THE TRANSITION TO A MARKET ECONOMY: MONGOLIA 1990-1998[1]

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Abstract

This paper examines Mongolia's experience of transition from a centrally planned to a market economy. Its objectives are to relate this experience to the economic and historical conditions which Mongolia faced in 1990, to describe the chief features of the immediate transition, to discuss the liberalisation and privatisation programmes which constituted the core of the reforms, and finally, to identify the problems which have delayed recovery and imposed further costs on the Mongolian people. The central argument of the paper is that the Mongolian authorities have placed too great an emphasis on conventional stabilisation and re-structuring packages and too little attention has been paid to the legal, institutional and historical constraints on the rapid movement to the market.

Introduction

Although the transition from a centrally planned to a market economy is a worldwide phenomenon with a number of common features there has been a wide variability in the impact of this process in different countries. The particular experience of transition is a function of historical background, economic endowment and the way these have interacted with country specific shocks and the policy decisions with which transition has been implemented.

The objective of this paper is to consider Mongolia's transition from a centrally planned to a free market economy within its particular historical and economic circumstances. The paper provides a brief

***International Journal of Economic Development*,**
2(1), 2000: pp. 35-66.

overview of Mongolia's characteristics and of its pre-1990 development. It reviews some of the key elements of Mongolia's actual experience of transition and highlights some of the problems, both theoretical and practical, which have been encountered during this process.

Mongolia: An Overview

Mongolia is a landlocked country in northern continental Asia bordering on the Russian Federation to the north and the People's Republic of China on the east, west and south. It has a land area of 1.6 million square kilometres, making it the fifth largest country in Asia and the seventeenth in the world. Mongolia had a population of 2.32 million people in 1995, giving it a population density of 1.5 persons per square kilometre, one of the lowest population densities in the world. The capital city, Ulaanbaatar, located in the north central part of the country, accounts for 25 per cent of the population, with other urban centres accounting for a further 25 per cent. Mongolia's transport and communications systems are poorly developed and this has exacerbated Mongolia's relative isolation from the global economy until recent years.

Although the economy developed a significant industrial sector during the period of central planning, the agricultural sector remains the backbone of the economy. It is estimated that 80 per cent of the total land area is suitable for agriculture in the broadest sense (UNDP, 1996) but only 1.5 per cent of this is used for crops, 1.0 per cent is mowed for hay and 97 per cent is used for pasture. Mongolia remains a largely pastoral society with animal husbandry the main economic activity.

There are important links between the agricultural and industrial sectors, with agriculture providing the inputs to many processing and manufacturing activities, including leather and shoe manufacture, wool processing, cashmere production and milk and bread production. Mongolia has rich mineral reserves, including copper, coal, molybdenum, fluorite, gold, iron ore, lead, phosphate, tin and oil and oil shale. Large deposits of graphite, construction and industrial materials (marble, gypsum, limestone, granite, quartz sands and others) have also been discovered. The economic viability of developing much of this natural wealth is, however, yet to be established (UNDP, 1996). Copper concentrate and animal products (especially sheep and goat skins) dominate exports although there has been a dramatic increase in gold exports in the last three years; in 1997 they amounted to 24 per cent of exports (BOM annual report, 1997).

The behaviour of Mongolian output and income between the pre and post reform period is difficult to compare for a number of reasons. These include conceptual differences between the UN System of National Accounts (SNA) and the Former Soviet Union (FSU) material product balance systems, the structure of relative prices in centrally planned economies, and the problems of choosing an appropriate exchange rate. They are compounded in Mongolia by the excessive official secrecy prior to 1991 when the first statistical handbook was published (Kim, 1996). Estimates of per capita GNP in the mid to late-1970s using the physical indicators method (PIM) varied between US $ 1617 to US $ 780 (Kim, 1996: p. 314). The IMF, using a rather complex conversion factor, estimated per capita GNP at US $ 522 in 1989 (Kim, 1996, p. 314) and gave an estimate for 1994 of US $ 330 (IMF, 1996). An estimate for 1995 (quoted in UNDP, 1996) puts per capita income at US $ 352. These estimates put Mongolia into the World Bank's low income country category, making Mongolia one of the poorest countries in the world.

The UNDP (1997) ranks Mongolia as a medium human development economy (101 out of 175 countries) but its human development index (HDI) ranking is lower then its ranking by adjusted real GDP per capita (measured at purchasing power party) which is inexplicably put at US $ 3766 (1994 estimate). If accepted this implies that Mongolia is in danger of undermining its previous socio-economic advances (with respect to literacy and life expectancy, for example) as it attempts to reduce the role of government and move to a market economy.

The Pre-Reform Economy

The national revolution of 1921 was followed by the establishment of the Mongolian People's Republic in 1924 and the increasing integration of its economy with that of the former Soviet Union (FSU). At the time of the revolution Mongolia's economy was in a state of chronic economic backwardness (Sanders, 1987, Chapter 4). In 1924, the decision was taken to follow the 'non-capitalist road' of development. The 1920s and 1930s saw the gradual development of light and food industries based on the processing of livestock produce and the concentration of coal extraction and electricity generation in the capital, Ulaanbaatar (Sanders, 1987).

The 1940-1960 period witnessed the establishment of rural economy collectives, the collectivisation of animal husbandry and the diversification of the economy into ore mining, metal working, timber processing and consumer goods production. Full-scale industrialisation accelerated in the 1960s, Mongolia joined the Council for Mutual Economic Assistance (CMEA) in 1962 and during the 1970s and 1980s the economy experienced significant structural change.

Table 1
Mongolia: Percentage Sectoral Share of GDP, 1970-1993

Agricultural			Industry			Services		
1970	**1980**	**1993**	**1970**	**1980**	**1993**	**1970**	**1980**	**1993**
33.1	17.4	17.8	26.3	33.3	33.0	40.6	49.3	49.2

Source: ADB, 1994, Table A6, p. 236.

The fall in the share of agriculture over the period 1970-1980, and the concomitant rise in industry and services, was significant, but there was little further structural change after 1980.

