社会開発調査部報告書

No. 22

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)
MINISTRY OF FINANCE, MONGOLIA

THE STUDY ON THE SUPPORT FOR THE ECONOMIC TRANSITION AND DEVELOPMENT IN MONGOLIA

FINAL REPORT OF THE RURAL BANKING SERVICES AND SAVING MOBILIZATION

THE STUDY ON THE SUPPORT FOR THE ECONOMIC TRANSITION AND DEVELOPMENT IN MONGOLIA

FINAL REPORT OF THE RURAL BANKING SERVICES AND SAVING MOBILIZATION

March 2000

DAIWA INSTITUTE OF RESEARCH LTD.
NOMURA RESEARCH INSTITUTE, LTD.

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)
MINISTRY OF FINANCE, MONGOLIA

THE STUDY ON THE SUPPORT
FOR THE ECONOMIC TRANSITION AND
DEVELOPMENT IN MONGOLIA

FINAL REPORT
OF THE
RURAL BANKING SERVICES AND
SAVING MOBILIZATION

March 2000

DAIWA INSTITUTE OF RESEARCH LTD.
NOMURA RESEARCH INSTITUTE, LTD.

PREFACE

In response to a request from the Government of Mongolia, the Government of Japan agreed to conduct a Study on Rural Banking Services and Saving Mobilization of Mongolia, and entrusted the study to the Japan International Cooperation Agency (JICA), under the framework of the "Study on the Support for the Economic Transition and Development in Mongolia".

JICA organized a study team composed of Daiwa Institute of Research Ltd. and Nomura Research Institute, Ltd. The team headed by Mr. Hirohiko SEKIYA of Daiwa Institute of Research Ltd. visited Mongolia for three times between October 1999 and March 2000. In addition, JICA set up an advisory committee headed by Mr. Shinji Asanuma, Professor, Asian Tax & Public Policy Program, Hitotsubashi University, between October 1999 and March 2000, which examined the study from specialist and technical points of view.

The team held discussions with the officials concerned in the Government of Mongolia, Ministry of Finance and other ministries, and conducted a seminar for technology transfer, based on the result of field survey. After returning to Japan, the team conducted further studies and compiled the final results and suggestions in this report

I hope that this report would contribute to policy decisions on rural banking services and saving mobilization in Mongolia. I also hope it enhances the friendly relations between our two countries.

I wish to express my sincere appreciation to the officials concerned in the Government of Mongolia, Ministry of Finance and other related ministries for their close cooperation throughout the study.

March 2000

Kimio Fujita
President
Japan International Cooperation Agency

March 2000

Mr. Kimio Fujita
President,
Japan International Cooperation Agency

Dear Mr. Fujita,

Letter of Transmittal

We, hereby, have the pleasure of submitting our report entitled "Rural Banking Services and Saving Mobilization" for the "Study on the Support for the Economic Transition and Development in Mongolia". The report describes the results of the Study conducted by Daiwa Institute of Research Ltd. and Nomura Research Institute, Ltd. in accordance with the contract entered into with the Japan International Cooperation Agency (JICA).

Our study team carried out field surveys for three times between October 1999 and March 2000. Based on results of the field surveys in Mongolia and study activities in Japan, the team held discussions with the officials concerned in the Ministry of Finance and other related ministries, and made suggestions on rural banking services and saving mobilization in Mongolia. Regarding these suggestions, the team researched subjects in cooperation with the Mongolian side. In addition, the team held a seminar for technology transfer based on the result of field survey, and finally, completed this report.

In view of the necessity of rural banking services and saving mobilization in Mongolia, and the need for socio-economic development of Mongolia as a whole, we recommend that the Mongolian government implement the suggestion as a top priority.

We wish to take this opportunity to express our sincere gratitude to your Agency, the Ministry of Foreign Affairs, the Japanese Embassy in Mongolia, and the JICA Ulaanbaatar office. We also wish to express our deep gratitude to the Ministry of Finance and other concerned organizations for the kind cooperation they extended to our team, as well as for the warm hospitality provided during our stay in Mongolia.

Very truly yours,
関屋 浩彦
Hirohiko Sekiya
Team Leader,
The Study on the Support for the Economic Transition and Development in Mongolia

Currency Equivalents

Currency Unit = Mongolian Togrog (MNT)
US$1 = MNT1,066 (October 1999)

Abbreviations and Acronyms

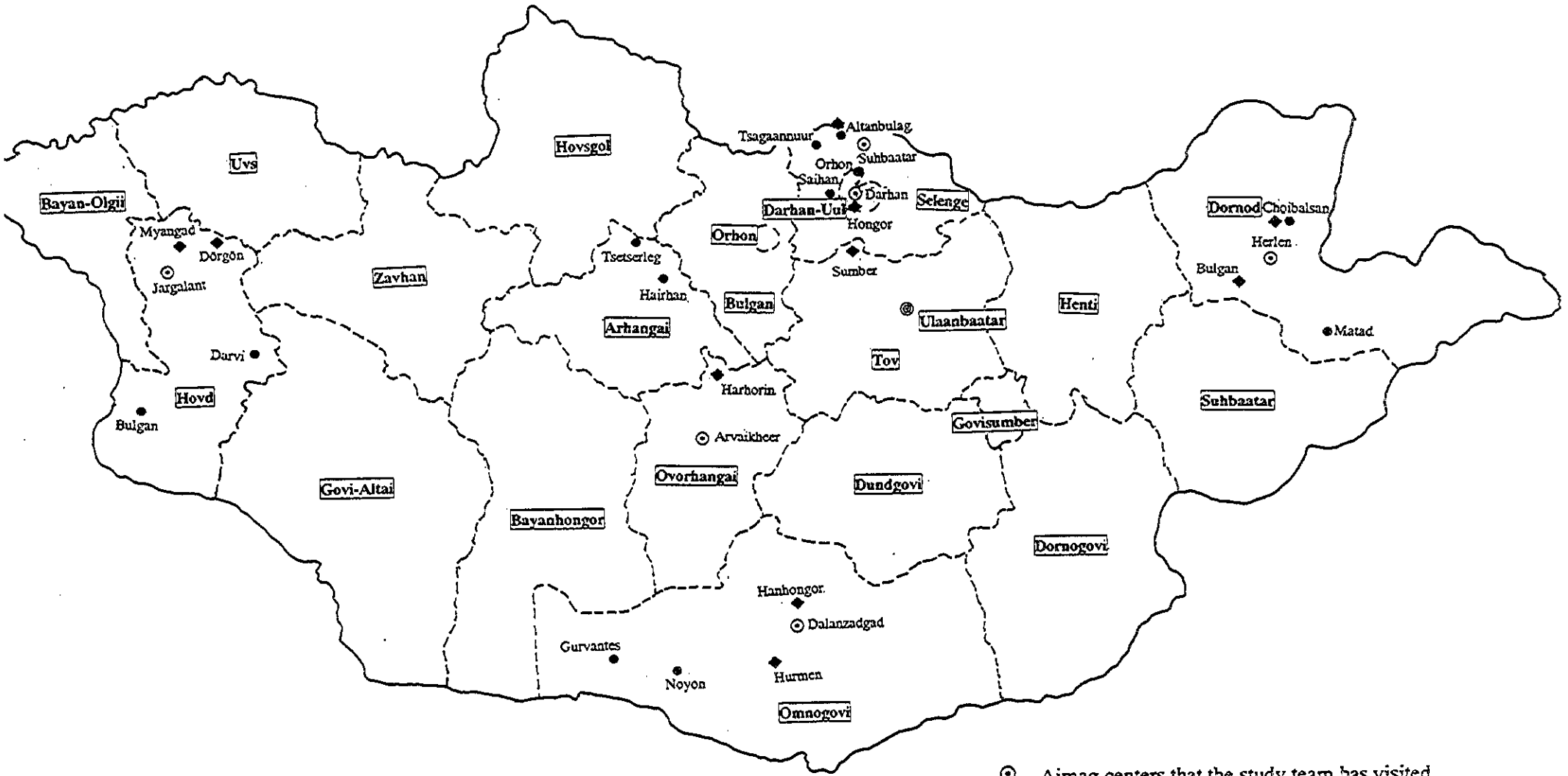
AB	Agricultural Bank
AC	aimag center
ADB	Asian Development Bank
bn	billion
BOM	Bank of Mongolia
CG	central government
CPI	Consumer Price Index
GCF	gross capital formation
GDP	gross domestic product
GF	Government Fund
GOM	Government of Mongolia
GTZ	German Corporation for Technical Cooperation
IB	Insurance Bank
IMF	International Monetary Fund
I/S	investment and savings
JERI	The Japan Economic Research Institute
m	million
MNT	Mongolian togrog
NUM	National University of Mongolia
NSO	National Statistical Office
OREO	other real estate owned
PB	Post Bank
PC	Mongol Post Company
PEB	People's Bank
RB	Reconstruction Bank
SB	Savings Bank
SOEs	state-owned enterprises
T/P	transfer and payment
TDB	Trade & Development Bank
UB	Ulaanbaatar
USAID	United States Agency for International Development
UNDP	United Nations Development Programme
WB	World Bank

TABLE OF CONTENTS

LIST OF TABLES

LIST OF CHARTS

Map of Mongolia
(Aimag centers and soums that the study team has visited)



⊙ Aimag centers that the study team has visited

◆ Soums that the Japanese consultants have visited

● Soums that NUM has visited

Executive Summary

1. Objectives and Background of the Study

Rural banking services in Mongolia faces a turning point in its existence, as Agricultural Bank, the dominant provider of the services, has been under the scrutiny of the central bank since 1999. There have been arguments on what to do with the rural financial network and on how to secure minimum service, such as the delivery of pensions and salaries to rural residents. This study researches the extent to which rural banking services are needed, the alternative methods for providing such services, and the costs of various servicing systems (networks), and finally provides suggestions for policy decisions on the issue.

2. The financial sector in Mongolia

The financial deepening of Mongolia is at a considerably low level. M2/GDP declined from 27.1% in 1994 to 19.1% in 1998. The ratios of time deposits as well as private sector lending to GDP also decreased dramatically from1994 to 1998.

Twelve commercial banks were operating in Mongolia as of October 1999, but few among them are sound. Three major banks (Agricultural Bank, Reconstruction Bank and ITI Bank) are insolvent—the licenses of Reconstruction Bank and ITI Bank were revoked in January 2000. We analyzed five major banking institutions (Agricultural Bank, Post Company, Post Bank, Savings Bank and Trade & Development Bank) as well as microfinance institutions. Out of them, Agricultural Bank, Post Company and Post Bank have potential to be a viable provider of rural banking services.

Agricultural Bank retains a nationwide banking network of 280 branches (including 259 sub-branches) and 905 employees. Post Company provides transfer service in Hovd Aimag, in cooperation with Post Bank, and has the potential to provide rural banking services utilizing its comprehensive postal network. Post Bank operates 21 aimag center branches and 21 sub-branches in cooperation with Post Company. Savings Bank does not have a large enough network to provide rural financial services. Trade & Development Bank, though the most credible among all commercial banks, has little interest in expanding its operation into rural banking business. Microfinance institutions are increasing the numbers of their branches and borrowers, but their lending services are mainly targeted at entrepreneurs in aimag centers.

3. Funds Flow in Rural Areas

Public funds constitute a main money flow as well as a main actual cash flow in rural areas in Mongolia. Pension payment and local budget subsidy flow into rural areas; sales proceeds of NIC, a state-owned gas station company, as well as post and telecom proceeds are transferred out of rural areas. Private businesses do not use banking services in rural areas. The balance being negative, cash has to be transferred from Ulaanbaatar to soums, through aimag centers. Thus cash flow in rural areas is in one direction, from aimag center to soum.

4. Demand and Supply of Banking Services

We conducted field surveys on rural banking services from the supply side as well as from the demand side. Based on the surveys, the major issues in rural banking are as summarized below:

(1) Sufficient banking services are not available in rural areas. The operations of major players in soum-level finance, Agricultural Bank, Reconstruction Bank, and Post Bank, are limited and liquidity is very low at the aimag and soum level.

(2) The common perception by the public is that banks are unreliable and inefficient. The result of the field survey showed that while the percentage of current users of banking services is around 20%, that of potential users after the improvement of banking services is more than 70%. It also revealed that the low credibility of banks is the most serious obstacle to the spread of banking services. The main reasons are (1) recent closure or consevatorship of several banks, (2) the banking sector's bad loan problem and low liquidity, and (3) customers' experience of having difficulty in withdrawing deposits and transfer delays.

(3) Private businesses do not use banking services, particularly in rural areas, because of their low trust in the banking system, the slow transfer services, and the government's current practice of utilizing bank records as a basis for the imposition of taxes.

(4) There is very limited possibility for economic expansion in rural areas. There are no economic complements among soums, and the economic channel is formed in a star-network system between the aimag centers and the soums.

5. Policy Alternatives for Rural Banking Network

Based on the above observations, we suggest the following measures for improvement of rural banking services.

(1) Rural banking network deserves to be maintained as a basic infrastructure. As it

seems difficult to make it commercially viable by itself, cost-reducing and/or revenue-increasing measures must be studied to minimize the government burden.

(2) Both the government and the banking sector should make efforts to restore the reliability of the banking system.

(3) The private sector usage of banking services needs to be increased in order to improve the low liquidity.

(4) In order to attain a sustainable rural banking network, long-term strategies should be planned to resolve the government deficit problem, the bad loan problem in the financial sector, and the limited extent of rural (agricultural) economic development.

We analyzed three alternatives for rural banking network, focusing on their cost aspect.

Alternative A (Active Use of Existing Bank Network)

In this option, the government decides to maintain Agricultural Bank's existing rural network. Alternative A has two sub-alternatives: (1) to utilize the whole organization of Agricultural Bank through recapitalization, and (2) to utilize only the rural network of Agricultural Bank. The second of these two sub-alternative is further divided into three options: (1) having a separate rural network account, (2) establishment of regional banks, and (3) unification with the postal network (analyzed in Alternative B).

Merits of the first sub-alternative are active use of existing nationwide banking network that can provide full banking services, lower average sub-branch cost than that of Post Company/Post Bank, availability of skilled human resources, and expected high contribution to the rural economy through sound lending activities of sub-branches.

