POLITICS AND ECONOMICS OF MONGOLIA'S PRIVATIZATION PROGRAM

Georges Korsun and Peter Murrell

While decisions on the scope and speed of privatization remain central to the politics of most of the ex-Soviet bloc, in Mongolia such decisions are now largely moot. Despite difficulties in implementing many aspects of the reforms introduced after the elections of 1990, Mongolia proceeded with remarkable swiftness to privatize state assets. In private shares of capital, Mongolia resembles Japan or Western Europe more than its erstwhile socialist comrades. This paper examines the remarkable story of Mongolian privatization, placing it in the context of the sweeping program of political and economic reforms implemented since 1990.

Looking back to 1990, one would hardly have predicted fast progress on the divisive issue of privatization. The Mongolian Constitution had state ownership as its fulcrum until 1992. The lurking influence of the USSR suggested restraint on reforms, and the ruling Mongolian People's Revolutionary Party (MPRP) had won the first democratic elections with a program embodying scientific socialism and dialectical materialism. The notion of privatization was just entering the political vocabulary; private ownership of even the smallest assets had only just become a reality. However, in a move interpreted variously as reflecting its disarray or its statesmanship, the MPRP invited members of the new parties into a coalition government. The most influential of these, the National Progress Party (NPP), was formed around a group of young economists whose leader, Ganbold, became first deputy prime minister in charge of economics. A month after the new government's

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formation, this group persuaded Prime Minister Byambasuren to commit Mongolia to an ambitious privatization program, which as we detail below, proceeded on a schedule remarkably close to that planned in late 1990.[1]

The progress on privatization stood in stark contrast to developments on other aspects of reforms that are complementary to privatization. At the beginning of 1991, the government controlled virtually all prices, domestic distribution, and foreign trade. The legal infrastructure necessary for protecting the rights of private owners and governing transactions between them was virtually nonexistent. The instruments of control necessary for macroeconomic stabilization in a market environment were absent. Developments on these three fronts—liberalization, legal and institutional reform, and macroeconomic stabilization—proceeded in fits and starts in the period following the 1990 elections. Even now, liberalization is incomplete. While many new laws were quickly enacted, major gaps remain in the legal system, especially at the level of implementation and adjudication. Macroeconomic stabilization shows short-run successes but long-term prospects remain uncertain. Of course, progress was hampered by the economic catastrophe consequent on the collapse of the USSR and the Council on Mutual Economic Assistance (CMEA)[2] but Mongolia was also unprepared for the tasks it was undertaking. Lack of knowledge of the workings of a market economy has been critical, with the old procedures and policies having a curious tenacity.

Mongolia provides a fascinating example of postsocialist reforms for a number of reasons. The speed of privatization is puzzling, given that it occurred in the face of opposition from important elements of the party that controlled the government. The degree of divergence between progress on privatization and on other reforms is greater in Mongolia than in other countries, with Russia a possible exception. In the future, Mongolia's economy will provide interesting lessons on the patterns of development that result when there is great discrepancy between formal private ownership and the institutional underpinnings that give substance to formal rights. It will provide a test of current theories that emphasize the effect of ownership patterns on the development of sound corporate and government policy. In this arti-

1. The information presented primarily reflects our own field research, conducted since January 1991. The paper reports facts learned in conversations numbering in the several hundreds, ranging across the spectrum of Mongolian society. Therefore, we give few citations; readers interested in clarification of sources are invited to contact the authors.

