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MONGOLIAN ECONOMY

The Beginning and End
of Mortgages

Barely a Chance

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MONGOLIA'S MORTGAGING BONANZA

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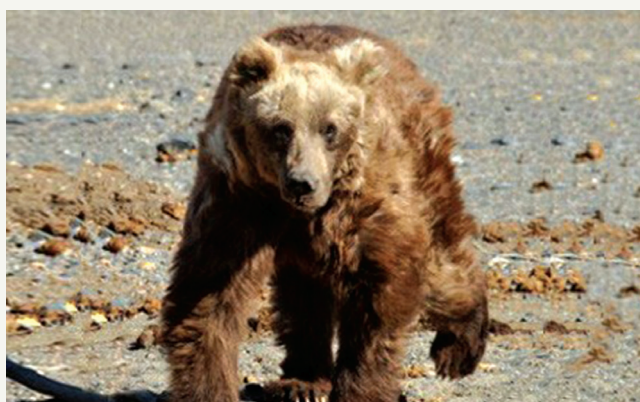
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MONGOLIA:



Mongolia was ranked 10th in the world for its coal resources. Available coal resources totalled 173.3 billion tonnes and exploitable resources were 21.5 billion tonnes.

In the beginning of this year, the exploitable resources increased by 2.6 billion tonnes. Erdenes Tavan Tolgoi is expected to mine 20 million tonnes by 2016. It plans to mine some six million tonnes from the East Tsankhi deposit at Tavan Tolgoi, where, according to the Mining Ministry, some 834,200 tonnes has been mined. The state-owned miner also plans to mine 2.5 million tonnes from the West Tsankhi this year, of which some 128,600 tonnes have been mined so far.



The new president of Asian Development Bank

(ADB), Takehiko Nakao, paid an official visit to Mongolia in July. ADB has invested USD 1.2 billion to Mongolia, or one fourth of total investments since 1991. Over the past two decades, ADB has successfully implemented a number of projects and programmes in many sectors of the Mongolian economy. ADB has most recently partnered with Mongolia to develop a brand for its organic agricultural products.



The State Great Khural's Standing Committee on Budget projected domestic production to grow by 14.7 percent and the Consumer Price Index by 6 percent in 2014. Total budget revenue was projected to reach MNT 7.27 trillion, or 35 percent of GDP, and total budgetary expenditure was MNT 768.3 billion. The projected deficit was MNT 416.3 billion.

The committee has made a preliminary estimate of MNT 2.3 trillion to be invested from the budget. The national debt is projected to be MNT 8.314 trillion.



The city of Ulaanbaatar is implementing the Green Ulaanbaatar project, in collaboration with a local nature conservation organisation of the Hokkaido prefecture, Japan. The three-year project will launch in September, involving some 280 gardeners from the city's nine districts for training. The hope is for Mongolians to learn from Japanese gardeners on how to plant trees and increase the forestry near rivers and the city.

The city of Erdenet



plans to construct 3,500 flats by 2020. The project is to be performed by Finep Group and the Czech Republic jointly with Mongolia's Ikh Khaadyn Tsuvaa. Some MNT 10 billion from the state budget will be spent in its construction at the initial stage.

Erdenet is planning three large projects for

housing, land development, and flat rentals to remove the ger districts from the city

A senior economist at the Bank of Mongolia, S. Bold, has developed the "Financial Stability Report - Mongolia". According to the report, the world's economic growth will exceed that of last year. The world's economy, which grew by 3 percent last year, is projected to grow by 4.2 percent this year. The report indicates that there will be a slight reduction of activity in the US and euro-zone economies due to spending cuts in government whilst Japan has made plans to spur growth.

For some developing nations, their domestic demands could potentially contribute to their economic growth. However, external demand is poor. Thus, the world's economy will likely rely on the economic growth of developing countries, especially in Asia



WORLD:



Gazprom, the world's largest extractor of natural gas, may get access to areas of the Arctic shelf as soon as the end of 2013, according to a statement from Sergey Donskoy, the Russian minister of natural resources. A government decree awarded Gazprom 17 offshore sites in the Barents and Kara Seas. The company applied for 20 fields. The minister confirmed that in the fourth financial quarter, the government plans to transfer licenses to Gazprom.



