CHALLENGES FOR A NATURAL RESOURCE-DEPENDENT MONGOLIA AND OPPORTUNITIES FOR FUTURE DEVELOPMENTS

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Abstract

After the Soviet Union dissolved in the early 1990s, Mongolia undertook various political and economic reforms and moved from a centrally-planned to a market-based economic system. Given Mongolia’s wealth in natural resources, one of the driving forces of the country’s economic development has been the mining sector. However, not all that glitters is gold. Even though Mongolia does not represent the worst example, it has been faced with the so-called “resource curse”, and is now encountering resource-related economic, political, social and environmental challenges. Due to geographical and environmental factors and its landlocked position, Mongolia has faced difficulties in shifting from an export-oriented economy and pursuing a sustainable development. Yet, the development of renewables, the tourism industry and the fintech sector holds great potential to contribute to decrease the country’s overdependence on mineral exports. On the basis of shared political values, the EU could also consider enhancing its relationship with Mongolia within the framework of the Europe-Asia connectivity strategy and support the country’s shift to a more diversified and less mineral-dependent economy.
Introduction

After the Soviet Union dissolved in the early 1990s, Mongolia undertook various political and economic reforms and moved from a centrally-planned to a market-based economic system. Given Mongolia’s wealth in natural resources such as coal, gold, copper, zinc, fluorspar, iron ore, tungsten, oil and gas, one of the driving forces of the country’s economic development has been the mining sector. Between the late 1990s and the mid-2000s the Mongolian government enacted new mineral laws hoping to attract investors and to expand its revenues. It thereby successfully increased the extractive industry’s contribution in terms of GDP percentage from 10 percent in the early 2000s to over 20 percent after the mid-2000s (Barma, 2014). In 2010, when Anglo-Australian mining giant Rio Tinto closed a long-term deal with the Mongolian government over the management of the country’s largest mine in Oyu Tolgoi, the sector received a strong push. Thanks to its vast mineral wealth, Mongolia managed to shift its status from “low-income” to a “middle-income” country in 2007. It turned into one of the world’s fastest-growing economies in 2011, as mining-related FDIs and projects flowed into the country. The service, finance and tech sectors are also said to have benefitted from this sudden and staggering economic growth (Muller, 2019).

However, not all that glitters is gold. Many scholars have highlighted that for countries being endowed with natural resources, wealth does not necessarily translate into well-performing economies. For instance, it has been observed that, in comparison to countries with fewer resources, resource-rich countries often have a less well-functioning economy and state apparatus, which prevents for a balanced and sustainable development to take place (Humphreys, Sachs, Stiglitz, & Soros, 2007; Frankel, 2012; Ross, 2012). Even though Mongolia does not represent the worst example, it has also been faced with the so-called “resource curse”.

The “Resource Curse”: Mongolia’s Economic, Political, Social and Environmental Challenges

Economic challenges. Due to geographical and environmental reasons Mongolia has only seen limited success in developing other robust sectors and diversifying its economy. The country’s economic growth and government revenues have become consequently strongly linked to the mining industry. According to the Observatory of Economic Complexity (OEC), Mongolia’s total exports have generally increased since the mid-1990s and the share of mineral exports on total exports has shifted from 45 percent in 1995 to about 70 percent in the mid-2000s and finally to 90 percent and above since 2011, at the expense of agricultural and animal products (OEC, 2017). As reported by the Mineral Resources Authority of Mongolia, the share of the mining sector to the state budget accounted for about 36 percent of the total state budget revenues in 2011 - including income taxes, royalties, land and water use fees, and other charges - and remained above 20 percent in later years (Mineral Resources and Petroleum Authority of Mongolia, 2017).

This dependence on non-renewable natural resources has come with some costs. First of all, the country’s revenues have been quite vulnerable to the volatility of commodity prices and importers’ demand. For example, few years after the mining boom in 2011, which had allowed an increase in government expenditures, commodity prices and foreign investments fell. The
demand for Mongolia’s mineral resources from China, Mongolia’s biggest trade partner, also suddenly dropped following China’s economic growth slowdown. As a result, the Mongolian government increased its debt-fuelled expenditures and the country was temporarily hit by a financial crisis (Muller, 2019). Thanks to government measures focused on easing the debt situation and protecting the banking sector, sustained by re-increased commodity prices and FDI in mining, Mongolia’s economy partially recovered. Yet, poverty and inequality levels did not improve as much.