There is general agreement that, until the middle 1980s, the overall growth of the Mongolian economy was “robust” (World Bank, 1992: p. 4). Both the World Bank (1994) and the ADB (1994) estimate the annual average rate of growth of GDP at market prices for the period 1981-1990 (1982-1990 in the case of the World Bank) at 5.6 per cent. Growth slowed from 1988 onwards however, before becoming negative in the post reform period.

The Mongolian Government itself was critical from the mid-1980s onwards of both the industrial strategy it had pursued and the performance achieved. It was argued that the wrong priorities were selected, for example, too high a priority was given to large-scale enterprises in the mining sector. Technologies utilised were out of date and the rate of growth of labour productivity was too low. In addition it was argued that the agricultural sector had been ignored, rural-urban inequalities had increased and that food shortages had emerged (especially of meat, the main food of Mongolians) (quoted in Nixson, 1991: p. 126). The World Bank (1992: p. 4) has argued, probably correctly, that Mongolia's capital-intensive, import-dependent, centrally planned economy had become incapable of generating self-sustaining growth.

By the second half of the 1980s, therefore, Mongolia had reached the limits of its chosen "model" of development, limits imposed by geography, history and politics as well as those inherent in the "inward-looking" heavy industry strategy of industrialisation. The economy was overwhelmingly dependent on the FSU in terms of trade, financial and technical assistance, it was dominated by largely loss-making public sector enterprises and was clearly unable to adjust rapidly to the twin external shocks of the cessation of capital flows from the FSU (which had accounted for up to 30 per cent of GDP) and the collapse of the CMEA in 1991 (World Bank, 1992: p. 4).

The Reform Process[2]

The removal from power in 1984 of Tsedenbal, Mongolia's leader for much of the post war period, marked the beginning of the economic and political reform process (Gibbons, 1992). In 1986 Mongolia launched a programme of political reform and economic liberalisation, but, in general, the reform programme was not successful and the economic and political situation did not improve (Gibbons, 1992, p. 2). Partly as a result of this lack of success and no doubt influenced by the changes that were occurring in the FSU, there was a groundswell of opposition to the communist party's hegemony. This culminated in popular demonstrations in Ulaanbaatar in early 1990 which led, in March of that year, to the resignation of the entire Political Bureau and Secretariat of the Mongolian People's Revolutionary Party (MPRP). The Constitution was amended in May 1990, introducing new electoral laws and the legalisation of political parties. The first multi-party general election was held in July. The Mongolian People's Revolutionary Party won with 68 per cent of the popular vote and 85 per cent of the seats in the 430 seat People's Great Hural, the upper chamber which deals with constitutional and overall policy matters. In January 1992 a new constitution was adopted incorporating the principles of a democratic society, guaranteeing fundamental human rights and based on a market economy. The name of the country was also changed from the People's Republic of Mongolia to Mongolia.

A general election was held in June 1992 with the MPRP retaining power. A further general election in 1996 led to the opposition parties taking power through the Democratic Union Coalition. There have been two changes in prime minister since that election and considerable political turbulence. Nevertheless, the reform process has been peaceful and rapid and has continued to receive general support across the political spectrum.

The central feature of the economic dimension of the reform process has been a package of re-structuring, which has crucially included price liberalisation and privatisation. The speed and phasing of reform has varied with political and economic circumstances but they have been a feature of the policy packages of successive governments. However, these reforms have been implemented against a background of severe macroeconomic turbulence, much of it outside Mongolia's control, against which the authorities have struggled to achieve a stable macroeconomic environment. This has, in turn, emphasised the importance of the institutions of a free market state, such as the central and commercial banks, and of the legal and other codes necessary to support the operation of a market economy.

Macroeconomic Management and Performance

As can be seen from Table 2, the macro performance of the economy in the immediate post reform period was extremely poor. Along with the significant fall in GDP, gross domestic savings, already in 1988 a small proportion of GDP, collapsed in 1990 and 1991.

Table 2
Mongolia: Annual percentage rate of growth of GDP at 1993 Market Prices

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
GDP growth rate	5.1	4.2	-2.5	-9.2	-9.5	-3.0	2.3	6.3	2.4	3.3
Gross Domestic Saving as % GDP	13.8	13.3	8.0	9.1	23.9	12.4	11.3	21.8	19.9	19.3
Gross Domestic Investment as % GDP	42.1	46.0	34.2	35.6	29.3	27.7	24.8	26.4	25.2	23.3

Source: Mongolian Statistical Yearbook, 1997, 1998.
Gross Domestic Saving is defined as the difference between GDP and total consumption expenditure in the national account.
Gross Domestic Investment is the sum of gross fixed capital formation and the increase in stocks.

However, concentration on GDP considerably understates the fall in disposable income available to Mongolia. In the pre-reform period GNP was approximately 30 per cent larger than GDP because of transfers from the FSU. These translated directly, through the government accounts, into consumer and investment goods, particularly components and fuel. These transfers abruptly ceased with the collapse of the FSU and the dissolution of the CMEA. In addition, the introduction of world prices for external trade led to a dramatic fall in the early 1990s of the price of copper concentrate relative to the price of oil which induced a sharp deterioration in Mongolia's terms of trade. Boone (1994) calculates that the overall impact of these internal and external shocks resulted in a 62 per cent decline in domestic absorption between 1989 and 1991; an unprecedented, large fall for a country in peacetime during the twentieth century and comparable to the falls experienced in Germany and Japan in the immediate aftermath of the second world war. The nature of these shocks determined the way in which transition impacted on the Mongolian economy and, in many respects, dominated the effects flowing specifically from the transition reforms themselves. Gross domestic investment as a percentage of GDP fell, from 46 per cent of GDP in 1989 to 27.7 per cent in 1993, in large part reflecting the withdrawal of financial assistance from the FSU. The cessation of financial transfers from the FSU represented a large negative supply multiplier effect (Mundell, 1997). In addition, the collapse of the traditional export markets in the CMEA allied to the fall in the terms of trade produced a subsequent further reduction via the demand multiplier (Mundell, ibid). As with so many other ‘shocked economies’ and the subsequent structural adjustment programmes, it is the squeeze on imports and investment that casts a long shadow over the resumption of economic growth and the recovery of the real economy.

