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Corruption in natural resource management in Mongolia

Query

What are the biggest vulnerabilities towards corruption within natural resource management in Mongolia?

Purpose

Our agency has received a request to advise our local projects in Mongolia.

Content

1. Overview of corruption issues in Mongolia's natural resource management
2. Corruption challenges in Mongolia and their potential impact on NRM
3. References

Caveat

There are very few publicly accessible research articles and sources of information focusing on corruption challenges in the Mongolian NRM system.

Summary

The recent discovery of mineral wealth in Mongolia's rapidly transforming economy brings both development opportunities and governance challenges for the country. Major contracts have been awarded to foreign companies in 2009 and 2011 for the exploitation of the Oyu Tolgoi copper and gold mining complex and the Tavan Tolgoi coal mine. Concerns over lack of transparency and corruption surrounding the negotiation process of such deals and of the distribution of mining royalties have led to large scale citizen protests over the distribution of mining royalties.

The government is committed to make all citizens benefit from the country's newly discovered mineral wealth through the creation of a Human Development Fund (HDF) and a direct distribution scheme, using cash transfers to citizens. However, the outcome of these efforts will largely depend on the country's ability to set up a robust legal and institutional framework that establishes strong corruption safeguards along the extractive value chain and ensures fair and equitable distribution of resource rents to all citizens.

In spite of important anti-corruption steps taken in recent years, Mongolia is facing important governance and corruption challenges. The quality of governance, as captured by major governance indicators, seems to be declining over years, especially with regard to government effectiveness and control of corruption.

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1. Corruption challenges in NRM

Background

Mongolia's democratic transition

Mongolia peacefully emerged from a communist one-party regime modelled on the Soviet system two decades ago, with the 1990 first multiparty parliamentary elections marking a shift towards successful democratic transition. In spite of lacking pre-communist experience with parliamentary democracy and a long tradition of political opposition which are commonly referred to as pre-conditions for a successful democratic transition, Mongolia has succeeded in preserving its newly established democratic system ever since (Bertelsmann Foundation, 2012), and reasonably free and fair elections have been held resulting in rotation of power following elections (Verena Fritz, No date). Simultaneously, the country began its transition from a socialist planned economy towards a market economy.

In April 2012, shortly before the Parliamentary elections took place in June 2012, former President Nambaryn Enkhbayar was arrested by the Independent Authority Against Corruption on corruption charges. At the time, his supporters claimed that his arrest was politically motivated and violated his basic human rights, with the corruption charges engineered to prevent him from running in the elections. While disqualified as a candidate for the parliamentary election, a number of his political allies won enough votes in the June elections to be invited into a government coalition with Tsakhiagiin Elbegdorj's Democratic Party. In August 2012, Enkhbayar was sentenced to four years in prison on corruption charges. According to observers, this verdict introduced some political uncertainty in this resource-rich nation, as Enkhbayar's party plays an important role in preserving the current coalition unity, at a time when politicians are considering major changes to mine and investment policies (The Wall Street Journal, 2012).

Natural resource management (NRM) at the heart of the Mongolian political debate

Mongolia's mineral wealth largely dominates the current political debate. Although the agricultural sector remains the backbone of the economy, the country's recent discovery of copper, gold, coal, and uranium deposits opened the floodgates to foreign investment and triggered a boom in the mineral sector, contributing to strong growth in the country 's GDP – which, according to World Bank statistics, grew by 17.2%, making it one of the fastest growing economy in 2011. In 2010 the extractive sector accounted for 30% of GDP, 32% of government revenue and 81% of exports (EITI report, 2012). Approximately 85% of all exports of minerals go to China. Recent contracts awarded in 2009 and 2011 to Australian, UK, Canadian and German companies confirm heavy foreign involvement in the management of natural resources, while the commitment to distribute mining royalties to all citizens is at the heart of the political debate (Freedom House, 2012).

In 2009, after years of negotiations, Ivanohe Mines (now renamed Turquoise Hill Resources Ltd) and Rio Tinto signed a USD 5 billion long term agreement with the Government of Mongolia for the construction and operation of the Oyu Tolgoi copper and gold mining complex, the largest financial undertaking in Mongolian history which is expected to account upon completion to more than 30 % of the country's GDP (Bertelsmann Foundation, 2012). In 2011, the contract to operate the Tavan Tolgoi coal mine was awarded to a joint venture between a German (Operta GmbH) and an Australian company (Mcmahon Holdings).

