



# Productivity *Insights*

Vol. 1–2



## Decentralization and Public-sector Productivity

Byambasuren Urgamal

Asian Productivity Organization



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# DECENTRALIZATION AND PUBLIC-SECTOR PRODUCTIVITY

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Decentralization and Public-Sector Productivity

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# PREFACE

The P-Insights, short for “Productivity Insights,” is an extension of the Productivity Talk (P-Talk) series, which is a flagship program under the APO Secretariat’s digital information initiative. Born out of both necessity and creativity under the prolonged COVID-19 pandemic, the interactive, livestreamed P-Talks bring practitioners, experts, policymakers, and ordinary citizens from all walks of life with a passion for productivity to share their experience, views, and practical tips on productivity improvement.

With speakers from every corner of the world, the P-Talks effectively convey productivity information to APO member countries and beyond. However, it was recognized that many of the P-Talk speakers had much more to offer beyond the 60-minute presentations and Q&A sessions that are the hallmarks of the series. To take full advantage of their broad knowledge and expertise, some were invited to elaborate on their P-Talks, resulting in this publication. It is hoped that the P-Insights will give readers a deeper understanding of the practices and applications of productivity as they are evolving during the pandemic and being adapted to meet different needs in the anticipated new normal.





# INTRODUCTION

Productivity is generally defined as the relationship between input and output, that is, a measure of the amount of output generated per unit of input. Therefore, in order to achieve greater productivity, we can either use fewer inputs to produce a certain amount of output, or we can try to increase the amount or quality of outputs from the same quantity of inputs. This seems quite straightforward and simple. However, it is a bit more complicated when we look at public-sector productivity.

In the current era of more people calling for more cost-saving “lean” government, they seem to overlook the output part of the equation, i.e., the quantity and quality of government services delivered to citizens. While there is no doubt that a lot could and should be saved in the public sector, increasingly relying on reduced inputs to boost productivity would, in most cases, result in poorer government service, which in turn would lead to lower productivity. In saying that, I am not talking about those amazing technological advances that enable huge cost cutting for the public sector but would like to focus more on the improvement of government services.

Government services are provided at subsidized prices or for free and are difficult to measure because of their enormous economic, social, and environmental dimensions. We may be able to measure the quantity of outputs but it would be more reasonable to look at their quality. A productive, efficient public sector plays an important role in ensuring the sustainable development of a nation through being constantly relevant and responsive to emerging challenges. Any achievement in public-sector productivity positively affects all stakeholders including, most importantly, the general public, leading to a better quality of life and citizen satisfaction and well-being [1–3].

Thornhill [4] identified three main reasons why public-sector productivity is crucial. First, the public sector is a major employer and has a significant share in the total employment figures of any country. Second, the public sector is a

major provider of services, including those provided by no one else but government. Third, the public sector is a consumer of tax resources. Due to these major reasons, changes in public-sector productivity have understandably significant implications for the economy of any country. Mongolia is no exception. Public-sector productivity is defined as optimizing the delivery of government services through the efficient use of public funds, resulting in increased citizen satisfaction, better accountability, cost effectiveness, competitiveness, and a better quality of life for people [1]. Trying to deliver better-quality service using its resources wisely has probably always been one of the greatest challenges for any democratic government.

In this article, I would like to share efforts by the Government of Mongolia to use its decentralization policy for better productivity in the public sector. These efforts check the two main aspect boxes of the public-sector productivity checklist: first, to provide an environment that is conducive to improving the quality of life of citizens and productivity of businesses; and second, to improve the productivity of the public sector itself. Although decentralization is a broad concept that includes political, administrative, fiscal, and economic decentralization, functional allocation of state organizations is considered as a core element of decentralization reform. Therefore, this article aims to explain how the Government of Mongolia is using its decentralization policy and functional allocation approach for public-sector productivity.

# BACKGROUND TO MONGOLIA'S DECENTRALIZATION EFFORTS

Mongolia is a country with a territory of over 1.5 million km<sup>2</sup>, placing it among the 20 biggest countries in the world, yet with a population of only 3.3 million. The country, a unitary state (Figure 1), is divided into 21 provinces, which are called aimag, and the capital city, Ulaanbaatar, where almost half of the population lives. Twenty-one aimags are divided into 330 counties called soum, and the capital has nine districts called duureg. As easily guessed, the sizes of these administrative and territorial units vary greatly both in terms of population and territory. Yet they need government services regardless of how many people live there, how remote a soum could be located from the capital, or how expensive they can be for the government to provide. Furthermore, they demand the services to be of decent quality and availability.