Demerits of this sub-alternative are high recapitalization expense, vague outlook for balancing the budget through large-scale lending activities and the danger that Agricultural Bank could fail again. Recapitalization of Agricultural Bank would cost about MNT7.3 billion. With support from German Corporation for Technical Cooperation (MNT1.7 billion), the government could cover the rest (MNT5.6 billion) by converting its existing current account balance and deposits and Bank of Mongolia's loans into capital. Liquidation of Agricultural Bank would cost the government more (MNT7–9 billion—or around MNT4.6 billion if 20% is written off and borne by depositors).

Besides recapitalization, Agricultural Bank needs the following: to establish management responsibility, to ensure transparency on decision-making, to receive

technical assistance on large-size loan appraisal, to be closely supervised by Bank of Mongolia, to streamline the head office and aimag center branches, and to control its lending and investing activities cautiously.

In the first of the three options under the second sub-alternative, there is a rural network account that is separate from the accounts of the head office and aimag center branches. In this case, government subsidization can be transparent, because it can be targeted at the rural network as an independent recipient. This separation also allows the avoidance of the business risk of the head office and aimag center branches. However, there is no guarantee on whether the accounts can be managed transparently and safely.

The second option of the second sub-alternative, establishing regional banks, does not seem appropriate, because there would be vulnerabilities of political intervention and weaker management, a shortage of human resources, and difficulty in technical assistance, although there might be greater flexibility for providing regional development programs.

Alternative B (Active Use of Post Network)

In Alternative B, the government decides that Post Company either (1) independently, or (2) jointly with a commercial bank (Post Bank, Agricultural Bank, or Savings Bank) is responsible for the transfer of pensions and benefits, utilizing its postal network. As for independent operation by Post Company, we analyzed two cases: provision of only transfer services, and provision of both transfer and deposit taking services. The deposits collected by Post Company would be invested in government and Bank of Mongolia bonds. As for joint operation with a commercial bank, we assumed full banking operation.

Merits for independent operation are Post Company's reliability, its comprehensive nationwide network, its efficiency in transferring money (shown in Hovd Aimag), and the economies of scope associated with its postal service revenue. If Post Company were to take deposits, it would also contribute to savings mobilization in rural areas. On the other hand, demerits of independent operation are the need to amend banking law in order for Post Company to start banking business (and the accompanying complication of formalities), the time required before operations can be performed adequately, a slightly higher transfer fee than what would be charged by Agricultural Bank, and the unavailability of lending service for rural residents.

In the case of joint operation, lending activity would contribute to regional economic development. In particular, joint operation with Agricultural Bank would make operation cost lower, as Agricultural Bank's rural finance resources would be utilized. As demerits, however, there may be confusion at the initial stage, as well as conflict between the management policy of a state-owned company (Post Company) and that of a commercial bank. In the case of joint operation with Agricultural Bank, bad effects may arise out of the monopolistic operation.

Alternative C (No Active Government Measures)

In Alternative C, the government does not care about the existing banking network in rural areas, and has not formulated policy measures to promote the postal network as a financial tool. In this case, alternative measures must be developed to at least transfer government funds.

Here, the government does not have to bear the cost of maintaining a rural banking network. On the other hand, it has to formulate a measure for transferring government funds to rural area soums and may incur cost burdens beyond the formal banking network cost.

We analyzed three ways government can approach funds transfer: (1) local governments by themselves could transport and deliver funds, (2) the government entrusts NIC to function as a pension deliverer, and (3) the government stops trying to create measures. However, all three are inefficient and are no better than Alternatives A and B.

The following describes cost analysis of Alternative A and B.

(Cost Analysis of Alternatives A and B)

The average annual costs of a sub-branch are MNT1.6 million for Agricultural Bank and MNT1.7 million for Post Company/Post Bank, while the annual revenue is only MNT0.8 million (without new lending activities) for Agricultural Bank and MNT1.0 million (including revenues from postal service activities) for Post Company/Post Bank.

An additional revenue source for soum branches should be the fee for public funds transfer that the government has so far been neglecting to pay regularly. The total operating costs of 264 sub-branches of Agricultural Bank (including aimag center branches' cost) are MNT483 million per year, whereas those of Post Company/Post Bank are MNT551 million, provided they have 264 sub-branches. To cover all operating

costs solely by means of transfer fees, Agricultural Bank needs MNT244 per transfer and Post Company/Post Bank needs MNT279. If we add revenue from their current other operations, the fee would be reduced to MNT145 for Agricultural Bank and MNT148 for Post Company/Post Bank. Although the government is planning to pay MNT100 per transfer for soum pensioners from the year 2000, this amount is not enough to pay the total costs of sub-branches, as shown above.

Thus Agricultural Bank and Post Company need other revenue sources to maintain the rural network. Agricultural Bank needs lending business and Post Company needs to invest its collected deposits in marketable government bonds. If they engage in these additional activities, the break-even unit transfer fee could be less than MNT82 for Agricultural Bank and MNT97 for Post Company.

6. Concluding Suggestions

Based on the above analysis, we are going to consider what policy decision should be taken to improve the Mongolian rural banking network. In deciding this policy, the government needs to analyze the issue from two aspects, cost-benefit and financing. The former clarifies whether the policy decision is justified from the point of overall society, and the latter considers the questions of how and by whom the cost of the policy should be shouldered and how the policy goal should be achieved.

The annual economic benefit derived from maintaining a rural banking network is estimated by calculating the cost that is otherwise incurred by rural residents to travel to the nearest aimag center in order to receive pensions and banking services. The annual economic benefit of a rural banking network is MNT12.2 billion, at minimum.

Annual economic cost is estimated by calculating both operation cost and initial cost (including the opportunity cost associated with Agricultural Bank's recapitalization or liquidation). For Agricultural Bank, the annual economic cost of the network is about MNT2 billion; for Post Company it is about MNT2–2.5 billion.

Therefore, it is clear that the minimum benefit of the rural banking network would be far greater than its maximum economic cost, and maintaining it is good investment from the point of view of the Mongolian economy as a whole.

Next, the government has to pay attention to the issue of financing. Although, it is

clearly beneficial to have a rural banking network, such network cannot be maintained without government intervention, because from the standpoint of commercial profit, it is not likely that the private sector itself would provide rural banking services.

As mentioned before, the total operating cost of the Agricultural Bank's network is cheaper than that of Post Company/Post Bank. Furthermore, if the government chose to use the Agricultural Bank's network, the cost for maintaining the rural banking network through subsidy and other means could be reduced.

The government should also consider its priorities concerning the scope of rural banking services (i.e., whether only transfer and payment service is sufficient or full banking service is necessary). If the government's only rural area banking concern is in regard to transfer payment services, then utilizing Post Company's network is a possibility. This option would allow the government to secure a reliable means of transfer and payment without fear of bad loan problems. However, the government should seriously consider that if the government chooses this option, the future development of rural banking services will be skewed from what be expected to shape on a full-fledged bank-based principle and will be hampered significantly.

The option of full banking services has advantages of savings mobilization, economic stimulus through lending, open-end possibilities brought by rural banking services. Agricultural Bank has experience in providing full banking services and has capable human resources. If Agricultural Bank's network is utilized, the possibility of re-failure should be minimized. Still, the desirable option is to use the Agricultural Bank network in order to maintain rural banking services.

1. Objective and Background of the Study

1.1 Objective of the Study

Rural banking services in Mongolia faces a turning point in its existence. Agricultural Bank, the dominant provider of the services, has been under the scrutiny of the central bank since February 1999 because of its insolvent financial situation. Since then, it has functioned merely as a provider of payment/transfer services, mainly delivering pensions and salaries in rural areas. It currently is restricted from extending new loans and receives very few new deposits. Even the payment service is not efficient at all, due partly to the bank's problem of low liquidity.

A strong argument can be made that since the rural network of Agricultural Bank is not commercially viable, the network should be abolished or, at least, downsized. If it is abolished, then rural residents will lose even the minimum service currently available. On the other hand, it is a common recognition among Mongolian policy makers that the rural economy and the welfare of rural residents are important social and political issues in the country, and that the rural banking network is an indispensable infrastructure for them.

To resolve the issue, some government circles suggest that the post network should be used as an alternative tool for delivering pensions and salaries. Others argue that local governments by themselves could handle the service. We are presented questions of, first of all, to what extent rural banking services are needed, and then of the alternatives for providing such service, the costs of various servicing systems (networks), and the roles of the government in the issue.

Our study firstly focuses on grasping an objective picture of rural banking services and its economic significance. The rest of Chapter 1 provides the background information on the rural sector and macroeconomic situation that are necessary for understanding the rural banking services. Chapter 2 describes relevant financial sector information—that is, recent macro development in the financial sector and major players in rural banking services. We analyze funds flow in rural areas in Chapter 3, and rural banking services in Chapter 4, from both the supply and demand sides. Then in Chapter 5, we suggest policy alternatives regarding rural banking services to the Mongolian government, based on the observation above. In Chapter 6, we provide suggestions for policy decisions on rural banking services and savings mobilization.

In this report, we use the term "rural areas" to broadly refer to the Mongolian territory other than the large city areas of Ulaanbaatar, Darhan and Erdenet. However, we define "rural banking network" mainly as a sub-branch network at the soum level, with only minimum management function of aimag center branches, unless otherwise noted.

1.2 The Rural Sector in Mongolia

Mongolia has three levels of government: the central government, aimag governments and soum governments. The Mongolian territory is divided into 22 aimags (provincial governments) including the capital city, Ulaanbaatar, and two other large cities, Darhan and Erdenet. In each aimag, there are on average 15 to 20 soums (villages), one of which is an aimag center, the capital of the aimag. There were 320 soums in the country, excluding aimag centers, at the end of 1998 (Table 1).[1]

Table 1 Provincial Governments and Population (thousand)

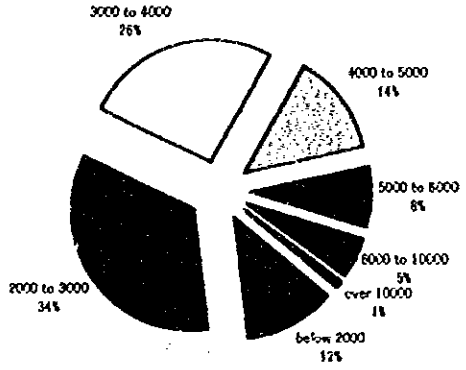
Aimag	Number of Soums	Population	Aimag Center	Population	Soum pop. /Total pop.
Arhangai	19	104	Erdenebulgan	21	80%
Bayan-Olgii	14	96	Olgii	21	78
Bayanhongor	20	92	Bayanhongor	23	75
Bulgan	16	66	Bulgan	16	76
Govi-Altai	18	75	Esunbulag	19	75
Dornogovi	14	50	Sainshand	18	64
Dornod	14	84	Herlen	39	54
Dundgovi	16	54	Mandalgovi	11	80
Zavhan	24	105	Uliastai	24	77
Ovorhangai	19	117	Arvaiheer	21	82
Omnogovi	15	46	Dalanzadgad	13	72
Suhbaatar	13	60	Baruun-Urt	15	75
Selenge	17	107	Suhbaatar	22	79
Tov	27	114	Zuunmod	15	87
Uvs	20	101	Ulaangom	27	73
Hovd	17	93	Jargalant	27	71
Hovsgol	23	124	Moron	26	79
Henti	19	78	Ondorhaan	16	79
Darhan-Uul	4	94	Darhan	71	24
Ulaanbaatar	9	669	Ulaanbaatar	669	0
Orhon	2	73	Erdenet	64	12
Govisumber	3	13	Govisumber	9	31
Total	342	2,413	Total	1,182	51
Total excl. UB, DH and EN	327	1,577		378	76

Note: Figures in the Number of Soums column include the aimag centers. All of the Ulaanbaatar population is treated as living in aimag center. Source: Mongolian Statistical Yearbook 1998 and additional data from NSO (Compiled by JERI)

[1] Hereafter in the paper, we use the term "soum" to mean a soum other than an aimag center, unless otherwise mentioned.

Out of the 2.4 million population, 670 thousand (28%) live in the capital city. About 65% of the population live in "rural aimags," areas which exclude Ulaanbaatar, Darhan and Eredenet. On average, each aimag has a population of 90 thousand; about 20 thousand live in the aimag center. The share of residents living in soums is 51% nationally, and 76% in the rural aimags. The arithmetic mean population of a soum is around 3,900; however, about half of the soums have less than 3,000 (Chart 1) and these small villages are scattered over the vast territory. About three-fourths of the soums are located more than 100 km away from an aimag center (Chart 2).

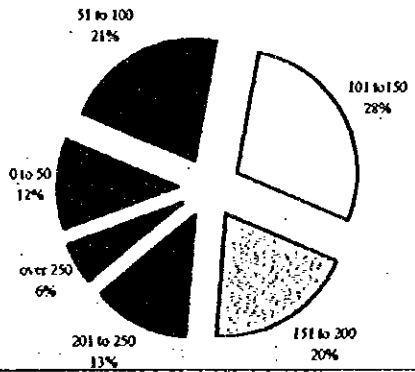
Chart 1 Soum Population Distribution



Not including UB and aimag centers, as of the end of 1998 (Source: National Statistical Office)

The average population per soum is about 3,900. The mode population of soums is between 2,000 and 3,000 and the median is below 3,600. The overwhelming majority of soums have a population of less than 5,000. (Compiled by JERI)

Chart 2 Distance from Aimag Center



Ratio of all soums • Not including aimag centers • Unit: km

Only 12% of the soums are located within 50 km of the aimag center. The overwhelming majority of soums are located farther than 100 km from the aimag center. Thus, for the majority of people, it is not practical to go to the aimag center to get banking services. (Compiled by JERI)

Table 2 Industrial Activities in Rural Aimags

Aimag	Herdsmen household share	Crop farming areas share	Industrial production share
Arhangai	69%	0.8	0.2%
Bayan-Olgii	54	0.2	0.3
Bayanhongor	66	0.1	0.5
Bulgan	47	8.4	0.6
Govi-Altai	60	0.4	0.2
Dornogovi	34	0.0	0.2
Dornod	25	2.5	0.3
Dundgovi	67	0.0	0.1
Zavhan	58	0.3	0.2
Ovorhangai	64	1.1	2.4
Omnogovi	61	0.0	0.2
Suhbaatar	56	1.5	0.2
Selenge	12	42.9	5.6
Tov	40	25.2	8.6
Uvs	53	5.1	0.2
Hovd	54	0.9	0.3
Hovsgol	62	1.1	0.5
Henti	44	4.5	0.1
Darhan-Uul	6	3.5	3.8
Ulaanbaatar	1	0.7	46.6
Orhon	9	0.7	28.8
Govisumber	17	0.0	0.2
Total	35	100.0	100.0
Total excl. UB, DH and EN	52		20.8

Note: Herdsmen household share is the share of herdsmen households to total households in each aimag.
Crop farming areas share is the share of all sown areas nationally.
Industrial production share is the share of total national production.
Source: Mongolian Statistical Yearbook 1998 (Compiled by JERI)

In 1998, Mongolia's agriculture sector, which in this case includes livestock farming in addition to crop farming, produced 33% of GDP and employed 49% of total employees. Livestock farming is particularly dominant in rural areas: the share of herdsmen households is 35% nationally, but 52% in the rural aimags (Table 2). On the other hand, crop farming is a major industry in a few aimags such as Selenge, Tov and Bulgan, which are located close to the capital city and other large cities. And national industrial activity is concentrated in the large city areas of Ulaanbaatar and Erdenet, and is quite minimal in rural aimags. Thus livestock farming and small-scale trading are practically the only businesses seen in rural areas.