The recent discovery of mineral wealth brings both development opportunities and governance challenges for Mongolia. International experience shows that natural resource wealth in the context of poverty and weak institutions can fuel corruption, conflict and insecurity. In addition, with large inflows of money into government coffers, corruption and vote buying could thrive. The outcome will largely depend on the country's ability to establish strong legal and institutional frameworks that ensure fair and equitable distribution of resource rents to all citizens.

Specific risk factors in the extractive sector

The Mongolian NRM sector is likely to be confronted by similar risks observed in other countries. A number of factors exacerbate corruption risks in the mining and NRM sector. These risks include (Marshall, I, 2002):

- **Commercial value**: The high commercial value of natural resources makes them a coveted target for misappropriation, plundering and rent seeking behaviour.

- **Government regulations**: In most countries, minerals are owned by the state and governments regulate the acquisition of rights for exploitation. The sector is more heavily regulated than other industries, due to its potential financial, social, and environmental impact as well as its impact on the local communities. Mining and extractive activities also imply frequent contacts or investment in the transport and energy sector, as they need to develop, upgrade or secure access to public infrastructure, as heavy users of transport and energy. This implies frequent interactions between the industry and a wide variety of ministries, government agencies and departments. As such, mining operations are more exposed to corruption risks involving public officials than other industries, as they require frequent contact and interactions with public officials for getting concessions, licenses and approvals for the exploration, development and operation of the mine (Chêne, M., Unpublished and Marshall, M., No date).

- **Capital intensive industry and high costs of mining operations**: Mining is a risky and capital intensive industry which requires up-front investment before mining operations can proceed and companies can start making profits. Exploration, contract negotiations, government approvals and construction processes can take several years before exploitation can begin. Mining companies therefore operate under considerable time pressure to make their investment profitable and repay their investment loan, which can make bribery a preferable option to speed up lengthy negotiation processes or negotiate favourable contract conditions (Marshall, M.,2002). In addition, given the high cost of mining concessions, it may appear less costly for investors to bribe than pay market price for a concession.

- **Intervention of foreign investors**: In many countries, domestic companies do not have the specialised skills to exploit mining concessions and the country needs to attract foreign investors which may create opportunities for transnational corruption and bribery. In addition, foreign companies operating in countries with a weak governance environment often rely on intermediaries who have the necessary contacts and act on their behalf to guide them through the country's bureaucratic processes. They may not always abide by the same ethical standards as the company and the company often lacks control and information over their local partner background, connections, and behaviours.

- **Opaque concession awarding/contract negotiation processes**: The negotiation process of mining contracts is complicated, lengthy, and highly technical and frequently occurs behind close doors due to confidentiality reasons often invoked in relation to such contracts (Chêne, M., 2007). The high technical complexity of such contracts also limits opportunities for public scrutiny.

- **Corporate opacity**: According to Transparency International's 2012 Transparency in Corporate Reporting report, which assessed the transparency of the world's 105 biggest companies, companies performed particularly poorly on country-by-country reporting. 39 companies scored 0 per cent in this category, meaning that they lack transparency in disclosure of any financial data in their countries of operation, while on average, companies scored around 4 per cent – a very weak result.

- **Governance environment**: Mining operations often take place in environments with weak governance structures, limited infrastructure and poor policy regulations to ensure transparency and accountability.

Overview of corruption challenges along the extractive industries value chain

In Mongolia, concerns over lack of transparency and corruption surrounding the negotiation process of such deals and large-scale protests over the distribution of mining royalties have resulted in the 2009 establishment of a Human Development Fund (HDF) to distribute mining royalties to citizens in 2009 as well as stricter government reporting requirements and pledges to disburse funds to citizens in the form of tuition fees, health coverage and cash handouts in 2012 (Freedom House, 2012).

