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RATIONAL ALLOCATION OF LOCAL BUDGET REVENUES

Research report

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RATIONAL ALLOCATION OF
LOCAL BUDGET REVENUES

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THE LIST OF ABBREVIATIONS

VA	Vehicles and other automotives
GDP	Gross Domestic Product
SIH	State Ih Hural
LIPT	Law on Immovable Property Tax
VAT	Value Added Tax
CRH	Citizen's Representatives Hural
PIT	Personal Income Tax
PITSVSB	Personal income tax on street vendors and small businesses whose production and service can not be categorized for the tax purposes
SPIO	State Professional Inspection Office

1. INTRODUCTION: RESEACRH OBJECTIVES AND METHODOLOGY

The purpose of the research is to analyze and assess the current policy environment of decentralization and the state of affairs of ensuring the process through budgeting. Based on the assessment, it aims to propose options for a local budgeting policy that is sustainable and predictable and that would produce budget revenues for independent local expenditure. For this purpose, the work makes an attempt to give answers to the following policy question:

"Does the current budget and finance system enable formation of a predictable, independent, fair and equitable budget that is sufficient for the local community?"

In other words, it will answer questions whether the local budget is:

   (i)   Adequate, i.e. sufficient in order to fulfill the mandated functions;

   (ii) Independent, i.e. transparent in terms of subsidy and revenue allocation; explicitly managed; authorized with power and opportunities to administer independently the recurrent budget;

   (iii) Equitable, i.e. equal in terms of per capita budget revenue and expenditure for all administrative units;

   (iv) Predictable, i.e. the principles of allocation of subsidies and revenues are guaranteed and fully applied.

Within the framework of the above key issue, the following four areas of research were identified:

- Whether the aimag and soum budget is autonomous in terms of planning and expenditure?

- Whether the tax and other revenues of the local budget are sufficient for fulfilling the functions mandated by law?

- Which type of tax revenues shall be the major component of the local budget revenue formation?

- Whether financial support from the central budget will become a major component of the local budget revenue?

In the frame of the research, the authors carried out a vertical and horizontal analysis and an assessment of the aimag and soum tax revenues based on the 2006 and 2007 local budget implementation and the revised 2008 budget. The

study covered budget data from 21 aimags and the capital city. Considering specifics of each region, a selective research was carried out in Khentii, Orkhon, Bayan-Ulgii and South Gobi provinces . Furthermore, one central soum and one peripheral soum were chosen from each province for a sampling research.

In order to determine the local tax authority, an analysis of legislation related to 6 kinds of aimag and 12 kinds of soum taxes was carried out and conclusions were made. Methods used in research included study of present laws, Government and CRH resolutions, meetings with related officials and representatives of related institutions, data collection in aimags and soums, discussions as well as qualitative methods.

The research has resulted in study and analysis of the tax authority and amount in each type of taxes, the conclusions of which are presented in Chapter 2 of the Report. The Chapter 3 presents the analysis of the local budget revenues in each of the tax revenues and the income growth, contraction and their reasons by the samples of the budget reports of the selected aimags. Chapter 4 of the Report deals with the issues of sufficiency of the local budget revenues , existence of a sustainable tax revenue base, of disparities between the urban and rural administrative units, of autonomous local taxation. Research outcomes are consolidated at the aimag and soum levels. Current principles of distribution of the central financial support among the local administrative units are examined in Chapter 5. Policy recommendations for rationalization of the central and local budget revenue allocations are presented in Chapter 6. The last or Chapter 7 suggests the ways of implementation of the above recommendations.

2. STUDY OF AUTHORITY IN THE LOCAL BUDGET REVENUE

The local budget revenue allocation requires the following universal principles to be ensured:

(i) The local government shall have adequate/sufficient sources for financing the services to be provided within its competence;

(ii) A priority should be given to collection of local budget revenues from within the local population and other tax payers and to matching of the revenue collection with efficiency of the local public services;

(iii) It should be predictable, i.e. principles of revenue allocation to the local administrations shall be clear, guaranteed by law and immune to arbitrary distortions;

(iv) A right to independent budget expenditure in the interests of the local community shall be respected.

Basic principles of the public finances stipulate that the local budget revenues of any country have the following sources:

1. Local tax revenues

2. Payments and fees

3. Central government transfers (subsidies, assistance)

4. and shared revenues

Each of these components plays substantial economic, political and social roles in the local budget.

Before talking about the local taxes, the theoretic definition of the term "local tax" should be given. The real local taxes are (i) levied by the local government[1]; (ii) rates of which are established by the local government; (iii) collected by the local government itself; and (iv) revenues from which are accumulated into the local budget (Bird, 2000-2005). However, in reality many taxes might embody one or two of these characteristics and the "owner" of those taxes might be unclear.

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[1] A local government is understood to be a body elected through democratic elections by the population belonging to the respective administrative unit. In the case of Mongolia, it is a Hural of the Citizens' Representatives.

For example, while in many countries a certain portion of the tax revenues stays at the local area , their rates are established, they are levied and collected by the central government. Such taxes are better considered as central government shared taxes, linked to transfers channeled to the local administrations. In other words, the taxing authority is shared by the local and the central government. There is certain ground for explaining it in this way because of the loose correlation between the local tax collection and the transfer revenues.

When the tax collection is in the hands of the central government, i.e. when there is a unified tax collection system, it is more effective, in economic as well as professional aspects. A decentralized tax collection system administered by each individual local government will, firstly, increase the administrative expenses[2]; and, secondly, complicate organization of the professional tax collecting activities.since in terms of training and methodology, an independent performance by the local administration is considered to be of a lower quality and less efficient. It should be kept in mind that having a unified tax collection system does not limit the rights of the local government to levy a tax, establish a tax rate, set the tax reliefs and collect revenues. An issue of who holds the political responsibility to establish the tax rate is the most important part of the local tax authority.

Taxes are divided as real estate, excise, personal income, utility, corporate, natural resources taxes.

Countries would channel some of these taxes into the central budget, some – to the local budgets, some – to both budgets (shared taxes).

Taxes that generate a large amount of revenues and that are universally and equally applied on the whole territory of a country, such as corporate income tax, import tariffs, VAT, and excise taxes, are overwhelmingly mobilized into the central budget in order to ensure the macroeconomic stability. They acquire a special economic significance especially at a time of crisis, instability and natural calamity. However, some countries have a practice of sharing the proceeds from these taxes with the local communities. Let us now examine some taxes that contribute to the local budget revenues.

Immovable property, i.e. Real Estate Taxes are traditionally considered the most reliable source of local taxation. Since real estates are visible and tangible, the respective tax collection and revenue generation tend to be easy. However, the tax base and the valuation of real estates in the developed nations have become complicated and disputable. On the other hand, since the real estate

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[2] An independent tax collection system at each administrative unit limits the potential to reduce the recurrent expenses related to the operation.

tax is paid only once a year, even a minor increase in the tax rate might cause dissatisfaction. Therefore, the local politicians have now less interest in meddling with real estate taxes. Though politically sensitive, such taxes established by a universal rule continue to take an important place in the local budget.

Excise Taxes, the rates of which are best to be established by the local administration in terms of the economic benefits, are related to the transportation facilities. Fuel taxes, vehicle taxes and road tolls are examples of such taxes. Local road amortization and impact of pollution caused by fuel consumption are in greater measure concerns for the local towns and communities.

Personal Income Taxes are, as experience of other countries show, transparent and in political aspect consistent with the principle of citizens' responsibility, and, thus, play a respective role in the local budget revenues. In the Scandinavian countries, the local authorities levy an additional percentage on the top of the general personal income taxes established by the central government and channel it to the local budget. In the transitional economies the local budget is formed by allocation of a certain percentage from the general personal income tax revenues. This percentage, for example, is 50% in Bulgaria and 30% in Poland. The local authorities in these countries do not have power to levy local personal income taxes or to establish the PIT rates. Therefore, these revenues are considered transfers redistributed from the central government revenues. The transfer of VAT practiced in Mongolia is similar. Many countries are at present considering introduction of a local percentage in addition to the general personal income tax.

Consumption Taxes belong to the types that are capable of creating efficient and flexible sources of income at the local level. Most countries apply a VAT which is one of these types of tax. Most central governments have the power to levy the VAT and to establish its rates. A part of the revenues then is allocated to the local government. There is an opinion that they should considered to be local taxes since tey are related to consumption of the local population. However, such a local taxation might impair the macroeconomic control and the responsibility to levy and collect taxes and might stimulate local authorities for tax exporting. Therefore, it is preferable to leave the VAT in the hands of the central government. Canada, Brazil and some other federal countries apply VAT at the local level.

Business Taxes include corporate income taxes, property taxes, patent and license fees, and others. Though local authorities are interested in levying these taxes, economists and researchers consider such local taxation to be able to create a macroeconomic distortion. However, in practice, these taxes belong to the central government budget taxes.

Local authorities fight for Taxes on Natural Resources to be in their power. However, this fight is repelled on the basis of several reasons.

First, uneven distribution of natural resources, especially minerals, among various regions will lead to an increased disparity between them, if the natural resources taxation is given to the local administration.

Second, revenues from natural resources are not sustainable and will cease to exist after a certain time, because the resources are not renewable. Therefore, they cannot be permanent sources. When the revenues stop, then the artificially increased expenditure will not get financing.

Third, rehabilitation of natural environment is costly, and if not carried out, the indigenous population will suffer. In addition, the local authorities lack professional and political capacity to rehabilitate it on their own.

Fourth, it is advised that revenue proceeds from the natural resources taxes should be appropriated into the central budget and used for national development priorities and investments.

Fifth, large tax payers together with the local authorities might conspire to launch various programs and projects that may lead to indirect corruption. Therefore, such taxes should be centralized.

Payment and fees for services are among the most potential income sources that the local government can use best. It is considered appropriate for the local authorities to charge adequate payment and fees for the services provided to the citizens. In economic terms, the payment and fees carry market information on the demand and need for the public sector services and on the basis of meeting demand of population and sharing expences effectiveness increases.

Local governments charge small fees and payment for services like licensing, documentation of citizen's identity and vehicle registration, notary and copying of documents. Most of these charges do not generate sufficient revenues. Establishment of a realistic rate of charge is also questionable.

Many countries are looking for a simple, realistic system of fewer charges based on careful calculations to replace the current system of numerous , cumbersome charges for public services.

Chapter 5 deals with the mechanism of transfers from the state budget in more detail.

The respective laws of Mongolia stipulate that the aimag budget revenues shall consist of 6 types of tax and the soum budget revenues – of 12 types[3]. Research

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[3] Article 7.4, General Tax Law; Articles 10.1 and 10.2, Law on Central Budget

has been done in the frame of the mandates of taxation, establishment of tax rates, tax discount and exemption, tax distribution and reporting with an aim to make a conclusion whether these types of taxes have characteristics of local budget revenues. The local budget revenues were classified at aimag and soum levels andeach type was codified to avoid duplication and misinterpretation.

Central Government Taxes   - (U1, U2, …Un)

Aimag Taxes   - (A1, A2, …An)

Soum Taxes   - (S1, S2, …Sn)

The study of the tax authority covers the existing laws of Mongolia, Government resolutions, decrees and decisions of ministers and heads of agencies, resolutions of the Citizens' Representatives Hural, decrees of governors. Also interviews of respective officials of the selected aimags were carried out to analyze implementation of laws and decisions, evaluate the taxation authority and identify challenging issues.

2.1 AIMAG TAXATION AUTHORITY

The Law of Mongolia on the Central Budget stipulates that the revenues of aimags, the capital city, soums and districts consist of tax and non-tax incomes.

The tax revenues for aimag and the capital identified in Article 10.1 of the above Law include:

1. Real estate tax
2. Municipal tax
3. Royalty for minerals (20%)
4. Land fee
5. Vehicles and other automotives taxes
6. License fees for mineral exploration (25%).

The aimag and capital city revenues of non-tax nature[4] consist of:

-   Payment for usage and proceeds from sale of local properties, interests, fines
-   Dividends from shares belonging to local government in the entities and organizations with local government ownership
-   Financing of procurement of goods ordered by the central budget administrator
-   Other incomes to be appropriated into the aimag and capital city budgets in accordance with legislation.

Most countries, where decentralization has succeeded, possess such characteristics as predictability of local budget revenues, the power of the local administration to establish its own tax rates, the adequate and equitable income generation.

Each type of aimag and capital city tax revenues is analyzed below by factors such as taxation, tax rates, tax concession and exemption, procedures of tax collection and reporting, and tax revenue allocation taken as criteria in order to determine its authority.

In determining full authority of local aimag and capital city administrative organizations on the issue of taxation primary and secondary data such as legislation and rules of respective aimags, and interviews with the senior officials and professionals from the aimags of Khentii, Orkhon, Bayan-Ulgii and South Gobi has been used.

Immovable property/Real Estate Tax (A1)

Tax Levy

The Law of 2000 on Real Estate Tax (RET Law) regulates taxation of immovable properties. Immovable properties include buildings and land plots owned by citizens.

The real estate tax rates are established by legislative acts approved by the Parliament. Local authorities have no right to establish, change or apply concessions to the rates.

Aimags such as Khentii and Bayan-Ulgii have seen recently construction of many private houses with commercial service designation[5]. Taxation of such buildings faces difficulties, because private houses are exempt from taxation by law, while buildings with commercial designation are to be taxed. Therefore, in most cases tax inspectors conduct their own assessment and charge the real estate tax on the commercial part of the building.

The real estate tax is charged on local immovable properties. Its rate does not depend on profitability of citizens and business entities. The registry of and change in immovable properties are transparent in local settings. Therefore, the local administration can fully forecast the expected size of revenues from this type of taxation.

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[4]   Article 10.2, Law on Central Budget
[5]   Ground floors are built for running shops, restaurants or bars

Tax Rate

The annual tax is levied on the real estate at rate of 0.6% of its market value. The provisions of establishing the rate, discounting and exempting for the tax are stipulated by the RET Law approved by the Parliament. The local authorities have no right to reduce, discount and exempt the tax.

Tax Concession and Exemption

Articles 6 and 7 of the RET Law provide for tax concessions. Private dwellings, public buildings and buildings of entities financed by government and local budgets are exempted fully from taxation.

Land plots owned by citizens for family use enjoy a tax concession of 95-98%, varying as for the capital city or aimag or soum; lands for other designations – of 30-85%, varying as for the capital or aimag or soum, and crop farming lands – of 95%.

The land plot of 0.07 hectare, which is given into proprietorship free of charge to every Mongolian citizen is 96-98% exempt from the real estate tax. Thus, the tax revenue from a household is minimal[6]. Paying a tax of MNT 40 , in addition to the cost of a bank transfer form at MNT100, is too negligible especially since expenditure the government is to bear collecting these taxes would far surpass the revenue.

Tax Distribution and Reporting

The taxpayer shall report on his/her real estate tax to the local tax authority by 10 February each year and transfer the annual payment by 15 February.

The real estate tax on land is levied by the respective land management authority. A tax officer shall collect the tax and make the payment to the local budget. In Orkhon aimag, however, the land management authority itself levies and collects the tax.

This tax is not channeled to the central government budget, but is fully used by the aimag budget. The real estate tax payment at a soum level is also channeled to the aimag budget.

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[6] See Attachment #10 for calculations of real estate taxes.

Municipal Tax (A2)

Though the Article 10.1.1 of the Law on Budget stipulates for this tax, no regulations for its collection are in place in Ulaanbaatar or any aimag. In other words, this type of tax is not applied.

Royalty on Minerals (A3 and C12)

Authority of Taxation

This tax is of a type shared among the central, aimag and soum budgets. Its rate is established by the law (Law on Minerals) adopted by the Parliament. Levying and collecting are the prerogative of the local authorities. The respective relationship is governed by the New Edition of 2006 of the Law on Minerals. The owner of a license on minerals shall pay a royalty on the sale's amount of all minerals extracted, sold and shipped for sale from the mines. The local government does not have the right to establish or to change the rate or to apply concession or exemption on the royalty. Only the Central Government has such a right.

The royalty charged on minerals produced at the Erdenet Copper Mine of Orkhon aimag, the Khurmen and Tavantolgoi Coal Mines of South Gobi aimag, the Bor-Undur Fluorspar Mine and Berkh Mine of Khentii aimag, and some others, is collected into the local budget. Bayan-Ulgii aimag, which imports its coal supply from Uvs aimag, has an income of MNT 38.6 million only from minerals royalty payment, lower compared to other aimags.

Since the local authority conducts a general registry of respective business entities and has the power to supervise, this type of taxation can be considered a predictable local tax revenue.

Tax rate

A rate of 2.5% on sales value of coal and other general purpose minerals and a rate of 5.0% on sales value of all other minerals (Article 32.3) are charged as royalty. As the Law on Minerals stipulates, 70%, 20% and 10% of all royalty proceeds are channeled, respectively, to the central, aimag and soum budgets.

Tax Concession and Exemption

The Law does not regulate the authority for tax concession and exemption.

Tax Distribution and Reporting

"Rules of payment and distribution of royalty on minerals"[7] stipulate that license holders shall pay the royalty with regard to gold, copper and copper concentrate to the central budget within 21 days from the date of sales transaction or shipment, and with regard to other minerals – to the aimag, the capital city or soum (district) budgets within 10 days from the date of sales transaction or shipment.

30% of the amount of royalty payment on gold, copper and copper concentrate accrued to the central budget within the respective month shall be channeled by the Finance Ministry from the central government account to the account of the respective aimag or the capital city, where the said mineral deposits are located, by the 25th of the following month.

70% of the amount of royalty payment on minerals other than gold, copper and copper concentrate accrued to the local budget during the given month shall be transferred to the central budget by the 30th of the following month by the respective local budget authorities, where the deposits are located.

The respective share of the amount of the royalty payment distributed from the central budget to the aimag (the capital city) budget shall be further channeled within 10 business days to the soum (district) budget, where the deposits are located.

Land Fee (A4)

Tax Levy

The Law on Land Fees adopted in April 1997 regulates the land fee relations. Citizens and entities that use land shall pay a land fee.

The land fee is calculated based on the basic land value. The annexes to the Government Resolution #152 of 1997 regulate this relationship. The local authorities establish the detailed land fee rates on the basis of the above Government Resolution.

Land registration, distribution and fee collection are carried out by the local administration. Therefore, the land fee revenue is predictable. Current practices of establishment of land fee rates suggest that rates are higher[8] in places with a higher concentration of the population.

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[7] Government Resolution #272 of 2006
[8] At the maximum level allowed by law.

Land Fee Rate and Size

The Law on Land Fees establishes the land fee calculation indicators as follows:

A. For pasture lands, per head of domestic animals, converted to sheep, as a percentage of the base land unit value, but a maximum of 0.01-0.03% of pasture land fee.

B. MNT 1,500-7,500 per kilometer of infrastructure lines as stipulated by in Article 13 of Law on Land.

C. For crop farming and animal fodder lands, a maximum of 0.01-0.03% of per hectare land fee.

D. 0.1-1.0% of per hectare land fee for cities, towns and other urban areas.

E. A maximum of 0.01-0.03% of per hectare base land value in other cases.

The land fee is a local tax, where the local authorities have the right and considerable independence to establish the final rates within the framework of existing legislation.

Tax Concession and Exemption

The Article 8.1 of the Law in its stipulates that the following taxpayers will be exempt from the following land fees:

A. Herder households – from pasture and animal fodder land fees;

B. Citizens of Mongolia, who own land for a family use – an exemption of 90% of fee for a plot of 0.07 hectare;

C. Citizens and entities of Mongolia – from state border land fees;

D. Citizens of Mongolia – from fees for land with natural, historic and cultural heritage, which he/she is entitled to preserve and protect;

E. State-registered nursing homes and all educational institutions of public and private ownership – from fees of land they operate on;

F. Citizens and entities – 5-year exemption for lands they use for perennial and leguminous plants in order to improve the soil quality and to transfer it to pasture;

G. Unions of apartment owners – from fees on ground land used upon contract;

H. The Government may grant concessions to citizens and entities that apply eco-friendly and land protection and rehabilitation technologies;

I. An exemption is applied to lands, where perennial plants and fruits and berries are planted for the first time until the first commercial crops are harvested.

Article 8.2 of the Law stipulates that the Government may grant concessions to citizens and entities that apply eco-friendly and land protection and rehabilitation technologies. In those 4 aimags, where studies were carried out, no entity was using concessions from the Government.

Tax Distribution and Reporting

In Ulaanbaatar City, Orkhon aimag and other urban areas the authorities in charge of land fee levy and collect the fees. In most other aimags, the land authorities levy the fees, but the local taxation authorities collect and supervise.

The land fee payer, unless otherwise stipulated in the land ownership and usage contract, shall pay the annual fee in 4 equal installments within the first 25th day of each quarter. Fees for subsequent quarters can be paid in advance.

Revenues from land fees shall be collected into aimag and capital city budgets. A certain part of the revenues shall be used for protection, rehabilitation and management works of state-owned lands.

Vehicle and Other Automotive Taxes (A5)

Tax Levy

The Law of 1992 on Vehicle and other automotive taxation regulates this type of tax. This is a universal tax levied on all vehicles and other automotives possessed by entities and private citizens. This is applied to all transport vehicles, buses, motorbikes, special-purpose vehicles, agricultural and construction machinery, trailers.

Since the registry and certification are handled by the local transport police, the present number and growth in number of vehicles are easily registered, and the tax revenues are directly accrued to the local budget, so the revenue pattern is predictable.

Tax Rate

The tax is different as for Ulaanbaatar, Darkhan and Orkhon, and other regions. The amount of taxes on passenger cars depend on their engine capacity, and on commercial vehicles – on their weight capacity[9].

The last revision of the vehicle taxes was made in 1997. Since then the rates have not changed for 12 years.

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[9] See Annex #4

Tax Concession and Exemption

No concession or exemption is applied.

Tax Distribution and Reporting

Citizens and entities pay their annual taxes once a year before June 1 to respective taxation authorities. When the annual vehicle inspection is launched, the tax revenue starts to flow to the budget.

The organization in charge of traffic control assists the taxation authorities in collecting the taxes on vehicles and other automotives. The tax revenue is collected into the respective aimag budget.

When there is a large fleet of vehicles and automotives at remote mines, the aimag sends a team to inspect and collect taxes on these vehicles on site and reports in the "Tax Division" column of Tax Reporting of Vehicles and Other Automotives.

License Fees for Mineral Exploration and Mining (A6 and C11)

Tax Levy

This is a shared tax, the rate of which is established by the Law on Minerals approved by the Parliament. The Government regulates the tax collection and revenue distribution[10]. The taxation in this field creates difficulties in terms of its redistribution to local governments. In other words, the central administrative body in charge of Geology and Geography issues collects the tax revenues and transfers them to the Finance Ministry, which redistributes the proceeds. The local governments have only a right to make a proposal. This situation leads to an incomplete distribution of the planned income for the local governments. For example, South Gobi aimag had a plan to earn MNT 5 billion of income from the license fees in 2008,but the actual transfer amounted to MNT 2.4 billion only and the remaining MNT 2.6 billion was not paid. Furthermore, the 50% of MNT 2.4 billion was not transferred to the respective soum, as required by law.

Tax Rate

The per hectare fee rate for exploration area is $0.1 in the first year, $0.2 – in the second year, $0.3 – in the third year, $1.0 for years 4-6, $1.5 – for years 7-9. The mining license fee is $15 per hectare in the licensed area. The fee for coal and other general-purpose minerals is $5.0 per hectare[11]. The Law on Minerals

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[10] Government Resolution #272 of 2006; Finance Minister's Decree #102
[11] §32.2, Law on Minerals

stipulates that 50%, 25% and 25% of the respective license fee proceeds shall be collected, respectively, into the central, aimag (the capital city) and soum budgets.

Tax Concession and Exemption

There is no provision in legislation for concession and exemption in this category.

Tax Distribution and Reporting

As "the Regulation on Payment and Distribution of Royalties on Minerals"[12] requires, the exploration and mining license owners shall pay the first-year fee within 10 business days upon receipt of the invoice and the subsequent year's fees in advance. The central state administrative body in charge of Geology and mining shall collect the fees, transfer the monthly revenue by the 25th to the state budget income account and report to the Finance Ministry in accordance with standards. The Finance Ministry, within 5 business days since the acceptance of of license fee revenue transferred by the central state administrative body in charge of Geology and mining, shall transfer it to aimag and capital city budget accounts. The aimag and capital city budget authorities shall further redistribute the required proceeds to soum and district budget within 3 business days since the date of receipt of the revenue transfer.

Despite the above regulation, the provisions seem to be not working. For example, South Gobi aimag received less than half of the proceeds from the license fee in 2008, and received it with a considerable delay. The aimag authorities also did not transfer the required shares to the respective soums, where exploration and mining take place. The finance and policy coordination division staff of the aimag government justifies their inaction by absence of detailed information on the companies, that paid or did not pay the license fees, which obstructs transfer of the allocation.

Such major functions as establishment of types and rates of tax revenues of aimags and their concession and exemption are prerogative of the Central Government as required by law. However, as for the land fees, the local authorities through the Citizens Representatives' Hural can take decisions conducive to the local specifics, but within the limits of legislation.

The central state administrative body in charge of Geology and mining awards mining and exploration licenses, collects fees and redistributes the proceeds through the Finance Ministry to aimags and soums. It also redistributes the proceeds from royalties on gold, copper and copper concentrates through the

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[12] Government Resolution #272 of 2006

Finance Ministry to local governments. Taxation and collection of other taxes are mainly carried out by local taxation authorities and are allocated to respective budget accounts.

From the aimag and capital city taxes as stipulated by the Law on Central Budget, the "municipal taxes" have not yet been applied. The regulations and rules of their application have not been worked out.

The study of the aimag-level taxes leads to a conclusion that establishment of aimag taxation and its rates as well as granting of concession and exemption are heavily centralized in the Parliament and the Central Government. The local authorities have the duties only to levy, collect and report on taxes.

In other words, the tax autonomy of the local self-governing administration lacks a legal foundation as a whole.

2.2 SOUM TAXATION AUTHORITY

As was said above, 12 types of taxes shall form the tax revenue of the soum budget in accordance with the Law on Central Budget and the General Tax Law. In the current Chapter, these tax revenues codified as C1, C2,…C12, are studied in detail within the soum authority to levy, establish the rate of, grant concession and exemption, to collect and report taxes.

"License fees for exploration and mining" under code C11 and "Royalty on minerals" under code C12 are tax revenues that, under the law[13], are income to be shared between different levels of government. Therefore, their analysis is equivalent to that of corresponding aimag taxes (A6 and A3). In other words, the tax authority analysis of C11 and C12 can be derived from that of A6 and A3.

Personal Income Tax (C1)

Tax Levy

This tax income is difficult to be treated as autonomous local tax revenue since the sole authority to establish the tax and its rates and to grant concession and exemption rests upon the Parliament in accordance with the Personal Income Tax Law.

However, the right to impose tax is administered by the soum tax officers. An amendment of October 2008 to the Law on Central Budget (Article 10.1.7) introduced a provision on appropriation of wages and salaries and similar

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[13] Law on Minerals of 2006

income in the aimag budget. Therefore, this tax is not anymore a local tax for soums assoums do not have any right to establish the tax and to change its rate. They are authorized only to impose and collect the tax for the budget.

It is also hard to predetermine the real tax revenue. In practice, this tax revenue is planned on the basis of the performance in the previous year. No detailed planning based on a clear tax base is carried out. For example, in imposing the tax on operational income, the soum tax inspectors are not able to document every activity of an individual or entity and face great difficulties due to incorrect or incomplete reports. On the other hand, individuals or taxpayers are often incapable of writing a tax return report. Taxes on income of citizens with domestic animals are imposed on the basis of the animal population census data of the previous year[14]. Sudden natural calamities may cause death of many animals, but the herdsmen might end up paying taxes on those perished animals.

Tax Rate

There is no real opportunity for the local government to establish the personal income tax rate flexible enough (within binding limits) to match the local specifics. Once the Parliament establishes the personal income tax rates by law, the local authorities are denied the opportunity to apply a flexible policy to increase local tax revenues or to promote employment through adjustable rates. Article 8.1 of the Law on PIT stipulates for the following rates imposed on different types of income:

Tax Concession and Exemption

The soum does not possess the authority to grant concession and exemption from this tax, since such an authority belongs only to the Parliament in accordance with the law[15]. MNT 84,000 from the annual taxable income from wages, salaries and identical incomes are exempted from taxation. 20   heads of livestock converted to sheep are tax-exempt per each member of herder's family. 50% of the income generated by farming of wheat grains, potatoes, vegetables, fruits and fodder plants are exempted from taxation.Tuition fees for undergraduate studies are also tax-free.

Though the above concessions and exemptions on certain types of income are defined for the purpose of national policy regulation, similar rights for a number of income types are missing at the soum level. Examples are the cases, when the personal income tax is levied on the number of domestic animals counted by the previous census. The number of unexpectedly lost animals can be documented, but not exempted from taxation by the soum tax inspectors.

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[14] For example, the income tax is levied in May 2009 for animals counted by November 2008 census.
[15] The income referred to in Article 16.1 of the Law on PIT is exempt from this tax.

Table 2.1 Personal Income Tax Rates

№	Types of Taxes	Rates
1	Wages, salaries, remuneration, bonus, and similar employment income	10%
2	Operational Income	10%
3	Capital Gains	10%
4	Capital Sales Tax	10%
5	Income of herdsmen and households with domestic animals (differing rates depending on regional specifics) in MNT	
	- The Capital City, Darkhan-Uul, Orkon, Selenge and Central aimags	- 100
	- Arkhangai, Bayankhongor, Bulgan, Gobi-Sumber, Dornogobi, Dornod, Dundgobi, Uvurkhangai, South Gobi, Sukhbaatar, Huvsgul, Khentii aimags	- 75
	- Bayan-Ulgii, Gobi-Altai, Zavkhan, Uvs Khovd aimags	- 50
6	Incomes from scientific, literary, art works; innovation, new products and profitable designs; organization of and participation in sports and artitistic performances, and other similar incomes	2%
7	Income of prizes from artistic and sports contests and festivals	5%
8	Income from paid quizes, bets, lottery	40%
9	Indirect incomes	10%

Tax Allocation and Reporting

The soum tax inspectors impose the personal income taxes and collect them directly to the soum budget revenue account in the State Fund[16]. Though taxpayers have a dutiy to file their tax return and make the payment, in reality they are usually late and rely on tax inspectors to collect taxes. This is related in part to the mentality and ethics of taxpayers.

In order to improve   effectiveness of tax collection and   efficiency of tax allocation, in Buyant soum of Bayan-Ulgii aimag, for example, the income tax proceeds from wages, salaries and identical incomes are appropriated in the soum budget, but only reported to the aimag authorities. The aimag would match

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[16] According to law, the tax collector shall appropriate the tax proceeds in the respective budget within the 10th of the next month. Herdsmen families and households with domestic animals are taxed twice a year and the proceeds shall enter the budget by 15 July and 15 December. Other taxpayers shall transfer the tax amount to the budget before the first 15th each quarter.

out the equivalent amount from the subsidies designated to that particular soum. This is an organizational method that may be used in aimags, where some parts of budget financing are subsidized.

The tax inspectors were observed to be using terminology different (used in their everyday work) from the one defined in the law, when reporting on personal income tax collection. For example, words like a "patent", sample tax, withholding are used. These might be common language among the professionals, but they deviate from the substance of legal terms . While reporting on personal income, individuals have few possibilities to document their income, hence the inaccurate information in the reports. Especially, the so called "sample tax", which is derived from taxation using methods for sample calculation approved by the Finance Minister, causes a lot of difficulties among citizens as they lack report-writing skills.

Firearms Tax (C2)

Tax Levy

The taxation authority excludes the firearm tax from being a local tax. The Law on Firearm Tax regulates all taxation authority (except the imposition). The Parliament has the sole authority to establish the firearm tax and its rate and to grant concession and exemption. However, the right to impose the tax rests with soum tax inspectors. The soum tax inspectors impose the tax based on the firearm registration database collected from the soum police unit. The tax inspectors in Khentii aimag complained that the firearm tax income was not realistic due to lack of coordination among state agencies and incomplete registration of firearms.

If the police unit makes true, complete registration of firearm , the respective tax revenue can be determined locally. However, the specifics of this type of tax limit the room for expansion of the tax base. Government policies on environment and hunting do not allow every citizen to own a firearm.

Tax Rate

The Law on Firearm Tax establishes the rate. MNT 4,000 is charged on shotgun and up to 6.4 mm -caliber gun, and MNT 6,000 – on all types of guns with caliber of 6.5 mm and above. These specific tax rates were introduced by the amended law of 1997 and do not reflect present real values. Local authorities do not have power to re-adjust the tax rates to meet the local conditions.

