studied.

This TA recommendation is needed to be considered appropriately taking into account other countries experience and recommendations given by other international organizations. It also will depend very much on initiatives of central and local government skilled staff, in particular on leadership ability of the managerial staff.

Taking this opportunity, I would like to emphasis the importance of the training has been carried by thus TA for government staff in Australia, where many similarities to Mongolia as of nature, climate and physical structure do exist.

I would like to express my gratitude to the ADB TA team leader Dr Derrin Davis, to its consultants members for its contribution to assist to strengthen “intellectual capital” capacity in area of regional development, notably is happening at first time.

There is no doubt that our cooperation in this area will continue and deepen further.

Thank you for you attention

# **APPENDIX 4: ASSESSMENT OF THE FREE ECONOMIC ZONES**

## **ECONOMIC POLICY REFORM AND COMPETITIVENESS PROJECT**

### **February 2004 Newsletter<sup>13</sup>**

#### **Assessment of Mongolia's Free Trade Zones program and site evaluation completed**

The project completed the assessment of Mongolia's Free Trade Zones program and site evaluations of the proposed Zamyn-Uud and Altanbulag FTZs, in response to a request from the Ministry of Industry and Trade (MOIT).

Led by José Cerón, a former FTZ manager and international expert fielded by EPRC, major findings of the assessment were:

- The Free Trade Zone Program of Mongolia presents serious competitive deficiencies compared with international best practice elements required to offer a competitive environment;
- Mongolia's Law on Free Economic Zones needs to be revised to raise the program to international standards of competitiveness;
- Lack of implementing regulations and procedural definitions encapsulated in Standard Operating Procedures (SOPs) prevents achievement of a minimal transparency and predictability quotient required to operationalize key international best practices;
- Identifiable funding is not in place to meet off-site infrastructure requirements for the Zamyn-Uud and Altanbulag sites; a situation that, combined with the program's low competitiveness level, seriously hampers the possible success of an international tender process for the Zamyn-Uud site; and
- The absence of a business demand study and a cost- benefit analysis for both potential firm investors and the country as a whole presents a weak foundation for launching an FTZ program.

The assessment included visits with GoM officials to the proposed FTZ sites of Zamyn-Uud and Altanbulag.

Main recommendations of the assessment included:

1. The GoM should explore a leisure development concession in Zamyn-Uud in response to the identified market niche opportunity and potential investors' interest provided by its proximity to Erlian City in China;
2. To prepare for such a concession, the GoM should assess its legal framework, regulations and compliance systems on anti money laundering, as well as contract international

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<sup>13</sup> This report comprised the first page of the Newsletter.

expertise in leisure related activities to assist in the concession agreement that could include conditions that would provide for FTZ off-site infrastructure requirements at Zamyn-Uud FTZ;

3. The leisure related activity and the Free Trade Zone (FTZ) should be “ungrouped” to allow the first to proceed at required speed under a concession agreement that should be based on a thorough cost-benefit evaluation process and take into consideration not only investor needs but country returns from the venture(s);
4. An international tender to attract an on-site developer for the Zamyn-Uud site should not be issued during the month of March 2004 to avoid a failed tender process that could possibly generate a Mongolian “negative brand” perception;
5. Prior to issuing the tender, a market demand study needs to be conducted to determine business interest in the Zamyn-Uud and the Altanbulag FTZ; and
6. If the market demand results are positive, a full feasibility study needs to be conducted to perform financial and economic analyses to measure cost/benefits for investors and the country.

Prior to his departure on 17 February, Mr José Cerón and EPRC presented these findings and recommendations to the MOIT and the Office of the Prime Minister.



**APPENDIX 5**  
**COMMENTS FROM MINISTRY**  
**OF FINANCE AND ECONOMY**

## INTRODUCTION

The comments on the Draft Final Report, provided by J. Jargalsaikhan, Director of the Economic Policy and Planning Department of the Ministry of Finance, are reproduced below (without editing).

As agreed at the meeting of the Steering Committee of 31 March 2004, responses to these comments are provided. The responses are placed in text boxes to distinguish them from the comments provided by Jargalsaikhan.

### **COMMENTS TO THE DRAFT FINAL REPORT OF MON 3948 MG: CAPACITY BUILDING FOR INTEGRATED REGIONAL DEVELOPMENT PLANNING**

The draft final report has been reviewed and following comments are provided:

1. *To revisit RDC, MTRDS with purpose to make existing five regions functional.*

Comment: For the country with developed markets and infrastructure (road, transport, communication, power etc) network and with concentrated population developing functional regions is appropriate. But regarding Mongolia where the most concentration of activities locates in Ulaanbaatar, market development is poor, small population, is the economic structure is mainly based on pastureland livestock, natural and mineral resources haven't been almost studied, it seems, there is a need to have look regional development issues from the different angles. In other words there are no possibilities to identify directly functional regions. Thus, it was decided to approve the policy according to which 4 regions to be established and Ulaanbaatar city to be developed as independent under the RDC with the first purpose to decentralize through establishing bigger regions and development of infrastructure network. The policy pursued is through developing infrastructure (road, transport, power etc.) network that would cover these four regions, as well as developing education, health etc. public service centers to create concentration of population in the regional centers, which will create and increase local demand, thus induce economic growth; utilizing region's aimags and cities available human resources, natural and mineral resources, local potentials to establish economic growth centers, establish industrial and service complex at least in each region. Thus the recommendation to delay the social, cultural and infrastructure investing in identified pillar centers cannot be accepted.