Award of contracts and licenses

The awarding of exploration and production rights is highly vulnerable to corruption, as companies have strong incentives to restrict competition and government officials may be tempted to get a share of the deal (Marshall, I, 2002). Major corruption risks associated with procurement processes apply to the sector. In particular, the integrity of the process can be undermined when governments are not making clear the grounds for why a particular company is given a contract and certain companies are granted special or preferential access to licenses. There are also cases where governments are awarding the licenses to companies whose beneficial owners remain undisclosed, and some of these companies may be owned or controlled by government or their private sector proxies (Global Witness, 2012).

In Mongolia, corruption is likely to occur both in concession auctioning processes as well as in contract awarding processes for the major construction and infrastructure projects associated with mining operations. Close to 40% of the firms interviewed within the framework of the 2009 World Bank/IFC enterprise survey reported being expected to make a gift to secure a government contract, with the value of the gift estimated around 3% of the contract value, while more than a third expect to give a gift to get a construction permit.

As already mentioned, in many countries there is a strong involvement of foreign investors, with some specific corruption risks attached. Some countries restrict access for foreign firms but restricting foreign interventions can also lead to missed opportunities. In Mongolia for example, the mining framework has shifted over time between a state protectionist model and openness to FDI, with regulatory framework and governance revolving around the relationships with foreign actors (Simpson, A., 2012). The government originally passed laws placing punitive taxes of foreign companies to ensure that the state retains a large share of the country's mineral wealth, which resulting in deterring investors and missed opportunities. The first contract was finally signed in 2009, following six years of negotiations, after Parliament revoked a number of mining laws, including a windfall profit tax on foreign companies (Pomfret, R., 2011).

Negotiations of the terms of the contract

After the licence has been awarded, contracts need to establish how rents will be divided and risks will be shared between governments and companies. As neither companies nor government can fully anticipate exploitation costs, levels of production and the evolution of commodity prices, both stakeholders are trying to get the beast deal possible. Bribery at this stage of the process can result in the country getting less revenue than they should. In addition, the negotiations of the terms of the contract are typically opaque and complex processes, with conditions of confidentiality often attached to such contracts due to the assumption that transparency could weaken companies' commercial advantage or the government's position in future negotiations. Mongolia is no exception in this regard, as reflected by sporadic waves of protests over the lack of transparency of mining deals (Freedom House, 2012).

Regulation and monitoring of operations

Given the high risks involved in mining activities, companies may be tempted to pay bribes, make political donations to the ruling parties or develop corrupt networks with local politicians to bend the rules and regulations applying to the sector in their favour. There have been examples of such interference of politicians and unclear relationships between mining companies and politicians documented in several countries (Global Witness, 2012).

Companies may also attempt to influence the way rules are being implemented and the contract enforced through unethical practices. For example, bribery can also occur during the monitoring process, with inspectors bribed for misreporting extractive activities or turning a blind eye to technical infractions or the environmental impact of mining operations.

In Mongolia, the Mineral Resources and Petroleum Authority of Mongolia is responsible for implementing the mineral law, issuing mining licences, archiving geological data and conducting surveys and research (Revenue Watch Institute, Website). However, the regulatory framework is assessed to be weak in the areas of public participation, sanctions, informal mining (The World Bank, 2006). Public participation in the permitting procedure was not formalised as of 2006 and there was no obligatory public involvement in the scoping and discussions of environmental impact assessments. Efforts are currently being made to institutionalise public participation in many state institutions (Global Integrity, 2011).

The institutional framework in Mongolia is also considered to be weak for enforcing mining regulations, especially those relating to procedures for local governments to issue land user permissions and contracts and to the enforcement of sanctions for licence violations (The World Bank, 2006). In addition, according to external observers, civil servants employed in the various ministries and government agencies providing oversight to the mining industry receive low wages, which may provide incentives to indulge in corrupt behaviours (Billiter Partners Ltd, 2012).

Collection of taxes and royalties

Revenues derived from selling the resources need to be divided and collected by the state but there is a risk that rents are captured either by individuals or by the local elite for political or private gain. In Mongolia, the population is relatively small and wealth concentrated in a small community of business people with close ties to government. In addition, conflicts of interest and the revolving door phenomenon between the public and the private sectors are widespread in the country, exacerbating these risks further (Verena Fritz, 2007).

