Mongolia's economic prospects and challenges

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Abstract

Mongolia, a sparsely populated country of 2.9 million, has experienced rapid economic growth driven by its resource-rich mining sector, which accounts for up to 25% of GDP. Key exports include copper, gold, and coal, with major projects such as Oyu Tolgoi and Tavan Tolgoi expected to further boost growth. However, dependence on mineral exports exposes the economy to commodity price fluctuations, while weak institutions, high government involvement, and corruption limit its ability to leverage the mining boom fully. Expansionary fiscal and monetary policies have contributed to inflation, currency depreciation, and a large current account deficit. The ability of Mongolia to translate its mining boom into broad-based improvements in livelihoods remains uncertain.

Keywords:

Mongolia, mining boom, economic challenges

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Mongolia's economic prospects and challenges

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In recent years Mongolia has become one of the most rapidly expanding economies in the world. According to the Economist Intelligence Unit [1], it was one of the top performers in 2013, with economic growth of 11.7 per cent, and it is projected to be the second top-performing economy in 2014, only after South Sudan (about 15 per cent).

Mongolia is a sparsely populated country with a total population of 2.9 million. Because of the economy's rapid expansion over the last few years, the World Bank now classifies Mongolia as a mid-low income country for per capita income, and it is expected to enter mid-high income in the near future according to Mongolia's Ministry of Economic Development.

The main driver of this rapid economic expansion has been the mining industry's development. Mongolia is richly endowed with natural resources. With increasing commodities prices in the world market for the past 15 years, the mining sector's share in GDP increased from 14 to 25 per cent. Mongolia's main export commodities are copper, gold and coal, and Mongolia is now one of the major coal exporters to China, briefly overtaking Australia [2] in 2011 and 2012.

Moreover, it is expected that during the next five years major mining projects of copper (Oyu Tolgoi project) and coal (Tavan Tolgoi project) will reach their full potential, likely further increasing economic expansion. By some estimates [3], Mongolia's GDP will reach US$25 billion by 2020, which is 2.5 times the size of today's economy.

These developments haven't gone unnoticed in the world market. Mongolia has become one of the most attractive economies for investors. In 2013 alone the Mongolian government sold US$1.8 billion of bonds in world markets, which is a testament to the strong upside expectation of the economy.

However, the Mongolian economy faces serious challenges to reach its full potential and take advantage of the mining boom's opportunities.

Since Mongolia is becoming increasingly dependent on the export of raw minerals, world price fluctuations for commodities have destabilising effects on the nation's economy.

Therefore a major policy question is whether Mongolia has enough safeguards in place to protect itself from drastic fluctuations in its terms of trade. Inside Mongolia there is broad agreement about the need to conduct countercyclical macroeconomic policies — especially that the government should be saving during good times to be able to maintain the level of expenditure during economic troughs and stimulate the economy when needed. However, looking at the past 10 years of policymaking, Mongolian governments have found it hard to implement these policies in practice.

During and after the 2008–09 world economic crisis the difficulties of implementing and maintaining these policies were on full display. One problem was that, in order to win elections, political parties had great incentives to promote and execute populist policies, such as cash distributions to citizens. To stop these kinds of policies, which greatly hurt macroeconomic stability, major political parties agreed to control this practice and the parliament passed the Fiscal Stability Law in 2010, putting limits on government debt, increases in expenditure and the budget deficit. However, even this law was not enough to discipline the government.

Since the country desperately needs to develop and expand its infrastructure to promote economic diversification, the government has found it hard to resist spending more. Its efforts in raising capital by issuing bonds in foreign and domestic markets, and spending it through the newly established Development Bank of Mongolia (DBM), have undermined the spirit of the Fiscal Stability Law. At the end of 2013, budget deficit was at 8 per cent of GDP (including the DBM's loans) and the overall debt level already exceeded the limit of 40 per cent of GDP set out by the law.

While the Mongolian government finds itself maintaining increasingly expansionary fiscal policies, the Bank of Mongolia (the central bank) is simultaneously undertaking expansionary monetary policy by extending more credit to government and commercial banks. As a result, in 2013, inflation reached 12 per cent and the exchange rate depreciated more than 20 per cent.

It should be noted that the exchange rate's sharp depreciation was also exacerbated by a decrease in the country's terms of trade. In contrast to previous years, the terms of trade depreciated by 15 per cent in 2013. Subsequently, the current account deficit for the year reached US$3 billion, or 28 per cent of GDP, and foreign direct investment decreased by 48 per cent (Mongol Bank – Balance of Payment statistics [4]).

This sudden reversal in foreign direct investment also reflects another great challenge for the country. It is evident from the experiences of resource-abundant countries that the quality of institutions is a key ingredient in successfully taking advantage of the opportunities presented by the mining boom. That is, if a country's institutional quality remains weak, the country will not be able to attract foreign investment, which is of paramount importance to reaching full economic potential.

Mongolian institutional quality is still lagging behind its stellar economic growth numbers. Institutional qualities can be partly measured by rankings, including: corruption perception, where Mongolia is ranked 83 out of 177 countries (Corruption Perceptions Index 2013 [5]); economic freedom, 97 out of 178 (2014 Index of Economic Freedom [6] — The Heritage foundation); doing business, 76 out of 189 (The World Bank 2013 [7]); and global competitiveness, 107 out of 148 (The Global Competitiveness Report 2013–2014 [8] — World Economic Forum).

Perhaps the most disturbing of all is the corruption index. Government's increasing role in the economy (government expenditure, including the DBM, is estimated to be around 47 per cent of GDP [9]) makes it an attractive breeding ground for rent-seeking by government officials. Although Mongolia is making some progress in tackling corruption [10] at state and regional levels, with some high-profile cases having been through the Mongolian justice system, it could be that these cases are just the tip of the iceberg.

Such challenges are not unique to Mongolia, and were experienced by many countries with abundant natural resources. Countries that have been able to put in place good institutional arrangements have overcome these obstacles, and the so-called 'resource curse', whereas countries struggling with corruption, governance and accountability have not.

Most importantly, the outcome of these challenges will greatly affect the livelihood of Mongolians. As of 2013, the poverty rate is 28 per cent. Whether the country can translate the mining boom into a better livelihood for all citizens remains to be seen.

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[1] Economist Intelligence Unit:
http://www.economist.com/blogs/theworldin2014/2014/01/global-growth

[2] briefly overtaking Australia:
http://www.bloomberg.com/news/2012-06-28/mongolian-mining-bets-china-will-double-coal-imports.html/

[3] By some estimates:

http://eri.mn/index.php/en/component/booklibrary/?task=view&id=11&catid=54

[4] Mongol Bank – Balance of Payment statistics:
http://mongolbank.mn/eng/liststatistic.aspx?did=1_1

[5] Corruption Perceptions Index 2013: **http://www.transparency.org/cpi2013/results**

[6] 2014 Index of Economic Freedom: **http://www.heritage.org/index/ranking**

[7] The World Bank 2013: **http://www.doingbusiness.org/rankings**

[8] The Global Competitiveness Report 2013–2014:
http://www.weforum.org/reports/global-competitiveness-report-2013-2014

[9] estimated to be around 47 per cent of GDP:
http://www.eri.mn/index.php/en/l?task=view&catid=54&id=828

[10] tackling corruption:
http://www.eastasiaforum.org/2012/09/13/governance-and-corruption-in-mongolia-mixed-messages/

[11] East Asia Forum Quarterly: **http://www.eastasiaforum.org/quarterly/**

[12] On the edge in Asia:
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