2. In "Mongolia: Privatization and System Transformation in an Isolated Economy," in *Changing Political Economies: Privatization in Post-Communist and Reforming Communist States*, Vedat Milor, ed. (Boulder, Colo.: Lynne Rienner, 1994), Cevdet Denizer and Alan Gelb estimate that urban living standards fell by 75%. In "Grassroots Macroeconomic Reform in Mongolia," *Journal of Comparative Economics*, 18:3 (June 1994), pp. 314–28, Peter Boone shows that the macroeconomic collapse exceeded that of any country in the Great Depression and matched that of Japan and Italy as a result of defeat in war.

cle, we present the basic facts necessary for an understanding of the developments on Mongolian privatization.[3]

Objectives of the Privatization Program

Kornai places the objectives of privatization in four categories—sociological, political, economic, and distributional.[4] The sociological aspect refers to the creation of a society with an influential, independent, property-holding bourgeoisie, rather than one dominated by a hierarchical bureaucratic structure. Politically, privatization provides a means of making general economic reforms irreversible. The economic objective centers on efficiency, the creation of enterprises that respond to market signals in the face of hard budget constraints, with corporate governance mechanisms ensuring that the enterprise is responsive to owners. The distributional aspects are compensation, entitlement, and equity in the transfer of property. The objectives of Mongolian privatization touched unequally on all these dimensions.

The objective enjoying universal support in Mongolia was the social one—creating citizens who had the mentality of private property owners, oriented to the spirit of the market economy. The language often echoed the roots of the speaker, with the ex-prime minister speaking of "breaking the soul of socialism," while modern reformers "institutionalize private citizens." But independently of the terms used, privatization was perceived, in large part, as a giant pedagogical exercise in which individuals long removed from the concept of private property reacquire a sense of ownership and develop an entrepreneurial bent by participating actively in the privatization process. The reformers continuously stressed the egalitarian aspects of the program—the fact that each citizen would receive the same number of vouchers, which would provide the only means of acquiring the country's assets. Thus, they fought against those who stressed the entitlement of workers to their factories and farmers to their farms.

There was more disagreement on other objectives. The head of the privatization Commission saw the program as a means of breaking up the old communist system. But the management of the Stock Exchange had a more technocratic orientation, downplaying the political dimension and emphasizing the increases in efficiency in the use of capital. However, a significant subset of the reformers who focused on the social aspects of privatization consistently denied that political and economic objectives were important.

3. Hongjoo Hahm considers the development of the private sector as a whole in "The Development of the Private Sector in a Small Economy in Transition: The Case of Mongolia," World Bank Discussion Paper No. 223, Washington D.C., 1993.

4. Janos Kornai, "The Principles of Privatization in Eastern Europe," *De Economist*, 140:2 (1992), pp. 153–76.

Genesis of the Privatization Program

In the late 1980s animal rental agreements between cooperative farms (*negdels*) and herders provided the first tentative steps to the market. Later, limits on the size of private herds were raised, making private commercial animal husbandry possible by 1989. Private cooperatives in the manufacturing and service spheres first appeared on a small scale in 1988. In mid-1990, after the political revolution, the government declared that Mongolia would have a private sector but privatization of existing assets was not yet a matter of public debate. In the months preceding the installation of the new government in September 1990, younger Mongolian economists privately debated the nature of privatization, its procedures, and developments in Eastern Europe. With the appointment of Ganbold as first deputy prime minister, these debates took on national significance. This small group of economists began to write national policy on privatization, one of the thorniest issues in the reform process.

Combining various ideas gleaned largely from the Russian and Hungarian media, this group proposed a far-reaching and innovative privatization scheme. Within three days, the prime minister accepted it and on October 25, 1990, announced the plan on national television. The announcement especially emphasized the egalitarian nature of the scheme, using free privatization vouchers to provide each citizen with an entitlement to an equal share of the country's assets. A large propaganda campaign did likewise. Ganbold then appointed an informal group, half from the NPP and other new parties, to flesh out the broad operational elements of the program. This group split into two in order to create two competitive plans, one by the more middle-of-the-road members and one by the more radical. The latter pulled together a plan within three weeks, during November 1990, while the former failed to produce a working document. This failure proved to be critical.

