



Debt Policy of State-Owned Mining Enterprises in Mongolia

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SEPTEMBER 2022



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Key messages

- Mongolia relies heavily on state-owned enterprises (SOEs) to manage several key mining assets. Baganuur, Shivee Ovoo, Erdenet, Mongolrostsvetmet and Erdenes Tavan Tolgoi are the most important majority state-owned companies operating large-scale mines.
- From 2019 to 2021, debt held by mining SOEs increased 4.3 times. The total liabilities of these companies reached USD 2.3 billion, representing 15 percent of GDP. The new debt was largely issued to cover social spending and an economically questionable railway project. It is unclear how the government intends to service this debt, particularly since profitability at most mining SOEs has been weak and most face liquidity challenges.
- Mining SOEs' poor financial health is due to the combination of quasi-fiscal activity financing, poor project selection and management, and inadequate legislation and control mechanisms for new debt issuance.
- Legal reforms to new debt issuance and stronger Ministry of Finance oversight of SOEs are needed, in addition to stricter implementation of existing legal requirements such as collecting and disclosing complete data on SOE debt. Mongolia's government should also review mining SOE quasi-fiscal expenditures, such as price controls on coal, and other reasons for low profitability of mines.

Executive summary

Mongolia's 10 most important upstream mining state-owned enterprises (SOEs) reported total liabilities of 6.45 trillion Mongolian tugrug (MNT) (around USD 2.3 billion) at the end of 2021, of which 26 percent could be classified as "debt." The liabilities of these 10 companies alone represented 15 percent of GDP, while liabilities officially declared as "debt" represented four percent of GDP. In comparison, around the world, SOE debt from all sectors is equivalent to roughly seven percent of GDP on average. While SOE debt can be a useful source of financing for economic development projects, Mongolia's mining SOE debt issuances represent a significant risk to economic stability and fiscal sustainability.

Mining SOE debt is 4.3 times larger than in 2019, while liabilities are 4.8 times greater. The biggest increases came from bond issuances from Erdenes Tavan Tolgoi to pay for the Gashuun Sukhait railway project, and Erdenes Mongol to pay for the government's policy to cover pension-backed loans and other subsidies to the elderly. In other words, the government has collateralized future revenues of mining SOEs to pay for projects that may not actually contribute to SOEs' improved performance.

In addition, mining SOE profitability is well below international standards and is highly dependent on volatile coal and copper prices. Three out of Mongolia's five state-owned operating mines make little or no profit. Shivee-Ovoo coal mine looks to be insolvent, Baganuur coal mine cannot pay its debts using operating income, and several state-owned mines are highly leveraged. Baganuur, Shivee-Ovoo, Erdenes Methane, Erdenes Silver Resources and Mon-Atom (a uranium exploration company) are severely cash-constrained, and even Erdenes Tavan Tolgoi is surprisingly cash-poor, given recent high coal prices and production. Borrowing to finance long-term state-owned projects of unclear feasibility risks throwing good money after bad.

Low profits from state-owned mines are largely the result of too much debt, excessive management costs and quasi-fiscal responsibilities. Supplier costs are only weakly controlled and administrative costs are unusually high. Several mines have an unofficial mandate to employ local people near the mine site and provide housing and living facilities for workers. Many state-owned mines invest in unprofitable

non-mining related projects. State-owned mines have been used to pay for utility bills and cash for citizens, on top of the pensioners' payouts. Additionally, Baganuur and Shivee Ovoo are required to sell thermal coal to domestic power plants at below market rates, harming SOE profitability while slowing the shift to improved technologies and renewable energies.

Given these high costs and the global energy transition, it is unclear whether mining SOEs will be able to pay back their debt. More likely, the government will need to cover mining SOEs' losses in the future using taxpayers' money, shifting state resources away from programs that would benefit the majority, such as investments in education, healthcare and modernizing infrastructure. Should Mongolia's SOE debt continue to grow without improving SOE performance and profitability, the government is risking another sovereign debt crisis.

The Ministry of Finance's involvement in SOE debt is limited to the approval of long-term debt issuances by wholly state-owned entities, and government-guaranteed debt. However, only a few larger SOEs issuing significant amounts of debt have asked for approval since the Law on Debt Management was passed. Even when approval is requested, the Ministry of Finance often lacks adequate information to make an informed decision.

This low level of central government involvement requires strong SOE boards of directors that can make cost-effective decisions. However, many SOEs have no boards at all, and where they do exist, their effectiveness is questionable. Board members are often appointed for political reasons, rather than based on their experience or qualifications. Several companies are run by CEOs who are members of the ruling political party. There is little incentive for board members to act in the public interest, rather than political or personal interests.

None of the mining SOEs in our sample has published a debt management or financial risk management document or policy. Interviews with SOE officials suggest that most, if not all, of Mongolia's mining SOEs exercise debt management and other risk control on an ad hoc basis.

To prevent the government covering mining SOE losses, the cabinet or the Ministry of Finance should approve all SOE debt issuances, subject to independent technical and feasibility studies demonstrating SOE project profitability. The ministry should also publish detailed debt information on all SOEs, require that all SOEs publish audited financial statements and annual reports, and enforce the Glass Account Law which requires SOEs to regularly disclose detailed financial information.

SOE governance could also be greatly improved. For example, mining SOE board members and senior management should be chosen based on qualifications and experience, rather than political connections. A new policy or SOE law that clarifies SOE mandates, prohibits purchase of non-mining assets, sets performance targets and requires independent audits of SOEs would be helpful. The government should also review mining SOE quasi-fiscal expenditures, such as price controls on coal, and other reasons for low mine profitability.

I. Introduction

RISKS ASSOCIATED WITH STATE-OWNED ENTERPRISE DEBT

When state-owned enterprises (SOEs) incur obligations, as public-sector entities, they create liabilities for the government and, ultimately, the taxpayer. As a result, when SOEs lose too much money or default on public debt, they are often bailed out by the government, as has been the case in Mongolia. The government and citizens therefore need to monitor and limit debt accumulation by SOEs and to ensure that SOEs are sufficiently profitable to repay these debts and contribute dividends to the public treasury.

State-owned mining companies are particularly susceptible to over-indebtedness, given the speculative nature of many deposits, the complex financial arrangements of mines, and political interference in natural resource exploitation. For example, in 2016, China's Guangxi Nonferrous Metals Group, owned by the Guangxi provincial government, declared bankruptcy, having only started operating in 2008. Losses began to accumulate in 2012, and by 2015, it had stopped publishing financial information. As of 2016, the company owed approximately USD 2.2 billion to creditors—USD 200 million of which was owed to state-owned China Development Bank—and could not make its interest payments. Guangxi Nonferrous Metals Group assets are being liquidated. However a large portion of the debt will be written off by state-owned banks or covered by other government agencies.¹

Similarly, New Zealand's Solid Energy—previously called State Coal Mines, then Coal Corporation—had a near-monopoly on New Zealand's coal industry. The company was profitable as recently as 2011, the chairman at the time even calling on the government to allow it to float shares to raise additional capital. Starting in 2012 when coal prices were slumping, and with the company formulating ambitious plans, Solid Energy began borrowing heavily, accumulating losses, and receiving government bailouts. The company is now being liquidated, having cost taxpayers approximately USD 130 million in bailouts and a portion of its approximately USD 300 million accumulated debt.²

As these examples show, bailouts of state-owned mining companies can take place in various contexts. They are generally the result of any of the following factors:

- **Inadequate debt-management framework and regulation.** In many countries, governments do not require Ministry of Finance or other types of approval of SOE debt issuances, and SOE debt is not included in general government debt figures. In countries where the debt-management framework covers SOEs, the regulator may not adequately assess the probability of repayment or the viability of projects financed through debt, rubber-stamping debt issuances instead.
- **Unfunded mandates.** In some contexts, the government may be the cause of SOE indebtedness—for example, by burdening the company with pension liabilities or quasi-fiscal responsibilities. These can include employment requirements or selling produce at lower than market prices, making the company unprofitable.