China has unveiled a series of moves aimed at boosting growth, indicating that policymakers are concerned about the slowdown in its economy. The steps include tax breaks for small businesses, reduced fees for exporters and opening up of railway construction. China's economic growth rate has slowed for two

quarters in a row and there are concerns that it may slow further.

US prosecutors have launched what they say is the country's largest-ever hacking fraud case. Five men in Russia and Ukraine have been charged with running a hacking operation that allegedly stole more than 160 million credit and debit card numbers from a number of major US companies over a period of seven years.

Private industry in the eurozone unexpectedly bounced back to growth this month for the first

time in more than a year and a half. The news comes in the latest euro-zone Composite Purchasing Managers Index, which is based on surveys of thousands of companies across the region. Markit, the organisation which carried out the surveys, said the rebound was pretty broad-based and Germany and France had the best responses, but even peripheral euro zone countries are "seeing a return to growth in manufacturing".

A Japanese appeals court Wednesday ordered the Tokyo Stock

Exchange to pay 10.7 billion yen (USD 108.8 million) compensation over its failure to stop a 40 billion yen trade blunder in 2005, upholding the initial verdict. The lawsuit against Asia's largest bourse was filed by Mizuho Financial Group, which demanded 41.5 billion yen in compensation. The Tokyo District Court ruled that the Tokyo Stock Exchange must pay 10.7 billion yen to the securities firm.



A. AMARSAIKHAN'S CARTOON



FEATURE

THE BEGINNING AND END OF MORTGAGES

B. BAYARTOGTOKH

The Bank of Mongolia's Price Stabilisation Programme has successfully revived Mongolia's construction sector, largely thanks to its 8 percent mortgage programme. The support given to construction and housing has not only halted price growth in the housing market, but it has also created new opportunities for the market.

The programme is distributing a total of MNT 800 billion in mortgages to employed applicants able to make a 30 percent down payment. The new mortgage loans have the potential to cut prices in the housing

market three times. And any household with a monthly income of MNT 1 million has a greater chance of receiving a mortgage.

In the first 23 days since the programme's launch, Mongolian commercial banks were overwhelmed by applications. Banks were tackled by requests from 13,021 citizens, with banks refinancing MNT 368.3 billion of mortgages, cutting the interest in half to just 8 percent. Banks also granted new mortgages of MNT 192.7 billion. Thus far commercial banks have processed 2,099 loans of MNT 105.2 billion.

A successful long-term housing programme has been a long-desired wish

of government. Now that the programme has taken off from the starting line, it will need continued support from government to last. It is a challenge for the government and a dream for the central bank.

Some economists have commented that the programme's importance lies in not only the stability of the economy, but also on bridling inflation.

The initial financing needed for the housing programme has already been transferred by the Bank of Mongolia. Whether or not the programme will be continued has been a question of great interest as it is unclear where the government will procure more funding ▶▶



for it. The programme may simply come to a halt once the initial MNT 990 billion is spent. Thus, it is necessary for the government to take a large part in financing the programme and developing a second mortgage market.

Providing citizens with the opportunity for home ownership and allowing people to move from their gers where they burn coal all winter-long, Ulaanbaatar could also have the added benefit of reducing air pollution.

“Mortgaging is a process of granting a loan by depositing for real state,” said Ts. Enkhbayar, chief executive of the Mongolian Mortgage Corporation.

“The mortgage market is divided into the first and the second markets. The first market is the relations between a citizen (the borrower) and a bank (the lender),” he said, adding that over MNT 870 billion in mortgages had been loaned since their introduction in 2003”.

That figure, however, could reach MNT 10 trillion with this latest programme. Naidansurenin Zoljargal, governor of the Bank of Mongolia, has noted that Mongolia’s mortgage market could finance itself if total mortgages loans reached MNT 5 trillion. But to reach that goal Mongolia will need to institute a number of legal and economic reforms.