Since 1994 there has been positive economic growth. Nevertheless, in 1997, GDP was still 10 per cent below the level of 1989 and gross national disposable income even further below the level enjoyed at the end of the 1980s. Gross domestic product was estimated by the State Statistical Office to have grown by 2.3 per cent in 1994 and, in response to favourable movements in the terms of trade, reached 6.3 per cent in 1995. The reversal of the favourable movement in the terms of trade in 1996 reined back growth to 2.4 per cent and 3.3 per cent in 1996 and 1997 respectively. This illustrates one of the chief difficulties of the Mongolian economy: the prices of its main exports are determined on world commodity markets over which it has no leverage and which are subject to large and unpredictable shifts.

The major growth sectors have been agriculture, industry and mining and construction (UNDP, 1996: p. 44). The mining sector in particular has been stimulated by a rise in the international price of copper concentrates and the development of gold mining. In 1995, there were 75 gold mines, the majority of which were privately owned, with total exports of gold worth US $ 25 million. By 1997, the total exports of gold reached US $ 116.9 million, representing 24 per cent of exports.

The abolition of central planning meant that the Mongolian Government had to move quickly to establish the new institutions needed for the operation of a market economy. In May 1991 the State Bank was divided into a central Bank (the Bank of Mongolia (BOM)) and a foreign trade bank (State Bank of Mongolia [International]). The commercial banking activities of the former state bank were transferred to seven new commercial banks that have gradually taken over most of the former state bank's branches. The number and composition of the commercial banking sector changed considerably in subsequent years. The newly established commercial banks lacked the expertise to deal with lending in an uncertain market environment. In addition, the legal framework necessary to recover bank debts has not been securely established. The result of this has been the growth of extremely large bad debts, which have threatened the solvency and, occasionally, the liquidity of the entire banking system. The Bank of Mongolia has been forced to support the banking system on a number of occasions and several liquidations and forced bank re-structuring operations have been mounted, particularly in 1996 when the largest and fourth largest banks were liquidated. This has contributed to a growing distrust of the banking sector with evidence of disintermediation into dollars and real goods, especially livestock (World Bank, 1997: p. 10). In addition, it has, on occasion, compromised the BOM's pursuit of a tight anti-inflation monetary policy.

Mongolia experienced a fairly typical inflationary episode during the early stages of transition. Inflation reached 330 per cent in 1993, peaking at an annual rate of 420 per cent in January 1993. By August 1994 it is estimated (World Bank, 1994) that inflation had fallen to an annual rate of 68 per cent. The monetary base was still growing rapidly, however, in part owing to the growth in subsidised credits to some government enterprises. Inflation remained over 50 per cent in 1995 and 1996. However, the election of the Democratic Union in 1996 led to a more determined squeeze on the growth of the monetary base and in 1997 the annual average rate of inflation was a respectable 17.5 per cent.

This was also a period of price liberalisation and although the new central bank from mid-1991 onwards was attempting to tighten monetary and credit policies to contain inflation and impose financial discipline on the enterprise sector (World Bank, 1992: p. 28), perhaps inevitably, monetary policies had to accommodate price increases (World Bank: 1994, p. 3.) This remained true throughout the period and the final de-regulation of fuel and other utility prices in 1996 was also accommodated. In addition, the floating of the tugrik in 1993 and the subsequent strong depreciation of the currency was absorbed quickly into inflation.

This inflationary experience is difficult to fit into a simple model of government deficits inducing increases in the money supply and consequent upward pressure on aggregate demand. Although there were episodes of inflationary funding through the banking sector, particularly in the run up to the 1996 election, the stance of fiscal and monetary policy throughout the period has been extremely tight. This has been especially true of fiscal policy, notwithstanding the overall budget deficit. The capital deficit has usually been substantially funded from overseas sources while the government has run a surplus on its current spending for the last five years; this is the most reliable index of the stance of fiscal policy. Similarly, the stance of monetary policy is most accurately indicated by the level of real interest rates; these have been, for most of the period, extremely high for borrowers, albeit sometimes negative for depositors.

Of course, with respect to public finance, major changes of necessity have occurred. The pre-reform fiscal system was based on two major revenue sources: remitted profits from state owned enterprises (SOEs) and import price differentials. Tax reforms were introduced in January 1991 with a view to expanding the tax base and improving the elasticity of the tax system (World Bank, 1992: p. 30). Subsequent measures included: the replacement of the turnover tax on SOEs by a sales tax; the introduction of selective excise duties (on petroleum, tobacco and spirits); the elimination of export duties and the replacement of import price differentials by an import duty set at a uniform rate of 15 per cent; and the introduction of corporate and individual income taxes. The Democratic Union government elected in 1996 embarked on a more radical reform of public finances and abolished almost all customs duties in May 1997. These represented approximately 15 per cent of government revenues and implied the need to expand the tax base elsewhere. Measures included expanding the coverage of the sales tax, increasing excise duties and instituting a new excise duty on passenger vehicles (ADB, 1998, p. 67). In fact, despite the attempts to broaden the tax base, government finances are dominated by the receipts from the income and corporate taxation of the copper industry. They are therefore extremely vulnerable to a change in the fortunes of this sector. The variation in the revenue of government after the stabilisation achieved by 1993 largely reflects the variation in the price of copper.

With respect to government expenditure, in the pre-reform period about 80 per cent of expenditures were current, half of which were subsidies and transfers. The evolution of general government revenue and expenditures over the period 1991-1997 is given in Tables 3 and 4 which are published by the Mongolian State Statistical Office.

