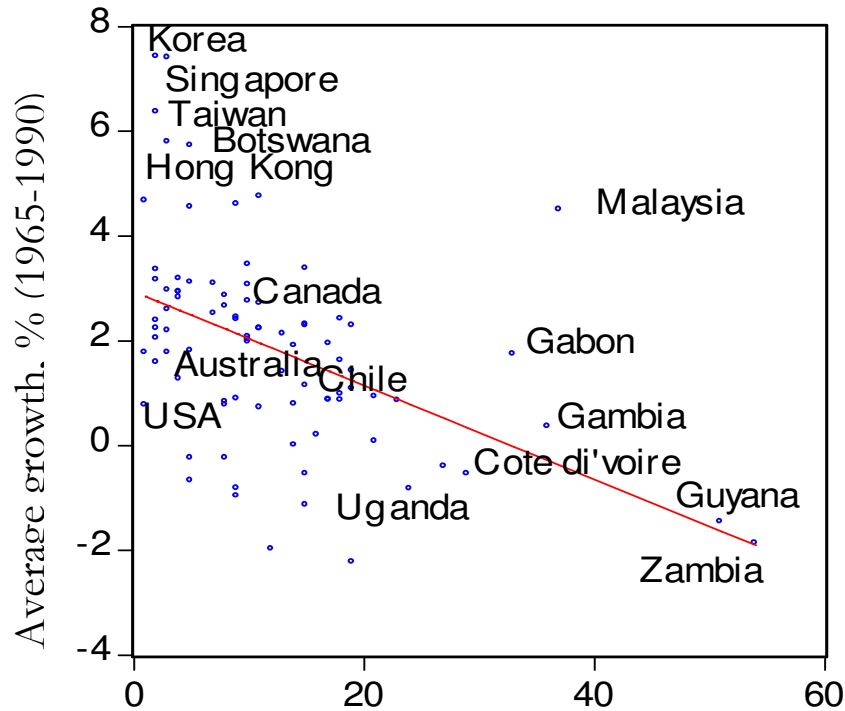


# Is Resource Curse Relevant for Mongolia

Erdenebat B. (PhD)

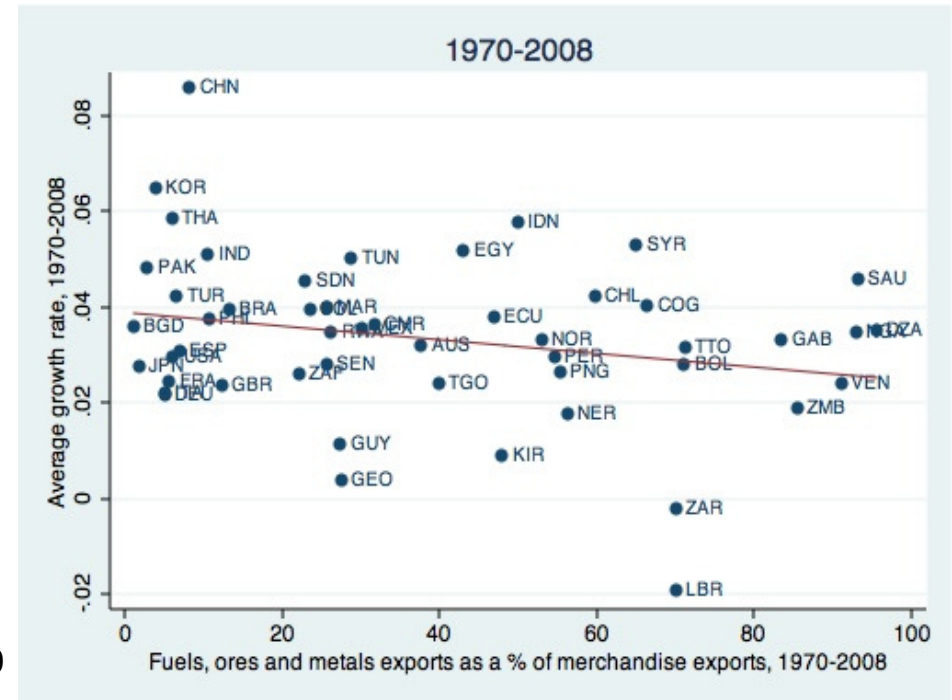
- There has been a lot of research since 1990 on a phenomenon referred to as Resource Curse by many researchers.
- Overall evidence is inconclusive: some supporting, some pointing out econometrical flaws in methodology that is used to back up the phenomenon.
- *Natural resource curse is defined as a phenomenon that countries abundant in natural resources fail to realise long term economic growth compared to their natural resource poor counterparts (cf Auty 1990)*
- This presentation documents the current role of mining sector in Mongolia and questions its sustainability