1.3 The Investment and Savings Balance

Table 3 shows the investment and savings balance in Mongolia for 1993 through 1998,

the most recent period for which data are available. Gross capital formation in Mongolia has been constant at around 25% of GDP. Since real GDP growth rates during 1995-1998 were around 3% (except 6.3% in 1995), ICOR is calculated rather high, at around 8.

Table 3 Investment and Savings Balance (% of GDP)

	1993	1994	1995	1996	1997	1998
Gross Capital Formation	27.8	24.8	26.4	25.2	26.0	25.8
Government Investment	25.5	17.9	16.7	12.8	12.8	11.7
Private Investment	2.3	6.9	9.7	12.4	13.2	14.1
Foreign Savings	3.3	2.5	2.8	9.4	1.3	12.6
Domestic Savings	24.5	22.3	23.6	15.8	24.7	13.2

Data for Gross Capital Formation and Investment are taken from NSO Mongolian Statistical Yearbook 1998, data for savings are taken from *BOM* Annual Report 1998, except for 1993 to 1995 data which are taken from IMF Country Report 1999. (Compiled by JERI)

Government's share of investment (capital expenditure including net lending) has been decreasing, from 25.5% of GDP in 1993 to 11.7% of GDP in 1998. Private investment, calculated as the residual, has been increasing, from only 2.3% of GDP in 1993 to 14.1% in 1998. Private investment became larger than government investment as of 1997. This change was largely due to privatization of government enterprises as well as new entrants to the private sector.

The funding for domestic capital formation (domestic investment) is the sum of domestic savings and foreign savings (net inflow of foreign capital). Foreign savings can be calculated as the sum of the trade balance and service balance of the balance of payments.[2] Foreign savings has been an important source of investment funds in Mongolia. Though domestic savings (calculated as the difference) has been the main source of investment funds, dependence on foreign savings in 1996 and 1998 was extremely high at 9.4% and 12.6%, which is not sustainable.

[2] Domestic capital formation is funded by the sum of domestic savings and foreign savings (K – S = F). On the other hand, domestic capital formation plus domestic consumption must be equal to the sum of GDP and net imports (K + C = GDP + M – X). Using the fact that domestic savings is equal to GDP minus domestic consumption (S = GDP – C), we arrive at K – S = F = - (X –M) = Trade Deficit.

Table 4 shows the government, foreign, and private sector fund balances. The government sector has continuously been in deficit. Since its current balance has always been in surplus, capital expenditure, which is mostly funded by foreign loans, can be regarded to be the cause of the government deficit. On the other hand, the foreign sector has continuously been in surplus, as seen above—the surplus being particularly large in 1996 and 1998.

Table 4 Sectors' Fund Balances (% of GDP)

	1993	1994	1995	1996	1997	1998
Private Sector	16.2	11.9	5.0	-0.4	8.0	-0.6
Business Sector*	-7.5	-7.5	-2.3	4.3	-0.3	-2.5
Households Sector	23.7	19.4	7.3	-4.7	8.3	2.0
Government Sector	-19.6	-14.4	-7.8	-9.0	-9.4	-12.1
Foreign Sector	3.3	2.5	2.8	9.4	1.3	12.6

Note: Business sector balance is calculated using the credit amounts of the private sector and SOEs

Data for Government Sector are taken from NSO Mongolian Statistical Yearbook 1998, and data for Foreign Sector are taken from BOM Annual Report 1998, except for 1993 to 1995 data which are taken from IMF Country Report 1999. (Compiled by JERI)

The private sector surplus (calculated as the difference) has been decreasing, and it was in deficit in 1996 and 1998. If we could substitute the credit amount (to public enterprises and the private sector, assuming all the credit was for business purposes) with the deficit amount of the business sector, it shows a continuous deficit except in 1996. Due to the turmoil in the financial sector, domestic credits were contracted drastically in 1996. But the household sector has behaved just the opposite and has been in surplus, except in 1996. A normal picture of finance is observed here: surplus funds of the household sector are funding the shortages of the business sector and government sector. However, the volume of funds flow (i.e., financial intermediation) has been shrinking rapidly, reflecting the serious deficiency of the financial sector.

Though private sector investment has been increasing as seen above, the business sector does not seem to be getting finance from other sectors, which suggests that self-finance must have become a major source of funds in the private sector.

2. The Financial Sector: Some Relevant Developments and Major Institutions

2.1 Some Selected Developments

Table 5 shows that the financial deepening of Mongolia is at a considerably low level, and has been rather deteriorating since 1995. The deterioration began earlier than the financial sector turmoil in 1996—the year in which two small banks, Ardenh Bank and Central Asia Bank, were closed in July, and People's Bank and Insurance Bank were closed in December. M2/GDP declined from 27.1% in 1994 to 19.1% in 1998. Cash holding in the money supply (M1/M2) has been on increasing trend, particularly in 1996 when its share was over 50%. Bank deposits, in terms of time deposit share against GDP, have not increased. In fact, TD/GDP has decreased by one third, from 1994(15.5%) to 1998(9.7%). On the other hand, bank loans, in terms of private sector lending share against GDP, have decreased dramatically, from 14.3% in 1994 to a mere 4.5% in 1998. Financial intermediation has virtually collapsed in Mongolia.

Table 5 Financial Deepening in Mongolia (%)

	M1/GDP	M2/GDP	M1/M2	Time Deposits/ GDP	Increase over previous year	Private Sector Lending/GDP	Increase over previous year
1992.12	16.2	27.6	58.7	11.4	n.a.	14.6	n.a.
1993.12	11.2	25.7	43.6	14.6	27.3	5.9	-59.5
1994.12	11.6	27.1	42.8	15.5	6.4	14.3	141.9
1995.12	9.9	23.8	41.6	13.8	-10.7	12.1	-15.9
1996.12	11.0	21.9	50.2	10.9	-21.1	3.5	-71.3
1997.12	10.0	22.4	44.6	12.4	13.3	3.3	-3.9
1998.12	9.4	19.1	49.2	9.7	-21.9	4.5	36.1

Source: NSO Statistical Yearbook, BOM Monthly Bulletin (Compiled by JERI)

The BOM Monthly Bulletin lists minimum and maximum deposit interest rates. Real interest rates are determined by subtracting the change in CPI from nominal interest rates. Though the minimum time deposit rate has always been negative, the maximum rate became positive in 1994, and has remained very high (around 30 to 50%), except in 1996 (1.4%). Thus bank deposits, in terms of time deposit share against GDP, have not increased despite the high level of real interest rates. TD/GDP actually decreased by one third, from 15.5% in 1994 to 9.7% in 1998.

According to a World Bank report of October 1999, the real interest rate on domestic currency commercial bank loans increased from 22.5% in December 1997 to 37.5% in

1998, and the spread between lending and deposit rates widened from 9.2% to 22.5%, due to the drop in the deposit rate. Interest rates on foreign-currency-denominated bank loans and deposits reveal the same characteristics. The BOM lists the interest rates on its commercial loans, and in real terms they have been very high, between 20 to 60% per year. And since commercial banks' rates are surely higher than those, the stagnation in lending may be caused partly by high real lending rates.

No clear correlation is observed between real interest rates and deposit and loan amounts (time deposit/GDP and private sector loan/GDP). The wide fluctuation of the index implies that structural problems other than interest rates exist in the banking sector.

Table 6 Deposits and Real Interest Rates (%)

	Demand Dep. max rate	Demand Dep./GDP	Time Dep. min rate	Time Dep. max rate	Time Dep. /GDP	Individual TD/GDP	Foreign C. Dep. max rate	Foreign C. Dep./ DP
1992.12		12.2			11.6	6.3		2.1
1993.12	-83.0	5.9	-113.0	-30.0	14.6	4.8		8.5
1994.12	-2.5	5.0	-16.3	34.9	15.5	8.9	8.9	5.3
1995.12	-10.5	4.0	-40.6	48.1	13.8	8.5	-4.4	4.9
1996.12	-24.2	3.9	-46.0	1.4	10.9	5.8	3.7	4.9
1997.12	17.0	3.5	-11.3	52.1	12.4	5.7	32.5	6.5
1998.12	13.6	3.0	-0.0	36.5	9.7	4.8	20.6	4.5
1999. 9	9.8		-5.0	32.8			18.4	

Data Source: NSO Statistical Yearbook, BOM Monthly Bulletin (Compiled by JERI)

Table 7 Bank Lending and Real Interest Rates

	Commercial Loan rate	Private Sector Lending/GDP	Public Enterprise Lending/GDP	P.S. + P.E. Lending/GDP
1993.12	32.4	14.6	25.8	40.4
1994.12	64.9	5.9	13.1	19.0
1995.12	40.4	14.3	4.4	18.7
1996.12	20.9	12.1	2.5	14.6
1997.12	50.5	3.5	2.4	5.9
1998.12	39.8	3.3	1.6	4.9
1999. 9	32.6	4.5	2.1	6.6

Data source: NSO Statistical Yearbook, BOM Monthly Bulletin (Compiled by JERI,)

2.2 Major Banking Service Institutions in Mongolia

There were 12 commercial banks in Mongolia as of October 1999, but few among them are sound. Three major banks (Agricultural Bank, Reconstruction Bank and ITI Bank) are insolvent. Reconstruction Bank and ITI Bank's banking licenses were revoked by Bank of Mongolia (BOM) on January 11th, 2000. Past banking crises in Mongolia have not yet been completely overcome. Mongolia still has not established a reliable banking system.

The major institutions providing banking services to the rural sector of Mongolia are listed in Table 8. They are Agricultural Bank, Mongol Post Company, Post Bank, Savings Bank and Trade & Development Bank. They have important roles from the viewpoints of rural banking services and savings mobilization. Though Mongol Post Company is not a financial institution, it does operate transfer/payment services in Hovd Aimag. Therefore we included it in the list of organizations to analyze. In addition to these formal institutions, we also see microfinance and other lending activities in Mongolia.

Table 8 Major Banking Service Institutions in Mongolia (As of Dec. 98)

	Agricultural Bank	Mongol Post Company	Post Bank
Establishment	Jan. 1991	Nov. 1994	Apr. 1993
Capital amount	MNT 835m	MNT 883m	MNT 830m at the end of June 99
Shareholders	56%: Private sector entities 33%: Individuals 8%: State sector (SOEs) 3%: State joint ventures	100%: GOM	48%: Individuals 47%:Private sector entities 5%: State sector (Post, Telecom, etc.)
Number of branches	280, including HQ, at the end of Sep. 99 (sub-branches: 259)	373、 including HQ (sub-branches: 330)	49, including HQ (sub-branches: 21)
Number of employees	961 by the end of Sep. 99	905	187
Operation	• Rural (agricultural) finance • Full banking services, but under receivership—new lending is restricted.	• Postal services, publication, transportation and money orders	• Joint banking with PC. • Lending is provided just in UB (HQ is now taking deposits, transfer/payment, etc.)

	Savings Bank	Trade & Development Bank
Establishment	Dec. 1996	Jan. 1991
Capital amount	MNT 400m	MNT 963m
Shareholders	100%: GOM	70%: State sector, 30%: Employees
Number of branches	38 including HQ (sub-branches: 1)	10 including HQ (sub-branches: 2)
Number of employees	342	223
Operation	• Government deposit bank • Deposit taking, transfer/payment, others • Lending is limited.	• Foreign trade finance, full banking

(Compiled by JERI)

2.2.1 Agricultural Bank (AB)

History:

Agricultural Bank was established in January 1991 as the Agricultural Cooperative Bank (ACB) to provide the agricultural community (herdsmen and agricultural farmers) with banking services. The ACB inherited the rural banking network of the State Bank. The assets inherited consisted of 337 branches, 2,600 employees, MNT2.2 billion in deposits and MNT2.3 billion in loans (mostly bad). The ACB itself began operations in February 1991.

In transition to the market economy system, agricultural collective farms and unions were privatized to form smaller private companies. The central and local governments expected the ACB to provide financial services for the agricultural sector. As a result, the ACB was reorganized as the Agricultural Bank of Mongolia in 1992.

There was deterioration in the Agricultural Bank's performance due to many factors, including (1) inheritance of bad loans from the State Bank, (2) ease of lending to state-owned companies, (3) directed loans, as ordered by the central and local governments, and (4) shortage of credit analysis ability.

Because of the bad loan problem and the liquidity squeeze, the Bank of Mongolia placed AB under conservatorship in February 1999. In October 1999 the BOM placed AB under receivership, and its liquidity problem keeps public confidence in the bank low. AB is now managed by three BOM-appointed receivers: Mr. B. Javkhlan (lead receiver), Mr. Zandanshatar and Mr. Batjargal.

Ownership:

As of the end of June 1999, the number of stockholders was 6,431. The equity shares are as follows: 180 state-owned business entities, 8%; 48 state joint ventures, 2.8%; 5,420 individual investors, 33%; and private sector business entities, 56%.

Organization:

AB has 280 branches, including its headquarters, and 961 employees as of the end of September 1999.

Business:

As of December 1998, AB had total assets of MNT7,738 million. Its liabilities exceeded

its assets by MNT4,001 million. The current account was MNT5.65 billion and deposits were MNT4.85 billion. The structure of the assets was as follows: cash accounts, MNT1.23 billion (16.0% of total assets); loans after deduction of loss provision, 2.48 billion (32.1%); OREO, 1.42 billion (18.4%); and fixed assets, 1.49 billion (19.3%).

