Mongolia

Country analysis and economic overview

Prepared for International Think Tank for LLDCs
and United Nations Development Programme

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Sandwiched as it is between Russia and China, it is not surprising that these two countries have played important roles in the development of Mongolia's economy, trade and investment. Over the last twenty years, it is China that has been the dominant influence, representing as much as 80-90% of Mongolia's exports and about a third of its imports. Mongolia also relies primarily on China for access to the sea and markets beyond. However, Russia still supplies almost a quarter of Mongolia's imports.

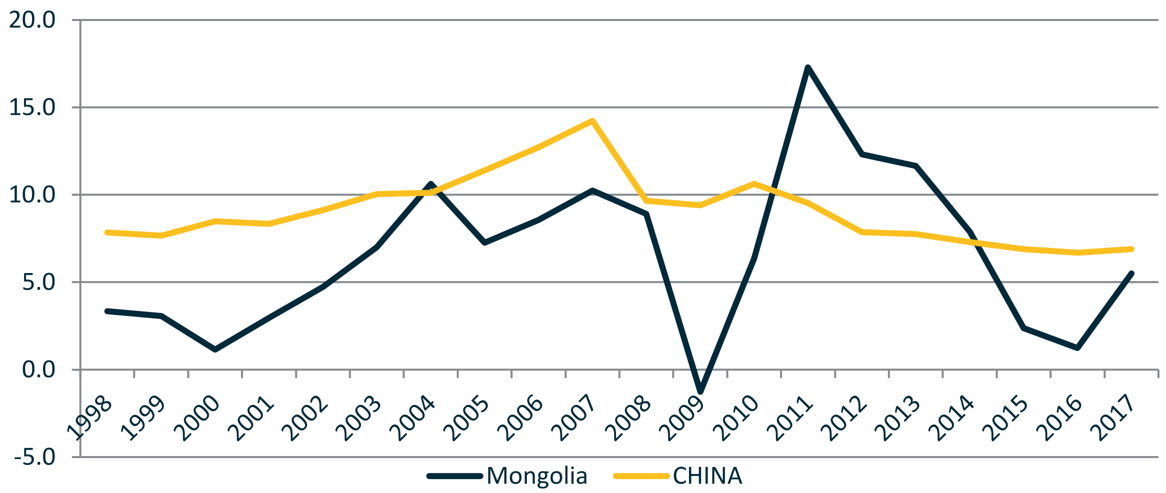
The country's large landmass contains significant mineral wealth that includes large deposits of copper, gold, uranium, and coking and thermal coal. The government's adoption of highly favourable mineral and investment legislation in the late 1990s generated significant interest from international mineral exploration and development companies, which brought with them the ability to deploy new technologies and rapidly raise output in the mining and quarrying sector.

Starting in the early 2000s, Mongolia entered a period of accelerating growth as FDI poured into mining and quarrying and produced a corresponding multiplier effect across the economy. Trade boomed, especially with China, pushing exports up to as much as 50-60% of GDP, and mining and quarrying products accounted for as much as 80-90% of exports.

However, this reliance on commodities amplified the impact of the global financial crisis of 2008-09, which saw the country slip into recession and require an IMF bailout. A quick recovery in commodity prices meant the country was able to make early repayments to the IMF, however, and the downturn was too short and recovery too fast for policymakers to learn a meaningful lesson from the crisis.

As a result, the country entered another boom cycle complete with a property bubble. In 2011, Mongolia received 4.6 billion dollars in FDI, more than the sum total for the previous decade. Another 4.3 billion dollars in FDI was injected in 2012. These sums represented 44% and 35%, respectively, of the country's annual GDP. Increased resource rents resulted in a classic case of Dutch disease as growth stalled in sectors other than speculative real estate.

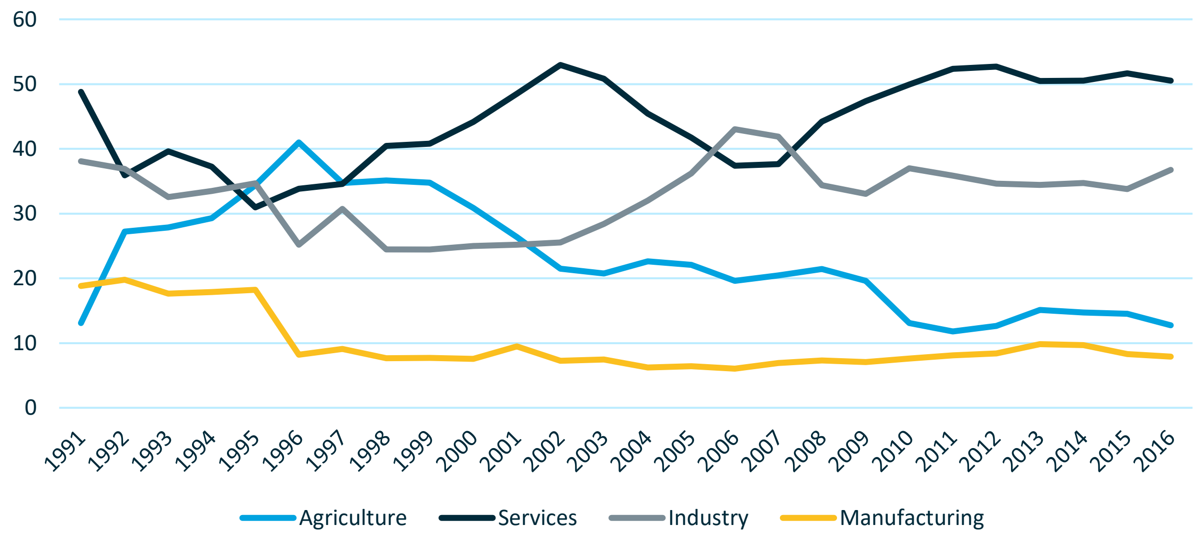
Figure 1: GDP growth rates for Mongolia and China (% per annum)



Source: World Bank, WDI

Mongolia achieved 6.2 billion dollars in exports and 4.3 billion dollars in imports in 2017. However, the country's market concentration of exports is very high. At the height of the commodities boom in 2011 and 2012, more than 90% of the country's exports were going to China. Although this reliance on the Chinese market has declined somewhat as the pace of growth in the Chinese economy has moderated, China still bought 79% of Mongolia's goods exports in 2016. Moreover, as of 2016, mining and quarrying accounted for 71% of its export earnings. Compared to 2015, total exports grew by 1.3 billion dollars, driven mostly by the similar scale of increase in coal exports.[1] The concentration in both export products and markets implies that Mongolia is seen as poorly diversified.

Figure 2: Value added (% of GDP)



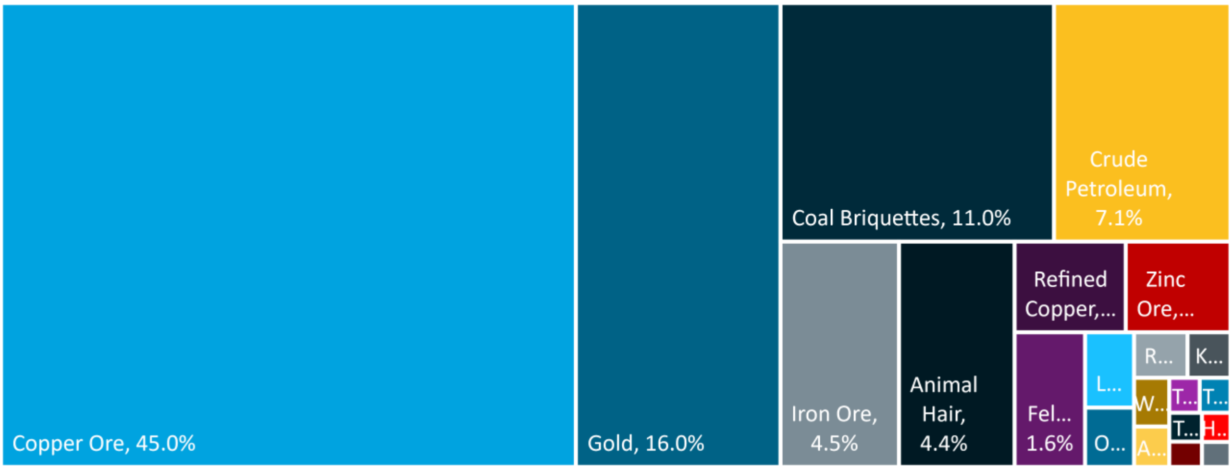
Source: World Bank, World Development Indicators

1 Mongolian Statistical Information Service

Mining and quarrying continued to account for 20% of Mongolia's GDP in recent years[2], in spite of the downturn in the global commodities cycle (and prices), and the latest pick up in this cycle is likely to raise its share in the economy. However, the largest macro sector is services, which has seen its share of GDP vary from 40% to 60% over the cycles of the last twenty years. As much as a quarter of services are accounted for by wholesale and retail trade, making this the second largest individual sector after mining and quarrying (at the detailed level). Wholesale and retail trade was the second largest contributor with 11% of GDP in 2016. Processing industries and real estate generated 7% each in the same year.[3]

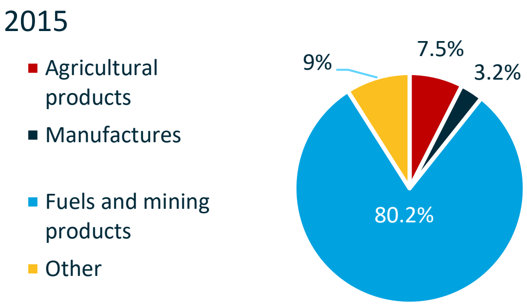
Manufacturing value added has remained low, averaging less than 10% of GDP for the past decade. Agricultural value added has seen a steep decline in its share since 1996 but it remains about on a par with wholesale and retail trade.

Figure 3: Export structure



Source: The Observatory of Economic Complexity (2015 data)

Figure 4: Total exports by main commodity group and partner



Top 5 export destinations 2016 (US$ million)		Top 5 import origins 2016 (US$ million)	
China	3,883	China	1,040
UK	787	Russia	862
Russia	56	Japan	331
Germany	43	Korea, Rep.	198
Italy	34	US	139

Source: World Trade Organization Country Profiles

2 Mineral Resources Authority, Annual Bulletin of Mining and Geology of Mongolia 2016 (https://www.bgr.bund.de/EN/Themen/Zusammenarbeit/TechnZusammenarb/Downloads/mongolei_MRAM_AnnualBulletin2016.pdf?__blob=publicationFile&v=2

3 Mongolian Statistical Information Service

Agriculture remains the largest employment sector, employing almost a third of the workforce: this is in stark contrast to the extremely weak level of investment in the sector. The second largest sector for employment (creating around 15% of jobs) is wholesale and retail trade. Education services are also a significant source of employment, currently employing 8.2% of the working age population.

