A window of opportunity for Mongolia

Chinggis Khaan

Walking on Sukhbaatar Square in Central Ulaanbaatar, it is impossible to miss the towering statue of Chinggis Khaan, the illustrious conqueror considered the founder of Mongolia, sitting in front of the Government Palace. Throughout my recent visit to Mongolia, I was reminded of his historical importance many times, from the international airport in Ulaanbaatar named after him to the many statues that adorn the capital. It is a reminder of how much the Mongolian people pride themselves on their heritage and independence.

The Mongolian empire at its peak was the largest contiguous empire in history – stretching from Central Europe in the west to the Sea of Japan in the east. Present-day Mongolia remains a vast country. Wedged between Russia in the north and China in the south, Mongolia is the second largest landlocked country in the world with its population of 3 million people spread evenly between the capital Ulaanbaatar and the rest of country.

For long the country’s main source of income was drawn from agriculture and animal husbandry. Less than 20 years ago, more than half of Mongolia’s exports were agricultural products. Even today, one third of the population works in the agriculture sector, and Mongolia counts more than 60 million units of livestock grazing the vast steppes, including 25 million goats, 25 million sheep, horses, cattle and camels. Mongolia’s goats are the second largest provider of cashmere in the world, and some of the most delicious (and exotic) lamb dishes can be tasted in Mongolia.

Mining Opportunity

While much of the country’s past has been determined by what happened on the vast steppes, it is what lies below the surface that has been rapidly transforming the country since the beginning of the twentieth century. Mongolia is endowed with a wealth of mineral and other natural resources that could make it one of the richest nations in Asia. Its deposits include among others coal, copper, gold and oil. Dozens of mining sites have mushroomed across the country, which altogether now contribute 20 percent of the country’s gross domestic product (GDP), 85 percent of its exports, and over 30 percent of the national budget revenue. Its mining resources – with an estimated worth between $1 trillion and $3 trillion –
could drive growth for decades to come and propel Mongolia to become a high-income country.

Coal reserves in Mongolia are estimated at 160 billion metric tons. They include both thermal coal deposits used for power and heat generation, and coking coal used in steel production. One of the world’s largest coal reserves is Tavan Tolgoi in the South Gobi desert in Mongolia, a mere 220 kilometers away from the border with China, estimated at more than 7 billion tons. Investment required to tap the full potential of the mine would amount to at least $5 billion – an enormous amount for a country with a GDP of $11 billion in 2017. The investment would cover a power plant and a railroad to the border with China.

In the meanwhile, mining at another mega-project in Mongolia – the Oyu Tolgoi copper and gold mine – has just barely scratched the surface. The first phase of the project started in 2013 and involves an open-pit mine. Investment in the second underground phase of the project is underway and is projected to cost about $5 billion. Production is expected to reach full capacity in 2021, at which point the mine could contribute up to 30 percent of Mongolia’s GDP during its anticipated lifespan of more than 50 years.

While Mongolia benefits from the abundant supply of mining resources, its proximity to China, which is the largest market for mining products is also an enormous bonus. This tremendously lowers transportation time and cost for these resources.

In addition, the timing of mining development in Mongolia coincides with several beneficial developments in China. Firstly, Mongolia is adjacent to the north of China, an area that has been lagging behind which China intends to focus on more intensely going forward. Secondly, China has recently decided to close down some of its own coal mines for environmental reasons, an opportunity for Mongolia to replace this supply with some of its own higher quality product.

It is crucial for Mongolia to seize this window of opportunity. Some experts I talked to in the country noted that China could potentially reverse its decision to close domestic mines to boost its own economy. More importantly, China is also in the process of reorienting its power supply from a system powered by coal to one that focuses more on renewable energy such as hydro-, wind and solar power. While this transition is likely to take a few decades, it illustrates that a time may come when coal no longer has the same value as it has today.

A similar golden opportunity presents itself for the copper mines in Mongolia. Copper is not only a key component for building construction, but it is also a crucial component for electric equipment, including in electric and hybrid vehicles. A hybrid vehicle requires twice as much copper, and a fully electric vehicle as much as three times the amount of copper needed in a traditional car. China is determined to become a world leader in the development and manufacturing of electric vehicles. The country aims to sell five million electric vehicles by 2020. This presents a tremendous opportunity for Mongolia.

A Taste Of The Booming Economy

The Mongolian population knows how much mining is capable of boosting the economy. It experienced its economic power about fifteen years ago, when Mongolia started benefiting from the economic expansion in China. Driven by the mining industry, exports rapidly expanded from a few hundred million dollars per year to several billion dollars. The share of mining in total exports jumped from one third to about 90 percent. Economic growth accelerated to an average of 8 percent from 2002 to 2011, peaking at over 17 percent in 2011. GDP per capita increased more than sixfold over the same period from less than $600 to almost $3,800. The economic expansion also benefited the poor, with the share of people below the national poverty line dropping from 39 percent in 2010 to 22 percent in 2014.