Furthermore, it is believed that to some extent Mongolia has been suffering from the “Dutch Disease”, a typical effect of resource-based economies (Narankhuu, 2018). First, the mining industry has been providing many jobs, employing over 42,000 people or about 4 percent of Mongolia’s labour force (Ibid.). However, it has also been observed that many skilled professionals have moved into mining from other sectors, attracted by more advantageous wages, thereby generating skills deficits, especially in the manufacturing sector. Second, the increase in value of resources’ exports has led to the appreciation in real exchange rate, making other export-oriented sectors, such as manufacturing and agriculture, less competitive in local and global markets (Ibid.).

Political and Social challenges. Since 1990, Mongolia has implemented Western constitutionalism and established itself as an electoral democracy, holding multi-party elections. Yet, according to the World Bank and other international institutions, the country’s governance seems to remain rather weak (World Bank, 2019a). Despite the country performing well in terms of political rights, civil liberties and absence of political violence, corruption and patronage networks are widespread in the major political parties (Freedom House, 2019). In spite of an overall improvement since the 2000s, Mongolia’s score in the Corruption Perception Index in 2018 was 37/100, slightly better than 2017 (36/100), but still worse than 2016 (38/100) and 2015 (39/100) (Transparency International, 2019). In general, it seems that corruption levels have been increasing in recent years, especially along with the state’s engagement in the mining sector (Freedom House, 2019). At the same time, corruption control, together with government effectiveness levels and rule of law enforcement, have been declining since larger revenues began to flow into the country due to favourable global commodity prices (Narankhuu, 2018). This observation is in line with resource-curse experts’ findings, demonstrating that the higher the institutional capacity of a resource-rich country, the weaker the effects on the country’s governance (Ross, 1999). Vice versa, less strong institutional capacity can deteriorate more easily.

In the case of Mongolia, the government only collects 18 percent of its income in form of taxes, while the rest is derived from off-budget resources and rents (Sorace & Jargalsaimkhan, 2019). It has been observed that states that are less reliant on taxation tend to be less transparent in budget and less exposed to the public scrutiny of public spending (Devarajan & Ehrhart, 2011). In fact, few initiatives to improve transparency have been taken, such as the adherence to the

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1 The index rates countries’ level of corruption in the public sector, from highly corrupt (0) to very clean (100).

2 Government Effectiveness, Rule of Law and Control of Corruption are three of the six sub-indicators included in the Global Governance Indicators issued yearly by the World Bank. The first refers to “the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies” (World Bank, 2019b). The second indicates “the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence” (Ibid.). The third traces “the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests” (Ibid.). These three indicators are often employed as a measurement of countries’ quality of institutions.
Extractive Industry Transparency Initiative (EITI)\(^3\) in 2010, the enactment of a Law on Information Transparency and Right to Information in 2011 and a Law on Conflict of Interest in 2012. There also exists an Independent Authority against Corruption. Yet, the 2011 Law on Information Transparency and Right to Information comprises exceptions that allow the authorities to withhold certain types of information from the public. A State Secrets Law also limits disclosures. Besides, laws and regulations aimed at government transparency and accountability are ambiguously written and rarely enforced. Investigations on corruption cases are also hardly ever pursued (Freedom House, 2019). For example, in October 2018, it emerged that some state officials and political figures had diverted government funds from a support programme for small and medium-sized enterprises, after which they did not face any consequence.