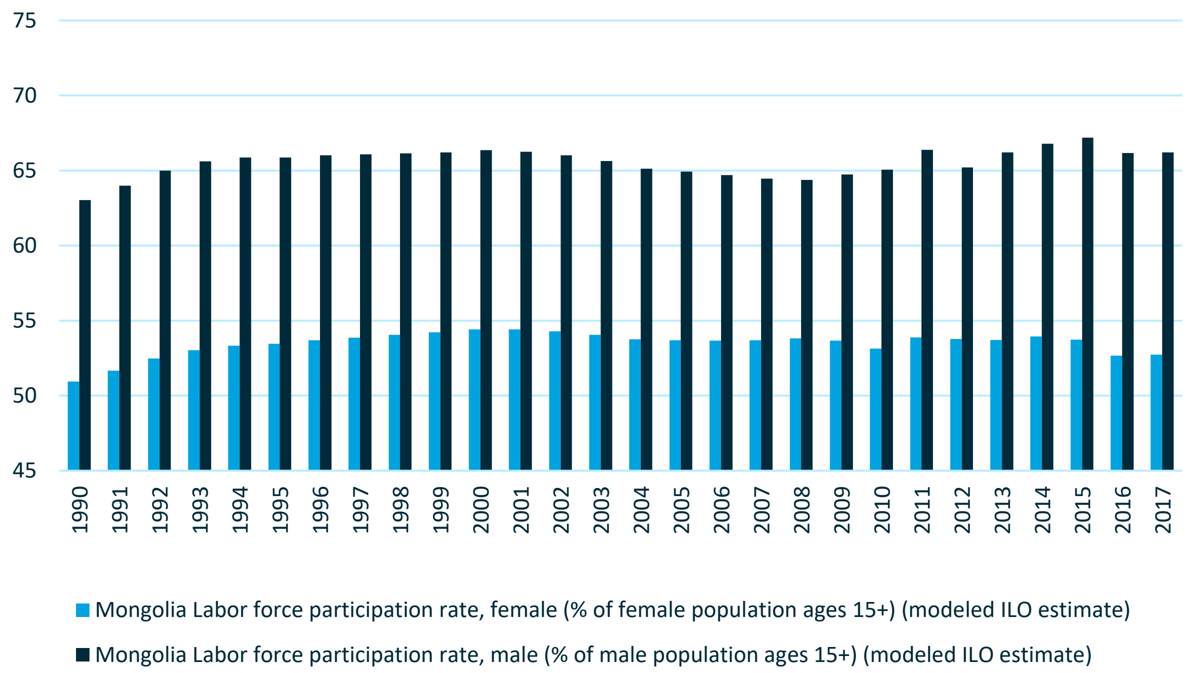
Mining and quarrying employs only 3.7%, reflecting the limited scope of artisanal mining activities and the predominance of large mechanised mines for production of the country's main export commodities. For example, the Oyu Tolgoi copper and gold mine, which will have cost about 20 billion dollars to develop and is expected to contribute as much as 30% of GDP once in full production, will only employ around 3,000 people.

Table 1: Labour force by sectors (%)

Divisions	2006 Q4	2007 Q4	2008 Q4	2009 Q4	2010 Q4	2011 Q4	2012 Q4	2013 Q4	2014 Q4	2015 Q4	2016 Q4
Education services	7.35%	8.90 %	7.09 %	7.69 %	8.94 %	8.92 %	9.04 %	8.19 %	7.97 %	7.48 %	8.23 %
Public administration and defence	3.32% .	6.14 %	6.05 %	5.38 %	5.82 %	5.43 %	6.10 %	6.54 %	5.52 %	5.42 %	6.85 %
Agriculture, forestry, fishing	37.50 %	35.70%	37.17%	34.46%	31.77%	34.04%	31.22%	29.37 %	28.59 %	31.37 %	31.07 %
Construction	3.85%	3.23 %	4.48 %	4.48 %	4.51 %	4.77 %	6.05 %	6.11 %	7.39 %	7.22 %	5.22 %
Mining and quarrying	1.86%	3.43 %	3.05 %	3.24 %	3.67 %	4.09 %	4.04 %	4.00 %	3.46 %	3.88 %	3.69 %
Wholesale and retail trade	14.66 %	10.72%	12.77%	16.69%	13.97%	12.69%	13.48%	14.62	14.65 %	14.47 %	15.25 %

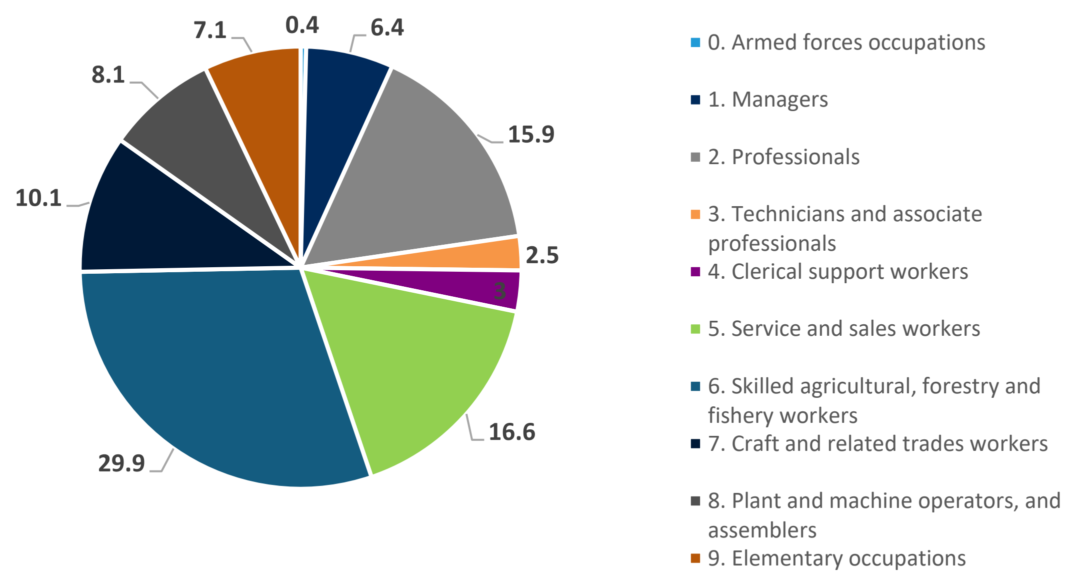
Source: Mongolian Statistical Information Service

Figure 5: Labour force participation (male vs female)



Source: World Bank, World Development Indicators

Figure 6: Employment distribution by occupation



Source: World Bank, World Development Indicators

The last commodity boom created a real estate bubble concentrated in Ulaanbaatar, the country's capital. With an estimated 500,000 people in the city living in 'gers' (traditional dwellings), there is a clear need for modern housing. Government mortgage subsidy programmes significantly contributed to the construction boom that peaked in 2012.

Figure 7: Growth in selected industries

Source: Mongolian Statistical Information Service

Nature and trends of economic diversification

Mongolia's location between Russia and China has been both a blessing and a curse. The country owes its sovereignty to the delicate political balance maintained between the two neighbours after the establishment of Soviet Russia and collapse of the Qing dynasty in China. While its natural resources have always attracted interest, Mongolia's relationship with its two neighbours was defined for most of the twentieth century by geopolitical considerations rather than economic ones. Ulaanbaatar aligned with Moscow when relations between the USSR and Mao's China soured in the 1960s. As result of this, Mongolia entered the 1990s with almost no trade with its southern neighbour and completely reliant on trade with and subsidies from the Soviet Union.

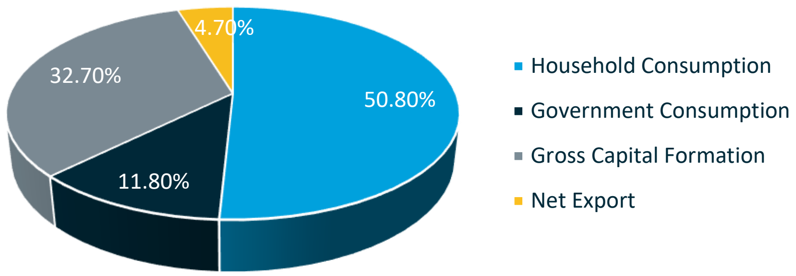
As these links disappeared with the collapse of the USSR, Mongolia was forced to make a quick transition into a China-facing market economy. By 2005, nearly half of Mongolia's exports were going to China, but by 2012 mineral products constituted 89% of exports, and 93% of all exports were going to China as both the production volumes and prices of the country's main export commodities hit unprecedented highs.

The HHI for the market concentration of exports went from 0.29 in 2005 to a peak of 0.86 in 2012, indicating a very tightly concentrated export market. A long period of high growth in China, driven by surging investment in fixed assets, fuelled its thirst for commodities from across the globe. Mongolia's geographic proximity to China and its status as a low-cost supplier of key raw materials such as copper and coal created a demand pull that crowded out the country's other sectors.

The demand side of the economy

The macro economy looks relatively well balanced from the perspective of the demand components of GDP (in global comparisons), although the export and investment shares are somewhat large.

Figure 8: 2016 GDP Composition – Expenditure Approach (Composition of GDP by expenditure approach, share total)



Source: Mongolian Statistical Information Service

The composition of GDP by expenditure approach shows household consumption at 50.8%, which is on par with the average for middle-income countries. Reflecting the high level of reinvestment into fixed assets required for the early stages of economic growth and development, gross capital formation is also high at 32.7%, equivalent to the level of upper middle-income countries. Government consumption is slightly lower than that for low income countries.

Within value added sectors, Mining and quarrying does not dominate GDP, but it does dominate trade and investment. It represented 20% of Mongolia's GDP in 2016, while 63% of exports went to China and mineral products constituted 71% of exports. Mongolia ran a trade surplus equivalent to 4.7% of GDP in 2016. However, the trade balance is highly dependent on commodity prices and it has been known to reach a deficit as high as 22.5% as recently as 2013.[4]

Employment and productivity

As of Q3 2017, unemployment in Mongolia was 9%. The participation of women in the labour force is significant, at 47% of total employment. Agriculture remained the largest sector of employment with around 30% of the workforce. Almost all those working in agriculture are involved in animal husbandry.[5]

4 World Bank, World Development Indicators
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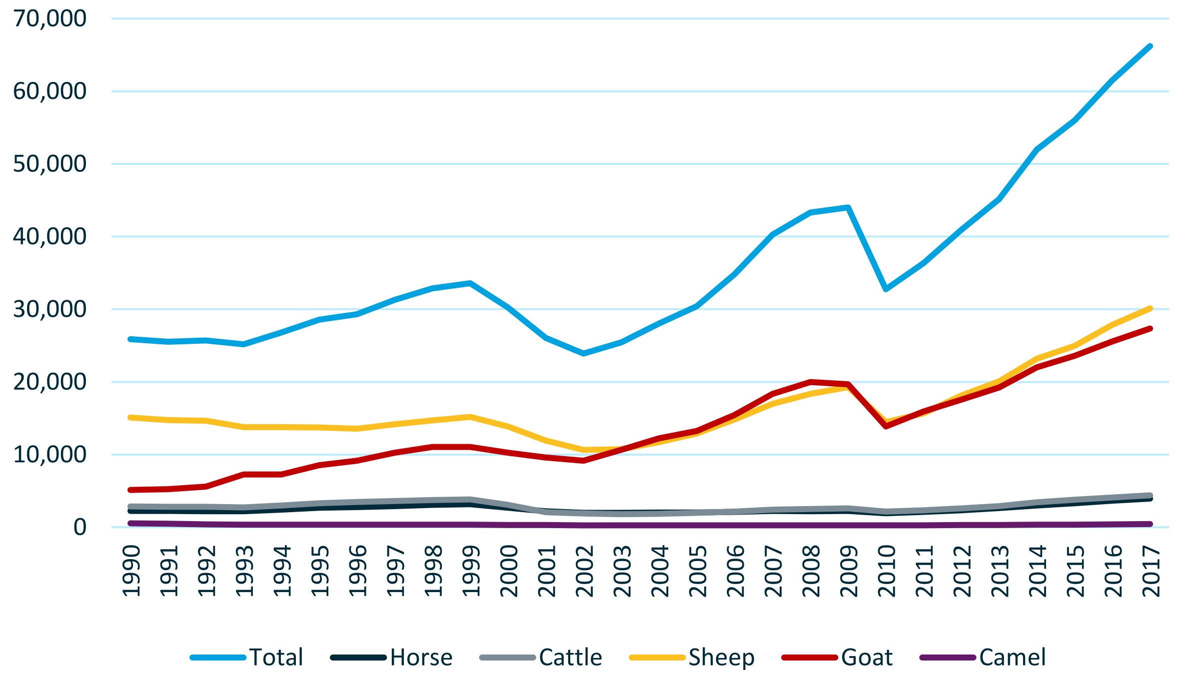
Labour productivity (measured as output per worker) increased significantly in the mining sector thanks to the substantial expansion of output in the sector generated by large capital investments. Such investments can turn very basic (labour intensive) industries into capital intensive processes.