1 Andrew Bauer, *Upstream Oil, Gas and Mining State-Owned Enterprises: Governance Challenges and the Role of International Reporting Standards in Improving Performance* (Extractive Industries Transparency Initiative, 2018).

2 *ibid.*

- **Lack of planning and dividend policy under volatile conditions.** Profitability in the mining sector is largely dependent on volatile commodity prices. When prices are high, mining SOEs are flush with cash. Unless dividend rules require the windfall profits to accrue to the national treasury, or the SOE saves such profits in the bank, the company will use the extra cash to reinvest in new projects. When commodity prices crash, it must borrow to fulfill contracts. Without a plan for the boom period, volatility can lead to debt accumulation.
- **Over-payment of dividends.** Governments, the ultimate SOE shareholder, often use SOEs as cash-cows, draining them of resources they need to pay for their operations, and therefore requiring them to raise capital.

These general observations are valid for Mongolia's SOEs, in particular those operating in mining, the country's flagship economic sector.

SOEs REMAIN IMPORTANT TO THE ECONOMY

Since Mongolia's transition to a market-based economy, the government has undertaken several rounds of privatization. In the early 1990s, the public sector represented more than 90 percent of GDP. By 2006, the private sector was responsible for approximately 70 percent of GDP, with almost all trade, service and manufacturing firms privately held.

Table 1. Existing state-owned enterprises
By legal forms

Legal forms	Number of entities
State owned stock companies	48
State owned LLCs	22
Partially state owned LLCs	31
State enterprises	36
State budgetary enterprises	28
Local property legal entities	299
Other	3
Total	46

Source: State Property Coordination Committee, *Introduction to Draft Law on State and Local Property*, www.parliament.mn, accessed in June 2022

However, the government has retained key state-owned enterprises in the energy, mining and transportation sectors, including power plants, an airline, railways, power stations and mines. As of 2022, 467 SOEs operated in Mongolia, including 299 local government-owned entities (see Table 1). Approximately 74,000 people work at SOEs and locally owned entities,³ representing around 6.6 percent of the country's formal-sector employees.

On paper, the SOE sector as a whole remains solvent. SOEs and local government-owned entities held assets worth MNT 37 trillion (USD 13.2 billion) on their books in 2019⁴, an amount roughly equal to the country's GDP that year. At the same

3 Government of Mongolia, "Agency for Policy Coordination of State Property is introducing a plan for improving SOEs governance" (press release, 3 September 2021).

4 Ministry of Finance, "The Finance Minister, Javkhlan B., introduced a plan to change SOEs' structure" (press release, 10 March 2021).

time, total SOE debt reached MNT 10.5 trillion (USD 3.7 billion), excluding the government's interest of 34 percent in the Oyu Tolgoi project carried by the project partner, Rio Tinto.

According to the Agency for Policy Coordination of State Properties (PCSP), all SOEs combined (excluding local government-owned entities) earned MNT 7.4 trillion (USD 2.6 billion) in revenue in 2020, representing approximately 16.7 percent of the country's GDP that year. SOEs are responsible for just over half the country's exports (50.7 percent),⁵ and clearly remain an important part of the Mongolian economy.

However, SOEs reported net profits of only MNT 688.4 billion (USD 244.7 million) in 2020, MNT 412 billion (USD 144.8 million) of which was earned by two mining companies alone: Erdenet and Erdenes Tavan Tolgoi.⁶

The mining sector is responsible for nearly 20 percent of the country's GDP, a quarter of government revenue and 90 percent of exports. SOEs dominate this key sector of the economy. The most significant is Erdenes Mongol, principally a holding company for many wholly or majority state-owned mining, processing and mining infrastructure assets. These include Tavan Tolgoi (managed by its subsidiary Erdenes Tavan Tolgoi and producing export coal), Shivee Ovoo and Baganuur (coal for powerplants), Erdenes Shivee Energy (power plant in development), Gashuun Sukhait Road (export coal haulage), and several exploration projects in the uranium, gold, silver, hydrocarbon and copper sectors. Other significant mining SOEs operate outside Erdenes Mongol's corporate structure, include Erdenet Mining Corporation (copper mining and processing), Mongolrostsvetmet (fluorspar mining) and Darkhan (iron ore mining and metallurgical plant). Local governments are the majority owners of several mining entities, including Bayan Teeg (coal), Mogoin Gol (coal) and Tavan Tolgoi (coal, run by Tavan Tolgoi stock company and not to be confused with Erdenes Tavan Tolgoi, which also operates in the vicinity).

Additionally, the Mongolian state has significant minority ownership over other operating mines and exploration licenses. Through Erdenes Mongol, the government owns minority shares in Oyu Tolgoi LLC (copper; 34 percent), Erdenes Ashid LLC (silver; 34 percent), Badrakh Energy LLC (uranium; 34 percent) and Gurvansaikhan LLC (uranium; 15 percent). The Minerals Law provides an option for the government to take either a 34-50 percent equity interest in "strategic" deposits or negotiate a special royalty in lieu of such interest.

The three top taxpayers in Mongolia in 2021 were fully and partially state-owned mining companies: Erdenet, Erdenes Tavan Tolgoi and Oyu Tolgoi.⁷

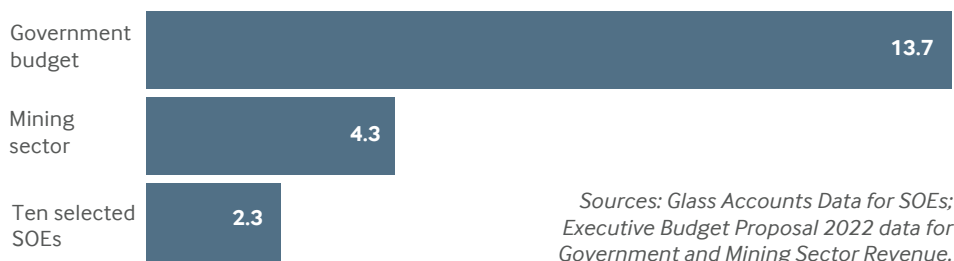
In recent years, the mining sector has consistently contributed 22-25 percent of the national fiscal revenue. This share jumped to above 31 percent in 2021. Around half of revenue from the mining sector comes from 10 SOEs selected for this study (see next section).