The income statement shows total revenue of MNT2.38 billion, of which interest revenue was 2.09 billion (87.8%). Total expenditure was MNT4.86 billion, of which interest expenditure was 1.13 billion (23.3% of total expenditure) and loss provision was 2.40 billion (49.4%). Loss after tax was MNT 2.54 billion.

As per BOM regulation, loss provision for standard loans is 1% of loans outstanding; for overdue loans, 1%; for sub-standard loans, 25%; for doubtful loans, 50%; and for bad loans, 100%. Regarding OREO loss provision, there is no procedure approved by the BOM. However, AB set for itself a loss provision level of 30% for all kinds of OREO.

A highly important characteristic of AB is its nationwide banking network. There are 259 sub-branches in the country. AB's organizational structure is suitable for providing rural banking services.

AB's typical soum branch has three people working (manager, cashier and watchman). AB has long banking experience, which along with its rural banking network can be properly exploited to improve rural banking services.

To restore (and then maintain) liquidity in AB, the government has to recapitalize the bank and recover the people's trust in it. This will cost about MNT7 billion. German Corporation for Technical Cooperation (GTZ) has decided to contribute about MNT2 billion in order to support small and medium sized companies in rural areas.

At present, because AB has been placed under receivership, its new lending has been stopped; however, its other banking services are still being offered. AB is now trying to reduce operation costs to survive, and some unprofitable branches are being closed.

Table 9 Agricultural Bank Data (As of Dec. 98)

Head office	Peace street-51, Ulaanbaatar-51, Mongolia; Tel/fax: 450444
Establishment	January 1991 as Agricultural Co-operatives Bank
Capital amount	MNT 835m
Shareholders	State owned, 8%; state joint ventures, 2.8%; individual investors, 33%; and private sector business entities, 56%.
Management	Mr. B. Javkhlan: Head of receivers authorized by BOM
Business history	91: State Bank's network: 337 branches, 2,600 employees, 2.2bn MNT deposit and 2.3bn MNT loan (mainly dead assets) were inherited 92: Reorganized as Agricultural Bank of Mongolia and started direct loans Feb. 99: put under conservatorship by BOM Oct. 99: put under receivership by BOM
Number of branches	280, including HQ by the end of Sep. 99.
Number of employees	961 employees by the end of Sep 1999
Number of branches (left) and employees (right) (number of watchmen)	HQ: 1 50 Branches in UB: - - Aimag branches: 20 253 (65) Sub-branches: 259 658 (210)
Business characteristics	Nationwide banking network, Main lender to the crop sector
Operations	Transfer/payment After the receivership, new lending is stopped
Asset size	MNT 7,738m
Total revenue	MNT 2,386m

(Compiled by JERI)

Table 10 AB's Balance Sheet 1998 (%)

Current Assets	22.2	Deposits & Current Account	135.8
Loans	32.1	Borrowings	10.5
OREO	18.4	Other Liabilities	5.5
Fixed Assets	19.3	Capital	-51.7
Other Assets	8.0	(Equity)	(10.8)
		(Reserves)	(2.6)
		(Loss of Previous Year & Current Year)	(-65.1)
Total Assets	100.0	Total Liabilities & Capital	100.0

(Compiled by JERI)

Table 11 AB's Income Statement 1998 (%)

Total Revenue	100.0
(Interest Revenue)	(87.8)
Total Expenditure	204.0
(Interest Expenses)	(47.4)
(Loss Provision)	(100.6)
Loss Before Taxes	-104.0
Taxes	2.7
Loss After Taxes	-106.7

(Compiled by JERI)

2.2.2 Mongol Post Company (PC)

History:

Postal services in Mongolia started in the first half of the 13th century via the horse courier system. Modern postal services started in July 1921, when a post and telegraph department was set up by the Mongolian People's Government. Mongol Post Company was separated from Telecommunication Services in November 1994 and the functions of the Mongolian Stamps company were transferred to PC in February 1997.

Since its origin, PC has operated nationwide postal services. However, responding to the request of the government, PC started tax collection and pension delivery in Hovd Aimag from June 1997. Now, through cooperation with Post Bank, efficient money transfers are available in Hovd Aimag using the telecommunication network. PC has a good reputation for its money transfer service.

Ownership:

PC is a 100% state-owned company. Its licensing by the Ministry of Infrastructure Development (MOID) effectively gives it a monopoly in postal operations. The license is valid up to May 2007.

Organization:

PC has 373 branches, including its headquarters, and 905 employees. In addition to its branches in all aimag centers, PC's rural network extends to 330 sub-branches, the widest in Mongolia. People trust PC as a governmental organization and it has no bad loan problem. It is possible to use PC's network as a rural banking tool.

Business:

PC is under the supervision of MOID. PC's Director Generals Council makes management decisions. There are five members in the Director General's Council. They are Mr. J. Baatarkhuu (Director General), Mr. B. Baatar (First Deputy Director), Mr. D. Tugsoo (Deputy Director General, Director of Operational Division), Ms. B. Purevsuren (Director of General Affairs Division) and Mr. O. Tomur (Director of Financial Division).

PC's income statement of 1998 shows total revenue of MNT1,567 million. The breakdown of revenue is 1,045 million (67%) for postal services, 317 million (20%) for publications, 146 million (9%) for passenger transportation and 57 million (4%) for

others. On the other side, total expenditure is MNT1,485 million. Some of the items and figures are salary, 473 million (32%); fuel, 166 million (11%); and transportation cost, 104 million (7%). Profit after tax is MNT20.5 million. Although PC's profitability is not so high, it has accumulated capital of MNT883,477.8 thousand. (The ratio of net worth to total assets is 68.3% as of the end of December 1998.)

PC pays all Hovd sub-branch costs (postal service and banking services) through a contract with Post Bank. In Hovd Aimag, the annual cost of one sub-branch is MNT1.7 million. Annually PC pays MNT30 million to maintain the Hovd Aimag banking network. This is one of the reasons for the low profitability of PC.

The balance sheet structure (assets and liabilities) of PC is sound. Total assets is MNT2,531 million. Current assets is 1,423 million, including 292 million in a commercial bank current account; and fixed assets is 1,107 million, mainly for post office buildings and fixtures.

Although PC has little banking experience, it has the potential to provide such services using its existing national network.

Table 12 Mongol Post Company Data (As of Dec. 98)

Head office	Sukhbaatar square-9, 210613 Ulaanbaatar-13, Mongolia; Tel: 320137 Fax: 314124
Establishment	November 1, 1994
Capital amount	MNT 883m
Shareholders	100% state owned
Management	Mr. J. Baatarkhuu: Director General Mr. B. Baatar: First Deputy Director General Mr. D. Tugsoo: Deputy Director General (Director of Operational Division) Ms. B. Purevsuren: Director of General Affairs Division Mr. O. Tomur: Director of Financial Division
Business history	Nov. 94: Separated from telecommunication services Feb. 97: PC succeeded Mongolian Stamps company June 97: PC collected taxes, delivered pensions in Hovd Aimag 1998: PC started money order services
Number of branches	373, including HQ
Number of employees	905
Number of branches (left) and employees (right) (number of watchmen)	HQ: 1 35 Branches in UB: 21 233 Aimag branches: 21 300 (34) Sub-branches: 330 337 (19)
Business characteristics	Nationwide postal network
Operations	Postal services, publication, transportation, money orders
Asset size	MNT 2,531m
Total revenue	MNT 1,567m

(Compiled by JERI)

Table 13 PC's Balance Sheet 1998 (%)

Current Assets	56.2	Current Liabilities	31.7
(Cash)	(0.3)	Capital	68.3
Fixed Assets	43.8	(Equity)	(34.9)
Other Assets	0.00	(Reserves)	(33.4)
Total Assets	100.0	Total Liabilities & Capital	100.0

(Compiled by JERI)

Table 14 PC's Income Statement 1998 (%)

Total Revenue	100.0
Total Expenditure	94.8
(Salary)	(30.2)
Profit Before Taxes	5.2
Taxes	3.9
Profit After Taxes	1.3

(Compiled by JERI)

2.2.3 Post Bank (PB)

History:

Post Bank was established in April 1993, starting operations in Ulaanbaatar only. From March 1998, cooperating with Post Company, PB started rural banking services (transfers of pension, salary and so on) in Hovd Aimag. All of the costs of PB's aimag center branches and sub-branches are paid by PC. In rural areas PB is located in the post office, its office space is provided by PC.

Ownership:

The main shareholders are private concerns; only 4.9% is held by the State and state-owned companies (Mongol Telecom, Post Company). Although there is a business relationship, PB is not a subsidiary company of PC, in practice or in law.

Organization:

There are 49 branches, including PB headquarters, and 187 employees. PB has a branch in each aimag center, and it has potential to expand the rural banking network.

Business:

Lending is done mainly at Ulaanbaatar headquarters, but PB is planning to expand this business to aimag center branches beginning this year. PB's criteria for opening rural branches are that the economic situation of the area is active and there is no competitor. PB is developing rural banking business in an attempt to improve its profitability.

Compared to those of the Savings Bank and Trade & Development Bank, PB's profitability is low, but its ratio of net worth is high (PB, 38.7%; TDB, 8.9%; SB, 5.3%). Total assets is MNT2,537 million. Loans is 1,410 million, and Deposits and Current Account are 1,420 million. The bad loan ratio is 16%. Total revenue is MNT394 million. Interest revenue is 234 million and non-interest revenue is 159 million—one revenue source is collection fee of sales cash of NIC (the state-owned gas station company) from its rural branches. PB is expanding its rural network, not only in Hovd, but also in other aimags.

The main borrowers from PB are large Mongolian companies such as Mongol Telecom, NIC and the State electricity authorities. Therefore PB has been able to guarantee a stable profit without significant risk.

Table 15 Post Bank Data (As of Dec. 98)

Head office	Sukhbaatar street-9, Ulaanbaatar-13, Mongolia Tel: 310993, 311607 Fax: 326518
Establishment	April 1, 1993
Capital amount	MNT830m as of June 1999,←MNT480m as of 1998 (←MNT50m as of 1993)
Shareholders	4.9%, state ownership (state-related companies); 46.9%, private economic entities; 48.2%, individuals as of June 1999
Management	Ms. D. Oyunjargal, Executive Director Mr. D. Bayar, Vice Director
Business history	April 93: Start of operation, 5 branches in UB March 98: Opening a branch and sub-branches in Hovd
Number of branches	49, including HQ
Number of employees	187
Number of branches (left) and employees (right) (Watchmen hired by PC)	HQ: 1 50 Branches in UB: 6 10 Aimag branches: 21 64 Sub-branches: 21 63 (21)
Business characteristics	Main banking business is done in UB. But rural banking services (just transfer service) have started in Hovd Aimag in cooperation with PC.
Operations	Lending is done just in UB HQ now. (Planning to expand lending business to aimag center branches from next year) Deposit taking, transfer/payment, others
Asset size	MNT2,537m
Total revenue	MNT3,943m

(Compiled by JERI)

Table 16 PB's Balance Sheet 1998 (%)

Current Assets	31.3	Deposits & Current Account	55.9
(Securities)	(7.3)	Borrowing	0.00
Loans	55.6	Other Liabilities	5.3
Fixed Assets	5.2	Capital	38.8
Other Assets	7.9	(Equity)	(18.5)
		(Reserves)	(20.2)
Total Assets	100.0	Total Liabilities & Capital	100.0

(Compiled by JERI)

Table 17 PB's Income Statement 1998 (%)

Total Revenue	100.0
(Interest Revenue)	(59.5)
Total Expenditure	97.4
(Interest Expenses)	(13.6)
Profit Before Taxes	2.6
Taxes	0.4
Profit After Taxes	2.2

(Compiled by JERI)

2.2.4 Savings Bank (SB)

History:

Savings Bank was established in December 1996 to secure the household deposits (MNT20.5 billion) of two liquidated banks: People's Bank, and Insurance Bank. The government paid SB's capital (MNT400 million), using the proceeds of a government bond for economic restructuring.

Ownership:

SB is 100% owned by the government (MOF).

Organization:

There are 38 branches, including headquarters, and 342 employees. SB has just 10 branches in rural areas—that is, SB does not have a branch in every aimag centre.

Business:

Mr. C. Enkbat has served as SB's CEO since January 1999. (In the past he was a lecturer at the Finance and Economics Institute of Mongolia before joining the MOF.)

SB's main activity is accepting deposits from the household sector. SB had MNT30,739 million in personal deposit at the end of 1998 (89% of the total assets). Lending is only extended to customers who put up their deposit as collateral. The loan limit is set between 70% and 90% of the deposit. Deposits are mainly invested in government bonds (restructuring bonds), which are not marketable.

From the savings mobilization viewpoint, SB plays the most important role in the country. SB's personal savings share is more than 50% in the country.

By the end of 1998, SB had MNT25,100 million (73% of all its assets) in government's economic restructuring bonds, and the accrued interest receivable on government bonds was MNT2,139 million. The net cash income is actually negative and there is fear about a liquidity problem (all accrued interest receivable on government bonds was paid in December 1999). Out of next year's budget, the government has set aside MNT5 billion for the redemption of government bonds, to ensure SB's liquidity. SB's net worth ratio is just 5.33%, the second lowest (to AB) of the five organizations.