Table 3
Budget Revenue

	1991	1992	1993	1994	1995	1996	1997
Current Revenue (per cent of total)	99.8	99.9	94.8	95.5	93.8	95.7	92.6
Of which tax	84.8	91.1	91.3	78.8	73.0	74.3	76.6

Source: Mongolian Ministry of Finance

Table 4
Budget Expenditure

	1992	1993	1994	1995	1996	1997
Current Expenditure	70.4	51.4	59.6	58.6	61.4	65.3
Goods and services	43.8	34.1	41.3	43.0	45.5	41.3
Debt service	0.3	2.4	1.3	1.0	1.9	7.8
Subsidies	26.3	14.9	17.0	14.6	14.0	16.2
Capital Expenditure	29.6	48.6	40.4	41.4	38.6	34.7
Share of total expenditure in GDP	40.1	52.5	44.2	40.4	36.0	38.7
Share of current expenditure in GDP	28.2	27.0	26.4	23.7	22.1	25.3

Source: Mongolian Ministry of Finance

However, examining IMF (1996) data indicates that the major fall in current expenditure occurred in the early period of transition when current expenditure as a proportion of GDP fell from 51.9 per cent in 1990 to 28.3 per cent in 1993, with large reductions in the proportions accounted for by wages and salaries and subsidies to public enterprises. As table 4 indicates, over the subsequent period the proportion has remained relatively stable. However, state owned enterprises (SOEs) increasingly rely on subsidies channelled through the financial system, in the form of credit at below-market rates of interest, and via non-repayment of bank debt (World Bank, 1994: p. 7). This means that the effective impact on the public sector is understated by the deficit as a proportion of GDP. The World Bank estimated (World Bank, 1997: p.3) that the operational deficit, which captures the net public-sector claim on resources, was much larger throughout the period than suggested by the budget deficit. For example, in 1996 it was estimated to be 15.3 per cent as against 9.9 per cent of GDP (World Bank, 1997: p. 3). However, they also note that it has fallen faster than the formal budget deficit over the period reflecting the strenuous efforts of the government to reduce its role in the economy.

Table 5
Deficit and Surpluses

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Current deficit/surplus per cent of GDP			-1.6	+5.9	+3.2	+8.0	+4.5	+2.4
Overall deficit/surplus per cent of GDP	-2.9	-15.3	-13.4	-17.7	-13.3	-6.7	-8.2	-8.8

Source: Mongolian Ministry of Finance

The evolution of the general government's current and overall deficit is shown in table 5. This indicates that there remains a substantial overall deficit but that, in the recent past, there has been a substantial surplus of current receipts over current spending. As table 6 indicates, a large proportion of the capital/overall deficit has been funded from external sources.

Table 6
Sources of Funds for Deficit, Percent of GDP

Share in GDP	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
From external sources	8.7	13.4	8.5	5.6	5.9	12.8
From internal sources	4.7	4.3	4.8	1.1	2.3	-4.1

Source: Mongolian Ministry of Finance

Although the government financed approximately one third of the 1996 deficit through the banking system, principally through the central bank, in 1997 net credit to the government fell very sharply and overall it was playing a significantly reduced role in the economy

Public investment fell markedly between 1990 and 1991, largely the consequence of the withdrawal of aid from the FSU, but public investment has since recovered in part through the availability of new sources of external finance (World Bank, 1994, p. 7.) Nevertheless, public investment is evidently a function of the windfall gains and losses due to changes in terms of trade impacting on the main corporate tax payers, principally the copper industry. Although public investment recovered strongly in 1994 and 1995, in 1996 and 1997 it fell sharply as a proportion of government spending. This was largely due to the squeeze on counterpart funds occasioned by the fall in copper revenues (World Bank, 1997: p.1).

With respect to policy co-ordination, the abandonment of central planning and the abolition of the State planning Committee in 1990 created an hiatus not completely filled by the creation of a Ministry of National Development. The World Bank (1992, pp. 32-33) notes that 'The rejection of the old central planning system has been so strong in Mongolia that any suggestion that new forms of planning are needed is unwelcome' (p. 32) (a view strongly confirmed by Collins and Nixson, 1993). The Bank continues:

> Especially during transition, however, an institutional framework and process are sorely needed to coordinate macroeconomic and development policies between ministries that no longer receive centralised direction.

> Through inexperience and policy disagreements, individual ministries and agencies have headed in different directions, and major policy initiatives have been taken without adequate interministerial discussion or consensus. Thus, the implementation of macroeconomic policy is fragmented - with agencies not sharing information, and dissipation of the full skills and experience of Mongolia's limited cadre of able decision makers. (World Bank, 1992: p. 32)

In addition to the policy co-ordination function, the Mongolian Government still needs to identify those areas where intervention in necessary and the appropriate forms that intervention should take. Key areas include action to overcome specific market failures (the regulation of private monopolies for example), the reform of the management of those enterprises remaining in the public sector, the improvement of public sector investment programmes and the development of project appraisal capabilities. The Asian Development Bank (1994: p. 91) too refers to "the difficulty of establishing and developing market-oriented institutions and the unfamiliarity of economic agents with workings of the market economy" as one of the main problems facing Mongolia at the present time.

Liberalisation of the Economy and Improved Incentives

Price and Market Reforms

Limited price liberalisation measures were implemented from 1986 onwards but major price adjustments were not made until January 1991. Controlled prices were limited to 35 categories of retail goods (down from 220 before), 10 categories of imported goods and the wholesale prices of certain basic goods and those still subject to state orders (World Bank, 1992: p. 34). Rationing coupons for 10 items were introduced at the same time.

In September 1991, the prices of half the remaining 35 commodities still under control were liberalised. Further liberalisation took place in March 1992, leaving only public utilities, transportation, housing rents, selected medicines, flour, bread and rationed vodka subject to price controls (World Bank, 1992: p. 35). In 1993, however, price controls were completely abandoned although prices of utilities and services (electricity, water, telecommunications and housing) were subject to administrative controls (World Bank, 1994: p. 8). The election of the Democratic Union coalition in 1996 led to the de-control and raising of most of these remaining prices. There were sharp rises in energy prices in 1996 and early 1997 and the removal of subsidies from water, housing and transport. By mid-1997 most prices, even if not formally market determined, were much more closely related to costs.

There was some feeling in Mongolia in the early part of the transition period that price liberalisation was proceeding too slowly (Nixson, 1995b) and that the private sectors' response to the government's price reform efforts was rather disappointing. Factor markets' prices have also been liberalised, with free labour mobility and the elimination of wage controls in the private sector. A minimum wage remains but is set so low that "it is unlikely to hamper job creation" (World Bank, 1994: p. 8).