Tax Concession and Exemption

Article 5.2 of the Firearm Tax Law lists some types of firearm to be exempt from tax[17]. Also firearms owned by disabled or people without income may be exempted from taxation for a particular year by the respective soum (district) tax authorities.

In cases other than the above, local governments do not have a legal right to grant an exemption. If the right to establish the firearm tax rates differently depending on regions is given to local authorities, it may become an instrument of promotion for carrying out a local policy to protect nature and fauna. For example, citizens reported that wolves have become rare in Khentii, while in South Gobi their number has increased dangerously.. However, the two aimags impose the same rate of tax. South Gobi aimag may grant a concession to firearm taxes in order to promote a policy on hunting wolves to reduce their population.. Unfortunately, local authorities lack power to change, reduce the rate or exempt from the tax.

Tax Distribution and Reporting

The firearm tax payment and distribution are organized in the following way. First of all, the respective local police unit will report to the tax authorities on registration and change of ownership of firearms by 15 February each year. Based on this report, local tax inspectors impose firearm taxes. The taxpayers will make the tax payment before 1 August each year to the local budget. The tax proceeds directly enter the local budget account, and therefore the income distribution and reporting go without any problems. However, tax inspectors have reported that the ownership database produced by the police tended to be incomplete.

State Stamp Duty (C3)

Tax Levy

Types and rates of this tax are established by the Stamp Duty Law. Proceeds become a soum tax income source. Soum tax inspectors have a right to impose the duty. The government[18] has the right to establish the visa fee rates for foreign citizens. Though it is a soum budget revenue source, the stamp duty has a limitation as an autonomous tax income.

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[17] - Firearms displayed in museum and artistic performance, or certified by police as unusable for hunting
     - Firear ms used officially by environment guards;
     - Firearms used solely for sporting and training.
[18] Foreign Minister's Decree #55 of 2002

It is cumbersome to estimate in advance the expected amount of revenues from stamp duties to the soum budget. At present, the expected amount is planned on the basis of the previous year's revenue. The tax base is difficult to identify in detail. The factors influencing the tax imposition service are many and unstable, hence the uncertainty persists.

Tax Rate

The Stamp Duty Law gives in detail tax rates for every type of duties. For example, duties shall be charged on court settlement of legal disputes, notary services, registration of citizen's marital status, issuance of passports, permits, visas, etc. Since the stamp duty types and rates are all detailed in law, only the Parliament shall have the right to make changes and amendments.

In many countries, as a rule, this type of tax authority belongs to local self-governing administrations. In our country, however, almost all public services are provided by the central government and ministries. Therefore, their fee rates are established by law. However, the cost of providing a particular service is different in different regions, and the local administration is best suited to manage the cost recovery.

Tax Concession and Exemption

The following court filings are exemp[20] from fees:

- Claim on pension and welfare payment;
- Claim on patent and copyright;
- Claim by state organizations;
- Demand on tax payment, fees, penalties claimed by budget;
- Claim on issues to be considered upon petition.

The court may postpone or exempt or reduce the fees depending on the wealth of individuals, who have submitted the claims or petitions[21]. Fees are reduced by 60%, when an individual or a private entity requests for a patent validity of a new product or a new design, or for an extension of such patents.

Tax Distribution and Reporting

As the Law on Stamp Duty requires, state bodies shall transfer fees for a particular type of service, when its amount reaches MNT 10,000, to the respective local budget. The annual report on fee collection shall be submitted to the State taxation authorities before 10 February every year.

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[20] Article 18, Stamp Duty Law
[21] Article 18.3, Stamp Duty Law

The state organizations, however, do not categorize their service fees and w transfer the total amount of all fees in a single transaction. Therefore, the taxation authorities have a report on only one transaction as a stamp duty payment, but not on each type of services provided.

In some cases, the fees paid may be returned (for example, the court has a right to reimburse the fees paid to it). In such a case, the General Tax Authorities faces a substantial difficulty in deciding from which category of fee payment it should be reimbursed.

Usage fee on hunting stock, permit fee for hunting or catching wild animals (C4)

Tax Levy

Local authorities have a limited power in defining and levying this type of tax income. The upper and lower band limits of tax rates are set by the Parliament, and the Government establishes the nominal fees within this band[22]. The Government also approved the regulation and instructions on a revenue collection for this type of tax by its Resolution 79 of 2008. Though there is an international practice for the band limits to be established by the central government, the practice of the Mongolian Government to fix the fee rates and regulate the taxation process for the local administration (among them for soums) undermines autonomy of the taxation authority.

The hunting stock of Mongolia is distributed unevenly throughout the regions and it is problematic to count and register the number of wild animals unlike that of livestock. Moreover, weakening control over protection of rare species might lead to their extinction. That is why the related tax income varies in different regions. . It is also not a major tax base for local budgets. For example, the hunting-related fees for 2006 and 2007 constituted respectively only 0.5% and 0.3% of the local budget revenues. This share is not expected to increase, because a ban on hunting a popular wild animal – marmots – is still in force.

Tax Rate

Paragraph 10.2.4 of the Law on Central Budget identifies this type of tax as "Usage fee on hunting stock, permit fee for hunting or catching wild animals". These are two different types of tax. The Government revised these tax rates in 2005 (see Appendix 1).

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[22] Government resolutions #248 (2005) and 264 (2001)

However, local tax reports tend to present these two types of taxes, namely, "usage fee" and "permit fee"as one. On the one hand, it is related to the fact that payment from the Ministry of Environment is transferred under the name of "payment for hunting stock", so it is unclear whether it is payment for hunted animals or fees for permission to hunt. O the other hand, it is related to inconsistency in terminology used in local tax revenue. For instance, in 2008 tax reports of Bayanulgii and Hentii aimags these fees were referred to as "usage fee on hunting stock", while in 2006 they were included under name of "income from hunting".

The Parliament has the sole power to clarify and amend terminology used in legislation, while only the Supreme Court has the authority to give its interpretation.

Tax Concession and Exemption

The Law on Hunting provides for an exemption of fees in the following cases:

• Catching animals with a purpose of their relocation and breeding;
• Organized hunting and slaughtering of animals with a purpose of destroying the infection focus;
• Hunting wolves in order to protect livestock herd or to reduce their excess population;
• Temporary catching for research purposes like blood sampling, measurement, labeling, ring-marking, attaching a scientific device.

The degree of concession is established by the Central Government, which is a provision that undermines the autonomy of local taxation. The Government might implement a policy to protect rare animals and those under treat of extinction, but should not indulge in extremes of granting concession and exemption of fees on every species of wild animals.

Tax Distribution and Reporting

The fee payer shall pay the amount every time he/she gets the permit (license). The tax collector also every time shall transfer the fee amount to the soum (district) budget. The respective authorities shall present the annual report by 10 January to the soum tax office; - by 15 January to the aimag (the capital) tax office; - by 1 February to the General State Tax Department. The latter shall consolidate the nation-wide report by 15 February.

According to the established regulations[23], respective local officers shall transfer the collected fees to the local budget. However, the Ministry of Nature and

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[23] Environment Minister's Decree #32 of 2001

Environment collects fees and payment for special permits or hunting permits issued to foreign citizens. This revenue finds its way to local budgets through many hurdles.

Exhibit 2.1 Special Hunting Permit

For example, a foreigner hunted one Altai wild sheep in Buyant Soum of Bayan-Ulgii Aimag in 2008. The hunting fee was $22,000 of which only $4,000 was paid to Buyant Soum. However, it was paid after the Soum Governor had travelled to the capital and lodged a claim with the Ministry of Nature and Environment presenting a copy of the hunting license (see Exhibit 2.1) as a proof.

In accordance with Article 7.3 of the Law on Hunting Stock Payment, foreign citizens' payment for hunting a wild animal shall go to the central budget, while the hunting license fee shall be transferred to the soum (district) budget within 15 days of payment. However, this provision conflicts with §10.3.1 of the Law on Central Budget, where it says that " payment for hunting a stock and the fee for license for hunting and catching wild animals" shall be appropriated into the soum (district) budget.

Permit fee for exploitation of natural resources other than minerals (C5)

Paragraphs 10.3.5, the Law on Central Budget, and 7.4.5, the General Taxation Law, stipulate for this provision. However, it is very vague on who will establish the authority and the amount and rate. Types of this tax are not defined and classified. Also it is unclear whether the local governments have the right to establish the rate and grant concession and exemption for this type of fee.

Plant harvest charge (C6)

Tax Levy

The Law on Fees for Wild Plant Usage establishes the band of fee charges. Though the provision provides for the soum's right to establish the fee, the aimag (the capital city) Citizens Representatives' Hural (CRH) exercises it instead.

Although the aimag (the capital city) CRH has a right determine the tax income base and establish the tax rate, identification and collection of this type of tax income are not satisfactory at the local level. No tax income, for example, was registered for 2005-2007 as proceeding from the plant harvest charge.

Indifference of the local authorities with regard to identification and collection of this tax base is the reason for losing a certain tax income.

Tax Rate

The Parliament has established the lower and upper limits of this charge as follows. For a very rare plant, the charge is between MNT 300 to 1,000,for a rare one – MNT 150-500,for a common plant – MNT 50-300. Though the aimag (the capital city) CRHs have the right to establish differential rates for plant harvest, there is no aimag, which has exercised this right and registered income there from.

Tax Concession and Exemption

An exemption is granted by law to individuals, organizations and business entities, that utilize common plants, use rare and common plants for research purposes, and harvest plants for animal fodder. There is a provision in the law[24] that the aimag (the capital city) CRH shall establish the conditions, requirements and rates of these charges taking into account the specifics of respective local territories. However, local authorities have not even identified the tax base and collection procedures.

Tax Collection and Reporting

Each time when the plant usage license is obtained, the taxpayer shall pay the amount of charge in cash to the official appointed by the soum (district) Governor or in a bank transfer to the soum (district) budget. The official appointed by the Governor shall deposit the cash received to the budget account. He/she shall also present the report of the tax collection to the soum (district) tax authorities before 10 January the following year. The soum (district) and aimag (the capital

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[24] §7.2, Law on Plant Harvest Charge

city) reports shall be presented to the upper taxation authorities, respectively before 15 January and 1 February each year. The central taxation authorities shall consolidate the report by 15 February. The procedure of collection and reporting, thus, is in place, however, it is not observed by the local authorities that lack initiative and enthusiasm.

Firewood and Timber Stocking and Usage fees (C7)

Tax Levy

The Government establishes[25] the rates and the power to grant concession and exemption within the band limits stipulated by law. The local authorities do not exercise the right except to levy and collect the fees. Therefore, it is difficult to include this type of tax into local tax income.

Depending on the regional specifics, aimags widely differ in terms of forest reserves, so their tax bases vary. Local authorities are best suited to identify the tax base. Nevertheless, the highest instance decides everything, which makes the local initiative redundant. On the other hand, the forest reserve is shrinking rapidly and the reforestation works are slow, which means the related tax income cannot become a stable tax base.

Tax Rate

The rate of firewood and timber fees is established by the central government, not the local authorities (see Appendix 2).

Tax Concession and Exemption

An exemption is granted when wood is cleaned for the purpose of protecting forestation lands and spring water sources, and when the forest guardian needs timber for building a work shelter. The concession is established by the Government[26] in the following way:

Tax Distribution and Reporting

Entities, organizations and individual citizens shall pay the fees in cash to officials appointed by soum (district) governors or in bank transfer to soum (district) budget before obtaining the right to stock timber and firewood. The officials appointed by governors shall present the tax report to the soum taxation office by 10 January the following year. The soum report shall be forwarded to the

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[25] Government Resolution #147 of 2005
[26] Ibid.

aimag (capital city) taxation authorities by 15 January. The aimag (capital city) report shall be presented to the central taxation authorities by 1 February. The latter shall consolidate the national report by 15 February.

Table 2.2 Rates of Concession for Firewood and Timber Fees (in %)

	Indicators	Unit	Zones and Concession Rates			
			1	2	3	4
1	To stock tree stubs and fallen trees for firewood with a cleaning method	%	40	40	50	60
2	To collect fallen branches and twigs by cleaning: 1. For citizens and non-professional entities a/ coniferous trees	%	30	40	50	70
	b/ deciduous trees	%	20	30	40	50
	2. For professional timber entities for their own firewood and timber usage	%	20	30	40	60
3	To stock firewood and timber by nursing forest aged above Class 2 of Age Classification	%	20	30	40	60

Exploitation fee for common minerals (C8)

Tax Levy

The central government ministries[27] exercise the right to establish the types of this tax. The local authorities establish the rates of the tax. For example, the Khentii aimag CRH set up the tax rates by its Resolution #02 of 2004. The Bayankhutag Soum CRH also established the rates (its Resolution #31 of 2005). Since this is a tax designated for the soum budget, the Soum CRH decision was correct. However, when the aimag CRH has already set up the rates, the soum decision was redundant.

If the local authorities conduct a comprehensive study of this tax type, it may become possible to determine and calculate the size of potential income.

Tax Rate

The joint Decree #A/121/88 of 1998 by the ministers of Food and Agriculture and Nature and Environment stipulates for levying taxes on exploitation of brick clay, sand, gravel, quartzite, construction stones, lime, dolomite, volcano rock, freestone, and similar minerals.

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[27] Joint Decree #A/121/88 of 1998 of the Ministers of Food & Agriculture and Nature & Environment

Varying tax rates are set up by the aimag, capital city CRH in accordance with law. For example, the South Gobi CRH has established the rates (see Annex 3) by its Resolution #9/5 of 2007.

Tax Concession and Exemption

Though the rates are established by the aimag CRH, there are no provisions on granting concession and exemption. The soum authorities do not possess the right on concession and exemption, which undermines the autonomy of soum taxation.

Tax Distribution and Reporting

Taxpayers shall pay the fees at rates established by the aimag (capital city) CRH. The soum tax inspectors shall levy the exploitation fees and shall transfer the proceeds to the soum budget. Since the tax income is appropriated directly into the soum (district) budget, no complication arises in terms of distribution.

Water and Mineral Water Usage Fee (C9)

Tax Levy

The right for and limits of tax concession are established by law. The Government determines the rates for water usage fees within these limits. The aimag CRH has the right to set up the usage fees for mineral water. However, a fact that the government and the aimag CRH set up fee rates for soums undermines soum tax autonomy.

The water usage fee is a potential budget income generation tax in regions, where mining is thriving. However, with exception of Ulaanbaatar, Darkhan and Uverkhangai, there are no aimags, where mineral water usage fees contribute to budget revenues. It is related to neglect by local authorities of the need to determine the tax base and to collect respective fees.

In planning for tax income, the proceeds from the previous year become the base for calculations.

Tax Rates

The Government sets up the water usage fees[28]. Mineral water usage fees are established by aimag (capital city) CRH in accordance with law. However, Khentii, South Gobi and Bayan-Ulgii aimags do not have such practice.

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[28] Government Resolution #7 of 2005

Table 2.3 Water Usage Fees

№	Designation of Water Usage	Unit	Water Usage Fees	
			Surface Water	Underground Water
1	As percentage of revenues from production and services for usage of water in hydropower stations, water transportation, water sports, farming of common aquatic animals and plants	-	1.0 хувь	-
2	Heavy industry	m³/MNT	20.0	30.0
3	Light industry	m³/MNT	10.0	30.0
4	Mining				
	-Gold and tin mining		80	100
	-Oil mining, zinc and lead enrichment	m³/MNT	80	100
	-Copper concentrate, fluorspar enrichment		80	100
5	Food production			
	-non-alcoholic beverages	m³/MNT	10.0	30.0
	-others		10.0	30.0
6	Entities and citizens engaged in business production and services for profit			
	1/In Ulaanbaatar, Darkhan and Erdenet		10.0	30.0
	2/In aimag centers and other towns of Bayan-Ulgii, Khovd, Uvs, Huvsgul, Bulgan, Selenge, Tuv, Zavkhan, Arkhangai, Uverkhangai, Dornod, Khentii	m³/MNT	10.0	10.0
	3/In aimag centers and other towns of Bayankhongor, Dornogobi, Dundgobi, Sukhbaatar, Gobi-Altai, South Gobi		10.0	30.0

Tax Concession and Exemption

An exemption is granted when water is used for drinking and household purposes, for watering of domestic animals and irrigation of household vegetable and crops plots, for fighting fire and other natural calamities, also in case of re-usage of water for production.

The law also contains a provision[29] for the Government to grant concession in cases when water is purified before use or is used for protection and breeding of wildlife, for planting different plants in order to restore natural resources.

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[29] §8.2 of Law on Water and Mineral Water Usage Fees

With regard to mineral water usage, the local authorities have a right to grant concession and exemption, which is rarely exercised since issues of determining and levying the tax have not been resolved.

Tax Distribution and Reporting

Payers of water and mineral water usage fees shall determine themselves the amount of monthly fee and deposit it to the local budget before the 10th of next month. They shall also consolidate the annual report by 10 January each year and file a tax return. Soum (district) tax inspectors shall supervise this process. The inspectors shall report on soum (district) tax income by 10 January to the soum (district) tax authorities that in turn shall report to aimag instances by 15 January. The aimag (capital city) tax authorities shall present their reports to the central taxation department by 1 February. The latter shall consolidate the report by 15 February.

Though the taxpayers shall determine their taxable income, in practice there are many discrepancies in filing and reporting. The taxpayers often fail their responsibilities. Therefore, collection and reporting on water usage fees is usually complicated.

Personal income tax on street vendors and small businesses (C10)

Tax Levy

This is a part of the personal income tax. All taxation authority in this respect belongs to the Parliament. The levying and collection rights, however, remain with the local government. Therefore, this type of tax income cannot be considered purely an autonomous local tax source.

In practice, the planning for this revenue source is based on the actual proceeds from the previous year, because it is difficult to pre-determine the tax in advance. This tax consists of types of tax revenue (called a patent tax) established by law and model types of tax revenue identified by the Finance Ministry (called a sample tax). Since individuals often do not have skills to file and report on their taxable income, such problems as late submission of reports etc take place and it is difficult for local authorities to determine the tax base and plan for revenue size.

Tax Rates

Monthly rates for personal income tax on street vendors and small businesses whose production and services can not be categorized for the tax purposes are

established by law[30] (see Appendix 4). These types of related taxes are called and reported by inspectors as "Patent Tax".

Model taxes on production and services, not regulated by contracts with entities, organizations and individuals, are established by the Finance Minister's Decree 55 of 2002. These taxes are called and reported by inspectors as "Sample Tax".

The law also stipulates the following tax rates for each instance of international passenger and cargo transportation.

Table 2.4 Tax Rates for International Passenger and Cargo Transportation

Types of Work and Service	Tax Rates (in MNT)	
	Via Zamyn-Uud and Altanbulag Border Crossing	Other Border Crossing
1. For each instance of international passenger transportation:		
a) By passenger car up to 4 seats	10 000	6 000
b) By passenger vehicle up to 8 seats	12 000	8 000
c) By vehicle up to 16 seats	14 000	10 000
d) By bus	18 000	12 000
2. For each instance of cargo transportation:		
a) By vehicle with 1-3 tonnage	16 000	10 000
b) By vehicle with 3-5 tonnage	18 000	12 000
c) By vehicle with 5-8 tonnage	20 000	14 000
d) By vehicle with tonnage over 8	22 000	16 000
e) By tractor	10 000	4 000

Tax Concession and Exemption

There is no provision on concession and exemption in the Law on Personal income tax on street vendors and small businesses whose production and service can not be categorized for the tax purposes. Therefore, these issues shall be regulated by the Law on Personal Income Tax.

Tax Distribution and Reporting

Individuals engaged in such businesses shall register with the local tax authorities and make the tax payment in cash or bank transfer. The payers of the "sample tax" as established by the Finance Minister shall pay each month MNT 10,000 in Ulaanbaatar; MNT 8,000 in Nalaikh, Baganuur, and central soums and permanent

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[30] Law on Personal income tax on street vendors and small businesses whose production and services can not be categorized for the tax purposes

border crossing points of Darkhan-Uul and Orkhon aimags; and MNT 4,000 in all other administrative units, as an advance payment and shall register and obtain a certificate as a taxpayer. The taxpayers shall report quarterly by the 15th of the first month of the next quarter and annually by 10 February the following year to the local tax authorities. Their taxable income shall be calculated in accordance with the methodology established by the respective Minister.

The tax payment and reporting are regulated as above. However, in practice individuals fail to file the tax return or do not have the ability to file it or their businesses tend to be temporary. Therefore, many difficulties exist. The tax distribution, nevertheless, is not complicated due to the direct appropriation of related revenues into the soum (district) budget income account.

Research into the above taxation authority reveals that the so called local tax types contributing to the local budget are all established by the central government authorities. In other words, there is no single tax that would possess all attributes[31] of a truly local tax. Especially, the types, rates, and concession and exemption authority for aimag-level taxes are centralized by the central government. Some of the soum taxes (for example, usage fees for plants, water, mineral water, and common minerals) are established by the aimag CRH in accordance with the law. This means that the soum taxation authority is overtaken by the upper instance and its authority is limited.

The local governments exercise their authority to levy and collect respective taxes and most of the proceeds directly go into their local budget. Only mineral royalty and exploitation and exploration license fees are centrally appropriated and then re-distributed by the central government. In other words, local taxes only have such attributes of classical local taxes as authority to levy and collect.

Some types of taxes such as permit fees (C5) for usage of natural resources other than minerals, municipal taxes, a dog ownership charge, inheritance and gift taxes are not regulated by legal acts at present. In other words, the authority for these taxes is not yet established. Some inconsistency is also observed in terms of legal provisions. For example, the Law on Central Budget stipulates for the usage fee for hunting stock and the license fee for animal hunting and catching as the two sources of soum budget revenues. However, the Law on Hunting Stock Usage Fee designates the hunting fee as the central budget source and the license fee as the local budget source.

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[31] (i) levied by local government; (ii) rates established by local authorities; (iii) collected by local authorities; (iv) the revenues proceeded to local budget

2.3 AUTHORITY OF NON-TAX REVENUE

This chapter looks at the definition of each particular type of non-tax revenue, which is stated in the Law about Consolidated budget of Mongolia, and legislation related to non-tax revenue and scope of their regulation.

Local non-tax revenue shall consist of the following revenues[32]:

1. Income from dividends from business enterprises with local ownership
2. Payment for use of local property, income from interests and penalties
3. Financing for output commissioned by the portfolio minister from state budget funds
4. Other revenue to be collected for aimag or capital city budget according to law

Although the law states in general these four types of revenues, in the tax return for Tax authority the following types of revenues should be shown in more detail:

1. Income from dividends from business enterprise with local ownership
2. Revenue from interests and penalties
3. Own income of State budget organizations
4. Revenue from rent and tenancy
5. Revenue from sale of property
6. Revenue from privatization
7. Other unclassified revenue

Therefore, related authority, legislation, its legal scope of each of these detailed revenues are studied in this chapter.

According to data from the local Tax authority, a number of problems such as contradiction between and misplacement of different types of non-tax revenues is observed. For example: Revenue from rent was classified in as "Rent revenue" in Umnugovi aimag, but in Khentii aimag it was stated in "Other unclassified revenue" for the financial statement.

Dividends from business enterprises with local ownership

If there is local property in the share capital of any business enterprise, the local autority has a right to receive dividends. However, a decision on the issuance of dividends and its amount per share is made by the majority of shareholders of that entity. In other words, shareholders decide whether dividends shall be

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[32] 10.2 of Law on State unified budget

issued. Whether local authorities receive dividends also depends on the decision of common shareholders and shareholders with preferential rights.

Of selected aimags, Unmugovi aimag holds 51% of shares in the Tsogttsegtsii coal mining company and has been receiving dividends every year. It received 6.0 million tugrugs worth of dividends in 2008. The Bayan-Ulgii aimag power station is partly locally owned, but it has not issued any dividends yet.

Revenue from interests and penalties

Interests and fines are the penalty from state autority for people, who violated law in local territories.

Income from interests and penalties comes in large part from three subjects: the Tax authority, the State professional inspection organization, and the Police department.

These organizations impose interests and fines according to the following laws:

A. Tax administration
   - Taxation law of Mongolia
   - Law on Administrative penalty of Mongolia
B. State Professional Inspection
   - Law on State inspection
   - Law on Administrative penalty of Mongolia
   - Labour law of Mongolia
C. Police
   - Law on Administrative penalty of Mongolia
   - Law on traffic of Mongolia

The amount of interest and fines is planned by the local authorities on the basis of an average income from fines, but related employees are not forced to accomplish this amount as a target nor it is viewed as a performance indicator.

In approximate estimation[33], most of the revenue from interests and fines is collected by the local Tax authority and the State professional inspection organization and the rest of revenue is provided by the Police department.

Own income of State budget organizations

According to the Public management and financing law, local govnernment units have aright to earn income from additional activities besides their main

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[33] Local tax administration do not book by organization, so the clear amount can not be estimated.

operations, so some local organizations provide some kinds of services to generate income.

State organizations make earn income from additional activities such as carrying out detailed research and data on commission, sales of publications, copying materials, sales of food products from their farms. The prices and types of recompenced services should be defined by by-laws of these organization.

On the other hand, asking for compensation for provision of services is improper, because the basic obligation of public organizations is to provide services to people. If state organizations are required to collect pre-planned high amounts of revenue, there is a danger of them following an improper principle of charging their services to population. In every aimag public organizations have their own revenue, but they differ in different aimags.

Revenue from rent and tenancy

If it is not against their interests, local organizations have the right to allow someone to temporarily use its property in order to generate income. The tenancy should be based on the decision of Citizen's Representatives' Khural of the territorial and administrative unit. The most regular type is rent of buildings and other structures.

The amount, terms of payment and other general regulations related to rent are determined in the frame of general regulations developed by the Citizen's Representatives' Khural, and specified by the Rent agreement between the local autority and the renter.

While certain income from rent was received in Govi-Altai, Tuv, and Dornogovi aimags, other aimags did not have this type of income.

Income from sale of property

This is imcome from sale of local property based on the decision of the Citizen's Representatives' Khural. Sale of property includes sale of movable and immovable properties, equipment etc.

In reality, there is almost no sale of property at local level in Mongolia and according to the Ministry of Finance report on budget income performance in 2006 to 2008, a few cases of sale of local property took place in Bulgan, Dornogovi, Umnugovi, Govi-Altai, Orkhon aimags.

Income from privatization

During the transition to the market economy, privatization of local property took place Mongolia, but in recent years, it was done rarely because privatization has

finished in general.

The Citizen's Representatives' Khural decides whether property should be privatized and determines the price of property and forms of payment, then the local privatization comission implements the process.

According to the Ministry of Finance report on budget income performance, some privatization took place in Tuv, Dornogovi, Govi-Altai aimags in the last three years.

Other unclassified revenue

There are no regulations that describe what kind of revenues should be included in this group, so every aimag reports according to their standard practice. Local tax inspectors explain that revenue received once as a result of certain activity are usually included in this classification.

Income from rent, own income of State budget organizations, interests and fines issued by the fire brigade were classified as a "other unclassified revenue" in the reports from local tax authorities.

If non-tax income is examined in general, local governments have three types of non-tax revenue that are within their power: revenue from privatization, sale of property and rent. Income from privatization and sale of property is very limited and as at present privatization and sale of local property have been finished, this type of revenue will not be there in the future.

Rates of interests and fines are defined by the parliament, so local governments have no right to redefine or lessen the rate.

Dividends from business entities with local ownership could present an opportunity to increase the local budget revenue. However, there is a danger that the local administration might engage in business activities using their advantage over other private businesses, so that the market system can be disturbed. Therefore, owning a share in such local business entity as a power station, which is difficult for private businesses to run on their own would be more effective.

Own income of state organizations is usually quite small and local authorities do not decide what the amount of revenue should be.

As a conclusion, revenues from privatization and property sale are disappearing and local authorities have no right to take part in process of defining authority of non-tax revenue types other than the rent revenue.

3. ANALYSIS OF LOCAL BUDGET REVENUE

The state budget revenue has been increasing for the last few years, while the percentage of local budget revenue in the total budget and GDP has been continuously decreasing.   The percentage of local budget revenue in the total income and expenditure as well as the percentage of local budget revenue in the GDP are main indicators of centralization or decentralization in any country. (See Table 3.1 and Graph 3.1.)

While the percentage of total budget revenue in the GDP increased from 33.4 percent in 2000 to 43.7 percent in 2008, the percentage of local revenuein the GDP decreased from 6.5 percent in 2000 to 2.8 percent in 2008. The percentage of the local revenue in the total revenue has had a similar dynamics of change decreasing from 19.2 percent in 2000 to 6.4 percent in 2008.

*Table 3.1   Percentage of the local revenues in the GDP and total
                 expenditure, 2000-2008*

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total revenue/GDP	33.4	37.2	37.9	36.8	36.3	36.7	34.5	39.4	43.7
Local revenue/GDP	6.5	7.6	8.4	3.2	3.1	3.1	2.3	2.8	2.8
Local revenue/total revenue	19.2	20	21.6	8.6	8.4	8.5	6.4	6.9	6.4
Local expenditure/ local revenue	196.8	183.4	161.1	105.4	115.4	111.8	109.4	106.7	127.7

Source: Calculations are based on the data from the draft budget for 2008.

Moreover, a fact that the ratio between the local expenditure and local revenue decreased from 196.8 percent in 2000 to 127.7 percent in 2008 is related to transfer of basic social service issues such as education, health, culture and social welfare from local competence to the respective ministries under the Law on Management and Financing of State Budget Organizations (LMFSBO). In general, implementation of the LMFSBO caused reduction of local responsibilities and expansion of the size, power and budget of the central government, its ministries and agencies thus leading back to centralization.

Graph 3.1 State and local budget revenue's percentage in the GDP
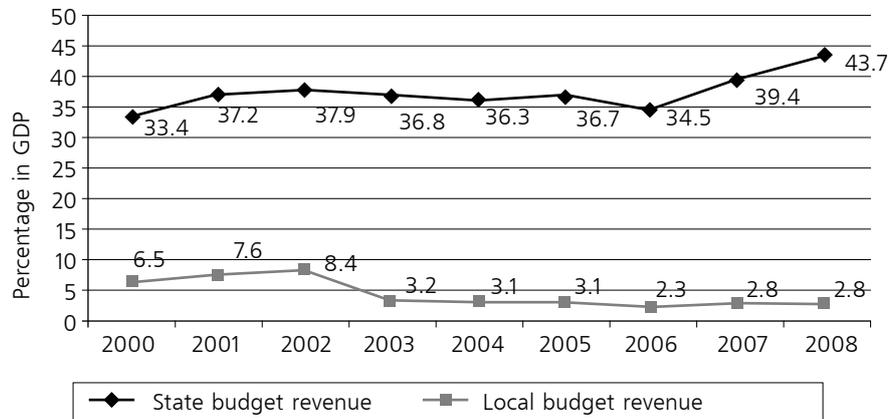
Transfer of financing of health and education services to the central government had certain positive effects such as timely financing of the services, absence of budget losses during the last years and improvement of the budget expenditure discipline, which cannot be denied. These positive outcomes were a result of establishment of uniform standards for service expenditures, establishment of the unified system of the state fund and improvement of supervision of expenditures. However, as the life shows they should not free local authorities from responsibilities related to provision of the above services to the electors and the solution can not be reached by centralization of powers.

According to researchers weakening of responsibility and initiative of local governments with regard to these services, impossibilty to make financing flexibly in accordance with the local conditions, over-supervision of expense administration resulted in a number of negative economic, financial, administrative and political consequences such as weakening of initiatives to save expenses ,impossibility to make a shift between different items of expenditure , weakening of the unity of the governance of an administrative unit, contraction of its role in the country's development, inability to solve any issues related to these services promptly at the local level, and weakening of the political accountability of the local governments . Many research reports, presentations and dicussions demonstrate such consequences.

Table 3.2 demonstrates indicators of centralization vs decentralization in foreign countries, including member states of the Organization of Economic Cooperation and Development. The average indicator of local budget expenditure in the GDP is 10-15 percent and the percentage of the local budget expenditure in the budget expenditure is 20-25.