Corruption and pervasive clientelist networks also put a strain on the government’s ability to optimise its revenues and improve collective welfare across the country. Despite attempts to redistribute the state’s rents through public investments, social programs and economic diversification through an SME Development Fund, investment planning has emerged as highly politicised, often favouring supporters of powerful politicians. Levels of socio-economic inequality are rising, with poverty levels remaining high. After having dropped as a result of the economic boom in 2011, poverty has risen again in 2016 as a result of the economic growth slowdown and financial crisis. The government’s inability to successfully address these and other matters like perturbing air pollution and a struggling economy have sparked anti-government protests in the capital Ulaanbaatar in late 2018 and early 2019, demanding the leadership to step down (Sorace & Jargalsaikhan, 2019). Despite smaller-scale demonstrations followed later in the year (Namjilsangarav, 2019) no changes in the government have taken place since Prime Minister Ukhnaagiin Khürelsükh survived a parliamentary vote of no confidence in late November 2018. Mongolians may thus have to await the 2020 elections to express their dissent.

Environmental challenges. Due to its geographical location, Mongolia is by definition one of the most vulnerable countries to the impacts of extreme weather on the Climate Risk Index (ClimateLinks, 2017). Increasingly frequent and catastrophic natural disasters, such as dzud\(^4\), droughts, floods, rising average temperatures and desertification have been detected in Mongolia over the last 60 years. Hostile conditions have made husbandry and rainfed agriculture, which almost 40 percent of the population lives on, less reliable and profitable, paving the way for the development of the mining sector as a more “secure” and viable solution. However, the development of the sector has, in return, had adverse effects on the environment. Mining activities and mining-related infrastructure projects have, indeed, contributed to the rapid increase of CO\(_2\) emissions in the country, the vast erosion of pasture land and deforestation. It is also blamed for compromising biodiversity and the health of local people, for changing hydrological regimes and deteriorating water quality by overexploiting water resources (World Bank, 2018). In fact, since 2002 there exists a Law on Land which outlines and supervises land use in Mongolia, beside other regulations and government entities in charge of preserving land quality and overseeing its use. Furthermore, Mongolia has been praised for being one of the first countries to adopt the Sustainable Development

\(^3\) The Extractive Industries Transparency Initiative (EITI) is a global standard for an open and accountable management of oil, gas and mineral resources through member countries’ disclosure of information along the resource sector value chain from the extraction process, to the government’s collection, deployment and redistribution of revenues (“Extractive Industries Transparency Initiative,” n.d.).

\(^4\) The term *Dzud* refers to a natural disaster unique to Mongolia, namely the occurring of especially dry and hot summers followed by harsh winters, causing the death in vast numbers of livestock in the Steppe.
Goals and integrating them into its legal framework and policy-making, as shown in the 2016 Mongolia Sustainable Development Vision 2030. However, an unripe legal setting for development policy and planning, as well as a short government operational duration, have made policy continuity and consistency difficult to achieve (Government of Mongolia, 2019). The resulting insufficient institutional coordination, weak or delayed policy implementation and inadequate monitoring represent an obstacle to effective action (World Bank, 2018).

For these reasons, it is important for Mongolia to decrease its overdependence on the mining industry. If successful, the country could transform its mineral wealth from a curse to a blessing. Economically, by developing and strengthening different sectors, it would be less affected by the volatility of commodity prices and demand. Politically, by diversifying the source of government revenues and building stronger tax base and check-and-balance mechanisms, it would improve the government’s accountability and institutional capacity. Consequently, the Mongolian government could also improve the management of its resources and optimise their use. Environmentally, by making the mining sector less economically essential and shifting to cleaner energy, it would pursue a development more consistent with the SDGs, while improving the life of its people.

Mongolia’s Possible Ways out of the Resource Curse

Due to geographical and environmental factors and its landlocked position, Mongolia faces difficulties in shifting from an export-oriented economy and pursuing a sustainable development. However, it has room for improvement.