In contrast, official data point to poor productivity growth in agriculture. Nevertheless, this may be misleading. An alternative estimate can be obtained by looking at livestock figures. The total livestock count has grown 2.5 times since Mongolia's transition into a market economy and the development of mining and quarrying. The headcount for goats increased fivefold, responding to the high prices offered for cashmere produced by Mongolian goats. Meanwhile, the share of employment in the sector declined from around 50% to 31%. At 66.2 million heads of livestock, Mongolia has a significant resource per capita. The virtues of transforming Mongolia's traditional animal husbandry into modern large-scale farms is a subject that is fiercely debated from economic, cultural and societal points of view. But the current evidence certainly points to a sharp increase in the volume of livestock managed per person employed in the sector, with most of the gains being achieved over the last decade.

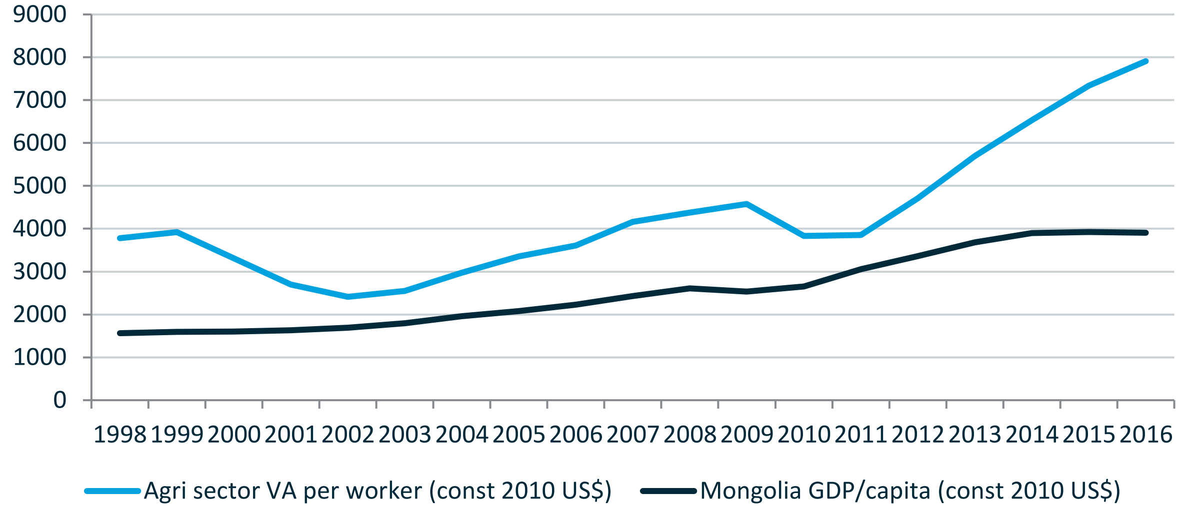
Figure 9: Livestock



Source: Mongolian Statistical Information Service

This calculation is substantiated by the evidence on output per worker for the agriculture sector, which has outperformed the economy as a whole (Figure 10).

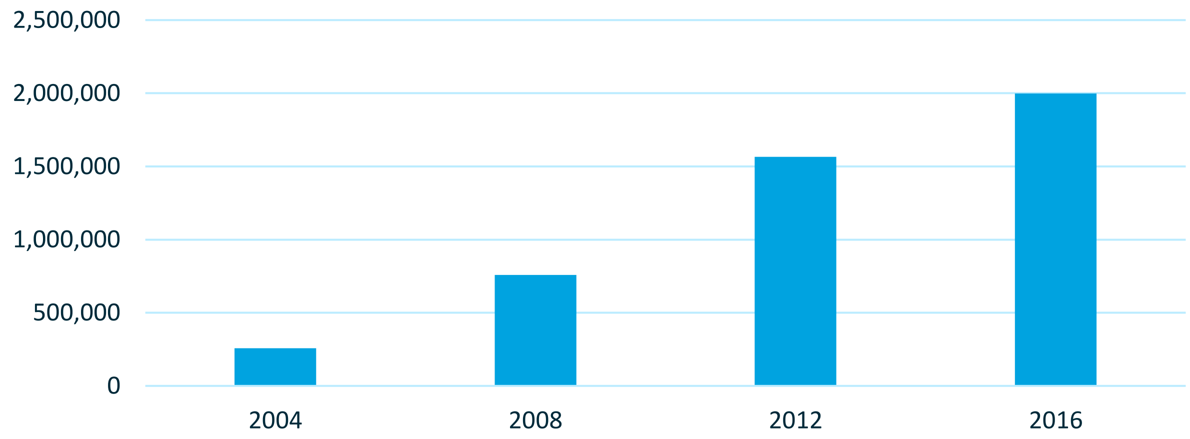
Figure 10: Output per worker in the agriculture sector versus GDP/capita for economy as a whole (both measured in constant 2010 US dollars)



Source: World Bank WDI

Processing industries also more than doubled in value between 2008 and 2016. This growth was mainly focused on import substitution of foods and basic household products rather than being export-oriented. But this too points to productivity gains in the sector.

Figure 11: Processing industries (value in MNT)



Source: Mongolian Statistical Information Services

Mongolia continues to be a fast-growing developing economy. It averaged an annual GDP growth rate of 7.7% over the decade from 2007 to 2016 (not far short of China's 9% rate), and the economy is reported to have grown by 5.8% in the first three quarters of 2017.[6] Growth continues to be supercharged by large investments in the extractive industries. From 2009 to 2016, almost 40% of total investment went into the mining and quarrying sector. From 2015 to 2016, exports grew by 1.3 billion dollars, almost all of which is attributed to increased sales of

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coal. As commodity markets continue to recover from their poor performance in 2014-15, Mongolia looks likely to pick up steam.

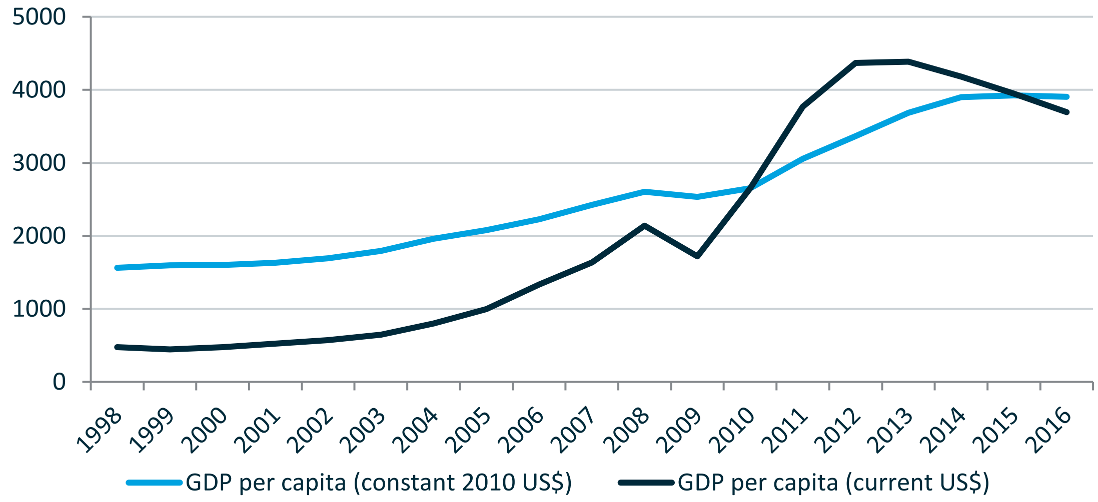
Exploring policy measures (national policy documents)

Mongolia's National Development Strategy (NDS), ratified by parliament in 2007, is the main policy document outlining the country's development and economic strategy leading to 2021. As outlined in the NDS, the government targeted extremely high growth rates of an average of 14% in annual GDP in the period of 2007-2015 and 12% in the period of 2016-2021. Growth was to be achieved on the back of the rapid development of its extractive sector, which was expected to provide significant resource rents. Excess revenues were to be collected into sovereign wealth funds and used for investments in infrastructure, broadening of the processing industry, and development of a knowledge-based economy.

The first shortcoming of the economic development policy was to underestimate the potential volatility of Mongolia's main export products, copper and coal. As prices for such commodities halved in the years after 2007, export earnings and government revenues fell substantially below targets even when productive capacity was increased. The commodities market assumptions that went into forming economic development policy were themselves not conducive to maintaining macroeconomic stability and did not allow for the range of adverse price movements in the country's main export earners.

Despite missing its very ambitious targets, Mongolia has been one of the fastest growing economies in the world as a result of massive inflows of FDI into its extractive sector. For a decade, starting in 2004 until the retrenchment in commodity prices in 2013, the average GDP growth rate was 9.2%: it remained high at 7.7% between 2007 and 2016, a much more turbulent decade globally. Furthermore, GDP per capita (in current US dollars) has more than quintupled.[7]

Figure 12: GDP per capita, in constant 2010 US dollars and in current US dollars



Source: World Bank WDI database

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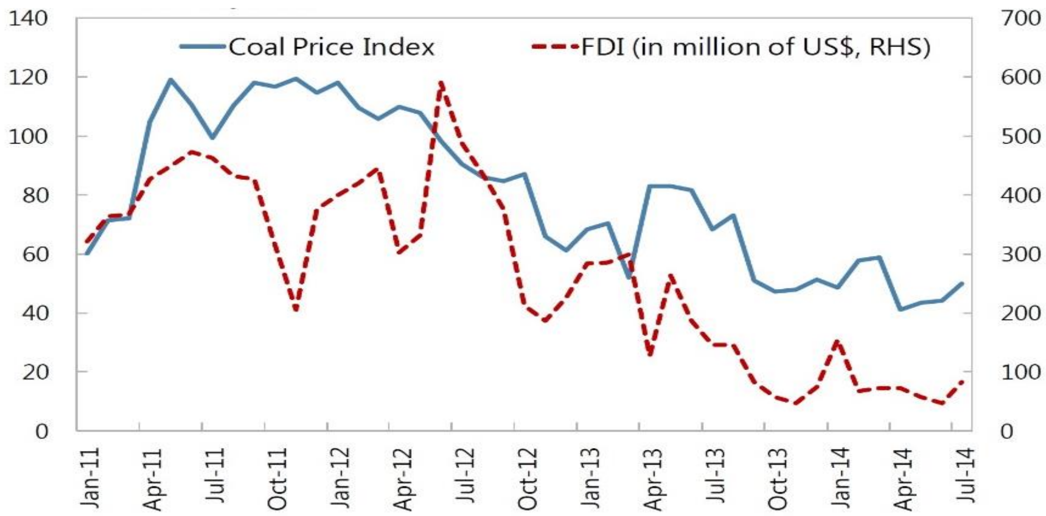
However, the extremely uneven distribution of gains in the period of fast economic growth, together with government policies that involved cash distributions to the population, created an environment that was encouraging of populist politics. The Democratic Party (DP) won the 2012 parliamentary elections on the platform of renegotiating the contracts for both Oyu Tolgoi and Tavan Tolgoi, the two huge mining projects that served as main engines of growth. When it took office, the development of the second phase of Oyu Tolgoi, with expected capital investment of five billion dollars, stalled. Attempts to renegotiate high prices for coal from the Tavan Tolgoi deposit meant that sales fell off sharply just as global prices were decreasing.

