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Using Mongolia’s wealth to spur social development: a comparative approach with resource-abundant countries

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Mongolia is now commonly called “Minegolia”. This Central Asian country sits on vast natural resources. Besides its abundant forests and fisheries, mines contain major deposits of coal (at Tavan Tolgoi), gold (Boroo and Gatsuurt), copper (Oyu Tolgoi and Erdenet) and uranium (Martha and Saddle Hills). Industry analysts and economists put the value of untapped precious metals and minerals at around $1 trillion .

The two largest mining multi-national companies running large-scale operations in Mongolia are Vancouver-based Ivanhoe Mines Ltd and UK-headquartered Rio Tinto. Ivanhoe Mines is expected to start production in the second half of 2012 at Oyu Tolgoi, the world’s largest new copper and gold mine, with some 80 billion pounds of copper and 46 million ounces of gold, according to its third quarter report. As Cameron McRae, Oyu Tolgoi`s CEO puts it, the mine will boost Mongolia’s GDP by 33 per cent by 2020 and represent about 30 per cent of the country’s economy . In addition, copper is the main source of budget revenue. In 2011, Mongolia’s government was estimated to collect $407 million in revenues from the exportation of copper and $292 millions from coal . Coal extraction in southern Mongolia is expected to triple the national economy by 2020 .

Mongolia is, undoubtedly, on the verge to be the next commodities hub in Asia with mining representing 70 per cent of its exports. It has also been coined the “world’s greatest resource boom” and “the Saudi Arabia of Asia”. Furthermore, economic prospects look positive. The International Monetary Fund (IMF) estimates that the Mongolian economy will grow 13 per cent on average through 2010-2015 . According to the United Nations (UN), rising copper prices and gold production enabled the economy to grow by nine per cent per year .

The issue, however, is that this resources boom has not driven human development. For instance, 71 per cent of foreign direct investment (FDI) went to the mining sector whereas one per cent only went to the communications and IT sectors . Even though mining exploitation has brought in large government revenues , two-thirds of the state’s Human Development Fund has served to increase civil service salaries and has been spent on monthly cash payments to secure electoral votes.

Moreover, after the dissolution of the USSR, Soviet assistance disappeared almost overnight. As the state has been transitioning from a Communist-style planned economy to a market economy, helped by the recent energy boom, it has confronted increased poverty and significant challenges to provide proper welfare services such as infrastructure, education and health care .

Today, Mongolia ranks 115th out of 185 nations, according to the Human Development Index, which measures health, education and standard of living. It is also amongst the top 10 countries most dependent on Overseas Development Assistance (ODA). Poverty has persisted with more than 30 per cent of the population living on less than $1.25 a day and 38.7% of Mongolians living below the poverty line in 2008, as the 2009 State Statistical Office indicates.

It is therefore paramount that Mongolia overcomes the "resource curse", a term British economist Richard M. Auty coined in 1993. Also called the "paradox of plenty", this thesis contends that countries with abundant natural resources tend to have less economic growth and worse development issues than countries with fewer or no natural resources. Indeed, resources-rich states rely heavily on the exploitation of resources, which hinders economic diversification and paves the way for poor social welfare performances, high levels of poverty, inequality and unemployment.

One classic example of this bonanza curse is the decline in competitiveness of the manufacturing sector, as the Dutch disease theory suggests. According to this economic model, developed by Australian and Irish economists W. Max Corden and J. Peter Neary in 1982, an increase in natural resources revenues and, subsequently, inflows of foreign currency and foreign direct investment and currency appreciation, will lead to a decline in competitiveness of the manufacturing sector in resource-abundant countries. This syndrome has come to be known as the "Dutch disease" because in the 1960s, the Netherlands significantly increased its wealth after it discovered large deposits of natural gas in the North Sea. Nonetheless, as the national currency became stronger, the competitiveness of non-oil exports decreased.

Although the terms "resource curse" and "Dutch disease" are usually used interchangeable, the former refers to the political and social consequences of resource-rich countries, whereas the latter often deals with the effects of the resulting currency appreciation and changes in the cost of factors of production.

Furthermore, heavily depending upon the mining sector threatens economic stability due to the volatility of world prices of copper and gold . Assuming that commodities prices will inevitably rise is not a successful economic policy. When the world price of copper nearly trebled in 2005-2006, Mongolia's economy grew faster. However, when this commodity boom came to an end and copper price dropped from over $8,000 per metric ton to under $4,000 in 2008, the country experienced fiscal problems. Besides, it did not save much from the revenue windfall during the boom times to reduce public indebtedness and translate these gains into development programs. In addition, relying heavily on oil, in particular, jeopardizes the economy's stability because of its future depletion and the technological sophistication it requires to exploit it.

To mitigate the effects of this "curse", Mongolia must better allocate mineral revenues and invest in basic social services, where opportunities are immense.