External Sector Reforms

In the pre-reform period, 95 per cent of Mongolia's trade was with the CMEA countries, handled by the large SOEs and five foreign trade corporations (World Bank, 1992, p. 37). Mongolia was forced, with the abolition of the CMEA in 1991, to reform its trade regime and diversify its sources of foreign exchange. There has been a series of devaluations of the tugrik vis-à-vis the US dollar. A multiple exchange rate system was established in June 1991, but this was abolished in May 1993 when Mongolia adopted a unified and floating exchange rate system. The tugrik depreciated from an official rate of $1.00 = tug.40 in mid-1992 to $1.00 = tug420 in 1994 (World Bank, 1994, p. 12), a substantial fall but not as large as that experienced by some other transitional economies. The comparative success of Mongolia's anti-inflationary policies have led to a stabilisation of the exchange rate. Its depreciation in 1997 was 17 per cent which is almost precisely the rate of inflation. Its average level in 1997 was US$ 1.00 : Tug 794 (ADB, 1998: p. 253). In fact, against a basket of currencies of its main trading partners it has appreciated, particularly relative to some South East Asian economies such as Korea.

The foreign trade regime was liberalised from 1990 onwards and quotas, export bans, minimum export prices and restrictions on the domestic procurement of export goods were abolished in 1993. Table 7 gives a summary of the balance of payments for the period of transition from 1990 to 1997. However, it is important to note that the current account deficit in 1989 was US $1233 million, which practically vanished over the next two years, representing a decline equal to approximately 6 per cent of GDP. The reduction in the current account deficit was the result of a massive cutback in imports, not an improvement in export performance. Exports in fact fell by more than half between 1989 and 1991 and only gradually increased in 1992 and 1993, with some increase in copper exports and a sharp expansion in the export of skins (especially horse skins) and leather goods (World Bank, 1994: p. 21). As noted above 1994 saw a recovery in world market prices of copper concentrates but a fall in prices in 1995-1996.

Table 7
Summary Balance of Payments (in US$ millions)

	1990	1991	1992	1993	1994	1995	1996	1997
Trade Balance	-578.8	-140.0	-62.6	-8.7	-3.5	-22.0	-87.4	-9.6
Exports (FOB)	444.8	346.5	355.8	365.8	367.0	451.0	423.4	493.7
Imports (CIF)	1,023.6	486.5	418.4	374.5	370.5	473.0	510.8	503.3
Services Balances	-72.6	-44.7	-25.4	-31.1	-33.8	-38.9	5.6	-15.3
Receipts	53.1	26.5	35.2	26.8	43.0	46.5	97.1	60.9
Payments	-125.7	71.2	60.6	57.9	75.8	85.4	91.5	76.2
Private Unrequited Transfers	0.0	0.0	-2.7	-0.1	-3.0	-2.8	-0.6	4.2
Current Account Deficit (-) (excluding official transfers)	-651.4	-184.7	-90.7	-39.9	-40.3	-63.7	-82.4	-20.7
Public Unrequited Transfers	7.4	41.6	37.9	71.0	77.7	67.7	64.8	47.7
Capital Account	583.5	106.9	30.7	-9.6	-36.1	5.8	15.3	69.2
Foreign Direct Investment	0.0	0.0	2.0	7.7	7.0	10.0	10.0	25.0
Medium/Long-term	516.7	130.3	86.3	32.5	7.9	33.7	46.8	79.3
Disbursements	537.4	139.3	112.1	54.0	60.3	83.0	84.1	116.2
Amortizations	20.7	9.0	25.8	21.5	52.4	49.3	37.3	36.9
Short-term	66.8	-23.4	-57.6	-49.8	-51.0	-37.9	-41.5	-35.1

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Errors and Omissions	7.3	-55.9	9.5	3.2	-8.7	0.0	-16.1	32.1
Overall Balance	-53.3	-92.1	-12.6	24.7	-7.5	9.8	-18.5	64.1
Financing	53.3	92.1	12.6	-24.7	7.5	-9.8	18.5	-64.1
Change in Net Official Reserves [a]	53.3	28.8	6.1	-20.6	-12.0	-12.8	15.8	-64.3
ArrearsAccumulated(+)/Payments(-)	-	63.3	-11.5	-11.0	-37.0	0.0	2.7	-5.5
Exceptional Financing (rescheduling)	0.0	0.0	18.0	6.9	56.5	3.0	0.0	5.7

[a] A negative sign indicates an increase
FOB = Freight on board; CIF = cost insurance and freight.
Sources: ADB (1997) and Bank of Mongolia Annual Report, 1997

The fall in imports is in large part explained by the withdrawal of financial assistance from the FSU. This declined from US $1228 in 1989 to virtually zero two years later (World Bank, 1994). These flows had allowed Mongolia to import over $2 billion worth of goods, largely from the FSU. Their cessation in 1991 was not immediately compensated for by flows from new bilateral donors or commercial borrowing. In addition, imports have also been adversely affected by exchange rate depreciation, the fall in output, incomes and employment and reductions in investment, bringing about a fall in demand for capital goods imports. Reductions in the import (in physical quantities) of cranes, machines, trucks, buses, fertilizers and cement and increases in imports of cars (but not, surprisingly, other durable consumer goods) are indicative of the crisis in the Mongolian economy and the changes that it is undergoing.

With respect to changes in the direction of external trade, a number of aspects are worth noting. In particular, although the export base is still relatively narrow it has considerably diversified compared to the pre-transition period. Prior to the transition the Russian

Federation/Commonwealth of Independent States was the largest trading partner. As recently as 1993, it held a 53 per cent share of exports and a 60 per cent share of imports. However, by 1997 the export share was nominally only 9.5 per cent while imports represented a 47 per cent share. China, which had been a negligible trading partner in 1990 has now become important, accounting in 1997 for 21 per cent of exports and 11 per cent of imports. A number of other countries have increased their share of both imports and exports. In particular, Japan increased its share of both exports and imports to approximately 9 and 6 per cent respectively (Mongolian Statistical Yearbook, 1997). Surprisingly, Switzerland has apparently established itself as the largest single trading partner for exports, nominally being the destination for 32 per cent in 1997. In fact, much of this is the export of copper concentrate to the FSU; the rise of Switzerland is merely the reflection of where the transaction takes place and is mirroring some of the nominal decline in the importance of the FSU (ADB, 1998: p. 68)

The commodity structure of trade has also diversified but remains very heavily concentrated on mining and agricultural by-products. Copper concentrate accounted for 40 per cent of exports in 1997, gold for 24 per cent, dehaired cashmere 7 per cent and skins and hides for 5 per cent (BOM Annual Report, 1997). Imports remain dominated by fuel, machinery and equipment and basic industrial inputs. In addition, a considerable proportion of consumer goods are also imported. Nevertheless, the elasticity of imports seems likely to be considerably lower than that for exports so that the external sector is vulnerable to exchange rate and terms of trade shocks..