Discussions are now being held by officials over creating sources for funding.

“The [Mongolian Mortgage Corporation] does not have any funding. The Mongolian Social Insurance Fund has a negative balance. Also, the Government of Mongolia lacks financial resources. Under these circumstance, the only source is the Bank of Mongolia”, said S. Bold, senior economist at the Bank of Mongolia.

According to Bold, any funding from the Bank of Mongolia is to be used for the purchase of securities. The Social Insurance Fund also needs to be re-examined for new financial sources. The government is now preparing to issue bonds domestically for banks to allocate securities to the fund in order to generate some revenue.

In the future, banks will rely on the private sector to fund mortgages.

Mortgages comprises 45 percent of GDP in Germany, 40 percent in Japan, 36 percent in Singapore, and 13 percent in South Korea compared with a mere 6.2

percent of GDP in Mongolia. Currently, some 66 percent or 316,000 households in Ulaanbaatar are living in ger districts. The ultimate goal of the housing programme is to close the gaps between inhabitants in ger and apartment districts and to accelerate the housing work in ger districts.

In most countries, mortgages comprise no less than 40 percent of GDP. Inflation is also more stable at about 1 or 2 percent. Mortgages would make home ownership more accessible, in addition to the support to the bond market. Also, it has the advantages of creating a second mortgage loan market and the strengthening of a stable and long-term mortgage system.

Internationally, it is seen as normal for a flat’s price to be four times the annual average salary. But in Mongolia the

average monthly salary is MNT 545,000 compared with flat prices of between MNT 75 million to 80 million last year—11 times the average annual salary.

“Mortgages are included on a list of the safest loans,” said Zolijargal. “We are, therefore, aiming to reach MNT 4 to 5 trillion”

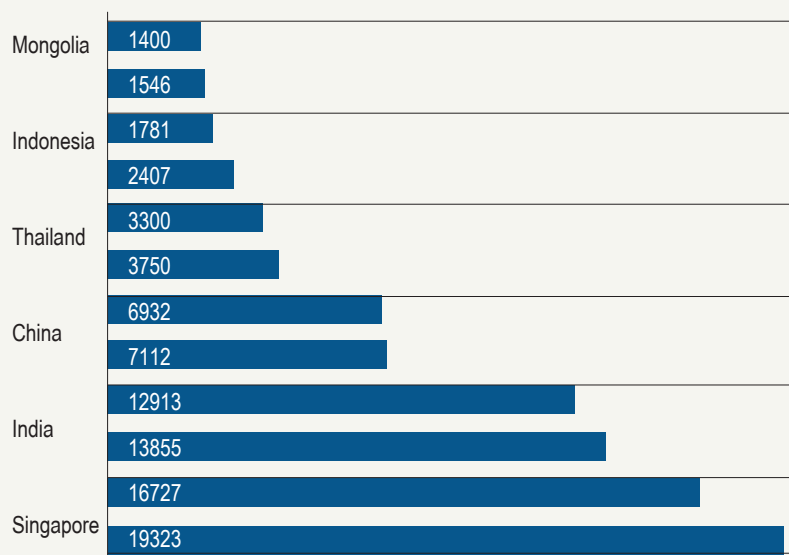
Commercial banks are more interested in mortgages because of their strong benefits to the economy and reputation as a safe loan. There are no bad loans in the mortgage loan package and overdue loans comprise only 0.3 percent.

It is said that if the start was good, then the end will be fine. That suggests that the government has no choice but to finance mortgages step-by-step to avoid extinguishing the fire that has been ignited. ■

Chart-1. Comparison of flat prices

Affordability	Price/annual salary	Countries
Too expensive	35	Beijing, China
	18	Singapore
	12	Mongolia New York, USA
Expensive	6	Australia
	5	New Zealand
Reasonable	4	USA (average)
Cheap	3	China (nationwide)

Chart-2. Comparison of price per square meter



MONGOLIAN ECONOMY'S QUESTION

What do you think about the 8 percent mortgage loan programme?

