



EPRC MONTHLY NEWSLETTER

MARCH 2007

Mongolian cashmere promotion in New York City

Representatives of four leading Mongolian cashmere garments export companies visited New York City from 12 to 17 March to showcase their products for some of the United States' most influential clothiers and garment distributors.



The four companies worked with the Mongolian Fibermark Society to organize the private trade event. They displayed sweaters, scarves, shawls and blankets designed and produced in Mongolia using only Mongolian cashmere, camel and yak wool. The companies, Altai Cashmere, Gobi Corporation, Goyo and Ezio Foradori have all been beneficiaries of the EPRC's *Routes to Market* program, which seeks new markets for Mongolian products and provides technical assistance to help companies reach the quality standards required by international brand holders and their customers.

The showcase was held in New York's famous garment district and attracted buyers from all the famous labels. Saks Fifth Avenue, Brooks Brothers, Polo Ralph Lauren, Bloomingdales, Liz Claiborne, and Perry Ellis were just a few of the companies that attended the event.

The cashmere industry has seen significant changes over the past three years. Traditionally Mongolia was always regarded as a supplier of raw material to the rest of the world, primarily the UK and Italy, but due to significant investment in new plant and equipment, more dynamic management and the application of international expertise, the industry is now moving toward finished garments and accessories. Mongolian designers are now aware of the trends in the international fashion industry, and an eye for detail and improved finishing has led to improved quality. As part of the *Routes to Market* program for cashmere garments, the project annually gathers and distributes to manufactures predictions of colors and styles for forthcoming seasons.

In addition to the trade event and private meetings with buyers, the companies also attended a seminar on conducting business in the United States, and took the opportunity to visit a major distribution center in order to gain better knowledge and understanding of the importance of packaging, labeling and reliable delivery.

Working Group approves draft National Program to establish a single electronic window for trade facilitation

At its second quarterly meeting on 29 March, the Working Group to establish a single electronic window for trade facilitation approved the draft National Program. Minister Bayartsaikhan chaired the meeting held at the Ministry of Finance.



In attendance at the meeting were:

- Mr. Ch. Saikhanbileg, Chair of the Working Group and Director of the Information and Communications Technology Agency (ICTA)
- Mr. S. Demberel, Chairman, Mongolian National Chamber of Commerce and Industry (MNCCI)
- Mr. B. Enkhmandakh, Deputy Minister, Ministry of Environment (MoE)
- Mr. Ya. Sodbaatar, Deputy Minister, Ministry of Industry and Trade (MoIT)
- Mr. B. Battumur, Director, Mongolian National Customs Administration (MNCA)
- Mr. L. Zorig, Director, General Department of National Taxation (GDNT)
- Mr. G. Gantumur, Director, Mongolian Agency for Standards and Metrology (MASM)
- Mr. J. Enkhbayar, Deputy Director, State Specialized Inspection Agency (SSIA)

- Mr. S. Altangerel, Secretary of the Working Group and Director, IT Department, Mongolian Customs General Administration (MCGA)

The National Program drafted included the following recommendations:

1. Make early decision on “business model” of entity to lead implementation.

After examining successful international experiences, the WG recommended that a “Build, Operate and Transfer” (BOT) model can also be used in Mongolia. Under this model, a strategic partner and lead investor implements the system using existing technologies, makes the necessary investments, operates the system as a concession for a number of years, after which the system is turned over to the government, as negotiated in a contract. Advantages to the government are minimal load on the budget, access to cutting-edge technologies and know-how, and development of local human resources.

2. Establish a separate, joint-stock, commercially run company.

Successful international experiences show this to be a common factor to foster inter-government agency coordination and operate with relative independence from parochial agency concerns and political influences.

3. Structure the new company as a private-public partnership (PPP).

The state has a role to play as a shareholder in the company but not as a controller. The GoM also has the first real opportunity to use this experience as a pilot case for structuring commercially viable PPPs in other sectors. Structuring such a venture will not be easy as many issues in the legal and regulatory environment will need to be addressed. The experience and lessons learned gained in such structuring will be very valuable for future PPP transactions.

4. Negotiate government equity in PPP Company.

After Parliament ratification, re-negotiate project loan from The Asian Development Bank to modernize customs administration to allow partial use of the loan (i.e., equipment procured) to be valued as the GoM equity contribution in-kind to the new PPP company. International precedent for this exist in the case of Ghana where the value of commodities procured through a World Bank loan and supplied to the PPP company represented the equity contribution of the government to the new company. Proceeds from potential revenues of the company could then be used to pay back the loan and reduce the fiscal burden of debt service.