At this time, the economists who had devised the privatization scheme came under fierce attack from a broad cross-section of their fellow professionals.[5] But when the scheme was presented to each of the political parties, there was no rival plan to galvanize the opposition to the radicals. Inaction was not a viable path, given the widespread desire within society and within all political parties for significant market reforms. Moreover, there was no organized opposition to privatization; conservative forces were in disarray after the recent successful democratic revolution, and even the Central Committee of the MPRP, trying to show its progressiveness, offered only minor technical amendments to the plan. The most radical of the reformers saw this as a signal to move forward with speed. The question of the speed and scope

5. By coincidence, a national economics conference was being held as the plan was being completed.

of privatization, therefore, was answered by the absence of any coherent alternative to the radicals' scheme in a society in which the momentum for reform was great.

The government instructed the informal group to prepare an official version of their plan during December 1990. Some members visited Austria and Hungary where they focused on the mechanics of stock exchanges but also collected legal information, particularly on the nature of company law. From this point, the stock exchange became a prime focus. Initial plans envisaged exchanged in all eighteen *aimags* and the three major cities, connected by modern communications systems. In a poor country plunging into economic crisis, aid requests emphasized technical assistance for training new jobbers and brokers, presenting no paradox for those designing reforms. The stock exchange and the trading of privatization vouchers were to provide the laboratory in which the Mongolian people would learn the psychology of capitalism—the most important aspect of the transition process for many reformers.

In January 1991, a government resolution officially set the privatization process in motion, establishing the Government Privatization Commission (GPC) and the stock exchange. The former was effectively a subcommittee of the cabinet, headed by Ganbold. With the commission's members distracted by the many commitments consequent on their high status, the staff of the GPC gained enormous power, for example, deciding which enterprises would be privatized first and how large would be the residual government share in privatized enterprises. The stock exchange was headed by Zholjargal, a Hungarian-trained economist who had contributed many of the ideas underlying the privatization scheme. Over the ensuing months, he built a stock exchange and broker network, now employing more than 700 people, that has performed a key role in the smooth privatization of most large Mongolian enterprises. Undoubtedly this organizational success, with no major technical problems and attracting comparatively few allegations of corruption, was a major factor in ensuring that privatization kept close to schedule, resisting major political delays.

The next task was to draft a privatization law. Each key detail of the law was debated by the legislative body, the Baga Hural, which was energetically participating in the new democratic processes.[6] The basic components of the radicals' original program made their way into the law of May 1991. Privatization would be comprehensive and fast. There would be a fundamental division between "small privatization," encompassing small enterprises mostly in the trade and service sectors, livestock, and eventually housing, and

6. For a short time, Mongolia had a bicameral parliament before reverting to the unicameral system. The Baga or Small Hural was the key legislative chamber at this stage, while the Great Hural focused on the Constitution.

"large privatization" comprising the *negdels*, the state farms, and large enterprises. For a nominal fee, every citizen could buy a set of ten privatization vouchers, three for small privatization and seven for the large. State assets would be sold only for these vouchers, not for cash. Vouchers would be the currency used on the stock exchange to buy state assets in large privatization, while small privatization would use the vouchers as currency in auctions.

However, some components of the law deviated significantly from the program's original design. First, in the face of pressure from the urban work force, the Baga Hural gave employees some preferential rights to obtain shares in their workplace. The radical reformers saw this as inconsistent with equity and possibly harmful to efficiency. Second, responding to the political power of the agricultural section, the Hural gave the *negdels* control over their own privatization. The radicals saw this as an attempt by the *negdels* to maintain their position and prevent new corporate forms from superseding them. Two further differences between the draft program and the final law, while not affecting the structure of the privatization process itself, might affect the post-privatization environment. First, the radicals wanted all vouchers to be transferable between citizens for cash. The Baga Hural allowed such transfers only for the three vouchers dedicated to small privatization, not for the seven in the large. Such salability would have facilitated the consolidation of ownership that promotes effective corporate governance in large enterprises. Second, the radicals wanted to place enterprises immediately on offer to foreigners, hoping to involve foreign expertise in restructuring. Given the history of Mongolia's relations with its neighbors, it is hardly surprising that this desire was not brought to fruition.