Policy which supports young people needs to be implemented



I work for a security company and my monthly salary is low, so I do not have any chance of making a deposit. Recently, I have been registered to go and work in South Korea. If I could work there for three years, then it would be enough to collect MNT 20 million.

As a young person, I back the implementation of

the housing programme implemented by the government. Mostly importantly, I hope that the programme would further continue stability. If the chance exists, then I could get a mortgage in the future.

D. Batmunkh, a citizen of Songinokhairkhan district

Employment is the guarantee



It is good that the mortgages are quite supportive of the middle class. But the majority of the class is subject to low and mid middle incomes. Thus, the threshold of a 30 percent advance payment seems very high. It means that there is more probability in which the mortgage cannot reach its targeted group.

When people want to receive mortgages, it becomes a hindrance. Besides that, the mortgage could be a chance for those who are employed and have enough income. But the amounts of current salaries are not enough to pay for mortgage loans while paying for living costs. If the salaries of some of the people who work in private sector are not increased, they will not have a chance to get a mort-

gage.

Citizens really want to get mortgage loans, but when they face that threshold there is no way. Of course, the implementation of a housing programme is a really good thing. Thus, the government needs to focus on stable and long-term implementation of the programme.

More chances should be given to young people. If their employment is guaranteed, there should be no need for a threshold. The guarantee of citizens is their employment.

The 8 percent interest rate is quite reasonable. It needs to be further reduced.

S. Oyunchimeg, citizen of Sukhbaatar district

Construction companies overprice their construction projects



A special housing programme for young people needs to be implemented. The threshold to get the mortgage is too high. It is too difficult unaffordable to those who have low and middle incomes. Thus, investment needs to be made initially for the salaries and incomes of citizens.

It is impossible for those who are just starting their lives to attain mortgages. The prices of flats

are sharply increasing and exceeding the livelihoods of citizens. Therefore, it would be appropriate to limit the growth of prices. Construction companies are making bubbles through the increasing demand. In the future, it would be better to lower the threshold. It is important that a more flexible policy is introduced to attract confidence.

D. Gan-Otgon, citizen of Bulgan aimag

Professional inspection authorities need to focus on the quality of flats



The government needs to focus on increasing salaries. Flat prices are very high. But citizens' lives are in difficult conditions.

Another important thing is that the related inspection authorities need to focus on the quality of newly built construction projects. With regard to this matter, some citizens are experiencing losses. They purchase flats at very high prices, but the quality of construction is not good. In recent construction projects, the cheapest and worst building materials were used.

Also organisations need to take care of their employees and to focus more on their social welfare issues. Organisations need to at least open the opportunity for attaining mortgages. However, they do not necessarily buy flats with them. In this scenario the salaries of citizens cannot be enough to afford flats. In this event, the mortgage loan is thought to be too far to reach.

E. Khurelbaatar, citizen of Khan-Uul district ■

OYU TOLGOI

THE ONLY HOPE FOR THE BUDGET

B. TOGTOKH

June 9, 2013 was the first day of copper concentrate export from Oyu Tolgoi, one of the top five copper deposits in the world. This is certainly one of the largest events to occur this summer. Indeed, it was supposed to be a day to discuss how Oyu Tolgoi's copper concentration could benefit the Mongolian economy.

There have been a number of delays in copper export from Oyu Tolgoi, including the presidential election and a dispute over the company's banking. The latter eventually led to a concession that all money streaming from Oyu Tolgoi would have to flow through Mongolia's banks but not necessarily have to remain there. Indeed, the Oyu Tolgoi project was supposed to proceed smoothly because of its enormity for Mongolia in terms of its importance to the economy. The initial export proves that initial infrastructure work is complete and the project has transitioned into stable mining operations. Bearing this in mind, Prime Minister Norovyn Altankhuyag called the first export a defining moment for both Rio Tinto and Mongolia's economic development.

During these times of decline for the prices of coal and copper, is there any possible better scenario? This year's budget included expectations that Erdenes Tavan Tolgoi's coal production would double and Oyu Tolgoi's investment agreement would be amended for greater tax revenue. But the reality is revenue this year has fallen short of predictions.