5. Identification and negotiations with potential strategic partner and investor.

During the course of preparation of the proposed National Program to establish a single window for trade facilitation (SEWT), the Working Group identified successful international experiences, technologies and countries. Mongolia can benefit from these experiences and proven technologies to shorten the implementation cycle. Mongolia does not need to “reinvent the wheel” so to speak but seek access to these technologies and operators and negotiate the best possible terms for the country. After the decision to create an independent joint-stock, commercially-run PPP is made, the company enter into negotiations with operators and investors who can provide access to the technology, have the proven know-how, and the financial resources to make the implementation of the SEWT concept successful.

6. Identification and attraction of Mongolian private sector investors with complementary skills.

Every effort should be made to attract Mongolian private sector investors who, besides capital, bring unique complementary skills to the company. The Mongolian National Chamber of Commerce and Industry (MNCCI) as the umbrella organization of businesses in Mongolia could be a representative shareholder of private businesses but additional Mongolian firms should be identified and given the opportunity to participate.

7. Conduct a public education campaign and dialogue on the concept and experiences in implementation of single windows.

A public education campaign using selected mass media (newspaper articles and briefings, TV and radio presentations, etc.) should be initiated to educate decision makers and the general public on the issue and gain understanding and support for the concept. The campaign should be targeted to different constituencies or groups as identified in the proposed action plan to implement the National Program. Some elements of this public education and national dialogue campaign can be coordinated with those of the program on one-stop local licensing services pilot project currently being implemented with Swiss cooperation.

8. Identify changes in legal and regulatory environment to facilitate implementation of single electronic window concept.

Once decisions have been made on the business model and structuring of a joint-stock, commercially-run PPP company, a legal review of existing laws and regulations needs to be initiated as soon as possible. This legal review should focus, *inter alia*, on the following:

- Review of the proposed existing draft law on customs to insure enabling of implementation of the single electronic window for trade
- Review of existing draft on a concessions law initially developed to help finance physical infrastructure projects and provide an adequate legal and regulatory framework for BOT and BOO (“Build, Operate and Own”) among others
- Expedite current review of existing laws and regulations on e-commerce and electronic transactions within the framework of current efforts to implement e-Government
- Review of legal and regulatory mandate of participating agencies in order to simplify processes, avoid duplication, and overlapping responsibilities
- General review of existing laws and regulations to enable adequate operations of electronic windows.

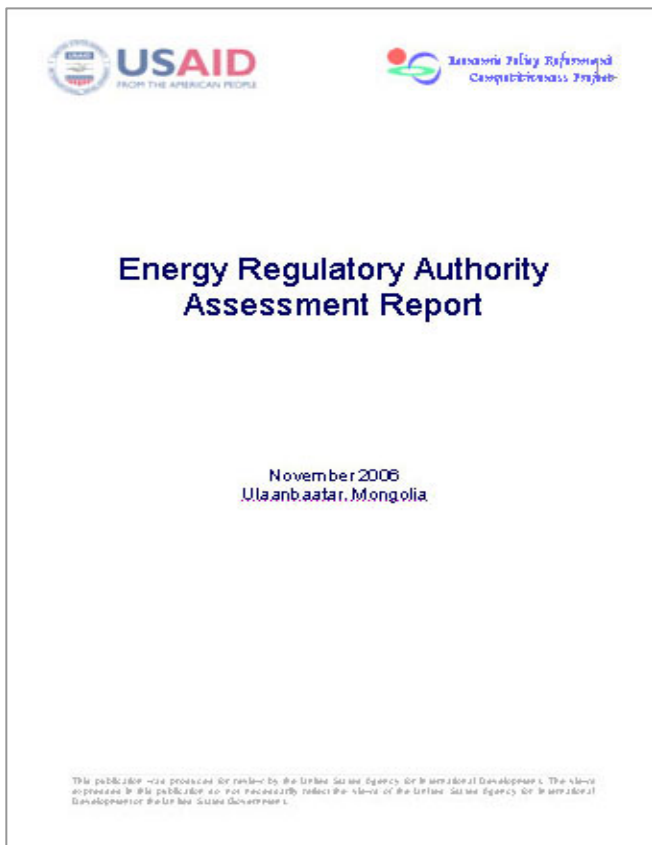
After discussion and exchange of ideas, the Working Group approved the draft document. Minister Bayartsaikhan requested that the group draft a government decree for Cabinet consideration. Such a draft is being prepared and will be circulated to Working Group comments and review prior to submission to the Minister.