If we look forward to invest in social, cultural and infrastructure when it will be seen economically efficient then it will be obvious to be asked When the rural regions are expected to be developed? And behind of this we expect many of problems to be addressed as public service, unemployment, poverty will deepen further. There is no clear explanation in the report how these functional regions are to be established. Understanding of economic region associated not only with economic growth, but social and administrative issues as well.

Government is responsible for creating enabling environment for market development and subsequently is responsible for providing same environment for infrastructure development.

According to the RDC approved by the Parliament of Mongolia four regions (plus Ulaanbaatar) are to be established and significant consideration was taken to reflect specific conditions and

current economic level of development of the country. Thus looking at regionalization somewhat in different approach and revisit RDC is seems should be postponed for a while. In the draft report there is no clear description included of where and how to define functional regions in Mongolia.

### Response

1. The first recommendation in the Final Report was revised to read: “The purpose for regionalization is thoroughly revisited in the RDC with a focus on the definition of functional regions.” It is also noted that there is a high level of commitment to the five region model in Mongolia and that reviews of any kind will need to be undertaken under the ‘umbrella’ of that model.
2. The approach to defining functional regions was outlined in Policy Advisory Paper No. 4. It is totally incorrect to assert that, at this stage of development, it is not possible to identify functional regions. Conversely, to not do so is likely to inhibit regional development and lead to a waste of resources. The adoption of a deconcentrated model of management for individual line ministries, as recommended for consideration in the TA, would result in functional regions that strongly support regional development.
3. It is a misrepresentation to assert that the TA has recommended against investment in the regions. As explained on a number of occasions, government has a range of core functions, including investment in and support of social infrastructure and services, particularly in education, health and social welfare. The point is made, however, that the present approach is mostly **supply-side**, based on an assumption that the establishment of infrastructure will automatically lead to development and private sector investment. This ignores the economic realities of competitive advantage, the limited investment resources available to government, and that fact that the nation is finding it difficult to maintain the infrastructure already in place. The argument – and recommendations – of the TA are that infrastructure investment should occur, but that it must be based on **demand** to ensure that government resources are used efficiently. Such an approach will achieve more in terms of regional development, and will achieve it more quickly, than the present supply-side approach.

### Response (cont.)

4. It has been recommended that investment in economic infrastructure (as distinct from social infrastructure) in the pillar centers, investment that will, supposedly, underwrite economic development, should not be pursued or, at least, that it should be subjected to thorough economic and financial analysis. Again, the government’s assumption is that developing infrastructure in centers that, in some cases, are small and isolated will result in private sector investment and economic growth and development. But the evidence from around the world is that this is simply not the case – unless there is clear competitive advantage, little private sector investment will occur. Again, it is important that there is at least an economic assessment of the proposed pillar center investments.
2. *In paragraph 2.2.5 it says, “There is a need to recognize the disappointing recent economic performance and the policy reasons underlying this”.*

Comment: It is not consistent with recent recognition of IMF, WB, international organizations and donors that macro economic condition in Mongolia has stabilized and improvement of economic growth is noticeable. I would like to suggest rewriting this point.

**Response**

This point is acknowledged and agreed with, and is noted in the Final Report.

3. *Related to the last parts of the paragraph 2.2.6. where it says that RDC, MTRDC have been developed based on central planning command economy method*

Comment: I do not agree with this view, it has been previously explained.

**Response**

Every review of the RDC (including previous reviews by an ADB funded study and by IDA/IMF) has made the point that the RDC is based on a centralized planning system with a focus on physical planning and infrastructure. This point is also made in the TA paper the preceded the present TA. Any objective review of the RDC and the MTRDS will indicate that there is very little use of market economy principles and that the approach is very much that of central planning. Furthermore, no credible previous explanation of this has been provided.

4. In the Policy Advisory Paper No. 5 it is recommended that:

“Concomitantly, it is **recommended** that government focuses on its core roles, including establishment of a suitable enabling environment for the private sector to establish in locations chosen by private investors on the basis of competitive advantage.”

Comment: I understand this point directly as that government should not implement development of pillar centers. Might be my understanding is wrong. However providing support for pillar centers will certainly impact on emerging of development in someway, thus it does not seem proper just to abandon these initiatives. Thus, I would suggest to revisit recommendations that seem very strict and make them more flexible.

**Response**

This comment is a little hard to follow. The focus in Policy Advisory Paper No. 5 is on the core functions of government in a market economy. The comment does not refer specifically to the pillar centers, although it does relate to government making investments in areas that could or should be made by the private sector (and thereby incurring deadweight loss). The question of the pillar centers was discussed above, with the key point being the need to at least undertake economic analyses on those proposed investments. Additionally, the point has been made consistently in the TA that government has a role to invest where market failure occurs, as happens often in relation to social services. Finally, the recommendations on matters such as the pillar centers are flexible – they do provide an alternative of first investigating the situation in an objective fashion, as distinct from simply assuming that such investments will facilitate positive returns.

The final point to make is that the comments from MOFE, and elsewhere, indicate clearly the ongoing weaknesses in government policy making circles in respect of policy making and development planning in **accordance with market economy principles**. Regional development policy is predominantly about microeconomic policy, yet the application of the principles of market economics, applied to microeconomic policy, is almost completely absent in the RDC and MTRDS.

Comments made by

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