Table 3.2   Percentage of the local budget expenditure in the GDP and in the budget expenditure

Country	Percentage of the local budget expenditure in the GDP	Percentage of the local budget expenditure in the budget expenditure
Scandinavian countries	16-30	35-50
USA and UK	8-10	20-22
Germany, France and Canada	6-7	15-18
New Zealand, Mongolia	3	8

Source: Anwar Shah, Local governance in industrial countries

The total local budget revenue has increased by 14.5 bln tugrugs in the past 5 years with the highest increase of 44.4 bln tugrugs in 2007, which is directly related to tax revenues, including income from minerals royalties.[34]

Graph 3.2   Total revenue of the local budget, current revenues, tax revenues and non-tax revenues in the budget expenditure

	2003	2004	2005	2006	2007	2008 rev.	2009 pla.
■ Local budget revenue	70.6	85.7	92.3	100.7	145.1	142.9	225
■ Current revenue	67.1	81.2	88.2	95.7	138.4	138.1	220.9
▨ Tax revenue	45.9	62.8	71.9	79.3	114.2	121.9	203.0
☐ Non-tax revenue	21.2	18.4	16.4	16.5	24.3	16.2	17.9
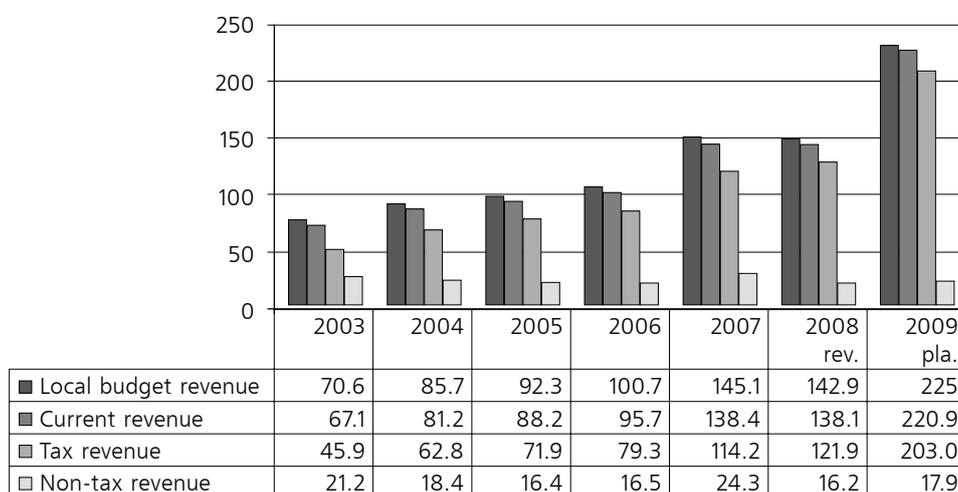
Souce: Data from the report of the Ministry of Finance

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[34] These numbers are calculated in comparison with 2008 data. Note: the data in the report are taken based on the comparison of the years for these data and the inflation rates of other years. See the methodology in Appendix #5.

The percentage of the tax revenue in the total budget revenue has increased to 65.03% - 78.65% of the total local budget revenue in the last 5 years. Meanwhile, the non-tax revenue has been continuously decreasing for the past 5 years from 29.9% of the total revenue in 2003 to 16.7% in 2007 and to 11.3% according to the revised budget for 2008. In other words, the percentage of the tax revenue in the total local budget revenue has increased and the percentage of the non-tax revenue has decreased. But the percentage of the soums and districts' tax revenue in the tax revenue has increased from 30.4% in 2003 to 40% for the last years. In other words, even at the local level the major part of the budget revenue is centralized at aimags and their revenue allocation is not even.

Graph 3.3   Weight of aimags, capital city, soums and districts` tax revenue in the total local tax revenue
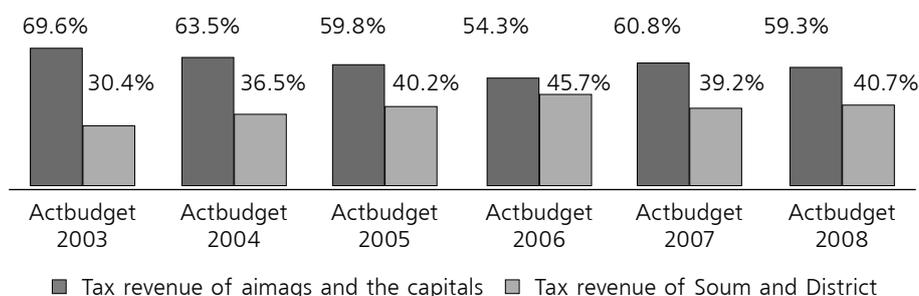
Source: Analysis is based on the budget revenue data from the Ministry of Finance

The analysis of the current local budget revenue in Mongolia raises the following questions:

- Are the aimags and soums' budgets autonomous in terms of planning and expenditure?
- Is there any permanent local income source or tax basis?
- Can the tax basis be a permanent income source?
- Are the tax revenues different across regions and administrative units?
- What is the main tax that forms the local budget revenue?

In order to find answers to these questions, a study was conducted based on data from 4 example aimags covering 8 soums, 2 soums from each aimag, taking into account their budget revenue differences, centralization, infrastructure, regional peculiarity and remoteness, thus avoiding expansive budgetary and financial research covering all administrative units in Mongolia. The soums are selected as a central one and a remote one.

Table 3.3 Aimags and soums covered by the study

Aimag	Soum	Comment
Khentii	Kherlen	Central
	Bayankhutag	Remote
Bayan-Ulgii	Ulgii	Central
	Buyant	Remote
Umnugobi	Dalanzadgad	Central
	Khanbogd	Remote
Orkhon	Bayan-Undur	Central
	Jargalant	Remote

In order to have an effective and accessible study, it was important to make an analysis based on budget statements and data of four aimags of different regions including two different soums of each aimag, to personally meet relevant authorities, to take records and clarify reasons of problems. With regard to the survey outcomes it was important to analyse local budget revenue at two basic levels of aimags and soums considering each tax revenue.

3.1 ANALYSIS OF THE AIMAG BUDGET REVENUE

This chapter studies in detail dynamic growth of taxes in aimags and the capital in 2003-2008, differences between aimags with respect to growth and decline of certain types of taxes for the respective years and factors that effected such situation based on the examples of Bayan-Ulgii, Khentii, Umnugobi and Orkhon aimags.

The study determined the percentage of the aimags and capital's tax revenue in local budget revenue in the selected four aimags, its future trends, the income base of the given tax, factors affecting it.

In order to compare tax revenues over years, the real revenue was determined by comparing data of the previous years with 2008 using an inflation index.

The structure of the tax revenue for the last three years in the selected aimags demonstrates that while the tax revenue derived from minerals constituted 21% of the local tax revenue in 2006, its percentage inreased rapidly up to 49% in 2007 and to 60% in 2008. According to Attachment #9, the percentage of revenues from related taxes also increased twice every year. The major growth of revenue from minerals royalties occured in Orkhon aimag and the growth of revenue from license payments occured in Umnugobi and Dornogobi aimags. Revenue from minerals related taxes rapidly grew over the last 2 years thus increasing local tax revenue.

*Graph 3.4   Weight of aimags' taxes in the total tax revenues in aimags and
              the capital*
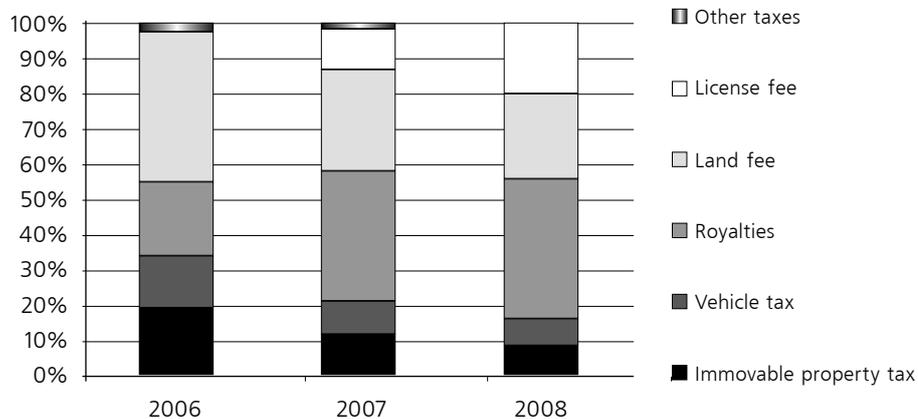
Source: Data from the Ministry of Finance for 2006-2008

However, the percentage of revenue from real estate tax, land fee and tax on vehicles and other means of transport in the aimags tax revenue decreased every year despite the growth of taxes every year. While the major part of the real estate tax and land fees was collected in Ulaanbaatar and Orkhon aimag, the major part of the tax on vehicles and other means of transport was collected in Ulaanbaatar alone. The Erdenet mining corporation is the main contributor to the local tax revenue in Orkhon aimag.

As the above data shows, the major part of revenue from minerals-related tax comes from areas with vast natural resources that are exploited, while the major part of revenue from real estate tax, land fees and tax on vehicles and other means of transport comes from Ulaanbaatar city with the highest concentration of population.

Let us look at the dynamics of growth of aimag and the capital city tax revenue in 2003-2008 by each type of the tax.

Immovable property tax

The rate of the immovable property tax has not changed since its adoption in 1997. While in 2004-2006 real revenue from the real estate tax to the local budget was at permanent rate of 8.9 bln tugrugs in average, it started to increase a little from 2007 – in average by 1 bln tugrugs. However, while the percentage of immovable property tax revenue in the local budget revenue was decreasing by 1% in 2003-2006, it started to decrease by 1.5% from 2006 thus it is likely to drop down until 3.5% in 2009.

Graph 3.5   Immovable property tax (comparative prices for 2008, in billion tugrugs)
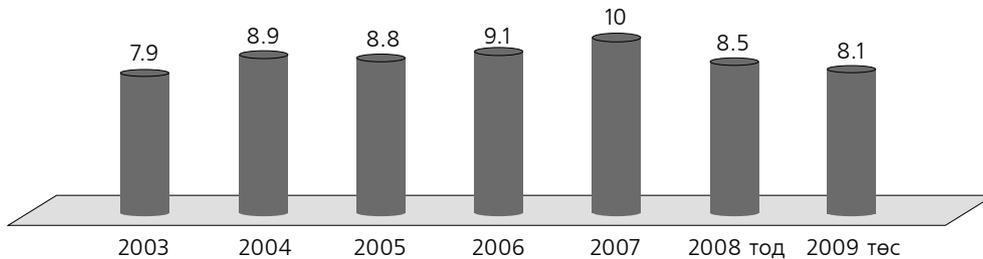
Source: Data from the reports by the Ministry of Finance

As business enterprises do evaluation of their fixed assets once in 5-6 years, the tax paid by them during the relevant years remains stable, but the real price decreases every year due to passage of time.. Though in 2003-2007 real revenue from the immovable property tax increased by 5-8%, it has a tendency to decrease in 2008 and 2009.

This demonstrates that though the percentage of immovable property tax in local budget revenue is decreasing due to increase of real revenue of the local budget, the real revenue is stable staying at 9 bln tugrugs in average every year.

Graph 3.6   Percentage of immovable property tax in local budget revenues, 2003-2009
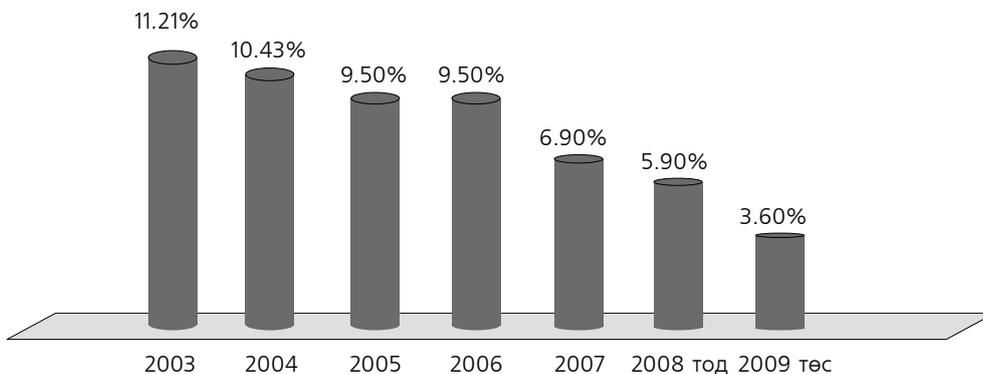
Source: Data from reports by the Mnistry of Finance

According to the study of revenue generated by immovable property tax in aimags in 2007, its percentage was 60.4% in Ulaanbaatar, 18.4% in Orkhon aimag, 4.7% in Darkhan-Uul aimag and 0.27-3.0% in other aimags., Ulaanbaatar city with the highest concentration of population, collects the most. In Orkhon aimag, buildings of the Erdenet mining corporation are the main source for the immovable property tax revenue.

Graph 3.7   Immovable property tax revenue (by aimags, 2007)
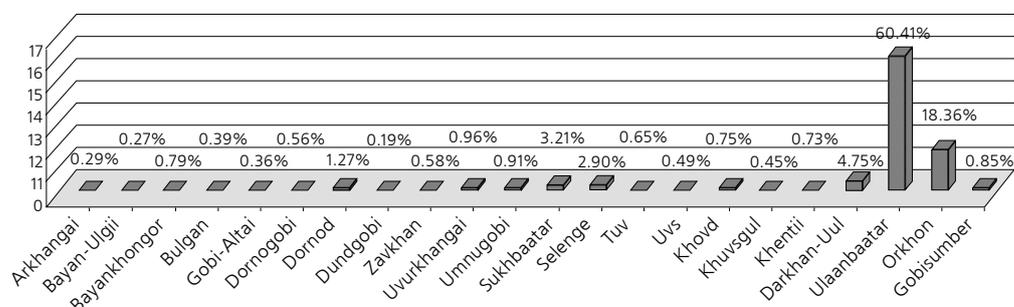
Source: Data from reports by the Ministry of Finance

Immovable property tax revenue is derived from buildings used by organizations and individuals for business purposes and land privatized to individuals freely.

In the selected aimags, revenue from this type of tax and their percentage in local budget revenues vary across the aimags. (See Appendix #6)

The average amount of revenue from immovable property tax is 20.0 mln tugrugs in Bayan-Ulgii aimag, 60.0 mln tugrugs in Khentii aimag, 100.0 mln tugrugs in Umnugobi aimag and 1.8 bln tugrugs in Orkhon aimag. As one of the biggest mines in the world – the Erdenet mining corporation – is located in Orhon aimag, its revenue is far higher than in other aimags. In Umnugobi aimag, the coal mine located in Gurvantes soum generates about 10% of the aimag's revenue from immovable property tax. Also other small mines contribute to the immovable property tax revenue to certain extent.

In contrast to other aimags, Bayan-Ulgii aimag does not have big mines. Many of its soums do not contribute any revenue from immovable property tax. All these circumstances lead to low revenue from immovable property tax. In Khentii aimag, soums contribute quite evenly from immovable property tax. Delgerkhaan, Tsenhermandal and Binder soums collect 2.0 mln tugrugs from immovable property tax and the Berkh village collects 8% of the aimag's revenue from immovable property tax.

Immovable property tax calculations (see Appendix #9) are made based on revenue estimations from immovable property tax to be collected from land owned by individuals and tax from buildings.

At present when each household owns 0.07 hectares of land, the real estate tax of 240 tugrugs paid to the aimag and 40 tugrugs paid to the soums every year is too low. It is even more evident if compared to the 300 tugrugs fare for public transport service.

Example 1
... It is meaningless to spend so much money in order to receive such low fees. Therefore, it is necessary to increase the amount of fees...

/Khentii aimag/

Though land ownership by individuals has increased in aimags, this type of tax revenue cannot significantly increase the local budget revenue.

To sum up, most of revenue from immovable property tax comes from real estate tax imposed on buildings, which leads to high tax revenue mostly in the areas with mines and large enterprises. Also, relatively high revenue from immovable property tax is derived from aimag centers with higher population concentration.

The following factors were examined in order to determine if this type of tax will contribute to sustainable local income and if its volume   will increase.

Although the percentage of the tax and the number of tax payers directly affect the volume of tax revenue, development of infrastructure and a potential for a new large plant or mine to operate in near future in the area are also important factors to influence tax revenue to a certain extent, though not directly.

According to the evaluation of infrastructure development, Orkhon aimag was evaluated as "very good" as it has   a paved road and a railway, Khentii aimag was evaluated as "good" as it has   a paved road, and Bayan-Ulgii and Umnugobi aimags were evaluated as "satisfactory" as they don't have either paved   road or railway. Population is also estimated to grow   with development of infrastructure.

It is possible to reduce concessions granted for immovable property tax imposed on the land owned free of charge by individuls and thus to increase the tax rates. . In other words, taking into account a fact that more than 10 years have passed since adoption of the Immovable Property Tax Law and the currency rate dropped to certain extent in that period, it is possible to significantly increase the immovable property tax revenue from local land ownership by reducing the percentage of concessions provided by Article 7 of the Immovable Property Tax Law.

Though the tax payment from buildings may increase following the increasing price of the immovable property, business entities usually do not make   re-evaluation of their immovable property. It is possible to increase the current rate of 0.6%. Therefore, aa conclusion was made that all aimags"have a possibility" to increase evaluation per unit.

We had interviews with local authorities and citizens to study whether there was a potential for establishment of new major enterprises and mines in the given area in near future. Umnugobi aimag, where a number of mines are going to

start operations and Khentii aimag, where there were rumors of a few new mines were assessed as "having a potential" . Bayankhongor and Orkhon aimags were assessed as "unclear", because there were no major mines or enterprises to be built in these aimags.

The aimags were evaluated evenly as "good", because this type of tax is paid from immovable property located in their territories thus being a long-term source for this type of revenue in these aimags.

*Table 3.4   Evaluation of the factors to influence the immovable property
                tax revenue*

№	Criteria	Khentii	Bayan-Ulgii	Umnugobi	Orkhon
1	Potential for increase of the tax basis	Good	Satisfactory	Good	Satisfactory
2	Development of infrastructure	Good	Satisfactory	Satisfactory	Very good
3	Potential for increase of the tax per unit	Possible	Possible	Possible	Possible
4	Tendency for population growth in near future	Good	Satisfactory	Satisfactory	Good
5	Potential for generation of long-term stable revenue	Good	Good	Good	Good
6	Potential for major enterprises and mines	Possible	Unclear	Possible	Unclear
	Evaluation of the potential of tax revenue growth	Good	Myy	Good	Satisfactory

If we summarize these factors, the potential for growth of immovable property tax revenue is evaluated as "good" in Khentii and Umnugobi aimags, "satisfactory" in Orkhon aimag and "bad" in Bayan-Ulgii aimag. Attention should be paid to other factors affecting growth of tax revenue such as local administrative capacity, their efforts, accountability.

Revenue from immovable property tax constitutes in average 10% in Orkhon aimag and in average 1.5-3.0% in other three aimags. Even if new mines are built in these three aimags and immovable property evaluation goes up , their revenue from immovable property tax may reach at the most 10% of the local budget revenue.

Therefore, aimags with good infrastructure, major mines and enterprises have a potential for growth of revenue from immovable property tax.

Vehicle and other automotives tax

The rate of this type of tax is imposed under the 1997 amendment. However, due to the increase of the number of automobiles by 10.0 thousand every years, this type of revenue has been increasing every year reaching 7.8 bln tugrugs in 2008, which is twice higher compared to 2003.

Graph 3.8   Vehicle and other automotive tax (comparative rates by 2008, in bln tug)
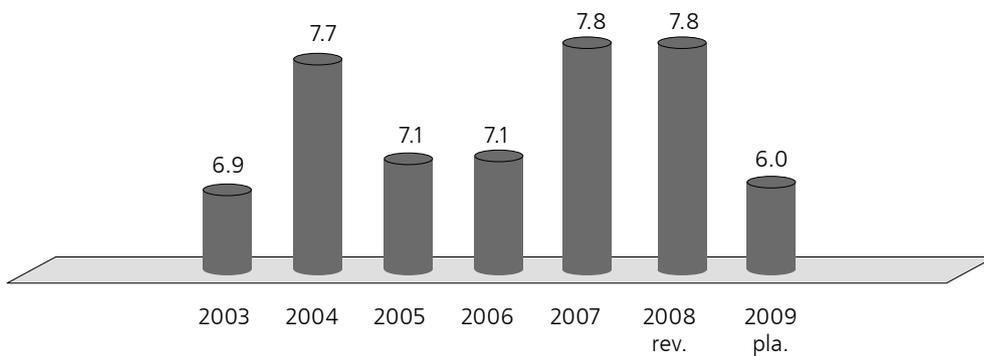
Source: Data from reports by the Ministry of Finance

Nevertheless, the percentage of this type of tax revenue in local budget revenue decreased every year reaching 5.5% in 2008 down from 9.7% in 2003. This is related to increase of the local budget revenue and the unchanged tax rate.

Graph 3.9   Percentage of vehicle and other automotive tax in local budget revenue (2007)
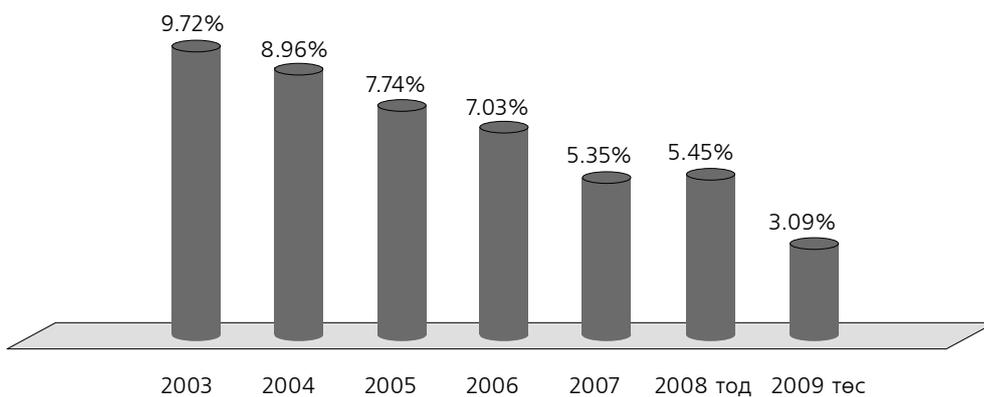
Source: Data from reports by the Ministry of Finance

60% of this type of revenue is collected in Ulaanbaatar. In other aimags the percentage is comparable – approximately 1.2-3.4%.

Graph 3.10   Revenue from vehicle and other automotives tax in aimags (2007)
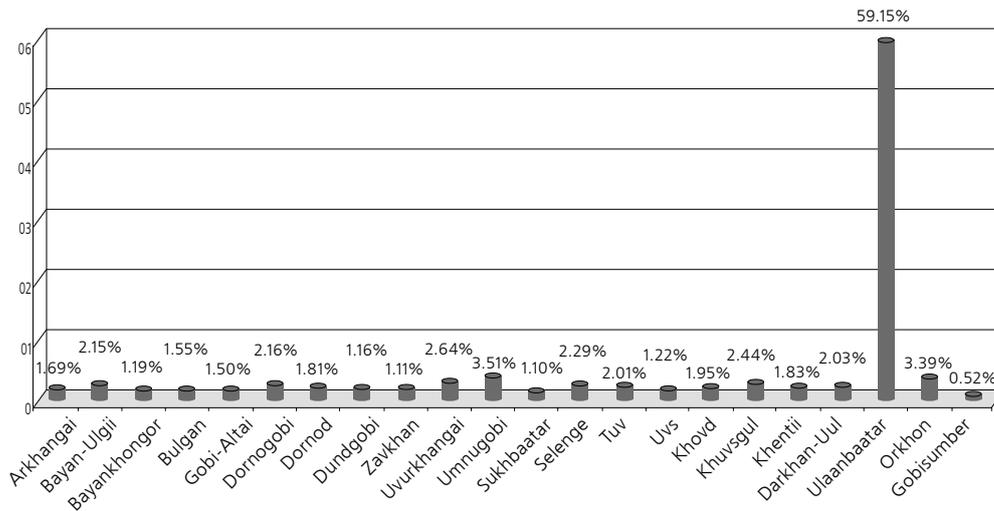
Source: Data from reports by the Ministry of Finance

This type of tax is imposed on all types of automobiles owned by individuals based on the capacity of their engines. No concession is granted on this type of tax.

The table in appendix 6 demonstrates main indicators of the tax in the selected four aimags.

Orkhon and Umnugobi aimags have a relatively high volume of this type of tax revenue – in average 250.0 mln tug each. Khentii and Bayan-Ulgii aimags collect in average 140.0 mln tugrugs each. The volume of tax revenue in Umnugobi aimag rose sharply up to 70.0 mln tugrugs in 2007 and 140.0 mln tugrugs in 2008. In other aimags the growth is low remaining at 10.0-30.0 mln tugrugs. In some aimags the volume has even decreased.

Examination of vehicles of major organizations in soums and other rural areas is conducted by representatives of aimag authorities.. The vehicles are recorded in the column "division" of the tax office records. While in 2007 revenue from the tax on vehicles was 110.0 mln tugrugs , it increased twice in 2008 reaching 220.0 mln tugrugs. This demonstrates that the major part of tax revenue growth is generated from new mining companies established in rural areas. Also, the

increased volume of tax payment per household is caused by popularity of Landcruisers among Umnugobi residents.

The average percentage of the vehicle tax in local tax revenue is 1.2% in Orkhon, 3.0% in Umnugobi, 6% in Khentii and 13% in Bayan-Ulgii. The percentage of this type of tax is low in areas with a well-developed mining sector and is high in areas with a low-developed mining sector.

For each aimag, the percentage of the tax in local budget revenue has a tendency for further decrease.

Development of roads, the population size and newly established mines may have a direct positive effect on the base of this type of tax.

While five years have passed since paved roads were built in Orkhon aimag, only one year ago such roads were built in Khentii aimag. Therefore, it was assumed that purchase of automobiles will increase in the aimag in the future.

Table 3.5   *Evaluation of the growth of the tax base on automobiles and other means of transport*

№	Criteria	Khentii	Bayan-Ulgii	Umnugobi	Orkhon
1	Development of infrastructure	Good	Satisfactory	Satisfactory	Very good
2	Potential for growth of the tax volume per unit	Possible	Possible	Possible	Possible
3	Tendency for increase of population concentration in near future	Good	Satisfactory	Satisfactory	Сайн
4	Potential for generation of long-term stable revenue	Good	Good	Good	Good
	Evaluation of the potential of growth of tax revenue	Good	Satisfactory	Satisfactory	Good

The vehicle tax has been imposed according to the rate adopted in 1997. If we take into account a fact that over 10 years have passed since then and the currency rate has dropped 1.8 times since 2001, then the local budget revenue may be augmented to certain extent by increasing the tax rate per unit.

If the tax rate was increased twice, it would constitute 8-15% in the local budget revenues of Khentii and Bayan-Ulgii aimags thus increasing the local budgets significantly, while in Orkhon and Umnugobi aimags it would bring a little growth compared to local budgets .

The example of Umnugobi aimag demonstrates that operation of newly established mining companies has high impact on growth of income from the vehicle tax. Therefore, the evaluation gave high importance to the potential of the aimags to build new major mines. As it is obvious that the number of vehicles will increase along with the total economic growth, it is not included in the evaluation.

To summarise the factors described above, the potential for growth of the vehicles tax base in Khentii and Umnugobi aimags is evaluated was "good", "satisfactory" in Orkhon aimag and "bad" in Bayan-Ulgii aimag.

In other words, while there is a possibility to increase the local budget revenue by increasing the tax rate, tax revenue in Umnugobi and Khentii aimags with high development of the mining sector or with a potential for such development may also increase with abrupt growth of the number of vehicles.

Minerals royalty

While in 2006 minerals royalty was 7.4 bln tugrugs in 2006, it reached 25.4 bln tugrugs in 2007, increasing 3 times and it is likely to reach 40.7 bln tugrugs in 2008, increasing almost twice compared to the previous year. In other words, the minerals royalty has been increasing 2-3 times every year.

Graph 3.11   Mineral royalty, 2003-2007 (comparative rates by 2008, in bln tug)
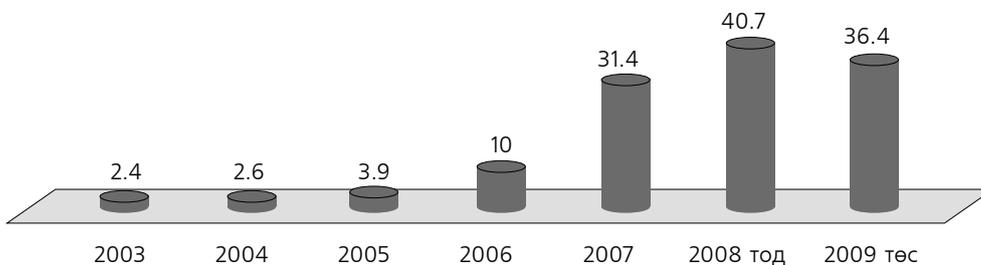
Source: Data from reports by the Ministry of Finance

The percentage of this type of tax in local budget revenue increased up to 21.6% in 2007 and 28.5% in 2008, while before 2006 it used to be 4% in average. This demonstrates that the volume of minerals royalty and its percentage in total local budget revenue increased at the same time and has become one of the main contributors to tax revenue in the local budgets.

Graph 3.12   Percentage of minerals royalty in local budget revenue, 2003-2007
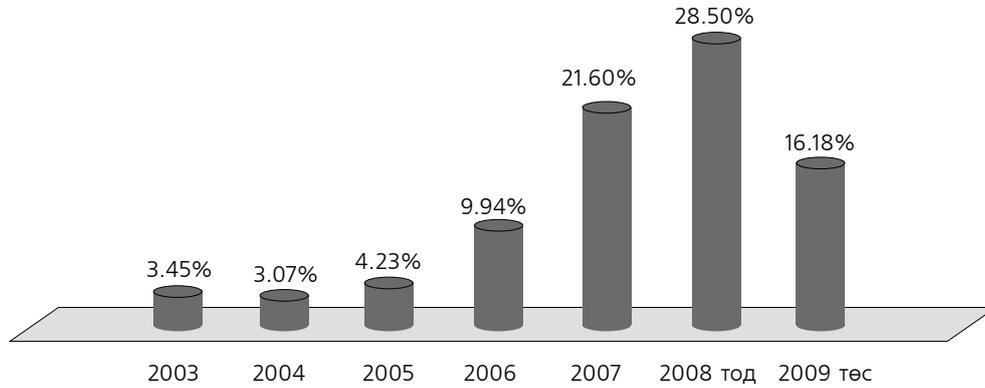
Source: Data from reports by the Ministry of Finance

Orkhon aimag alone contributed 60% or 14.8 bln tugrugs to this type of tax revenue. Selenge aimag contributed 10%, Umnugobi aimag's - 6.4%, Sukhbaatar and Central aimags - 5.5% each, Bayankhongor aimag - 3%, and Uvurkhangai aimag - 4%. Other 15 aimags contribute 0.1-1% each thus having very low percentage in the total revenue. The minerals royalty revenue is higher in aimags with a developed mining sector.

Graph 3.13 Minerals royalty, 2007 data by aimags
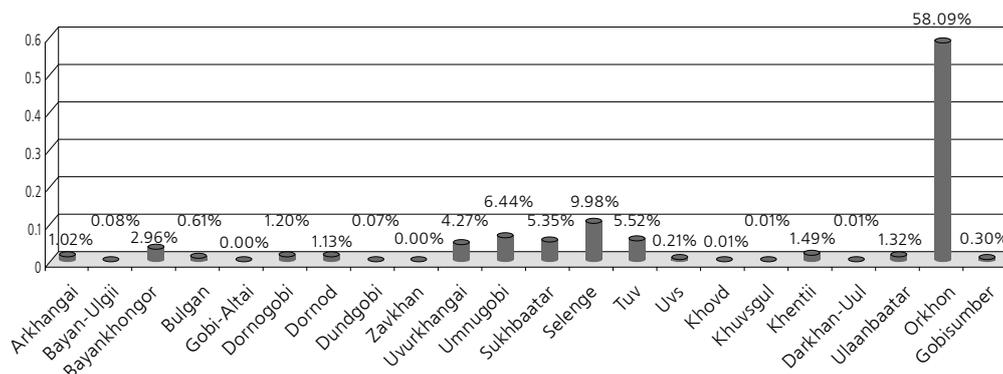
Source: Data from reports by the Ministry of Finance

Royalty for usage of mineral resources such as gold, copper, coal and fluorspar is a tax paid to the national and local budgets.

While payment and settlement of royalties for gold and copper are made to the state budget for subsequent transfer of respective amounts to the local budgets, royalties for coal and spar are collected by local tax offices for subsequent transfer to the state budget.

While the minerals royalty accounts for 2-3% in the Bayan-Ulgii aimag's budget, it accounts for 60% in Orkhon aimag and 20% in Khentii and Umnugobi aimags each. As Bayan-Ulgii aimag does not have an operating major mine (they receive coal they need from Uvs aimag), income from minerals royalty is low there. Khentii aimag collects the royalty from the Bor-Undur fluorspar mine and the Chandaga coal mine. Umnugobi aimag collects the major part of it from Tavantolgoi and Suhait coal mines. Orkhon aimag receives most of the revenue from this type of tax from sale of copper mined at the Erdenet mining company.

Minerals royalty is a major source of tax revenue in the budgets of areas with a developed mining sector. However, the study shows that the local authorities are interested in increasing their share from this type of tax and do not pay enough attention to revenue from other types of tax.