Such strategy implies economic diversification to direct a significant part of investments into non-energy sectors. The energy-rich countries of the Gulf, which are some of the world's fastest growing economies, illustrate the benefits of diversifying the economy. Like Mongolia, they have earned considerable revenues from natural resources (oil and gas) and have small local populations (with the exception of Saudi Arabia). Even though the UAE relies significantly of the exploitation of resources, which enabled the country to achieve a significant degree of economic development from 1973 to 1982 mainly with the high oil prices, it has also diversified its exports to more than 184 industrial products . Similarly, Qatar Petroleum's total contribution to the national economy exceeds 50 per cent of GDP and, with its foreign partners, accounts for almost the total of Qatar's exports. On the other hand, it used its hydrocarbon resources to heavily invest in education, health, construction and infrastructure projects. In 2011, the Human Development Index ranked the country 37th.

In Mongolia, one major area to invest in is the infrastructure sector. The country's rapidly changing economy has fuelled demand for adequate infrastructure. Ulaanbaatar's population has expanded by 70 per cent over the last 20 years but the capital's infrastructure has not been able to keep up with the growth. According to a World Bank report on Mongolia's Infrastructure Strategy, only 20 per cent of its 2.7 million population lives in comfortable apartments connected to the urban service system. More than 50 per cent live in gers (traditional felted tents) that not connected to the central water system. They also lack adequate heating systems: during glacial winters, residents can only use poor quality stoves or household boilers fuelled by coal and black tar dipped bricks and cars' tires. This significantly contributes to high levels of pollution, making UB one of the most polluted capitals in the world. The Mongolian government and socially-oriented entrepreneurs have, nonetheless, promoted pilot programmes to use high-efficiency stoves. Yet, the scale of the problem is larger: providing more effective heating tools is a temporary solution and does not overcome the challenge of making housing affordable. Domestic construction companies produce very little material and import the majority of it, such as concrete, from China. In the coming years, Mongolia will have to find a less costly and more effective system to provide affordable housing to every Mongolian.
On top of that, ger areas constitute a source of concern for the government because it is challenging to integrate these temporary settlements in the city development process and infrastructure programming. Indeed, investments cannot be coordinated if there is no national strategy for development encompassing the whole population. As an example, the Qatar National Vision 2030 provides a long-term policy framework within which development national strategies can be developed and implemented.

Investing in utility services such as heating infrastructures, hot water and sanitation is all the more necessary as winters, especially extremely snowy ones called "zud" in Mongolia, are hard due to severe climatic conditions (temperatures revolve around -30 Celsius). In addition, heating and electricity demand is expected to increase by four to five per cent annually between now and 2020 , thus providing opportunities for investment.

Transport is another sector calling for investment. In southern Mongolia especially, the Gobi desert, which possibly contains the biggest deposit of coking coal on the planet, requires effective railways and roads .

The UAE offers valuable lessons on the ways to use efficiently its natural resources. Pampered by petrodollars, this country has heavily invested in infrastructure. When Mongolian Prime Minister Sukhbaatar Batbold met with his Emirati counterpart Sheikh Mohammed bin Rashid Al Maktoum on January 2011, he said he was "impressed by the highly developed infrastructure in Dubai and United Arab Emirates (UAE)". Indeed, the UAE has used its resource-based industries to boost its social and economic infrastructure. In 2008, nearly 70 per cent of all project contracts were construction projects, according to Financial Times estimates . Investment in infrastructure has enabled the UAE northern region, which suffers huge gap in quality of life compared to other Emirates regions, to benefit from better roads and access to a pool of jobs for locals. Investment in telecommunications, power and railways has also greatly increased productivity and longer-term growth.

Investing in human capital is another crucial factor to the growth of the economy. According to the "paradox of the plenty" thesis, energy-rich governments tend to disregard the need of education. School enrolment is inversely related to natural resources abundance. For instance, the East Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan), which have little natural resources, invest a great amount of money on education, whereas members of the oil cartel OPEC spend only half the global average on school children and students .

However, some Gulf countries are exceptions. The UAE government redirects a large part of its oil revenues towards free education for all citizens and Arabic-speaking children of expatriates employed in the public sector. Emirati citizens can also choose between studying at the Emirates University or abroad for higher education (undergraduate, Masters, Ph.D.) thanks to the state's generous scholarships. In Qatar likewise, policy-makers have placed emphasis on education. Citizens are required to attend government-provided education from kindergarten to high school.

In Mongolia, whilst the literacy rate is 98 per cent for men and 96 per cent for women, the government must still invest in people because Mongolians' skills do not match labour needs. Current employees work at 34 per cent in agriculture including herding, 61 per cent in services and just five per cent in industry. Thus, the unemployment rate amounted to 11.5 per cent in 2009, according to the National Statistical Office data . Among them, 45 per cent have secondary education but it is irrelevant to the current market needs. In the coming years, Mongolia will need to leverage its educated young population as more than 40 per cent is below 20 years. For instance, the government could prioritize vocational schools in order to teach unemployed Mongolians job-specific skills that are need, and integrate them in the economy.
Investment by local businesses with international expertise and technology should also generate job opportunities and provide adequate training. With respect to this, the Oyu Tolgoi mine will be supporting an $85 million project to train Mongolian youths for future employment in the mining industry over the next five years, through investment in university equipment, building schools and providing scholarships .

