The Economic Climate and Business Opportunities in Mongolia

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THE ECONOMIC CLIMATE OF MONGOLIA

Mongolia's rugged landscape and history of conquest has bred a character of independence in its populace. Twice the size of Texas and with a population of 2.1 million, Mongolia is one of the most sparsely populated countries in the world, and its inhabitants have a long tradition of rural freedom. It has abundant agricultural land, of which 80% is suitable for the main agricultural activity, animal husbandry involving cattle, horses, camels, goats and sheep. Crop cultivation was emphasized in the 1950s but the severe climate permits only a 90 day growing season.

Mongolia is also rich in mineral resources, including coal, tin, iron, copper, gold, silver, tungsten, zinc, fluorspar and molybdenum as well as semiprecious stones. Total coal reserves are estimated at about 100 billion tons. There are three major cities in Mongolia: Ulaanbaatar, the capital city with a population of 550,000; Darhan, with a population of 80,000; and Erdenet, with a population of 50,000. These three cities account for 35% of the population and most industrial activity.

With Russia to the north and China to the south, Mongolia has been historically at the crossroads of trade between these two giants. Mongolia is now in an important stage of development—the transition from a centrally planned to a market economy. During the period of central planning, the health of Mongolia's economy relied largely on trade with the former Soviet Union and COMECON trade partners. Five years have now passed since Mongolia embarked upon the path towards democratic reform and its transition from a one party monopoly political system to a multi-party system, and from a command to a market economy. During this period, many radical changes were implemented in all aspects of the country's life. The new democratic constitution of Mongolia, adopted in 1992, created the primary legal guarantee for democratic changes in Mongolia. Yet the dismantling of the old political and economic systems has been peaceful, and the political situation in Mongolia is relatively stable.

A few years ago, production, distribution and consumption were centrally planned and controlled. Today a free-market system prevails within a legal framework that covers taxation, customs, foreign investment, and anti-monopoly laws. In accordance with the three year arrangement under the Enhanced Structural Adjustment Facility (ESAF), as agreed with the IMF, Mongolia has begun to implement policy measures aimed at promoting the transition to a market economy. Substantial progress was made toward macroeconomic stabilization, and a foundation was laid for the implementation of the key tasks of the Government's Program of Action adopted by Parliament in 1992. Privatization is continuing and the role of the private sector in the national economy has been constantly increasing. All prices which were administered by the government have been liberalized and the foreign trade regime has been liberalized. The previous monobanking system has been replaced with a two-tier banking system, and commercial banks are operating with assistance from the IMF, IBRD, ADB and developed countries.

In 1995, for the first time since 1989, there was an increase in GDP. And for the first time, industrial production also increased and agricultural output substantially improved. The average monthly inflation rate in 1994 was 4.3%, three times less than the 1992 level. The average monthly inflation rate in the first 7 months of 1995 was 4.8% in comparison with 5.4% in the same period in 1994. The exchange rate between the national and foreign currencies was relatively stable. At the end of 1994, international reserves were equal to seven weeks of imports; urgent debt pressure was reduced; and substantial improvement was made in the supply of main consumer goods, especially foodstuffs.

Steps have also been taken to make Mongolia's present two-tier banking system more effective. The introduction of Central Bank bills in December 1993 was a major step toward indirect monetary policy. However much work remains to be done to create a sound banking sector and indirect monetary control.

Broad money in 1994 was the equivalent of 25% of GDP, while in 1990 it was equal to 50% of GDP. This is due to liberalization of prices and tariffs, and to people spending money according to their needs. In order to maintain stable, consistently positive real interest rates, rates were reduced as the rate of inflation fell. At the end of 1994, the clearing loan interest rate was 15 to 22% per month, and the resource loan interest rate was 7% per month. Consequently, the average interest rate of loans granted to business entities dropped from 206.8% in 1993 to 130% in 1994. Substantial changes also occurred in the structure of outstanding loans to economic entities. At the end of 1993, 68.8% of total loans were granted to the state sector. However, at the end of 1994 only 23% of total loans were granted to enterprises with dominant state ownership. From 1990 to 1994 loans to the state sector were reduced by 44%, while loans to the private sector rose 4.1 times.

The tugriks/dollar exchange rate was relatively stable in 1994, ranging between 402 to 414 tugriks per dollar. During the first 7 months of 1995 this exchange rate has increased slowly to 453 tugriks per dollar. Establishment of a stable exchange rate promotes exports and restricts unnecessary imports. The sales tax was extended to the revised income of large restaurants, bars and hotels. Also, in the second half of 1994, customs and sales taxes were imposed on automobiles imported by private persons, a minimum customs rate for imported alcoholic drinks was established, and a new regulation was introduced for taxes levied on goods imported under barter arrangements.

Estimates indicate that 1994 budget revenues grew by over 30% compared with 1993. In 1994 total budget expenditures were ten percent less than the planned level. These savings were used for salary increases and to address social problems of the employees of state organizations. The introduction of a partially fee-financed health insurance system was an important step in cutting budget expenditures.