In addition, revenue collection is typically a sector highly vulnerable to corruption. Complex arrangements are often in place for collecting taxes, royalties and other revenues derived from extractive operations, based on the local fiscal regime. Corruption can manifest itself in the form of tax evasion committed by extractive companies, collusion between tax officials and companies, or corruption by tax officials themselves, resulting in risks to the country's development prospects.

These risks can be especially acute in countries where relevant institutions do not have adequate administrative and audit capacities, or when regulations are overly complex, with large numbers of tax rates, exemptions and special rules which grant tax officials discretionary power to interpret the rules and provide leverage for bribery. In Mongolia for example, 20 % of the firms interviewed within the framework of the 2009 World Bank/IFC enterprise survey report being expected to make gift when meeting a tax official.

Regular and accurate public reporting is a pre-condition to ensure effective monitoring of compliance with the sector's regulations as well as the terms of the contract, prevent revenue derived from extractive industries from being manipulated, mismanaged and misappropriated and make sure that the country benefits from its mineral wealth as it should. This implies regular and accurate reporting as well as effective monitoring and oversight of the various revenue streams, including taxes and royalties, as well as appropriate collection and verification of data on production, exports, consummation, prices, etc.

In Mongolia, in spite of progress made, oversight and accurate reporting remain challenged by the spread of artisanal mining and several efforts to regulate this sector have failed in recent years (Revenue Watch Institute, Website).

Revenue allocation and distribution

Once revenue flows into state coffers, decisions need to be made on how to use it for sustainable development and the benefit of all citizens. In some countries, corruption and rent seeking behaviours can distort the allocation of resources towards projects with more lucrative prospects and discourage productive investment, reducing the social and economic efficiency of spending. Governments may also be tempted to grant favoured enterprises or individuals privileged access to natural resources for political reasons, with mineral wealth benefitting a small political elite. “Easy” rents can also result in patterns of spending that favour short term expenditures over long term investments (Sayed, A., 2007).

At another level, revenue flows can result in weakened accountability, as the governments can use natural resource revenues to relieve social pressures that might otherwise lead to demands for greater accountability. When government rely on natural resources rents, public accountability may be weakened as government is under less pressure to seek public approval from tax payers for spending policies. This can result in weakening the longer term development prospects of the country, as the country needs to use a share of its revenues for long term economic growth and development, anticipating resource depletion or price decline.

In Mongolia, a consensus is emerging that revenue streams should be used with a long term perspective, to improve access to basic services and reduce inequalities, maintain environmentally sustainable resource flows as well as mitigate climate change and pollution. The country has set up special instrument for managing resource wealth, in the form of the above-mentioned Human Development Fund (HDF) and a direct distribution scheme, through the use of cash transfers to citizens. In particular, the HDF makes all citizens equally eligible to receive a share of the nation's mineral wealth and is expected to provide pension, health, education and housing benefits and cash pay outs to all citizens. A mechanism was also established in 2009 for saving surplus revenue from mineral royalties when prices are high in order to stabilise the state annual budget in case of price decline (Brookings, 2012). The HDF is financed from mining dividends and a part of royalty payments to the budget (Isakova, A. and al, 2012)

While originally set up for investment and capital repairs as well as to reduce budget deficits and establish social welfare systems, the distribution plans have been (mis)used in the 2009 Presidential election campaign by the two main political parties to implement electoral promises in order to attract citizens' votes. Unrealistic promises were finally reduced post-election to more realistic figures by Parliament after the 2009 elections. Still, in 2011, the Parliament stipulated that close to USD 600 million would be distributed for health insurance and students tuition fees, with about USD 15 per citizen for cash pay outs, representing almost 40 % of the state budget and 10 % of 2010 GDP (Isakova, A. and al, 2012). The World Bank and the IMF criticised these allocations as too expansionary and fuelling the country's high inflation rates and the distribution schemes remains at the heart of the political debate. According to observers, the main challenges facing the country are to protect revenue flows from corruption on the part of the stakeholders managing/having some degree of control over it as well as preventing politicians to prioritise short term issues over long term priorities (re-investment and mitigation) for political campaigning purposes (Brookings, 2012).