**FIGURE 1**

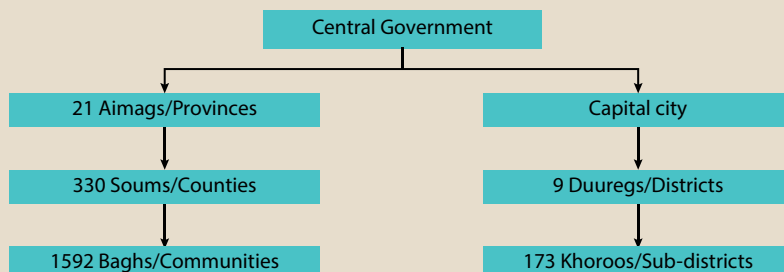
## ADMINISTRATIVE STRUCTURE OF MONGOLIA.

### Country background-Mongolia

- Territory: 1,564,116 sq km
- Population: 3.1 million
- Governance: Uni-chamber Parliamentary

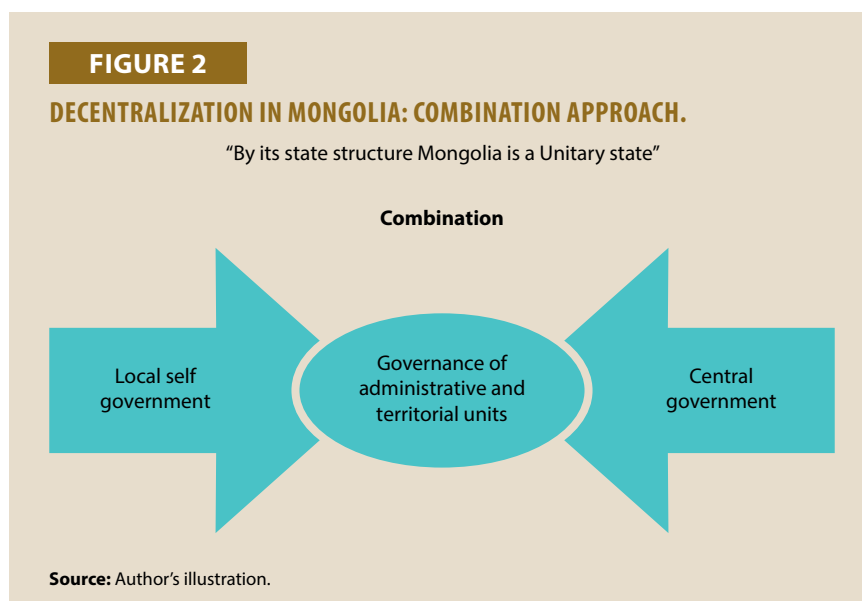


### Administratively Mongolia is divided:

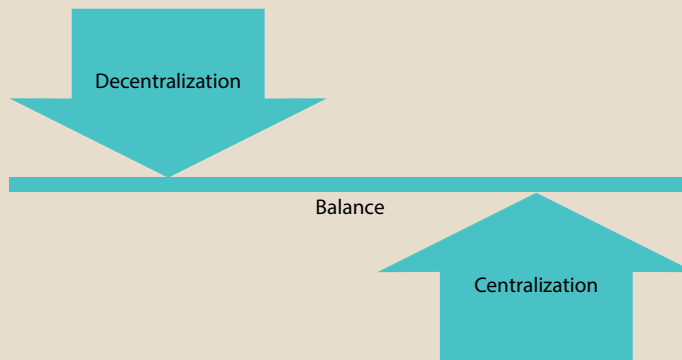


Source: Author's illustration.

According to the Constitution of Mongolia (1992), governance of administrative and territorial units is organized on the basis of a combination of the principles of both self-governance and central government [5]. Given the size of the country and its population, it is clear that a decentralization policy could play an important role in boosting public-sector productivity through giving real power where it should be. In order to define where the power should be, we turned to rational reallocation of functions based on a thorough functional review as a key, core instrument for enforcing decentralization reform [6]. Once functional reallocation is done, financial resources to implement those functions should follow to complement the process. It is important to keep a balanced combination of the constitutional principles, and finding the right, delicate balance between centralized and decentralized government is of the utmost importance and very context specific (Figures 2 and 3).