As part of the external sector reform package, the Mongolians have placed great emphasis on attracting direct foreign investment (DFI). A “generous” foreign investment law (drafted with US assistance) was enacted in 1990 and included provisions for unrestricted repatriation of capital and remittance of profits and dividends (World Bank, 1992: pp. 37-8). There is little systematic data publicly available on DFI although World Bank (1994: p. 2) is optimistic. Between 1991 and April 1994 the Government approved 333 DFI projects amounting to approximately $40 million. Russia accounted for 137 project proposals, worth $16.7 million and the Chinese accounted for 106 proposals worth $8.2 million. The sectors and activities in which DFI is most likely are services, construction, agroprocessing and small scale manufacturing activities. Joint ventures have been established to explore for oil and a Mongolian-American-Russian joint venture for the exploration and processing of uranium was under negotiation in 1994 (World Bank, 1994: p. 22). The position in 1997 was that the annual direct foreign investment inflow was US $ 25 million with 258 foreign enterprises registered during the year. This investment was distributed as follows: 33 per cent in engineering, construction and construction materials; 19 per cent to geological exploration and mining, 17 per cent to trade service (sic.) and 7 per cent to highways and transportation (Bank of Mongolia Annual Report, 1997).

Given Mongolia's rich mineral reserves, larger scale DFI can perhaps be expected in these sectors if and when the economy emerges from its current crisis. The World Bank (1994: p. 15) argues that garment manufacture ('cut and sew' operations) is attractive to foreign enterprises, given that Mongolia faces no quotas under the Multifibre Arrangement. It appears that there is interest from Hong Kong and South Korean enterprises in this sector, with 17 joint venture operations in existence in 1994. It is unclear at this stage whether the downturn in growth consequent upon the financial turmoil in South East Asia will postpone these developments.

Since 1990, Mongolia has experienced a rapid growth in its aid receipts, with an increase in the number of donors and a greater diversity in its aid programmes. Over the period 1991-1997 Mongolia received US $478 million in foreign aid (UNDP, 1997: p.8). The majority of the aid is from bilateral donors. In 1995, approximately 63 per cent of disbursements were from bilateral donors with Japan, Germany and the USA the largest individual donors. The Asian Development Bank was the largest multilateral donor.

The disbursements have changed through time, both in terms of sectoral distribution and by type. In 1992, economic management, international trade and humanitarian aid and relief were the dominant sectors. By 1995, disbursements were concentrated in the energy, transport, industry and agricultural, forestry and fishery sectors, reflecting the changing priorities of the development of the transitional economy (UNDP, 1996, Table A.1: pp 70-75).

Free-standing technical co-operation was the most important category of aid, reflecting the Government's focus on the transfer of technical and managerial skills and know-how aimed at developing national technical capabilities (UNDP, 1996). Investment-related technical co-operation aimed at strengthening the capacity to execute specific investment projects and investment project assistance was directed towards capital investment projects (for example, Japanese assistance to strengthening the Mongolian Railway). By 1995, food aid was no longer a major item, as it had been in 1992, and emergency and relief assistance had fallen to below one million dollars. It is the case however that Mongolia's poverty alleviation efforts are heavily dependent on the UNDP (National Poverty Alleviation Programme), the World Bank (Poverty Alleviation for Vulnerable Groups) and UNDP assistance to the Poverty Alleviation Fund to assist in activities with a high impact on women (UNDP, 1995a).

Mongolia joined the International Monetary Fund (IMF) in February 1991. Priority was given to the design and implementation of an economic stabilisation programme, the key component of which was the 'tightening of financial policies' (IMF, 1996: p. 3). A 12-month IMF stand-by arrangement was approved in October 1991 and a three-year IMF enhanced structural adjustment facility (ESAF) was approved to run from November 1993 to November 1996. However, the slowdown in the pace of reform in 1995 and 1996 led to a breakdown in the negotiations for the third tranche of the facility during 1996. However, the renewed commitment of the new Democratic Union government led to a successfully negotiated further three-year ESAF in July 1997, the key targets of which included 5 per cent annual growth and inflation in single digits by the year 2000.

Privatisation and Enterprise Reform

The privatisation programme has been a key element in Mongolia's reform programme and the move to a market economy. The programme was initiated in October 1991 and was based on a voucher system similar to that used in a number of other transitional economies (Czech and Slovak Republics, Poland and Romania). The decision to use the voucher system was a consequence of the low level of domestic financial savings, the lack of a well-developed capital market and the absence of an adequate means of valuing state enterprises' assets (IMF, 1996: p. 12).

The initial phase of the programme was the *small privatisation* phase, with the assets of small business, agricultural units, restaurants, factories, shops and retail outlets auctioned to private individuals. Potential buyers amassed the necessary vouchers through the secondary market and supplemented the auctioned price with cash as required.

The second, *big privatisation* phase, had a different structure. It was to begin with enterprises developing privatisation plans and seeking approval for implementation by the Privatisation Commission. The enterprises were then to be converted into joint stock companies and the Commission would value their fixed assets, audit their balance sheets and issue shares on the basis of net assets. Shares were to be sold in batches on the Mongolian Stock Exchange (established in February, 1992) and bidders, using their blue vouchers, were to declare a price or price range for the shares. Brokers in each aimak (the unit of local government) would collect declarations and phone in bids to the Stock Exchange. The broker with the highest bid would win and be registered as the new owners of the enterprise (Word Bank, 1994, Annex I).