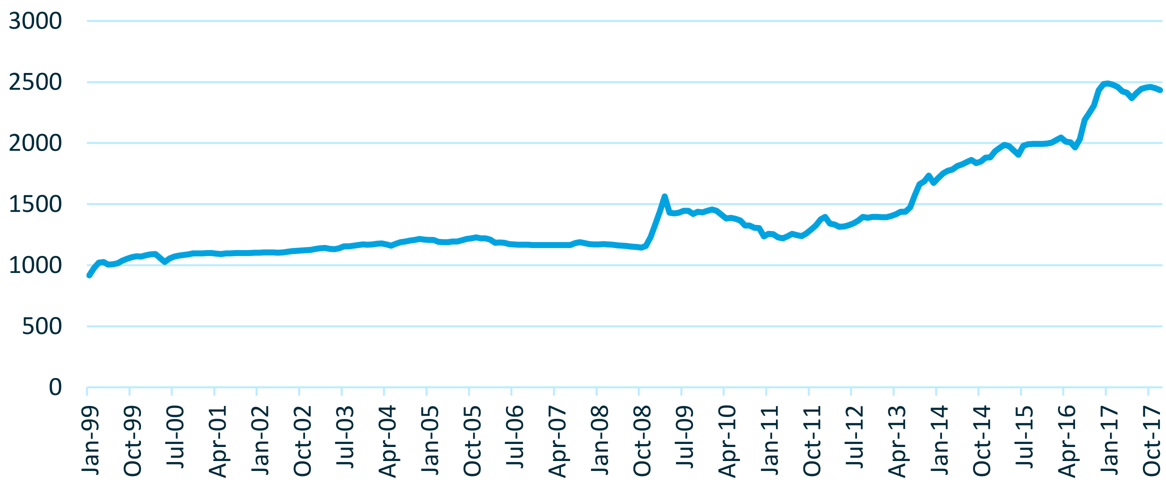
Figure 13: Coal export price and FDI



Source: IMF WEO

Shocks to FDI and self-inflicted damage in coal exports, coming against a backdrop of continued loose fiscal policies, led to reserve losses and a sharp depreciation of the domestic currency starting in 2013. The latter implies a sharp hike in import prices, hitting the population, but it may also have encouraged import substitution.

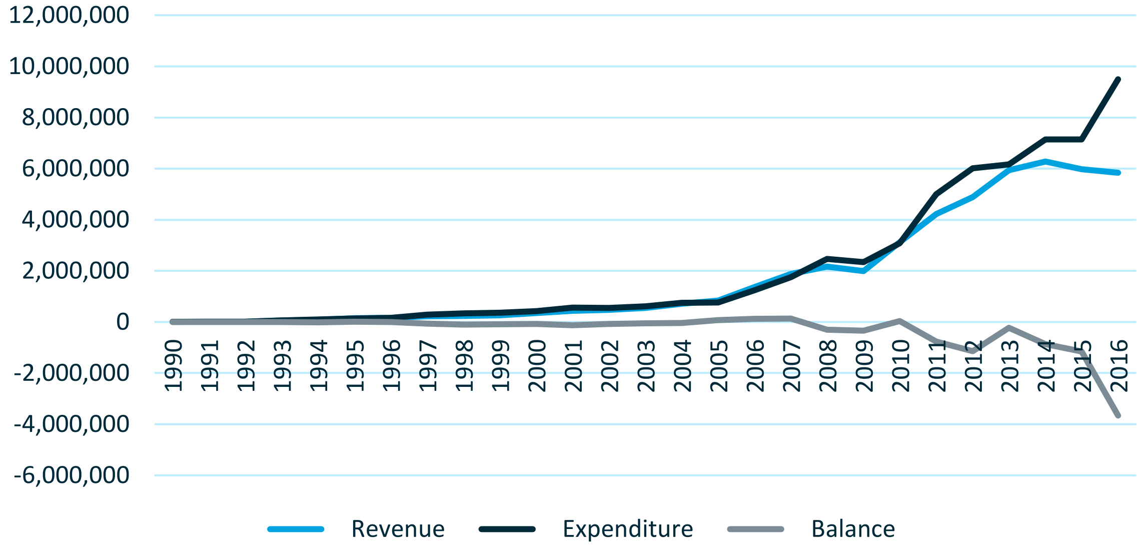
Figure 14: Exchange Rate (MNT/USD)



Source: Bank of Mongolia

Mongolia has a stated policy of economic diversification and reinvestment of resource rents. However, the mechanisms of implementation are weak, and the government continues to take an excessively pro-cyclical approach to fiscal management. The Fiscal Stability Law, which went into effect in 2013, set a ceiling of 2% of GDP for the fiscal deficit. However, the Development Bank of Mongolia ("DBM"), established in 2011, continued to make what amounted to off-budget fiscal expenditures equivalent to as much as 8% of GDP.[8]

Figure 15: Government revenue, expenditure and balance (MNT)



Source: Mongolian Statistical Information Service

The DBM was set up to make loans to commercial projects that would diversify the country's economic base. However, in effect, it became a vehicle for fiscal spending on mostly infrastructure projects, with a small portfolio of commercial loans whose merits are difficult to evaluate. The Future Heritage Fund ("FHF") and Stabilization Fund are two other mechanisms for accumulating resource rents. The FHF came into effect in 2016 and is intended to accumulate capital for outbound investments. The Stabilization Fund was established in 2010 to absorb external shocks. To date, the downturn in the commodities markets has meant that no meaningful funds have been accumulated in the FHF, while Stabilization Fund reserves have been run down.

In 2008, Mongolia launched an agricultural subsidy programme -- "Atariin Ayan 3" -- which aimed to eliminate the country's dependence on imports of grain and vegetables. Within three years, the country was able to meet 100% of the domestic demand for wheat and potatoes and 53.7% of other produce. The programme was abruptly terminated by the subsequent government, however. As businesses shut down, the country reverted to dependence on Russian imports of grain.

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The overall effectiveness of policy measures over the last five years has been poor, even given the limited ability to implement policies due to the economic downturn and fiscal constraints. Some aspects, such as roads and highways infrastructure programmes, have been relatively successful, however. The share of economic activity in non-extractive industries has increased, although it is not likely to prove sustainable in the medium term as commodity prices recover. Mechanisms for accumulating resource rents are institutionally weak and prone to political interference. While efforts to improve trade conditions and ease of doing business have been positive, the country still faces constraints in terms of transaction costs and the bureaucratic burden at customs.

In June 2016, the Mongolian People's Party (MPP) gained an absolute majority in parliament. Assistance from the IMF combined with a recovery in commodity prices helped to restore the economy growth and curtail further depreciation of the national currency. In March 2018, the MPP government formally adopted the Action Programme of the Government of Mongolia 2016-2020, which aims to further stabilise the economy and create macroeconomic resilience. The document outlines specific measures to accomplish the following main objectives:

- eliminate remaining obstacles and boost Mongolia's economic growth engines;
- diversify the economy and provide special assistance to industries outside of mining and quarrying; and
- improve the livelihood of citizens by improving access to healthcare, education and employment and enhancing social security.

The programme aims to diversify the industrial base through efforts to organise and coordinate industrial development, support non-extractive sectors with favourable tax policies, and improve access to financing. To boost foreign trade, Mongolia will seek to increase its participation in international and regional trade agreements and will make further efforts to join economic integration initiatives and infrastructure networks. The plan calls for rationalisation of customs and inspection bureaucracy and improve infrastructure at and near border points. The "Mongol Export" programme will provide state support for coordinating research and marketing of export products, for example through state-sponsored international fairs and exhibitions. It will also provide support for outbound investments and assist in accessing international financial and property markets.

Specifically, the government will develop industrial mapping of Mongolia and implement a coordinated plan for developing heavy industry. Companies that are working on large industrial projects may receive government assistance in securing long-term lower interest loans. The plan also envisages a push for development of Free Economic Zones (FEZ) and will seek to attract domestic and foreign investors. Businesses in rural areas will receive support through the "Regional Discount" subsidy program. Non-tariff barriers will be reduced by a push to harmonise national standardisation and assessment of products in compliance with international and regional standards. Particular attention will be paid to the agricultural sector where the government pledges to create an integrated system of production, transportation, processing and supply of products from animal husbandry.

Companies outside of the extractive sector that export more than 50% of their product will receive tax breaks and customs processes will be streamlined and moved online or to one-stop service centres. Pricing for industrial production inputs such as steam, water and electricity will be stabilised with the goal of gradual decreases in tariffs.

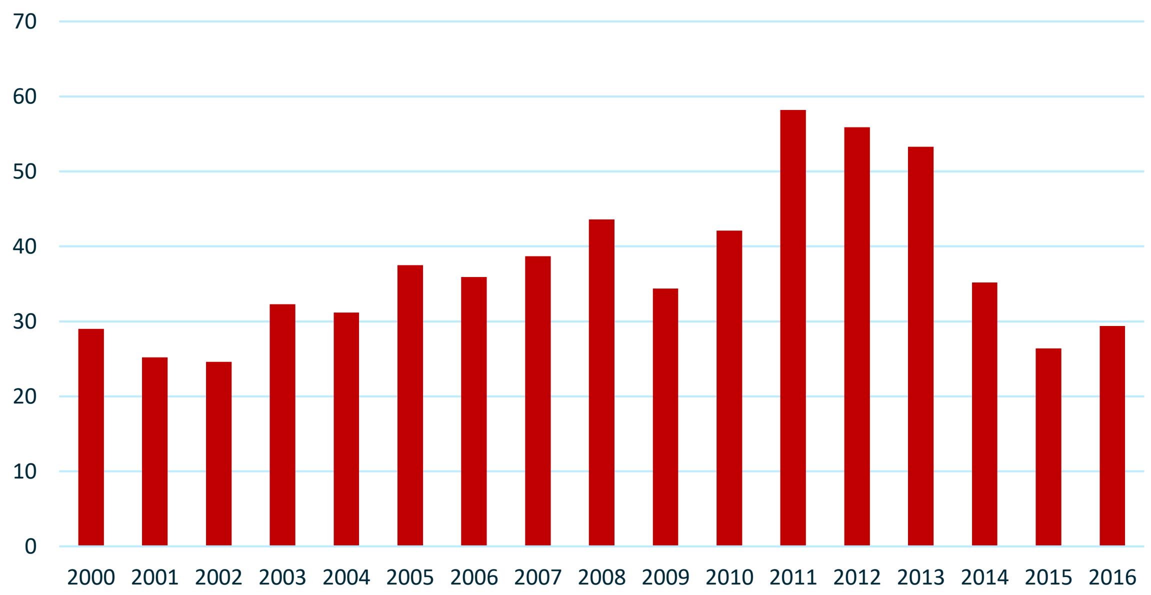
The Action Programme will also seek to encourage more competition in the banking and financial sectors with the aim of reducing cost of capital for businesses. The government will seek to set up subsidised unsecured financing for SMEs through a "Loan of Trust" programme.