We studied a potential for establishment of new mines in near future, existence of a market for purchase of extracted minerals and a potential for growth of the price of raw materials as factors having an important influence.

Table 3.6 Evaluation of growth of the minerals royalty base

№	Criteria	Khentii	Bayan-Ulgii	Umnugobi	Orkhon
1	Potential for new mines	Good	Satis-factory	Good	Bad
2	Raw materials price growth trends	Satis-factory		Satisfac-tory	Satisfac-tory
3	Market for purchase of minerals	Satis-factory		Satisfac-tory	Good
	Evaluation of the potential of the tax revenue growth	Satis-factory	Satis-factory	Satisfac-tory	Satisfac-tory

The potential of Khentii aimag is assessed as "good", because there are plans to establish new coal and Fluorspar mines. That of Umnugobi aimag is also assessed as "good", because the Energy Resources company and several mines such as the Khurmen coal mines are prepared to start mining activities there. The potential of Bayan-Ulgii aimag is assessed as "satisfactory", because

at present there is no mine to be possibly mined there except for the Asgat silver deposit. Orkhon aimag does not have any new mines to exploit at present.

As the coal mined in Umnugobi aimag is always exported to China, the codition of its market,where the commodity prices might drop (the Chinese are likely to take steps in order to drag down the price among numerous Mongolian coal companies) is assessed as "satisfactory". As copper is sold at the global market, the market situation is assessed as "good".

As prices for raw materials are currently low at the world market, but are going to grow in a certain time period according to estimates of the global community, the market situation is assessed as "satisfactory". (It is impossible to guess, when the prices will start to grow.) An issue of possible exploitation of the Oyutolgoi deposit located in Umnugobi aimag is not included in the evaluation.

Minerals royalty is a type of revenue, which highly depends on the price of raw materials at the world market rather than on local administrative activities. Therefore, it is difficult for local authorities to control and plan this type of revenue.

Based on the above situation, it was concluded that if the copper price at the global market does not start to rise, revenue of Orkhon aimag will reduce significantly and the minerals royalty based revenues in other three aimags will not grow, but will drop a little.

Land fee

Land fee is derived from the land used and possessed for any purposes by individuals and business entities from the local area.

Though the land fee has increased by 5% in average every year, its revenue to the local budget has decresed by 2% in average every year.

Graph 3.14   Land fee revenue, 2003-2009 (comparative rates by 2008, in bln tug)
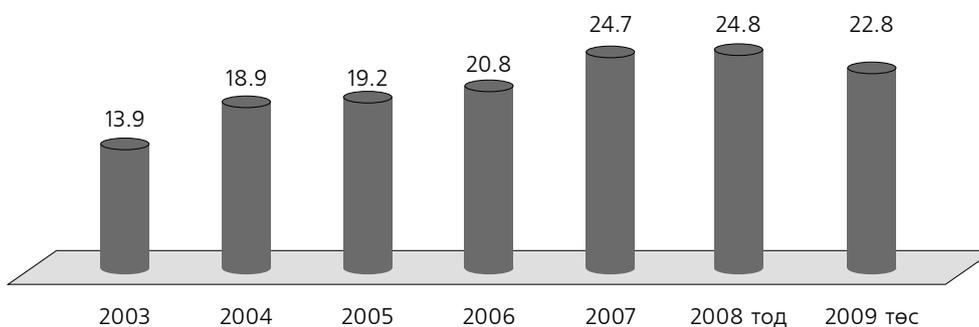
Source: Data from reports by the Ministry of Finance

Graph 3.15   Percentage of land fee in the local budget revenue,
2003-2007
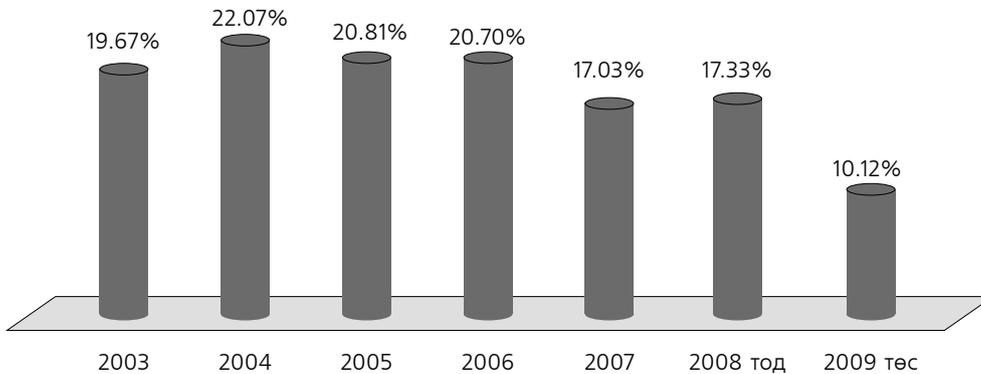
Source: Data from reports by the Ministry of Finance

Of total land fee 56% is collected in Ulaanbaatar, 32% in Orkhon aimag and
the remaining 12 % in other 20 aimags. Ulaanbaatar city with high population
concentration contributes the major part of revenue. The amount of revenue
depends on population concentration, so the large number of land owners and
relatively high land prices in the capital city is the reason for it collecting the
largest part of land fee revenue.

Graph 3.16. Land fees in 2007, by aimags
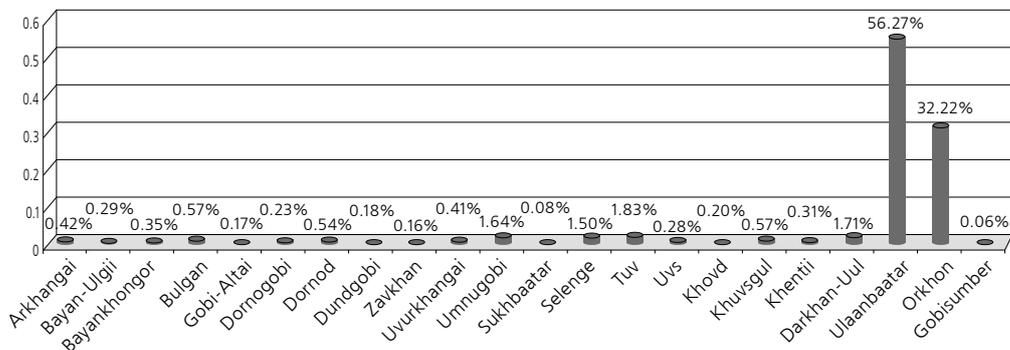
Source: Data from reports by the Ministry of Finance

A comparison of the land fees and their percentage in the local budget revenues is
made in the selected 4 aimags as demonstrated in Appendix #6.

In Orkhon aimag, land registration and land fee collection are carried out by
the Land Office, while in Khentii, Bayan-Ulgii and Umnugobi aimags, land fee
collection is implemented by Tax Divisions.

According to Graph 3.16, in Orkhon aimag, land fees account for 25% of the local budget revenue , while in other aimags the land fees make up 1.5-7%. Of total land fee revenue in Orkhon aimag 15.0 mln tugrugs is paid by individuals, 73.0 mln tugrugs – by Erdmin and Shim technology enterprises, 5.0 mln tugrugs – by business entities and individuals engaged in agriculture, and the rest – by the Erdenet mining corporation.

As for Umnugobi aimag, Khanbogd soum collects 75% of the land fees amounting to 250.0 mln tugrugs and the major part of remaining fee is collected from the mines located in other soums. Though percentage of the land fees in the budget revenue of Umnugobi aimag is lower than that in Bayan-Ulgii aimag, the amount collected is five times more than in Bayan-Ulgii.

In Bayan-Ulgii aimag, the main part or 60% of total land fees is collected by the aimag center and the rest is paid by the soums engaged in crop cultivation activities. In Khentii aimag, the aimag center collects 11% and the rest is paid by Dadal, Gurvanbayan and Batnorov soums, where mining activities are conducted.

While in Khentii and Bayan-Ulgii aimags the volume of land fees increased by 10.0 mln tugrugs in average every year (according to the respective year), it rapidly increased in Umnugobi aimag by 50.0-80.0 mln tugrugs in average and in Orkhon aimag by 100.0-200.0 mln tugrugs in average. Land fees from land used for mining purposes contibute greatly to local budget revenues.

Such factors as tendency of individuals and enterprises to possess and utilize new areas of land and a potential for establishment of new mines were taken into account along with evaluation of the tax base per unit.

Table 3.7 Evaluation of the land fee base growth

№	Criteria	Khentii	Bayan-Ulgii	Umnugobi	Orkhon
1	Potential for granting new areas of land	Good	Good	Good	Bad
2	Possibility to change the percentage of tax concession	Possible	Possible	Possible	Possible
3	Tendency for increase of population size in near future	Good	Satisfactory	Satisfactory	Good
4	Tendency for establishment of major enterprises and mines	Possible	Unclear	Possible	Unclear
	Evaluation of the potential of tax revenue growth	Good	Satisfactory	Good	Satisfactory

Orkhon aimag has a smaller territory compared to other aimags. Therefore, it is difficult to grant new plots of land there. In other aimags, avalability of land plots is better , therefore they were assessed as "good".

Example 2
... The land capacity is low in Orkhon aimag. It is possible to expand the area by giving Erdenet the status of a city through an amendment in the Law on Administrative and Territorial Management...

/Orkhon aimag/

As land fee calculations show, in rural areas 97%-98% of land fees are exempted from tax, so at present revenue is "too low". Therefore, it is possible to increase revenue by reducing the amount of concessions except for Orkhon aimag. In other words, even if the size of croplands is expanded, the percentage of land fees in the local budget revenue is unlikely to increase significantly. (See land fee calculations from Appendix #9.) It is possible to significanty increase the amount of land fee revenue in the local budget by reducing tax concessions and changing the 1997 procedures for land evaluation and tax exemption.

Example 3
... Some provisions of the Land Law have not been implemented yet. Article 7 of the Land Law provides for collection of land fees from engineering lines. But this provision is not observed in our aimag...

/Khentii aimag/

A number of mines is planned to be opened in Umnugobi aimag and 1-2 mines are going to be opened in Khentii aimag. Therefore, these aimags are assessed as having a potential for establishment of new major mines and enterprises.

As revenue from land fees increases depending on capacity and size of the mine, over 250.0 mln tugrugs per year may be collected from such big mines as Oyutolgoi. Currently, there are no plans about establishment of such big mines. According to the example of Umnugobi aimag, one new mine may add 50.0-60.0 mln tugrugs in average to the budget. Also, there is a possibility to augment land fee revenue by the way of implementing those legal provisions, which are not observed at present.

Based on these factors, it is concluded that Khentii and Umnugobi aimags have "good" potential for increase of land fee revenues in near future, while that of Bayan-Ulgii and Orkhon aimags is assessed as "satisfactory".

Minerals license fee

Real revenue from minerals license fees has increased twice, and so has its percentage in the local budget. Minerals license fee (hereinafter referred to as license fee) is one of the main taxes contributing to the growth of the local budget.

The main part of this type of revenue is paid by Umnugobi and Dornogobi aimags – with 22.8% and 13.4% respectively. Other 12 aimags, where exploration licenses are granted extensively (e.g. Khentii, Bulgan and Uvurkhangai) contribute 3%-6% each in average.

Graph 3.17   Minerals license fee revenue (comparative rates by 2008, in bln tug)
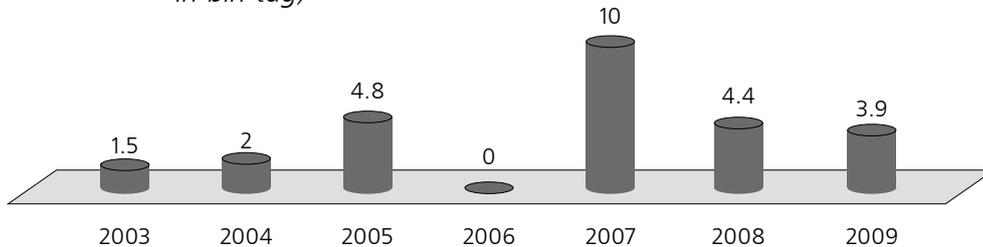
Source: Data from reports by the Ministry of Finance

Graph 3.18   Percentage of minerals license fee in local budget revenue, 2007
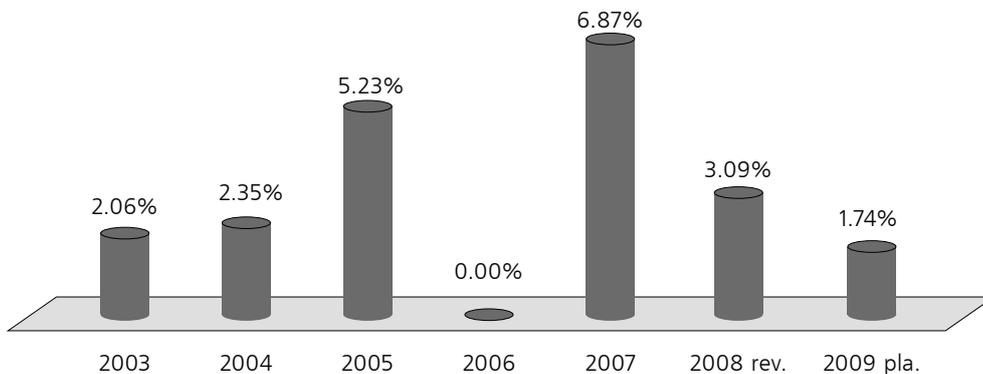
Source: Data from reports by the Ministry of Finance

Darkhan and Orkhon aimags as well as Ulaanbaatar city with high concentration of population and relatively small areas almost do not have such type of revenue. Aimags without exploration areas or with fully explored land generate very little of this type of revenue or have hardly any of such revenue.

Graph 3.19   Payment of minerals license fees in 2007 (by aimags)
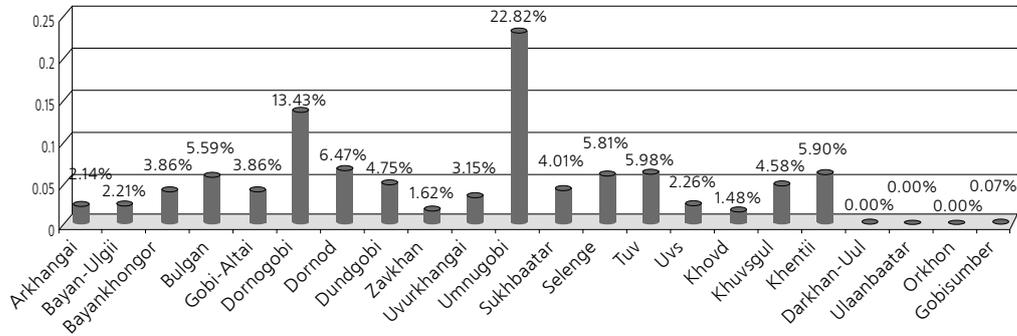
Source: Data from reports by the Ministry of Finance

According to the 2007 Minerals Law, 25% of revenue from minerals exploration and mining licenses are allocated to the aimags and soums.

The amount of license fees in the selected aimags is compared in Appendix #6.

License fees constitute 10%-20% of the budget revenues of aimags. As Orkhon aimag has a very small area compared to other aimags and its resources under ground are fully identified, it collects little revenue from license fees. The percentage of license fee in the local budget revenue is very low in Orkhon aimag, while it is higher in other aimags.

This type of tax is collected by the central government agency in charge of Minerals and then transferred to the Ministry of Finance for subsequent allocation to aimag budgets. Therefore, as can be seen from the research, local authorities are not able to forecast its payment and regulate it.

Example 4
... According to the 2008 data, there are more than 540 business entities holding licenses in our aimag. But we only received 2.4 bln tugrugs for the aimag's budget as license fee payment. It is not clear which business entities paid such fees for which areas. When we ask for details of the allocated funds, they are not sent to us. Therefore, we are not able to meet license holders and demand fees from them...
... 5.0 bln tugrugs were planned to be received from license fees according to the 2008 plan,but we received only 2.4 bln tugrugs. It is not clear who will be responsible for the failed plan. It would be unreasonable to blame the local authorities. The problem is that responsibility for failed works due to lack of funds is imposed on the local authorities. This is abnormal...

/Umnugobi aimag/

According to the government procedure on regulation of license fees, 25% of the payment from license fees to the aimags must be transferred to the soums. However, in Bayan-Ulgii and Umnugobi aimags they are not transferred to the soums, but disposed by the aimags. The aimags explained that as it was unclear, which business entities paid the fees, it was impossible to transfer the funds to the soums.

Example 5

...Suddenly one day people come and start drilling and digging in the soum area. When we ask them, they show us their exploration licenses. But we know nothing about the licenses, the areas they granted for exploration and the license holders. When we complain to the Minerals Authority, they answer "We don't have to ask you where to hold exploration". Coordination among our government organizations is really bad...

...Article 19.3 of the Minerals Law requires for permission for exploration from local authorities and sets the limit of 30 days for response. If the local authotities do not respond in 30 days, the permission is deemed given. In many cases licenses are issued without obtaining our permission. Sometimes we receive such requests 1 day before the deadline. Sometimes they send us only numbers and coordinates of the area. We do not have special equipment such as GPS in order to check the coordinates...

/Umnugobi aimaga, Khanbogd soum/

When we met with soums authorities in Bayan-Ulgii and Umnugobi aimags and asked why they had not received funds from license fees, they replied they did not know that the funds should have been transferred to the soums. Therefore, according to the study, it is necessary to ensure full control of payment of license fees by strengthening capacityof soum authorities, improving technical equipment and improving coordination between government organs and to improve the minerals law.

As issuance of licenses, collection of the fees and control of the payment is implemented by the Minerals Authority, local authorities have no competence to plan and supervise payment of the fees. Therefore, local authorities cannot forecast the growth and future amount of this type of tax revenue.

3.2 ANALYSIS OF SOUM BUDGET REVENUE

Total tax revenue in local areas (including soums) consists of revenues from few types of taxes. For example, though the law specifies 12 types of tax revenues, about 90% of the total tax revenues is derived from only personal income tax, stamp duty, minerals royalties and minerals license fee.

Graph 3.20   Weight of soum tax revenue in total tax revenue

	2006	2007	2008 revised
▣ Personal income tax	0%	0%	1.3%
☐ Firearm tax	0.5%	0.5%	0.4%
☐ State Stamp Duty	8.7%	5.9%	3.8%
▦ Minerals exploration and mining licence fee	0.5%	1.2%	0%
▨ Usage fee on hunting stock, permit fee for hunting of catching wild animals	1.9%	0.8%	0.3%
■ Fee for usage forest wood for fuel pursope	3.9%	3.0%	1.4%
■ Minerals royalty	24.2%	51.9%	53.3%
☐ Lisence fee for usage of natural recources other than minerals	0%	0%	20.2%
■ Water and mineral water usage fee	14.5%	12.2%	8.3%
▦ Popular minerals royalty	0.5%	0.3%	0.1%
☐ Fee for usage of natural plants	45.3%	24.3%	10.9%

But as to these four types of taxes, the weight of the personal income tax and stamp duty is decreasing, while the weight of minerals royalties and license fee is increasing.

Personal income tax (C1)

Personal income tax accounted for 16% in 2005, 18.58% in 2006 and 10.12% in 2007 in total local budget revenue. In these years the tax on salary and other similar income, the main generator of the tax revenue, was paid to the centralized state budget. According to the revised General Law on Taxation, since 2009 the tax is to be paid to the local budget. However, as this payment is made to the aimag budget, it does not add to the soum budget.

Graph 3.21 Personal income tax (comparative data for 2008, in billion tugrugs)

	2003	2004	2005	2006	2007	2008 rev.	2009 pla.
□ Personal income tax	7.7	12.7	14.8	18.7	14.7	8.3	98.8
■ Wages, salaries, remuneration, bonus, and similar employment income	0	0	0	0	0	0	89.8
▥ Personal income tax on street vendors and small businesses	2.5	3.7	3.8	2.8	2.8	2.9	2.8
▨ Tax on individuals' income from private businesses	2.1	2.8	2.6	2.7	5.1	2.7	3.1
▦ Tax from citizens whit livestock	2.9	2.8	3.0	3.2	3.3	2.6	2.7
■ Tax on individuals property income and tax on sale of property	0.3	3.5	5.4	10.0	3.5	0.0	0.5

Source: Budget data from the Ministry of Finance

According to the graph above, personal income tax revenue in the soums located at aimag senters or close to aimag centers (according to the performance data for 2007, the revenue in Kherlen soum is 25.8 mln tug, Ulgii soum – 19.1 mln tug and Dalanzadgad soum – 22.8 mln tug) is relatively high. The tax directly depends on such factors as population size, unemployment and development of small and medium enterprises. Bayankhutag soum of Khentii aimag is located about 30 km far from the aimag center, has small population, underdeveloped infrastructure and weak economy. Its total budget revenue was 70.8 mln tug in 2007. The personal income tax generated 24% of the total budget revenue in that soum, while the percentage was 11% in Kherlen soum, the aimag center soum of Khentii aimag. In 2008 the percentage was 16% in Dalanzadgad soum, the central soum of Umnugobi aimag, and only 4% in Khanbogd soum, a remote soum of the same aimag. **In other words, the personal income tax revenue is higher in soums with larger population and better infrastructure than in isolated soums with small population.** The personal income tax is one of the main sources of the soum's budget revenue in soums with undeveloped infrastructure and scarce minerals resources. Meanwhile, in soums with greater mining business opportunity, with ongoing exploration works and a relatively good infrastructure, the personal income tax is not able to become the main source of soum's budget revenue.

Graph 3.22 Personal income tax in the soums covered by the study
*   (mln tug)*
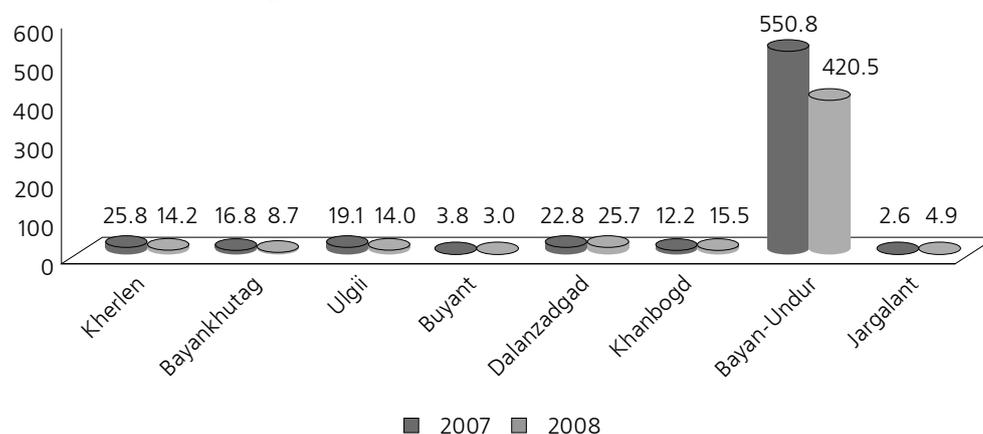
Source: Data from budget statements for the last two years in the respective soums

Tax on salary and other similar types of income, which constitute the main part of the personal income, started to be paid to budgets of aimags and the capital city in 2009. The tax used to be paid to the state budget before. Other types of income tax such as the income tax from citizens with livestock, tax on individuals' income from private businesses with the income impossible to determine timely, tax on individuals' property income and tax on sale of property are paid to the budgets of soums and districts. For example, while Kherlen soum of Khentii aimag (the central soum with population of 17,494 people) paid 329.9 mln tug to the state budget, Bayakhutag soum in the same aimag (a remote soum with a population of 2280 people) paid 7.3 ml tug to the state budget in 2007. If the tax on salary and other similar types of income is paid to the soum budget, then remote soums can have more sources of such tax. As to the central soums with larger population and a relatively high rate of employment, it should be more effective to pay the tax on salary and other similar types of income to the aimag budget for re-allocation. For example, 550.8 mln tugrugs revenue accounted for this type of tax in Bayan-Undur soum (with a population of 85,121 people) of Orkhon aimag. In total, 5.7 bln tugrus is paid in the soum as the tax on salary and other similar types of income. In other words, sufficient revenue for further financing of the aimag's total expenditure can be generated from this type of tax.

Though in soums personal income tax payments, in high or low rates, constitute a stable source for budget revenue, in current situation, opportunities to increase this source are limited. For example, such factors as high concentration of population in central soums, low development of infrastructure in remote soums and payment of tax on salary and other similar types of income to the aimags'

budget limit opportunities to increase the tax bases. Though it is possible to increase the number of livestock, limitations due to livestock pasture capacity will limit citizens' income tax base.

Firearms tax (C2)

According to the average of the last 3 years, the firearms tax accounts for 0.15% of total budget revenue, which demonstrates the low weight of such type of tax.[35] Due to the perculiarity of the tax, real chances for higher revenue from this type of tax are limited.

Firearms tax cannot be the main source of tax revenue in budgets of both remote and central soums. For example, firearms tax constituted 1.1% of the total budget revenue in Kherlen soum in 2007, 0.8% in Jargalant soum, and 0.3% in Ulgii soum. Though in Bayan-Undur soum a relatively high revenue of 2.6 mln tugrugs comes from that tax, it constitutes only 0.01% of the total budget revenue.

This tax has a low weight in the soum budget revenue and the chances for wider tax basis are limited. For example, there were 1,683 adults in 2007 in Buyant soum, who paid 378.0 thousand tugrugs as firearms tax. This number stands for approximiately 63 guns. If all adults in the soum had weapons, about 1,620 more guns would be necessary. In other words, in that case 10.0 mln tugrugs of the soum's budget may come from firearms tax. This would be 33.9% of the Buyant soum's budget revenue for 2007. However, this is impossible due to reasons of national security and protection of fauna.

As revenue from this type of tax is not a mere budget issue, but is also related to social security and environment protection, it is important to properly organize collection of the tax.   Soums tax inspectors impose tax based on the data provided by the police. According to tax inspectors of Kherlen soum, such data may be inaccurate.

State stamp duty (C3)

Though total revenue from state stamp duty has increased by 1.5 billion tugrugs during the past 5 years, its weight in the total budget revenue decreased from 7%-to 5%. This is related to growth of total budget revenue. On the other hand, revenue from this type of tax is the highest in Ulaanbaatar city.[36] In other words, the amount of this type of tax is high in urban areas with high concentration of population.

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[35] See Graph 3.24 for details

[36] According to the 2007 performance, 87.3% of the total revenue from state stamp duty across the country comes from Ulaanbaatar.

Graph 3.23 Firearms tax in the selected soums (thousand tug)

	Kherlen	Bayankhutag	Ulgii	Buyant	Dalanzadgad	Khanbogd	Bayan-Undur	Jargalant
2007	254.0	260.0	406.0	378.0	76.0	160.0	2,668.2	30.0
2008	161.5	152.0	319.0	344.0	488.0	322.6	2,647.8	30.0
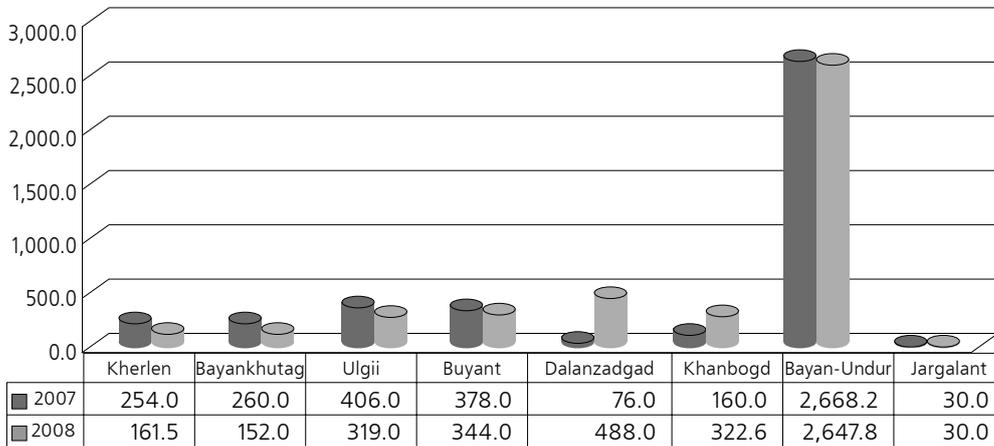
Source: Data from budget statements for the last two years in the respective soums

Graph 3.24 Soums tax revenue (comparative data for 2008, in billion tugrugs)

	2003	2004	2005	2006	2007	2008 тод	2009 тес
Firearm Tax	0	0.2	0.2	0.2	0.2	0.1	0.1
State Stamp Duty	2.2	6	6.5	6	7.4	6.3	5.8
Minerals exploration and mining license fee	0.0	0.0	0.0	0.0	0.0	15.4	14.9
Mineral royalty	2.4	2.6	3.9	10.0	31.4	40.7	36.4
Fee for usage of forest wood for fuel purpose	1.1	1.0	1.1	1.6	1.8	1.1	1.0
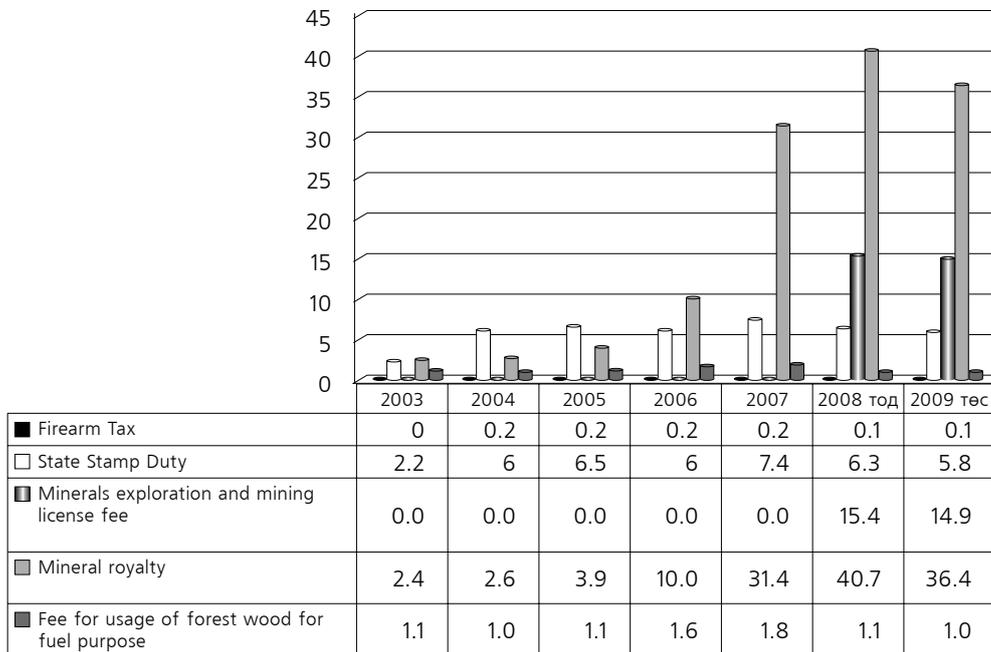
Source: Budget data from the Ministry of Finance

Stamp duty is a type of payment charged by state organizations for service to citizens. It directly depends on population size and availability of state services. For example, in central soums with larger population (Kherlen, Ulgii, Dalanzadgad and Bayan-Undur) revenue from this type of tax is relatively high. However, according to the 2007 data, 4.2% of the Kherlen soum budget revenue, 17.5% of the Dalanzadgad soum budget revenue and less than 1.25% of the other soums' budget revenues was derived from stamp duty. In other words, stamp duty cannot be the main basis for some soums' budget revenues.

Graph 3.25 Stamp duty in the soums covered by the study (mln/tug)
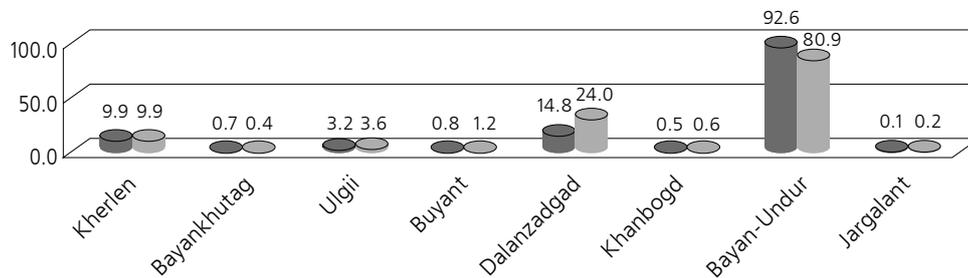
Source: Data from budget statements for the last two years in the respective soums

Highly populated central soums have a certain stable tax base, while remote soums have hardly any opportunity to increase their tax base. For example, if Jargalant soum aims to gain 5% of its total budget revenue from stamp duty, that will be 1.7 mln tugrugs. According to the average of previous years, 0.1 mln tugrugs were paid in 2007 for provision of public services to 3,048 people and 0.2 mln tugrugs were paid in 2008 for provision of public services to 3,009 people. If calculations were made according to this standard, while not adding types of stamp duties, the average for 2009 would be 1.7 mln tugrugs worth revenue from public services provided to 25,500 people. As for Jargalant soum, it is not real that its population of 3,000 may grow up to 25,500.