In June 1994, the Cabinet approved guidelines for a programme of ‘cash’ privatisation, using a variety of methods to sell state assets including auctions, sales of shares and the establishment of joint ventures. More than 400 enterprises were identified to be sold on a cash basis (IMF, 1996: p. 14). However, it was only with the new government of 1996, pledged to increase the rate of privatisation and concerned at the low level of receipts, that the scheme received some impetus. At this stage more than 900 enterprises were still under state control (BOM annual report, 1996) and the state owned large assets, including housing. 2 billion tugriks of enterprises were sold by auction in 1996. However, 1997 saw a much more radical programme. 205 former state properties were privatised earning 13.4 billion tugriks and property valued at 3.9 billion tugriks was privatised in the provinces. An audit of state property was undertaken with a view to further sales. At the same time privatisation of housing without charge was initiated with 27.8 thousand apartments privatised in 1997; this represents over 30 per cent of the total number of apartments (BOM annual report, 1997: p. 11).

A number of problems remain, relating to issues of corporate governance, financial accountability and managerial autonomy and access to capital. Little attention has been given to the regulatory framework and Mongolia's auditing and accounting standards are still inadequate. Particular problems remain in the agricultural sector, where the privatisation of agricultural entities was kept separate from the small and big privatisation process.

Success is judged, however, purely on the basis that public sector assets have been transferred to the private sector. Nothing is known about the performance of newly privatised enterprises, the distributional consequences of privatisation, the impact on employment and possible macroeconomic implications (many enterprises may require assistance in restructuring which the government will find difficult to ignore but which may put pressure on government spending). Many Mongolians argue (Nixson, 1995b) that the driving force behind privatisation has been largely political rather than economic, with the purpose of transforming not just the ownership structure of the economy but also the whole pre-reform structures of power and privilege (but needless to say, creating new structures not necessarily more desirable than the old).

Social Dimensions of Adjustment

The social dimensions of 'adjustment' have been dramatic. The unemployment rate was negligible in 1990, rose to 8.7 per cent in 1994 and was still estimated at 7.6 per cent in 1997 and expected to rise. However, these figures are widely regarded as a considerable underestimates (some estimates put it as high as 20 per cent in 1993, World Bank, 1996). Real wages halved between 1990 and 1992 and probably declined by a further one third in 1993. According to official estimates, the proportion of the population living below the poverty line rose from 16 per cent in 1992 to 26.5 per cent in April 1994. Estimates by the World Bank (1996) however, using information from the governments' Monthly Household Survey and the Living Standard Measurement Survey, put the number of poor people at 0.8 million, 36 per cent of the population. The poor and vulnerable were identified as female-headed households, small herders, the unemployed and dependent children. An updated survey in 1997 suggests that this figure has not fallen. In addition, the proportion in poverty is very sensitive to small changes in the definition of the poverty line; it is clear that a very large number of families are close to poverty even if they escape inclusion in the formal figures.

Even without the economic and social problems associated with transition, the Mongolian economy would still have been destabilised by external shocks. However the rationalisation of public sector employment and the break-up of state owned enterprises removed the 'safety net' for many people, and liberalisation, inflation and recession have added to the insecurity and poverty.

There have been reductions in the delivery and quality of basic education, health services and social assistance services especially for the most vulnerable groups in society. Subsidies and welfare programmes have been cut, there have been falls in the real value of pensions and the closure of co-operatives has led to the loss of facilities for pregnant women, for example. Livestock privatisation discriminated against single women (many of whom head households that received insufficient animals to survive on). The maternal mortality rate rose in the immediate years of the transition and even though by 1996 it had begun to fall again it still remains above the 1985-1989 average (UNDP, 1997). The infant mortality rate has also remained high, especially in rural areas. Job creation has taken priority over the provision of welfare and it is estimated that there will be 30,000 new recruits to the labour market each year (World Bank, 1994: pp. 35-42).

The Mongolian Government has introduced a poverty fund and has created a Poverty Alleviation Programme Management Unit to facilitate monitoring and decision-making. It has also become heavily dependent on external donors, both bilateral and multilateral to fund specific programmes and provide technical assistance. These programmes provide food and medicine, work programmes, training, education and special assistance for women (World Bank, 1994: p. 44). The Government has also, with the assistance of the United Nations Development Programme (UNDP) formulated a comprehensive multi sectoral National Poverty Alleviation Programme (UNDP, 1995a). However, the agencies involved in poverty alleviation are poorly co-ordinated at the national level "…thereby making the formulation of a comprehensive poverty alleviation strategy difficult."(ADB, 1998: p. 69).

The focus of government action, in principle at least, is on job creation and the maintenance of basic social services to the poor. But even if the transition to a market economy is completed successfully, there is no guarantee that the market alone can “solve” problems of poverty, inequality and unemployment.

Some Problems in the Transition to a Market Economy

Since the implementation of ‘shock therapy’ economic reforms in 1990 and the collapse of the Soviet Union in 1991, the Mongolian economy has undergone a painful transition. Gross Domestic Product (GDP) at market prices declined for four consecutive years (1990 - 1993 inclusive) with a cumulative loss of 20 per cent of national income. Real private consumption per capita declined by one third and real investment fell by two thirds. Inflation reached 330 per cent in 1993 and exports and imports fell by more than one half between 1990 and 1993 (World Bank, 1994).

External shocks were undoubtedly severe and Mongolia was ill-equipped to deal with them. Almost irrespective of the policies followed subsequently by the government, the external shocks would have inevitably led to a significant fall in output, consumption and perhaps employment. The World Bank (1994), for example, argued that the ‘natural difficulties’ of the transition had been exacerbated by ‘severe external shocks’, namely the disruption caused to Mongolia’s external trade by the abolition of the CMEA and the almost complete withdrawal of financial and technical assistance from the former Soviet Union in 1991.

But to focus only on external shocks is to ignore the internal dimensions of the transition. The Mongolian economy has suffered from a number of self-inflicted wounds, including ill-defined or non-existent development objectives, inappropriate sequencing of the reform process and hasty and ill-advised privatisation measures.