Investment

Mining and quarrying received by far the largest share of investment until 2014, when adverse global trends as well as a contentious Foreign Investment Law and disputes over the country's largest mineral projects, Oyu Tologi and Tavan Tolgoi, caused investors to pull back sharply. Nevertheless, the sector has seen some recovery since 2014 and it remains the heavyweight sector for investment, along with construction. This contrasts markedly with the paucity of investment in both agriculture and processing industries, which completely reverses the sector rankings for employment.

Arguably, this could be seen as a form of diversification: people (human capital) are invested in agriculture and services (where they can better "own" their businesses) while the weight of financial capital is ploughed into "large scale" industries such as international minerals, quarrying and big construction projects.

Figure 16: Gross capital formation (% of GDP)



Source: World Bank

Table 2: Investment by sector (million USD)

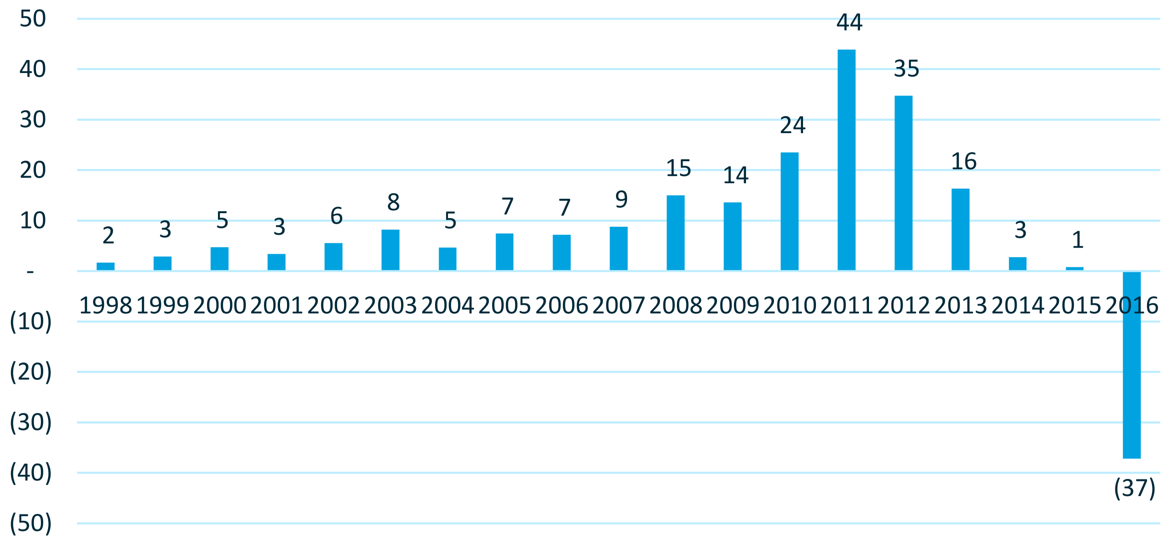
	2009	2010	2011	2012	2013	2014	2015	2016
Agriculture, forestry and fishing	21.0	23.3	38.0	64.6	50.0	88.2	139.7	147.5
Mining and quarrying	487.0	1,761.7	5,195.5	4,694.5	3,031.5	917.2	1,374.8	1,457.3
Processing industries	60.9	71.5	92.1	139.2	228.7	418.9	351.1	81.7
Utilities	120.8	103.8	207.0	171.6	199.4	310.9	331.3	348.1
Construction	148.4	262.8	990.7	913.8	802.8	1,098.8	788.3	1,331.9
Wholesale and retail	304.7	497.7	326.9	1,466.5	480.7	835.0	424.6	502.2
Transportation and storage	126.4	136.7	280.1	510.5	212.7	356.8	83.0	406.6
Information and communication	34.9	60.4	91.6	156.2	388.5	273.4	225.8	157.2
Financial and insurance	71.4	103.3	227.2	168.3	216.0	410.3	151.2	130.0
Real estate activities	26.9	89.7	64.0	39.3	150.2	118.9	39.1	161.8
Public administration and defence	374.1	370.3	373.6	429.1	401.8	427.2	380.3	500.4
Educational services	158.1	79.2	140.3	122.3	126.7	359.1	232.8	302.8

Source: Mongolian Statistical Information Service

FDI as an indicator of diversification and connectivity

Over 2010-2012, Mongolia was the beneficiary of some of the largest rates of FDI inflows as measured as a share of the recipient's economy. Net FDI inflows surged to the equivalent of 44% of GDP in 2011 and 35% of GDP in 2012. However, retrenchment in the commodities market combined with policy blunders resulted in FDI declining to just 1% of GDP by 2015. Russia's sale of its stake in Erdenet, the second largest copper producer, tipped FDI into a net outflow in 2016. Nevertheless, the recent pick up in commodity markets and investment should boost a new round of FDI inflows into Mongolia.

Figure 17: FDI, net inflows (% of GDP)



Source: World Bank, World Development Indicators

As noted above, most of the FDI into Mongolia is concentrated on the development of large mineral projects. Thus, the key sources of FDI are likely to be those countries in which there are large concentrations of the types of big international companies that manage such projects, notably Australia and China.

Aside from mining and construction, all sectors of the country's economy need substantially increased investment inflows. The government of Mongolia recognises findings made by UNDP which assessed that value-added manufacturing was only 20.3% of total industrial production. The government adopted the "Industrialization Program 21:100" in January 2018. The programme seeks to create one hundred projects in non-mining value added manufacturing sectors financed by both public and private capital. Table 3 illustrates the objectives of the newly adopted Industrialization Program.

The build-out of these industrial units has a capital requirement estimated at 1.4 trillion tugriks (about 580 million dollars). The plan envisages financing from multiple sources including central and regional government, loans from donor countries and aid, domestic and foreign investors, government bonds and concession agreements.

Table 3: Objectives of the newly adopted *Industrialization Program 21:100*

Metric	Unit	Base Measure	Goal	Source Document
Share of value-added manufacturing in total exports	%	9	15	National Statistical Office 2016, National Sustainable Development Policy 2030
Share of processed leather and hide	%	20	60	National Sustainable Development Policy 2030
Share of processed wool and cashmere	%	36	60	National Sustainable Development Policy 2030
Industrially processed meat and meat products for human consumption	%	6	30	National Sustainable Development Policy 2030
Industrially processed dairy products for human consumption	%	9	40	National Sustainable Development Policy 2030
New industrial units	#	-	100	Action Program of the Government of Mongolia for 2016-2020
New jobs created	#	-	6,000	Action Program of the Government of Mongolia for 2016-2020
Share of domestic manufacturing standards compliant with international standards	%	42	50	National Standardization Strategy and Plan 2017

Source: Mongolian government documents

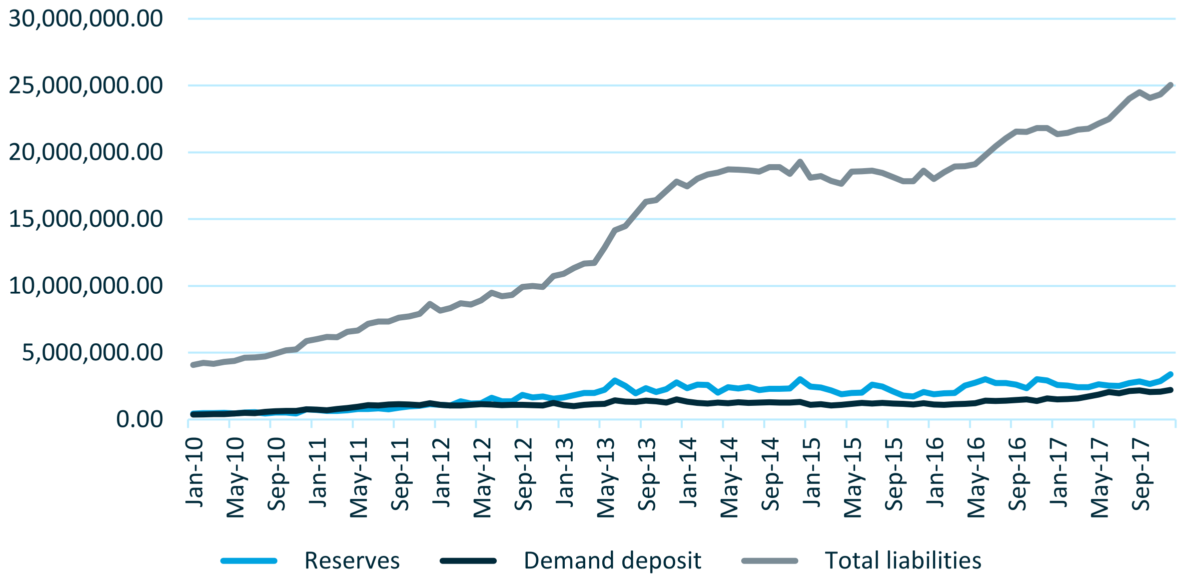
Private sector

The Mongolia Export Development Project was launched in 2016 with the help of a modest loan of 20 million dollars from the World Bank. Its aim is to support development of Small and Medium Enterprises (SMEs), which currently provide almost half of the jobs in the country. Mongolia has good potential to develop niche industries such as organic products including cosmetics, foods and artisanal products. However, aside from subsidised loan programmes, access to funds for SMEs is limited as bank loans are difficult to obtain and have very high interest rates. Loans from non-banking financial institutions can have monthly interest rates of as high as 5% and require heavy collateralization. Mongolia's banking and finance sector requires significant reform if it is to become part of the structure needed to accelerate indigenous business development and growth.

Overall, Mongolia is heavily privatised, and only a few sectors are government owned. There are some SOEs such as Erdenes MGL in the mining sector and the national airline, but most businesses are private.

Since 2012, there has been significant growth in the banking sector, but interest rates remain stubbornly high and are generally 20% or more even for well qualified borrowers. Efforts to advance internal reform and introduce foreign competition have been stifled by the banking lobby. This is significant as over 90% of financing in the country is through bank loans. The stock market is highly illiquid and does not function well as a means of raising equity capital.

Figure 18: Bank balance sheets



Source: Mongolian Statistical Information Service

Mongolia also needs a rapid development of its energy infrastructure and should seek to become a net energy exporter on the back of its abundant fossil and renewable energy resources. There are several proposed private power plant development projects, but none have secured financing. During the Mongolia-China Business Forum held in April 2018, 36 agreements with a nominal value of 4.6 billion dollars were signed. It is difficult to say how many of these will ultimately come to fruition, but reality, but amongst the signed deals was a project to build a 300-megawatt station in Tuv Province.