## Resource curse



Resource dependence (1970)

Source: Mehlum et. al (2007)

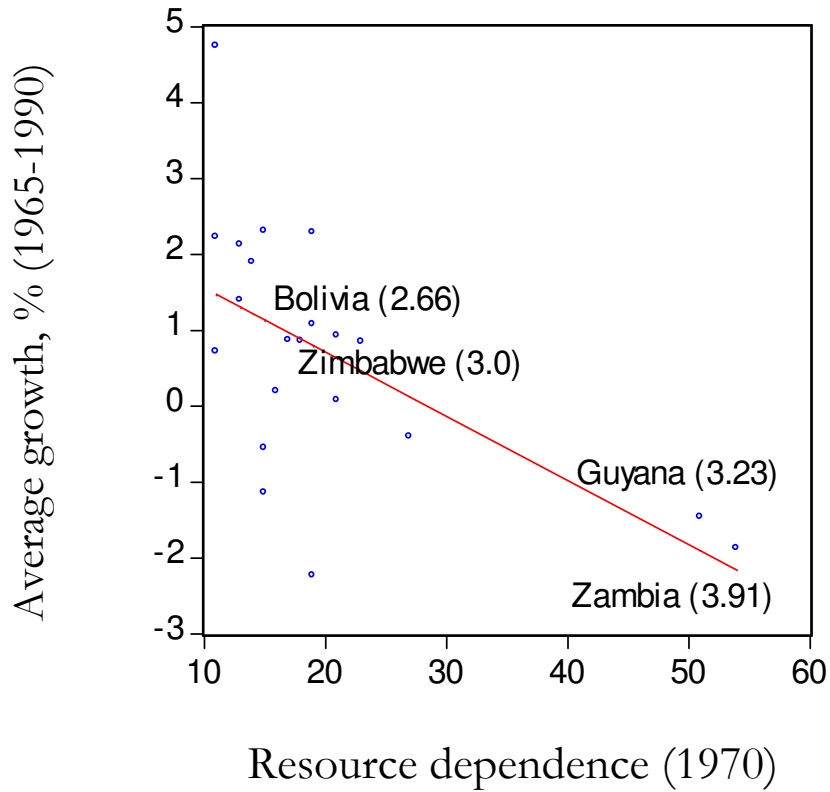


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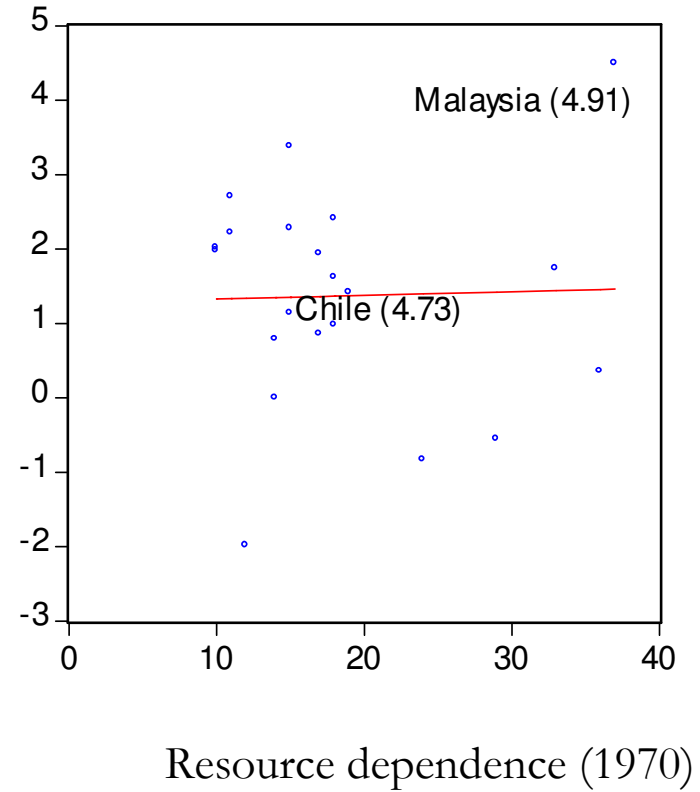
Source: Frankel (2010)

In Mongolia extractive sector share in GNP was 36% in 1997 and 43% in 2008. Average growth 6% (1997-2010)

A. Countries with bad institutions



B. Countries with good institutions



Mongolian institutional quality index in 2006-2008 is 3.13, 3.09, 3.08 respectively.