Some 576 tonnes of copper concentrate on 16 trucks have headed for the Gashuun-Sukhait border point. The initial export of copper concentrate was 5,800 tonnes. After the export was halted twice, Oyu Tolgoi's board of directors unanimously agreed to export after they were able to review the sales agreement. The newly built processing plant is expected to produce between 650,000 and 700,000 tonnes of copper concentrate containing 27 to 30 percent copper for the first three years. At full production the plant is expected to produce 78 million tonnes of copper concentrate with 22.7 million tonnes of refined copper, 26 million ounces of gold, 170 million ounces of silver, and 129 million pounds of molybdenum. According to a preliminary study, the processing plant is expected to produce 2.8 billion tonnes of ore for an estimated period

of 65 years.

"According to our estimates, total revenue from Oyu Tolgoi is expected to reach USD 1 billion until the end of this year if its operation is stabilised and there will not be any delay," said Tserenbat Sedvanchig, chief executive at Erdenes Oyu Tolgoi, told *Undesnii Shuudan* in a July 16 article. "More than USD 100 million in royalties is estimated to be generated for the state budget."

The launch of export from Oyu Tolgoi it is expected to increase the volume of copper concentrate export from Mongolia by 80 percent and total export by 30 to 40 percent. Additionally, the volume of domestically produced minerals is projected to grow by 20 percent. Mongolia could become the 15th largest copper producer in the world.

"The current annual capacity of »

► Oyu Tolgoi's concentrating plant is as much as 12 million tonnes more than Erdenet Mining Corporation's. Expanding its capacity in the future may bring it to 54 million tonnes a year by 2018", said Mining Minister Davaajav Gankhuyag. "It would be appropriate for the company's board and shareholders to focus on supplying products, work, and services from the domestic market as much as possible. I hope that even the current transportation of copper concentrate is to be handled by national entities in the near future. Also, joint companies need to implement a comprehensive policy for promoting national entities".

The Oyu Tolgoi mining unit has projected annual copper production of 600 million tonnes. Currently, copper ore is mined from an open-pit mine at Oyu Tolgoi. The initial stage of work for an underground mine has already commenced. However, its financing has not been yet approved, and it has recently been decided approval will have to come from the State Great Khural. The government is expected to generate tremendous revenue from the project via royalties and taxes. According to deputy mining minister O. Erdenebulgan, Oyu Tolgoi plans to export 300,000 to 500,000 tonnes of copper concentrate this year. Chul-uuntserenyn Otgonchuluun, head of the strategy and planning department at the Mining Ministry, said that the export of copper concentrate depends on the capacities of the roads and border points.

But not everyone is convinced Mongolia is reaping as much benefits as possible.

"According to the investment agreement made between the government of Mongolia and Oyu Tolgoi, value-added tax, income tax and import duties are not paid to the state budget. Only royalties are paid at a mere 5 percent", argued B. Bayarkhuu, researcher and member of the Mongolian Association of Budget Experts, in an address to the State Great Khural on July 1. Oyu Tolgoi on July 10 released a statement that the copper it produces will be sold at above market price because the agreement was made with the purchaser when the

price of copper was higher.

"Commencement of export of Oyu Tolgoi's copper concentrate is a historic event. According to recent news, some 70,000 tonnes of ore has been

processed every day and the volume of processing is increasing on a regular basis", said Kay Priestly, chief executive at Turquoise Hill Resources, in a statement on July 8. ■

What do you think is the significance of first export from Oyu Tolgoi

In the past four decades, there has not been any gigantic infrastructural work like Oyu Tolgoi's processing plant. Today's export of Oyu Tolgoi's copper concentration is the result of a joint framework that was done by Mongolians and foreign investors for almost a decade. When Oyu Tolgoi's processing plant starts to operate at full capacity, the volume of Mongolia's mining export is expected increase by 30 to 40 percent.