Energy Regulatory Authority gets high marks in assessment of its performance during last five years

Five years after the creation of Mongolia’s first independent regulatory authority, a recent report gives the agency high marks for its performance. The report, “Energy Regulatory Authority assessment report”, benchmarks the agency against recommended and accepted best international practices and concludes that:

“ERA has achieved a very high level of competency in its short history. They have developed a full set of rules; they have issued tariff orders and licenses and they are addressing a broad range of customer complaints. The assessment showed that ERA has outperformed other participants in the energy

sector in Mongolia on six key measures of effectiveness. ERA scored well or very well on all of the measures tested.”¹



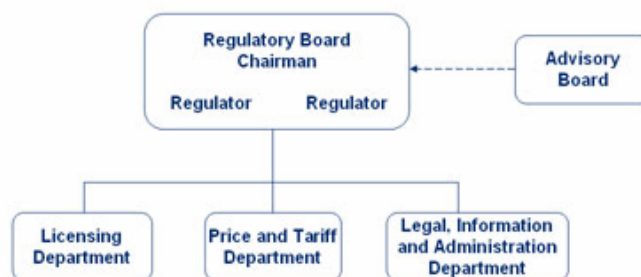
exercise of its functions, be subject to the direction or control of any other person or authority” (Source: Energy Regulatory Authority Assessment Report by Mary Webster). Simply stated, implementation of regulatory activities should be independent from short-term political interests and without interference from government ministries and agencies.

Since 2001 the ERA has been at the center of restructuring of the energy sector in Mongolia and in charge of regulating the 18 new entities in generation, transmission, dispatch, and distribution and supply created through the unbundling of the then vertically integrated energy sector.

ERA structure and operations

Organizational structure. The ERA has a simple, straight-forward organizational structure, as shown in Exhibit 1. The staff has been stable for five years, in spite of the increased demands and work load placed on ERA. The staff now stands at 29, 26 staff plus the three Board members, excluding service workers.

Exhibit 1: Organization chart of ERA



What is the Energy Regulatory Authority?

The Energy Regulatory Authority (ERA) was established on April 16, 2001, by Government Resolution #83 in compliance with Clause 5.12 of the Energy Law of 2001. ERA regulates the operations of the Central Energy System (CES), Eastern Energy System (EES) and Western Energy System (WES) that provide energy throughout Mongolia. Other small regulatory bodies in aimags and capital cities regulate heat-only boilers and small stand-alone generators. Thus, for practical purposes, the ERA regulates the whole energy sector of Mongolia.

ERA’s mandate, per Article 8.1 of the Energy Law is to *regulate the generation, transmission, distribution, dispatching and supply of energy*. Thus, the agency has authority to regulate the whole energy cycle, from production through delivery to consumers. This statutory authority includes responsibility for licensing, setting tariffs and dispute resolution.

The creation of the ERA in 2001 was a novel concept for Mongolia as the country had never had a separate authority outside the government structure and line ministries. For example, the Telecommunication Regulatory Commission, another regulatory authority, was established as an agency under the former Ministry of Infrastructure.

This independence from line ministries and normal government structures was consistent with international best practices that affirm: “the rules and procedures governing or affecting the functioning of regulatory authorities should clearly affirm and protect their independence or the authority shall not, in the

A three-member Regulatory Board governs the ERA, with members or regulators appointed by the Prime Minister. According to the Energy Law, “The Chairman and Regulators of the Board shall be appointed by the Prime Minister based on a proposal of the Cabinet Member in charge of energy. They shall be appointed initially for 2, 4, and 6 years, respectively, and thereafter for 6 years, so that expiration of their terms of service have intervals of 2 years. The terms of service may be extended once”. The Regulatory Board issues decisions by majority vote.

The ERA also has a part-time Advisory Board that was established pursuant to Clause 8.5, Chapter 8 of the Energy Law of 2001. The Advisory Board has eight members, with an equal number of representatives from consumers and licensees (generation and transmission companies).