5 Government of Mongolia, *Introduction to Draft Law on State and Local Property*, (press release, 7 June 2022).

6 *Ibid.*

7 Ikon, *Top 100 Businesses in Mongolia*, 23 May 2022.

Figure 1. Government revenue in 2021
in MNT trillion



MOTIVATION AND METHODOLOGY

This study analyzes the size, characteristics and risks associated with the debt of mining SOEs, in particular as they relate to general government finances. Its intention is to contribute to ongoing discussions on policy options for managing SOE debt. The study describes and analyzes borrowing trends for selected SOEs using available data, and identifies policy options and recommendations for the executive and the legislature, the State Great Hural. It does not intend to identify SOE-related operational or macroeconomic risks or to forecast the fiscal burden arising from SOE activities.

We selected 10 companies to study in depth (see Table 2), taking into consideration such factors as the size of assets and income, legal status, key products and functions, and stage of development. Aside from Erdenet and Mongolrostsvetmet, all are formally part of the group of companies headed by Erdenes Mongol.

The collection and availability of data was an important factor in carrying out the research, especially considering some limitations in approaching officials due to COVID-19 related restrictions. We used publicly available data on companies' finances and operations, reviewed media and other reports on the subject, and approached companies with requests for information, some of which were followed by individual meetings with relevant officials. For public information, we specifically used the 10 companies' financial reports, disclosed through the government's Glass Accounts portal.⁸ We also sourced information from companies' websites, government websites (including for parliament) and government budget documents, such as the executive budget proposal to parliament.

We sent letters requesting information directly to each of the 10 SOEs, along with a list of questions about their debt policy, referencing relevant clauses of the Law on Information Transparency and Right to Access Information.⁹ Of the 10, only Erdenet, Erdenes Tavan Tolgoi, Erdenes Silver Resources and Baganuur replied in writing, and only Erdenet included debt-related information in its response. Erdenes Tavan Tolgoi responded by requiring further details on the research and allowed an interview with a relevant company official. We also emailed a request for information to the PCSP, but received no response.

8 *Glass Accounts* is the unified government transparency portal run by the Ministry of Finance, in accordance with the Glass Accounts Law of Mongolia, 2014.

9 Parliament of Mongolia, The Law on Information Transparency and Rights to Know, Clauses 3.1.9, 9.1 and 11.1., (16 June 2016).

Table 2. State-owned companies in 2021
in MNT billions

Company	Assets held	Net income	Main product	Legal form	State equity %	Main market	Main project stage
Erdenes Tavan Tolgoi	15,317.7	110.8	Coal	SC ¹	85	Export	Production
Erdenes Mongol	10,136.8	-13.9	Management	LLC ²	100	Subsidiaries	Various
Erdenet	5,773.1	901.5	Copper	SE ³	100	Export	Production
Erdenes Oyu Tolgoi	2,753.4	1.1	Copper	LLC	100	Export	Production
Erdenes Silver Resources	1,095.8	48.4	Gold and silver	LLC	100	Domestic	Pre-Production
Monrosvetmet	283.9	85.8	Fluorspar	SE	100	Export	Production
Baganuur	263.5	1.5	Coal	SC	75	Power plant	Production
Shivee-Ovoo	120.8	-8.6	Coal	SC	90	Power plant	Production
Mon-Atom⁴	1.9	2.3	Uranium	LLC	100	Export	Pre-Production
Erdenes Methane	0.6	-0.6	Methane	LLC	100	Domestic	Exploration

¹ Stock company ² Limited liability company ³ State enterprise

⁴ Mon-Atom LLC reported a net income of MNT 2.3 billion in 2021. However, an audited net loss of MNT 1.2 billion for 2021 was published by the National Audit Office of Mongolia.

Source: Glass Accounts reports and company websites

Through a document review, interviews and statistical and financial analysis, this study sets out to answer the following key questions:

- 1 What is the financial health of selected mining SOEs in terms of indebtedness and borrowing trends?
- 2 What is the current state of mining SOE debt and its potential implications for government finances?
- 3 Are the roles and responsibilities of key stakeholders, including the central government, clear in the management of SOE debt?
- 4 How transparent is SOE borrowing? What can be done to improve transparency?
- 5 What could the government do to assess and mitigate debt-related risks?

The study comes at the time of policy reform debates surrounding SOEs in Mongolia. Parliament is currently discussing a proposal to limit the establishment of new SOEs and to revise the Law on State and Local Property, the key law applying to SOEs. The government is also planning to establish a new development fund which will consolidate the ownership of many SOEs, especially in the mining sector.

The study begins by describing the legal framework that governs SOE debt (Section II). Section III discusses the division of responsibilities among the authorities for issuing and overseeing SOE debt, specifically focusing on mining SOEs. The study then describes what we know about debt and liabilities for the selected mining SOEs (Section IV). The next section explores the types of operations and activities that mining SOEs fund with capital raised through loans (Section V). The study concludes with a set of policy options and recommendations for the Government of Mongolia on how to improve management and oversight of mining SOE debt (Section VI).

II. Complex legal framework governing SOE debt

Legal framework for SOE debt and other liabilities

Four main laws govern the issuance and management of SOE debt in Mongolia:

- 1 Fiscal Stability Law, 2010 (amendments in several subsequent years)
- 2 Debt Management Law, 2015 (amendments in 2019 and 2021)
- 3 Law on State and Local Property, 1996 (amendments in 2003, 2011, 2013, 2014 and 2016)
- 4 Law on Glass Accounts, 2014 (amendments in 2014 and 2016).

The relevant elements of these laws and regulations related to SOE debt are summarized in Table 3.

Table 3. Laws regulating SOE debt management

Key laws	Main purpose	Rules pertinent to SOE debt
Fiscal Stability Law	Regulate the government's fiscal rules for the purposes of ensuring fiscal stability.	Defines 'government debt'. The definition does not include SOE debt except that which is guaranteed by the government. As such, SOE debt and other liabilities are not counted as government liabilities in determining annual general government fiscal expenditures and debt. The law also sets limits to the overall government debt as a share of gross domestic product.
Debt Management Law	Regulates government's debt practices in line with the medium-term strategy and other policies.	Covers SOE debt issuances only if the debt is explicitly guaranteed by the government.
Law on State and Local Property	Describes types and legal status of state and local property or enterprises and determines rights and responsibilities of stakeholders in managing the state and local property.	Outlines procedures for issuing public debt. State-owned or state-controlled enterprises must receive the approval of the Ministry of Finance for all debt issuances with the maturity of over one year.
Law on Glass Accounts	Establishes an open and useful information system that enables public oversight over financials operations of national and local spending, including SOE expenses	SOEs must publish decisions that result in debt issuance.

The Debt Management Law and the Law on State and Local Property are particularly important, as they contain sections that directly regulate the management of debt by SOEs. The Debt Management Law sets out requirements and principles for the government's guarantees on SOE debt. However, it does not cover SOE debt if it is not explicitly guaranteed by the government.