First of all, Mongolia has a great unexploited renewable energy potential, especially in terms of wind and solar power, which could meet domestic energy demand (World Bank, 2018). The Mongolian government has, in fact, showed interest in pursuing a greener development. In 2014 it pledged to increase the total share of renewable energy installed capacity to 20 percent by 2020 and 30 percent by 2030 – ranging around 12 percent in 2018 (Asian Development Bank, 2018). It also introduced Feed-in Tariffs (FiTs)5 for wind, solar and hydropower in order to attract investments in the sector, which resulted in the successful establishment of several wind farms and solar plants. However, due to technical problems with the power grid and consumers’ difficulty in accepting the tariff rises, renewable energies remain uncompetitive to date (World Bank, 2018). Besides, the country’s electricity and heating services still rely for over 90 percent on outdated coal-based power generation and struggle to meet the country’s internal demand, making electricity imports a necessity (Asian Development Bank, 2018). In addition to decarbonising the energy sector, increasing the share of renewable energy would create more and longer-term local jobs, and generate more stable revenues than non-renewable resources have done so far (Overland, 2019).

Secondly, Mongolia could consider promoting the development of the tourism industry, capitalising on the country’s unique natural landscapes and on an international “brand” as a remote and exotic place. For instance, Mongolia is one of the very few countries where traditional nomadic lifestyles can still be observed.

In fact, the country offers a very short tourist season and relies on an insofar poor infrastructure, which make mass tourism very difficult to imagine. However, as it often causes

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5 With feed-in tariff policies, governments set prices for different types of renewables to reimburse producers for the higher costs of producing clean energy.
disruptions in the local social and natural environment, mass tourism is not necessarily desirable, while a more sustainable form of (eco-)tourism could represent a potential source of diversification.

Finally, Mongolia should point at diversifying its economy through non-climate dependent sectors such as the service industry, and in particular the digital and financial sectors. Being a landlocked country, Mongolia is limited by physical boundaries and, thus, struggles to become internationally connected and gain access to global financial markets. Besides, it borders only Russia and China, two bigger economies and two global powers, which its economy is highly dependent on, yet not extremely crucial for\(^6\). For the European Institute for Asian Studies (EIAS), pursuing the development of financial services would be a key element for Mongolia to successfully gain financial inclusion, to increase its economic potential and to improve the Mongolian people’s quality of life (Medina, 2019). In particular, the development of FinTech, which brings together digital technologies and financial services, could give a positive leverage to the economy (De Decker, 2018). Mongolia is already moving in this direction, for example by hosting the Frontier Fintech Summit in May 2019 in Ulaanbaatar, organised by the Ministry of Foreign Affairs, the Financial Regulatory Commission (FRC) and the Mongolian Fintech Association. Experts and investors in the field from different Asian countries gathered during the summit to discuss the state of art and role of Fintech innovation in developing economies.

The development of these sectors holds great potential to contribute to decrease the country’s overdependence on mineral exports, shield the economy from commodity prices boom-and-bust cycles and reduce the rise of corrupt practices in itself. Shifting investments from mining activities to renewable energy would also lessen the impact on the already stressed environment, setting the basis for further climate change mitigation attempts.

Renewables and energy efficiency are also top priorities of the 2018 EU’s strategy for connecting Europe and Asia, in which the EU affirms its intention to “respond to the challenges of climate change and environmental degradation”, and to “promote decarbonisation of the economy and respect high standards” (European Commission, 2018a). Within the same strategy the EU also supports policies to bridge the digital gap, especially in remote regions or landlocked countries. The EU wishes to deepen digital and financial inclusion and expand digital financial services to foster socio-economic development (Ibid.). Besides promoting digital and energy connectivity, the EU also encourages the expansion of people-to-people dialogue and city-to-city cooperation – the so-called “people to people connectivity” –, to boost mutual understanding and, thus, economic growth (Ibid.). The EU’s strategy for connecting Europe and Asia might represent an opportunity to deepen the EU-Mongolia cooperation in the light of Mongolia’s current challenges.

What Role for the EU?