By the middle of 1991, the privatization process was ready for implementation and local privatization commissions were created to complement the GPC. Under the law passed by the Baga Hural, there would be three, largely separate elements to privatization: (1) agricultural privatization in the hands of the agricultural units themselves, out of the control of the central government and therefore entailing the possibility of much local variation in procedures and results; (2) small privatization under the control of local privatization commissions whose political hue and economic orientation varied across regions, the more reformist elements dominant in the three largest cities and the more conservative MPRP officials in the countryside; (3) large privatization under the control of the radical reformers on the staff of the GPC and in the stock exchange.[7] These three sectors went their individual ways, but there were certain common elements to the ebb and flow of the

7. A number of rural enterprises undergoing large privatization were under the control of local privatization commissions.

process over the next two years caused by the surrounding political developments.

In the latter half of 1991, several factors led to a slowdown. First, general economic deterioration, largely caused by the breakdown of relations with the USSR, brought market reform into some disrepute. Second, groups that perceived themselves threatened by the privatization raised objections. Enterprise directors delayed submitting information to the GPC that they viewed as hostile to their interests; workers protested, fearing that they would not achieve their goal of owning their own enterprises. Third, the conservative wing of the ruling MPRP was regaining its cohesion, bolstered by the economic crisis and these protests. Paradoxically, the party in power then instituted a large propaganda campaign against the privatization policies of its own government. But the conservatives did not have sufficient power to halt privatization. The strongest element in the Baga Hural was a coalition of more liberal MPRP members and members of the new opposition parties, and a radical first deputy prime minister was in charge of economic policy and of the GPC. At this stage, any attempt to oust the government would have been interpreted both internally and by Western aid donors as a reversal of reform. Membership in the IMF and the World Bank was now pending, entailing significant prestige and massive aid during the economic crisis. The USSR was in its death throes.

Moreover, workers within small enterprises, once they had been given preferential rights, and the members of cooperative farms, once they had been given control over the process, had a clear economic incentive to push for privatization. The ideological politics of privatization became less important to conservative politicians from the countryside once their constituents saw gains from the process. The great speed of agricultural privatization shows how conservative resistance crumbles once its constituency has the economic incentive to pursue privatization.

The main effect of the propaganda campaign was to delay the beginning of large-scale privatization until early 1992 and to increase concessions to workers, especially within the small privatization process. From mid-1991 to mid-1992, both agricultural privatization and small privatization in the trade and service sectors were virtually completed, and large privatization gained momentum and kept it going until mid-1993. Nearly three-quarters of large privatization was completed before the process was eventually slowed by the new government that came to power after the mid-1992 elections. The MPRP won by a landslide and the new government was more conservative than the previous one. However, this government has been cautious in exerting its control over privatization, choosing instead to concern itself with remedying a stabilization policy that had gone badly awry under its predecessors. The slowing of privatization has been of limited consequence because so much had already been accomplished and because the new government did not attempt any reversal of previous privatizations.

The Legal Framework

We use the term privatization to refer to the formal transfer of ownership from government to private individuals, but in capitalist societies a whole set of legal and social arrangements gives meaning to ownership, defining the rights of owners and enabling them to exercise their rights. Therefore, for privatization to have its fullest effect, further legal developments are necessary, especially in Mongolia where socialism was implanted in a feudal society with no experience of modern capitalism.

The law that most definitively recognized private ownership was enacted after privatization began. In January 1992 the Great Hural passed the new Constitution, which became operative the following month. Article 5 recognizes all forms of property and mandates that owners' rights can be restricted only by due process of law. In principle, a Constitutional Court gives private owners a forum in which they can defend their rights. The Privatization Law of May 1991 laid out the basic features of the privatization process, giving a great deal of discretion to the various participants. The GPC staff could decide on the levels of residual state ownership in enterprises, the enterprises were responsible for preparing their own privatization plans, and the former owners of enterprises, for example industrial ministries, could specify conditions on enterprise operations in the immediate post-privatization period.