As required by the Debt Management Law, the State Great Hural approved the government's three-year debt management strategy in 2019. This document defined the goals, principles and procedures of the government's debt management policy.

It mainly focused on Mongolia's foreign debt, particularly the government's foreign debt. Again, unless an SOE has a foreign loan which is explicitly guaranteed by the government, this document does not include SOE debt management issues. There is also no rule delineating SOE projects that can or cannot receive a government loan guarantee.

The Law on State and Local Property requires Ministry of Finance approval for any SOE debt issuance with a term greater than one year. However, it does not include any detail on what information the ministry has access to in order to make an informed decision, or what procedures must be followed prior to approval. According to an official source, only larger SOEs issuing significant debt have asked for approval since the law was passed, with five or six such requests made in recent years.¹⁰

These laws provide roles for parliament and the executive, including national-level ministries which hold shares in SOEs. They also allow municipal councils (Citizens' Representative Khurals) and local administrations to manage and oversee local government-owned enterprises. PCSP and the National Audit Office both exercise oversight roles. Table 4 shows key stakeholders' responsibilities.

At corporate level, none of the selected SOEs has published a debt management or financial risk management document or policy. Interviews with SOE officials suggest that Mongolia's mining SOEs exercise debt management and other risk control on an ad hoc basis. Responsibility for this function is mostly divided between companies' finance departments and internal monitoring units.

Two main laws regulate transparency of SOE debt information. The Debt Management Law states that information about debts, liabilities, guarantees and contingent liabilities of central and local governments must be disclosed for public access.¹¹ The law tasks the Ministry of Finance, in collaboration with the Central Bank, with maintaining a centralized debt registry, which consists of the data on national gross external debt, government debt, government guarantees, contingent liabilities and the debts of state or local government-owned enterprises. SOEs must submit their debt report to the Ministry of Finance every quarter.

However, implementation of these regulations is weak. An official from the Ministry of Finance said that SOEs do not submit their debt reports to the central debt registry unless they are applying for approval of a debt issuance. PCSP might have that information, but it does not report to the ministry.¹² The Central Bank's website has more recent external debt figures, but it does not specify SOE debt.

The Law on Glass Accounts also regulates transparency of SOE debt information. This requires SOEs to regularly disclose financial information, including budgets, financial statements and decisions regarding loans, guarantees and any other financial instruments that create obligations.¹³ Like any other listed company, publicly traded SOEs must publish all detailed financial data, including debt-related activities, through the Mongolian Stock Exchange. The implementation of financial disclosures by mining SOEs is summarized in Table 5. As well as the above-mentioned regulations, the government budget proposal includes some information on SOE debts and debt guarantees.

10 Interview with an official from the Debt Management division of the Ministry of Finance, August 2021.

11 Parliament of Mongolia, *Debt Management Law*, Articles 38, 39 and 40 (18 February 2015).

12 Interview with a senior official from the Debt Management division of the Ministry of Finance, August 2021.

13 Parliament of Mongolia, *Glass Account Law*, Article 6, (1 July 2014)

Table 4. Responsibilities of key stakeholders with respect to SOE debt or government guarantees

Actors	Debt Management Law	Law on State and Local Property
Parliament (municipal council, in the case of local government-owned entities)	<ul style="list-style-type: none"> Approve the government's medium-term debt strategy, including setting the government debt ceiling and guarantees each year Ratify foreign loan agreements Discuss the government report on implementation of the debt strategy and exercise parliamentary oversight 	<ul style="list-style-type: none"> Exercise ultimate ownership of state properties on behalf of the people Decide whether to use state property as collateral Make decisions on the transfer, privatization or nationalization of SOEs
Government (or local government)	<ul style="list-style-type: none"> Produce and implement its medium-term debt strategy Make decisions with respect to government loans and guarantees Approve municipal loans Enact government debt-management regulations 	<ul style="list-style-type: none"> Regulate SOE rights to possess, use and manage state assets (debt-issuing rules may be included, though not mandated explicitly) Establish, re-organize or dissolve SOEs Enact bylaws for SOEs Approve SOE requests to invest or divest in joint ventures with other business entities Decide whether an SOE is subject to state or local authority
Ministry of Finance (or the minister)	<ul style="list-style-type: none"> Sign on-lending agreements with receiving agencies or SOEs on behalf of the government Organize the Debt Management Advisory Council¹⁴ Track and report total outstanding government debt and medium-term projections on debt servicing costs on a quarterly basis (SOE debt only included if guaranteed by the government) Record and report total outstanding national foreign debts quarterly, in collaboration with the Central Bank 	<ul style="list-style-type: none"> Approve SOE loans with maturity greater than one year, according to the Law on State and Local Property
Line ministries exercising ownership of SOEs		<ul style="list-style-type: none"> Support SOEs through specialized business and financial expertise in their respective industries Propose investment plans for SOEs
Central Bank	<ul style="list-style-type: none"> Register and publicly report national foreign debt data on a quarterly basis, in collaboration with the Ministry of Finance 	
National Audit Office	<ul style="list-style-type: none"> Audit debt-management performance and compliance with laws Audit SOEs' financial performance 	
National Statistical Committee	<ul style="list-style-type: none"> Report statistics on national foreign debt and government debt and guarantee, on quarterly and annual bases, by sector 	
PCSP		<ul style="list-style-type: none"> Set performance targets for SOEs, including income and profit targets, in consultation with relevant bodies, such as line ministries Appoint government representatives to SOE boards Determine what assets and liabilities to include in SOE balance sheets

14 The Debt Management Advisory Council consists of nine members, including representatives from the National Security Council, Central Bank, Financial Regulatory Commission, and independent experts. It is a non-standing advisory body to the Ministry of Finance.

Table 5. Disclosure of financial statements by selected SOEs

Company	Website	Latest financial reports			Response to information request
		Company website	Glass accounts	Stock exchange website	
Erdenet	erdenetmc.mn		2021 audit report	n/a	Sent reply with information
Erdenes Tavantolgoi	ett.mn	2010-2021 none	2021	n/a	Sent reply without information; interview
Erdenes Mongol	erdenesmongol.mn	2018	2021 Q3	n/a	No response
Erdenes Silver Resources	erdenessilver.mn	2021 audit report	2021	n/a	Sent reply without information
Baganuur	baganuurmine.mn	2021 audit report	2021	2021 Q4 not complete	Sent reply without information
Erdenes Methane	erdenesmethane.mn	Glass accounts portal ¹⁵	2021	n/a	No response
Mon-Atom	monatom.gov.mn	none	2021	n/a	Response over phone, no information
Monrostsvetmet	mongolros.mn	2021 audit report	2021	n/a	Response over phone, no information
Shivee-Ovoo	shivee-ovoo.mn	2017 audit report	2021	2021 Q4 not complete	No response
Erdenes Oyu Tolgoi	eot.mn	link to shilendans.gov.mn	2020 Q1,2	n/a	No response
Data format		pdf	pdf	xls	

Overall, Mongolia's legal framework for SOEs is complex and creates some ambiguities. In particular, the government could improve debt management at SOE level by requiring at least larger SOEs to develop and implement debt-management policies. Under the State and Local Property Law, the government should approve SOE by-laws directly or through government SOE directors. Secondly, the many legal forms SOEs can take may be the reason for the non-uniform approach in managing SOEs, including their debt. For instance, state enterprises are often directly controlled by their shareholding government agencies and focus on complying with the Law on State and Local Property, while limited liability companies and companies listed on the stock exchange are also subject to complex company law and, in the case of the latter, stock market regulations. The level of transparency and reporting also differs across SOEs set up under different legal forms. Thirdly, SOEs can partner with private actors in many different ways, which can impact the nature and level of SOE indebtedness. For instance, shares convertible to debt and vice versa could expose the government to risks if the partnerships are unsuccessful. SOEs might also have access to debt instruments under criteria that differ from those faced by private counterparts. For instance, Mongolia's mining SOEs have received significant loans from the state-run Development Bank, and are among the main clients behind bad loans at the bank. All these nuances are poorly regulated by current laws or by company charters and bylaws, setting the stage for opportunistic and unsustainable debt practices at SOEs.