2. Overview of corruption challenges in Mongolia and their potential impact on NRM

Mongolia's ability to manage its mineral wealth in a sustainable and transparent manner largely depends on the quality of its economic and political institutions, the country's broader governance context as well as the legal and institutional anti-corruption framework in place to ensure transparency and accountability.

In general terms, a few positive features have been identified in the country that have the potential to mitigate the risk of Mongolia becoming trapped into what is often referred to as the "resource curse". These include (Hasnain, Z, 2011):

- A relatively stable two party system with at least two parties capable of winning election contests enhance electoral accountability;

- A generally homogeneous social fabric and the relative absence of ethno-linguistic cleavages, which reduce risks associated with the combination of ethnic rivalries and resource rents observed in other countries;

- A relatively egalitarian society that does not have a traditional oligarchic elite dominating the political and economic landscape which reduce risk of a kleptocratic elite plundering the country's natural wealth for the benefit of a few;

- A relatively free and vibrant press and numerous civil society groups that have the potential to provide checks and balance on the executive in their use of resource rents;

- Relatively high literacy rates and education levels which potentially increase the ability of citizens to hold government accountable for its decision and use of resources.

In addition, a number of civil society organisations and networks have been formed to promote responsible and sustainable mining in Mongolia, such as OT Watch or the Responsible Mining Initiative for Sustainable Development (RMI) which brings together representatives of government, civil society, industry, and academia.

Overview of corruption

Extent of corruption

In spite of these positive characteristics, the relatively high degree of electoral accountability and respect for political and civil rights have not fully translated into major governance gains. Mongolia is facing important governance and corruption challenges, and the quality of governance, as captured by major governance indicators, seems to be declining over recent years, especially with regard to government effectiveness and control of corruption (Fritz, V., 2007).

Most governance indicators suggest widespread corruption permeating all levels of society. Transparency International's Corruption perceptions Index ranks Mongolia 120 out of the 183 countries assessed, with a score of 2,7 on a 0 (highly corrupt) to 10 (highly clean) scale, suggesting high levels of perceived public sector corruption.

Consistent with these findings, the World Bank's Worldwide Governance Indicators indicates relatively low (and declining) performance in control of corruption, with a score of 27 in 2011 on a 0 to 100 scale compared to 34, 1 in 2006. Except for rule of law and regulatory quality which remained relatively stable compared to 2006, the country scores decreased on all other areas of governance assessed, especially with regards to government effectiveness (31,3 in 2011 compared to 40,5 in 2006) and voice and accountability (49,3 in 2011 compared to 54,8 in 2006). This suggests that corruption challenges are becoming an increasingly serious problem.

73 % of the Mongolian citizens interviewed within the framework of Transparency International's 2011 Global Corruption Barometer (GCB) share this view and consider that corruption has increased in the last three years preceding the survey, while 49 % report having paid a bribe in the twelve months preceding the survey.

Corruption patterns and vulnerabilities

Sectors most affected by corruption

According to GCB data, political parties, parliament and the judiciary are perceived to be the institutions most affected by corruption, respectively scoring 4,2, 4,2 and 4,1 on a 1 (not-at-all-corrupt) to 5 (very corrupt) scale, followed by the police (4,0), the education system (3,7) and public officials (3,6).

There are important institutional and capacity constraints, which, combined with low pay and politicisation have eroded ethical standards in the public sector (Fritz, V., 2007). Government conflicts of interest safeguards and checks and balance are generally weak, as reflected by Global Integrity's indicators (Global Integrity, 2011)

Licensing is also a highly vulnerable area of government operations, with a third of the companies interviewed within the framework of the World Bank and IFC 2009 enterprise survey reporting being expected to give a bribe to get a construction permit. This is likely to pose serious challenges to the large-scale construction projects associated with mining activities, especially in the Mongolian context which lack major infrastructure.

Procurement

In the area of public financial management, there are many concerns expressed over the lack of transparency of government operations. In particular, Mongolian CSOs are especially concerned about the continuing lack of transparency in government procurement practices. Corruption in procurement is reportedly high, with indications of favouritism towards companies with good connections to politicians or political parties (Bertelsmann Foundation, 2012) as well as a high level of reported bribery to secure government contracts (World Bank and IFC, 2009).