Hunting royalties and hunting license fees (C4)

According to the study of the last 3 years, hunting royalties and hunting license fees have been decreasing and their weight in the total budget revenue has decreased down to 0.7%-0.3%. (Graph: 3.26) In other words, they do not account for the main part of the local budget revenue. The name of this type of tax attracts attention. The General Law on Taxation specified this type of tax as "hunting royalty and hunting license fee". In fact they were included in tax statements as "hunting stock payment" and "fee for permission to hunt". However, payment and fee are different types of tax and it is not clear if the payment and fee were

reported under one name. The Ministry of Environment issues special permits to hunt and charges fees and payment. Afterwards, the Ministry of Environment transfers a certain part of hunting payment to local areas based on documents that prove hunting of animals in certain local areas. As the local authorities do not know whether such transfer is hunting royalty or license fee, they specify it as "hunting resource payment".

Graph 3.26   Local tax revenue (comparative data for 2008, in billion tugrugs)

	2003	2004	2005	2006	2007	2008 тод	2009 тес
☐ Usage fee on hunting stock, permit fee for hunting of catching wild animals	0.9	0.7	0.7	0.8	0.5	0.2	0.2
■ Lisence fee for usage of natural recources other than minerals	0	0.4	0	0.2	0.7	0	0.1
▥ Water and mineral water usage fee	0.2	0.4	3.5	3.6	3.5	2.9	2.6
▨ Popular minerals royalty	0.1	0.1	0.2	0.2	0.3	0.3	0.3
▦ Fee for usage of natural plants	0.6	0.0	0.0	0.0	0.0	1.0	0.9

Source: Budget data from the Ministry of Finance

This type of tax depends on hunting resources and the regional features. No revenue was generated from this type of tax in soums other than Buyant and Khanbogd for the last 2 years. In Buyant soum 36.4% or 9.3 mln tugrugs of the soum budget revenue and in Khanbogd soum 5.8% or 17.7 mln tugrugs of the soum budget revenue came from this type of tax in 2007. In 2008 one Altai wild ram was hunted thus adding 4.6 mln tugrugs to the Buyant soum budget. Meanwhile, revenue from this type of tax has reduced to 0.5 mln tugrugs in Hanbogd soum. In other words, hunting royalty cannot be the source of stable tax revenue to the soum budget.

Every year the Minister of Environment approves quota for hunting of animals for personal and industrial use. Aimags distribute the number of animals to be hunted in their soums within the limits of such quota. Based on the above limits and quota

adopted by the aimags, it is possible to estimate and plan hunting royalty. However, as this tax base is not stable and is unlikely to grow, the revenue from this tax has no potential to increase. For example, Bayankhutag soum does not have especially rare species out of the animals assessed by Government Resolution 248 in 2005, but there are a few species of the animals assessed as common. However, according to environment inspectors, no study or calculation of the number of such species is done in the soum.

Graph 3.27   Soums' budget revenue generated from hunting stock payment (mln tug)
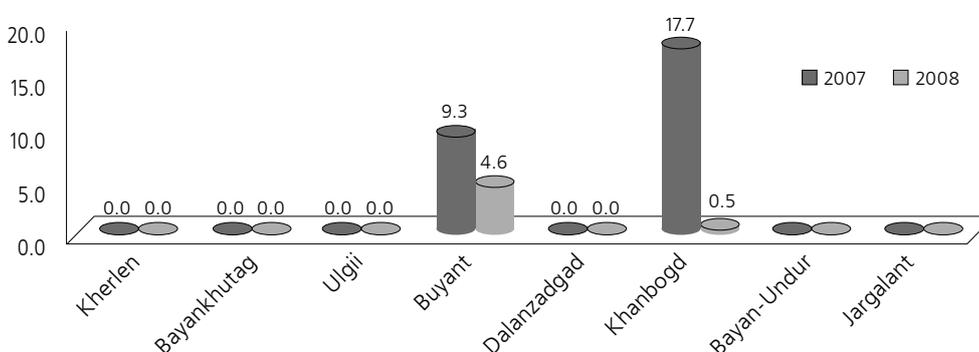
Source: Data from budget statements for the last two years in the respective soums

If Khanbogd soum planned to gain at least 10% of the soum budget from hunting royalty and estimated a hunting rate of 1 brown deer to be 12,000 tug (under Government Resolution 248 of 2005), then it would become necessary to hunt 2,522 brown deers in average every year. However, according to Decree 46 by the Minister of Environment of 2008, the maximum number of brown deers to be hunted for personal use in 2009 is 87 over the territory of the whole country.

License fee for usage of natural resources other than minerals (C5)

Revenue from license fee for usage of natural resources other than minerals was 27.0 mln tug in 2005, reached 126.0 mln tug in 2006 and increased up to 553.4 mln tug in 2007. (Graph 3.26) However, the percentage of this type of tax revenue in the local budget is relatively low – 0.07-0.4%. According to the 2007 performance, the highest percentage of this type of tax revenue occurred in Darkhan-Uul aimag, constituting 88%. It is quite unlear how the types of this tax, their coverage and percentage are determined. There may be inaccurate data reported after compilation of tax statement data. For example, 487.1 mln tugrugs

worth revenue from this type of tax is reported in the Darkhan-Uul aimag's budget. However, close examination of the report reveals that the tax named "royalty for common minerals" is included in the report as this type of tax. This has to do with irresponsible acts by officers compiling the tax statement data. In the soums covered by the study, no budget revenue was generated from this type of tax.

Plant harvest charge (C6)

Though the fee for usage of natural plants is specified in relevant laws and local authorities are empowered to set their rate and collect them, there is no tax revenue generated from this type of tax either in soums or even at national level. This demonstrates lack of awareness and initiative by local authorities with respect to their tax-related powers. There is no unified activity or organizational work implemented in order to study and determine the source of such tax, its imposition and collection.

Firewood and Timber Stocking and Usage fees (C7)

Though revenue from the fee for firewood and timber stocking has increased by 345.0 mln tugrugs in average for the past 3 years, its weight in the total budget revenue is 1,2%-1,5% (Graph 3.24). In other words, it is a type of tax with a low share. This type of revenue also varies across aimags and the capital. For example, if, according to the 2007 performance, the highest amount of tax revenue – 148.3-162.0 mln tugrugs - was collected in Khuvsgul, Bulgan, Selenge, Darkhan-Uul and Arkhangai aimags, there is no such revenue recorded for Bayankhongor, Dundgobi, Sukhbaatar and Gobisumber aimags. In other words, this type of revenue greatly depends on geographical location of aimags. Therefore, there is no source for this type of tax in some aimags without forest resources.

Graph 3.28   Fee for usage of forest wood for firewood (2007, in mln tug)
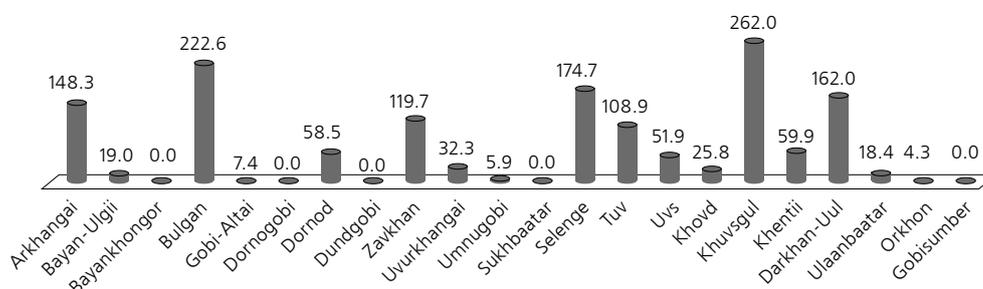
Source: Data from the report by the Ministry of Finance

As for the soums covered by the study, there is no revenue generated from this type of payment in soums except for Khanbogd, Bayan-Undur and Jargalant. In other words, these soums do not have a source for this type of tax. Less than 9% of the Mongolian territory is taken up by forests. In general, there are no forests in the desert and steppe areas. Bayan-Undur and Jargalant are soums located in the forest zone and therefore they have forest resources. Meanwhile, Khanbogd soum collected 400-600 thousand tugrugs for its budget in 2007-2008 from payment for usage of desert saxaul tree. However, according to Buyan-Ulzii, the Deputy Governor of the soum, Khanbogd soum is facing a threat of total destruction of the saxaul tree forest and it is now necessary to limit its usage. In other words, this soum does not have enough source for this type of tax.

Graph 3.29   Firewood and timber stocking and usage fee in the soums covered by the study (mln tug)
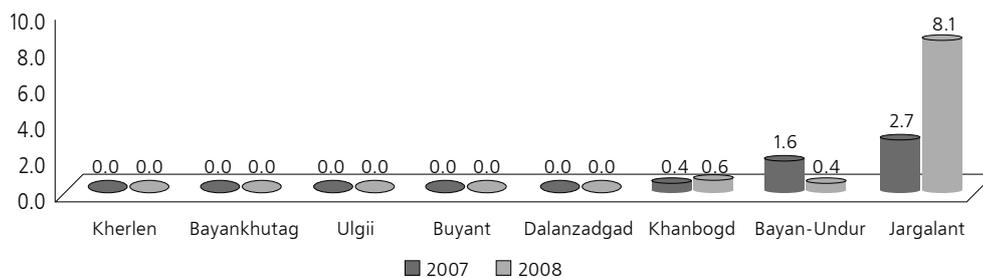
Source: Data from budget statements for the last two years in the respective soums

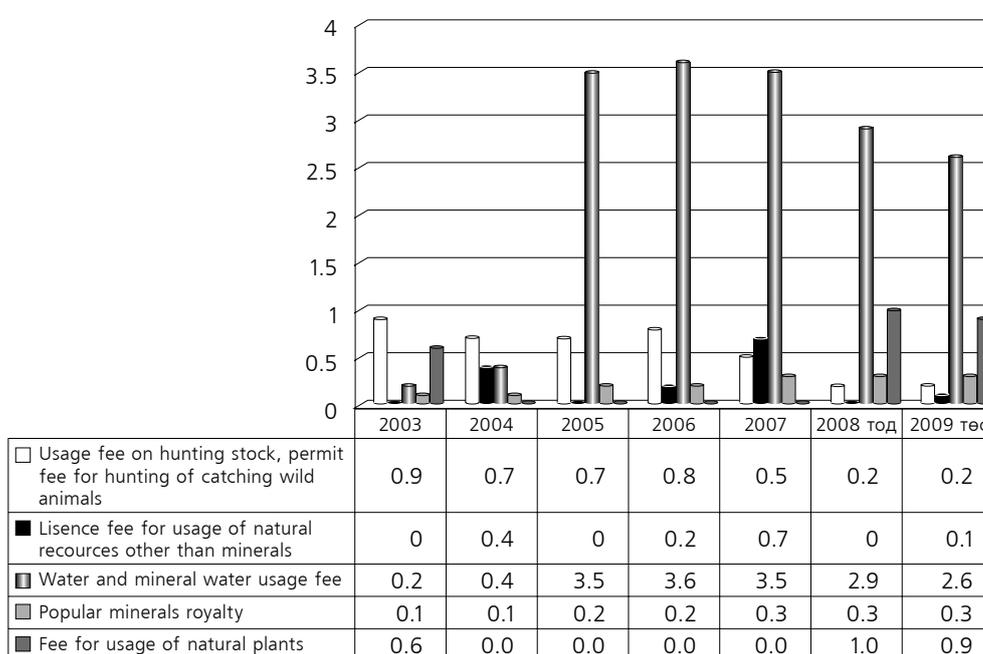In Khanbogd and Bayan-Undur soums, the weight of this type of tax revenue in total budget revenue is very low – less than 0,002%,but in Jargalant soum the fee for usage of forest constituted 12.4%-23.8% of total budget revenue in 2007-2008. If a specific policy on reclamation and forest usage is implemented in soums located in zones with forest resources, this type of tax may become a stable source of revenue.

Common minerals royalty (C8)

Common minerals royalty has increased in the past 3 years by over 140 mln tugrugs reaching 303.3 mln tugrugs according to the 2008 revised budget. (Graph:3.26) Though this is related to increase of the demand for natural sand, gravel and stone due to the construction sector growth, revenue from royalty in the total local budget was 0.2% in average for the last years.

This type of tax is one of the few taxes ,which rate is fixed by the local authorities. Mostly, its rate is fixed by the aimag's Citizens' Representatives Hural. Natural raw materials used for construction of roads, bridges and buildings are the main base of this type of tax. As to the 8 soums covered by the study in 2008, the percentage of this type of tax in the total local budget revenue was as follows: 1,5% in Dalanzadgad soum, 3,7% - in Khanbogd soum, 0,2% - in Kherlen soum, and 0,6% - in Bayankhutag soum, and no revenue was derived from this royalty in other soums.

Graph 3.30   Common minerals royalty (mln tug)
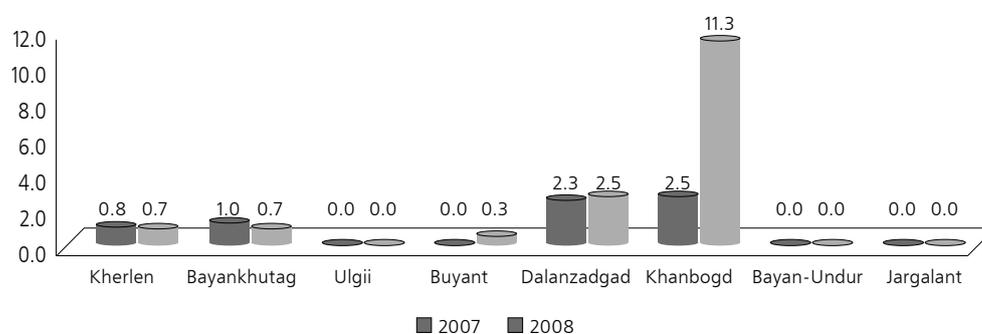
Source: Data from budget statements for the last two years in the respective soums

The term "common" does not mean that the mineral is everywhere over the territory. The source for this type of tax varies across the soums depending on their geographical location and natural structure. For example, Dalanzadgad and Kherlen are soums with developing infrastructure, in which gravel is used for the purpose of road, bridge and building construction. They bring gravel from neighbouring soums (Bayankhutag). The Oyutolgoi mine located in Khanbogd soum pays royalty for sand and gravel to the soum budget. However, there was no such revenue in Ulgii and Buyant soums of Bayan-Ulgii aimag and Bayan-Undur and Jargalant soums of Orkhon aimag. Though Citizens' Representatives Hurals of these aimags issued relevant acts fixing the rate of the common minerals royalty, the tax base was not determined specifically.

If infrastructure develops in local areas and construction works, road building and transport intensify accordingly, this type of tax may generate stable revenue for soums budgets. On the other hand, it is not sufficient that local authorities only fix the rate of the tax. They need to do research and determine specifically, which minerals are common and usable in their territories.

Water and mineral water usage royalty (C9)

The amount of water and mineral water usage royalty has increased rapidly for the past years. For example, if the amount was 278.8 mln tug in 2004, it reached 2.7 bln tug in 2006. (Graph 3.26) It is due to the Government's decision in 2005 to renew the rate of the royalty.[37] The percentage of this type of tax in the total local budget has been relatively stable for the past 3 years – 3.4%. It is higher than other types of soum taxes. However, because of local features and because the rate for the mineral water utilization royalty is not fixed by the local authorities, revenue from this type of royalty is generated mostly from water use royalty (excluding Ulaanbaatar).

Graph 3.31 Water use royalty (2007, mln tug)
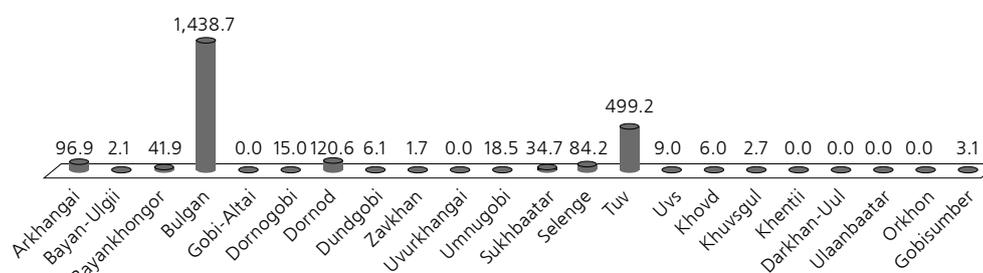
Source: Data on budget from the Ministry of Finance

According to the 2007 performance of aimags, Bulgan aimag collected 1.4 bln tugrugs as water use royalty, which is higher compared to other aimags. This is due to the Erdenet Mining corporation, which uses water from the aimag water resources. Central aimag collected 499.2 mln tugrugs. In many aimags like Gobi-Altai, Khentii, Darkhan-Uul, Ulaanbaatar, Orkhon and Uvurkhangai, no revenue was generated from water use royalty. This demonstrates that this type of tax has different bases depending on geographical location of aimags and existence of mines at their territory.

In the soums covered by the study, only water use royalty is collected under this type of tax and mineral water utilization royalty is not collected. In other words, on the one hand, most soums do not have mineral water sources due to their natural structure and regional features, on the other hand, soum's authorities do not use their legal power to fix the rate of this type of tax and lack resourcefulness.

The graph above shows that soums with operating mining enterprises collect a high percentage of water use royalty. For example, Khanbogd soum collected

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[37] Government Resolution 7 of 2005

7.8 mln tugrugs to its budget in 2007 and 3.3 mln tugrugs in 2008 (with the percentage of 2.5% in 2007 and 1% in 2008 respectively). The main taxpayer is the Oyutolgoi mine.

Graph 3.32 Water use and mineral water utilization royalty (mln tug)
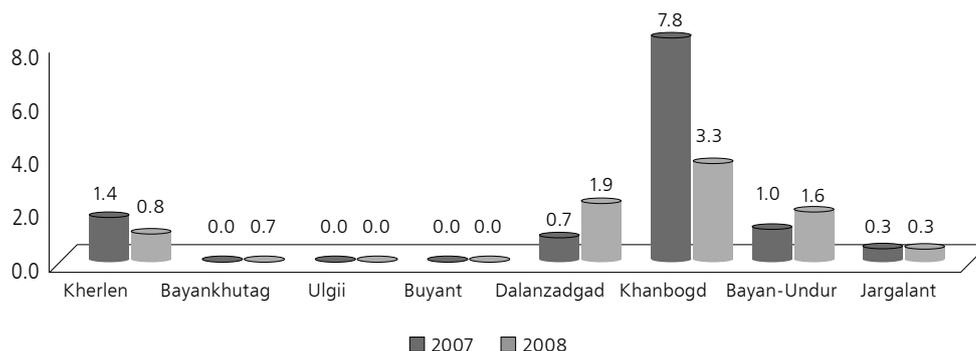
Source: Data from budget statements for the last two years in the respective soums

Though the Erdenet mining corporation, located in Bayan-Undur soum, uses a lot of water resources, they take water from Khangal soum of Bulgan aimag.

The base for water use royalty is closely related to population density, development of industry and mining in the area. In Kherlen, Dalanzadgad and Bayan-Undur soums, this type of tax revenue comes from royalty paid for usage of drinking water, water for personal use and water for provision of services to the population. In Jargalant soum, tax revenue was generated from the royalty paid for water used in agriculture. . However, royalty paid for the personal usage of water cannot become the main part of the local budget revenue. For example, Bayan-Undur soum (with the largest population among the soums – 86,866 people) collected 1.6 mln tugrugs, which is even less than 0,0001% of the annual budget revenue. The percentage is 1% in Dalanzadgad soum.

Royalty paid for water used for mining and other industrial purposes is the main source of this type of tax. In other words, soums with no mining and other developed industries have limited chances for increasing the tax base.

Personal income tax on street vendors and small businesses (C10)

This type of tax is one of the main parts of the personal income tax (Graph 3.21). It consists of 2 kinds of revenue: the so-called "sample based" one and the "patent based"one. Central soums with larger population size and emerging small businesses collect more of this type of revenue. For example, Kherlen, Ulgii, Dalanzadgad and Bayan-Undur soums collected more than 10 mln tugrugs. They

collected 63.9% of the personal income tax for the last 2 years from this type of tax. However, in remote soums this type of tax constitutes only 20% of personal income tax (for example, Bayankhutag soum – 2% and Buyant soum – 6%).

Graph 3.33 Personal income tax on street vendors and small businesses whose income is impossible to determine timely (mln/tug)
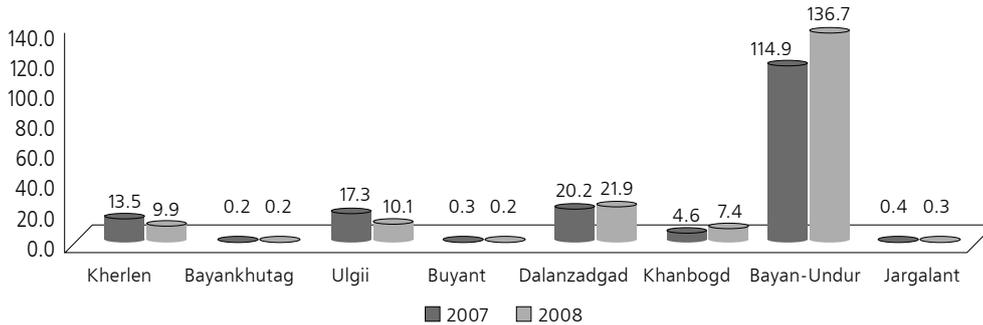
Source: Data from budget statements for the last two years in the respective soums

Personal income tax is the main contributor to the soums' budget tax revenue. In central soums, its main part is the tax on individuals' income from private businesses with income impossible to determine timely, and in remote soums its main part is income tax from citizens with livestock. In other words, this type of tax is the main source of revenue for the budgets of central soums, while it cannot be the main source of tax revenue for the budgets of remote soums. If migration from the countryside to the cities continues and rural areas do not develop their infrastructure, this tendency will remain.

Example 6
...sample-based taxes are calculated on the basis of tax reports. But as it is not possible for individuals to document all their activities , it is not possible to prepare such reports. Even though such reports are prepared, they are biased. On the other hand, consciousness of individual taxpayers is weak and there are many people, who do not have skills to write reports.

From an interview with tax inspectors in Bayan-Ulgii aimag

A "Sample based tax" is paid by a tax payer based on their tax reports. Consequently, in reality such practice highly impacts tax imposition and collection, making it biased.

Minerals exploration and mining license fee (C11)

Minerals exploration and mining license fee, the so called "shared tax" (50:25:25), started to contribute to local budgets in 2008. According to the revised 2008 budget, its revenue of 15.4 bln tugrugs is quite high, thus creating a potential for imbalance.

This shared tax is not a stable source of local budget revenue. In other words, it is fee in cash paid only when a license for minerals exploration and mining is obtained. For example, in 2007, this type of tax contributed 6.1 mln tugrugs to Kherlen soums budget and 44.3 mln tugrugs to Bayankhutag soum's budget. In 2008, this type of tax revenue reached 123.1 mln tugrugs, increasing 20 times in Kherlen soum, but went down to 17.0 mln tugrugs in Bayankhutag soum, decreasing 2.6 times. According to the Kherlen soum authorities, as there are 14 business entities conducting exploration (12) and mining (2) activities in the soum, this tax revenue base is expected to increase in 2009. However, it is difficult to forecast how the revenue will change in the subsequent years. In Bayan-Undur soum, the percentage of revenue from this type of tax in the local budget is 0.15%, which means the tax is not the main source of revenue for the soum budget.

Graph 3.34 Minerals license fee (mln tug)

Source: Data from budget statements for the last two years in the respective soums

There is no revenue derived from minerals license fees in other soums. Some soums may have no such revenue, because they do not have mineral resources and exploration operations are not conducted on their territories. Along with this they may not receive such revenue because of flaws in tax collection and distribution system. For example, as the soum tax inspector B.Dorlig says, though there is a Geo Min LLC conducting exploration activities in Buyant soum, not a penny was added to the soum budget from exploration license fees.

Imposition and collection of this type of tax has to be done by the Minerals Authority, centralized at the Ministry of Finance and allocated to aimags for further allocation to soums. Due to such multi-stage system, soums often do not

receive tax revenue. Because local soum authorities do not have information about businesses, which obtained mining and exploration licenses on their territories, money allocated by the Ministry of Finance is less than the amount planned and there is not sufficient information about companies that paid taxes, it is burdensome for aimags to allocate 25% of the received tax to soums.. For example, 2.4 bln tugrugs were collected in Umnugobi aimag in 2008 out of the 5 bln planned to be collected from minerals license fees. However, no money was allocated to soums out of these 2.4 bln. The same situation was observed in Bayan-Ulgii aimag.

This type of tax may generate different amounts of revenue to budgets of different soums, thus causing imbalance in revenues. For example, while Kherlen soum collected 123.0 mln tugrugs for its budget in only one year, Jargalant, Buyant and Ulgii soums did not collect any revenue from this type of tax. It is difficult to plan revenue because the base for such type of tax is not stable for soums and soums do not have any powers with respect to tax imposition, collection and allocation.

Minerals royalty (C12)

Revenue from minerals royalty has increased 13 times over the past 5 years from 2.4 bln to 31.4 bln tugrugs. This number reached 40.7 bln tugrugs according to the revised 2008 budget. This type of tax constituted 4.23% in total local budget revenue in 2005, 9.94% in 2006 and 21.6% in 2007. (Graph 3.24) This is directly related to the Minerals Law adopted in 2006, under which this type of tax was determined as "shared tax".

Graph 3.35   Minerals royalty (2007, mln tug)
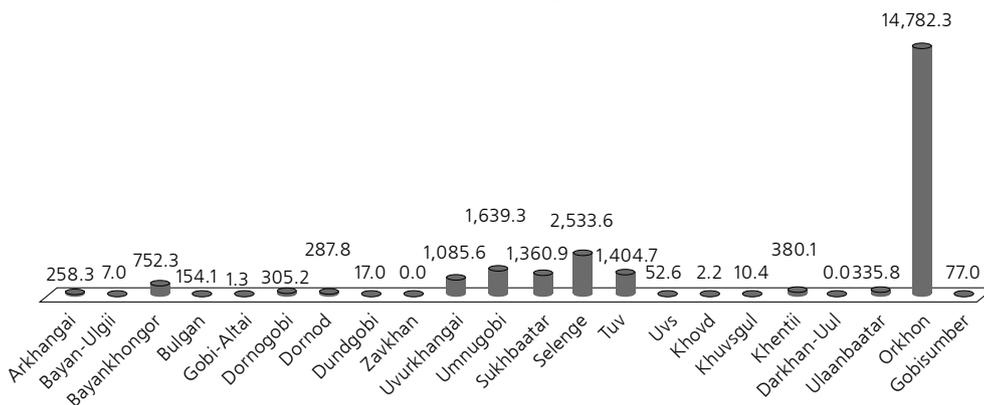
Source: Data on budget from the Ministry of Finance

The situation with this type of tax is relatively imbalanced across the aimags. According to the 2007 performance, the highest revenue was collected in Orkhon – 14.78 bln, then Selenge – 2.5 bln, Umnugobi – 1.6 bln, Central – 1.4 bln, and Sukhbaatar – 1.3 bln. Darkhan-Uul, Zavkhan and Gobi-Altai aimags basically do not have this type of revenue. The "shared tax " created in 2006 granted an opportunity for earning high revenues to the zones with a lot of mineral deposits and caused imbalance in other zones.

Graph 3.36   Minerals royalty amount (mln tug)
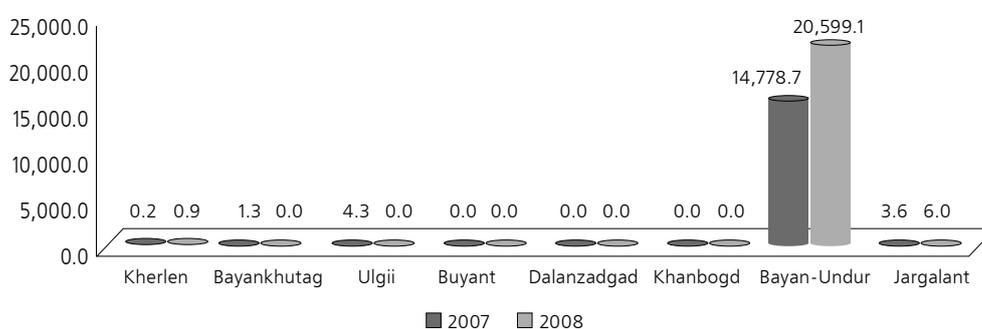
Source: Data from budget statements for the last two years in the respective soums

Minerals royalty is a relatively stable source of revenue compared to minerals license fee,but still soums face imbalance in revenue distribution. Bayan-Undur soum of Orkhon aimag collected 86.9% of its total budget reenue in 2008 only from minerals royalty. In other words, the Erdenet mining corporation paid 20.6 bln tugrugs worth taxes to the soum budget revenue. However, Buyant, Dalanzadgad and Ulgii soums did not collect any revenue from this type of tax for their budgets. As the issue of mining of Oyutolgoi, a deposit with significant mineral resources, is not resolved yet, Khanbogd soum of Umnugobi aimag cannot derive any revenue from minerals royalties. If the deposit is mined, Khanbogd soum will collect such high tax revenues that will be incomparable with other soums.

Among the soums covered by the study, Bayan-Undur and Jargalant soums of Orkhon aimag as well as Ulgii and Buyant soums of Bayan-Ulgii aimag are quite different with respect to tax collection and payment. For example, the types of tax named as "aimags' taxes" by the General Law on Taxation and the Unified Budget Law (e.g. land fee, immovable property tax, tax on automobile and other means of transport) are included in the soum budget revenue.

All soums of Bayan-Ulgii aimag finance their expenditures with subsidies from the aimag. In order to ensure effective collection of the tax in soums, the types of tax, which are to be paid to the aimag budget and collected from soums, are centralized

in the common account for the soum budget revenue. Soum Tax inspectors report tax revenue by each type of the tax. Based on such statement, deductions are made from subsidies granted by the aimag in proportion to taxes. This regulation is effective since 2003 and, according to Nurgaiv, the head of the tax division of Bayan-Ulgii aimag, it helps soums to be responsible in collecting the taxes for their budget revenue.

Orkhon aimag is a highly populated and urbanized aimag. Bayan-Undur soum has 36,866 residents. The aimag transfers proportional revenue from its budget revenue to the state budget. In other words, the aimag tax division works on the territory of the soum for tax collection and the soum does not have any competence with respect to revenue collection. The tax division is financed from the aimag budget. On the one hand, the soum does not have adequate administrative structure for its large population, but on the other hand, such practice violates the local governance principle declared in the Constitution of Mongolia and the Law on Administrative and Territorial Units. Jargalant soum, together with other soums of Bayan-Ulgii aimag, collects its budget revenue from taxes that generate the aimag's revenue. Though this is a regulation developed by the aimag authorities, it violates provisions of the Unified Budget Law[38].

Likewise, there are problems of legal inflexibility and ones of administrative character that arise in the process of generating local budget revenues.

3.3 ANALYSIS OF NON-TAX REVENUE

The percentage of non-tax revenue in total local revenue, types of revenue constituting the non-tax revenue, their potential for further increase, differences between aimags with respect to non-tax revenue and other issues were defined based on examples and data collected from the selected aimags as well as detailed statements by the Ministry of Finance.

While total local revenue has increased by about 10.0 blm tugrugs every year since 2003 and by 50% since 2006, non-tax revenue has remained stable at the average rate of 25.0 bln tugrugs. While the percentage of non-tax revenue in total local revenue was 35% in 2003, the rate has decreased by 6% every year thus reaching 14% in 2008.