15 Glass Accounts Portal, *Erdenes Methane*, 2021

III. Inadequate process and poor control for SOE debt

The decision to issue SOE debt may rest with an SOE's board of directors or a centralized agency, or may be a shared responsibility, depending on the country. In Germany, Slovenia and Lithuania, for example, SOE boards determine whether and when an issuance is made, and its terms. In the Czech Republic, Finland, Poland and the UK, the central government influences capital structure decisions, mainly through participation in annual shareholders' meetings. Conversely, in Australia, Ireland, the Netherlands, New Zealand, Sweden and Switzerland, government agencies provide SOE boards with explicit guidelines for debt and equity policies, often in the form of an announced credit rating target, which is used as a benchmark for all subsequent decisions impacting the capital structure.

In the rest of the Organization for Economic Cooperation and Development (OECD), recommendations by SOE boards about capital structures are subject to direct review and approval by the government.¹⁶ More than half of lower-income developing countries also require central government authorization for external and domestic borrowing by public-sector entities. At least seven central governments impose SOE debt limits.¹⁷

In Mongolia, Ministry of Finance involvement in SOE debt policy is limited to authorizing long-term debt issuances by wholly state-owned entities, and government-guaranteed debt. This relatively low level of central government involvement might indicate trust in boards' abilities to make cost-effective decisions. The central government agencies which are formal shareholders in specific SOEs can provide guidelines to the directors representing the government, but these guidelines can lack specificity on some decisions, for instance, over debt issuance or other decisions that could substantially alter debt. However, many of Mongolia's mining SOEs lack effective boards.

SOEs operate under different legal frameworks, complicating decision-making around debt issuances. Companies operating under the Securities Market Law—Erdenes Tavan Tolgoi, Baganuur and Shivee-Ovoo—are subject to higher standards of corporate governance than most SOEs. However, SOEs which operate under the Law on State and Public Property—such as Erdenet and Monrostsvetmet—are not required to have a board of directors, and CEOs are appointed either directly by the cabinet or PCSP.

As Table 6 shows, only four of the SOEs in our sample have boards of directors, though another two—Erdenes Silver Resources and Erdenes Methane—may have boards which have not been publicly disclosed. Where boards are appointed, members are often picked for political reasons, rather than based on their experience or qualifications.¹⁸ Of the 10 mining SOEs in our sample, the CEOs of seven are known to be members of the ruling political party. There is little incentive for board members to act in the public interest, rather than political or personal interests. As a result, the Ministry of Finance and other central agencies may need to take a more proactive approach to improve SOE performance, including decisions around debt issuance.

16 T. Ter-Minassian, *Identifying and Mitigating Fiscal Risks from State-Owned Enterprises* (Inter-American Development Bank, Discussion series, 2017).

17 World Bank, *Debt Transparency in Developing Economies*, (2021).

18 Andrew Bauer and Dorjdari Namkhajantsan, *Wild Growth: An Assessment of Erdenes Mongol* (Natural Resource Governance Institute, 2019).

Table 6. Corporate governance and oversight structure of selected SOEs

Name	Bodies with shareholder rights	Corporate governance hierarchy	Internal oversight
Erdenet	PCSP, but the cabinet also exercises rights	No board of directors (BoD) CEO appointed by cabinet Bylaws not disclosed A special government taskforce controlled management activities from September 2018 to October 2020	No BoD, hence no audit committee No information about internal oversight mechanism
Erdenes Tavan Tolgoi	Ministry of Mining and Heavy Industry (MMHI); PCSP	11-member BoD (four independent), appointed by shareholders 15% of the company is owned by citizens of Mongolia but they have no voting rights. Therefore, there is no public participation. BoD appoints CEO Bylaws and other rules published on company website	BoD appoint an audit committee and publish their names Internal audit office, under BoD audit committee Internal Monitoring and Risk Management Department
Erdenes Mongol	PCSP, but the cabinet exercises rights	Cabinet appoints nine-member BoD (three independent) BoD appoints CEO and executive management team	BoD audit committee required by bylaw No information about appointments State Audit concluded in 2019 that internal oversight mechanism was non-functional
Erdenes Silver Resources	Erdenes Mongol LLC	Bylaws not disclosed Reported to have a BoD, but no information available on composition and appointments	No information
Baganuur	Erdenes Mongol LLC	12-member BoD (four independent), appointed by Erdenes Mongol with representatives from MMHI, Ministry of Energy, Ministry of Finance and Cabinet Secretary Bylaws and other BoD decisions not published	Executive director appointed an internal oversight personal in consultation with the board No other information
Erdenes Methane	Erdenes Mongol LLC	Bylaws not disclosed Reported to have a BoD, but no information available on composition and appointments	No information
Mon-Atom	Erdenes Mongol LLC	Erdenes Mongol BoD exercises shareholder rights and appoints CEO Decided not to have a BoD	No information
Monrostsvetmet	PCSP, but the cabinet exercises rights	Has no BoD CEO is appointed by the cabinet Bylaws not disclosed A special taskforce of the government controlled management activities from September 2018 to October 2020.	No information. BoD oversight mechanism existed before new status
Shivee-Ovoo	Erdenes Mongol LLC	BoD appointed by Erdenes Mongol LLC Names of 18-member BoD (four independent) published on Mongolian Stock Exchange website are outdated; names of new directors not published BoD resolutions not disclosed since 2017	No information
Erdenes Oyu Tolgoi	Erdenes Mongol LLC	Decided not to have a BoD CEO is appointed by Erdenes Mongol BoD	No information

Another angle from which to look at debt authorization and issuance is the level of debt that is viewed as having an implicit guarantee by the government, if not explicitly guaranteed. For instance, Erdenes Tavan Tolgoi has financed two railways, one from the company's mine site to the border with China, the other linking the site to the existing railway and beyond. The economic justification for these projects, especially the line linking to the existing railway, has been widely questioned, yet the company decided to finance these projects, costing trillions of tugrugs, instead of paying dividends to the government and allowing the government to decide the use of such large amounts of earnings through normal budgetary processes. In addition, the government classified the railway projects as confidential, raising further doubts about their suitability.