Table 18 Savings Bank Data (As of Dec. 98)

Head office	Commerce Street-6, Ulaanbaatar-11, Mongolia; Tel: 312043 Fax: 327467
Establishment	December 1996
Capital amount	MNT 400m
Shareholders	100% state owned
Management	Mr. C. Enkhbat (CEO)
Business history	Dec. 96: Established to secure household deposits (20.5bn MNT) of liquidated Peoples Bank and Insurance Bank: GOM issued government restructuring bonds and paid 400m MNT in capital
Number of branches	38, including HQ
Number of employees	342 at the end of 1998
Number of branches (left) and employees (right) (number of watchmen)	HQ: 1 21 (-) Branches in UB: 27 207 (4) Aimag branches: 9 107 (34) Sub-branches: 1 7 (4)
Business characteristics	Deposit taking is the main activity Deposits are mainly invested in government bonds Lending is just for the customers who offer their deposit as collateral (lending limit is 70—90% of the deposit)
Operations	Deposit taking, lending, transfer/payment, others
Asset size	MNT 34,235m
Total revenue	MNT 8,712m

(Compiled by JERI)

Table 19 SB's Balance Sheet 1998 (%)

Current Assets	95.6	Deposits & Current Account	94.1
(Securities)	(81.7)	Borrowing	0.0
Loans	1.1	Other Liabilities	0.6
Fixed Assets	1.6	Capital	5.3
Other Assets	1.7	(Equity)	(1.2)
		(Reserves)	(4.2)
Total Assets	100.0	Total Liabilities & Capital	100.0

(Compiled by JERI)

Table 20 SB's Income Statement 1998 (%)

Total Revenue	100.0
(Interest Revenue)	(97.6)
Total Expenditure	95.9
(Interest Expense)	(87.8)
Profit Before Taxes	4.1
Taxes	0.0
Profit After Taxes	4.1

(Compiled by JERI)

2.2.5 Trade & Development Bank (TDB)

TDB is the biggest bank in Mongolia. Its asset have grown to MNT57,565 million (37% of the total assets of the Mongolian banking sector), of which deposits is MNT43,564 million (33% of total deposits in the country).

History:

TDB was established in January 1991 by separating the international settlement division of the State Bank. The assets it inherited were mainly those of excellent customers conducting international business. TDB has been fortunate in its banking life.

Ownership:

TDB was 100% state-owned at its establishment, but now the State's share is 70% and the employees have a 30% stake.

Organization:

TDB has 10 branches in total and there are 223 employees. Its main activities are focused in Ulaanbaatar where there are four branches, including its head office. There are only six rural area branches: TDB has little interest in rural banking business. The bank is a leader in foreign trade finance.

Business:

The management committee members are Mr. D. Naranhuu (President and CEO), Ms. B. Saran (Senior Vice President), Mr. B. Medree (Vice President), Mr. O. Khurelbaatar (Vice President) and Mr. S. Orgodol (Director of the Administration and Personnel Department).

TDB's profitability is high: the ratio of net profit to total revenue is 19.7%. TDB's asset structure is loans, 32%; placement with other banks, 26%; securities, 19%; cash & short-term funds, 11%; and fixed assets, 6%. Deposits and current accounts occupy 78% of total assets, and the ratio of net worth to total assets is 8.9%.

Public trust in TDB is the highest among commercial banks.

Table 21 Trade & Development Bank Data (As of Dec. 98)

Head office	Khudaldaany gudamj-7, Ulaanbaatar-11, Mongolia; Tel: 312362, 327020 (Int) Fax: 325449, 328231
Establishment	January 1991
Capital amount	MNT 963m
Shareholders	State ownership, 70%; employee ownership 30%
Management	Mr. D. Naranhuu, President and C.E.O Ms. B. Saran, Senior Vice President, Mr. B. Medree, Vice President Mr. O. Khurelbaatar, Vice President
Business history	Jan. 91: Members of international settlement division of the former bank established
Number of branches	10, including HQ
Number of employees	223 as of the end of 1998
Number of branches (detailed)	HQ: 1 Branches in UB: 3 Aimag branches: 4 Sub-branches: 2
Business characteristics	By the end of 1998, TDB's share of Mongolia's banking sector accounted for about 37% of the total assets, 72.4% of foreign assets, 33.2% of total deposits, and 42% of corporate and 18% of retail customers' current account balances. There was also a drastic increase in the deposit balance (by 60.8%) compared with 1997. Lending activities in 1998 were focused on export-oriented and import-substituting sectors, promoted by the GOM. TDB is a leader in the foreign trade finance sector.
Operations	Deposit, lending, transfer/payment, others
Asset size	MNT 57,565m
Total revenue	MNT 10,492m

(Compiled by JERI)

Table 22 TDB's Balance Sheet 1998 (%)

Current Assets	60.1	Deposits & Current Account	78.3
(Securities)	(19.3)	Borrowing	8.4
Loans	32.2	Other Liabilities	4.3
Fixed Assets	6.4	Capital	8.9
Other Assets	1.3	(Equity)	(1.7)
		(Reserves)	(7.3)
Total Assets	100.0	Total Liabilities & Capital	100.0

(Compiled by JERI)

Table 23 TDB's Income Statement 1998 (%)

Total Revenue	100.0
(Interest Revenue)	(76.0)
Total Expenditure	70.8
(Interest Expenses)	(8.8)
Profit Before Taxes	29.2
Taxes	9.6
Profit After Taxes	19.7

(Compiled by JERI)

2.2.6 Microfinance and other lending activities

2.2.6.1 Microfinance and other lending activities

Formal financial services in Mongolia are decreasing. This situation has caused an increase in the number of microfinance and other lending activities, although their lending size is small. For instance, Golden Fund for Development, supported by the UNDP, started micro-credit in September 1998, and Mercy Corps International (MCI), supported by USAID, is set to start lending activities as a part of the Gobi Regional Economic Growth Initiative. Lending activities by a few cooperative associations are being supported by GTZ; and several other savings and credit cooperatives have been established since 1997. However, it is not easy for these institutions to substitute and to provide full banking services.

These institutions are lending at an average monthly interest rate of 6%. The number of borrowers is growing rapidly, and the rate of bad loans is low. These lending services are mainly targeting entrepreneurs in cities (aimags). In order for such business to be successful, it is essential that there be credit analysis before lending, monitoring after lending, and transparency and accountability.

2.2.6.2 Golden Fund for Development (Golden Fund)

This microfinance institution was established in September 1998 with the support of the UNDP. Its main task is to provide microcredit for individuals. It gained a lending license from BOM in September 1999.

Golden Fund for Development has already served 3,862 customers—loan outstanding is MNT202 million (US$190,000)—since its operation started. The ratio of bad loans during this period is only 1.8%, indicating that the lending business in Mongolia is feasible. The lending scheme of the Golden Fund is a monthly interest rate of 6%, a loan term of three months, and a requirement of collateral. The average loan amount per project is around MNT146 thousand (about US$140). As for the customers, 62.6% are engaged in trading, 23.5% in production business and the rest in service industry.

The Golden Fund is basically modeled on Grameen Bank in Bangladesh. However, it has been modified to suit the business activities in Mongolia. The main characteristics are that (1) it does businesses mainly in cities (aimags), not in rural areas (soums); (2) it focuses on individual loans, not on group lending; and (3) its main goal is not poverty alleviation but contribution to social economic development.

The headquarters and three branches are located in Ulaanbaatar. There are two branches in Dornogovi aimag and one branch each in Hentii aimag and Darhan-Uul aimag. One of the branches in Dornogovi was established in Airag soum in October 1998. After one year of operation, the Airag branch has 154 customers with loans outstanding of MNT19,949 thousand (about US$19,000). Its bad loan ratio is 6.4%, which is relatively high compared to the ratios at other branches.

2.2.6.3 Mercy Corps International (MCI)

USAID started the Gobi Regional Economic Growth Initiative in March 1999. This is a part of 5-year economic development plan for the Gobi area. It consists of projects regarding (1) information system, (2) local governance, (3) business development and (4) national policy. MCI is one of the operating entities and is ready to start lending activities that are a part of the business development project. The targeted customers are entrepreneurs in such industries as agricultural product processing, manufacturing, trading, physical distribution and service delivery. An individual loan ranges in size from US$1,000 to US$30,000; the loan term is from three months to three years; and interest rates are market-based.

2.2.6.4 Cooperative Association

Twenty-four of Mongolia's savings and credit cooperatives have united and established a non-profit organization called the Mongolian National Confederation of Savings and Credit Cooperatives (established in April 1999). The confederation provides such services as consulting for the members.

The savings and credit cooperatives are regarded as financial intermediaries among the members. Figures for the average cooperative are as follows.

(1) Number of members: 10 to 20
(2) Capital amount: MNT1 to 10 million
(3) Total amount of savings: MNT1 to 5 million
(4) Interest rates (savings): 1 to 3% per month
(5) Total amount of loans: MNT1 to 3 million
(6) Interest rates (loans): 5 to 8% per month
(7) Ratio of bad loans: 1%

Twenty of the 24 cooperatives of the confederation are located in Tov Aimag, two in Zavhan aimag and, one each in Govi-Altai aimag and Tov aimag. One of the two in Zavhan aimag is operated in a soum. The total number of members is 695.

3. Funds Flow in Rural Areas

3.1 Overview

Public funds constitute a main money flow as well as a main actual cash flow in rural areas in Mongolia. Pension payment and local budget subsidy flow into rural areas; sales proceeds of NIC, a gas station company, are transferred out of rural areas. Including the funds of such state-owned companies as NIC, Mongol Post Company and Mongol Telecom, the money going through the banking system in rural areas comes mostly from the public sector. Private businesses do not use banking services, at least not for transactions in rural areas. Cash is actually physically brought in and taken out of rural areas instead of transferring money through the banking network. Rural residents do not deposit their cash income; they spend it on consumption goods, and this cash does not come back to the banking network.

Table 24 Money Flow in Rural Areas

	Money Inflow to Soums	Money Outflow from Soums
Active	General budget subsidy	NIC sales transfer
	Pension payment subsidy	Post and telecom sales transfer
	Other benefits payment	Private money transfer
	Private money transfer	
Inactive	Loan funds from AC branches	Deposit transfer to AC branches
Outside of the of banking system	Procurement of agriculture products	Purchase of consumption goods

(Compiled by JERI)

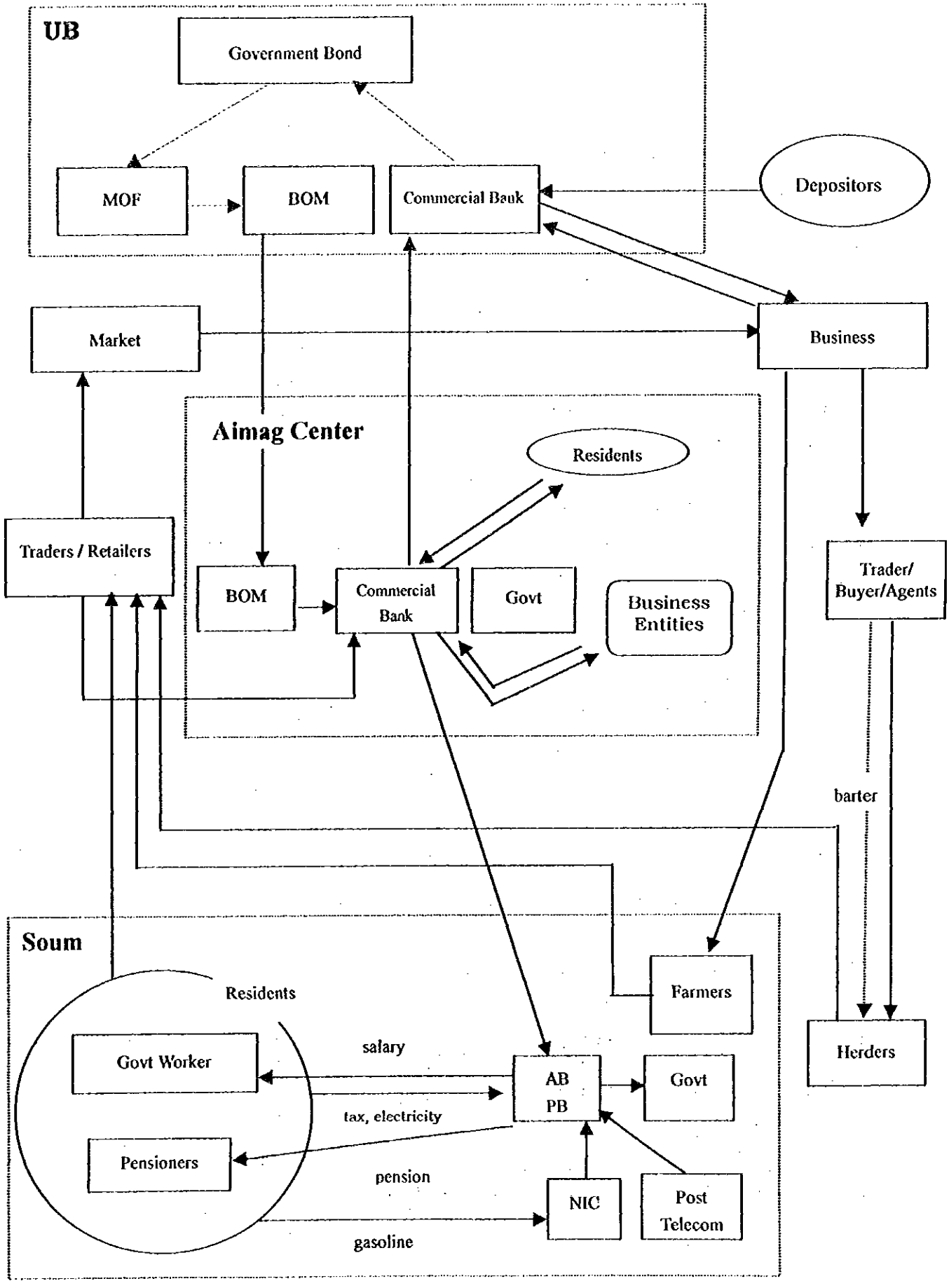
At the soum level, a bank sub-branch receives (sales) cash from NIC, Mongol Post Company and Mongol Telecom to be transferred to their UB head offices, and pays out pensions, social benefits and the salary of government officials. Since the balance of these activities is negative, cash has to be transferred to the soum branch from its aimag center branch. That cash initially has to be transferred from UB, since the aimag center branches are also usually short of cash. Thus cash flow in rural areas is in one direction, from aimag center to soum. There is now practically no new lending or depositing at soum-level bank branches.

Table 25 Cash Flow at Bank Branches in Soums

	Cash Inflow to Bank Sub-branches	Cash Outflow from Bank Sub-branches
Active	General budget subsidy	Salary payment
	Pension payment subsidy	Other budget payment
	Other benefits budget	Pension payment
	NIC sales	Other benefit payment
	Post and telecom sales	
	Tax payment	
	Social insurance premium payment	
	Private money transfer	Receipt of private money transferred
Inactive	Deposits	Deposit withdrawal
	Loan repayment	New loans

(Compiled by JERI)

Chart 3: Funds Flow in Rural Areas



(Compiled by JERI)

3.2 Budget Funds Flow

The state budget (general government budget) is composed of the central budget and local budget. The central government budget includes such special purpose funds as social security fund, social assistance fund, etc. The local budget consists of the aimag government budget including UB city and the soum government budget, which do not include special purpose funds.