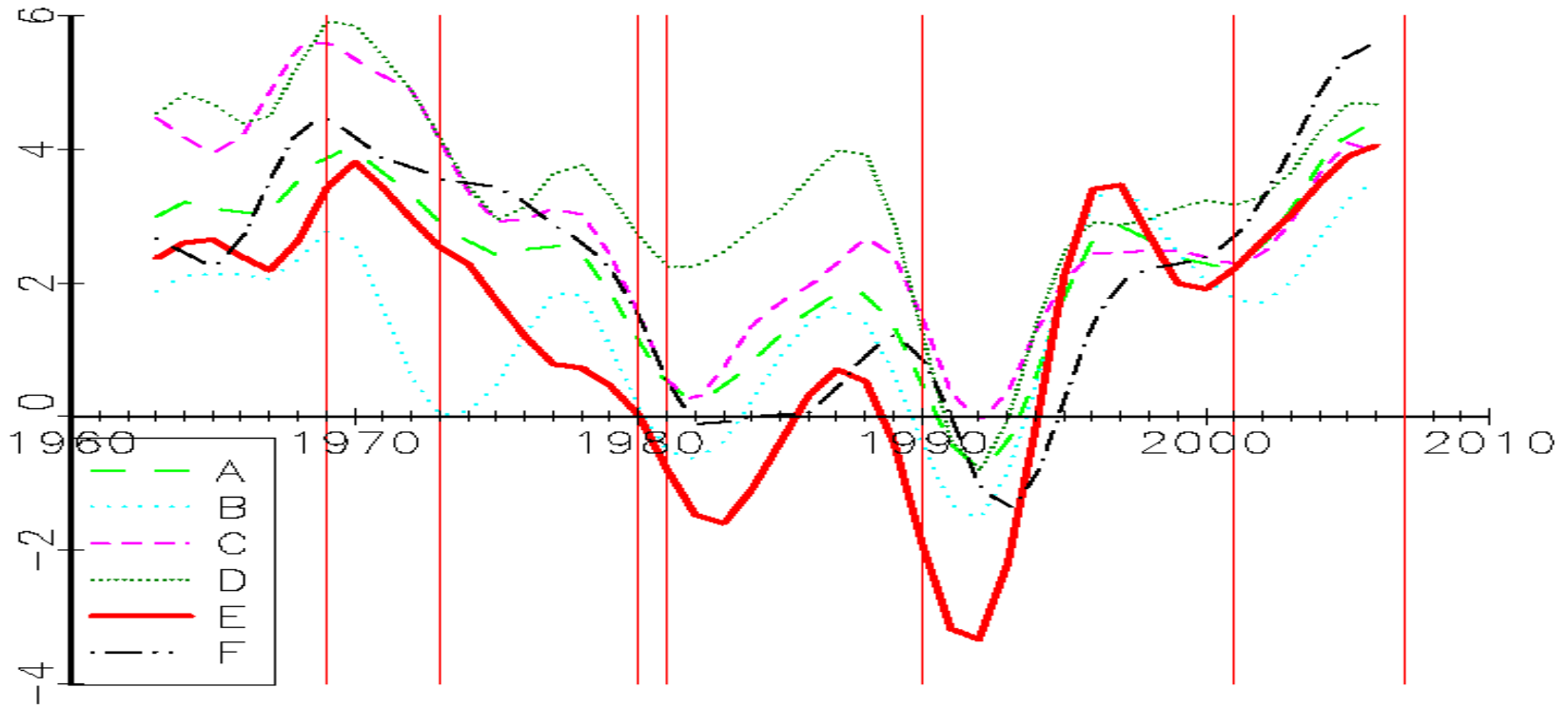
- Since this is about long term growth it may not be relevant for Mongolia.
- But there is a scope for learning from other's experiences and not to repeat their mistakes.
- It's vital that we manage well the income from the natural resources.