The Constitution of Mongolia (1992) states "...The authority of higher instances shall not take decisions on matters coming under the jurisdiction of local self-governing bodies" [5], thereby establishing a strong foundation for decentralization. However, the country has gone through certain phases not always supportive of the decentralized government service approach. We can identify four distinct phases of the decentralization process since the approval of the Constitution in 1992 [7]. The decentralization policy was actively

**FIGURE 3****DECENTRALIZATION IN MONGOLIA: BALANCED APPROACH.**

**Source:** Author's illustration.

supported and certain measures were taken to implement it between 1992 through 1996. As a result of implementation of the decentralization policy, local governments exercised greater autonomy between 1996 and 2002. However, the recentralization approach started to gain a strong momentum as well. The 11-year period after that can clearly be defined as the time of power recentralization. The autonomy, structure, organization, and budget of local governments were visibly weakened during those years. The fourth phase, starting from 2013, brought a new life to decentralization efforts. New initiatives have emerged, especially toward fiscal decentralization, functional allocation, and increased citizen participation.

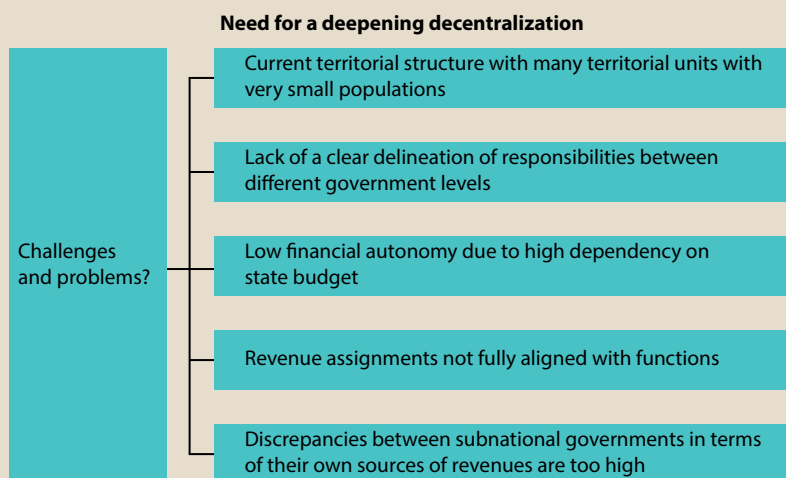
### **Finding the Balance: Reallocation and Adjustment**

At all levels, we began to understand that the whole situation needed to be addressed in some way. At the center of everything, Mongolians wondered if a too-centralized approach was taking more and more power out of the hands of local administrations. Is there something wrong with public-sector functions, leading to increasingly incapacitated governors, who have to work with agency directors appointed directly from government ministries while being responsible for all provincial affairs he or she is assigned to answer for? Too much has been decided at the central government level, leaving local administrations incapable of making decisions on truly, genuinely local matters.

It turned out that the allocation of functions across government agencies and levels was inaccurate and definitely needed adjustment. Many functions at different levels overlapped and, in many cases, responsibilities were defined or distributed in a contradictory or competing way. Furthermore, revenue assignment was not aligned with functional assignment, and discrepancies between subnational governments regarding their own sources of revenues were too great. Those local governments were too dependent on transfers and subsidies from the central government and they did not have enough administrative power and capacity to fulfill the functions effectively and efficiently. On top of all that, the territorial and administrative structure consisting of too many small units with very small populations seemed to undermine the implementation of the constitutional ideal. Under those circumstances, it was hard to talk about enhancing public-sector productivity (Figure 4).