Most of the local governments are not self-sufficient and receive gap-filling subsidy from the central government (Table 26). At the soum level, the self-sufficiency rate is even lower (Table 27). The social security fund is not self-sufficient either and is subsidized by the general budget, while the social assistance fund is wholly budgeted by the general budget. Thus there are two large government funds flows from the center to rural areas, i.e., subsidy for local budget and subsidy for social security payment (including social assistance). Pension and other benefits payments are the other major cash inflows to rural areas. The major expenditure items of the local budget are education and health (mostly used for wages of teachers and medical staff). When the wages of administrative staff are included, wages is the largest expenditure item for soum governments. Thus the government funds flow into rural areas is for the monthly paychecks of rural residents.

Table 26 Local Government Budget in 1998 (MNT billion)

	Local Budget Total	Excluding UB, DH, SL	State Budget
Expenditure	100.7	56.3	324.7
Revenue	60.7	19.9	227.2
Subsidy from CG	28.0	28.0	-
Self-Sufficiency rate	60.2%	35.3%	70.0%

Data Source: NSO Mongolian Statistical Yearbook 1998 (Compiled by JERI)

Table 27 Average Budget Per Soum Government in 1998 (MNT thousand)

Aimag	Hovd	Omnogobi	Arhangai
Expenditure	14,647	13,174	17,232
Own Revenue	1,327	569	926
Subsidy	13,320	12,605	16,450
Self-Sufficiency Rate	9.1%	4.3%	5.3%

Data above exclude those of aimag center soums.

Data provided by the relevant aimag governments (Compiled by JERI)

To transfer money, the government basically employs Agricultural Bank for rural payment and Savings Bank for UB area payment. Because the public payment delay has become serious, the government has begun using the BOM network to transfer funds to aimag centers. But, the delay has been caused by the government's financial problem, just as much as by the lack of liquidity at banks. As to pension payment delay, business entities' (employers') delays in making premium payments are another major reason.

A new regulation on inter-bank clearing was introduced on July 1, 1999, requiring banks to clear inter-bank transfer only at their head offices. As for the government funds mentioned above, cash is actually sent from the MOF account at the BOM head office to a BOM aimag center branch. In order to transfer funds from the BOM branch to a commercial bank branch in the aimag center, funds must be cleared at the head office of the commercial bank before the funds are finally paid out to receivers. The new clearance process requires two to three days more than needed under the previous rule. However, this delay is not so serious when compared with the two-to-three-month delay caused by the liquidity problem of the government and banks.

3.3 Social Insurance and Social Assistance Funds Flow

The social security system in Mongolia is administered by the Ministry of Health and Welfare (MOH) and implemented by three agencies under MOH. The State Social Insurance General Offices (SSIGO) is responsible for the pension and other social insurance system, while the Labor Regulation Office is responsible for unemployment benefits, and the Social Assistance Office is responsible for other benefits systems.

Social security is the responsibility of the central government and is implemented by its nationwide organization and staff. The Social Insurance Department is present in each aimag government, including UB City and its districts. At the soum government level, generally there is one SSIGO staff member (three to four in large soums) responsible for social insurance. There are separate and independent budgets at the local government level for the general account and social insurance. The local governor can neither intervene in the social insurance budget nor use it for other purposes.

The current social insurance system is composed of five kinds of insurance: retirement pension, social benefits insurance, work injury insurance, unemployment insurance and health insurance. Employers and employees contribute to the insurance fund. The total contribution rate is 30% of the employee's wage; employees pay 10% and employers pay 20%.

The minimum amount of retirement pension is stipulated as MNT12,000 by law. According to the estimation of SSIGO, the average pension is between MNT17,000 and MNT18,000. However, actual payments in 1998 seem lower than that figure, around MNT12,000 to 13,000, and they are varied among aimags. Monthly payment of pensions and benefits (excluding those made in aimag centers) in 1998 was around MNT3 to 4 million per soum (Tables 28 and 29).

Table 28 Social Security Payment in 1998 (I)

	Total Payment Nationally	Number of Recipients	Average Monthly Payment per Person
Pension	MNT39,075 million	273.1 thousand	MNT11.9 thousand
Other benefits	19,726	140.5	11.7
Total	58,801	413.6	11.8

Data provided by NSO (Compiled by JERI)

Table 29 Social Security Payment in 1998 (II) (MNT thousand, persons)

	Dornod	Hovd	Omnogovi	Selenge
Aimag's Total Pension Payment	873,693	496,951	696,049	983,211
Aimag's Total Number of Recipients	5,492	5,959	4,363	6,077
Avg. Monthly Payment per Person	13.2	6.9	13.3	13.5
Avg. Monthly Payment per Soum	2,510	1,657	2,809	2,368
Number of Recipients per Soum	187	276	221	168
Aimag's Total Benefits Payment	355,018	171,818	277,889	444,904
Aimag's Total Number of Recipients	2,740	2,017	6,669	2,656
Avg. Monthly Payment per Person	10.8	7.1	3.5	14.0
Avg. Monthly Payment per Soum	895	499	1,073	949
Number of Recipients per Soum	80	82	345	76

Note: Figures per soum exclude those of the aimag center. In the case of Selenge, Mandal is also excluded in addition to Suhbaatar.

Data provided by the aimag governments (Compiled by JERI)

Though the government wants the system to be self-sufficient, the central government currently subsidizes the system by about 30% of the pension and health insurance expenditures (from the general budget). All aimags except Ulaanbaatar, Dahan, Orhon and Govisumber receive subsidy from the central government. The other three insurance types are self-sufficient and are funded only through insurance premiums. Receiving subsidy from the budget, SSIGO has to report its financial status to MOF, and MOF has a representative on the National Council of Social Insurance, the decision-making organ of the social insurance system.

Actual cash transfers to rural areas from the central government are calculated as follows.

To aimag government: Total pension payment in the aimag, including those of the aimag center, less the social insurance premium paid in the aimag. The difference is transferred to the aimag center office from UB.

To soum government: Total pension payment in the soum, less the social insurance premium paid in the soum. The difference is transferred to the

soum from the aimag center office.

Each of the five insurance types has an individual account with BOM. Funds for insurance payment are transferred to aimag centers through the BOM network. Staff of Agricultural Bank's soum branches receive cash at aimag centers and take it back to the soums.

However, the government subsidy has been delayed due to the government's financial situation. The current amount of the delay outstanding is MNT1.4 billion. Since SSIGO does not know when it will receive subsidy, available funds have to be distributed equally among aimags. At the soum level, those who are in most need (i.e., those dependent solely on pension) are given priority to receive pension. Most such cases are for residents of soum centers.

SSIGO calculated the cost of carrying out pension payment by itself in the event of an Agricultural Bank network closure, and found out that the cost was huge and that SSIGO did not have human resources and equipment capable of transferring money. However, according to SSIGO judgement, closures of Agricultural Bank branches near aimag centers have not caused serious problems so far. Residents can access aimag centers by themselves and through mobile banking services.

3.4 Tax Collection Flow

Taxes collected in rural areas should create money outflow from rural areas to UB. In reality, however, the taxes collected in rural areas are expended in rural areas and do not flow out.

The national tax of Mongolia is comprised of state tax and local tax. Local tax is collected by local governments and expended by local governments. State tax is collected by the General Department of National Taxation (GDNT), as well as by local governments, and is expended by the central government. In reality, the state taxes collected by local governments are not transferred to the Treasury. Soum governors are permitted to expend all taxes collected in their soums except for VAT. There are one or two tax officers in each soum who assign and collect tax.

Among the state taxes, VAT is the only tax that is supposed to be shared between the central government and local government, 80% and 20% respectively. The law states that all of the VAT collected by local governments should be transferred to Treasury, then MOF returns 20% of it to the aimag governments. In reality, aimag governments retain all of the VAT collected and expend it by themselves. MOF and GDNT decided that from January 1, 1999, the whole VAT collected by local governments would indeed be transferred to Treasury. This is intended to provide a better picture of the public's tax burden, which has been unclear to GDNT because tax payment and expense were handled at the aimag level. VAT on gold (10%) can be captured at the time of the sale to the central bank. VAT on other goods is difficult to collect.

In GDNT there is a division which is in charge of large corporations regardless of their head office location. Corporate income tax and withholding income tax are collected solely for the central government.

3.5 NIC Funds Flow

NIC (the state-owned gas station company) has an extensive national network of 340 stations in rural areas and 30 in the UB area. Banking services in rural areas are important issues to NIC, which generates 70% of its sales from rural areas. In a reciprocal manner, NIC's sales are important to rural banking, since NIC is the largest cash generator at the soum level. It should be noted that NIC's sales have been declining due to import shortage as well as competition from independent operators, mainly in large city areas.

NIC had a monopoly status in sales of petroleum products up to 1994. Since then several independent operators have come into the business, and NIC's sales share has been declining rapidly—to 57% in 1998. NIC sold 227 thousand tons of petroleum products worth MNT67.6 billion in 1998, by importing it mainly from Russia. In rural areas, sales volume almost halved between 1997 and 1999.

NIC's sales proceeds used to be large enough to cover the payment of pay pensions and salaries in soums, but they now seem to be insufficient in some areas. Average annual budget expenditure per soum was about MNT15-20 million in 1998 (Table 27), roughly about MNT1.5 million per month. Social security payment (including pensions and benefits) per soum was about MNT4 million per month in 1998 (Table 29). In total MNT5-6 million per month was necessary for government related payments in a soum. NIC's sales seem to have been sufficient to cover the payments in 1998. However, gasoline sales have been declining and, at best, seem barely enough to cover the payment in 1999 (Table 30).

Table 30 NIC Average Monthly Sales in Rural Areas (MNT million)

		Hovd	change	Omno-govi	change	Dornod	Change	Selenge	change
Total aimag sales	1997	235.7		179.2		154.4		202.6	
	1998	193.8	-17.8	150.3	-16.2	157.1	1.8	125.8	-37.9
	1999 (1-9)	132.5	-31.6	105.9	-29.5	102.7	-34.7	82.9	-34.1
Aimag center sales	1997	73.1		69.9		64.8		54.7	
	1998	62.0	-15.1	59.8	-14.5	64.1	-1.1	51.7	-6.8
Soums sales	1997	162.7		109.3		89.5		147.9	
	1998	131.8	-19.0	90.5	-17.2	93.0	3.9	74.1	-49.9
Number of soum stations		14		9		11		16	
Per soum sales	1997	11.6		12.1		8.1		9.2	
	1998	9.4	-19.0	10.1	-17.2	8.5	3.9	4.6	-49.9

Data provided by NIC (Compiled by JERI)

NIC transfers sales proceeds from rural areas to UB through banks. For the sales transfers from soums, NIC has to use the Agricultural Bank network, as it is the only available channel to the UB head office. NIC's stations in soums sell gasoline for cash, and the sales proceeds are taken to a soum branch of Agricultural Bank, which in turn makes a payment order to its aimag center branch. Then the aimag center branch makes a payment order to the Agricultural Bank's head office, which makes payment to NIC's current account.

For sales transfer in aimag centers, NIC uses TDB, where their branches are available. NIC started using Post Bank in rural areas in June 1999. NIC's internal policy is to transfer sales money to its head office within three days. TDB and Post Bank can usually handle the transfer on time, but Agricultural Bank is always slow. Thus, NIC's current order of priority for banking services is (1) TDB, (2) Post Bank, and (3) Agricultural Bank.

Transfer fees differ depending on banks and distance; the average rate is about MNT140, ranging from MNT100 to MNT180. TDB provides the lowest flat fee, MNT100; the Post Bank charges MNT120, and the Agricultural Bank charges higher. An additional fee is charged for expedited transfers from aimags to UB (MNT1,000).

NIC does not use banking services other than for transferring sales proceeds to the head office. Because NIC is always in need of cash to purchase petroleum products, it does not deposit its sales proceeds and keeps only current accounts at banks. In addition NIC needs bank credit for working capital to cover the time lag of 30 to 40 days for the purchase, shipment, and distribution of petroleum products.

NIC does not even use banks to pay salaries of soum station employees, because soum bank branches may not have enough cash on hand to cover such payment. Therefore, a group of NIC experts deliver the pay when they visit soum stations every month, to check the petroleum reserve, or soum distributors are paid when they visit aimag centers branch to submit financial statements and other documents.

3.6 Agricultural Industry Funds Flow

(1) Business sector

Major livestock products which can earn cash income are cashmere, wool, hides and skins, and meat (live animals). Among them, cashmere has become the most marketable product, and the number of goats in the country has increased sharply, reaching 11 million in 1998 from around 5 million in 1990. The majority of the goats are raised in the southwest aimags (Bayanhongor, Govi-Altai, Ovorhangai, Omnogovi, Dundgovi, Hovd, and Zavhan). Crop farming products such as wheat and potato, shared only 12% of the total agricultural output in 1998.

Under the socialist regime (up to the early 1990s), the procurement of livestock products was implemented according to the State plan. There was an organized procurement system. The Trade and Procurement Agency at the soum level made contracts with producers, processors and transporters. The Trade and Procurement Board at the aimag level operated as an intermediary between the State and the soum-level organizations. All the trade was settled in cash, for which bank loans were available. The procurement of crop products was simpler, since most were produced by relatively large-scale State farms which were geographically concentrated in the central part of the country. The State farms made their own individual contracts with processors.

With the collapse of the state procurement system, herders, becoming private owners of livestock, now sell their products through various channels. They mostly sell to private traders or directly to processing companies. Private traders are either independent, agents of Chinese traders or agents of processing companies. Soum or aimag-based traders mostly sell their purchased products to Chinese agents at the border trade points. Because of high demand and competition in the procurement of cashmere, domestic processors have started to establish representatives in rural areas to secure raw materials. Mongol Amical, a US joint venture cashmere processor, now has thirty warehouses in aimag centers and soums for stable procurement. It is roughly estimated that two-thirds of all cashmere is purchased by domestic processors and the rest by Chinese traders. A meat processing company, Mahimpecks, also has its own procurement agents in 10 western and two eastern aimags to purchase livestock.

Cashmere and camel wool are sheared and traded in spring and early summer (March to June), sheep wool in summer, and hides and skins in late autumn and early winter. Because of the seasonal feature, livestock product procurement requires working capital.