Resource curse is argued to affect the long term growth through the following channels:

1. Resource price volatility increase country's risk and vulnerability to aberrant movements in international markets
2. Currency appreciation reduces the tradable sector competitiveness and the sector shrinks as a result with its dynamic economic effects (Dutch disease)
3. Natural endowments can lead to poor institutions such as corruption, inequality and power struggles,
4. Political rent seeking could destabilize the political situation which is harmful for economic growth

In this presentation we will focus on (copper) price volatility

## GDP growth (5 year average growth, %)



A: World average

B: Poorest 50

C: Richest 50

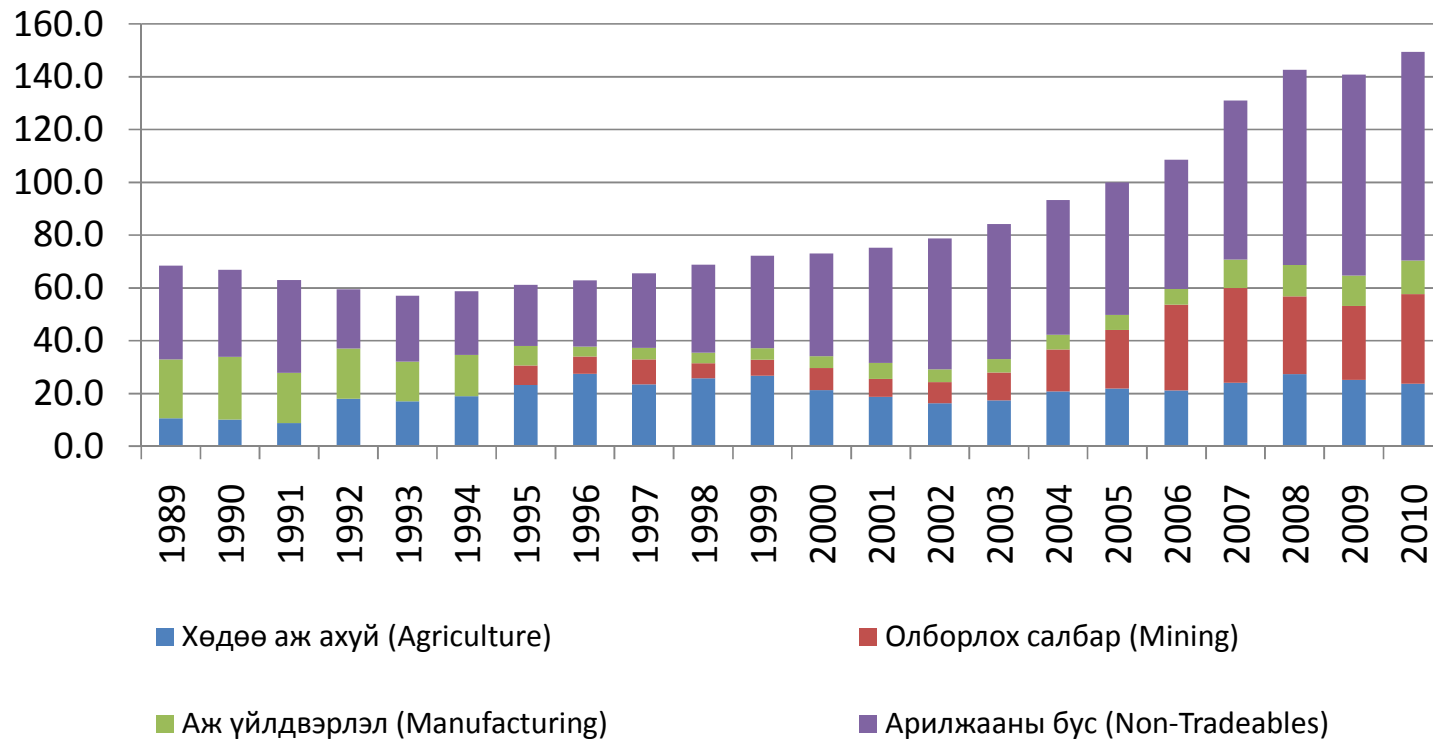
D: Most industrialized 50

E: Most mineral dependent 50

F: Most fuel dependent 50

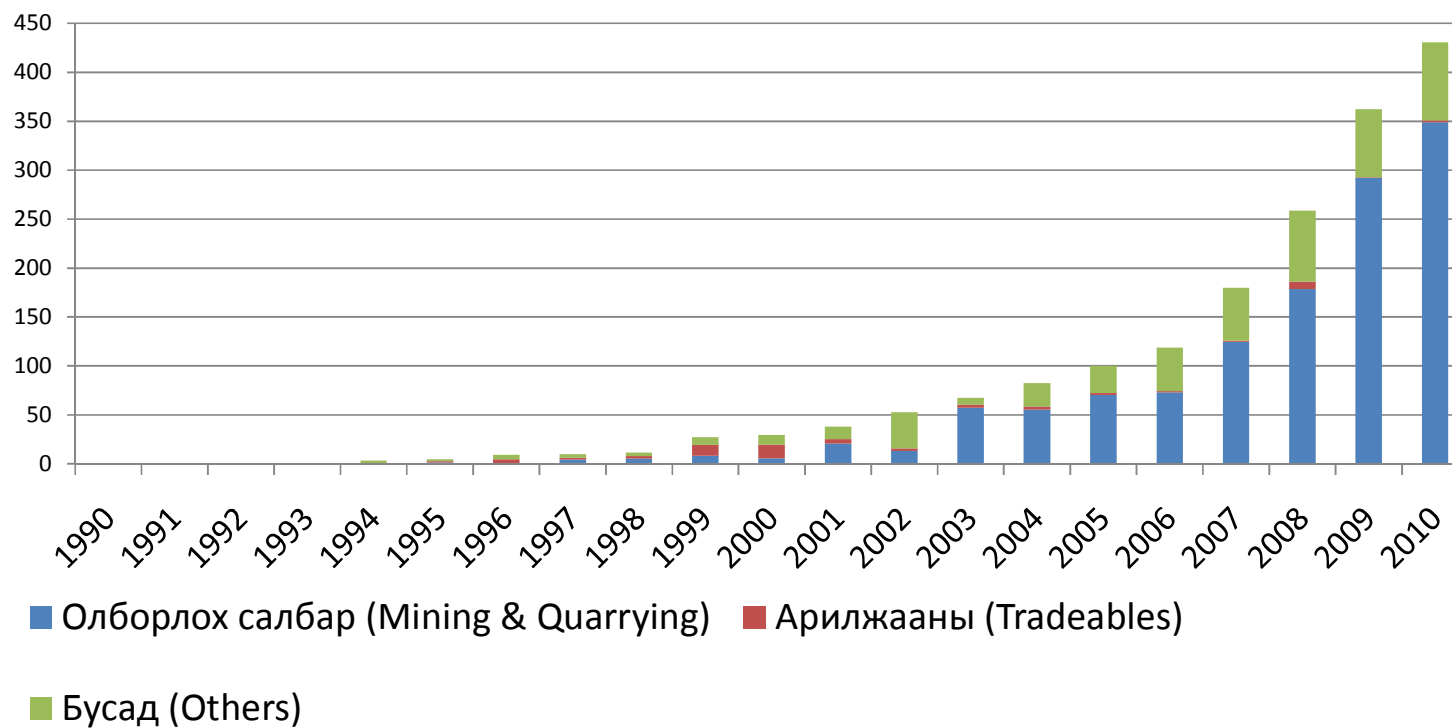
# Mining Sector in Mongolian Economy

Real GDP (2005=100)



Recent years have seen significant expansion in mining and other related activities and associated with them in non-tradable sector.