**FIGURE 4**

### CHALLENGES AND PROBLEMS TO TACKLE IN DECENTRALIZATION.



**Source:** Author's illustration.

# FUNCTIONAL REVIEW PROCESS

The last 15 years witnessed several serious efforts aimed at conducting functional reviews with funding from international development partners and nongovernmental organizations (NGOs) [8]. A World Bank-funded project did a limited-scale functional review at three ministries during 2006–2007, mainly focusing on the social development sector. An Asian Development Bank project team in cooperation with the National Development and Renovation Committee of Mongolia, a government development policy agency, performed a functional review at ministries and agencies with the aim of eliminating duplications and improving the coordination of their operations. However, it did not result in any follow-up government decision or resolution that would have converted the findings of the work into something enforceable. The Open Society Forum funded two research projects, the first (2005) on functional reallocation between central and local governments and the other (2008) on functional review of the education sector as part of the review of local budget expenditure. The Mongolian National Academy of Governance, the government’s major public administration research and training institution, came up with several policy recommendations based on the outcomes of its three thorough research projects executed between 2006 and 2011.

Looking at functional reallocation from an academic perspective, the findings of those efforts all seemed to point out problems we had long had in Mongolia, such as that the structures of government organizations were unstable and subject to constant changes, there was no government body with a clearly assigned mandate to perform functional reviews, and legal reforms and governance decisions were biased toward or simply guided by centralization ambitions. They all suggested that functional reallocation should first be done at the central government level based on functional review and followed up at local government level later. It was noted that ensuring the decentralization and autonomy of local administrations must be considered in connection with functional reallocation along with possibilities of well-sequenced measures, including delegating and transferring certain government functions to relevant stakeholders including civil society, NGOs, and the private sector.

# STATE POLICY ON DECENTRALIZATION: REFLECTING REALITY

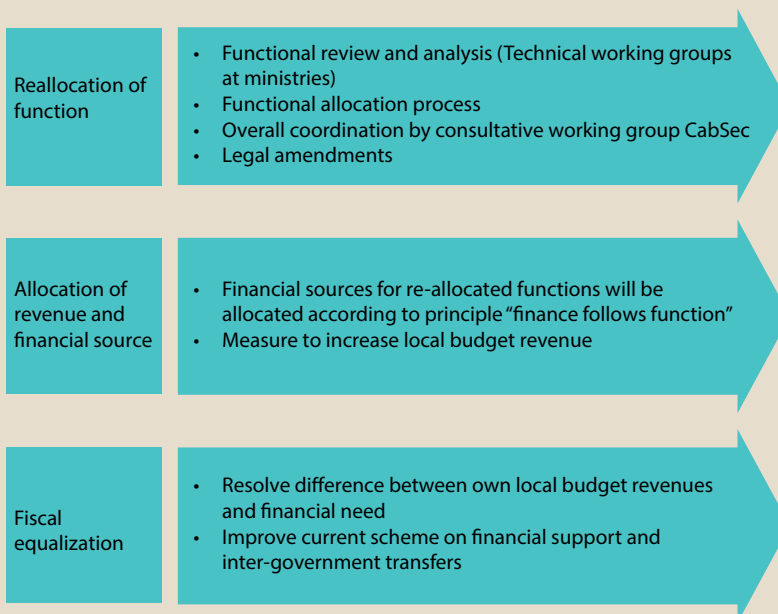
All those circumstances required the government to adopt a well-sequenced workable state policy on decentralization reflecting Mongolian-specific reality. Given the urgent need for decentralization reform, extensive discussion rounds were organized to incorporate growing political will to proceed with this reform with carefully designed instruments for implementation. As a result, a draft policy document was developed and the government approved it in 2016 under the name “The State Policy on Decentralization.”

The policy paper, the first of its kind in the country, covers issues such as history, background, experiences, lessons learned from the decentralization process, main goals, principles, directions, results, and benchmarks of decentralization policy. The main goal of the State Policy on Decentralization is defined as “...to foster transparent, accountable and good governance and economic and social development based on citizen participation,... to create conditions for more effective and accessible public service delivery to citizens by implementing decentralization in Mongolia in a sequenced, coherent and comprehensive manner...” [7]. In order to achieve those goals, Mongolia has identified three main actions as implementation instruments for decentralization: reallocation of functions; allocation of revenue and financial sources; and fiscal equalization (Figure 5). I would like to focus on the reallocation of functions as the main cornerstone of decentralization reform.