During 1991 the Baga Hural passed a series of measures relevant to the private sector. Foremost among these was the Economic Entities (or Company) Law, which went into effect on July 1, bringing modern corporate forms and limited liability to Mongolia for the first time. It was written when contracts with developed countries were only beginning and when foreign aid, which could have been crucial in helping to draft a better statute, was minimal. The law adapted textbook examples of European laws, using the drafters' knowledge of recent Hungarian experience. Several clauses bespeak its Central European parentage, but it also showed signs of being filtered through perceptions derived from socialist experience.[8] This law had great significance because it was the only statute remotely relevant to corporate governance procedures, which was unfortunate since the law was neither especially appropriate for Mongolia nor for privatizing enterprises. Hence, interpretation was crucial. Most important was the interpretation that the GPC gave to its role in the new corporate entities awaiting sale to private citizens. Based on the procedures for privatization of large enterprises, it was

8. Article 4 specifies that state financial organs should monitor the financial activities of economic entities.

clear that many months could pass before citizens were able to buy shares, and in the interim the GPC "owned" a huge block. The commission's staff interpreted the Economic Entities Law as mandating the first "shareholder" meetings during this time. Together with the current general director and the workers, the GPC staff established corporate governance procedures in the privatizing enterprises.

The Economic Entities Law also had a curious effect on the formation of bodies that mediate between shareholders and permanent management. There was no equivalent in the law to a board of directors, and the only outside influence on the general director and the workers (besides shareholder meetings) was a Control Council, an institution that seems to be a curious hybrid between the monitoring units of the old centralized administrative system and a German-type supervisory board. Given that the first control councils were chosen by the GPC, the workers, and the general directors before any outside shareholders existed, they are unlikely to represent the interests of the new outside shareholders.[9]

On other vital legal matters, progress has been slow. The economic demand for markets to retrade enterprise shares has existed since late 1992, but the legal framework is still in development. The Hural passed the Securities Law in late 1994, after much unaccountable delay. The Securities Commission, mandated by this law, is still in the process of formation, and will then need time to formulate precise regulations before secondary trading can begin. Similarly, the government has been lax in allocating the responsibility for representing its interest in enterprises in which it has retained ownership. In direct response to an IMF condition, a late-1993 resolution placed responsibility for this oversight within a new agency in the Ministry of Finance, but one year later this agency was not functioning.

The weakness of the surrounding legal system diminishes the effectiveness of legislation. For example, the Bankruptcy Law of 1991 contains no specification of procedures for enforcement, primarily because there is no pertinent legal infrastructure. As long as this infrastructure is weak, legislation will have a limited effect in securing the autonomy and bolstering the performance of the privatized entities. Then, too, the general social climate will be crucial. In this respect, two opposing influences are of enormous importance. The first is the habits and institutions inherited from the old system, which still have considerable effect; the second is the firm commitment of the society to market reforms, which holds for the present government even though it is a creation of the old MPRP. While the former influence argues for diffi-

9. Amendments to the Economic Entities Law were passed on July 5, 1993, including a clause mandating that companies must have a board of directors.

culties in the short-term, we believe that the latter portends significant, continuing progress in the years to come.

Elements of Privatization

The agricultural sector. Before 1990, the *negdels* were governed by the central state apparatus.[10] When the Union of Agricultural Cooperatives met in March 1990 to seek independence from the state, rapid change began. With leading officials now elected, the Union began to represent its members' interests, and after mid-1990 it could garner enough support within the new parliament to dictate the policies most vital to it. This power was crucial in the debate on the Privatization Law, when rural interests ensured that agriculture was exempt from the general framework for privatization. Over the objections of the radical reformers, the law allowed farms to select their own privatization method. Vouchers issued to farm members could be used to acquire farm property.

Soon after the law's passage, the Union issued guidelines on privatization methods for *negdels*; these did not have the force of law but were influential. Those farmers whose property had been collectivized and who were still working on the cooperative were to have priority purchase rights. The organization of the cooperative was to remain intact, with collectively owned property to be at least 60% of the total, privatized property and individually owned property to be no more than 40%. The property acquired by each member would be a function of how many years the member had worked. But many elements of these guidelines were ambiguous at best, leaving many decisions to be made at *negdel* meetings.