The main function of the Advisory Board is to foresee and review current issues facing ERA and make recommendations to the Regulatory Board for their consideration when issuing resolutions related to the interests of consumers and licensees. According to the law, this Board may offer recommendations but the ERA does not necessarily have to accept them. The Committee meets with the ERA once per year but may hold other meetings as needed.

Operations. ERA conducts its operations through its three main departments: Licensing, Price and Tariffs, and Legal, Information and Administration.

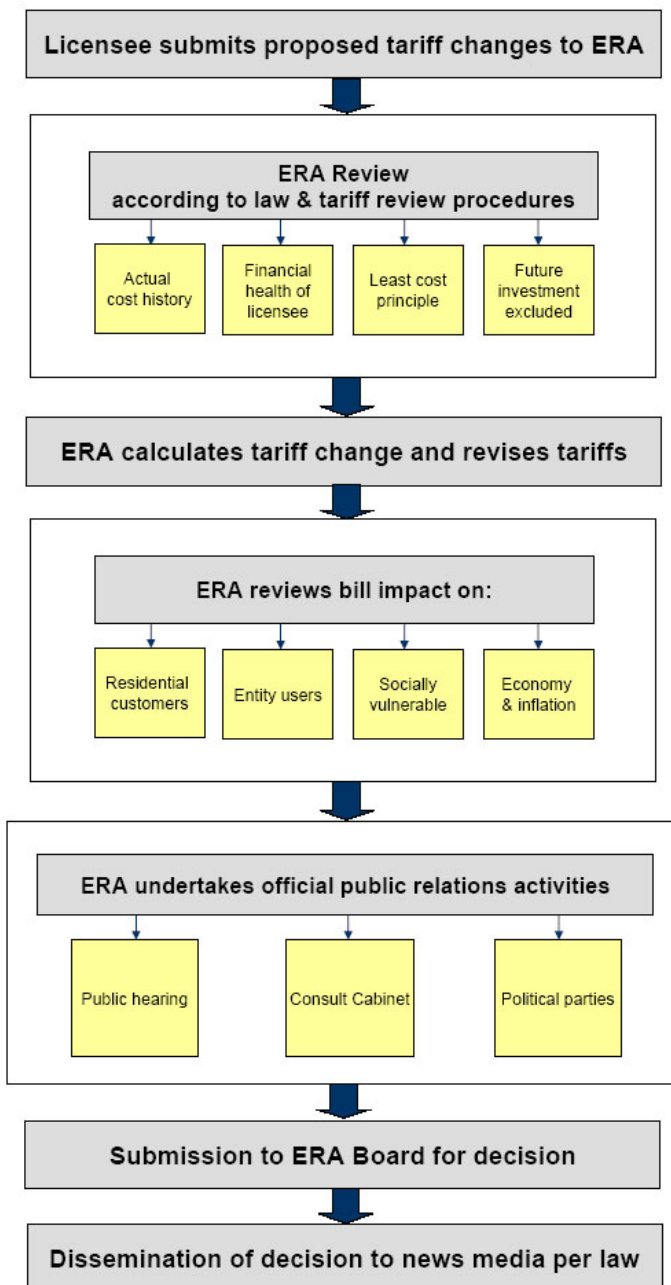
- The Licensing Department has four main areas of responsibility:
1. Receive, review and process license applications
 2. Monitor activities of licensed companies for compliance with license conditions
 3. Review procedures to be followed by Licensees
 4. Dispute resolution between Licensees.

¹ Economic Policy Reform and Competitiveness Project. “Energy Regulatory Agency assessment report.” Ulaanbaatar, Mongolia. November 2006, p. 47.

Licensed companies file monthly, quarterly and annual reports with ERA.

The Price and Tariff Department performs tariff reviews and audits licensed companies. Exhibit 2 shows the tariff review process.

Exhibit 2: Tariff review process



The Legal, Information and Administration Department handles consumer relations in terms of:

- Consumer complaints about licensees
- Licensees disputes among each other.

ERA has formally approved Complaint Procedures and is implementing them. Public hearing procedures are also in place and four large public hearings have been held since 2004. In all, ERA has adopted eight rules and procedures protecting Mongolian consumers.

Budget and financial independence

ERA has an annual budget for 2007 of approximately \$389,700 (Tg 475.5 million). Revenues are derived from charges for regulatory services provided to licensees with charges based on gross sales of each licensee. These fees for regulatory services fund the ERA budget without recourse to any additional funds from the central budget. Cabinet must approve these fees.