## **Decentralization Implementation Instruments: Reallocation of Functions**

The State Policy on Decentralization is being implemented in two phases of four years each. The first phase from 2016 through 2020 aims at forming the necessary conditions for implementing the policy, including adoption of some relevant legislative acts and the functional reallocation methodology. Despite encountering unforeseen challenges like the COVID-19 pandemic, which is



**FIGURE 5****IMPLEMENTATION MECHANISMS FOR THE DECENTRALIZATION POLICY.**

**Source:** Author's illustration.

shifting government priorities to more urgent issues, we can safely say that the first phase is being completed successfully. The main goals of the second phase, scheduled to run until the end of 2024, are adequate reallocation of financial resources and improvement of the fiscal equalization system [7].

Rational allocation of public-sector functions is the key to implementing decentralization. Despite long-going talks about decentralization and elimination of duplications and gaps in government functions, we still have overlapping functions across all government levels and departments. In some cases, public responsibilities are still defined in a contradictory or an unclear way, causing confusion or lack of responsible bodies or persons. There was neither a generally agreed clear definition of function nor a classification of functions. Integrated full-scale government-wide functional review aimed at drawing the whole picture has not been undertaken yet despite some good work through the previously mentioned research and projects on the subject.

## Decentralization Policy Support Project

The Cabinet Secretariat of the Government of Mongolia runs the Decentralization Policy Support Project with technical and financial support from the Swiss Agency for Development and Cooperation, and all the efforts for decentralization reform were organized around the project. Under the project, we sought advice from leading authorities on the subject including Dr. Roland Fischer and Dr. Stefan Pfaffli, Professors from Lucerne University of Applied Sciences and Arts, Lucerne, Switzerland, who worked as the main international consultants, and Dr. Rainer Rohdewohld, a leading expert on functional assignment and the co-author (with G. Ferrazzi) of the excellent book *Emerging Practices in Intergovernmental Functional Assignment*, who kindly accepted our invitation to visit Mongolia and offer his valuable thoughts and opinions on our work. Inputs and contributions from scholars and experts and the aforementioned research work along with good practices from the international community served as a basis for the Functional Reallocation Methodology Paper approved by the Government Cabinet in January 2018.

The methodology paper aims to address the core issue of decentralization [6], which is “Who does what?” The methodology sets the four main principles that are to be adhered to in reallocating functions [9]. They are: First, the principle of subsidiarity, which means functions should be allocated to the level closest to the citizens which can fulfill the function effectively and efficiently. Second, the principle of disentanglement, which means that a strict separation of powers between different levels of government is applied and for each function responsibilities are clearly defined for each level of government. Third, finance should follow function. This principle means that if functions are to be reallocated, the same amount of money as used by the level of government previously should be transferred to the new level responsible. Fourth is the principle of participation by all stakeholders. This means that the participation of all stakeholders, governmental bodies, NGOs, and professional associations and their mutual agreement are ensured during the process of reallocating functions. These guiding principles of the functional allocation process are well in line with academic research on the subject and international good practices and methodology.

In addition to the main decentralization principles, the identification of the appropriate state level for functional allocation is based on the three objective decentralization criteria of allocative efficiency, operational efficiency, and equity [10].

Allocative efficiency refers to the use of scarce resources for the different policy functions like health, transportation, education, defense, etc. Resource allocation is efficient if it responds in an optimal way to the needs of society. Unfortunately, as resources are scarce, it is never possible to maximize the provision of goods and services by the public sector. Therefore, the provision of public-sector goods and services must be optimized, opting for the best possible bundle of these goods and services by allocating the resources in the best possible way. Preferences for public-sector goods and services may not be uniform across a country; they may be different in urban and rural areas. In such cases, the optimal bundle of goods and services from the public sector looks different in different regions. If this is the case, this is a reason to allocate the function locally. However, spillover effects, or side effects of an activity performed at local level on neighboring state entities, could make it necessary for a higher state level to intervene. This could also be the case when there is a high need for coordination.

Operational efficiency means that costs are minimized for a given amount of goods and services. The criterion of operational efficiency requires that functions are allocated at the state level that can perform them in a cost-effective manner. In the economic view of the public sector, attainment of economies of scale is a significant criterion, which works to reduce unit costs of delivering certain functions by increasing the quantity of service provision [6]. However, economies of scale, i.e., cost advantages of large units or when expensive know-how is required to perform a function, may be a reason to allocate the function to a higher state level.