Integrating the principles of the Vienna Programme of Action

Mongolia has taken a proactive role in promoting the interests of LLDCs. The International Ministerial Conference of Landlocked and Transit Developing Countries and Donor Countries and International Financial and Development Institutions on Transit Transport Cooperation was held in Almaty, Kazakhstan in 2003. The meeting resulted in the Almaty Programme of Action for LLDCs. Subsequently, at the heads of state meeting in Havana in 2006, Mongolia's President Enkhbayar Nambar called for the creation of an international think tank to increase the analytic capacity available to LLDCs. In July 2009, the International Think Tank for LLDCs was officially launched in Ulaanbaatar by H.E. Ban Ki-moon, United Nations Secretary-General, and H.E. S. Batbold, Mongolia's Minister of Foreign Affairs. In 2009 the UN-General Assembly adopted a resolution welcoming its establishment. The organisation is mandated to conduct research and advocacy activities to benefit LLDCs.

Mongolia's National Development Strategy (NDS), the main policy document outlining the country's development and economic strategy for the period of 2007-2021, is based on the Millennium Development Goals that were endorsed at the United Nations Summit in 2005. The main principles of NDS include a commitment to democracy, justice, and human rights, the pursuit of sustainable development based on a market economy, and the primacy of transparency and respect for law. Mongolia's firm commitment to democracy and human rights is notable, particularly in contrast to the political structures of its two neighbours.

The stated objectives of the NDS are largely in line with the Vienna Programme of Action. However, it places primacy on sovereignty and national security. In terms of development goals, it lists the following priorities:

- achieve the Millennium Development Goals and provide for all-round development of Mongolia;
- actively develop export-oriented, private sector-led, high-technology driven manufacturing and services, and the creation of a knowledge-based economy;
- exploit strategically important mineral deposits, build savings, ensure high rates of economic growth and develop modern processing industries; and
- actively develop regions and infrastructure to reduce urban-rural disparities.

To understand the government's development vision and policy priorities, it is useful to evaluate strengths and weaknesses that are specific to Mongolia as a LLDC:

Advantages

- Proximity to China and Russia;
- the transit neighbour countries, particularly China, have rapidly developing economies with strong infrastructure programmes;
- the world's largest consumer of Mongolia's main commodity products is just across the border;
- free of internal civil conflicts and international disputes;
- relatively high Human Development Index score of 0.735, with the government aiming to reach 0.8 by 2021; and
- high mobile phone penetration rates and good telecommunications coverage, with almost a quarter of households having internet access at home in 2016.

Disadvantages

- Small and dispersed population;
- labour force shortages, particularly of qualified engineers, technical staff and expertise in market economy;
- extreme climate;

- reliance on very few mineral products for export earnings;
- reliance on low-value agricultural products;
- widespread poverty;
- high transport and trade transaction costs;
- limited infrastructure;
- vulnerability to climate change, continued desertification and land degradation; and
- weak governance.

While legislation and policies have been broadly in line with development goals outlined in the NDS, implementation has faced challenges due to political interference and institutional weaknesses.

Improving the transport infrastructure

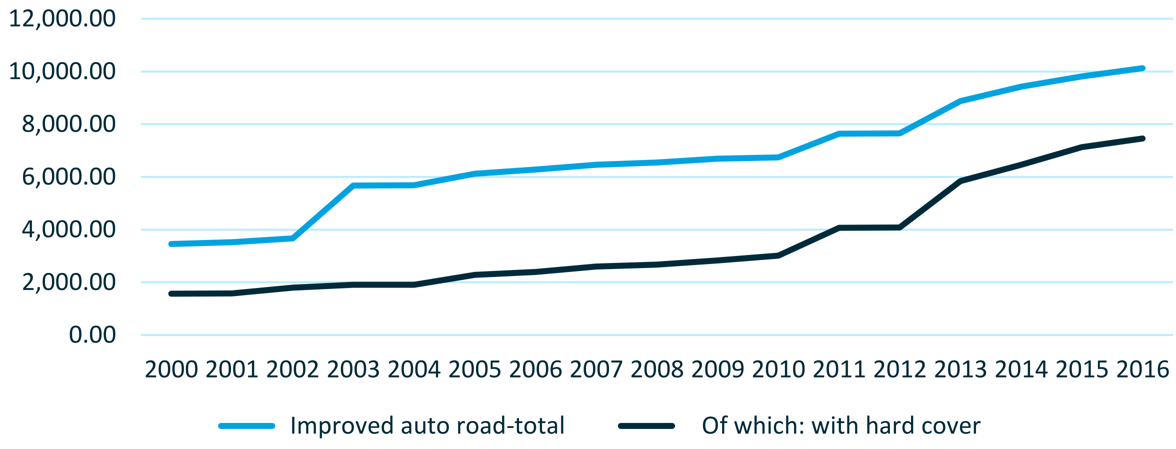
Mongolia overwhelmingly relies on China for transit of its goods. The Chinese port of Tianjin handles most of its imports and exports from overseas. In 2014, Mongolia and China entered into a bilateral agreement which guaranteed transit rail transport and access to seaports. It also increased the number of border crossings between the two countries. Mongolia's current rail network, co-owned by Russian Railways, has a wide gauge rail system while China uses narrow gauge. Although Mongolian law allows for the building of narrow gauge railways on its territory, there has been significant political opposition on national security grounds.

In 2010, the government set out a phased approach to developing the country's railway network. Subsequently, creating rail transport from major mines in the south to Chinese rail ports became a priority. However, further development has stalled due to lack of financing and political disagreements over the gauge to be used.

Mongolia has had an agreement with Russia dating back to 1992 on access to the sea across Russian territory, and in 2014 the two countries entered into a bilateral transit and transport agreement. Although the ability to transport via ports in far-eastern Russia now exists in theory, the reality in terms of costs and delays means that this is not currently a viable option.

There is also an agreement with Kazakhstan on the international transport of goods via road. Mongolia's western province of Bayan Ulgii has a significant ethnic Kazakh population and has meaningful trade with Kazakhstan. The NDS outlined an ambitious goal of building 10,000 kilometres of paved roads to connect the major regions of Mongolia. The programme enjoyed sufficient financing and was well managed, resulting in a rapid build-out of the country's road infrastructure:

Figure 19: Road length over time (km)



Source: Mongolian Statistical Information Service

In 2004, the Mongolian parliament ratified membership of the Asian Highway Development programme and committed the government to build 4,286 km of paved roads. Although the build out of roads proceeded at a rapid pace, Mongolia did not provide sufficient budgeting for road maintenance. According to a study by the Asian Development Bank, the current budget covers only about 20% of the funds required to maintain paved roads without losing substantial road assets.[9]

International trade and trade facilitation

Mongolia became a member of the WTO in 1997, and it now has bilateral investment treaties with 44 nations.[10] Notable trade agreements include:

- Agreement reached with the EU in 1997 for tariff-free import of textiles from Mongolia;
- Mongolia signed TIFA agreement with United States in 2005;
- EU GSP+ status for tariff free export of Mongolian goods in 2006;
- Mongolia's first comprehensive free trade agreement (FTA), with Japan, reached in 2015;
- the U.S.-Mongolia Agreement on Transparency in Matters Related to International Trade and Investment, or Transparency Agreement, went into effect in 2017; and
- an agreement with Canada for the promotion and protection of investments also went into force in 2017.

9 Asian Development Bank – Mongolia Road Sector Development to 2016
10 UNCTAD

A proposed FTA with China has been under intermittent discussion since 2010 and the two countries are currently conducting a joint feasibility study for establishing a Free Trade Zone.

Regional integration and cooperation

Mongolia currently has observer status with the Shanghai Cooperation Organization, a Eurasian political, economic and security organization. The country is also a member of the Chinese-led Asian Infrastructure Investment Bank and falls firmly within the scope of China's One Belt One Road initiative.

Value added in agriculture

Mongolia recognizes the enormous potential of its livestock businesses. Given proper processing, certification and transportation, the country has the potential to develop a substantial organic meat industry. There is high global demand for such products. Starting in 2000, Mongolia has entered into bilateral agreements and protocols covering veterinary and quarantine services (SPS) with a growing number of countries, including China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Belarus, Indonesia, Qatar, Laos, and Vietnam.

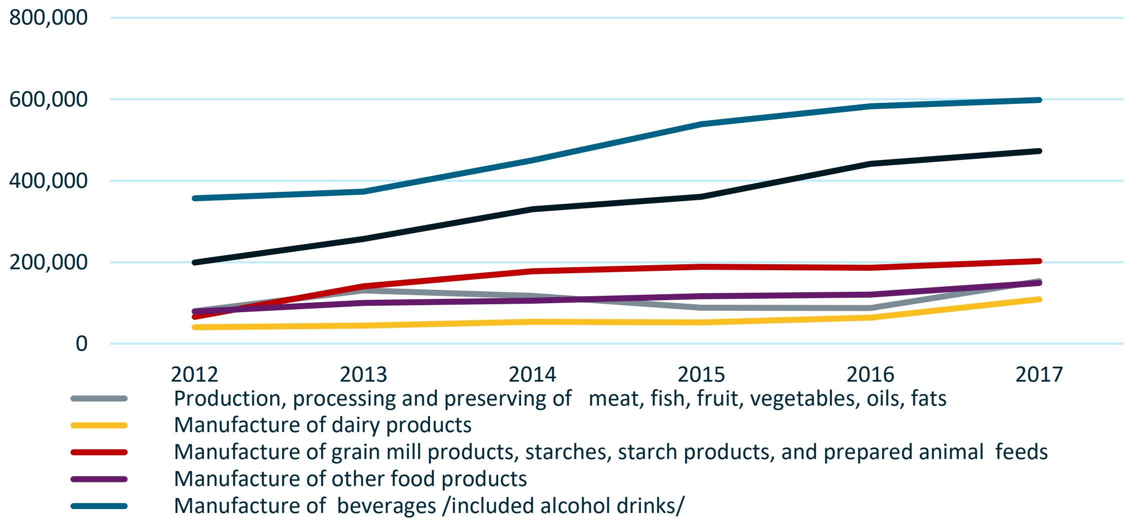
The cashmere industry in Mongolia combines agricultural and manufacturing valued added. Mongolia is the second largest producer of raw cashmere in the world. The share of cashmere manufactured garments has been steadily increasing, but still represents less than 30% by weight of the total cashmere produced in the country.

Structural Economic Transformation

The NDS outlined a vision for economic diversification and envisaged a phased transformation of its economic structure. In the first phase, Mongolia aimed to leverage its mining and agricultural sectors to boost efficiency and production, including downstream processing of raw materials, in particular animal husbandry products. The second phase prioritised import substitution of food products, construction materials and small machinery. The downturn in the commodities market and resulting weakening of the domestic currency have already resulted in increased import substitution. Development of services and knowledge-intensive industries such as high-tech manufacturing, information technology and biotechnology were to be pursued in the third phase.

In recent years, beverage manufacturing and textiles have shown meaningful gains; the depreciation of the MNT may have encouraged consumption to shift to cheaper domestic alternatives. However, given the scarcity of capital and overall low growth environment over the past five years, very little sustainable structural change in Mongolia's economy has occurred. As of 2016 and 2017, the commodities sector has picked up and its share in the total industrial production mix has reverted to representing over 72% of total output.