In Mongolia, procurement is decentralised to line ministries and agencies, with the Procurement Policy and Coordination Department of the Ministry of Finance providing the regulatory and monitoring role and conducting prior reviews for large contracts. Provisions for direct contracting in the road and energy sectors were introduced in 2007 in the procurement law. The development of mining depends on large-scale investment in infrastructure, including transport, power supply and water supply. These provisions are likely to undermine the integrity, efficiency and competitiveness of the sector's procurement processes and of the big-scale construction projects associated with the exploitation of Mongolian mines[1] (Isakova, A., Plekhanov, A and Zettelmeyer, J., 2012). For example, a 2008 government audit report revealed that 34% of 2007 contracts were subsequently awarded through direct contracting, often without supporting technical documentation, to politically well-connected companies (Hasnain, Z., 2011). While such practices have reportedly decreased since the publication of this audit report, provisions for direct contracting remain in the procurement law.

Private and public sector collusion

As in many post-communist countries, some observers point to a blurred line between economic and political elites, with widespread conflicts of interest compounded by ineffective governmental oversight bodies (US department of State, 2011). This dates back to the initial privatisations of state-owned enterprises in the 1990s and corruption challenges associated with the subsequent privatisation of large sections of state-owned enterprises and property (Asia Pacific Group on Money Laundering, 2007). Successive waves of privatisation have provided members of government opportunities for illicit enrichment and resulted in government and business becoming increasingly closely intertwined. As of 2005, MPs with business interests accounted for between 50 and 70 % of the total and a number of government ministers were

[1] This is especially true in Mongolia, where the existing stock of infrastructure assets in Mongolia is particularly low as reflected by its poor performance in terms of infrastructure quality according to the Global Competitiveness Report 2011-12

known to have business interest in sectors falling under their mandate (Fritz, V., 2007).

In addition, several conglomerates have been developed in recent years, resulting in the emergence of a small elite of businessmen with close ties to the government. For example, a diligence report produced by an investigation firm warns investors about the difficulty to identify potential conflicts of interests, due to the lack of transparency surrounding the ownership of many Mongolian privately held conglomerates and their link to high level politicians in a country where the small size of the population is combined with a high concentration of wealth and power “within an elite who mix business and politics” (Billiter Parner Ltd, 2012).

Against this backdrop and in the wake of the recent discovery of mineral wealth, there is a risk that the nature of high-level corruption becomes more predatory, with political elites attempting to take control over private companies and consolidating the public and private sectors’ nexus.

The informal sector

As a predominantly cash economy, Mongolia has a large informal sector, which makes it highly vulnerable to money laundering. In addition, Mongolia’s significant underground banking sector (reflecting high demand for low cost remittance by the large numbers of Mongolian workers abroad), combined with a highly fractured commercial banking system further exacerbate these risks (Asia Pacific Group on Money Laundering, 2007).

In the natural resource sector, Mongolia also has a large informal mining sector, and there are estimates that up to 100,000 miners illegally extract deposits of gold and other minerals without a mining license (Asia Pacific Group on Money Laundering, 2007)., representing 20 % of the rural work force (Bertelsmann Foundation, 2012) This challenges accurate reporting and oversight of extractive activities, with potential implications on revenue flows.

Anti-corruption efforts in Mongolia

Mongolia has taken steps to address these corruption challenges, with the enactment of a number of laws to improve the legal environment for preventing and sanctioning corruption and the establishment of an Independent Authority Against Corruption (IAAC) in 2007. But there is still widespread scepticism regarding government efforts to fight corruption. According to 2011 GCB data, 53 % of the respondents perceive government efforts against corruption as ineffective.

The legal framework

Global Integrity 2011 rates the legal framework as strong with a very weak implementation score, suggesting a wide implementation gap. Active and passive corruption, bribery of foreign officials, extortion, attempted corruption and money laundering are criminalised in the criminal code and the anti-corruption law which provides for fines or imprisonment of up to five years. A long-awaited access to information law was passed in June 2011 (Global Integrity, 2011). Parliament also enacted a long overdue law on conflicts of interest in 2012. There are asset declaration requirements for public officials (and those of relatives, including spouses, parents, children, and live-in siblings) and the IAAC declared that nearly all of the most senior officials complied with these requirements (US department of State, 2011). The government also amended the Public Procurement Law of Mongolia (PPLM) in June 2011 to include a new formal role for civil society and professional organizations in bid evaluation and contract monitoring.

