Need for economic diversification

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Mongolia's leadership has made clear its awareness of the dangers of over-dependence on its vast mineral resources

For all too many emerging economies around the world, possessing oil, minerals, diamonds, or copper have brought only poverty and corruption. The so-called curse of natural resources is well known to economists and development experts, and examples abound of countries that have fallen prey to it.

The last decade has seen the Mongolian economy wax and wane according to global commodity prices, particularly of copper and gold. Half of the state budget has for many years come from the Erdenet Mining Corporation alone. Mongolia's leadership has made clear its awareness of the dangers of over-dependence on its vast mineral resources, and as it readies itself for a new era of mining development, is working with bilateral lending agencies to implement strategies based on the success stories of nations like Canada, Norway, or Chile where economic stability, control of public spending, saving for the lean years, diversifying the economy, and preventing income from being concentrated have proved beneficial.

The economic and political achievements of the last two decades cannot be overestimated, but as the country faces the challenges of declining mineral prices on the international market, high inflation, and the global financial crisis, the need to diversify Mongolia's economy is more acute than ever, says the Government. At the first joint economic policy conference organised by the Government of Mongolia and the World Bank Group last year, President Enkhbayar noted that Mongolia's high inflation underscores the urgency of "facing the unavoidable need to identify the long-term development priorities" so that Mongolia can meet its long term goal of developing an economic structure similar to that of a middle income country by 2021. And to achieve that goal, the Government and bilateral lending institutions both agree that the best way for Mongolia to diversify its economy is by continuing to improve its investment climate.

A key building block in this regard will involve developing good logistics to reduce business costs. The country has already made progress here, and is a top-10 destination for doing business in Asia. That said, it performs poorly in the Logistics Performance Index, and is ranked 136th of 150 countries. Poor logistics due to geography does not necessarily condemn a country to poor export performance. Better coordination between transport, customs, clearance, and warehousing will go a long way to improving the current situation.

Next comes the need to improve infrastructure. Bottlenecks mean costly transport, complex logistics and long transit times. In Mongolia, one third of windfall gains collected by the Development Fund are spent on infrastructure as are significant amounts received through development aid. Good economic management and governance can reduce infrastructure bottlenecks and other business costs by improving roads, power systems, security and financial systems.

The Government is also working on establishing a strong and stable financial sector. Measures are being taken to improve financial and capital market oversight and regulations, to raise standards around corporate governance and to improve financial institutions, perhaps most immediately those involved with trade finance. Public-Private Partnerships will help encourage new sectors. Export diversification does not need to mean diversification towards manufacturing or heavy industry, which could go against Mongolia. Chile has active policies that encourage a range of new exports such as salmon, fruit and wine. These have involved Public-Private Partnerships with industry groups - supporting knowledge sharing and setting high standards.

The Government has developed three main strategies in this regard. The first involves developing new sectors like bio-technology and nano-technology capable of creating high value addition. A number of specific projects are coming up in these areas. Second, Mongolia's dependence on world markets will be less when it begins to process mineral ores and export finished products with added value. This in turn will require continued capital inflows and access to new technology. The third strategy calls for developing those areas with enormous potential, and still in their infancy in Mongolia. Agriculture and tourism offer the most immediate prospects.

In terms of using its mining revenue more efficiently, Mongolia has already established a Development Fund. But the World Bank points out that the rules for spending are very much linked to current revenue. Instead, says the Bank, Mongolia could consider rules other countries use, such as transferring mining revenues to a dedicated resource fund, as was done in Chile and Norway, and to then introduce a rule governing the transfer of resources from the Fund to the budget. Equally, expenditure from the fund could be restricted to its real interest income, as is done in Norway; and a reference price mechanism to stabilise fiscal spending around the longer-term trend. F