Privatization of agriculture began in September 1991, most occurring late that year and early in 1992. Before the process began, there were 255 old-style *negdels*. After the initial wave of privatization, 57 of these still existed, 40 had disbanded completely, and the remaining 158 generated 320 new companies. At the same time, the privatization of livestock proceeded, the private share of livestock increasing from 32% in 1990 to 80% by 1993.[11] In many cooperatives, the process deviated from the guidelines. As a result, there have been persistent allegations of corruption, focusing on local officials' control of decision-making. This brought the privatization process into disrepute in some rural areas, especially among rural professionals who were unable to secure ownership stakes since they were not *negdel* members. Ad-

10. There were significant differences between state and cooperative farms; we focus solely on the latter, the most important.

11. Robin Mearns, "Pastoral Institutions, Land Tenure and Land Policy Reform in Post-Socialist Mongolia," PALD Research Report no. 3, Institute for Development Studies, University of Sussex, February 1993, pp. 11–12.

ditionally, central government privatization officials believe that the decentralization of agricultural privatization, entailing dominance by local officials, led to the perpetuation of the old structures.

But one advantage to the autonomy of agricultural privatization is the implied flexibility in governance arrangements. The Union of Agricultural Cooperatives and rural officials wanted to keep the cooperatives intact as supply, sales, and organizational entities, simply decentralizing ownership of livestock. But in some cases, members voted to break up the cooperatives into smaller units or to become completely independent. Mearns identifies some economic rationality behind the differing decisions, risk-sharing cooperative arrangements being more common in regions with larger natural risks.[12]

There remains the question of how deep these changes really are, and the evidence is mixed. Some agricultural entities continue as before, fulfilling state production quotas and supplying official distributors. However, cooperatives with alternatives, such as those able to trade with China, resist the demands of the center and establish new commercial relations. The large private sector exports of agricultural raw materials provide evidence of the new activities of privatized farms. It is clear that the stage is set for a very dynamic process. The farms are certainly in the hands of their members. Therefore, privatization is likely to be only the first chapter in the radical reconstruction of rural arrangements that will continue for a number of years. There are, for example, reports of cases in which the original postprivatization arrangements were further modified less than a year later.[13] The increasing population of goats, in response to higher prices of cashmere, shows that farmers are reacting to economic incentives.

Large privatization. All large enterprises must go through three steps in becoming private—plan preparation and approval, corporatization, and sale. In the first two stages, the process is largely top-down, with the GPC or other agencies making the important decisions. The last stage is demand-driven, by the decisions of individual citizens on the use of their vouchers. To begin the process, the GPC decides on the size of the state's residual ownership stake. The radical reformers advocated minimal state involvement, limited to public utilities and perhaps two or three "critical" enterprises such as the Erdenet copper mine and the national airline. However, the government's guidelines loosely specified a large set of "strategic enterprises" that were to have some state ownership, and these guidelines were rather flexibly inter-

12. Ibid.

13. Shombodon, Bat-Erdene, and Densmaa, "Changing Agricultural Enterprises and Livestock Ownership in Mongolia: A Case Study of Dornogobi and Arhangai Aimags," PALD Research Report no. 9, May 1993.

preted by the GPC's staff. In fact, in 41% of privatized enterprises, the state retained stakes ranging from 15% to 80%. Prior to privatization, the GPC undertakes only minor enterprise restructuring efforts, consistent with its lack of administrative capacity for direct intervention. Restructuring has involved breaking up a number of enterprises and changing management. Over 17% of the first 300 privatized enterprises were spin-offs of existing ones, and over half of the directors of enterprises were replaced in the period between the political revolution and privatization. However, this managerial turnover was a consequence of the many personnel changes that occurred after the overthrow of the old guard rather than a feature of the privatization process.