Under these circumstances, general legal rules on debt practices, and specific policies on debt at SOE level, could play a vital role in regulating SOE debt. It is important to note that SOE debt is different from private-sector debt in that it could lead to government bailouts and become a liability for taxpayers. SOEs might also have access to loans and financing not available to private counterparts, which in turn could lead to poor project selection and risky undertakings. However, government financing of quasi-fiscal activities by SOEs should be limited and subject to detailed review by parliament. SOE reporting on debt is inadequate and lacks detail on the term, cost, creditors and projects being financed, making it difficult to assess the sustainability and associated risks. Especially important is the disclosure of information in advance, allowing stakeholders to make informed decisions and keep SOE management accountable for decisions that might have consequences far beyond SOEs.

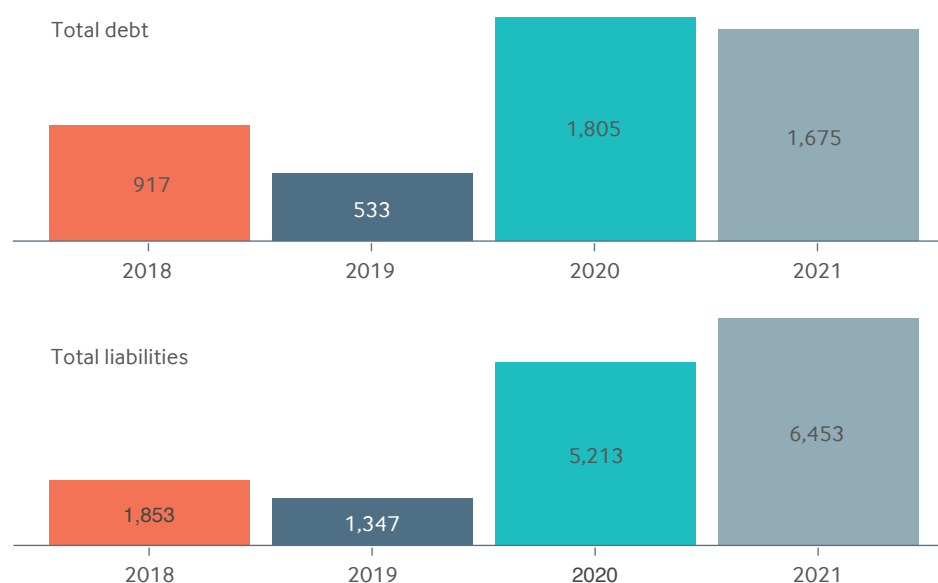
IV. SOE liabilities and quasi-fiscal spending

SURGE IN SOE DEBT AND LIABILITIES

The 10 mining SOEs in our sample reported total liabilities of MNT 6.45 trillion (around USD 2.3 billion) at the end of 2021, of which 26 percent could be classified as “debt.”¹⁹ This is 4.8 times the value of liabilities held by these same companies in 2019—a substantial jump in liabilities by SOEs over the past two years. During the same period, the debt held by these companies jumped 4.32 times, as shown in Figure 2 below.

Figure 2. Change in total debt and total liabilities

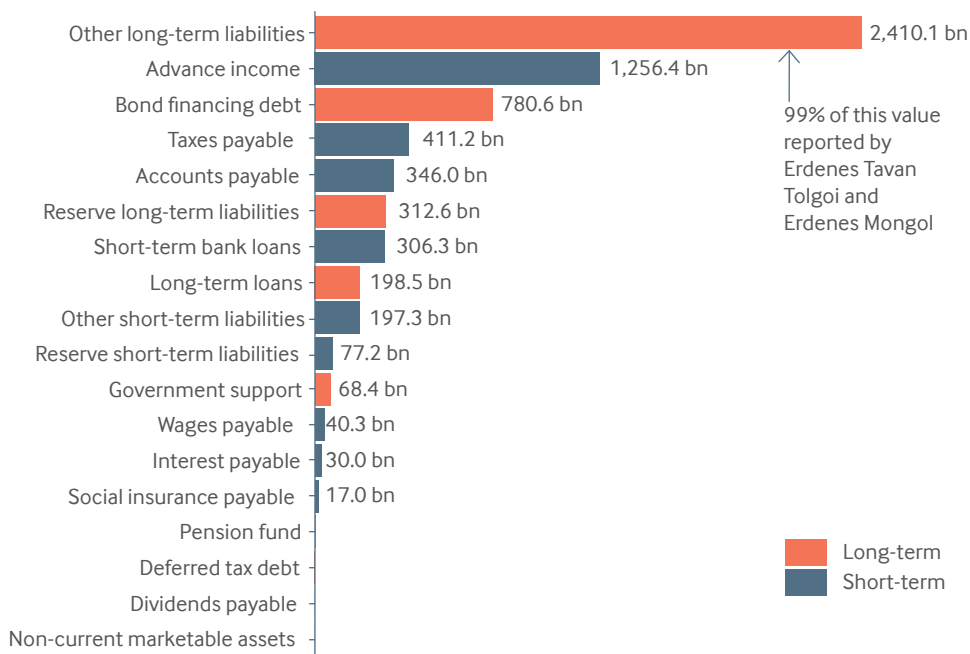
In MNT billion



A closer look at the structure of liabilities of the 10 mining companies (Figure 3) indicates that a significant portion falls into the “other” category, which is not clearly defined. Other significant liabilities are proceeds from advance sales and funds raised through bonds. Ninety-nine percent of the liabilities labelled as “other long term” are reported by two companies, Erdenes Mongol and Erdenes Tavan Tolgoi. A representative of Erdenes Tavan Tolgoi explained that this category includes “dividends payable,” which are payments owed to the company’s shareholders, including almost all adult citizens of Mongolia, each given a small number of shares in the company. The company eventually “reinvested” this money in the coal hauling railway projects discussed above. For Erdenes Mongol, the large amount of liabilities under this category is linked to financing the government’s program on forgiving pension-backed loans for elderly people.

19 These include short- and long-term bank loans, reserve liabilities and bond financed debt.

Figure 3. Components of liabilities
Total held by 10 SOEs, in MNT



Mining SOE debt represented more than four percent of GDP and seven percent of nominal government debt in 2021.²⁰ However, this may underestimate the debt challenge, since there may be significant debt disguised by the government as “other liabilities,” as discussed above. It is also unclear which SOE debts are included in consolidated government debt figures and which are not. The 10 mining SOEs’ liabilities were equivalent to 15 percent of GDP in 2021.