Unfortunately Mongolia’s economic fortune reversed in 2012. When global growth slowed and China started rebalancing its economy, mineral prices dropped and investment in the mining sector in Mongolia slowed to a trickle. Economic growth
rapidly decelerated to 1.2 percent in 2016. The Mongolian togrog depreciated by more than 50 percent between 2012 and 2016. The economic slowdown also affected the government’s fiscal balance. Finding it difficult to curtail spending in line with reduced revenues, the expansionary fiscal policy combined with pre-election spending culminated in a budget deficit of 17 percent of GDP in 2016. Public debt nearly doubled from 46 percent of GDP in 2013 to 88 percent in 2016.

To address the external and fiscal situation, the government reached an agreement in early 2017 with the International Monetary Fund (IMF) and a coalition of multilateral and bilateral partners on an assistance package worth $5.5 billion over three years. In return the government committed to reduce the fiscal deficit and undertake structural reforms.

The agreement restored market confidence and the government was able to refinance its maturing external debt. Aided by increasing mineral prices, investment returned to the mining sector and growth picked up to 5.1 percent in 2017. Increased government revenue and reduced expenditure resulted in a substantially narrower fiscal deficit of 1.9 percent of GDP, while public debt declined to 85 percent of GDP in 2017. The recovery is expected to be sustained, with growth forecast between 5 to 6 percent for this and the following year.

A Second Chance

With the economy stabilized in the short term and the next major mining boost not coming online until 2021 when the second phase of the Oyu Tolgoi project will be ready, the country now has a unique opportunity to ready itself and take full advantage of the next mining bonanza. The IMF program is helping the government in preparing the country to prevent the next mining cycle from turning into another dizzying roller coaster ride. Below are some of the key issues the country is addressing. While fixing these issues is certainly challenging, it is not impossible, as some other resource-rich countries have demonstrated.

Smoothing Boom-Bust Cycles

While the eagerness to spend all available revenues is understandable, particularly in developing countries that aim to reach a higher-income status, experience has demonstrated that it is not the best approach to sustainable development. Setting aside excess resources in sovereign wealth funds when mineral prices are high for when the economy slows down or for the benefit of future generations is a great help in smoothing boom-bust cycles. It prevents the government from adding fuel to the fire when the economy is already running high, and helps to cushion the blow when the economy slows down.

The Mongolian government has already established a set of funds. With the help of the development partners, it is now strengthening the necessary institutions and rules to ensure effective management and use of these resources for the benefit of the people and the economy.

Managing The Changing Lifestyle

The transformation of the economy is also resulting in a rapidly changing lifestyle. Many Mongolians are giving up the traditionally nomadic lifestyle, flocking to the capital to seek better economic fortunes. Half of Mongolia’s three million inhabitants now live in the capital Ulaanbaatar. This rapid influx of people is putting stress on the infrastructure of the city. The city continues to expand into the surrounding mountains, with an estimated 60 percent of its residents now living in so-called ger areas, named after the traditional ger or tent that is typical for the nomadic lifestyle. People living in these areas have limited access to electricity, running water, sanitation and heating.

The economic expansion has also resulted in increased car ownership in the city, causing regular traffic jams in Ulaanbaatar during rush hour. Sitting in traffic, I was surprised by the immense popularity of the Toyota Prius. I was told that Mongolians love it because it is fuel-efficient and it also starts easily in Mongolia’s arctic winters with its large battery. This is no luxury, as Ulaanbaatar is the coldest capital in the world, with an average annual
temperature of minus 1 degrees Celsius, dropping to minus 40 in wintertime.

To improve the housing situation and make housing more affordable, the government offered a subsidized housing program, where Mongolian people could obtain mortgages at a highly subsidized rate of 5 to 8 percent, much lower than the regular market rate of close to 20 percent. Due to budget constraints, the program had to be scaled down. With the help of the Asian Development Bank, the government is now embarking on a program to upgrade facilities in the ger districts and to build decent and affordable housing.

To create sufficient jobs and ensure that growth is inclusive, it is also important to reduce reliance on the mining sector and broaden the scope of the economy. This is a daunting task for any resource-rich economy, but all the more so for Mongolia as a geographically isolated and landlocked country. The government realizes that while mining can bring prosperity, it cannot be the only engine of growth and employment. With assistance from developing partners, the country is undertaking efforts to diversify its economic base. Sectors that hold potential include agricultural products – Mongolia has some of the finest cashmere in the world – and tourism.

**Protecting The Environment**

Mining can be taxing on the environment, and with the major mines located in the Gobi desert, mining has had to compete for scarce water resources and land use with the traditional livestock herding sector.

The government’s task is to ensure that the mining sector is well-regulated and balances its needs with other sectors of the economy, which may not have the same bargaining power. To achieve this, the government aims to take measures to better protect water resources, rehabilitate areas that have degraded due to mining, and improve public participation in environmental protection.

As I came across yet another grand statue of Chinggis Khaan on my way out of the country, I imagined him smiling down on the Mongolian people in anticipation of them ushering in a new era of sustained prosperity in Mongolia.

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