

CHAPTER 16 MONGOLIA

Introduction. After four years of "reformist" coalition parties in power, Mongolians voted for the "ex-communists"—the Mongolian People's Revolutionary Party (MPRP)—in the parliamentary election on 2 July 2000. The triumph of the MPRP, which ruled the country from the 1920s until 1996, raises the question:

Why did MPRP win? The economy still struggles a decade after communist rule ended.

- The people remain mired in poverty.
- Corruption is rife.
- A terrible winter hurt livestock production.
- Political infighting weakened the coalition government.

Economic Woes. The new MPRP government under Prime Minister Enkhbayar therefore faces tough times:

- The economy is shaky, the social welfare system has collapsed, and drought wreaked havoc on livestock herding—a major source of livelihood.
- Unemployment is officially low. The CIA estimates that about 5% of the population is jobless. However, the CIA number is misleading. A more illuminating measure of the country's economic condition can be found in the 40% poverty rate.
- In 1999, a UN study found that half the population goes hungry.

What economic strategy will MPRP follow? Fear of communism is misplaced. Mongolia's democratic culture is well entrenched. That won't change. Nor is the MPRP headed back to communist state planning and totalitarianism.

- MPRP will slow the pace of privatization. But it has at least promised to carry the process forward.
- The old Democratic Union under Prime Minister R. Amarjargal—that came to power in 1996 with a Newt Gingrich-style "Contract with Mongolia"—is peacefully giving way to the MPRP under Prime Minister Enkhbayar, who models himself after Britain Prime Minister Tony Blair.

Figure 16-A. Selected Historical Data

\$ Billions (or %)	'97	'98	'99	'00
Gross National Income	1.0	..	0.9	1.0
Purchasing Power	4.0	5.8	3.9	4.2
Real Growth (%)	4.9	3.5	3.2	1.1
Inflation (%)	36.6	9.4	7.6	11.6
Exports	0.5	0.3	0.4	0.5
To U.S.	0.044	0.045	0.068	0.121
Imports	0.5	0.5	0.5	0.6
From U.S.	0.034	0.020	0.007	0.017
FDI from U.S.
In U.S.	0	0	0	0
Cur Account /GDP %	2.6	-13.2	-14.1	-14.8
Fiscal Balance /GDP %	-9.2	-14.3	-11.4	-6.3
External Debt /GDP %	67.0	71.8	103.4	..

Sources: IMF, ADB, World Bank, U.S. Commerce

Economic prospects. The new government probably will not do any better at reviving the economy.

- The MPRP does not have any new initiatives to resolve the economic problems.
- The MPRP is unlikely to make the difficult reforms necessary to attract more foreign investment.
- In fact, by slowing the pace of privatization, the MPRP may worsen corruption and inefficiency.
- All of this will jeopardize financial support from the International Financial Institutions (IFIs).
- Mongolia is already heavily dependent on foreign aid.

Why Did the Economy Falter? Western advisers got too caught up in the debate over whether to privatize quickly or slowly and neglected free market laws and institutions—the critical software of the society. While it's important to get the means of production in private hands, that's clearly not a sufficient condition for getting this post-communist economy growing again. The root cause of Mongolia's economic stagnation is structural.

Distrust. The key lies in the intersection between culture and government. Mongolian society's ability to produce wealth depends mainly on its businessmen being able to conduct transactions with reasonable confidence that the other party would fulfill his obligation. What is missing, therefore, in Mongolia's business climate is trust.

How Corrupt Political Economy Works.

Corrupt Mongolian government officials:

- Sell the myth that government ownership provides the people with a safety net.
- Control many of the common resources and turn power into money.
- Extract a cut of every transaction, a practice known as rent-seeking.
- Milk the enterprises in return for political protection. So there's little incentive to concentrate on efficiency or profits.

What should Ulan Bator do to change this rent-seeking behavior?

- Starve the rent-seeking impulse by creating transparency and fully disclosing financial data. i.e., "Stop lying, and open up your real books."
- Build a group of well-motivated and honest regulators to enforce the law.
- Encourage the growth of independent checks and balances on company managers by strengthening the accounting and legal professions.
- Foster the free market laws and institutions that allow two parties to cooperate in an atmosphere of trust.

Bottom line. Without the proper free market laws and institutions to enforce them, Mongolia continues to be a free for all—"the Wild, Wild West"—much like Russia in 1998.

Conclusions

The MPRP—comprising the so-called ex-communists—is back in power. A poor economy was a key factor contributing to their return to power.

- The good news is that democratic culture in the MPRP is well entrenched.
- The bad news is that the MPRP will likely slow down economic reforms, which will jeopardize support from IFIs.
- While a terrible winter killed livestock and damaged the economy, the root cause of Mongolia's economic stagnation is structural.
- What's missing in Mongolia are free market laws and institutions—the critical software of society.