Enterprises then prepare privatization plans addressing the level of worker ownership; a firm's history, technology, and capital base; and post-privatization organization. The approval rate for these plans has been very high, reflecting their genesis in negotiations between enterprises and officials. During preparation of the plans, employees have to decide whether to buy shares through a priority purchase scheme or wait and use their vouchers on the stock market, gambling on the vicissitudes of stock prices. A meeting of owners, called the constituents' assembly, establishes the enterprise's formal independence. Because these meetings occur before the sale of shares, they are attended by workers, management, and a staff member of the appropriate privatization commission, the latter ostensibly representing the interests of the yet-to-exist outside shareholders. These meetings adopt corporate charters and elect control councils, locking in future owners to these decisions.

The third phase is the sale of enterprise shares for vouchers through a system of auctions conducted by the stock exchange and its network of 29 brokerage houses. This country-wide network gives every citizen the opportunity to invest in any of the country's enterprises. Rudimentary financial information appears in newspapers 21 days before the stock exchange auction begins. Those citizens overwhelmed by the complexity of such information have an easy alternative: the brokerages run mutual funds that invest in a portfolio of firms. The dominating characteristic of this phase, however, has been that employees and their families have invested their vouchers predominantly in their own enterprises. In the 106 enterprises that we surveyed, the average ownership share of employees and their families was 44%.[14] Given a residual state share averaging 21%, the resultant 35% share of outsiders is much lower than that targeted by the designers of the privatization plan. A primary objective of the program designers was to engage all citizens in market activity by having them make investment choices among

14. Georges Korsun and Peter Murrell, "Ownership and Governance on the Morning After: The Initial Results of Privatization in Mongolia," IRIS Working Paper, University of Maryland, 1994.

enterprises. This would also satisfy a second objective: dominance of outsider owners. But with the vast majority of employees investing in their own enterprises, even the mutual funds—which provided an easy alternative for the wary investor—did not prosper, garnering only 2% of shares.

Throughout 1994, the pace of large privatization slowed. This was not only a reflection of the government's preferences; the major task was over since virtually all of the industrial, service, and trade sectors were now private. The large enterprises remaining under state control were in the utility, mining, and transportation sectors in which it is common to find a preponderance of state ownership in market economies. While it is too early to predict the consequences of large-scale privatization, early indications are available from enterprise survey data.[15] General directors are firmly in control, while outside shareholders have only a small amount of influence. But state control is declining as a direct consequence of privatization, and the former state enterprise sector is now decentralized, each enterprise making its own decisions. This is a necessary first step in ensuring that enterprises become responsive to economic criteria. The next step is for outsider owners to gain some power, a change that is beginning but will take many years given the lack of institutional support for such owners.

Small privatization. Small privatization centered on economic units with assets of less than three million tugrik (approx. $50,000). The vouchers could be traded for cash and special exchanges were set up to conduct such trades. In theory, a small enterprise would be auctioned off to the highest bidder, who would pay with the vouchers of family and friends and those purchased in the exchanges. In practice, the course of small privatization diverged from the design.[16] Prior to privatization, small enterprises were subject to a hierarchy of decision-making bodies called subordination councils that were actively involved in the day-to-day management of small enterprises, often dictating their operations and assuming responsibility for accounting and financial management. Consequently, managers often knew little about their business and developed few managerial skills, casting doubt on their ability to direct their enterprises. Opponents of privatization used this argument to slow the whole process, helped of course by the subordination councils, which would lose all their power after privatization. The privatizers needed allies in the process, and found them in the workers.

15. Georges Korsun and Peter Murrell, "The Effects of History, Ownership, and Pre-Privatization Restructuring on Post-Privatization Governance," IRIS Working Paper, University of Maryland, 1995.

16. This description draws on Aart Kraay, "A Workable Privatization Program: Lessons from the Mongolian Experience," mimeo, Harvard University, 1992, and Adil Rustomjee, "Voucher-Based Privatization of Small and Medium Enterprises: The Mongolian Experience," Jeffrey D. Sachs and Associates, March 1992.