These figures are high by global standards. Based on a sample of 15 countries where debt issuances are fully transparent, the median SOE debt levels (domestic and external) for all sectors amounts to roughly 7.3 percent of GDP.²¹

Over the period of 2018-2021, the total liabilities of the 10 companies increased by MNT 4.6 trillion (USD 1.6 billion). Three SOEs—ETT, Erdenes Mongol and Erdenes Silver Resources—account for 96.8 percent of this increase. ETT issued a MNT 347 billion (USD 123 million) bond and recorded an obligation of approximately MNT 900 billion (USD 321 million) to the government’s Future Heritage Fund, as the company had to pay for the Gashuun Sukhait railway project.²² Bodi International, the contractor for the railway, had no previous experience building railways and is the parent company of the bank which finances the construction. The contractor will receive 10 percent of the coal produced at ETT at cost, as return on its investment. State Bank would cover part of the costs should Bodi International be unable to maintain the necessary cash flow.²³

Erdenes Mongol issued MNT 930 billion (USD 326 million) in bonds to finance the government’s policy to cover pension-backed loans and other subsidies to the elderly. Around 230,000 pensioners took loans from commercial banks using their future pension benefits as collateral. In January 2020, Erdenes Mongol issued a MNT 930

20 Bank of Mongolia, *Government debt data*, (2021).

21 World Bank, *Debt Transparency in Developing Economies*, (2021).

22 If the dividends were distributed, the government share should have been allocated to the Future Heritage Fund, according to the law on Future Heritage Fund. However, the company decided to spend the money directly on a railway project without declaring dividends.

23 E.Odjargal, “Building Mongolia’s Railway of Hope” (Mongolian Mining Journal, 22 January 2021).

billion (USD 326 million) bond cashed by the Central Bank and commercial banks to pay for the pension-backed loan forgiveness and give cash to elderly citizens who did not have pension-backed loans. The loan forgiveness portion benefits not only pensioners who borrowed money, but also the commercial banks who loaned money, including Mongolia's largest commercial banks. To around 194,000 pensioners who did not borrow money out of their state retirement fund savings, and 44,000 pensioners with small pension-backed debts, the government distributed vouchers for MNT 1 million (USD 352) each, which was later funded from the Erdenes Mongol bond income.

Erdenes Mongol plans to repay these bonds out of the earnings from the Salkhit silver mine, which is owned by its subsidiary Erdenes Silver Resources. Separately, Erdenes Silver Resources recorded MNT 936 billion (USD 328 million) in long-term debt at the end of 2020, mainly to finance this quasi-fiscal government operation.²⁴ The remaining new liabilities of Erdenes Silver Resources of approximately MNT 1 trillion (USD 351 billion) are not explained in any government documents.

Mongolian mining SOEs do not generally report details about their debt, such as types of loan, interest rates, currency denomination, term or other conditions. However, some details have entered the public domain, either through foreign partners or because the debt is issued publicly in a traded exchange. In 2016, Erdenes Mongol LLC agreed a 15-year, USD 35 million soft loan from the Asian Development Bank.²⁵ The loan aimed to strengthen the company's management capacity. Its conditions were made public because it is a government guaranteed loan and is therefore registered in the centralized debt database.

In early 2021, ETT announced it would raise up to MNT 1.9 trillion (USD 677 billion) by issuing 24-month bonds at the Mongolian Stock Exchange, denominated in tugrugs and dollars. In April 2021, it sold a MNT 347.7 billion (USD 124 million) bond at 10 percent annually for Mongolian tugrugs and 6.8 percent annually for US dollars. ETT stated that it plans to allocate the capital raised in the following ratio: 48 percent for infrastructure projects such as a railway and a 450 megawatt power plant; 19 percent for part of a processing plant and other mine developments, and 33 percent to re-finance existing debts.

Mining SOEs have also borrowed from the government to cover losses. For instance, the Shivee Ovoo coal mine regularly experiences financial difficulties due to price controls on the sale of coal to Mongolian power plants, quasi-fiscal obligations (e.g., local employment) and inefficient operations. It received a MNT 60 billion (USD 22.7 million) loan from the government in 2018, registered as a liability on the company's balance sheet. Similarly, Mon-Atom LLC, a state-owned uranium exploration company, has borrowed around MNT 2.8 billion (USD 1.1 million) over last three years from the government to cover its operations. The terms and conditions of these loans have not been made public.

SOE DEBT POSES SUBSTANTIAL RISKS

SOE debt accumulation can be either helpful or harmful to economic development. When used to finance projects or activities that generate a substantial financial return, or to invest in public services that will contribute to economic growth and prosperity, debt can be an appropriate financing option. However, if loans are used to finance immediate consumption or unproductive projects, taxpayers may end up covering

24 Government of Mongolia, *Glass Accounts* (2022).

25 Asian Development Bank, *Proposed Technical Assistance Loan Erdenes Mongol LLC*, (March 2016).

Table 9. Liquidity ratios^a

Colors indicate difference from the industry benchmarks

Company	2021 actuals		Industry benchmarks	
	Cash	Current	Cash	Current
Baganuur	0.01	0.83	0.36	1.60
Erdenes Tavan Tolgoi	0.03	1.38	0.36	1.60
Erdenet	0.09	0.85	0.37	0.95
Monrostsvetmet	0.94	2.52	0.37	0.95
Shivee-Ovoo	0.01	0.47	0.36	1.60

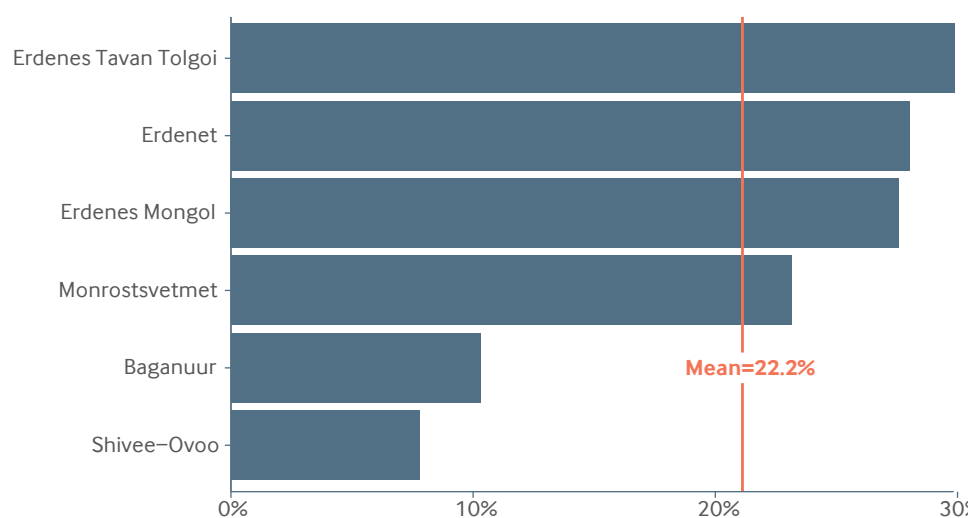
^a Cash and current ratios are cash and current assets divided by current liabilities respectively; both indicate a company's ability to meet immediately its short term obligations.

SOE OVERHEAD COSTS AND FINANCING OF QUASI-FISCAL SPENDING

Overall, Mongolia's state-owned mines are weighed down by liabilities, excessive management costs and quasi-fiscal responsibilities. Supplier costs are only weakly controlled and administrative costs are unusually high. On average, the general and administrative costs, sales costs and costs categorized as "other" comprise 22.2 percent of total sales for the six companies, as shown in Figure 5. Except for Shivee-Ovoo and Baganuur, these costs are very high. The list is topped by Erdenes Tavan Tolgoi, which ought to be more profitable considering the quality of coal produced, its proximity to buyers in China, and coal prices.