Figure 20: Processing Industries 2012 - 2017 (MNT million)



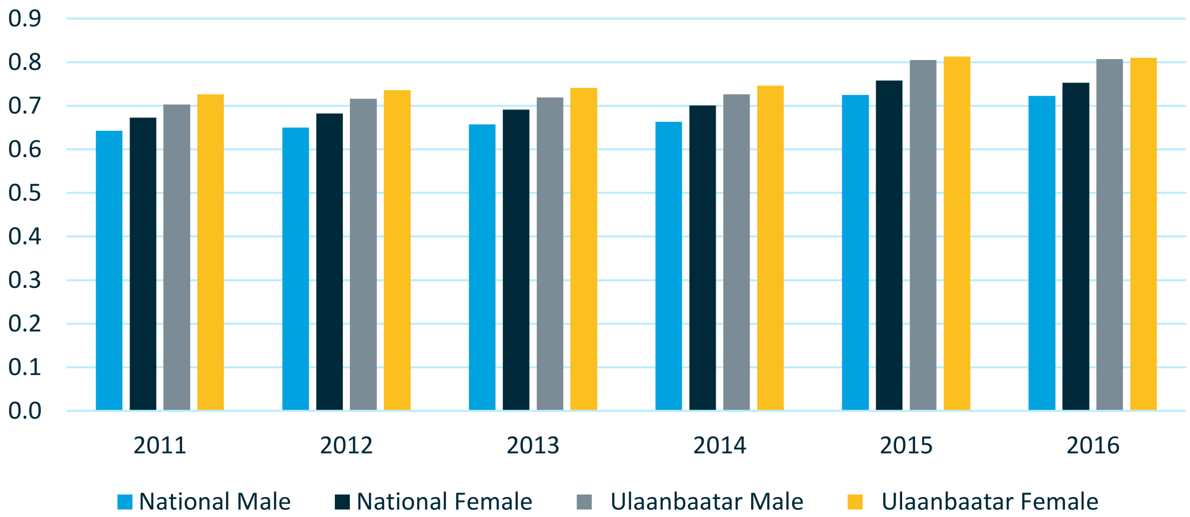
Source: Mongolian Statistical Information Service

Gender impacts and equality

Mongolia did not have any national laws addressing gender equality until 2011, when it passed the Law on Promotion of Gender Equality.

Gender equality in Mongolia is not a one-sided issue: the country shows high scores in some aspects, while it lags in others. The 2016 CPIA Gender Equality Index gives Mongolia a score of 4, with 6 being highest. Comparison of the Gender Development Index (GDI) for Mongolia with the Human Development Index (HDI) shows gender differences in relation to life expectancy, education and living standards.

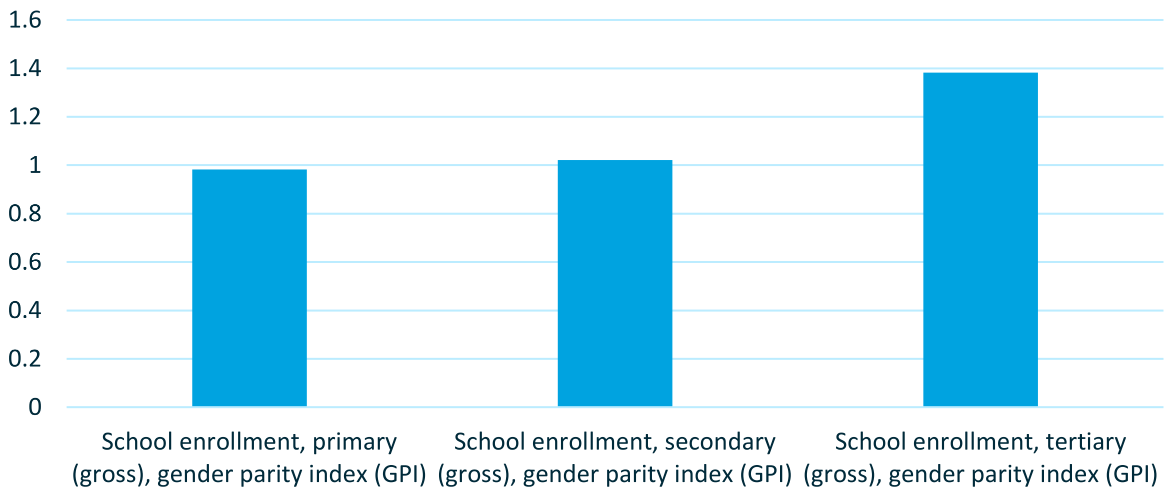
Figure 21: Gender development index



Source: Mongolian Statistical Information Service

The ratio of women's GDI to HDI is above 100% nationally for 2015 and 2016, meaning that women fare better on those basic indicators. As of 2014, Mongolia's GDI ranked 32nd among 161 countries. Women are also more educated as indicated by enrolment rates in primary, secondary and tertiary educational institutions.

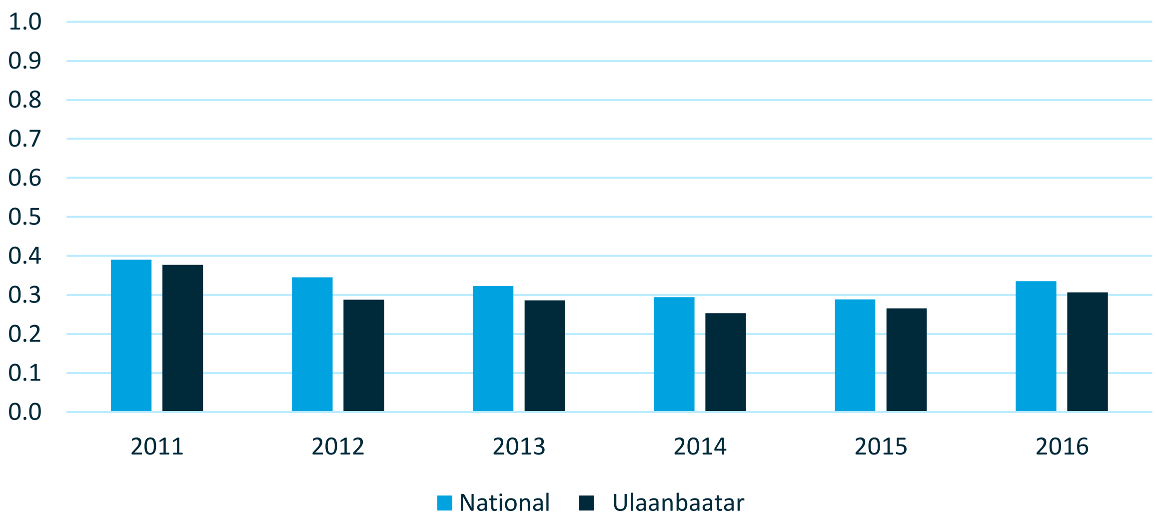
Figure 22: Female enrolment in educational institutions 2014



Source: World Development Indicators

However, the strong showing in education and GDI do not appear to translate into empowerment measures. The Gender Inequality Index (GII) measures inequality along three dimensions: reproductive health, empowerment and access to labour markets. As of 2014, Mongolia ranked 63rd among 155 countries.

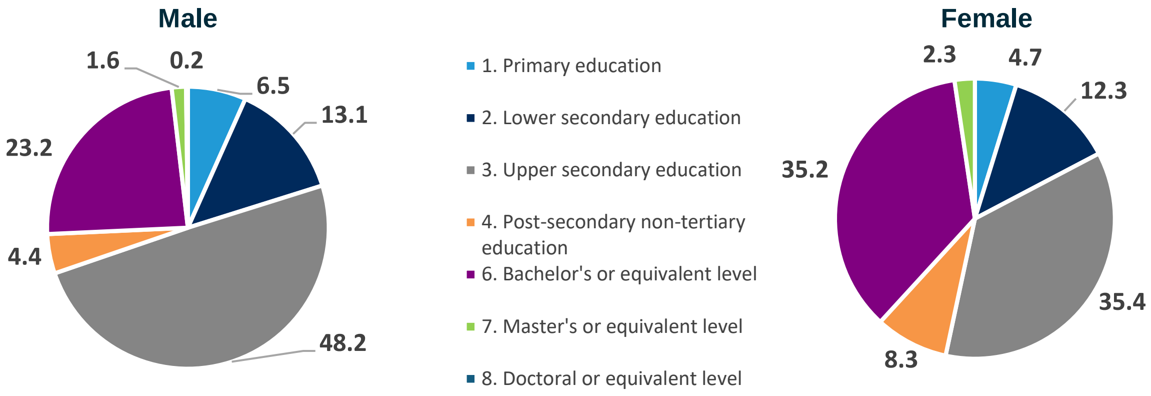
Figure 23: Gender inequality index (0=perfect equality; 1=extreme inequality)



Source: World Development Indicators

According to the GII, Mongolia has a middling position in gender equality scores, held back slightly by the number of women parliamentarians in the legislative body of the country. There are 13 women in Mongolia's 76 seat legislature, representing about 17% of total. The average for the region in 2012 was 18.8% and 22.9% globally.

Figure 24: Education (Male vs Female), 2016



Source: ILO Labour Force Survey Mongolia 2016

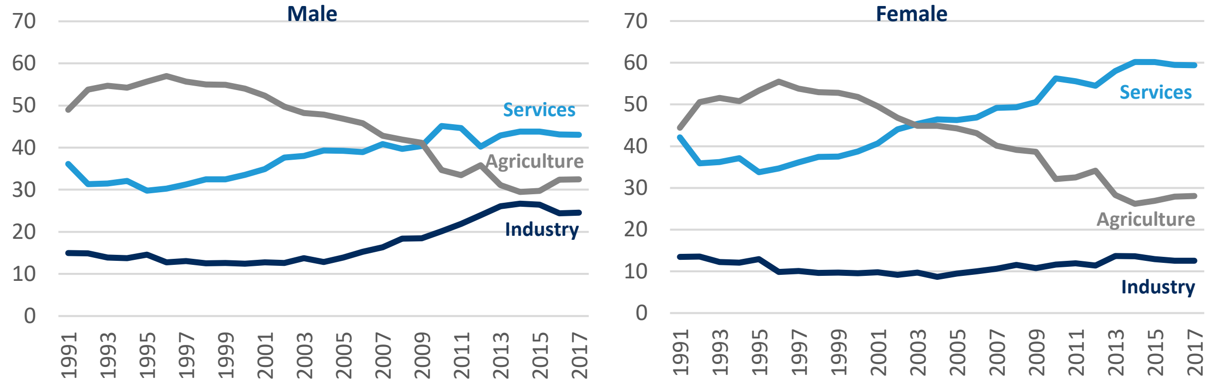
An estimated third of women are also in nominally unpaid family work in rural areas. However, this is a more complex issue where it is difficult to estimate what share of economic revenues rural women ultimately receive from seasonal sales of agricultural products as well as increases in livestock capital. Traditionally and currently women participate in all major decision making pertaining to agricultural activities.

Mongolia's Labour Law sets the voluntary retirement age for women at 55, five years earlier than for men, and ten years earlier, at 45, if a woman has four or more children. While the original intent was to assist women, there is evidence that some employers misuse the law to pressure women to retire early to replace them with younger staff. Until 2008, labour regulations prohibited female employment in what were categorised as dangerous occupations such as mining and trucking, and this resulted in women not participating in high growth sectors. Traditional values prevalent in the society also result in women self-selecting occupations in retail, catering and teaching.