In spite of progress made, the legal framework needs to be strengthened in the area of party financing, campaign financing, transparency of income of public servants and auditing of state spending (Bertelsmann Foundation, 2012).

The institutional framework

- **Independent Authority Against Corruption**: The IAAC is the government body responsible for combating corruption and is reportedly provided with a relatively large budget and broad mandate (US Department of State, 2011). According to Global Integrity, the agency has the highest paid staff in Mongolia. A public council has been created within the IAAC in 2009 to actively engage the public and provide recommendations to the IAAC. In March 2011, the head of the IAAC was sentenced to two years in prison for leaking state secrets and other charges, including misuse of public funds (Freedom House, 2012 and Global Integrity, 2011).

- **The Judiciary**: While the judiciary is guaranteed by law, rules are not sufficiently enforced and there are widespread concerns of corruption and nepotism. According to the Bertelsmann Foundation, the appointment of high ranking judges is politically motivated, while low salaries, resources undermine the effective administration of justice. Corrupt officials are not adequately sanctioned. In particular, immunity provisions hamper the investigation and punishment of corruption allegations against high ranking officials.

- **Other institutions**: The Mongolia National Audit Office conducts performance and financial audits of government agencies and ministries and makes reports available to the public. The Human Rights Commission acts as an Ombudsman and has the mandate to investigate the actions of government on behalf of citizens.

Revenue transparency

Since October 2010, Mongolia is an EITI compliant country, which indicates that the country produces EITI Reports that disclose revenues from extraction of its natural resources. Companies disclose what they have paid in taxes and other payments and the government discloses what it has received and these two sets of figures are compared and reconciled. Findings show that there is a minimum discrepancy between payments made by companies and payments received by government.

Expenditure transparency

Some major improvements have taken place in a relatively short period of time, especially with regard to budget transparency. Mongolia's score on the Open Budget Index dramatically increased from 18 in the 2006 Survey (indicating that government publishes only scant information on the budget) to 60 in the 2010 Survey, which is among the highest score in the Central Asia region and well above the worldwide average (42). The government now publishes budget documents that had previously not been available to the public, has created an e-budget portal and provides more comprehensive information on revenues and expenditures. Additionally, the Mongolian Supreme Audit Institution makes its Audit Reports available to the public on its new website. A new Integrated Budget Law (IBL) was passed in December 2011 in order to improve the legal framework for budgeting, budget relations and fiscal management by integrating the Budget Law of 2002 and Public Sector Management and Finance Law. Among other things, it increases citizens' participation in the budgeting process and requires feasibility studies and alignment with national priorities for projects to be included in the Public Investment Program and the budget (Lkhagvadorj, A. 2012).

Government resolutions and decrees # 17 and # 143 also aim at promoting transparency in budget and finance and promote indicators and criteria for transparency.

These reforms are welcome as government spending in 2011 was almost double that in 2009 in real terms, reflecting pre-election year pressures, efforts to make good on earlier political promises for large cash transfers and large increases in capital expenditures (World Bank, 2012). However, in spite of progress made, there is still substantial room for improvement in the amount of budget information the government provides to the public and other areas of public financial management. In particular, budget oversight provided by Mongolia's legislature is inadequate because the legislature does not hold open budget discussions allowing citizen participation in the process (Global Integrity, 2010).

These positive developments in terms of increased budget and revenue transparency are important steps towards building an integrity system that supports the transparent, sustainable and participatory management of Mongolia's natural resources. However, these measures have failed so far to yield the expected results in terms of controlling corruption, as reflected by the country's declining performance on major governance indicators. Given the country's specific patterns and risks of corruption, the main challenges are to protect revenue flows from corruption, ensure transparent and equitable distribution of wealth to all citizens, while prioritising sustainable growth over short term political considerations. A more detailed and comprehensive risk assessment of the county's NRM sector as well as whether mining income is managed effectively and transparently for the benefit of all would be needed to assess Mongolia's preparedness to respond adequately to these challenges.

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