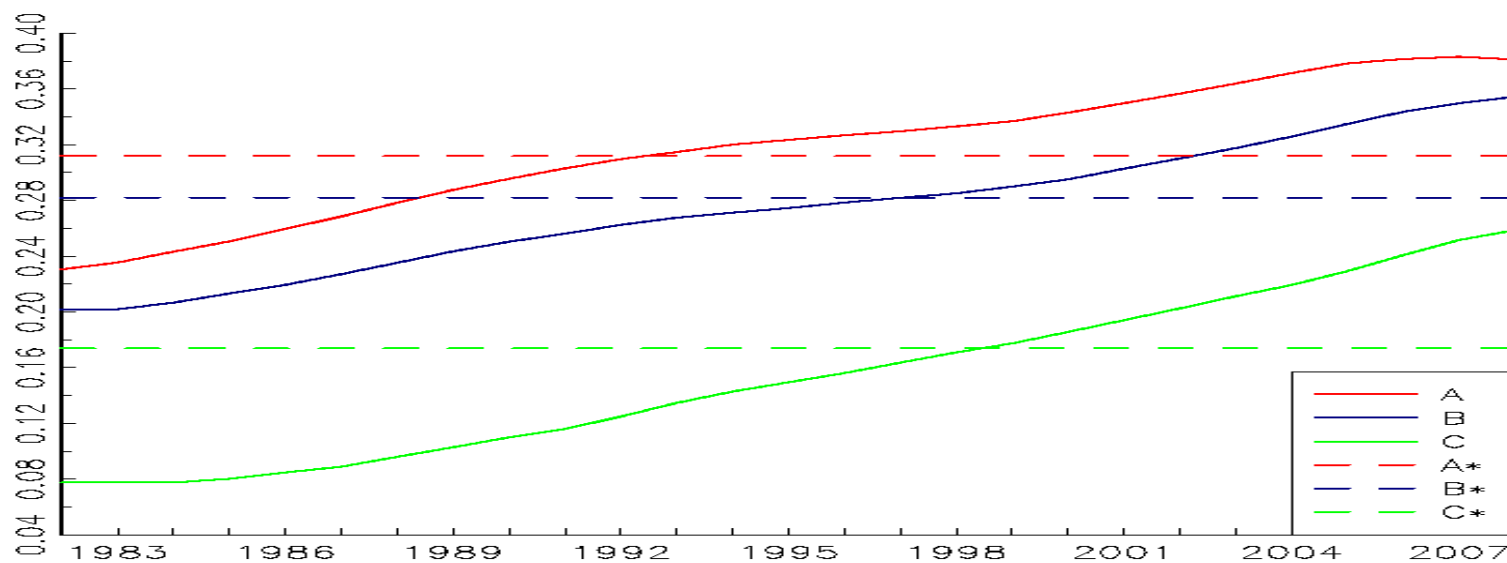
## FDI, 2005=100



Most of the FDI are directed into Mining sector



## Correlation between GDP growth and copper price change, local projection analysis



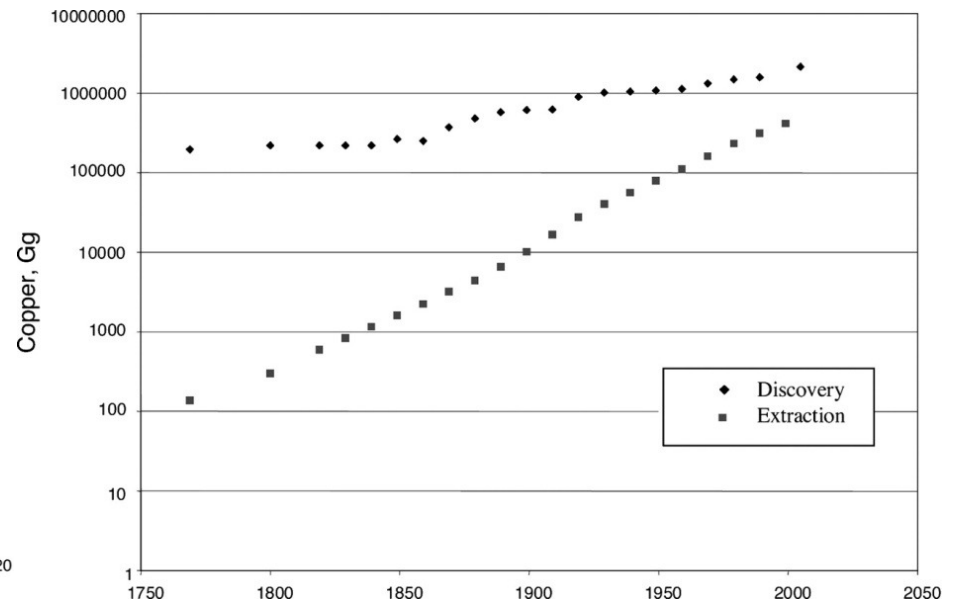
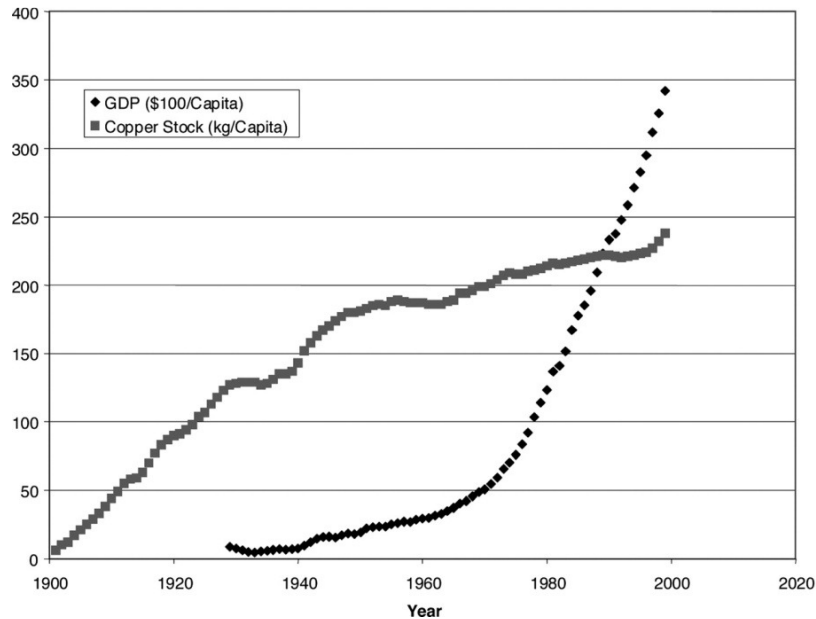
Red line depicts contemporaneous correlation, blue and green are lagged correlations (1 and 2 years respectively)