ERA prepares its own budget and after a lengthy review process it goes to Cabinet for approval. In 2006 this process took five months to complete as approval was needed from many ministries. As currently structured this process limits the financial independence of the authority. While checks and balances are necessary for budget review and execution, the approval process is cumbersome and subjects the ERA to unnecessary political interference. The regulatory function must be independent of policy and operations functions to avoid conflicts of interest. As the government is both an owner and operator of the energy companies that the ERA is mandated to regulate, the current budget review and approval process subjects the authority to unnecessary short-term and parochial political influences.

How well has the ERA performed?

Jon Stern and Steve Holder, of the London Business School, published a landmark report about measuring effectiveness of electricity regulatory agencies in 1999². In 2006, Jon Stern revisited this study and published an article that examined regulatory governance and realization of its expected impact on investment. Stern demonstrated a 15-20% average investment increase in electricity generation capacity for average performance on his 1999 indicators³.

Stern concluded that regulatory governance does matter. In the long-run (i.e. after about ten years or more), best quality regulatory governance is associated with about 15-20% higher generation capacity per head. Each one point increase in the index implies 4-5% increase in generation capacity per head in long run.

The ERA assessment used six indicators of regulatory governance that Stern and Holder proposed:

1. Clarity of roles and objectives
2. Autonomy of the regulator
3. Public Participation
4. Accountability of the regulatory
5. Transparency of the process
6. Predictability of outcomes

How well has the ERA performed since its creation five years ago? Possible scores in these indicators range from zero to 5.00, with 5.00 being the best score and 0.00 being the worst possible score, as follows:

- 5.00 is perfect score
- 0.00 is bottom score
- 2.50 or better is above average performance
- 3.50 or better is very strong performance
- 4.00 or better is outstanding performance

² Stern, Jon and Steve Holder, "Measures of Effective Regulation", World Bank, March, 1999.

³ Cubbin, J.S and Stern J., (2004), "Regulatory Effectiveness: The Impact of Good Regulatory Governance On Electricity Industry Capacity And Efficiency In Developing Countries". AEI Brookings Joint Center for Regulatory Studies, June, 2004.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=695385

- Scores above 2.50 indicate better than average performance and are expected to produce better than average investment in electricity generation capacity.

1. Clarity of goals: score: 2.90

The average score for clarity of goals indicators was 2.90 out of 5.00. ERA has performed slightly above average on this indicator. Where performance fell down was in the lack of clarity over the role of the Ministry. The Energy Law of 2001 assigns certain responsibilities to ERA and certain others to the State Central Administrative Authority. Lack of clarity in national legislation may be a contributing factor albeit not the only one. Clarity about the scope and lines of authority of other actors in the energy sector are also significant factors affecting this indicator. ERA has made very concerted efforts to be clear about their goals. However, others in the power sector also need to be clear about the goal of ERA, regulation, restructuring, and the need to make policy changes sustainable.

2. Autonomy: score: 3.12

The average score for the autonomy indicators was 3.12. ERA has performed above average here, and taken specific steps to demonstrate their autonomy in the energy sector. Lack of budget autonomy affected this indicator due to concerns about political interference affecting the ERA budgeting process.

3. Public Participation: score: 3.70

ERA scored well above average on this indicator, and won especially high marks for their efforts to promote public participation through public hearings. Some respondents thought they could promote public participation more by being more responsive to public comments.

4. Accountability: score: 4.10

ERA scored very well on this indicator. 4.10 is a very high score for a regulatory authority that is only five years old. They were seen to hold themselves accountable, especially through publication of their very detailed Annual Reports. The less than perfect score is attributable to the fact that ERA is new.

5. Transparency: score: 3.83

ERA scored well on this indicator. It scored well on the transparency of decisions and orders but scored slightly less well on the detail of documents that are available in the public domain. Especially for state-owned enterprises, there should be no information that is confidential or withheld from the public domain.

6. Predictability: score: 3.71

ERA scored well on this indicator. ERA has made a concerted effort to operate in a consistent manner. However, where there is a potential for political interference in regulation of the power sector, outcomes will not be fully predictable. This will make investors less confident of their ability to make successful investments in the power sector in Mongolia.

The assessment concluded that the ERA has performed exceptionally well in spite of being in operation for only five years. The authority is increasingly gaining a reputation as the one of the best regulatory authorities in Central Asia.

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