There has also been an improvement in the balance of payments. Last year the volume of exports and imports were basically in balance. Instability on the world market of the price of copper concentrate, the main Mongolian export, affected the volume of exports, while the price increase of petroleum products—the main import item—led to an increase in the value of imports. Twenty percent of total 1994 imports consisted of consumer goods, and 80% were for production and technical purposes; 28.8% of the latter consisted of petroleum products.

In the three years since privatization started, 82% of the targeted property has been privatized, including 100% of trade, public food and other services; over 90% of the animal husbandry sector has been privatized. The passage of a Security Law in the Mongolian Parliament allows for the opening of a second stock exchange for securities, and implementation of the second phase of the privatization program. In this stage, state ownership in previously privatized entities will be sold, along with entire state enterprises. In 1994, the private sector produced more than 50% of GDP, a sign of its increasing role in the national economy. The measure of Mongolia's success will be its ability to hold fast to its plans to stimulate private sector development. Even the country's National

Development Board, which coordinates the economic reform programs of various ministries, concedes that it will not be easy.

The Mongolian Business Development Agency (MBDA) was set up in October 1994 and has been registered with the Ministry of Justice as an independent, autonomous, non-profit, NGO. The MBDA was founded on the initiative of ministries, state committees, international donor agencies, and public and private sector business organizations. The Agency operates on the principles of democracy and market economy and adheres to business principles and practices, pursuant to applicable state laws. The MBDA's objectives are to coordinate and act as a liaison between private sector and government organizations, develop proposals in support of Government activities to advance the private sector, and submit them to appropriate organizations for consideration; provide business related information to public and private sector organizations; initiate, supervise and coordinate consultancies and provision of technical and managerial skills to the Mongolian business community; initiate, supervise and coordinate delivery of selected training courses for the Mongolian business community; promote international investment opportunities and projects as well as provide information and advisory services to foreign investors; and develop a self-sustaining, national focal point for business information and advisory services.

The MBDA Governing Council and founding members are as follows:

Government agencies:

1. The National Development Board (NDB)
2. The Ministry of Population Policy and Labor
3. The Government Privatization Commission
4. The General Customs Administration
5. The State General Customs Administration
6. The Institute of Economics

Private sector:

7. The Mongolian Chamber of Commerce and Industry (MCCI)
8. The Union of Mongolian Production and Service Cooperatives
9. The Central Union of Mongolian Consumers' Cooperatives
10. The Mongolian Private Owners' Association
11. The Mongolian Companies Association
12. The Mongolian Banks' Association

To encourage the flow of more funds into Mongolia, the government passed a foreign investment law in July 1993 which provides attractive incentives and protects the rights and property of foreign investors. The results have been less than anticipated, but the increased investment flow is nevertheless encouraging. In 1994, the government approved US$44 million in foreign investment, a fourfold increase over 1993. A total of 500 approved joint ventures involved 22 countries including Russia, China, South Korea, Japan, the United States, Hong Kong, Singapore and Germany. The government expects the flow of investment to strengthen as the structural reforms lead to more robust economic growth. It believes Mongolia's strategic position makes it a natural conduit for trade with Russia and China, two of the world's largest economies.

ADVANTAGES, DISADVANTAGES AND FUTURE CHALLENGES OF THE MONGOLIAN ECONOMY

Given Mongolia's historical development and its economic advantages and disadvantages, the main long term Mongolian economic and social development strategy must be to overcome the present economic crisis and rehabilitate its economy, while establishing its income-generating capability in harmony with its environment and the improvement of the peoples' living standards.

Mongolia has the following comparative advantages:

- political stability;
- an open economy;
- a comparatively pristine environment;
- a large land area available for agriculture and other purposes;
- traditional animal husbandry practices and the nomadic life style of its people;
- mineral resources;
- renewable energy resources;
- a young, comparatively well-educated labor force;
- adjacency to the huge markets of China and the Russian Federation;
- the opportunity to link with Central and Middle Asia, Europe and South and Northeast Asian countries.

Disadvantages include:

- the present inefficient and uncompetitive economic structure;
- a landlocked economy isolated from the international transport system;
- a fragile and vulnerable environment;
- a lack of capital, financial and foreign reserves;
- a small population and limited labor force.

Mongolia's national development strategy is designed to diminish the influence of negative factors and utilize the country's comparative advantages. The medium term strategic objectives of Mongolian development are

1. stabilize the economy and lay a social base for future development; to this end, the Government will direct its activities towards arresting the economic decline and stabilizing the economy;
2. deepen structural reforms to improve efficiency and rapid growth;
3. ensure economic security;
4. guarantee human rights, and various freedoms necessary for stability;
5. overcome poverty and underdevelopment.

To reach these objectives the following targets have been devised:

- increase GDP by 3.0% in 1995, 4% in 1996, and 5% in 1997;
- continue a tight monetary policy and maintain the exchange rate at a normal level in 1995-1996;
- significantly reduce the inflation rate;
- provide flexibility of credit and deposit interest rates in order to mobilize financial resources and improve the effective use of loans;
- increase hard currency reserves to two and a half months of imports and clear overdue debts;
- provide control over financial losses and improve the current budget balance;
- give priority to development of the infrastructure sectors;
- reduce the poverty level to 10% of the population;
- keep unemployment below 5%; and
- improve administrative management by staffing state institutions with persons able to function well under market conditions.