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[38] Article 10 of the Unified Budget Law

Graph 3.37   Dynamics of total local revenue and non-tax revenue growth in 2003-2008 (comparative data for 2008, in billion tugrugs)
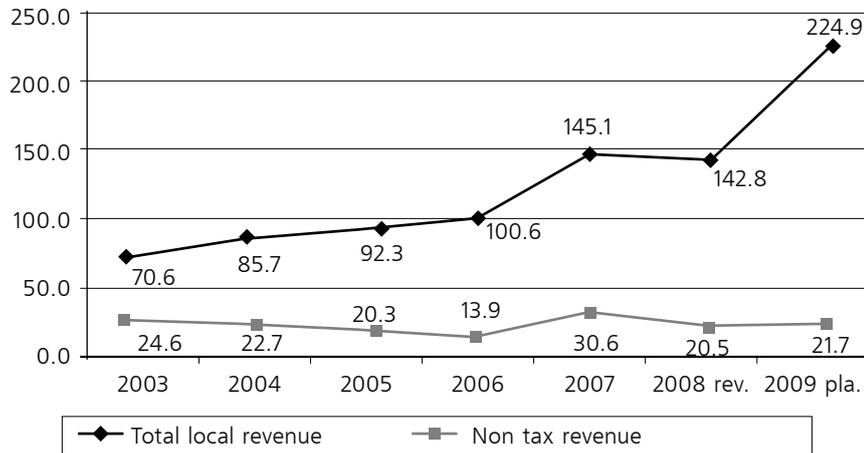
Graph 3.38   Percentage of non-tax revenue in total local revenue in 2003-2007
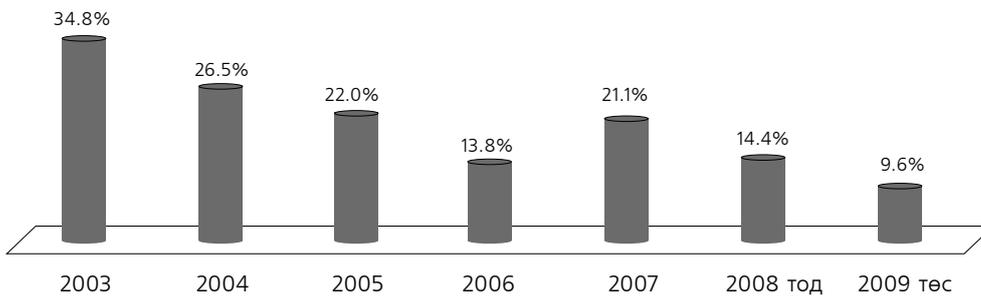
Source: Budget revenue data for 2007 from the Ministry of Finance

According to the above graph, non-tax revenue has not influenced growth of total local revenue remaining stable at about 25.0 bln tugrugs.

Now let us examine the different types of non-tax revenue by percentage.

The only major part of non-tax revenue is comprised from interests and penalties which permanently constituted the average percentage of 40% in 2003-2008.

If operational income and privatization income of state budget organizations permanently constituted an average percentage of 10% each, the percentage of income from dividends started to grow fast in 2006 reaching 12% in 2006 compared to 2% in 2005. This is related to the fact that 51% of the coal mine in Tsogttsetsii soum of Umnugobi aimag is owned by local authorities.

Graph 3.39   Percentage of types of revenue constituting non-tax revenue
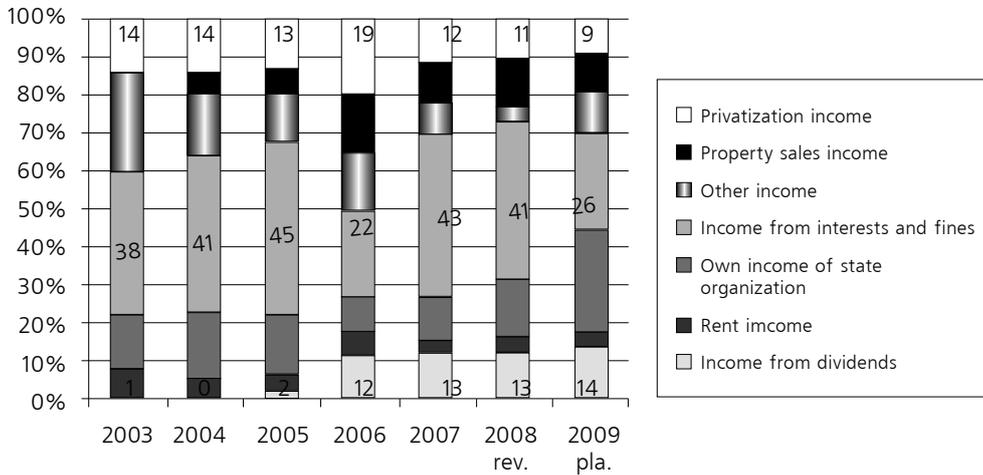
While rent income constituted 3%-4% in non-tax revenue and the percentage of income from sale of property constituted 10%, the percentage of other unclassified revenue has decreased every year down to 4% in 2008 compared to 26% in 2003.

Graph 3.40   Non-tax revenue collection (2007, by aimags)
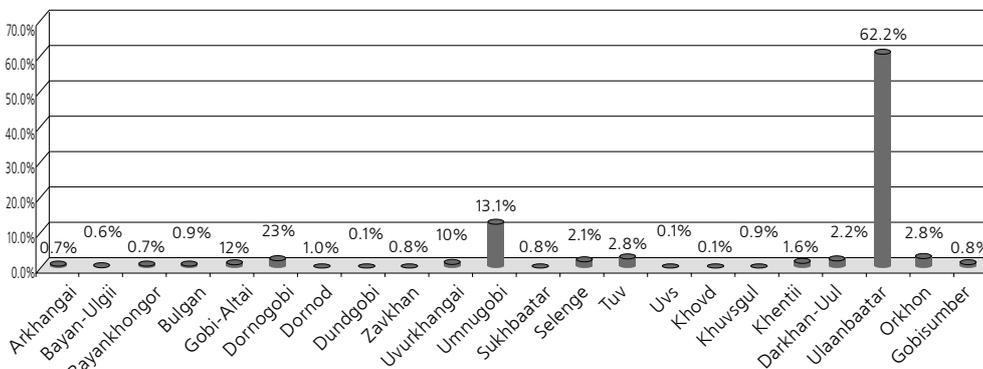
Source: Budget revenue data for 2007 from the Ministry of Finance

According to data prepared by aimags, 62% of non-tax revenue comes from Ulaanbaatar city and 13% comes from Umnugobi aimag. Other aimags have an average of 0.7%-1.0%. Aimags with higher concentration of population such as Darkhan, Orkhon, Central and Selenge contribute 2.0%-2.2%.

Dividends from the coal mine in Tsogttsetsii soum of Umnugobi aimag were 1.0 bln tug in 2006, 3.0 bln tug in 2007 and 6.0 bln tug in 2008, which constituted the major part of non-tax revenue of the same aimag.

Table 3.8:   Non-tax revenues of the selected aimags

	Bayan-Ulgii			Umnugobi			Khentii			Orkhon		
	2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev
1 Dividends				1 096,9	3 015,9	6 021,5	0,0					
2 Rent income						0,0	0,0					
3 Own income of state budgeted organizations	14,3	17,9	6,0	29,6	27,1	0,0	28,5	52,4	29,4	150,4	198,1	169,4
4 Income from interests and penalties	14,9	21,2	12,1	125,8	118,1	162,7	86,1	132,9	91,4	134,8	85,1	134,8
5 Other unclassified revenue	57,4	115,1	53,9	42,1	79,7	68,2	107,8	80,0	80,0	140,1	71,2	
6 Income from sale of property		1,1		8,0	45,4	0,0	15,5	134,2	10,0	0,0	343,0	200,0
7 Income from privatization	0,2			0,3		0,0	0,0					
NON-TAX REVENUE	86,8	155,4	72,0	1 302,8	3 286,3	6 252,4	237,9	399,6	210,7	425,2	697,4	504,1

There is almost no rent income and privatization income in the selected four aimags. There is little income from sale of property, but their percentage varies across the aimags.

Income from interests and penalties, own income of state budget organizations and other unclassified income contribute a certain percentage to the aimag budgets every year.

If income from interests and penalties generates revenue of 15.0 mln tugrugs at least or in average in Bayan-Ulgii aimag, it contributes 100.0 mln tugrugs in other aimags.

If in Orkhon aimag own income of state budget organizations is 170.0 mln tugrugs in average, it is 20.0-30.0 mln tugrugs in other aimags. This is related to centralized records of tax revenue as well as to existence of the Erdenet mining corporation at the territory of the aimag.

Below are defined sources of non-tax revenue, their further tendency to increase or decrease and factors to influence them.

1.   Dividends from business enterprises with local ownership

According to the data from the Ministry of Finance based on local budget revenue statements, there are few aimags, which gain dividends[39]. It is unclear how many shares is owned by local authorities in business enterprises.

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[39] It is not possible to see from these statements from the Ministry of Finance if the local authorities own any shares. But it is possible to see their dividends.

Income from dividends mainly depends on profitable activities and economic growth of the enterprise. This type of revenue has a potential of increasing in great measure[40].

2. Income from interests and penalties

Revenue is derived from interests and penalties imposed on individuals and organizatons ,who violated law in the local area. It is inappropriate to demand payment of interests and penalties by setting a plan of their payment. Related authorities should pay more attention to preventive measures in order to ensure strict compliance with laws by individuals and organizations.

Therefore, it is inappropriate to gain a major part of the local budget revenue from this type of income. It should be at a stable low rate in order to improve responsibility for law implementation.

3. Own income of state budget organizations

This type of revenue is gained through performance of side-work by state budget organizations. This revenue is unlikely to grow in the future, because in the current circumstances of market economy there is plenty of private enterprises to perform the work. So this type of revenue is unlikely to be regularly generated.

4. Income from rent and tenancy

This type of revenue depends on the local circumstances and management. Therefore, it is unlikely to grow.

5. Income from sale of property

This type of revenue is not stable, because there is limited property in local areas and there is no permanent activity to sell the property.

6. Income from privatization

As already more than 20 years have passed since Mongolia made a transition to market economy, there are now very few objects left for privatization. As this type of revenue is generated only once, it may be deleted from the law in the future.

7. Other unclassified revenues

There is no revenue, which may fall under this type of revenue, because records by the tax authorities are held uniformly across the local areas.

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[40] There is no specific limit.

4. ANALYSIS OF LOCAL TAXATION AUTHORITY AND TAX REVENUE ASSESSMENT

4.1 AIMAG TAX REVENUE

The impact and delivery of aimag tax revenues as identified by the Law on Central Budget of Mongolia – real estate tax, royalty for minerals (20%), land fee, taxes for vehicles and other automotives, license fees for mineral exploration (25%) – are compared against the classical norms[41] of local taxation and the interests of the country. In this comparative study, reports of the Finance Ministry and data and research collected from the taxation offices of the local governments have been used.

Actual Authority of Local Governments in Local Taxation

Taxes for vehicles and other automotives, real estate, royalty for minerals, license fees are established by the highest authorities through legislation. Therefore, local governments have no power to alter or reduce these tax rates. So in the sense of "having authority to influence", it is insufficient to consider the above taxes as "local" in its classical meaning. Nevertheless, since the proceeds from these taxes are transferred to local governments' accounts, they can be treated as "local revenues".

The land fee and its rates can be administered locally within the legal framework by the local governments. However, any power on concession or exemption of the land fee is legally established, and, thus, the local governments have no authority to intervene.

Therefore, from among the legally established local taxes, the land fee is comparatively close to the "classical local tax types" authorized to local governments.

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[41] Norms of substantial role of the local government in taxation authority; predictability at the local level; local tax collection, etc.

Table 4.1:   Taxation Authority of Aimags and the Capital

№	Code	Types of Taxes	Establishment of types of taxes	Establishment of tax rates	Concession, exemption	Collection	Revenue channeling
1	A1	Real Estate Tax	CG	CG	CG	AG	AG
2	A2	Municipal Tax	This type of tax is yet to be launched. No legal framework is established.				
3	A3	Minerals royalty	CG	CG	CG	AG	AG, CG, SG
4	A4	Exploration and Mining License Fees	CG	CG	CG	CG	AG, CG, SG
5	A5	Vehicle and Automotive Taxes	CG	CG	CG	AG, SG	AG
6	A6	Land Fees	CG	CG, AG	CG	AG	AG

Explanation:
CG - central government
AG - aimag government
SG - soum government

Predictability

The authority to award mining licenses and to collect the related fees and charges is exercised by competent authorities of the Central Government. Therefore, the local governments have very little avenue to predict expected revenues. In addition, despite the standing clause in the law that a consent of the local government should be obtained prior to issuing mining licenses, the ambiguous statement[42] in that clause leads to a situation, where the local authorities would have no information on the holder of a license and what part of the local territory the license covers.

The local governments independently organize collection of statistical information and recording and tax collection with regard to land fees, real estate taxes,

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[42] The Law allows that, after having filed an application for a license with the competent central authorities, the applicant may wait for the expiry of 30 days designated for obtaining an approval from the local government after which the central authorities are forced to issue the license even without the local approval.

vehicle and automotive taxes and others, and have all avenues for a relative prediction of their trends.

Except for gold and copper, the royalty payments for minerals are collected by the local tax office directly from the taxpayers and are relatively predictable as compared to the license fees. For gold and copper, their royalty payments are transferred through the central tax administration, and, therefore, have some complication and less predictability for the local governments.

Capacity as Long-term Sustainable Source

O Tax revenues based on local real estates (land fees and real estate taxes) present long-term sources for stable income in the local finances.

Movable properties can create tax revenues in a relatively short term. However, for example, movable properties like vehicles as a necessity are continuously replaced and written off. Therefore, vehicle and automotive taxes act as a long-term, stable source locally.

Another advantage of these taxes is demonstrated by incremental increase of revenues each year contributed by them as the economy expands.

The royalty for minerals and license fees are those types of tax that produce benefits from natural wealth within a limited time span. In other words, natural resources are not renewable. The respective size and stability of revenues depend largely on the life and the annual volume of extraction (production) of minerals.

As compared to immovable property taxes, the minerals-related ones would generate a large amount of revenues in a short period, but tend to have a relatively short life.

Local Tax Income Gap

A priority policy of the central government is to evenly develop administrative and territorial units, so it attempts to distribute evenly budget revenues. In other words, population should receive public services of equal quality and amount regardless of the territory they reside in.

The study showed that urbanized aimags with large population differ substantially from rural aimags. The present law does not take into account the disparities, which does not meet the actual demand.

That is why a status of "a city" should be introduced in the legal frame and legal basis for its budget and financing should be developed. Budgets and financing of sparsely populated rural aimags with relatively large areas, based on agriculture should be considered separately.

Natural wealth is an important, but non-renewable resource. Thus, by treating this wealth as not local, but national endowment, and redistributing the proceeds equally among the entire population would help narrow the income gap.

Today the bulk of local tax revenues in this country is generated by the mining sector, which widens the income disparity among aimags depending on their minerals development.

Assessment of the Tax Base

The assessment on the tax base made in the previous part reveals that taxes are different with regard to a city and an aimag. Aimags differ as those with mineral deposits and without such deposits. This leads to a gap in generation of budget revenues among the local governments. Among the 4 aimags selected as samples, Bayan-Ulgii as the representative of those aimags less endowed with minerals collects the lowest amount of license fees and royalties.

Ulaanbaatar City with the highest population density produces 50-60% of its revenues solely from real estate taxes, land fees and vehicle and automotive taxes. In aimags regardless to their population size or budget expenditure these taxes are evenly distributed and less diverse.

The tax base of this type of taxes is evenly distributed in rural aimags. In the future, taxation authority and power to set tax rates should be given to local authorities, so that aimags shall introduce a tax policy conducive to local specifics, which will give them an opportunity to increase their tax revenue. An issue of bringing evaluation of assets of population and land value close to market prices and putting them in economic turnover is especially important.

The royalty and license fees for minerals are derived from the mineral resources in rural areas, so urban areas lack a tax base. The volume of these taxes is dependent on the world market prices for minerals, which will directly affect exploration and mining activities.The short-term potential of these taxes to increase revenues, thus, is classified as "uncertain".

4.2 SOUM TAX REVENUES

At present, 12 types of taxes stipulated by the General Tax Law and the Central Budget Law of Mongolia constitute the tax revenues of soums. These so called soum tax revenues are not legally independent, for they are levied and their rates are established by the central government, and the local governments have no right to grant a concession and exemption. Thus they have lost their meaning of local (soum) tax revenues. Though local governments have some rights to establish rates of several taxes, this right does belong not to soum

governments, but to the aimags'Citizens' Representatives Hural (tax revenues in C6, C8, and C9 of Table 4.2). In reality they are called aimag or soum tax revenues only based on which budget they are channeled to.

Table 4.2   Analysis of Taxation Authority of Soums

№	Code	Types of Taxes	Establishment of tax categories	Establishment of tax rates	Concession and exemption	Levying and collecting	Channeling of revenues
1	C1	Personal income tax	CG	CG	CG	SG	SG
2	C2	Firearms tax	CG	CG	CG, SG	SG	SG
3	C3	State stamp duties	CG	CG	CG	SG	SG
4	C4	Usage fee on hunting stock, permit fee for hunting or catching wild animals	CG	CG	CG	SG	SG
5	C5	Permit fee for exploitation of natural resources other than minerals	No designated regulatory mechanism for taxation				
6	C6	Plant harvest charge	CG	AG	CG, AG	SG	SG
7	C7	Firewood and timber stocking and usage fees	CG	CG	CG	SG	SG
8	C8	Common minerals royalty	CG	AG	CG	SG	SG
9	C9	Water and mineral water usage fee	CG	CG, AG	CG	SG	SG
10	C10	Personal income tax on street vendors and small businesses whose production and service can not be categorized for the tax purposes	CG	CG	CG	SG	SG
11	C11	25% of license fees for exploration and exploitation of minerals	CG	CG	CG	CG	CG
12	C12	10% of the royalty for mineral deposit	CG	CG	CG	CG, SG	SG

Explanation:
CG −Central Government
AG −Aimag Government
SG − Soum Government

As for these taxes, the soum has been reduced to as a unit of the central government structure that is responsible only for levying and collecting taxes. There is no legal environment yet for soums to take initiatives on regulation, revenue increase and tax collection. Although every country has a common practice whereby the highest government institutions establish the maximum and minimum threshold for tax rates, it is the local authorities, who normally have the right to fix the actual rates.

A fact that soum tax revenues constitute about 40% of the total local tax revenues demonstrates an increasing concentration of the tax base in the local communities. Since most of the so called soum taxes (12 types as defined by law) have a low value, the soum tax income is made in fact by personal income tax, 10% share of the soum in the royalty payment for minerals, state stamp duty, and mining license fee.

Table 4.3   Share of the Soum Taxes (average of last 3 years)

	Tax Share	Soum Taxes
1	Above 20%	- 10% of minerals royalty payment - Personal income tax
2	6%-20%	- Stamp duty - 25% of exploration & exploitation license fees of mining
3	0%-5%	- Other tax revenue

It can observed recently that the share of the personal income tax and state stamp duty is decreasing, while that of minerals royalty and license fee is increasing[44]. In other words, tax contribution generated by mining is growing. The tax base related to mineral deposits (mining industries) is diverse and unequally distributed from soum to soum. The personal income tax and state stamp duty are the tax revenues closely correlated with the population size, economic development, public services in a particular soum and are balanced (there are large or small, different tax bases in each soum).

Though the tax revenue and base derived from mineral deposits are increasing, their uneven distribution creates a budget income disparity at the local (soum) level. Since this tax base is set to increase further, the income gap among administrative units will widen, if redistribution of tax revenues does not take place.

The base for taxes other than those generated by mineral deposits and mining production has an insignificant potential to increase *(some tax bases may grow along with development of infrastructure and mining).* Nevertheless, if the local

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[44] See map 3.1: "Share of soum tax revenues in the total tax income".

governments engage in entrepreneurship, develop infrastructure and create jobs, the tax base for revenues from personal income tax, stamp duty and others has a full potential to grow. More efforts are needed as well in terms of research and identification of unused sources[45] of the tax base and organization of fair and flexible mechanism for tax collection.

Taxes such as personal income tax and state stamp duty have considerable differences in urban and rural areas. Especially the components of personal income tax are substantially different[46].

4.3 ASSESSMENT OF NON-TAX REVENUES

From among the non-tax revenue types, property privatization income and property sales proceeds may cease to exist in the future and might produce one-time revenues for the local governments.

Own income and rental revenues of the government organizations may exist for a longer period, but they will not grow because of their independence from economic development.

Since the overdue charges and other fines have a purpose of improving law enforcement, the revenues thereof shall not be planned and placed a high importance in the local income. This kind of revenue will exist for a certain period in the future, but it will not bring significant sustainable revenue to local areas as it has a different role.

The rates of the above charges and fines are established by the General Tax Law and the Law on Administrative Responsibilities. Therefore, the local governments have no authority in this respect.

As can be seen from the case of South Gobi aimag, dividends from shares can become a stable source of local income. The local authorities can provide support to, if not to influence directly, the profitable operation of the respective companies.

To sum up, it can be concluded that non-tax incomes do not constitute substantial revenue to the local governments, their potential to grow is limited and they can only contribute small stable income to the budget.

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[45] No data is available, for example, for plant harvest charges (C6) in aimags and soums.
[46] Studies show that in rural soums personal income tax of herdsmen is the major contributor while in the cities personal income tax on street vendors and small businesses whose production and service can not be categorized for the tax purposes is overwhelming.

Table 4.4 Assessment of Local Taxes

Дугаар	Code	Types of Tax	Ranking in Local Budget*	Potential to expand Tax base**	Difference between urban & rural units	Explanation
Aimag, Capital City Taxes						
1	A1	Real Estate Tax	3	3	different	Assessed as "limited", since a rapid and substantial increase of the size of real estate is considerably limited. The Ulaanbaatar City produces alone 60% of the real estate tax revenues. Therefore, there is a difference.
2	A2	Municipal Tax	This provision is yet to be implemented			
3	A3	Minerals royalty	1	2	different	Assessed as "not sure" because of its dependence on world market prices. The capital has zero revenue.
4	A4	Mineral exploration fees and license fees	2	2	different	There is a difference between the capital and aimags and the income correlates with degree of mineral deposit concentration.
	A5	Vehicle and other automotive taxes	3	1	different	Assessed as "different", for Ulaanbaatar generates alone 50% of income. Revenue is potentially to increase along the tax rate increase. The number of vehicles is growing substantially as well.
5	A6	Land fees	2	1	different	Main revenues come from Ulaanbaatar and areas with large mines. Possible to increase the revenue size through reducing the concessions on land values

Soum taxes

1	C1	Personal income tax	1	Substan-tially dif-ferent	The share is high in central area soums, but low in rural soums. The share in the total soums tax income was up to 45.3% until 2006. However, it is shrinking in connection with taxes on minerals (was 10.9% in 2008).
2	C2	Fire arm charge	3	Not different	
3	C3	State stamp fee	2	Substan-tially dif-ferent	Relatively high in administrative units with large population.
4	C4	Usage fee on hunting stock, permit fee for hunting or catching wild animals	3	Different	Relatively high in rural soums. However, the tax share depends on geographical location, habitat and distribution of wild animals, and regional specifics rather than on urban and rural differences.
5	C5	Permit fee for exploitation of natural resources other than minerals	3	Not different	
6	C6	Plant harvest charge	3	Not different	There is a potential to mobilize some income if the local tax base is identified and income generation is given more attention.
7	C7	Firewood and timber stocking and usage fees	3	Not different	The tax income is not different in terms of urban and rural units, but different depending on regional specifics and geographical location (forest reserves).

Дугаар	Code	Types of Tax	Ranking in Local Budget*	Potential to expand Tax base**	Difference between urban & rural units	Explanation
8	C8	Exploitation fee for common minerals	3	2	Not different	
9	C9	Water and mineral water usage fee	3	2	Not different	Not the urban and rural difference, but the water-intensive production and mining development is the major factor.
10	C10	Personal income tax on street vendors and small businesses whose production and service can not be categorized for the tax purposes	C1 Major tax component	2	Substantially different	The tax share is relatively high in urbanized soums with large population.
11	C11	25% of license fees for exploration and exploitation of minerals	2	1	Not different	Large difference is not relative to urban and rural units, but to regions with mineral deposits.
12	C12	10% of the royalty for mineral deposit	1	1	Not different	Large difference is not relative to urban and rural units, but to whether regions have mineral deposits.

* Ranking is noted by numbers: 1- "good", 2 –"average", 3- "weak".
** Potential is ranked by numbers: 1- "Potential to increase", 2 –"Not sure", 3 –"Limited"

Table 4.5 Assessment of Non-Tax Revenues

Дугаар Code	Types of Taxes	Ranking in Local Budget*	Potential to expand Tax base**	Difference between urban & rural units	Explanation
Non-tax Income					
1	Income from dividends of entities with local ownership	1	1	Not different	Though it contributes little to local budget, it produces a bulk of non-tax income, as in the case of South Gobi aimag. Therefore, it is considered to have a positive effect on local budget.
2	Income from interests and penalty	2	3	Not different	It generates 40% of the non-tax revenues. However, it will not increase and be used in limited way.
3	Own income of public institutions	2	2	Not different	It will remain small and at certain level.
4	Rent income	3	2	Not different	It depends on local specifics and development levels.
5	Proceeds from property sale	1	2	Not different	Properties are a few and not often sold.
6	Privatization proceeds	1	2	Not different	Privatization will complete in future.
7	Other unclassified income	1	2	Not different	They will cease to exist if income categorization becomes complete. New income types are not probable to emerge.

5. FINANCIAL SUPPORT AND DISTRIBUTION PRINCIPLE

The central budget transfers in any country constitute the core part of the local budget irrespective of income sources and size.

The share of theses transfers in the local budget and their distribution principle and application mechanisms differ from country to country. For example, the share of transfers in the local budget is 70-80% in Italy, Britain and the Netherlands; 50-70% in Greece, Portugal and Spain; 40-50% in Germany and Belgium; 30-40% in the USA, Australia, Japan and France; 20-30% in Finland, Sweden, Denmark, New Zealand, Canada and Austria. The transfer distribution principles must deal more with the transfer policy outcome rather than with instruments of ways of distribution (Bird, 1993). In other words, the principles must ensure the distribution efficiency and adequacy and the macroeconomic stability.

Therefore, an adequately organized transfer mechanism provides for efficiency and effectiveness of the local budget even when the transfer share is very high. Similarly, without a well-organized mechanism, a transfer that occupies a smallest share in the local budget can not meet the above conditions. Consequently, what matters the most is not the extent to which local budgets depend on the central government transfers, but the way it depends on it.

The main role of the transfers is to ensure the vertical and horizontal balance of the budget. The budget balance deals with two key issues of local financial relations. First, it aims to ensure the balance of income and expenditure of administrative units of various levels. It means that the local governance shall have a sufficient financing in order to fulfill its mission. Second, its purpose is to narrow the gap between administrative units of the same level in terms of demand for expenditure and capacity for income generation[47].

Many factors influence the transfer allocation. First of all, there is a need to identify the role and function of the local administration itself, and to estimate the size of transfers in correlation with the administrative costs.[48]

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[47] S See more in Fiscal Equalization in South Eastern Europe, Gabor Peter; Budapest, LGI
[48] Services and function of the local administration required by law are called "Mandatory public service", meaning the sole and political responsibility for the quality of services.

The next factor is the size of an administrative and territorial unit. In other words, it will depend on the population size of a given unit. Countries, where the population density is low, treat the transfer very carefullybecause, small administrative units have a weak capacity to generate revenues. In developed countries like Island, France, Greece, Austria and Spain, the lowest administrative units have the smallest population size of 1,000 to 5,000; in Canada, the USA, Germany and Norway – 5,000-10,000; in Belgium, Denmark and Australia – 15,000-20,000; in Sweden and Portugal – 30,000-35,000; in Ireland and New Zealand – 40,000-50,000; and in Britain – over 100,000.

Another factor to influence the transfer allocation is the capacity of the local governments to generate their own revenues. This depends on their tax base, the principle of tax shares and the ability to collect taxes. Considering this factor, more transfers are allocated to those units that have a limited capacity to generate revenues.

In the former communist countries of Central and Eastern Europe, there are following three major models of transfer allocation:

1. *Transfers filled in the gap.* This is a type of transfer from the central budget with special designation for the purpose of filling in the gap between the potential expenditure and estimated revenue. This model is based on the allocation negotiated between the central and local governments. In other words, the highest level of government will control and decide the local government's functions and expenditure limits. In this case, local administrations will have low interest in increasing its income and responsible and independent operations. They will rely on the central budget and will prefer an easy life. Extra revenues on top of the planned will lead to a cut in transfers. This model is identical to what we practice in Mongolia in terms of the financial support the central budget provides to the local governments.

2. *General grant.* This model provides for matching to certain service indicators, when the central budget transfers funds to the local governments. At the same time, no limitation is imposed on the power of transfer expenditure. Examples of the service indicators include the population size, its age structure, service recipients (number of pupils, number of hospital beds). This model allows a larger freedom in planning and expenditure of local budget and stimulates the interest of local income expansion.

3. This is the most complicated model and it is treated with substantial caution in transfer allocation. It is called a model of standardized expenditure and revenue capacity. The transfer allocation is based on a difference between standardized expenditure and local revenue. The

local expenditure is standardized and calculated with use of a formula. The local revenue is estimated at the minimum or potential average. After assessing the above two indicators, the difference is allocated as transfer.

This transfer model is more effective than the other two in terms of budget balancing. The expenditure is based on a common standard. The real expenditure difference of each administrative unit is treated individually. The unit with a limited revenue capacity will receive a larger transfer and will be responsible for ensuring the inflow of the planned average revenue. If the local administration falls short of the planned average revenue level, the difference will not be compensated. If its revenue exceeds the planned level, that will not serve as a reason to cut the transfers.

The transition countries have applied a constructive solution for the budget balancing transfers with combination of these three models.

5.1 State of Financial Support Allocation in Mongolia

A majority of aimags and soums in Mongolia finance their expenditure with the financial support from the central budget and the aimag budget, respectively.

Currently, the local budget expenditure includes (i) the budget of aimag and soum governors and their offices; (ii) operational costs of aimag and soum Citizens' Representatives Hurals; (iii) operational costs of bags; and (iv) investment. Each fiscal year, aimags prepare the budget expenditure draft based on the previous year and the local revenue plan and submit them to the Ministry of Finance. The Ministry examines the draft budget, estimates compensation for shortages through a financial support to those aimags, which are unable to balance their budget, and have the draft budget approved by the Cabinet and the State Great Hural. The approved financial support is then considered by the Aimag Hural of Citizens' Representatives and allocated to soums.

The capital city and 5 aimags in Mongolia are self-sufficient in finances and the rest of aimags receive transfers from the central budget. For these aimags, between 4 to 60 percent of the total expenditure are financed through central budget transfers. This indicator is the highest, or above 43 percent, in the 5 western aimags. It is related to limited sources of local income in these aimags (see Table 5.1).

The amount of currently allocated transfers is sufficient only for locally responsible expenditure or operational costs of local government offices. Based on the theory of central-local financial relationship and international experience, we will analyze the state of implementation of the following principles of the transfer mechanism in Mongolia.

*Graph 5.1   Local Revenue and Financial Support of Aimag Budget
              (2007 figures)*

	Own income	Support
Gobi Sumber	41.8	59.2
Orkhon	100.0	0.0
Ulaanbaatar	100.0	0.0
Darkhan Uul	100.0	0.0
Khentii	60.2	39.8
Khuvsgul	52.2	47.8
Khovd	41.1	85.9
Uvs	34.8	64.2
Tuv	86.0	14.0
Selenge	100.0	0.0
Sukhbaatar	84.3	15.7
Umnugovi	100.0	0.0
Uvurkhangai	75.2	24.8
Zavkhan	35.6	64.4
Dundgovi	45.3	54.7
Dornod	77.1	22.9
Dornogovi	100.0	0.0
Govi Altai	36.2	63.8
Bulgan	93.2	6.8
Bayankhongor	63.7	36.3
Bayan-Ulgii	46.0	54.0
Arkhangai	55.6	44.4

Table 5.1   Share of Local Revenues in Total Budget Expenditure of Aimags

	Share of local own revenues in total expenditure	Number	Aimags
1	31-50	8	Bayan-Ulgii, Gobi-Altai, Dundgobi, Zavkhan, Central, Khovd, Gobi-Sumber, Uvs
2	51-70	4	Arkhangai, Bayankhongor, Huvsgul, Khentii
3	71-90	3	Dornod, Uverkhangai, Sukhbaatar
4	91-100	7	Bulgan, Dornogobi, South Gobi, Selenge, Darkhan-Uul, Ulaanbaatar, Orkhon

Source: 2007 Budget Revenue Report, Ministry of Finance

5.2 Transfer Allocation Principle

An established principle of central-to-local transfer does not exist in Mongolia. Aimags submit to the Finance Ministry their income-expenditure plans. The Ministry calculates the required transfer amount on the basis of the previous year's implementation of income-expenditure plan with some modification for expected changes in the current year. The State Great Hural debates and approves each year the local budgets. Extending financial support on the basis of annual negotiations on the income-expenditure differences leads to a weakened

responsibility for mobilizing local revenues and relying more on budget support from the upper instances.

Such a state of affairs also feeds the interests of some self-sufficient aimags and soums to inflate their expenditure and to minimize their contribution to the central budget. For example, the South Gobi aimag appropriates its excess revenues to its "My Land Endowment" fund and distributes the proceeds to its citizens in cash. Such a cash distribution falls into a category of social welfare and transfer services and is not allowed by law at the local level.