Figure 5. Administrative and sales expenses

As a share of total sales



Note: Expenses include general and administrative, sales and marketing and other expenses.

With respect to quasi-fiscal activities, several mines have an unofficial mandate to employ local people near the mine site and provide housing and living facilities for workers. More recently, the government has financed programs to combat COVID-19 by drawing on mining SOE revenues. For example, in December 2020, the government suspended water, heat, electricity and waste payments by households and businesses, except for state-owned entities, mining companies, financial

institutions, telecommunication companies, and alcohol or tobacco producers. Erdenet Mining Corporation paid approximately MNT 650 billion to finance this initiative.

Mining SOEs have also been required to make non-core investments at the government's behest. For instance, Erdenes Tavan Tolgoi made a MNT 269 billion (USD94.5 million) investment in Tavantolgoi Tulsh (Fuel) to produce briquettes for burning by residents of traditional dwellings (ger), in an effort to decrease air pollution in Ulaanbaatar during winter. With subsidized prices for briquette coal, this investment is unlikely to cover costs. The government cut the price of coal briquettes by 75 percent during the COVID period to support ger district households. Earlier, the discount was 50 percent. All this was funded by Erdenes Tavan Tolgoi.

Baganuur and Shivee Ovoo are required to sell thermal coal to domestic power plants at below market rates. Coal prices are set by the government to keep electricity costs down, given the obsolete power-generation technology still in use. Not only does this harm SOE profitability, but it also creates an incentive to produce electricity with coal rather than shift to renewable energies.

Previous research by NRGi suggests that Erdenes Mongol had also made a number of non-mining investments. In recent years, the company has invested in steel, mineral refineries and power plants, each without comprehensive feasibility studies or market assessments. The company is unlikely to generate significant financial or economic returns from these investments.²⁷

These kinds of quasi-fiscal activities generate losses or unnecessary expenses for SOEs and raise contingent fiscal liabilities. In addition, the State Great Hural does not discuss many of these quasi-fiscal activities, undermining parliamentary accountability and the public financial management system of procurement and oversight.²⁸

27 Andrew Bauer and Dorjdari Namkhajantsan, *Wild Growth: An Assessment of Erdenes Mongol* (Natural Resource Governance Institute, 2019).

28 Dorjdari Namkhajantsan, *Quasi-fiscal expenditures* (Open Society Forum, Fiscal Council Briefing, 2021).

VI. Conclusions and recommendations

CONCLUSIONS

Many examples globally and in Mongolia illustrate debt-financed state-owned projects contributing to improved living conditions, from Hydro-Quebec's investments in hydroelectric dams to Korail's investments in South Korea's national railways, or Mongolia's road crossing expansion in 2012, paid for through the country's first significant US dollar-denominated bond issuance. Similarly, several profitable state-owned mining or oil companies have been partially financed through debt issuances, including the China National Petroleum Corporation and Sweden's LKAB.

The difference between SOEs that provide public services, such as power plants, public transport or postal services, and those involved in mining is that, unlike public-service SOEs, mining SOEs provide few direct benefits to citizens, except through a small number of jobs at mine sites. The most important contribution that mining SOEs can make is generating large amounts of revenue for the state, which can be used to finance education, healthcare, infrastructure and other services that benefit the public.

To this end, Mongolian mining SOEs are less than successful. As we have seen, only three state-owned mines are profitable and solvent, but these are largely dependent on the prices of coal and copper, while only Monrosvetmet is adequately liquid. Mongolia's government seems intent on throwing good money after bad by encouraging the expansion of state-owned mining (and non-mining) activities, even where feasibility studies and financial modelling have not been carried out.

Much of this expansion is debt financed. Ten state-owned mining companies' liabilities represent 15 percent of GDP, while mining SOE debt increased 4.8 times from 2019 to 2021. Not all of this money will accrue to the SOEs; much of the capital raised will finance pension-backed loan forgiveness and a rail project that may be unprofitable in the long run.

Therefore, not only has the government approved a significant expansion of mining SOEs, but it also risks seeing state-owned mines lacking capital to meet their future financial obligations, either in terms of debt servicing or developing mines and other projects. While Baganuur and Shivee-Ovoo are currently most at risk, surging liabilities at Erdenes Tavan Tolgoi, Erdenes Mongol and Erdenes Silver Resources might drive economic instability and drain public resources in coming years. Additionally, without legal reform and better implementation of existing laws, mining SOEs are likely to take on even more debt in the future.

RECOMMENDATIONS

It is not too late to implement institutional changes that will prevent another economic or budgetary crisis in Mongolia. Here we give recommendations and policy options for the government, to bring Mongolia in line with international standards and improve mining SOE performance.

The Mongolian government should undertake legal reforms:

- Require all mining SOEs to obtain Ministry of Finance approval for all debt issuances, regardless of size, term and legal status of the entity, and cabinet approval for debt issuances above a minimum threshold (e.g., USD 20 million per year). Where the debt is to fund a particular project, approvals should be contingent on independent technical and feasibility studies demonstrating that the SOE's projects will be profitable in the medium to long term and generate a minimum rate of return for the state. These studies should be published on the SOE's website. These measures would require amendments to the Debt Management Law or incorporation in a new SOE law.
- Require the Ministry of Finance to publish detailed debt information on all SOEs, including size, currency, term, maturity and coupon rate, among other relevant information. This would require amendments to the Debt Management Law.
- Require that all operating state-owned mines appoint a board of directors with security of tenure and minimum qualification and experience for each member, to be delineated in law. This might require amendments to the Law on State and Local Property.
- Amend budget laws to require parliamentary approval for any quasi-fiscal government spending financed by SOEs, and limit SOEs' ability to retain profits and finance large projects at the expense of dividend payments to the state budget.

The Mongolia government should enforce existing laws:

- Enforce the requirement for Ministry of Finance approval of SOE loans with maturity greater than one year.
- Enforce the Glass Account Law with respect to making public all SOE financial information, including detailed revenues, expenditure, assets and liabilities, on a timely basis.
- Require that all SOEs comply with the Companies Law in terms of meeting international accounting standards.

The Ministry of Mines and Heavy Industry and Agency of Policy Coordination for State Property should:

- Draft a new national policy that clearly names eligible and prohibited asset classes for investments by state-owned mining companies, and defines mandates for mining SOEs.
- Review mining SOEs' role in quasi-fiscal expenditures, specifically price controls on coal, railway financing, employment requirements and other non-mining activities.
- Commission an operating review of each state-owned mine to improve financial and operational performance or, if the social benefits to maintaining operations are less than the financial costs, consider privatization.

- Develop a sound performance-monitoring system, including profitability and efficiency indicators.
- Require that all operating SOEs undergo an annual independent audit to international standards and publish the audit on their websites.

The Ministry of Finance should:

- Adjust the Glass Accounts database to allow SOEs to report details of their debt.
- Include SOE debt in the government debt registry as a contingent liability.
- Strictly enforce implementation of the Glass Accounts Law by all SOEs.

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