- As a result Mongolian economy is becoming more and more dependent on this single sector

Expansion in mining sector is driven by both production and price increases.

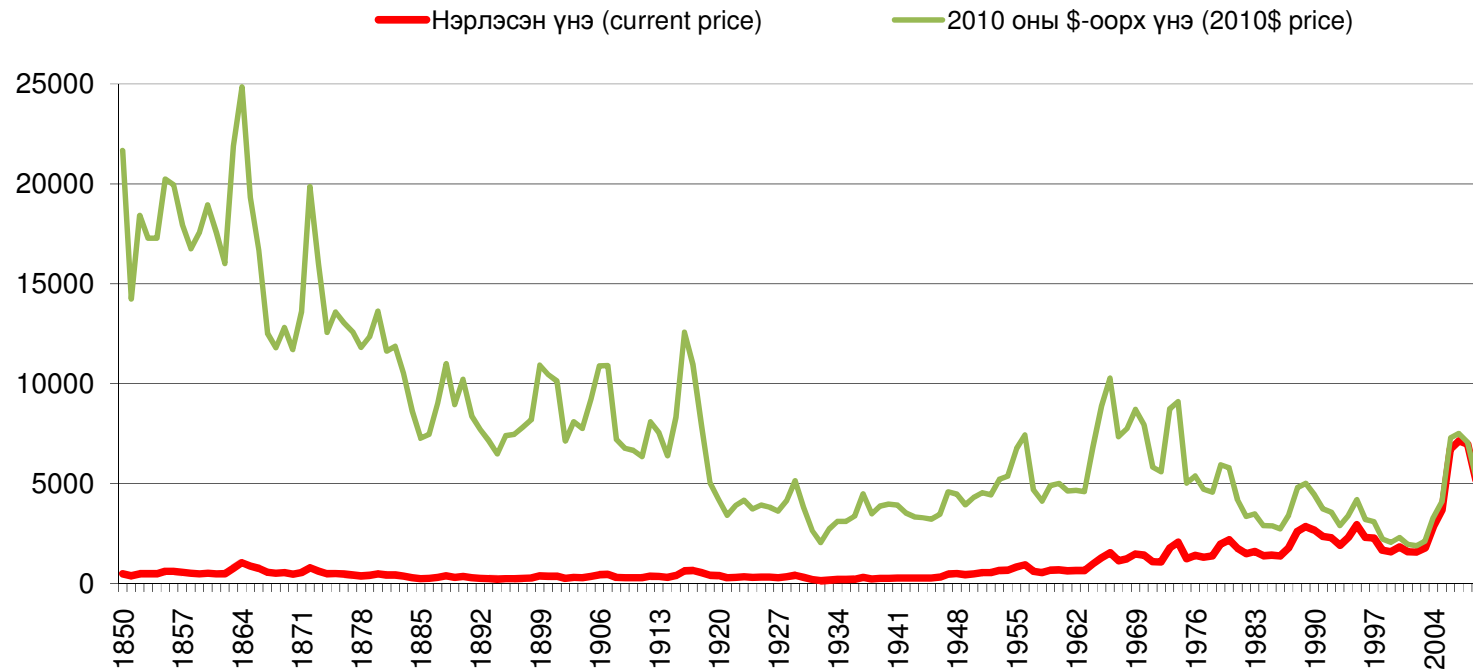
However future development in mineral prices is uncertain:

## Reasons why the prices might increase



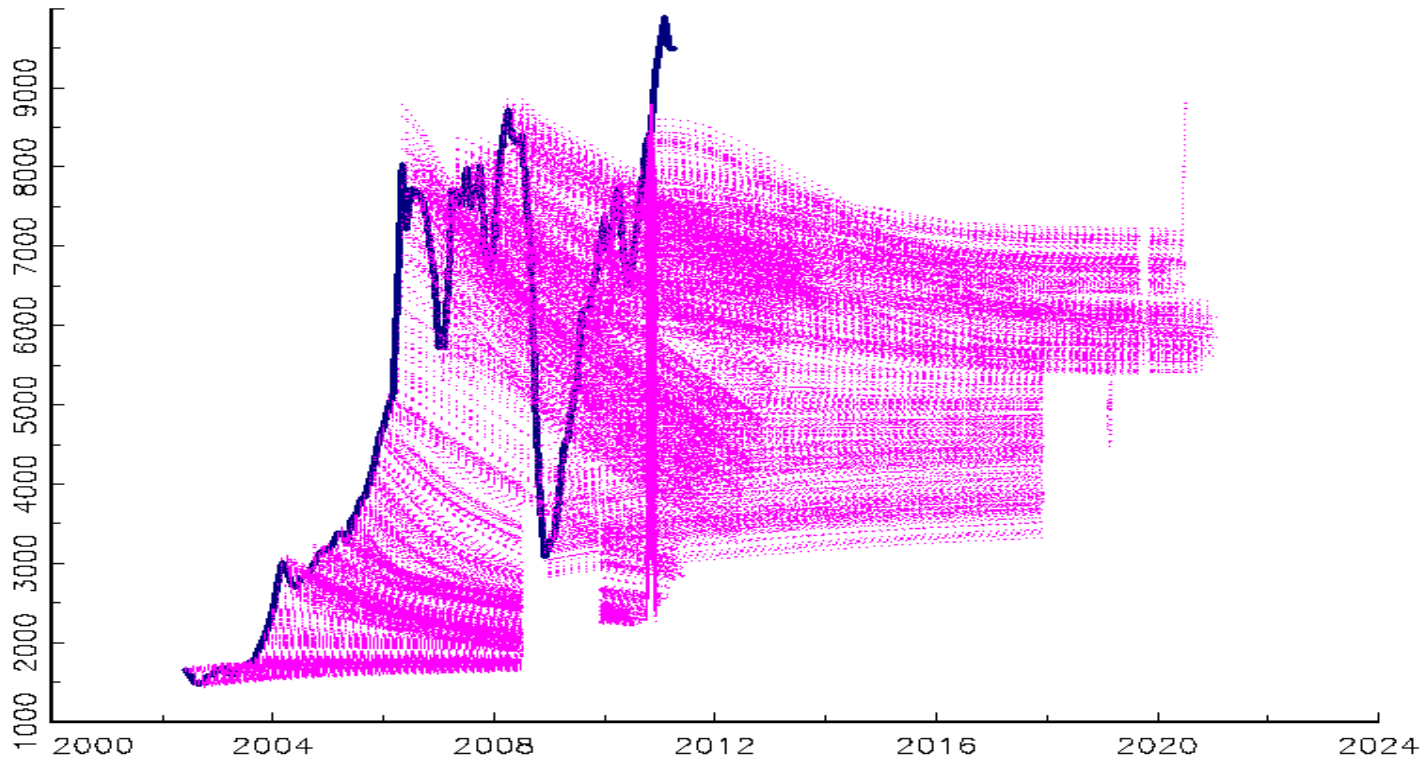
- OECD countries copper consumption increased commensurate with the per capita income. This might have implications since the emerging economies income is increasing
- World copper extraction rate is faster than the discovery rate

## Reasons why price might fall



- Every exceptional price hike in commodities is usually followed by technological innovation in saving and substitution, exploration increases and non-economical mines coming into operation
- Since Ouy Tolgoi is said to be the largest undeveloped copper mine its exploitation may depress the prices

## Copper spot and Futures prices



- Financial market is capable of reducing the prices uncertainty for the next two decades if used properly
- However since the market is unpredictable and hugely volatile, when the prices go up some realised contract prices may be too low

## **Conclusion**

- There are so many countries that failed to turn their natural resources into long term economic success and
- Learning from their mistakes and not repeating should be our starting point
- Mongolian economy's dependence on few commodities is unacceptable high
- There is an urgent need to diversify the economy
- Innovative application of new and already established tools are necessary to hedge against the price volatility
- Optimal administration and use of natural resource savings funds, use of financial markets to reduce risk could be among them