Predictability

It is not possible for aimags and soums to estimate in advance and predict the size of financial support from the central budgetfor the current support system is not based on objective factors such as the population size, the number of service recipients, remoteness of territory, the number of administrative units, and unit costs of services. It is based only on mutual agreement to finance the actual difference between expenditure and income. There is no formula to calculate the financial support. Therefore, financial support can not serve as a predictable, guaranteed source of revenues.

Guarantee

A fact of submission of transfer proposals through the Finance Ministry to the Parliament for approval reduces the level of guarantee that the fundamental principles of local income sources be protected by law. The principle of transfers and the key indicators of its calculations are established by law in the developed countries and in the post-communist countries of Eastern and Central Europe. In our case, codification of treatment of the local budget as an integral part of the central budget has eliminated legally independent local budget management. In other words, the local budget does not stand as independent and separate, but as an integral component of the central budget. Such a state of affairs stems from a substantial logical misunderstanding dictated by the Constitutional statement that Mongolia is a unitary state and has a single budget. Being a unitary state means that its territory is divided into administrative and territorial units and it has a unified legal system, but it does not amount to codification of centralized governance and single budget.[49]

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[49] Tony Levitas, Rethinking State-Local Relation in Mongolia Today: Possible Directions for Local Government Reform, UNDP Local Government Support Project , June, 2008; takes up in detail numerous challenges and difficulties faced by Mongolia's local governance and stemming from the illusion of a unitary state.

A local budget system requires to be regulated by a special law and to be legally independent and guaranteed. This is a question of, first, codification of separation of functions for the local government and   public management; secondly, codification of local taxation authority and financial support principles.

Ensuring the Budget Balance

It was noted at the beginning of this Chapter that the principle goal of any transfer mechanismwas to ensure the vertical and horizontal balance of budget.

There are two methods of checking whether today's financial support mechanism ensures the budget balance. First, we will look at per-capita distribution of total local revenues. This measure will be only convenient when the central government aims at equalizing per-capita income. Moreover, the local income generation capacity is not included in the estimation.

A regression analysis is used to examine the correlation between the per-capita financial support, the financial capacity and the demand variable of expenditure. If demand variables of population and poverty increase the support amount, while the financial capacity decreases it, it is considered to ensure the balance. An estimation of the 2007 figures has revealed that the current financial transfers have a considerable balancing role.

For example, here we have studied the per-capita GDP of aimags and unemployment, and presented their correlation with per-capita financial support[50] (table 5.2).

The aimag's per-capita GDP seems to have no influence on the amount of financial support. This means that it does not depend on the aimag's financial capacity. But when the unemployment rate is higher, in other words, when the demand for expenditure grows, the size of financial support increases. Also when the share of agriculture in the aimag's GDP is higher, the size of financial support increases. It illustrates that the financial support distribution principle in our country is directed only at financing expenditure needs regardless of output indicators of the given aimag. Therefore, it is necessary to change the present financial support distribution principle.

If we include the royalty payment for minerals in the equation, the correlation becomes weaker. In any case we can say that balancing between aimags does not work well as for 2008. In addition, current financial support does not strengthen the local revenue capacity.

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[50] See more in the report by B. Tumennast; Open Society Forum's Compilation: Responsible Government: Financial Centralization, Local Self Administration. Ulaanbaatar 2008, pp. 72-78

Table 5.2   *Balancing Test (Regression method)*
              Per capita financial support is the dependent variable)

	I	II
Constant	-5.948	-3.009
	(10.197)	(10.102)
Population	0.226	-0.053
	(1.165)	(1.146)
Aimag's per capita GDP	0.391	0.535
	(1.854)	(1.802)
Unemployment	4.332**	3.598*
	(1.760)	(1.782)
Share of animal husbandry in GDP	2.041**	1.782*
	(0.943)	(0.932)
Minerals Royalty		-0.298
		(0.207)
Adj. R2	0.48	0.51
N	22	22

Standard deviation is in parenthesis. ***,**,* denote significance at 1,5,and 10 % respectively. All variables are in logarithm.

Source: Ministry of Finance, Central Statistical Office

As large mineral deposits in a few aimags become commercial, allocation from the minerals royalty to aimags will increase over the years,but other aimags will not benefit from the increase. This will lead to a further gap in budget balancing.

Map 5.2 below presents per-capita budget indicators of aimags. The per-capita local revenue is the highest in aimags such as Orkhon and South Gobi, while the lowest is in Uvs, Bayan-Ulgii, Zavkhan. The ratio of the highest and the lowest is 1 to 19. After financial support from the central budget is injected, the ratio of per capita expenditure for the highest and the lowest becomes 1 to 4, which indicates that the current negotiations-based financial support mobilizes resources from the high income aimags and redistributes them to the low income ones. Nevertheless, the disparity between aimags in terms of per capita expenditure remains high. In other words, the horizontal balancing of budget is not working.

Graph 5.2   Per-capita Fiscal Indicators in Aimags
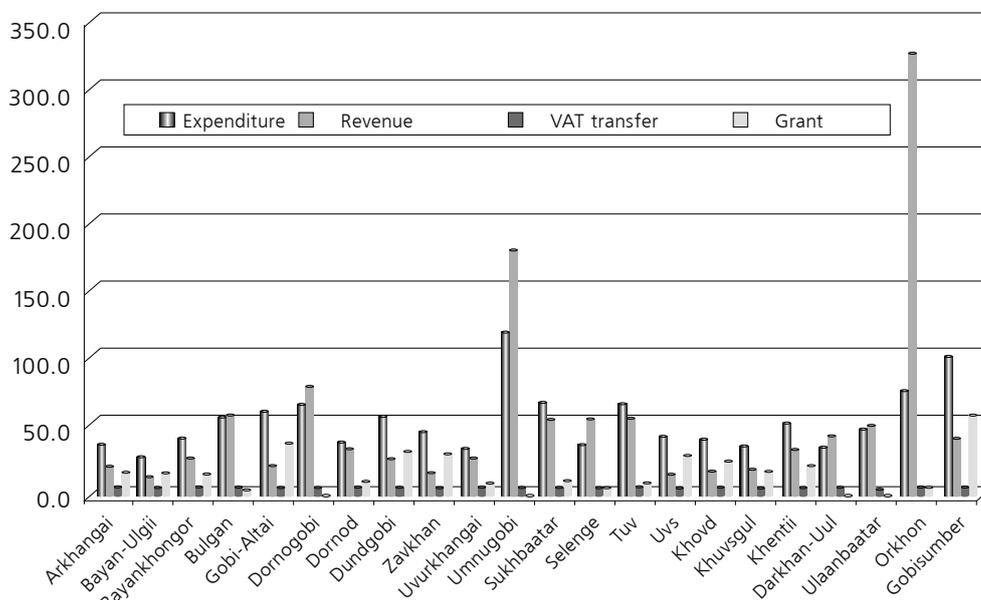
Source: Estimates based on the 2007 local fiscal report provided by the Ministry of Finance. The per-capita indicators are in thousand tugriks.

The difference between the tax amount paid by the local population of aimags and the public services provided in return is called net fiscal benefit. This benefit varies among regions and administrative units depending on non-market reasons or decisions of the central government. If this variation is the reason for internal migration of citizens, then it is considered that the horizontal budget balancing among regions is not ensured. For example, according to the above concept the fiscal revenue of South Gobi aimag might increase substantially and its citizens may enjoy services of higher standard as compared to the citizens in Khovd aimag. Consequently, the citizens of Khovd might migrate to South Gobi aimag. A fact that the local governments do not have taxation authority, or while the personal income tax rates are same throughout the administrative units, their budget income and expenditure are considerably different, manifests that there is a strong need for a mechanism to ensure the horizontal budget balancing. This is not to be solved by delegating the taxation authority to local governments and sharing the tax proceeds with them. The only solution is to establish a new mechanism of financial support to the local governments.

6. POLICY RECOMMENDATIONS FOR RATIONAL ALLOCATION OF LOCAL BUDGET REVENUES

The analysis of local taxation authority, tax revenues and financial support presented in the previous chapters reveals the following state of affairs in this country:

1. The local tax revenue base is concentrated in a few aimags with high population density and developed industry, trade and services. These include the capital city of Ulaanbaatar, Orkhon and Darkhan.

2. In aimags with large mineral deposits and mines, local taxes such as royalty, land fee, water usage fee, generate higher revenues as compared to other aimags. This might lead to a further disparity in the horizontal budget balancing. Such a trend can be observed on the examples of Orkhon, South Gobi and Selenge. The above conclusion suggests that there are only 5-6 aimags with a sufficient tax base, which is about one-third of all aimags.

3. At the soum level, the population is small and the economy is underdeveloped, which severely limits the potential to expand the tax base. Some soums with several mineral deposits and soums at the center of aimags with some concentration of population present a certain potential for an expansion of the tax revenue sources.[51] Out of total 340 soums of Mongolia only 10% have such a potential.

4. Large mineral deposits of strategic significance are distributed unevenly and located in a few aimags only.

5. The income generation capacity of administrative units is not adequate. Only a few have a sufficient capacity, while the majority does not.

6. Criteria of transparency, guarantee and predictability of financial support of the central budget to the local governments are not met.

The above reality dictates that the following policy is pursued and reforms are undertaken to rationalize the central-local budget relations. The key policy recommendations are, as follows:

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[51] There are legal justifications to this statement, for as of 1 January 2009 the proceeds of income taxes on salaries and wages are left to the local government; 10% of the royalty is transferred to the local budget.

(i) "to expand the local taxation authority,

(ii) to reform the tax distribution,

(iii) to create a new mechanism for financial support (transfer) in order to strengthen autonomy of administrative units and

(iv) to rationalize the central-local budget relations".

Within the above policy recommendation, the following three directions of local budget reforms are suggested:

I. To expand the taxation authority of local self-administering organizations and to introduce some reforms in the current local tax allocation

II. To reform the distribution mechanism of financial support in order to ensure the balance of budget

III. To delegate some public services functions to the local governments and to provide respective financing

6.1. EXPANDING LOCAL TAXATION AUTHORITY

Based on the study of the local budget revenue and taxation authority and outcomes of the selected research for 4 aimags and 8 soums, we are proposing the following policy reforms of the current budget revenue allocation and the local taxation authority. The reform proposals are summarized in Table 6.1.

Trends of theory, practices in foreign countries and specifics of this country are taken into account in making the choice of appropriate levels of central and local governments for the purpose of authorizing different types of taxation. In terms of theory, it is a question of applying principles of ensuring the adequacy of delegation of tax authority to different levels of government, of ensuring efficiency and effectiveness of such a delegation.

Efficiency of delegation is about the most beneficial and optimal choice of the level of government for spending and allocation of tax revenues. According to the decentralization theorem of Oates, the cost of a service is defined by the tax amount the local voters are willing to pay for the service. The mechanism of rational distribution prefers to have decisions being made at the lowest level of government.[52]

There is a concept that the immediate recipients of local services shall pay for the cost of service.

In some cases these three concepts conflict with each other. Thus, finding a solution of the choice of a level of central and local government for delegating

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[52] See more in Stephen J.Bailey, Local Government Economics, Principles and Practice, 1999, (London: Macmillan Press Ltd).

the taxation authority becomes complicated and controversial. However, we are not talking here about finding the only best solution, it should be resolved in the frame of general principles to be followed, experience of other countries and real conditions of our country.

As in other countries, Mongolia applies common national taxes of economic entity, sales, excise, and customs.

From a view of income redistribution, these taxes shall stay as central government taxes rather than being delegated to local governments. Since these taxes generate large revenues, the priority shall be placed in ensuring equitable application rather than in profitability and transparency.[53] Delegating these taxes to local governments or sharing with the latter is not appropriate, for local governments with higher income will have interests to distribute these revenues to the citizens of their own thus aggravating the income gap of those local governments, which have low income. In the case of Mongolia, most of industrial and trade entities are concentrated in the capital city, and just a few large mining entities (like Erdenet copper mine) generate a bulk of the tax revenues. These facts demonstrate that the above taxes shall stay at the central government. Most of developed countries have a similar practice.

The sales tax or the VAT has the same nature as the corporate tax. If taxation authority is given to local governments, then large cities with a high concentration of population might prefer to levy a higher VAT. Then their citizens will opt for purchasing goods outside the high VAT region, which would result in a "tax export". It means that non-residents will pay the taxes. These people will jot tale part in the decision-making on local services, while the residents, who pay less tax will have the advantage of making decisions and participating in elections. In this sense, sales taxes are better in the hands of regional governments rather than the local.International experience suggests that authority to establish the rates shall rest with the central government. In the case of this country, the current practice of collecting and establishing the rates of VAT by the central government and redistributing to aimags shall remain intact. For the purpose of transparency in distribution, the return of a part of the VAT, generated by a particular aimag, shall be based on additional factors like the population size, so that it becomes a transparent, guaranteed income source.[54] Or it can take a form of income sharing. For example, 90% of the VAT proceeds are channeled to the central budget, and 10% - to the local budget.

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[53] Stephen J.Bailey, Local Government Economics, Principles and Practice, 1999, (London: Macmillan Press Ltd); pp. 155-157

[54] The current principle applied by the Finance Ministry in the VAT return to aimags is unknown.

Proposals with regard to the Aimag Taxation Authority

In considering income redistribution of local tax proceeds, a differential treatment of tax bases and specifics of rural aimags and municipalities is needed. The current taxation and budget laws liken aimags to the capital city and soums to city districts. The Constitution specifies the capital city and its districts as administrative units, but stops short of defining the status of cities (towns).[55] City (town) administrative units with large population, developed industries and trade, and a small territory have a number of differences as against the rural aimags. For example, the main tax base is related to employment, real estate taxes and land fees levied on economic entities and organizations. At the same time, the proceeds from royalty and common minerals are minimal.

In rural aimags, income taxes of herdsmen, royalty of mineral deposits and exploitation fees of common minerals are the main components of the tax base, while taxes related to employment and real estate are insignificant.

Vehicle and Automotive Taxes

It is suggested that the central government exercises authority to establish the general rates of this type of tax, while local governments be given the right to establish the rates within certain boundaries and to levy and authorize tax concessions. Local governments with taxation authority on vehicle will be able to allocate proceeds to construction and upgrading of roads and bridges, which will improve distribution efficiency and expenditure transparency. This will also help direct the taxation policy to minimize air pollution and CO_2 emission by old cars and trucks. The taxes on vehicle shall be delegated to the aimag governments.

Land Fees

The land fee proceeds from mining are very high in a few aimags. Therefore, in order to balance income distribution, the proceeds shall be redistributed through central and aimag budgets (cross-budget fund). How the reallocation would work, how does it fit into the system of intergovernmental finances, what will happen with those aimags who presently benefit a lot from these revenues? The 2007 land fee proceed in Orkhon, for example, was the highest – 7.0 billion, while the lowest was recorded in Sukhbaatar to the amount of 16.1 million only. The Orkhon land fees are paid mostly by the Erdenet Copper-Molybdenum Complex.

Payment of the other land fees[56] is suggested to remain at the local government, which is the current practice.

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[55] Articles 57.1 & 58.1 of the Constitution of Mongolia
[56] Commercial usage and ownership of lands by citizens and economic entities.

Real Estate Taxes

It is suggested that the current system of redistributing proceeds from this type of taxes to local governments should remain. However, if local governments are given authority to establish the rates within certain boundaries, then this will improve efficiency and provide an opportunity to pursue a taxation policy conducive to their specifics. For example, the overpopulated Ulaanbaatar City may establish higher tax rates for real estate to reduce concentration and to encourage the movement of capital to regions with lower tax rates.

In our country citizens' dwellings are fully exempted from real estate taxes and are charged only 2-3% of the nominal land fees. Over 90% of this type of taxes is generated by proceeds from the real estate taxes paid by businesses. A fact that urbanization in this country is very young is the reason for a weak real estate tax base. On the contrary, European countries generate a considerable part of the local budget proceeds from real estates owned by citizens and households.

Royalty for Mineral Deposits

The current practice of sharing royalty proceeds among the central, aimag and soum budgets shall be revised. We propose to appropriate all royalties into the central budget for a balancing purpose. Or a 30% provision of royalty retention at local budget shall be changed to establish a cross-budget fund, from which it is redistributed among aimags as transfers. For aimags with active mining industries, a provision might exist to retain royalty proceeds all 100%. Then in order to finance recreation of mining sites, to compensate for displacement of local population and for factors undermining traditional economic activities. The rate of royalty shall be established on the basis of real production factors.

Fees for mining exploration and exploitation licenses shall be fully appropriated into the central budget and redistributed. Or the current practice of 50% local retention shall be changed to establish a cross-budget fund from which the proceeds shall be redistributed.

Proposals with regard to Soum Taxation Authority

1. The personal income tax is one of the main components of soum budget revenue structure and is related to the population and socio-economic development situation of the soum. Starting from 2009, tax proceeds from salaries, wages and similar personal incomes are retained at the local (aimag) budget. The components and shares of personal income tax are different for urban and rural units. Therefore, the remote or rural soum budgets may retain the entire income taxes on salaries and wages. As for the centrally located or largely populated soums, a certain percentage of the personal

income tax proceeds may be retained, while the rest be appropriated into aimag budgets (or fully appropriated into aimag budget and redistributed as matching transfers). In other words, centrally located soums will practice taxation shared by aimag and soum.

Such a regulation will create for soums with no mineral deposits and a weak tax base a potential to expand its personal income tax base. For example, in 2007 Bayankhutag Soum of Khentii Aimag generated 24% of its budget revenues from personal income taxes and transferred to the central budget 7.3 million tugriks (10.3% of the total revenues) as tax proceeds from salaries and wages. If this amount was retained at the local budget, then the personal income tax will have produced up to 34 percent of revenues.

2. Taxes related to mineral deposits create disparities of budget revenues at the soum level. Therefore, proceeds from these taxes shall not be shared with the local governments. Instead, they shall be collected wholly by the central government. Such centralized tax proceeds may be redistributed as financial support to the local governments. In doing so, certain financial resources shall be retained at the local budget to compensate for ecological damages and for rehabilitation purposes..

3. There is a need to study in detail taxes established by law, but not collected at the local level, and to analyze the tax base. Also important is to identify new types of tax that might present a potential for the local government and to create a new tax base.

    For example, local governments do not administer plant harvest charges. They need to take an initiative to study this type of taxation and its base. There is also an urgent requirement to define the tax base and streamline tax collection for municipal tax, pet tax, inheritance and gift tax, which are stipulated by law.

    Transparent, sustainable and controlled exercise of exploitation of common minerals, wild animal hunting, water and mineral water usage, and plant harvesting, shall be carried out by the soum administration with participation of citizens and entities. Looking at mineral wealth as only a tax income source is prone to cause ecological damages to the nature. In the future, extraction of gold and other non-renewable natural resources shall be bannedA policy of expansion and full utilization of tax base and taxes related to employment, businesses, properties, commercial activities at the soum shall be pursued. The proposals for soum taxation authority are summarized in Table 6.1.

Table 6.1 Summary of Proposals for Central, Aimag and Soum Taxation Authority

№	Code	Types of Tax	Establishment of types and rates of tax	Right to grant concession & exemption	Levying and collecting	Income distribution	Explanation
TAX REVENUE TO CENTRAL BUDGET							
1	U1	Corporate Income Tax	CG	CG	CG	No change	
2	U2	Customs Duty	CG	CG	CG	No change	
3	U3	VAT	CG	CG	CG	90% to central budget, 10% to aimag budget	
	U4	Excess Tax	CG	CG	CG	No change	
	U5	Fuel Tax	CG	CG	CG	No change	
	U6	Windfall Tax	CG	CG	CG	No change	
	U7	Minerals Royalty	CG	CG	AG	100% to central budget, or 30% to inter-budget account	
	U8	Mineral Exploration and Exploitation License Fee	CG	CG	AG	100% to central budget or 50% to inter-budget account	
TAX REVENUE TO AIMAG BUDGET							
A1		Real Estate Tax	CG	CG	AG	No change	
A2		Land Tax	CG/AG	CG	AG	50% of mine land fee to each of central and aimag budgets. 100% of other land fees to aimag budget	Related to the responsibility of Central Government for subsoil

					Allocation	Notes
A3	Vehicle and other automotive tax	CG/AG	CG/AG	AG	100% to aimag budget	Central Government establishes the band for tax rates and degree of concession and exemption, while the local authorities set the actual number
A4	Wages and salaries and similar income	CG		AG	In aimag center soums, 50% to aimag budget, 50% to soum budget, in other soums 100% to soum budget	For aimag center soums, the tax is shared among aimag and center soum budgets
TAX REVENUE TO SOUM BUDGET						
C1	Personal income tax	CG	CG	SG	In aimag center soums, wages and salaries and similar incomes shall be shared with the aimag budget. All other tax revenues shall be appropriated into the soum budget.	Tax rates and authority to grant concession and exmeption shall be established by law. Soums shall have functions to collect only.
C2	State Stamp Duty	CG AG	AG	SG	It shall be directly deposited to soum budget account.	Aimags shall have the authority to establish the rates and to grant concession and exemption. Some duties on specific services can be set by central government. Soums shall have the finction to collect only.
C3	Exploitation fee on common minerals	SG	SG	SG	It shall be directly deposited to soum budget account.	
C4	Water and mineral water usage charge	SG	SG	SG	It shall be directly deposited to soum budget account.	

C5	Payment for usage of hunting stock and license fee for hunting and catching wild animals	CG SG	CG SG	It shall be directly deposited to soum budget account.	Central professional authorities shall assess the economic value of rear and endangered species.
C6	Firewood and timber usage fee	CG	SG	It shall be directly deposited to soum budget account.	The usage fee for forest reserve shall be established by the center, the other rights shall remain with local authorities.
C7	Natural plant usage fee	SG	SG	It shall be directly deposited to soum budget account.	
C8	Firearm tax	CG	CG SG	It shall be directly deposited to soum budget account.	Rates, some conditions for concession and exemption shall be set by the center. Other rights shall remain with soums.

Explanation:
CG - central government
AG - aimag government
SG - sum government

6.2 REFORMING TRANSFER SCHEMES IN ORDER TO PROVIDE BUDGET BALANCE

Despite some expansion of taxation authority of local governments and redistribution of some tax income (wages and salaries) to local authorities, most of aimags and soums are not capable to self finance their expenditure. Therefore, the central government's financial support through an inter-budget fund[57] shall become the major source of local income.

Establishing the inter-budget fund by law will make the local budgets sustainable, guaranteed and predictable. The inter-budget fund may consist of the central government's financial support to local budgets, shared tax revenues for budget balancing, loans and aid to local governments. Principles and rules for the fund's appropriation and expenditure shall be established by law.

The amount of financial support to be appropriated into this fund can be estimated on the basis of pegging principle tied to some macroeconomic indicators. For example, the amount can be established equivalent to 5% of the GDP. Then the financial support of that amount will be automatically transferred to the inter-budget fund by law.

The tax revenues shared with local budgets like VAT, PIT on wages and salaries, minerals royalty, will be placed as a nominal percentage established by law in the inter-budget fund.

The fund will become a source of financial support to be channeled to aimags. The principles of fund's expenditure shall be set by law. The transfers will be distributed among aimags using a special formula. All this will create conducive environment for an aimag revenue source that is transparent, sustainable, predictable, and guaranteed.

The Parliament shall only set the principles by law, but not to take up each year the income-expenditure report of the Fund. Thus, the central and local budgets evolve as inter-dependent, but autonomous. It will present also a useful innovation to separate the responsibilities of each budget and to make it transparent. The scheme of the inter-budget fund is presented below.

It is appropriate to provide financial support from the national budget to the local one in order to keep the balance of budgets. We are proposing to reform the current mechanism of financial support into the one that is based on the principle

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[57] According to the current legislation, the amount of financial support to aimags is approved each year together with the central budget. It is recommended to change this practice and to establish an inter-budget fund where the tax revenues to be shared with local governments and the financial support shall be appropriated.

*Figure 6.1   Chart of the Revenues and Expenditures of the
                Inter-Budget Fund*
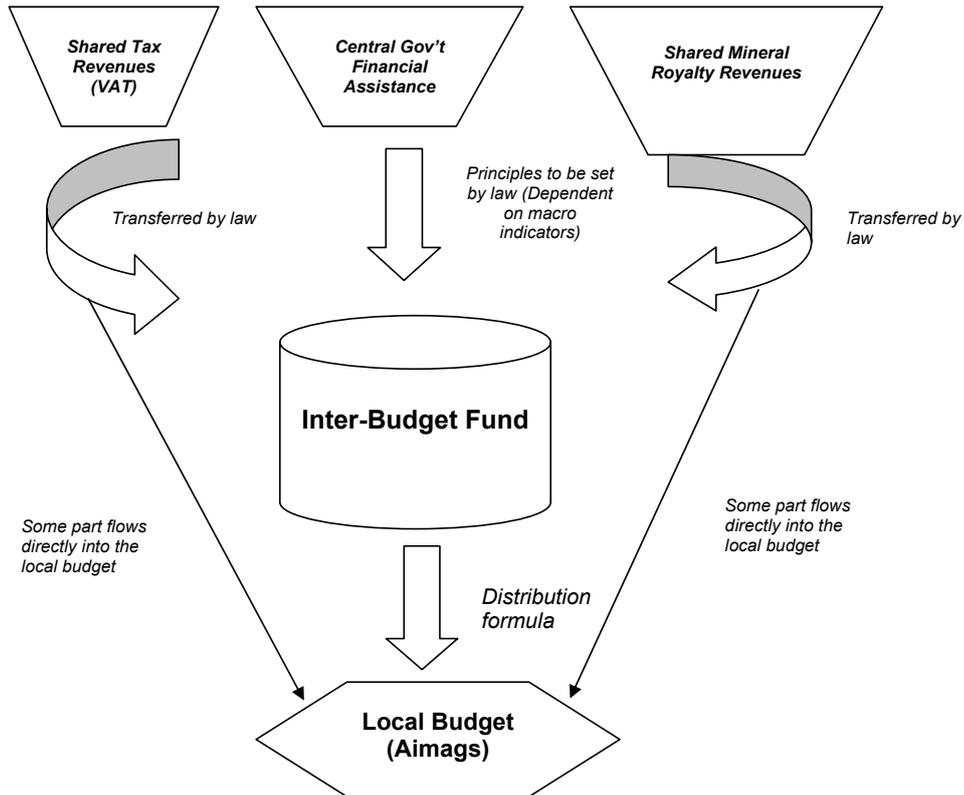
of financing the difference between standardized expenditure and revenue capacity. This would be a transfer for general purpose.

This principle takes into account the following objectives: first, ensuring vertical budget balance by financing the difference between the standardized expenditure of the administrative unit and its revenue capacity; secondly, ensuring horizontal budget balance by financing differences in revenues of administrative units of the same level; and thirdly, taking into account local specifics and contexts, when implementing any national government programs in the future.

We propose to use the following formula in allocating financial assistance from the central budget to aimag budgets:

$$G = EEx + Ex$$

Financial assistance shall depend on two elements: standardized expenditure and revenue capacity. Each element is discussed below.

1. Estimating standardized expenditure

In calculating the amount of financial assistance to a given aimag, it is necessary to take into account standard per capita expense incurred by the aimag for providing any given service (expenditure) as well as an average national indicator for this expenditure. This can be expressed by the following formula:

$$EE_X^i = (POP)_x [(PCSE)_X^i - (PCSE)_{na}^i] \qquad (1)$$

Here:

EE_X^i	i - Amount of assistance to be allocated to or deducted from the aimag for a given service
$(POP)_x$	Population size of the aimag
$(PCSE)_X^i$	i - Standard per aimag resident expense for providing the service
$(PCSE)_{na}^i$	i - National average standard per capita expense for providing the service

As currently aimag government is only providing administrative services, we can consider that i=1 in this formula. Ni the future, if specific state service duties are added to local governments, the above formula can be used for each added expenditure and their sum can be used to calculate the amount of financial assistance to be provided to the given aimag.

The result of the above formula can be positive, negative or zero. If the result is negative, it means that the per capita cost of service provision in that aimag is lower than the national average. Therefore, the amount of financial assistance to be provided to that aimag shall be less. Conversely, if the result is positive, the aimag shall receive commensurate financial assistance.

In this manner, the formula can be used to calculate standard expenditure for each of the local government functions and the sum can be used to calculate the amount of financial assistance to provided to or deducted from the aimag.

The most important consideration in using the formula is realistically establishing the standard expenditure $(PCSE)_X^i$ for each service for each administrative unit. Currently, the standard per capita expenditure for local government's administrative services has not been established. In calculating budget expenses for this service, the Ministry of Finance controls and calculates each aimag's

Local Governor's Office salaries[58] and other expenses, the number of soums, the Soum Governor's Offices' salaries and other expenses, etc.

Due to the absence of a standard per capita expenditure for these expenses, the actual per capita expenditures differ widely. The 2007 budget performance report shows that per capita budget expenditure is the highest in Umnugovi aimag at 112.4 thousand TG and the lowest in Bayan-Ulgii aimag at 26.8 thousand TG with a difference being 85.6 thousand TG.[59] National average per capita expenditure is 51.4 thousand TG. Widely different per capita budget expenditures stem from establishing administrative expenses so as to fit into the Government-imposed staffing and expenditure limits, without taking into account costs associated with remote distances, population density, etc. Total expenditure for a given aimag can be accurately calculated only if the standard per capita expenditure is calculated realistically and accurately for that aimag.

The above example implies that the cost of delivery of public services to an average aimag resident in Umnugovi aimag is 4 times higher than that in Bayan-Ulgii aimag. However, in reality, the number of soums in both aimags is nearly equal: 14 in Bayan-Ulgii and 15 in Umnugovi. Yet given the greater distance between the central government and Bayan-Ulgii, the cost of government service delivery should be higher in that aimag. On the other hand, service delivery costs should be higher in Umnugovi aimag given its territory, which is 3.6 times larger than that of Bayan-Ulgii. But in Govi-Altai, which territory is comparable to Umnugovi's, budget expenditure per capita is twice lower than that in Umnu-Govi, at 60.2 thousand TG. This comparison clearly demonstrates that the current budget expenditures are not standardized.

Therefore, it is necessary to develop uniform standards for each service provided by the local government. In this case, the mechanism we propose for allocating central government assistance shall be most effective.

It is a critical issue, indeed how the expenditure standards are set. Please make it clear, whether you propose input based estimation of standard costs or they can be calculated from the present aimag averages? I would vote for the latter one.

2. Estimating revenue capacity

The next element to be used in calculating the amount of financial assistance to be provided to a local government is the capacity of that local unit to generate revenues. This can be calculated using the following formula:

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[58] Staffing size and structures of aimag and soum governors' offices are approved by a Government Decree using a uniform template.
[59] This sum includes investment.

$$E_X^i = (POP)_x \{[(PCTB)_{na}^i \times t_{na}^i] - [(PCTB)_x^i \times t_{na}^i]\} \quad (2)$$

Үүнд:

$(POP)_x$ Aimag population size

$(PCTB)_{na}^i$ National average i tax revenue base amount per capita

$(PCTB)_x^i$ i tax revenue base amount per aimag resident

t_{na}^i National average i tax rate

The above formula should be used for each type of the local government's own revenue and the sum of the results should be used to calculate the amount of financial assistance to be provided to or deducted from the administrative unit. Let us assume i=1 in order to simplify the formula for the sake of effective explanation and because in Mongolia, the share of any given type of local tax revenue is small in the overall local government tax revenue. Furthermore, given that according to current laws, the local tax revenue rates are equal throughout the country (essentially no differences between aimags), we can leave the t_{na}^i component out of the calculation. Then we can convert the formula (2) as follows (3):

$$E_X^i = (POP)_x [(PCTB)_{na}^i - (PCTB)_x^i \quad (3)$$

The $(PCTB)_{na}^i$, and $(PCTB)_x^i$ components in this formula can be understood as own tax revenue amounts per capita rather than tax revenue bases.

The E_X^i could be positive, negative or zero. If the result is positive, it shall mean that the given aimag's per capita revenue amount is lower than the national average, i.e. that the revenue capacity of the aimag is weak and therefore the aimag should receive financial assistance. If the result is negative, it shall mean that the aimag's per capita revenue amount is higher than the national average, i.e. that the aimag has strong revenue capacity and therefore should receive less, if any, assistance. In other words, the principle is to collect revenues from relatively well-off administrative units and provide assistance to relatively poor administrative units.

Finally, the total amount of assistance to be provided to a given aimag shall be determined on the basis of the sum of the results of both standard expenditure (1) and revenue capacity formula calculations (2).

Below we give an example of the above model of financial assistance using the 2007 local budget revenues, expenditures and financial assistance performance data for each of the aimags.