Furthermore, there are great opportunities to translate mineral wealth into growth of the health sector. According to the World Bank, UB, a city of one million, has some of the worst urban pollution levels in the world. Mongolia's Public Health Institute stresses that respiratory diseases caused by the concentration of gasses created by coal burning during winter are among the leading five causes of death in the country . As there has been an increase in health expenditure from 2000 to 2010, health insurance coverage (introduced in 1994) reached 82.6 per cent of the Mongolian population in 2010. However, only 54.5 per cent of the population had access to improved drinking water source in 2009, according to the World Health Organisation (WHO).
Gulf countries' management of their heath care system provides some key insights for Mongolia as it highlights the possibility of promoting economic growth whilst ensuring universal access to health services. For example, in the UAE, a federal law states that all people residing on the Emirati territory must be sponsored with health care insurance by the companies they work for. In Saudi Arabia, the Ministry of Health, which supervises the

healthcare system of both the public and private sectors, offers universal healthcare coverage and access to medical care.

In Mongolia, the issue is that the country suffers from a shortage of qualified doctors and other care-givers since most of health care professionals flew back to Russia after the collapse of the USSR. In addition, the government has not achieved universal coverage as it pays the health insurance of senior citizens and vulnerable groups only. However, the introduction of a health insurance system in 1994 that enabled the government to provide health insurance coverage to 92.4 per cent of the population was a step forward. Mongolia should, therefore, use its massive resources revenues to fund health care training and, ultimately, face the challenges of an aging population. The United Nations Economic and Social Commission for Asia and the Pacific stresses that ageing is a growing concern for Mongolia as the government is trying to balance its economic development and the need to provide adequate services to its growing elderly population. In this regard, there must be independent bodies monitoring the quality standards of government-run hospitals and clinics and private providers alike.

Finally, a transparent government should ensure that a resources boom spurs social development. The “resources curse” theory argues that in mineral-rich countries, governments do not need to be accountable because the state does not tax citizens as it has a guaranteed source of income from natural resources. Hence, this breeds corruption.

The World Bank’s Worldwide Governance Indicators show that Mongolia’s score for Rule of Law has been trending downwards, from 56 per cent in 2004 to 43 per cent in 2009. It was also ranked the 85th most corrupted country in 2004. In addition, USAID 2010 Mongolia Democracy and Governance Assessment underlines that businessmen dominate politics. It is fair to point out that many of these people have the economic interest of the country in mind. This issue has a significant impact on the economy because investors consider governance and government effectiveness the key development priorities in Mongolia, according to a December 2011 World Bank report .

In this regard, Botswana, which has also a two-million population and is endowed with numerous minerals, offers an inspiring model of how to ensure that natural resources’ exploitation benefits the whole population. This African country has developed a Sustainable Budget Index (SBI) to use resource revenue for finance investment expenditure and health and education spending. It has also invested a portion of its natural resources in a Sovereign Wealth Fund that keeps a part of diamond exports’ income for future generations.

From another standpoint, a private management of natural resources could offer an alternative. This is a sensitive issue in Mongolia as attempts to privatize Erdenet Copper Mining Company in the late 1990s contributed to significant political discord. However, comparing the Alaska Permanent Fund (APF) and the Alberta Heritage Trust Fund (AHTF), which were set up to manage the American and Canadian government’s revenues from oil and natural gas resources and transform mineral assets into other forms of capital, emphasizes the benefits of the private sector. The government-directed AHTF has had limited success because the government failed to invest resources in a productive way. In contrast, APF, an independent corporation, was more successful as it directed half of the mineral revenues into a trust fund that would be distributed to citizens .

Mongolia's booming energy industry offers many opportunities to spur social development in a country where minerals have brought billion-dollar revenues but Mongolians' quality of life has deteriorated. In 2010, the World Bank indicated that Mongolia had the 60th lower income per capita out of 215 countries. To avoid the pitfalls stemming from being overly reliant on commodity production, the country should weigh the pros and cons of resource-abundant states' policy choices in dealing with "the resource curse." Perhaps most importantly, it should avoid the Gulf states' authoritarian tendencies that thwart social progress as revenues from natural resources allow them to police their own people.

On 4 August 2012, the Global Institute For Tomorrow (GIFT) will conduct an executive education programme in Mongolia to create an impact investing fund in the country. It aims at aiding Mongolia in diversifying its economy and de-emphasising reliance on the current resource boom for growth. To enrol or find out more, please e-mail Eric Stryson at estryson@global-inst.com or visit GIFT at www.global-inst.com.