Originally, all small enterprises were to be auctioned for vouchers but pressure from workers led to a mechanism for worker buyouts. When these buyouts began in Ulaanbaatar, the enterprise valuation process resulted in significant discounts for workers. Objections from the local privatization commissions, prompted by their Western advisers, resulted in much higher valuations, raising the ire of the workers. Ultimately, valuation procedures were redesigned to yield valuations equal to estimates of a heavily discounted auction price. With these new procedures in place and with employees now having a great incentive to own, the privatization process accelerated. Within three months, by early 1992, all small enterprises in the capital city had been privatized, 60% of these through employee buyouts and the rest by voucher auction. In the countryside, the proportion of employee buyouts is even higher.

Because of the underdevelopment of the service sector in the centrally planned economy, the small privatization program covered only a minor share of assets. Hence, increasing access to space and facilities for producers of new ventures is much more important than privatization in the progress of the service sector. One essential ingredient in this process is the clarification of use and ownership rights for land, which unfortunately has not progressed quickly.

Land privatization. Land privatization remains the most controversial element of Mongolia's program, despite the fact that most land is pasture and barred from privatization by the Constitution. Therefore, the most ambitious reformers envisage privatizing only land in urban areas (0.3% of Mongolia's land mass) in a first phase and arable land (an additional 2%–3% of land mass) in a second phase. Even so, rancorous debate delayed the enactment of a very necessary land law regulating land use, establishing lease and use rights, and providing a common-land management mechanism. After many attempts, a land law was passed in late 1994 but this law explicitly defers consideration of the mechanism for effective ownership transfer to later legislation. The current law, in conformity with the Constitution, explicitly prohibits foreign ownership, a provision rather transparently aimed at the Chinese. The fear of foreign ownership has been primarily responsible for the lack of movement on land use issues, resulting in the underdevelopment of markets for commercial facilities in urban areas.

Housing privatization. Housing privatization has also lagged. Many difficult issues must be resolved before an effective beginning can be made, and there is some uncertainty about what policies are most appropriate, given the current heavily subsidized rents and deteriorating housing stock. Policy choices will have important distributional implications since there is a severe housing shortage and nearly 40% of the population of Ulaanbaatar still resides in *gers*, the traditional nomad dwellings.

Concluding Reflections

This article has described the progress of one of the fastest privatization programs in the reforming socialist countries. As we have shown, privatization encountered pitfalls and it is too early to judge the ultimate effect on Mongolia's economy. Nevertheless, the Mongolians accomplished one of the most complex tasks of reform in a manner that avoided many of the roadblocks encountered elsewhere. The fast progress of privatization was surprising, since nobody would have predicted such a result at the beginning of 1990 when Mongolia was firmly in the Soviet block, isolated from the capitalist world, and privatization had not yet entered political discourse. Several factors stand out in understanding why things changed so quickly.

First, there was the serendipity of personal connections between the radical reformers and the new leadership. Second, a general desire for change was present throughout the society, echoing the spirit of the new democracy and independence from the USSR. Third, no cohesive group formed around the anti-privatization position because of the spirit of change within the country and because of the disarray in the conservative wing of the MPRP after the democratic revolution. Fourth, as soon as agricultural privatization was in the hands of the rural population, the conservative politics of the rural areas took a back seat to personal interest. Fifth, the radical reformers showed unexpected organizational capabilities, especially in the organization of large privatization. Given that more allegations of corruption arose on agricultural than on large privatization, conservatives could not credibly use that issue to foment a backlash against the radicals on the issue of privatization.

But a last fact is probably the single most important element in an explanation of the speed and scope of the Mongolian privatization. The overwhelming proportion of privatization has simply resulted in the transfer of ownership to those already inside the organizations being privatized. In the agricultural sphere, this occurred because of the raw political power of the rural sector. In small privatization, it occurred through a combination of political intervention and the collective action of employees. In large privatization, it was a result of the way in which employees individually or collectively used their vouchers. Paradoxically, the privatization process might have achieved one of the primary objectives of its designers, speed, precisely because it did not achieve another of its goals, the creation of outside ownership.