In 1992 two World Bank economists argued that:

> Mongolia’s economic crisis has many dimensions: first, macromanagement is unsure and it is if anything compounding the problems caused by the withdrawal of Soviet aid; second, reforms are being introduced with reference to political imperatives and

> at a rate which far exceeds the absorptivity of an economy lacking even the most basic market institutions…here is as yet no strategy for mobilising domestic resources, strengthening the productive sectors, developing infrastructure and diversifying exports. Instead of striving after greater self reliance, the current thinking has not evolved beyond seeking alternative sources of financing to maintain consumption standards and support a variety of still quite nebulous projects (Yusuf and Burki, 1992: p. 27).

This judgement remains accurate in 1998. The Mongolian economy still lacks some of the most basic market institutions; infrastructure remains extremely poor; the export base remains narrow and makes the economy subject to terms of trade shocks. In addition, public finances are weak and vulnerable to economic downturn in the copper industry and the banking sector remains fragile, with confidence not having been fully restored after a number of banking crises. These issues, of enterprise and state governance, of legal framework and law compliance, of physical and human capacity and of market institutions as well as simple incentives have not been dealt with adequately. It is the argument of this paper that too much weight has been given to the orthodox policy prescriptions of the IMF, the World Bank and other institutions and individuals that represent the "Washington Consensus" and that too little attention has been paid to those who have argued for a more balanced, and perhaps more cautions, approach to economic reform. Since 1990 successive governments have pursued policies that have deepened the crisis brought about by the external shocks and have further harmed the well being of the population. There is no single "model" or "process" of transition and the contrasts between transitional economies are as great, if not greater, than the similarities. The Mongolian Government in 1990 and successive governments since, have chosen to implement 'shock therapy' rather than pursue a more carefully sequenced and gradualist reform process. This choice has been made by the Governments themselves even though it was perhaps influenced by foreign advisers and with external technical assistance.[4]

Concluding Comments

This article has attempted to give an overview of the process and outcomes of transition in Mongolia. The focus has been on the macroeconomy and the major productive sectors and the process of privatisation and the development of the private sector.

We have argued that by the mid-1980s it was becoming increasingly obvious that the Mongolian economy was reaching the limits of its chosen 'inward looking' development model, and that fundamental reforms were essential. The collapse of the FSU and the abolition of the CMEA administered severe shocks to the economy and made reform inevitable. The issue was therefore not whether to reform and restructure but how and when.

The rejection of the old central planning system was complete and Mongolians seemed determined, for whatever reason, to change as quickly as possible existing institutions and structures. Privatisation was clearly of strategic importance in this respect, transferring state assets into the private sector in the shortest possible time, without too much agonising over technical issues such as asset valuation, corporate governance, regulation and the distributional consequences. It would probably be misleading in the Mongolian context to see this merely as the nomenklatura maintaining its control of and privileged position in the economy. Elements of the nomemklatura were undoubtedly present in pushing for rapid reform and large-scale privatisation but also important were senior enterprise managers, those working in the emerging financial sectors and those with experience of working or living in western market economies. Whether such people genuinely saw no other alternatives available to Mongolia, or whether there was a strong element of economic self interest present (and the two are not necessarily mutually incompatible) must remain an open question at present.[5]

What is clear, however, is that Mongolians have paid a heavy price in the transitional period. The collapse of output, employment, savings and investment has impacted harshly on health and educational facilities and standards and the increase in poverty has been dramatic. Past socio economic achievements are under threat and the belated attempts to alleviate poverty are highly dependent on external assistance. Although a private sector is emerging, there can be no guarantee that Mongolia will succeed in developing a dynamic market economy. Expectations with respect to DFI might well be disappointed.

Among the many issues facing Mongolian policy makers at the present time, two may be singled out for final comment. First, the highest priority must surely be to create the conditions necessary for the resumption of rapid and sustained growth. This requires inter alia, expanding and diversifying exports in order to earn the foreign exchange required for what will inevitably be import intensive investment programmes. Getting sustained growth in the real economy must be an immediate objective.

Second, policy makers need to be clear with respect to the goals they are pursing. Having demolished the structures of planning in a command economy and having (implicitly) rejected the notion of “development” as progress towards some clearly defined set of goals or objectives, all Mongolian policy makers are left with is some notion of a “market economy.” As we have argued elsewhere (Nixson, 1995b) they appear to work with a textbook model of a market economy which is highly abstract, simplified and ideological, which does not include history, institutions or culture and which draws little from the experience of newly industrialising economies such as Korea, Taiwan and Malaysia. This is not meant to suggest that Mongolian policy makers could or should attempt to replicate those particular development experiences. It is to argue, however, that Mongolian policy makers need a clearer appreciation of the proper and necessary role that the state plays in the development process.

Notes

1. This is an updated and amended version of a paper which appeared in Handbook of Economic Development. Ed. K. T. Liou. New York: Marcel Dekker Inc.

2. This section depends heavily of Sanders (1987) and Gibbons (1992), with greater detail given in Nixson, 1995 a and b.

3. It is interesting to note that these views do not appear to be shared by the authors of World Bank (1994) with its emphasis on orthodox stabilisation and adjustment programmes. The recognition of

internal policy failings also adds weight to the argument of this Chapter that it was not solely external shocks that were responsible for Mongolia's transitional crisis.

4. As Nolan (1995, Chapter 4) notes, however, little attention had been paid in the 1970s and 1980s to the problems of the transition away from the command economy system. It was assumed that the transformation "of the entire economic and political system was best conducted rapidly and simultaneously in all areas of politics and economics" (p. 108) and that orthodox stability and structural adjustment programmes would be effective in achieving macroeconomic stability and the resumption of economic growth.

5. It is conventionally argued that "shock therapy" approaches to reform are necessary as a more gradual approach would give the opponents of reform time to organise resistance to slow down or prevent the reform process. It is not intuitively obvious that this is the case either in transitional economies in general or Mongolia in particular. The nomenklatura and other privileged groups may capture the spoils of economic reform irrespective of its speed and especially in the case of Mongolia, it is not clear who the opponents of reform (if indeed there were any initially) are and whether they could actually slow down the reform process.

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