- As current budget expenditures are not standardized, an aimag's per capita expenditure was calculated approximately, taking into account the aimag's distance from the center and regional characteristics of the aimag's location.[60]

- Aimags' per capita revenues were calculated by dividing the 2007 aimag tax revenue performance by the number of residents.

Current national average per capita budget expenditure is 51.4 thousand TG. Aimags' standard expenditures were calculated by comparison with this national average into account. The standard expenditures are listed in column (4) of the table provided in Appendix 11.Column (5) contains the total standard expenditure. When amounts listed in this column are compared with the actual budget performance for 2007, substantial differences shall be observed with some of the aimags' expenditures.

Column (10) lists amounts of financial assistance calculated using the proposed method. If the number in column (10) is positive, the aimag shall receive financial assistance of that amount from the central budget. If the number is negative, the aimag shall contribute that amount to the central budget. Column (11) shows per capita expenditure after allocation of financial assistance based on the proposed method. These figures show that the proposed method of distributing financial assistance reduces differences of per capita expenditure between aimags and ensures budget balance more effectively than the current system. Please compare column (11) with column (3).

6.3 TRANSFERRING SOME STATE FUNCTIONS AND PROVIDING APPROPRIATE FINANCING

Policy makers and experts interviewed in the course of this research, unanimously stated that responsibilities of local self-governing bodies and administrative units and their impact on local socio-economic life have declined dramatically due to centralization of fiscal power at the level of central government (following the passage of the Public Management and Financing Law in 2002). Due to the failure to provide the guarantees for financial, budgetary and other rights of local self-governance systems, which form the basis of the democratic governance enshrined in the Constitution, local government has been overpowered by the central government. As a result, local governments' responsibilities towards their citizens have become blurred. For many years, local governments have existed purely symbolically, having no real power to make or implement independent decisions due to the lack of funds and financial power.

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[60] In the future, it is necessary to carry out this calculation more carefully based on expenditure factors.

Members of the local Citizens' Representatives' Khurals and Local Governors hold that their participation is necessary in delivering education and health services to the people. According to the Public Management and Financing Law, aimag Governor signs a contract with the Minister of the given sector, thereby assuming responsibilities for delivery of the relevant services. The Governor appoints the heads of aimag's education, culture and health offices based on agreements with respective ministers (since 2006). These officials then form result-based contracts with the Governor.

However, although the Governor assumes duties for delivery of education and health services on paper and by law, in reality, the Governor does not have any powers to organize these services or to control and manage the budget allocated for these services. Aimag agencies receive their budgets directly from their respective ministries, bypassing the local budget. Each ministry allocates funds for the given services to each aimag using a method of calculating a given product's cost based on variable expenditure norms.

Before the passage of the Public Management and Financing Law, budgets for the above services formed a part of the local budget expenditures. Employees of these service sectors reported that during that period, budget allocated for the services were often not spent according to their intended purpose and budgetary discipline was weak. They reported that with the passage of the Public Management and Financing Law, these problems were eliminated and funds are now provided continuously, without any interruptions.

Of course, we should not dismiss that there may have been positive effects as mentioned above. Nevertheless, we posit that there must be participation of local government in the delivery of these services for the following reasons:

1. Political accountability: Education, culture and health service recipients are local citizens. Citizens must be provided with an opportunity to hold decision-makers politically accountable in relation to the quality of these services. In other words, if the quality of services is bad, citizens should be able to hold accountable and refuse to re-elect those decision-makers, who define service policies, organize their delivery and control and manage the budgets.

    However, in Mongolia, the quality of these services is not linked to political accountability mechanisms. The only body that is elected by citizens at local level is the Citizens' Representatives' Khural. This body is not at all involved in delivery of the above services. The representatives do not have any possibility to influence the service policies or control the budget and organization of the service delivery. They are relegated to the role of independent observers and can only make demands from the outside. However, sectoral laws specify the duties and responsibilities of local

self-governing bodies and governors in relation to the provision of any state service.[61] In practice, they are unable to fully implement their duties and exercise rights. The local government particularly lacks any powers to influence the budgetary decisions related to the service delivery.

This situation leads to pro-forma treatment of the issues at hand at the expense of citizens' interests. Thus local citizens are unable to turn to their local government to resolve any issues that arise in relation to the delivery of state services as all budgetary decisions for these services are made by sectoral ministries located in Ulaanbaatar city.

Thus, the political accountability mechanism has been weakened to such an extent that no matter how many times citizens may elect their Citizens' Representatives' Khurals and no matter how many times the Local Governors are newly appointed, the quality of services citizens receive may not improve. In order to make the mechanism of political accountability work for the people and render people's political choices meaningful, it is necessary that the local self-governing body assumes specific duties and responsibilities in the area of education, culture and health services.

2. In the interest of effective distribution, it is best to delegate certain decisions related to the delivery of the services to the lowest level administrative units. When the service budget is 100% financed from the central budget, the local units are interested in maximizing their planned expenditure. In other words, the central government is unable to realistically sense the actual needs of the local units. Some aimags believe that excessive investments were made to local units when the central budget revenues were high in 2007. Furthermore, school, hospital and cultural center buildings are considered to be local property. Therefore, the fact that service costs are fully financed by the central government might be serving as a disincentive for local units to improve efficient use of their own property.

Based on the two above-mentioned reasons, we recommend that local, particularly soum administrations be put in charge of regular expenditure components for education and cultural services. These would include heating, electricity, construction and maintenance, support staff salaries and other expenses. However, sizeable variable expenses such as teachers' salaries, their social insurance contributions, and expenditures related to lessons and projects should be financed from the central government.

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[61] Articles 29 and 30 of the The Law on Education (2002) specify the full powers of Citizens' Representatives' Khurals and Local Governors on education-related issues. In a similar fashion, other sectoral laws contain provisions on legal rights and duties of local self-governing bodies and local administrations. However, in reality it is impossible to implement these provisions.

Financing for the above types of expenses should be transferred to local administrative units as conditional grants (Ce - conditional grant for education).

In other words, financial assistance to a given aimag shall consist of general and conditional support.

$$FS = G + Ce + ...$$

Here:

FS   - Financial support

G   - General grant

Ce   - Conditional grant for education

It is recommended to analyze expenditures for each service sector in this manner to appropriately define central government and local self-government responsibilities and provide relevant financial resources in the form of conditional transfers.

It is possible to conduct detailed analysis of each state service sector and define sectoral functions and responsibilities to be transferred to aimag and soum self-governments and provide financing for those functions and responsibilities as special subsidies in the form of conditional transfers. Depending on the specifics of the service, the formula for determining standard expenses and amount of assistance shall be relatively different. In any case, conditional grants are bound to be directly dependent on the number of service recipients.

7. IMPLEMENTATION

The following steps are proposed towards implementation of policy recommendations discussed in the previous chapter:

1. Define the scope and elements of reform recommended in the previous chapter, which would be politically acceptable

2. Analyze budget revenue distribution for each aimag within the framework of the proposed policy

3. Develop a new system of distributing local self-government and central government functions and responsibilities based on scientific studies and accordingly amend relevant laws or develop relevant amendments

4. Define the scope and areas of legal reform, which shall be required for the current budget and tax laws (especially in terms of broadening local government's tax collection powers and redistribution principles)

5. Calculate and establish a standard expenditure for local government functions and responsibilities for each aimag

6. Legalize the principles of general and block transfers

7. Define standards and develop formula for calculating conditional grants for educational and cultural services

8. Carry out a detailed calculation of the inter-budget fund within the current and the proposed legal framework

9. Legalize the principles of the inter-budget fund operations, revenues and expenditures

10. Produce a new law that regulates local budget to systematically address all of the above issues

8. APPENDICES

Appendix 1

Hunting Stock Usage Fees, Animal Hunting and Catching License Fees
(In '000 MNT)

		Hunting Stock Usage Fees		License Fees for Animal Hunting and Catching for Private Purpose
	Animal Types	Industrial Hunting and Catching	Hunting and Catching for Cultural and Science Purposes	
One. Mammals				
1	Wild (Prjevalski) Horse		800.0	
2	Wild Ass		400.0	
3	Wild Bactrian Camel		740.0	
4	Wild Mountain Sheep		1800.0	
5	Wild Mountain Goat		400.0	
6	Wild Deer		500.0	
7	Elk		560.0	
8	Wild Reindeer		400.0	
9	Musk deer		400.0	
10	Antelope		28.0	28.0
11	Boar		40.0	40.0
12	Mongolian Gazelle		400.0	
13	Goitered Gazelle		300.0	
14	White Gazelle	8.0	8.0	12.0
15	Asian Wild Dog		200.0	
16	Wolf*		18.0	
17	Fox		16.0	16.0
18	Steppe Fox		8.0	8.0
19	Leopard		800.0	
20	Lynx		400.0	
21	Forest Mink		60.0	

22	Pine Marten		60.0	
23	River Otter		200.0	
24	River Beaver		100.0	
25	Ondatra	1.0	1.0	1.5
26	Wolverine		3.0	
27	Wild Cat		3.6	3.6
28	Badger		22.0	22.0
29	Brown Bear		400.0	
30	Gobi Bear		1000.0	
31	Altai Marmot	5.0	5.0	7.5
32	Brown Hare, Rabbit		1.2	1.2
33	Raccoon		16.0	16.0
34	Marbled Polecat		0.5	0.5
35	Skunk		0.5	0.5
36	Kolinsky		1.0	1.0
37	Other Weasels		0.5	0.5
38	Dark Squirrel	10.0	10.0	10.0
39	Panther		100.0	
40	Gopher	1.0	1.0	1.5
41	Other ground squirrels	0.3	0.3	0.45
42	Chipmunk	0.3	0.3	0.45
Second. Birds				
1	Swan Trumpeter		15.0	
2	Swan Whooper		12.0	
3	Crane Siberian		40.0	
4	Crane Black, White-naped		15.0	
5	Crane Red-crowned		7.5	
6	Bustard Great, Houbara		15.0	
7	Vulture**		20.0	30.0
8	Pelican Dalmatian		30.0	
9	Spoonbill Eurasian		1.8	
10	Stork Black, Oriental		4.0	
11	Goose		8.0	
12	Goose Steppe		8.0	
13	Goose Spoonbill		8.0	
14	Goose Pigmean		8.0	
15	Goose Other species**		2.0	
16	Gull Relict		10.0	
17	Pheasant		6.0	
18	Snow cock Altai		15.0	

19	Teal Baikal	8.0	
20	Other ducks** and water birds**	3.0	
21	Ухаа шумбуур	2.0	
22	Scoter	2.0	
23	Pintail	2.0	
24	Усны бух шувуу	2.0	
25	Snow Heron	2.0	
26	Woodcock Asian	2.0	
27	Хилэн жигүүрт	2.0	
28	Эгэл хүрзгэнэ	2.0	
29	Barred owl, Ural owl, Night owl	1.8	
30	Saker Falcon	200.0	
31	Gyrfalcon	100.0	
32	Amur Falcon	100.0	
33	Other Falcon Species	90.0	
34	Heath Bird**, Grouse**	1.8	
35	Хөтүү**, Quail**, хахилаг**, Birch Partridge**	1.8	
36	Vulture, Bearded Vulture	20.0	
37	Eagle**, Harrier, Hawk	20.0	20.0 /Eagle only/

Appendix 2

Rates of Charge for Firewood and Timber of Noncommercial Consumption
(in MNT)

	Types of Tree	Unit	Up to 50 km of Transportation				Мод тээврийн зай 51-100 км			
			Volume of Timber for Household Usage			Fire-wood	Volume of Timber for Household Usage			Fire-wood
			Large	Medium	Small		Large	Medium	Small	
A	1	2	3	4	5	6	7	8	9	10
Zone #1										
1	Spruce, Fir	M³	26000	21700	17800	6000	16000	13300	11000	3700
2	Pine	M³	22900	19100	15700	5300	14100	11700	9600	3300
3	Larch	M³	18400	15300	12500	4250	11300	9400	7700	2600
4	Birch	M³	11000	9200	7500	2500	6800	5600	4600	1600
5	Aspen, Poplar	M³	9400	7800	6400	2200	5800	4800	3900	1400
6	Bush	M³	-	-	6900	600	-	-	4600	400
7	Khargana	M³	-	-	-	2000	-	-	-	1400
8	Saxaul	тн	-	-	-	9400	-	-	-	6200
9	Other bushes:	M³	-	-	-	3100	-	-	-	2100
Zone 2										
1	Spruce, Fir	M³	15850	13200	10800	3500	9800	8100	6800	2200
2	Pine	M³	13900	10800	8900	2900	7800	6500	5300	1800
3	Larch	M³	11200	9300	7600	2500	6900	5700	4700	1600
4	Birch	M³	6700	5600	4600	1500	4100	3400	2850	1000
5	Aspen, Poplar	M³	5700	4750	3900	1300	3500	2900	2400	800
6	Bush	M³	-	-	4700	500	-	-	3100	400
Zone 3										
1	Spruce, Fir	M³	13900	11600	9500	3100	6800	5700	4700	1400
2	Pine	M³	11300	9450	7750	2500	5450	4550	3700	1200
3	Larch	M³	9800	8150	6700	2200	4800	4000	3300	1000
4	Birch	M³	5900	4900	4100	1300	2900	2400	2000	600
5	Aspen, Poplar	M³	5200	4200	3400	1100	2450	2050	1700	500
6	Bush	M³	-	-	4700	500	-	-	3100	400
Zone 4										
1	Spruce, Fir	M³	11900	9900	8150	2650	5900	4900	4000	1200
2	Pine	M³	9900	8300	6800	2200	4900	4000	3350	1000
3	Larch	M³	7900	6600	5400	1750	3900	3300	2650	800
4	Birch	M³	4800	4000	3300	1100	2350	2000	1600	500
5	Aspen, Poplar	M³	4000	3400	2750	950	2000	1650	1350	400
6	Birch	M³	-	-	4000	500	-	-	2650	400

Explanation: A large timber is when the diameter of narrow end is over 25 cm, large — if that is between 13.0-24.5 cm, small — if that is between 3.0-12.5.

| | Types of Tree | Unit | Transportation is over 101 km | | | |
| | | | Household usage timber size | | | Firewood |
			Large	Medium	Small	
A	1	2	3	4	5	6
Zone 1						
1	Spruce, Fir	M³	10150	8300	6950	2800
2	Pine	M³	9000	7300	6100	2500
3	Larch	M³	7100	5800	4900	2000
4	Birch	M³	4300	3500	2900	1200
5	Aspen, Poplar	M³	3650	3000	2500	1000
6	Birch	M³	-	4600	3850	400
7	Khargana	M³	-	-	-	1400
8	Saxaul	TH	-	-	-	6300
9	Other bushes:	M³	-	-	-	2100
A	1	2	3	4	5	6
Zone 2						
1	Spruce, Fir	M³	5900	4950	4050	1250
2	Pine	M³	5200	4350	3600	1100
3	Larch	M³	4200	3500	2850	900
4	Birch	M³	2500	2100	1700	500
5	Aspen, Poplar	M³	2150	1800	1450	450
6	Birch	M³	-	-	3100	300
Zone 3						
1	Spruce, Fir	M³	3900	3250	2650	700
2	Pine	M³	3000	2500	2100	600
3	Larch	M³	2750	2300	1900	500
4	Birch	M³	1650	1400	1150	300
5	Aspen, Poplar	M³	1400	1200	1000	250
6	Birch	M³	-	-	3150	300
Дөрөвдүгээр муж						
1	Spruce, Fir	M³	2000	1650	1350	600
2	Pine	M³	1600	1400	1100	500
3	Larch	M³	1300	1100	900	400
4	Birch	M³	800	650	550	300
5	Aspen, Poplar	M³	700	550	450	200
6	Birch	M³	-	-	2700	300

Appendix 3

Attachment to South Gobi CRH's
Resolution #9/5 of 26 December 2007

Royalty for Exploitation of Common Minerals

Types of Minerals	Unit	Royalty Rate (in MNT)
Brick Clay	м³	900
Construction Stone	м³	1125
Sand	м³	1125
Gravel	м³	1200
Limestone (dolomite)	м³	2250
Palisade Stone	м³	1875
Blackearth	м³	900
Ocher, earth dye	м³	1500
Yellow Clay	м³	825
Quartzite	м³	675
Зануужин /алевролит/	м³	1575
Granite and other magma	м³	1500
Porphyrite (railway bottoming stones)	м³	675
Жуган	м³	750
Cretaceous	м³	1500
Хувирмал чулуулаг	м³	900
Grapholite	м³	1875
Saline	м³	1125
Saltpeter	м³	3000
Salt	м³	3000

Appendix 4

Monthly Tax Rate on citizens with production and services whose income size is not possible to measure

	Types of Production and Services	Ulaanbaatar	Nalaikh, baganuur, Darkhan-Uul, Orkhon aimag center soums and other soums with permanent border crosssing	Other aimags' center soums	Other locations
	A	1	2	3	4
1.	Production and sale of fine arts, sculpture, engraving, souvenir items, decorative products, various toys	3000	2000	1000	500
	Planting and sale of decorative and room plants and flowers	1200	900	600	200
	Engraving and repair of souvenir items	2400	2000	1000	200
2.	Repair of household electronic products, equipment and furniture	4500	3500	2500	1500
	Repair of radio and television sets	6000	4000	2000	1000
	Repair of watch	3000	2000	1000	500
3.	Crafting and jewellery works: - gold and silver - other	16000 8000	14000 7000	12000 6000	10000 5000
4.	Teaching, tutorial, training, manuscript preparation, copying printed materials	2000	1600	1200	1000
5.	Photograph service, contract-based movie shooting, vedeo taping, renting and showing VHS/DVD tapes	7000	5500	4000	2000
	Renting audio tapes	2400	2000	1600	1000
	Copying and selling of vedeo and audio tapes	10000	6000	4000	1000
6.	Gaming business (except billiards)	12000	9000	4500	3000

7.	Repair and servicing of shoes and cloths: - repair and dyeing - tailoring and sale - shoeshining	4000 6000 900	2800 4000 400	2400 3000 200	2000 2500 100
8.	Automobile washing	3000	2000		
9.	Packaging, loading, unloading, transportation and delivery of goods and cargo Servicing by horse cart	2800 5000	2000 3000	1200 1500	1000
10.	Warehousing goods and raw materials	15000	10000		
11.	Street vendor trading	6000	4000	2000	1000
12.	Shop counter trading	6000	4000	2000	1000
13.	Foreign exchange trading	25000	15000	10000	5000
14.	Fortune teller service	1200	1000	800	400
15.	Retail sales (nuts, fruits, milk, yogurt, mare's fermented milk, icecream, books, newspapers, magazines, firewood, coal, technical oil, etc.)	2400	2000	1600	600

Appendix 5

Quotient of inflation-adjusted comparative prices

	2001	2002	2003	2004	2005	2006	2007	2008	2009 /төл/
Average inflation level (%)	8,0	0,3	5,1	8,2	12,7	5,1	9,0	23,2	12,0
Inflation index compared to 2001	1,000	1,003	1,054	1,140	1,285	1,351	1,473	1,815	2,033
Inflation index compared to 2008	0,551	0,553	0,581	0,628	0,708	0,744	0,812	1,000	1,120

Explanation:
Figures from the 2007 Statistical Bulletin of Mongolia and the Mongol Bank's State Monetary Policy Statement for 2009.

Appendix 6

Shares of Tax Revenues in Local Budget Income (adjusted at 2008 prices)

In million MNT

№	Indicators	Khentii			Bayan-Ulgii			Orkhon			South Gobi		
		2006	2007	2008 rev	2006	2007	2008	2006	2007	2008	2006	2007	2008
	Local Budget Income	1 586,9	2 300,0	3 254,1	1 315,3	924,8	1 844,1	13 357,5	29 524,4	35 021,0	5 549,3	9 414,2	11 171,1
1	Real estate tax income	53,1	72,8	65,4	25,3	26,6	18,4	1 810,6	1 838,9	1 455,5	75,5	91,4	130,8
	Percentage in local budget income	3,3%	3,2%	2,0%	1,9%	2,9%	1,0%	13,6%	6,2%	4,2%	1,4%	1,0%	1,2%
	Real estate tax income (nominal for each year)	39,5	59,1	65,4	18,9	21,6	18,4	1 347,1	1 493,2	1 455,5	58,8	74,2	130,8
2	Vehicle and other automobile tax	123,8	142,1	121,6	179,5	167,0	130,8	234,7	263,1	277,1	193,2	272,3	368,2
	Percentage in local budget income	7,8%	6,2%	3,7%	13,6%	18,1%	7,1%	1,8%	0,9%	0,8%	3,5%	2,9%	3,3%
	Vehicle and other automobile tax (nominal for each year)	92,1	115,4	121,6	133,5	137,7	130,8	174,4	213,3	277,2	143,7	221,0	368,2

3	Land fee	63,5	75,9	53,6	58,5	71,0	36,3	8 931,9	7 961,2	7 108,5	374,3	405,9	426,1
	Percentage in local budget income	4,0%	3,3%	1,6%	4,4%	7,7%	2,0%	66,9%	27,0%	20,3%	6,7%	4,3%	3,8%
	Land fee (nominal for each year)	47,3	61,6	53,6	43,4	57,9	36,3	6 812,0	7 027,2	7 108,5	278,8	329,6	426,1
4	Mineral exploration and mining license fee	0,0	0,0	375,3	0,0	0,0	142,6	0,0	0,0	27,0	0,0	1 847,8	2 420,7
	Percentage in local budget income	0,0%	0,0%	11,5%	0,0%	0,0%	7,7%	0,0%	0,0%	0,1%	0,0%	19,6%	21,7%
	Mineral exploration and mining license fee (nominal for each year)	0,0	0,0	375,3	0,0	0,0	142,6	0,0	0,0	27,0	0,0	1 847,8	2 420,7
5	Mineral royalty fee	105,6	473,3	662,6	0,0	29,3	38,6	972,9	18 204,7	20 605,1	2 434,4	1 830,7	2 146,0
	Percentage in local budget income	6,7%	20,6%	20,4%	0,0%	3,2%	2,1%	7,3%	61,7%	58,8%	43,9%	19,4%	19,2%
	Mineral royalty fee (nominal for each year)	78,6	384,3	662,6	0,0	23,8	38,6	723,9	14 782,2	20 605,1	1 811,2	1 486,6	2 146,0

Appendix 7

Selected Aimags' Budget Income Collection

(in '000 MNT)

№	Indicators	Bayan-Ulgii			Orkhon			South Gobi			Khentii		
		2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008 тел.
1	Soum Budget Income	293,9	453,8	277,1	551,2	809,3	697,4	378,3	2 301,5	3 699,6	525,6	588,9	432,4
2	Aimag Budget Income	195,8	474,1	366,9	9 061,0	23 541,1	29 475,6	3 497,4	5 300,0	9 228,0	257,1	1 097,5	1 535,3
3	Central Budget Income	788,1	849,8	1 625,4	12 222,8	17 289,5	11 306,3	2 885,6	9 109,0	1 632,2	824,8	1 956,9	1 477,6
	Total	1 277,8	1 777,7	2 269,4	21 835,0	41 639,9	41 479,3	6 761,3	16 710,5	14 559,8	1 607,5	3 643,3	3 445,3

Explanation:
Based on Reports of Aimag Taxation Authorities.
Non-tax revenues reported under Section "Division" of tax reports are added as aimags' income .
Local tax contribution (income from gold and copper) to the Central Budget in accordance with law is included. The respective information is provided by the Finance Ministry.
Minerals royalty and license fee revenues are not included.

Selected Aimags' Budget Income Collection (in %)

№	Indicators	Bayan-Ulgii			Orkhon			South Gobi			Khentii		
		2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008 төл.
1	Soum Budget Income	23%	26%	12%	3%	2%	2%	6%	14%	25%	33%	16%	13%
2	Aimag Budget Income	15%	27%	16%	41%	57%	71%	52%	32%	63%	16%	30%	45%
3	Central Budget Income	62%	48%	72%	56%	42%	27%	43%	55%	11%	51%	54%	43%
	Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Appendix 8

Selected Aimags' Non-Tax Revenue Collection

In '000 MNT

		Bayan-Ulgii			Orkhon			South Gobi			Khentii		
		2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev
1	Stock Dividends				1 096,9	3 015,9	6 021,5	0,0					
2	Rental Income						0,0	0,0					
3	Internal Income of State organizations	14,3	17,9	6,0	29,6	27,1	0,0	28,5	52,4	29,4	150,4	198,1	169,4
4	Interest and fine proceeds	14,9	21,2	12,1	125,8	118,1	162,7	86,1	132,9	91,4	134,8	85,1	134,8
5	Unspecified other revenues	57,4	115,1	53,9	42,1	79,7	68,2	107,8	80,0	80,0	140,1	71,2	
6	Real estate sales tax income		1,1		8,0	45,4	0,0	15,5	134,2	10,0	0,0	343,0	200,0
7	Privatization proceeds	0,2			0,3		0,0	0,0					
	NON-TAX REVENUES	86,8	155,4	72,0	1 302,8	3 286,3	6 252,4	237,9	399,6	210,7	425,2	697,4	504,1

Selected Aimags' Non-Tax Revenue Collection (in %)

	Bayan-Ulgii			South Gobi			Khentii			Orkhon		
	2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev	2006	2007	2008 rev
1 Stock Dividends				84%	92%	0%						
2 Rental Income												
3 Internal Income of State organizations	16%	12%	8%	2%	1%	0%	12%	13%	14%	35%	28%	34%
4 Interest and fine proceeds	17%	14%	17%	10%	4%	0%	36%	33%	43%	32%	12%	27%
5 Unspecified other revenues	66%	74%	75%	3%	2%	0%	45%	20%	38%	33%	10%	0%
6 Real estate sales tax income		1%	0%	1%	1%	0%	7%	34%	5%	0%	49%	40%
7 Privatization proceeds												
NON-TAX REVENUES	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Appendix 9

Aimags' Tax Revenue Volume for 2006-2008 (in % and '000 MNT)

№	Aimag Tax Revenue	2006	2007	2008	2006	2007	2008
1	Real estate tax	19%	12%	8%	6 785,2	8 131,6	8 450,8
2	Vehicle and other automobile tax	15%	9%	8%	5 269,5	6 301,7	7 784,2
3	Minerals Roaylty	21%	37%	40%	7 445,3	25 447,7	40 709,6
4	Land Fee	43%	29%	24%	15 507,1	20 065,2	24 757,4
5	Minerals Exploration and Mining License Fees	0%	12%	19%	0,0	8 096,0	19 819,0
6	Other Taxes	2%	1%	0%	772,2	1 017,6	220,7
	Total	100%	100%	100%	35 779,4	69 059,9	101 741,7

Appendix 10

Estimation of Real Estate Tax Revenues

. Real estate tax estimation for private lands

№	Indicators	Land size (hectare)	Land size (sq. meters)	Unit Value (MNT)	Total Value (MNT)	Levied Tax (MNT)	Tax Discount (in %)	Actual Annual Tax (MNT)
1	Aimag Centers	0,07	700,0	2 000,0	1 400 000,0	8 400,0	97%	252,0
2	Soum Centers	0,07	700,0	480,0	336 000,0	2 016,0	98%	40,3
	Total	0,14	1 400,0		1 736 000,0	10 416,0		292,3

B. Real estate tax estimation for buildings

№	Names	Real estate value (in '000 MNT)	Soum	Tax Rate	Levied Tax (MNT)	Discount	Actual Annual Tax (in MNT)
1	D. Chantsalnyam	20 000,0	Хэрлэн	0,6%	120 000,0	0%	120 000,0
2	T. Tegshbayar	20 000,0	Дархан	0,6%	120 000,0	0%	120 000,0

Appendix 11

Төсвийн тэнцвэрийг хангах санхүүгийн дэмжлэгийг томъёогоор тооцоолсон үр дүн

	Aimags	(1) Expend. (2007 actual)	(2) Population (POP) x (2007 act)	(3) Expend. Per capita (2007 act)	(4) Standard Expend. Per capita (PCSE)x	(5) Standard Expend	(6) EEx	(7) Budget own revenue (2007 act)	(8) Budget own revenue. Per capita (PCTB)x	(9) Ex	(10) G - grant (G=EEx+Ex)	(11) =(10+7)/2 Expend. Per Capita
1	Arkhangai	3,239,373.7	92.8	34,907.0	55,000.00	5,104,000.0	18,981.82	1,855,974.9	19,999.73	3,008,441.76	3,027,423.58	52,622.83
2	Bayan-Ulgii	2,706,668.4	100.8	26,851.9	58,000.00	5,846,400.0	323,018.18	1,285,454.4	12,752.52	3,998,308.52	4,321,326.70	55,622.83
3		3,358,635.1	84.2	39,888.8	56,000.00	4,715,200.0	101,422.73	2,193,100.7	26,046.33	2,220,518.72	2,321,941.45	53,622.83
4	Bulgan	3,280,946.6	60.5	54,230.5	55,000.00	3,327,500.0	12,375.00	3,368,717.1	55,681.27	-197,410.98	-185,035.98	52,622.83
5	Gobi-Altai	3,487,835.1	60.2	57,937.5	58,000.00	3,491,600.0	192,913.64	1,223,206.6	20,319.05	1,932,374.03	2,125,287.67	55,622.83
6	Dornogobi	3,475,302.6	55.6	62,505.4	53,000.00	2,946,800.0	-99,827.27	4,158,943.0	74,801.13	-1,244,486.47	-1,344,313.74	50,622.83
7	Dornod	2,686,774.8	72.9	36,855.6	57,000.00	4,155,300.0	160,711.36	2,408,058.3	33,032.35	1,413,234.53	1,573,945.89	54,622.83
8	Dundgobi	2,653,071.2	48.8	54,366.2	52,000.00	2,537,600.0	-136,418.18	1,245,609.9	25,524.79	1,312,402.31	1,175,984.13	49,622.83
9	Zavkhan	3,546,521.0	80.5	44,056.2	58,000.00	4,669,000.0	257,965.91	1,280,938.6	15,912.28	2,938,733.18	3,196,699.09	55,622.83
10	Uvurkhangai	3,782,359.1	115.7	32,691.1	54,000.00	6,247,800.0	-92,034.09	2,977,379.4	25,733.62	3,087,415.94	2,995,381.85	51,622.83
11	Umnugobi	5,274,421.8	46.9	112,461.0	55,000.00	2,579,500.0	9,593.18	7,911,031.9	168,678.72	-5,452,614.43	-5,443,021.25	52,622.83
12	Sukhbaatar	3,529,507.3	55.1	64,056.4	56,000.00	3,085,600.0	66,370.45	2,897,352.2	52,583.52	-9,104.81	57,265.64	53,622.83
13	Selenge	3,577,185.9	100.5	35,593.9	52,000.00	5,226,000.0	-280,943.18	5,324,022.2	52,975.35	-55,984.76	-336,927.95	49,622.83
14	Tuv	5,412,032.9	85.9	63,003.9	50,000.00	4,295,000.0	-411,929.55	4,595,660.2	53,500.12	-92,929.69	-504,859.24	47,622.83
15	Uvs	3,336,757.2	80.4	41,502.0	59,000.00	4,743,600.0	338,045.45	1,187,104.3	14,764.98	3,027,325.65	3,365,371.10	56,622.83
16	Khovd	3,446,013.3	88.6	38,894.1	59,000.00	5,227,400.0	372,522.73	1,445,305.3	16,312.70	3,198,954.57	3,571,477.30	56,622.83
17	Khuvsgul	4,199,257.2	122.4	34,307.7	57,000.00	6,976,800.0	269,836.36	2,258,882.6	18,454.92	4,157,115.23	4,426,951.60	54,622.83
18	Khentii	3,577,253.8	71.3	50,171.9	55,500.00	3,957,150.0	50,234.09	2,232,820.4	31,315.85	1,504,603.17	1,554,837.27	53,122.83
19	Darkhan-Uul	2,923,967.8	87.6	33,378.6	52,000.00	4,555,200.0	-244,881.82	3,608,743.6	41,195.70	983,097.99	738,216.17	49,622.83
20	Ulaanbaatar	47,170,368.2	1,031.2	45,743.2	49,000.00	50,528,800.0	-5,976,272.73	50,185,830.9	48,667.41	3,867,902.48	-2,108,370.25	46,622.83
21	Orkhon	5,749,817.5	80.1	71,783.0	55,000.00	4,405,500.0	16,384.09	24,438,482.9	305,099.66	-20,239,778.44	-20,223,394.35	52,622.83
22	Gobisumber	1,212,682.4	12.6	96,244.6	50,000.00	630,000.0	-60,422.73	502,112.7	39,850.21	158,357.67	97,934.94	47,622.83
	Average			51,428.65	54,795.45				52,418.28			53,891.85
				$(PCSE)^i_{na}$ 54,786.16					$(PCTB)^i_{na}$ 53,891.85			

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