SMEs are a very important segment of Mongolia's economy, representing 98% of all registered enterprises. According to a 2014 IFC study on women-owned SMEs, the country's commercial banks estimated that about 60% of micro-scale, family-owned and sole entrepreneur businesses are owned by women.[11] This estimate came from a joint lending programme headed by the Development Bank of Mongolia and the Ministry of Economic Development and Ministry of Food and Agriculture. The Mongolia Enterprise Survey 2013 compiled by the World Bank indicates female ownership at 38.9%.

11 IFC - SMEs and Women-owned SMEs in Mongolia (2014)

Figure 25: Labour force participation rate in agriculture, industry and services (% of male or female employment)



Source: World Bank

However, it is possible that the survey answers were affected by cultural attitudes where Mongolians consider the oldest male in the family as "head of household," nominally assigning ownership without real economic substance. The financial institutions in the study considered women to have better repayment rates while stating that often women don't have the necessary collateral. The collateral issue isn't specific to women and as most businesses are set up by families, the nominal ownership in the registry doesn't truly reflect economic or managerial control.

Mongolia has an educated and economically active female population but policies that encourage increased women's participation at the top levels of national government and corporate boardrooms are needed. Given the country's young population and the educational advantage that young women enjoy, more effective implementation of gender equality policies will likely lead to the next generation of political and business leadership having a significantly increased female representation.

Challenges, opportunities and policy recommendations

Reliance on two neighbours for access to overseas markets, low population and harsh climatic conditions are some of the external challenges beyond the country's control. However, Mongolia has been able to sustain a high economic growth rate on the back of its natural resource endowment.

Mongolia's growth in the past decade and a half has been reliant on the mining and quarrying sector and will continue to be the case for the immediate future. Imbalances caused by such concentrated growth can be alleviated with proper policy and, equally importantly, efficient implementation. The objective should be to successfully accumulate capital from proceeds of mineral rents and to efficiently deploy it to diversify the economy, strengthen human capital and develop industries that reduce economic dependence on commodities exports. Non-extractive sector business growth should be fostered with proactive policies.

Diversification should not be sought at the expense of the extractive sector – the world will continue to need mined commodities and Mongolia's mineral endowment and location next to its largest consumer is a competitive strength that should not be squandered. Instead, Mongolia should seek to develop a sustainable mining industry.

To mitigate the challenges and capitalise on the opportunities, Mongolia could consider policies and initiatives aimed at developing a sustainable mining industry, diversifying the economy not at the expense of the extractive sector but in addition to it, modernising business procedures, combating corruption and enhancing accountability, while improving road and energy infrastructure.

Developing sustainable mining industry

Sustainable development as defined by the United Nations World Commission on Environment and Development is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." In this sense, economic, social and environmental impacts need to be carefully weighed. Reserves and resources also need to be continuously replenished through private and public investment in exploration. The following practices will help achieve sustainability and balance:

- consultation with international institutions and development organizations, such as UN Agencies and the World Bank, on overall policy and international coordination;
- cooperation with NGOs including Greenpeace, Transparency International and the World Wildlife Fund as measures of accountability;
- membership in international standards such as the Extractive Industries Transparency Initiative (where Mongolia is already a member);
- gradual and continued adoption of best practices and standards in environmental and social impact by domestic agencies and regulatory bodies;
- active participation of multilateral institutions such as the IFC, EBRD and ADB as stakeholders; and
- public investment in broad-scale geological mapping work.

Mongolia needs to create fair and stable conditions for further development of the key mining and quarrying sector. Involvement of international institutions in negotiating major investment agreements both in terms of enhancing the country's expertise in negotiations as well as ensuring transparency may help. Agreements reached with a broad support base and through a transparent and well-discoursed process will be less likely to fall victim to populist revisions that had previously stalled major projects.

Avoiding equity ownership in mineral projects in the near term

The model of SOEs has not worked well so far because of the lack of institutional strength, independence of relevant agencies as well as a lack of overall management and technical expertise. For projects in the intermediate future, Mongolia should seek to negotiate a progressive royalty and tax regime, which are harder to subvert for political purposes, are more transparent and may prove to provide more predictable and reliable source of revenues. As the country's political system further matures and domestic technical and managerial capabilities are developed both in the private and public sectors, it may make sense to reconsider state equity involvement in the sector and development of "national champions."

Fostering economic diversification

While growing and strengthening its extractive industries, Mongolia should seek to implement policies to accumulate and deploy resources to create a more balanced economy. Key policy recommendation to foster economic diversification of Mongolia fall within the following main categories:

- create overall favourable macro-economic conditions;
- strengthen institutional capabilities;
- improve infrastructure;
- foster private sector growth;
- develop capital markets;
- identify and develop new niche industries; and
- create a comprehensive national branding strategy.

Existing mechanisms for accumulating resource rents should be reviewed and restructured with the following objectives:

- to minimise political interference;
- to professionalise management; and
- to operate as independent, for-profit agencies of the government.

Mongolia's stabilisation fund needs to be built up at times of higher commodity prices. This will require fiscal discipline as well as legislation requiring minimum contributions to the fund. Overall strengthening of institutional capabilities should be a priority. Foremost, agencies such as the Development Bank of Mongolia should operate free of political interference. Strict protocols need to be set for appointing professional management and determining how ministries and politicians interact with and influence these agencies.

Privatising certain sectors, combating corruption and enhancing accountability

Partial or total privatisation of certain sectors and SOEs can introduce additional measure of accountability. Erdenes MGL, Mongolia's state mining company, has been haunted by accusations of corruption and overall inefficient operation. Its portfolio of undeveloped strategic deposits has seen no demonstrable progress towards development and exploitation. Mongolia has sought to gain a listing for Erdenes MGL in the past. It should do so while the commodity markets are still strong. Gaining international investors on its roster of shareholders will enhance management discipline and accountability.

Further investing in road infrastructure

Mongolia has been reasonably successful in developing its road infrastructure in the past decade. However, sufficient funds for maintenance need to be allocated for the investment to continue to pay dividends. Exports of bulk commodities such as coal and iron ore suffer from lack of rail transport capacity and bottlenecks at the border. Over the next decade, Mongolia should seek to develop its rail infrastructure at the same pace that it was able to develop its roads. As the main population centre and economic hub, the city of Ulaanbaatar requires significant investments. Improvements in energy, clean and waste water infrastructure and public transportation will help alleviate costs associated with pollution and lost productivity.

Streamlining and modernising business procedures

A comprehensive national review targeting elimination of outdated legal requirements and the system of multi-agency approvals should be implemented. The Mongolian National Chamber of Commerce Industry and other business associations such as the Business Council of Mongolia need to be consulted for recommendations on streamlining regulatory approval processes. The overall bureaucratic system should be modernised to reduce and, where appropriate, eliminate requirement of physical documents, excessive notarisation requirements and adoption of electronic filings and electronic signatures.

Businesses and particularly entrepreneurial ventures in Mongolia suffer from access to affordable capital. Although the country has sixteen banks, there is limited competition among lenders. Interest rates remain very high with even the most credit-worthy businesses paying 20% or more in annual interest. Banks can earn upwards of a 4% spread between its savings interest and loans. The banking lobby has been very successful in protecting itself from competition from abroad. The country's top banks no longer need protecting as they have become strong institutions with a domineering presence in the country's economy. For example, a group backed by the Trade and Development Bank of Mongolia, the country's largest bank, was behind the purchase of Russia's shares in the country's strategic Erdenet Mining Company in less than transparent circumstances. Mongolia should consider both issuing new banking licenses to credible counterparties as well as opening the sector to foreign competition.

Increasing support to SMEs

Some of the capital accumulated in Sovereign Wealth Funds should be allocated towards domestic venture capital investments. In particularly entrepreneurship in technology, biotechnology, renewable energy and other knowledge-based sectors with potential for development of intellectual property should be supported as a matter of policy. Also, Mongolia may have potential for developing a domestic artisanal industry such as high-end fashion, decorative art and jewellery.

Capitalising on 'organic' agriculture practices to win international markets

After mining and quarrying, agriculture is the second largest sector in the economy and the largest source of employment. The country's large livestock population can be developed towards an export-oriented organic meats and dairy industry. Its traditional animal husbandry practices are very much in line with modern trends for organic, free range and grass-fed meats and dairy products. If successfully branded and managed, these products can effectively compete in international markets. Internally, the government should focus policy towards implementing nationwide veterinary standards and a strict certification regime.

Successfully integrating registration and electronic information system for food safety

The Mongolian government's Action Program for 2016-2020 calls for establishment of an integrated registration and electronic information system for food safety. Further investments in infrastructure for processing, storage and transportation are needed and the government should seek ways to incentivise private sector investment. Internationally, Mongolia should continue to gain bilateral trade agreements and adoption of mutually recognised certification regimes. The country's Trademark and Geographic Indications Law has been in place since 2003. Currently it covers only four products: yak wool, yak cheese, camel milk cheese and sea buckthorn from Western regions. The list can be expanded to a much larger variety of meat, dairy and other organic products. Mongolia should not seek to compete on cost or volume given its geographic and population constraints. Mongolia's national branding strategy should draw its strength from its pristine environment and authenticity of its nomadic tradition of animal husbandry, something that is effectively utilised in China for marketing products from Inner Mongolia.

Re-branding to increase the market share

As a low-population LLDC, Mongolia should seek to develop its manufacturing in sectors with potential for significant differentiation and strong competitive advantages. Organic products outside of meat and dairy can significantly benefit from a common branding strategy. These can range from alcoholic and non-alcoholic beverages to organic cosmetic products.

Mongolia's main export market will continue to be its southern neighbour China. However, development of value-added exports such as organics should be with the aim of creating a more diversified market. Cooperation and investment from overseas markets will function as the economic pillar of Mongolia's cornerstone "third neighbour" foreign policy. Maintaining friendly and strategic relationships with its two neighbours will help overcome some of the challenges of LLDCs.

Encouraging and developing nascent industries

The small size of Mongolia's economy and its geographic remoteness often result in the country being overlooked by international brands. This tends to mean that larger companies do not enter the country's market to facilitate technology transfers, but it also creates opportunities for local entrepreneurs to come up with innovative solutions and adopt new technologies without significant competitive pressures. This too requires quick action by policy makers to create a favourable environment for the development of nascent industries. For example, the ride-hailing company Uber has not entered the domestic market so there is a local company that has created a similar solution. However, existing taxi and limousine regulations regarding left-hand-drive vehicles cut against the reality of the significant share of vehicles on the road being right-hand-drive imports from Japan. Regulators should exercise a degree of flexibility and pragmatism to encourage the emergence of domestic industries in view of existing realities.

Pursuing proactive policy making

Mongolia's key regional strength is its dynamic political and social system that has a demonstrated ability to change and adapt over the past two and a half decades. As such, Mongolia should seek to leverage its legislative and regulatory nimbleness and to foster a political culture of proactive rather than reactive policy making.

Assessing and working on creating a favourable environment for emerging technologies should be a priority that can be tasked to agencies as well as through formation of a parliamentary working group. Blockchain and cryptocurrencies are examples of transformative new technologies that many advanced economies are struggling to regulate and adopt given legacy considerations. Mongolia can afford to be in the forefront of adopting friendly regulations and should take a serious look on how the country can benefit from championing legal and regulatory silos for such new technologies.