Until 1996 there were operative branches of People's Bank and Agricultural Bank throughout the country; and processing companies could borrow money from the banks for procurement of livestock products. Currently 20 to 30% of the purchase is settled in kind. Barter is equally common throughout the country. In barter trade, the livestock products are exchanged for such goods as motorbikes, flour, tobacco and other consumer goods. The local traders and agents survey the needs for goods of herders.

Barter trade is observed even in international trade. Mahimpecks exports beef to Russia and sells mutton domestically. The export is in exchange for such goods as motorbikes, petroleum and flour. The petroleum is sold to NIC and other goods are used for barter trade with herdsmen.

Neither processing companies nor private traders use banking services now. First of all, bank loans are not available for them now. And they do not use transfer/payment services for procurement in rural areas, since they do not trust in the service. Therefore, they take cash and barter goods in rural areas either directly or through agents. The processors and/or agents transport the cash and barter goods either by plane or by jeep and truck with security guards (generally contracted policemen).

(2) Herders' cash revenue

The main cash revenues of herders are from cashmere sales in spring, and livestock or meat sales in autumn. There is a large difference in the cash revenue from cashmere sales and that from meat (livestock) sales. According to a meat processor, the average livestock sales volume per herder was one cow and ten sheep per year, which is equivalent to only MNT100,000 to 200,000. However, the largest sales amount for one herder reached as high as MNT4 million.

According to a processor which buys cashmere from Uvs Aimag herders, the annual average sales per herder was around 150 kg (500g/goat times 300 goats), which was equivalent to about MNT1.5 million. The price per kg, then, is equivalent to MNT 10,000, which level was prevalent up to early 1999. However, the price of raw cashmere increased violently in 1999, reaching MNT40,000 in November and December. A Field survey by National University of Mongolia also revealed that herders with cashmere goats in Omnogobi Aimag generally have MNT3 to 4 million in cash savings.

Table 31 Local Prices of Selected Livestock (Products)

(MNT)

Item	Unit	Price
Sheep		18,000-20,000
Cow		50,000-60,000
Bull (castrated)		100,000-130,000
Cashmere	per kg	20,000-23,000
Milk	per liter	250-450
Sheepskin	piece	2,000-4,000

Note: Livestock prices were as of 1997. Livestock product prices were as of November 1999.
Data: MBDA (Compiled by JERI)

4. Demand and Supply of Banking Services

We conducted field surveys on rural banking services from the supply (and institutional) side as well as from the demand side. We divided the Mongolian territory into five regions—west, central, south, north and east—following the lead of the *Living Standard Survey* of NSO in 1998.

The Japanese consultant team conducted surveys in Dornod (representing eastern aimags), Hovd (western), Omnogovi (southern) and Selenge (northern) Aimags, interviewing such institutions as local governments, central bank branches, commercial banks and post offices. The interviewing of soum residents was consigned to the National University of Mongolia. It was conducted in five aimags, the four aimags mentioned above and Arhangai Aimag (central).

The choice of areas was to reflect regional characteristics. However, we observed that rural banking sector problems were common to all aimags we studied, which was consistent with our research in the capital city.

4.1 Availability of Rural Banking Services

4.1.1 Banking Network in Aimag Centers

Each aimag center has between three and five bank branches, from among AB, PB, RB, ITIB, TDB, and SB (Table 32). However, among these players, only TDB provides full banking services and it operates only in selected large cities. AB, RB and ITIB have been under central bank control since February 1999, and they have stopped new lending. Deposits have been withdrawn from these banks (Table 36). Services are also provided by healthier players, though to a limited extent. PB provides rural areas with only transfer/payment services. SB has started lending, but the lending is only for those who offer their deposits as collateral, and its loans outstanding is quite small.

There used to be more bank branches in aimag centers when lending was loosely and competitively conducted, but they either failed or went under conservatorship. The current number, three to five, is still considered large for the economic activities in rural areas.

4.1.2 Banking Network in Soums

In each soum there is basically one bank sub-branch, which is under the administration

of an aimag center branch. Though some sub-branches close to aimag centers have been closed, the formal banking network practically remains intact at the soum level. AB's rural banking network is in all aimags except Hovd (served by PB), Selenge (served by RB) and the large city aimags of Ulaanbaatar, Darhan-Uul and Orhon. PB and PC have joint operations in rural areas: at the soum level in Hovd Aimag and at all aimag centers. PC provides office space and staff at soum branches for both itself and PB. PC covers all of PB's rural operation costs.

Generally, three employees (manager, cashier and guard) work in each sub-branch of AB and PB. Because of the low liquidity at soum branches, sub-branch staffers go to aimag branches to receive cash for pension and salary payment. They go by jeep with security guards, often off-duty policemen, since security is an actual and important issue in transporting the money. As for PB soum branches, the mail car is used for cash delivery.

Table 32 Numbers of Bank Branches (As of Oct. 1999)

Aimag	AB	PB	RB	SB	TDB	Others	Total
Arhangai	18	1	0	0	0	0	19
Bayan-Olgii	12	1	1	1	0	0	15
Bayanhongor	18	1	0	1	0	0	20
Bulgan	15	1	0	0	0	0	16
Govi-Altai	17	1	0	0	0	0	18
Dornogovi	15	1	2	0	1	1	20
Dornod	15	1	0	0	1	0	17
Dundgovi	12	1	0	0	0	1	14
Zavhan	21	1	0	0	0	0	22
Ovorhangai	18	1	0	0	0	0	19
Omnogovi	14	1	0	0	0	1	16
Suhbaatar	12	1	0	0	0	0	13
Selenge	1	1	17	0	1	1	21
Tov	23	1	0	1	0	0	25
Uvs	20	1	1	1	0	0	23
Hovd	1	17	8	1	0	0	27
Hovsgol	23	1	0	1	0	0	25
Henti	18	1	0	1	0	0	20
Darhan-Uul	1	1	1	1	1	2	7
Ulaanbaatar	1	8	9	28	7	24	77
Orhon	1	1	1	1	1	2	7
Govisumber	0	1	1	0	0	0	2
Total	276	46	40	37	12	32	520

The numbers above include branches (in aimag centers) and sub-branches.
Data: BOM (Compiled by JERI)

4.1.3 Postal System

The postal system has a comprehensive network all over the country, having one office (sub-branch) in each soum. In addition to mail, its rural area services include subscription to publications, transportation (utilizing mail cars), and provision of money orders and NIC checks (prepaid checks for oil purchases). Mail delivery service from aimag centers is usually once or twice a week by vehicles; however, this has recently been reduced due to gasoline shortage.

Aimag center branches have staffs of about 15, 10 for postal operations and 3-5 for banking. Soum offices have staffs of one or two. Hovd soum offices have three persons, who perform both postal and banking services. When postal service and telecommunication service were separated into two different companies in 1994, their offices also separated but remains in the same building. Though organizationally separated, the PC/PB joint bank business has preferential access to the telecommunication network, which is the most important communication channel and covers all soums in the country.

4.1.4 Cash Flow

As we saw in Chapter 3, the main money inflow to soums comes from pension payment and the central government subsidization of the soum government budget. The main money outflow from soums comes from NIC sales transfers to the head office, and post and telecom fees to the head office. Only SOEs are using banking services now and the money outflow is not sufficient for the money inflow. Thus, cash flows one way—from aimag centers to soums—and returning money does not flow through the banking system.

4.1.5 Transfer/Payment

Pension payments were actually delayed in all five of aimags we surveyed. AB and other banks misused pension payment funds for such other purposes as extending loans and deposit repayment (because of low liquidity and slack management). After being put under conservatorship, the liquidity of AB deteriorated at first, due to increasing deposit withdrawal. Then in August 1999, the government announced that of AB was secure and deposit withdrawal subsided. Improved liquidity was the result of decreased deposit withdrawal as well as a loan collection effort. According to the Hovd experience, PB provides quicker transfer services than AB did previously and PB does not have a liquidity problem since it does not extend loans in rural areas.

4.1.6 Deposit

Bank deposits are being withdrawn and are decreasing in all aimags (Table 36). Among soum residents there seems to be low potential for saving as well as low trust in the banking system. On the other hand, herders in Omnogovi seem to have enough cash for savings, but they would rather lend it to acquaintances. Interest rates seem to be lower than the profits available from trading and other business. PB started a policy of accepting deposits in Hovd Aimag last September, but has not collected any yet due to its low interest rate, 0.8%, compared with SB's 1.5% (at mid October).

4.1.7 Lending

All banks have had bad loans, mostly out of the loans extended for crop farming. Financial intermediation has not been conducted appropriately; most loans are directed loans and were made without first performing credit analysis. As we saw above, no new lending is available at the soum level.

Table 33 Comparison of Rural Banking Services in Selected Aimags (I)

Aimag (Aimag Center)	Dornod (Herlen)	Hovd (Jargalant)	Omnogovi (Dalanzadgad)	Selenge (Suhbaatar)
Economy	Livestock farming, Railway runs, Border trade, Former SOEs (flour, meat, coal and power) are stagnant.	Livestock farming, Border trade, Electricity shortage closed plants since 99.4.	Livestock farming, Border trade, Tourism	Crop farming (287ha), Railway runs, Border trade, Wood processing, Alcohol, Gold mining
Banking Network Aimag Center	AB. TDB took over PEB in 93 and now has a majority business share. PB provides only T/P and P/P since 99.2. PB took over services of RB and ITIB in 99.7. Central Asia, IB, RB, ITIB were closed. Telecommunication network is a problem.	AB, RB (took over PEB & IB in 96.12), SB, PB since 98.6 provides only T/P ITIB were closed (earlier AB branches sold to ITIB).	AB, Renovation Bank took over ITIB in 98.12. PB has provided T/P since 99.1 and mobile service to trading locals. Mongol Daatgal Bank was closed in 96.12, and RB in 99.9. (USAID project will start lending operations)	AB, RB, and ITIB which provides only T/P and loan recovery TDB has been in service since 93.7. PB has provided T/P since 98.9.
Banking Network Soums	AB has had branches in 12 soums and 1 bag. One soum-b near AC and 9 bag-b were closed. Only 2 of the soum-b are profitable, but banking skill is same at all soum-b. 11 out of 42 soum-b staff are college graduates.	PB has had branches in 16 soums since 98.3, (RB in 7 soums), provides only T/P, has losses due to security cost. PC pays all costs of PB banking services. AB branches were closed in 98.9.	AB in 13 soums; 1 soum-b near AC closed in 97 Go to AC for banking services PB in a few soums provides T/P (99.1-), facing security issue	RB took over PEB and has branches in all 16 soums. 61 staff in total. Bad loans of MNT560m, mainly for farmers. Average loan loss of MNT3m/sub-b. Four profitable soum-b are along the railway.
Post System	Has offices in 13 soums and 2 bags. 1/w service for soums, 2/w between UB and AC by airplane. Transfer/payment from 99.2 Delay due to gasoline shortage	Has offices in 16 soums. PC started banking in 97.6. Three staff at each soum office. Before T/P started, only one staff was responsible for both post and telcom.	1/w service, mail service only	1/w service for most soums, 3 times/w for soums along the railway. Mail and money order services, and sell NIC check.
Cash Flow	Bank money flow is one-way from AC to soums. Return flow by traders is outside of bank. During 99.1-10, cash out (of MNT2b) from BOM branch and cash in of only MNT74m	SB deposits are transferred to UB Money flows from AC to soums, 20% remains in soums, 30-40% to AC, 50% to UB	One way from AC to soums Cash deficit is 30% at AB, 15% at Innovation Bank, 0% at PB.	Unregistered businesses can't open bank accounts.
Government Budget	No subsidy received from CG in 1997 and 1998, not clear for 1999→ need deficit cut measures. Pension MNT873m, Benefits MNT355m	Expenditure, MNT434m (own rev. 7%), Pension MNT497m, Benefits MNT172m	Expenditure, MNT288m (own rev. 4%), Pension MNT696m, Benefits MNT278m	No subsidy from CG. Pension MNT983m, Benefits MNT319m

Abbreviation: AB: Agricultural Bank, BOM: Bank of Mongolia, IB: Insurance Bank, PEB: People's Bank, PB: Post Bank, PC: Post Company, RB: Reconstruction Bank, TDB: Trade & Development Bank
AC: aimag center, CG: central government, GF: government funds, Soums: soums excluding AC, soum-b: branch at soum, T/P: transfer/payment, P/P: pension payment, 1/w: once a week
Source: Field survey conducted by the study team from 12 to 22 October 1999 (Compiled by JERI)

Table 34 Comparison of Rural Banking Services in Selected Aimags (II)

Aimag (Aimag Center)	Dornod (Herlen)	Hovd (Jargalant)	Omnogovi (Dalanzadgad)	Selenge (Suhbaatar)
Transfer/Payment	P/P delayed but not serious after conservatorship. GF are transferred now by BOM to AC (by air), by AB to soums (by jeep). Under the new clearing rule, transfer delayed further in AB. Only SOEs use banking services now. PB started pension delivery in 99.7.	AB and RB delayed pension payment in 1997. GF are transferred now by BOM to AC, by PB to soums (earlier by RB). PB is quicker than RB and AB. Main private transfer is tuition payment (in September from aimag to UB).	Pension payment actually delayed. NIC started use PB (in AC since 99.1 and at soums since 99.4). NIC concerns on PB security using mail car. PB had only 4 transfers during 99.1-10.	Pension payment delayed. Delay is not serious in areas close to AC, but serious in some areas.
Deposit	Withdrawal increased after conservatorship. Low capacity of deposits by households due to bad economy. Difficult to withdraw deposits due to low liquidity problem. Deposit withdrawal in 1993 due to int. rate decrease.	SB has 70% of deposits in Hovd (MNT233m), offers higher interest rate. Soum residents do not make deposits, they keep cash. 60-70% of depositors at AB and RB are herders. PB started deposit taking in 99.9, but no deposits have come yet.	Generally low capacity of deposit by soum residents, but herders have enough cash. No trust in banks. Better to do business than to deposit at low int. rate. Government bank is expected by some.	RB deposits were transferred to AB and SB. Low trust in banks. Better to do business than to deposit at low interest rate.
Lending	AB has bad loans (mainly to crop farming). Loans extended at all levels, including soum-b. Collateral collected can't be sold away. Only TDB lends now, at 3.45-4.5% for business and at 4-6% for individual. Demand for loans exists, but no collateral is available for them.	Majority of AB's bad loans were made at AC. RB lent to manufacturing business in 97 and 98. Only SB lends now, collateralized by 70-90% of the value of deposits.	Bad loan volumes are 72m at AB, 14m at ITIB. Borrowing needs of local residents are for trade and agriculture. USAID project will start.	AB, RB and ITIB have bad loans (mainly to farmers). Directed loans were extended during 93-95. Only TDB lends now, mainly to farmers (MNT55m /50 loans). Farmers borrow from flourmill companies. (Golden Fund Darhan started operation in 99.8, has provided 106 loans, at interest rate of 6%, serves 16 of 60 bags)