Equity is used here as a synonym for fairness and justice. It implies giving as much advantage, consideration, opportunity, or freedom to one party as given to another. More specifically, it means that income, costs, goods, and services are fairly divided among the population. Equity concerns may require that a higher state level should take responsibility for a function, partially or even fully. This may be the case when uniform or minimum service delivery standards are required or desired or when fairness issues are at stake. Deliberations on equity issues depend on the values and the culture of a country. The reallocation of functions should result from the considerations guided by the above-mentioned decentralization criteria [10].

With the approval of the functional reallocation methodology within the implementation scope of the State Policy on Decentralization, functional

reallocation had a clear legal framework to follow. The Mongolian Law on Budget (2011) stipulates that “...functional and performance review to be conducted every 3 to 5 years and results are to be reported to the government in order to eliminate functional overlaps and gaps, to increase productivity, and to improve quality and availability of government services to people...” [11]. We have referred to the Classification of Government Functions (COFOG) [12], defined by the UN Statistics Division as the main reference in doing the functional review and aimed to define how general functions, main functions, and subfunctions are allocated and coordinated both horizontally and vertically across three levels of government in terms of administration, organization, financial and human resources, services, and control powers.

### **Reallocation Process: Technical Working Groups, Use of Software, and Examples**

The functional reallocation process started with functional reviews at government ministries and some administrative units including Ulaanbaatar, the capital city. Technical working groups were formed consisting mostly of experienced professionals within the ministry or governor’s office concerned including administrators, lawyers, legal counselors, finance officers, and monitoring and evaluation specialists most familiar with government operations and the functions of their organizations. The whole process was coordinated by the Consultative Working Group formed at the Cabinet Secretariat from the very beginning, and a professional team of consultants from the Decentralization Policy Support Project has helped the technical working groups. They looked at the functions assigned to their organizations by law and government resolutions and other legal acts and tried to identify possible gaps or overlaps with the methodology as the main guideline to complete the whole exercise. They did not limit their work to functions their organizations were mandated with but instead tried to look at the bigger picture to identify the functions that could be performed more efficiently if they were reassigned or removed.

In order to facilitate the technical working groups’ processes, we developed a special software tool to make functional reallocation review an easier, less time-consuming process. This software tool made a database of all the relevant laws and legislative acts available online with a user-friendly search engine. Once a certain function is entered into the search box, all the relevant articles of laws or other legislative acts are displayed, making this process paperless

and automated, thus saving time and making the process more productive. The software, albeit not the most complicated and state of the art, has definitely reduced the workload and significantly accelerated work processes for the technical working groups.

All the working groups have completed their reports and submitted them along with proposed changes to the Cabinet Secretariat of the government. Needless to say, it was an enormous effort to map all the functions with the government and lasted for more than a year. Some ministries wanted more functions assigned to them and saw those additional responsibilities as a way of making their work more complete and growing into a better-performing agency. Aimags (provinces) and the capital city wanted more autonomy and power too. Not everyone was willing to part with some of the functions they were already assigned but did not rule out possible changes and suggested some policy alternatives as well.

According to the functional reviews, government ministries in Mongolia execute 38 general functions, 152 main functions, and over 800 subfunctions [8, 13]. Most subfunctions are co-implemented with local administrations, and resource-wise, those heavy workloads are distracting some understaffed ministries from their main functions, most likely resulting in some compromised service quality.

Based on the reviews, we have come up with proposals that can be summed up in four directions [8]. First, some functions must be transferred to appropriate levels of government or delegated and outsourced to professional associations or NGOs. Second, we need to update legal regulations for the sectors, making required changes to some laws and legislative acts. Third, there is a need to structurally reorganize ministries to address the reality and to form some designated agencies or entities if required. Last but not least, those functions to be implemented through cooperation between sectors (ministries) or government levels have to be clearly defined.

Look at the example of functional reallocation proposed by the Ministry of Education, Culture, Science and Sports, a very big ministry, which was in 2020 divided into two separate ministries (the Ministry of Education and Science and the Ministry of Culture) and an agency (the State Committee on Physical Culture and Sports). The Ministry of Education, Culture, Science and Sports

had proposed transferring functions related to establishing schools; granting, extending, and terminating school operation licenses; and safety and hygiene of training and catering facilities at schools to the governors of aimags (provinces) and the capital city. Printing and production of textbooks and teaching and training materials as well as their distribution could be designated as a function of the Institute of Education, which is a separate body that reports to the ministry. All the functions related to culture could be transferred to the ministry's subordinate agencies. The proposal was in line with the subsidiarity principle based on whether the current functions have contributed to the centralization of power and authority.