2019 marked the 30\(^{\text{th}}\) anniversary of EU-Mongolia diplomatic relations and the 2\(^{\text{rd}}\) year since the opening of the fully-fledged EU Delegation in Ulaanbaatar, as well as the entry into force of the 2017 EU-Mongolia Partnership and Cooperation Agreement. The EU is Mongolia’s third biggest trading partner with Mongolia benefitting from preferential access to the EU

\(^6\) According to the OEC, China and Russia are respectively the first and fourth export destinations of Mongolia’s products, and the first and second import origin (OEC, 2017).
market under the GSP+ scheme, which appears to be quite successful, as illustrated by Mongolia’s average utilisation rate\(^7\) of 85 percent between 2014 and 2016 (European Commission, 2018b). EU-Mongolia relations encompass several fields of cooperation, including trade and investment, sustainable development, justice, freedom and security. The New Multi Indicative Programme 2014 – 2020 specifically focused on Mongolia’s overreliance on extractive industries and on improving the management of revenues as well as fostering the creation of employment opportunities outside the mining sector (European External Action Service, 2014). The EU has also engaged in aid projects in rural development, in humanitarian aid operations and disaster management, in addition to the support to SME private sector development (European Commission, n.d.). However, despite the EU’s clear intention to strengthen its ties, its engagement with Mongolia seems to remain mostly on paper, with limited concrete impact on the ground.

In addition, since 2014, Mongolia has been included in China’s Belt and Road Initiative along the China-Mongolia-Russia Economic Corridor (CMREC). The project is said to benefit the country by bringing more business opportunities in the mining and energy sectors and by easing exports through a 997-km long expressway between China and Russia, as well as railways, power grids, gas and oil pipelines, (“Mongolia’s Prairie Road Initiative - BRI updates,” n.d.). However, Mongolian officials lament the fact that the country’s inclusion in the BRI remains merely a dialogue with no concrete implementation (Judge & Jargalsaikhan, 2019). Besides, it seems that projects would rather exacerbate Mongolia’s reliance on its mineral resources.

The Mongolian government has also been debating whether to “upgrade” its status in the Shanghai Cooperation Organization (SCO) from being an observer state to a fully-fledged member. Even though the SCO focuses mostly on security issues, supporters of Mongolia’s full accession to the SCO believe it would bring dynamism to the aforementioned trilateral economic agreement and improve trust between Mongolia, Russia and China, as well as boost to the dialogue with Central Asia (Li, 2018; Wishnick, 2019). However, sceptics maintain it would compromise Mongolia’s geopolitical neutrality and diplomatic independence and would be detrimental for its “Third Neighbour” foreign policy. The policy consists of Mongolia’s effort to build relationship with countries other than China and Russia, like the US, Japan and the EU. Joining the SCO is also believed by some to be irrelevant for Mongolia, as the country does not share the security concerns underpinning the organisation, while its economic relations stretch rather to Northeast Asia and the Asia-Pacific than to Central and South Asia (Li, 2018).

China and Russia are not the only countries courting Mongolia. The US also seems to have recently put greater attention on the country. Despite the US and Mongolia having long-standing relationships within the Third-Neighbour policy framework, in the last year reciprocal state visits and high-level diplomatic exchanges have become more frequent, resulting in a Strategic Partnership in July 2019. However, it has been anticipated that the unfolding of the US-China trade war could negatively affect the country’s growth through changes in the price of exported commodities (World Bank, 2019a).

Given the uncertainty and the dubious benefits offered by other actors, the EU would now have the chance and momentum to step up its role in Mongolia. In fact, the EU and its Member States already partner with other organisations and institutions involved in the direct or indirect promotion of projects in Mongolia. For example, Germany, France, the UK, Italy and

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\(^7\) Under a trade agreement, the utilisation rate refers to the amount of preferential imports as a percentage of eligible imports or the degree of usage of existing preferences (Marx, 2018).
the Netherlands are among the twenty biggest donors of the Asian Development Bank (ADB), which is currently financing projects in the renewable sector in Mongolia. Yet, on the basis of shared political values, the EU could consider enhancing its relationship with Mongolia within the framework of the *Europe-Asia connectivity strategy* and support the country’s shift to a more diversified and less mineral-dependent economy. The strategy’s focus on renewables, energy efficiency, digitalisation and people-level exchange, which might not only boost mobility in the education sector but also enhance expertise exchange and the tourism industry, seems indeed to fit Mongolia’s needs for the decarbonisation and diversification of its economy.
References