Abbreviation: AB: Agricultural Bank, BOM: Bank of Mongolia, IB: Insurance Bank, PEB: People's Bank, PB: Post Bank, PC: Post Company, RB: Reconstruction Bank, TDB: Trade & Development Bank

AC: aimag center, CG: central government, GF: government funds, Soums: soums excluding AC, soum-b: branch at soum, T/P: transfer/payment, P/P: pension payment, 1/w: once a week

Source: Field survey conducted by the study team from 12 to 22 October 1999 (Compiled by JERI)

Table 35 Basic Aimag Data

Aimag (Aimag Center)		Dornod (Herlen)	Hovd (Jargalant)	Omnogovi (Dalanzadgad)	Selenge (Suhbaatar)
Number of soums, incl. AC		14	17	15	17
1998 population: (1,000)	total AC, soum (%) (national %)	84.3 38.6 45.7 (54) (3.4)	93.0 27.4 65.6 (71) (3.9)	46.2 12.6 33.6 (73) (1.9)	107.0 22.3 84.7 (79) (4.4)
1998 households: (1,000)	total, herdsmen (%)	16.9 4.2 (25)	19.0 10.3 (54)	11.3 6.9 (61)	22.5 2.7 (12)
1998 pensioners & beneficiaries: (1,000)	@soum other than AC (% of population)	5.5 @186 2.7 @80 (6.5)	6.0 @281 2.0 @82 (6.4)	4.3 @220 6.7 @345 (9.3)	6.1 @289 2.7 @119 (5.7)
1998 sown area 1989 : in hectares	(national %)	8.2 (2.5) 48.1 (5.7)	2.9 (0.9) 9.4 (1.1)	0.1 (0.0) 0.3 (0.0)	140.1 (42.9) 195.9 (23.3)
1998 industrial output: MNT billion	(national %)	11.5 (0.3)	12.0 (0.3)	8.3 (0.2)	24.3 (5.6)
1998 budget: MNT billion	budget revenue subsidy (self%)	2.9 1.4 1.6 (48)	3.1 0.8 1.7 (26)	2.2 0.5 1.4 (2)	5.4 5.2 0 (96)
1998 loans outstanding 1995	MNT million (overdue%)	405.7 (79) 1021.6 (32)	588.1 (95) 1085.5 (21)	128.6 (71) 230.3 (20)	913.6 (64) 3663.8 (7)

Data: Mongolian Statistical Yearbook 1998(Compiled by JERI)

Table 36 Aimag Banking Data (MNT million)

Aimag (AC)	Dornod (Herlen)			Hovd (Jargalant)			Omnogovi (Dalanzadgad)			Selenge (Suhbaatar)		
	96.12	97.12	98.12	96.12	97.12	98.12	96.12	97.12	98.12	96.12	97.12	98.12
Ind. deposit	434	374	318	461	442	408	480	403	272	475	430	358
national %	0.8	0.7	0.6	0.9	0.8	0.7	0.9	0.7	0.5	0.9	0.8	0.6
Loans	596	368	405	1134	675	588	196	98	128	3408	919	913
national %	1.0	0.8	0.6	1.8	1.4	0.8	0.3	0.2	0.2	5.5	1.9	1.3

Source: BOM AC branches, NSO Statistical Yearbook(Compiled by JERI)

4.2 Demand for Rural Banking Services

4.2.1 Outline of the Financial Needs Survey

This survey was conducted in cooperation with the National University of Mongolia, the National Statistical Office, and the financial departments of each aimag.

I. Survey period

The survey was conducted from the middle of October to the middle of November 1999.

II. Survey sites

We chose one typical aimag from each area—Arhangai (the central area), Hovd (the western area), Omnogovi (the southern area), Selenge (the nothern area) and Dornod (the eastern area)—for the field survey.

There were six interview groups for the survey. Each group visited two soums in each aimag. The following lists the soums visited in the aimags.

- Arhangai (Tsetserleg, Hairhan)
- Dornod (Matad, Choibalsan)
- Omnogovi (Noyon, Gurvantes)
- Selenge 1* (Altanbulag, Saihan)
- Selenge 2 (Orhon, Tsagaannuur)
- Hovd (Bulgan, Darvi)

*Two interview groups went to Selenge Aimag: the Selenge 1 group interviewed nomads, soum residents and enterprises, while the Selenge 2 group interviewed only crop farmers.

III. Subjects of the survey

Table 37 shows the subjects of the survey. The subjects were categorized as to occupation (nomad, farmer, or soum resident) and enterprise. (Most of the enterprises have staffs of three to eight people.)

Each of the six groups visited about 110 households and enterprises. The total number of the subjects is 656.

Table 37: Characteristics of Interviewees

	Nomad	*Farmer*	*Soum Resident*	*Enterprise*	*Total*
1 *Arhangai*	31	0	61	21	113
1 Tsetserleg	15	0	31	11	57
2 Hairhan	16	0	30	10	56
2 *Dornod*	30	0	74	7	111
1 Matad	15	0	35	5	55
2 Choibalsan	15	0	39	2	56
3 *Omnogovi*	32	0	47	30	109
1 Noyon	15	0	23	17	55
2 Gurvantes	17	0	24	13	54
4 *Selenge 1*	31	0	28	54	113
1 Altanbulag	16	0	14	25	55
2 Saihan (Hutul)	15	0	14	29	58
5 *Selenge 2*	0	100	0	0	100
1 Orhon	0	50	0	0	50
2 Tsagaannuur	0	50	0	0	50
6 *Hovd*	36	0	48	26	110
1 Bulgan	21	0	23	13	57
2 Darvi	15	0	25	13	53
Total	160	100	258	138	656

(Compiled by JERI)

IV. Survey method

Local researchers conducted a questionnaire survey of householders and enterprises through individual interviews of household heads/enterprises.

V. Survey items

The subjects were questioned on basic information regarding households, savings, debt, money transfers, and settlement.

4.2.2 Results of the Financial Needs Survey

4.2.2.1 Deposits

Answers to the questionnaire showed that 19.4% of all interviewees had banking accounts (Table 38). The ratio of account holders varied among the aimags. For example, whereas the number of interviewees with banking accounts in Omnogovi and Hovd Aimags were 27.5% and 32.7% respectively, in Arhangai and Dornod Aimags the percentages were just 11.5% and 6.3%. In addition, an occupational factor was apparent. While 25.0% of nomads had accounts, only 9.0% of farmers and 15.5% of soum residents did. The occupational factor was ubiquitous throughout the aimags: in Omnogovi Aimag, 40.0% of enterpreneurs had accounts, though only 12.8% of soum residents did.

As shown in Table 39, 47.4% of the subjects planned to open bank accounts when banks re-started their business. The ratio differed among the various aimags. In Selenge Aimag, more than 70% of the subjects wanted to open an account, while only 13.6% of those in Hovd Aimag did.

Reasons for the respondents' unwillingness to deposit are shown in Table 40. The biggest reason, given by 46.3% of the respondents (multiple answers were accepted), was a lack of money. In Dornod and Hovd Aimags, more than half of the subjects gave this reason. The second and third biggest reasons, cited by 44.2% and 36.5% of respondents respectively, were a distrust of banks and the fear that they might not be able to withdraw deposits. For enterprises, distrust of banks was the biggest reason, given by 48.1% of the respondents. Clearly, the low credibility of banks is seriously hindering efforts to mobilize savings. In Selenge 1 and Omnogovi Aimag, more than 50% of the subjects mentioned a distrust of banks, while in Hovd Aimag, where the Post Bank is operating and has not accepted any deposits, only 21.3% did so. Low

interest rates, the fourth reason at 22.0%, do not seem to be so significant. A geographical factor was apparent here. While low interest rates were the third reason in Omnogovi (33.3%), they were only the seventh reason (9.5%), in Selenge 2.

The expected ratio of bank account holders reaches 95.7%, when one includes those who are willing to deposit money when the quality of banking services is improved and the above mentioned problems are solved (Table 41).

4.2.2.2 Loans

Answers to the questionnaire showed that 26.4% of all interviewees were current recipients of loans (Table 42). We also found that the ratios of borrowers were different among aimags. For instance, compared with the relatively high ratios in Omnogovi Aimag (32.1%) and Arhangai Aimag (31.0%), that of Dornod Aimag was only 19.8%. Here, too, an occupational factor was found. For example, while 30.6% of soum residents had loans, just 15.0% of nomads did. The occupational factor was also observed within individual aimags: in Omnogovi Aimag, 42.6% of soum residents were currently borrowers, while only 30% of enterprises were.

Most of the subjects got their loans from relatives, friends, and so on. Only 8% of those who borrowed money used banks (Table 43). The interest rate seems to be the most important factor in choosing a lender (Table 44). No collateral requirement also appears important. However, about half of borrowers said that they had no options. Dozens of respondents complained that loan terms were generally too short. There seems to be significant demand for longer-term loans.

Thirty-seven percent of borrowers used the money to pay living expenses (Table 45). For the next biggest group (19%), the purpose was to start a business. Here too, the occupational factor was remarkable. While 57.5% of soum residents used their loans to pay living expenses, only 18.2% of farmers did.

As shown in Table 46, 70.1% of the respondents indicated that they would want to borrow when banks re-started their lending activities. Among these, 57% wanted to use the money to start a business (Table 47). Other than in Selenge Aimag, about 70% of expected borrowers wanted to start a business (Table 48). Half of those who wanted to borrow money said they had not done so before because no bank would finance them (Table 49). This may be because there was no bank sound enough to extend loans, or

because the credit status of the borrowers was insufficient. Only in Omnogovi Aimag did the respondents cite high interest rates as the biggest reason (Table 50).

4.2.2.3 Money Transfers (Sending Funds)

The survey revealed that 24.1% of all interviewees were remitting money (Table 51), though to different extents in different aimags. For example, 52.3% of interviewees in Omnogovi Aimag reported using a bank to send money, while the percentages of those who did so in Arhangai and Dornod were just 8.0% and 18.0% respectively. An occupational factor was also apparent. For example, while 23.3% of soum residents used a bank to send money, only 9.0% of farmers used the service. A geographical factor was apparent within each occupation: although transfer services were used by 100% of enterprise respondents in Dornod and 60% of those in Omnogovi, the figure for Arhangai was a low 23.8%. We should note here that the number of respondents was not large enough to judge the importance of the geographical factor.

The most common reason for remittances was "to send funds to a family member" (24.5%); the second was "to send funds for business purposes" (21.5%, as in Table 52). (Multiple answers were accepted.) As indicated in Table 53, 66.3% of the respondents noted that they lacked choice in selecting a financial institution to perform the remittance. Only 1.8% of respondents mentioned "low fees" as the reason for selecting a financial institution for this purpose.

Of all of respondents, 75.2% indicated that they would use a bank to send money when banks improved the level of their remittance services (Table 54), though the expected usage ratios for Dornod, Selenge 1, and Hovd were lower than for other aimags. The most quoted reason in this case was "to send funds to a family member" (58.1%), followed by "to send funds for business purposes"(45.7%).

Questioned as to why they had not remitted money yet, the largest grouping of respondents (18%) cited the unreliability of banks. This was followed by "bad service" (8.5%, Table 56). The most common reason given in Dornod, Selenge 1, and Hovd, where the expected usage ratio is low, was the unreliability of banks (26.3%, Table 57). Here again, the lack of credibility of banks is shown to be a significant obstacle to their usage. High charges for remittances seem not to be so important.

4.2.2.4 Money Transfers (Receiving Funds)

The survey showed that 24.1% of all interviewees were using a bank to receive money (Table 58). The level of this activity differed among the aimags. For example, 51.8% of the interviewees in Hovd Aimag used a bank to receive money, while in Omnogovi and Arhangai Aimags the figures were just 4.6% and 8.8% respectively. In addition, an occupational factor was found: while 15.9% of soum residents used a bank to receive money, only 9.0% of farmers used the service. The occupational factor also existed within each aimag. In Dornod Aimag, 85.7% of enterprises used a bank to receive money, while only 5.4% of soum residents did. We need to note here that the number of respondents was not large enough to make broad generalizations.

As shown in Table 59, 79.1% of respondents said that they had no options when selecting a financial institution to receive payments. "Business" was cited by most respondents (38.2%) as the reason for their receiving payments, followed by "receiving pension funds" (29.1%) and "receiving salary" (27.3%, Table 60).

A total of 77.7% of the respondents indicated they would want to use a bank to receive money when banks improved the level of their transfer services (Table 61). The most important purpose in this case would be "to use for business" (58.1%), followed by "to use for family" (48.3%), "to receive salary" (21.4%) and "to receive pension funds" (15.4%).

Respondents who had not yet used a bank to receive funds mentioned the "unreliability of banks" as their biggest reason (20.2%, Table 63). Here again, the lack of bank credibility seems to be a significant obstacle to their usage.

4.2.2.5 Summary

The survey produced results that point to a strong demand for financial services in rural areas of Mongolia, though consideration must be given to regional and occupational differences. The low credibility of banks is the most serious obstacle to the spread of banking services.

For example, the ratio of current bank account holders was found to be 19.4%, but 95.7% of the interviewees said they would open an account given certain conditions. While the ratio of current borrowers was 26.4%, the expected ratio is 70.1%. Of the interviewees, 24.1% currently use a bank to send money, while 16.9% use one to

receive money. Based on the expected ratio of users, 75.2% of the interviewees want sending services and 77.7% want receiving services.

Consequently, we can conclude that the insufficient financial services in rural Mongolia significantly affect the daily life of rural residents. We also recognize significant potential demand for banking services in rural areas. The quality of financial services clearly needs improvement. In particular, the low credibility of banks is the most significant hindrance to the use of banks. It is essential that banks rebuild their credibility. Interest rates seem to be an important consideration, but not as important as credibility. There appears to be significant demand for long-term loans. The greatest impediment to remittance usage is, again, the low credibility of banks. Remittance charges do not seem to be a significant factor in low usage.