Another ministry that proposed more decentralization measures was the Ministry of Food, Agriculture and Light Industries. Its approach was very interesting, as it thought that some 13 subfunctions under the main function of livestock industry development policy could be transferred to relevant professional associations and NGOs by signing outsourcing agreements. This ministry went even further on some subfunctions under the main function of crop industry development policy, suggesting their delegation to competent individuals besides professional associations and NGOs. According to the ministry, functions related to ownership, usage, and data and information on croplands should be transferred to the Agency of Land Administration and Management, Geodesy and Cartography that operates under the Ministry for Construction and Urban Development. Policy implementation of light industries in provinces should be given to governors, while functions related to vegetable production and supply could be delegated to provincial agencies. Based on a thorough review of functions, the Ministry of Food, Agriculture and Light Industries proposed those changes. Functions, where possible, should be given to another ministry (within the central government level), down to provincial governors and agencies (local government level), and to professional associations, NGOs, and even qualified individuals (outside of government). Those proposals are aligned well with the subsidiarity and disentanglement principles as set out in the methodology paper.

# CONCLUSION

From the Cabinet Secretariat standpoint, we received a better, clearer picture of government functions in Mongolia and were able to identify some overlaps to eliminate and gaps to bridge. There are some functions that are simultaneously assigned to several ministries, making them co-responsible. Such an approach leads to those functions being left without clear ownership. On the other hand, some functions are divided into “smaller pieces of the bigger puzzle,” making different government ministries responsible for only their part of the issue and leaving the fate of policy decisions in the hands of their cooperation and understanding. Such voids and overlaps should be addressed. In short, the functional review process proved that some changes were required regarding functions.

When these functional reallocations are set to occur, we have to follow another principle of the methodology: the principle of participation by all stakeholders, as all concerned parties must reach a consensus. Those reallocations will only be possible by making relevant changes in laws and legislative acts, although the functional reviews were exercises well worth the time and resources required. With relevant data and proposals available, we now have a solid foundation for deepening the process of functional reallocation.

In conclusion, 57 proposals directly related to functional reallocation and more than 110 proposals on resolving intersectoral-related issues were made. In relation to those, more than 150 sectoral law amendments were proposed, indicating the scale and scope of the work conducted during the exercise [13]. On the other hand, it is encouraging to see that more than 10 laws directly related to functional reallocation have been submitted to Parliament for discussion, while several have already been approved by lawmakers. For example, as the Law on Water was approved, the Water Agency, to which some key proposed functions from the Ministry of Environment and Tourism were transferred, was established. Also, under the approved Law on Medicine and Medical Devices, the Drug Control Agency was established. We can boast that the formation of these agencies in 2020 was a direct result of functional reallocation work.

Furthermore, with the recent adoption of amendments to the Law on Administrative and Territorial Units and Their Governance, the principal legislative act that regulates local governance affairs, a major legal foundation is being strengthened in Mongolia to deepen the existing decentralization process by increasing the power and authority of local administrations and reallocating functions in a rational way at each level of government. Further momentum for decentralization reform would be created by reflecting decentralization concepts, principles, and main insights from functional reallocation under this law.

With all the functions reallocated following changes to the relevant laws, financial resources needed for implementing those reallocated functions at the appropriate level or organization should follow. The main principle here is “finance follows function.” When functions are reallocated to the subnational level, relevant measures must be taken to increase revenues for local budgets. Another instrument of the implementation mechanisms of decentralization is fiscal equalization aimed at resolving the difference between local revenues and financial resources needed for carrying out those functions allocated at the local level.

Functional reallocation is a multidimensional, time-consuming process and it requires tremendous political will and mutual understanding within the government to successfully implement decentralization reforms. It is still not complete. But we see functional reallocation as being a way to boost public-sector productivity, which plays an important role in the Government of Mongolia’s pursuit of its broader economic and social development goals.

People will always demand better service from the government, and citizens’ satisfaction is of great importance to any government that measures and monitors its performance. With a more productive, efficient public sector, where functions are rationally reallocated, we can deliver that quality of public service people expect. With the first achievements to brag about, we are confident that we are on the right track.



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