Norovyn Altankhuyag, Prime Minister

Everybody involved in the infrastructural work of Oyu Tolgoi is proud of what they have done. Building this gigantic plant is an extraordinary achievement and we are all looking forward to its very first transportation from the plant. This is the first big step in which the transition has been made from global-scale infrastructure to global-scale copper producer. I would like to express my sincere gratitude for all those who contributed to the project.

Cameron McRae, Chief Executive of Oyu Tolgoi

Three years ago, the investment agreement for Oyu Tolgoi was signed by the government of Mongolia and foreign "third neighbour" investors. This has remained a unique event in the development history of Mongolia's mining sector. This is the achievement in terms of an agreement for Mongolians' optimistic wish, the value of resources inherited from our ancestors and the enormous effort of the investors, board and workers at Oyu Tolgoi.

I am so grateful that the processing plant, which has the potential to process 36 million tonnes of ore annually, has commenced and its product is being exported.

Davaajav Gankhuyag, Mining Minister

For Oyu Tolgoi it has been a long trip. It has been 12 years already since the first discovery there was made. This might seem like a long time, but this is just a part of the more than 50 years of exploitation that we expect. We need to work hard in order to overcome challenges successfully that might be encountered in the future. Our investments are not only for us, but for our future generation and for our children.

Ts. Sedvanchig, Chief Executive of Erdenes Oyu Tolgoi

According to the latest news, the processing plant has reached the appropriate levels in terms of quality and quantity to launch commercial production. Oyu Tolgoi plans to process 100,000 tonnes of ore per day, so far reaching 90,000 tonnes in the past 10 days. This means it has almost reached its main production capacity. In any project for a processing plant, the plant is considered stable if it reaches about 70 percent of its projected production capacity and operates normally for two months.

The production capacity of Oyu Tolgoi is expected to increase and has the potential to product 100,000 to 110,000 tonnes a day.

Jean-Sebastien Jacques, Chief Executive of Copper Group at Rio Tinto ■



RESOURCE CURSE

IMPORTANT PRINCIPLES FOR SOVEREIGN WEALTH FUNDS



Jan Hansen
Senior Country Economist
Asian Development Bank

The Government of Mongolia is working on the establishment of a sovereign wealth fund (SWF) to improve the effectiveness of economic policy. The purpose of this article is to outline some important principles for the design of SWFs, based on good international experience. The article is the third of a series of four articles on mining-driven economic development and wealth management.

For developing countries, natural resources provide a unique opportunity for economic development. The reality, however, has often been different. Naturally resource-rich countries often fail to

grow more rapidly and perform less on human development indicators than less-endowed countries—a phenomenon which is sometimes called the “natural resource curse”.

Because natural resources are an element of wealth, natural resource revenues should be generally saved rather than spent. SWFs play an important role for fiscal policy over the long-term (i.e., time horizons beyond 5-10 years) to ensure sustainability and wealth preservation for future generations by saving a large part of the natural resource’s revenues. SWFs also play an important role for fiscal policy over the short-to-medium term (i.e., time horizons of up to five years spanning

the business cycle) by supporting a countercyclical policy stance; when the resource price is high, the fund would receive revenue, which in turn will be paid out to the budget when the price is low.

SWFs, to be effective have to be integrated into a fiscal policy framework which specifies, through an appropriate fiscal rule, the short- and long-term fiscal policy target. A SWF which merely consists of rules for the in- and outflow of funds, but no specific fiscal policy target, might be ineffective because the government has the option to borrow the funds it has to put into the SWF.

Key decisions to be made for the ►

► design of a SWF relate to (i) objective and mandate; (ii) integration with the budget process; (iii) governance structure; (iv) investment policy and strategic asset allocation; and (v) transparency and accountability. Some essential principles for the design of SWFs are discussed in the following.

Sovereign wealth funds should have a clear objective, but not their own spending mandate

The objective of the SWF should be clearly stated in relevant legislation. In most cases, SWFs are established as stabilisation and-or saving vehicles. The two objectives can be achieved either through a single fund with a dual purpose or a structure where the SWF comprises of two or more sub-funds, with each sub-fund having specific objectives.

Good international practice suggests that SWFs should not have an own spending mandates, other than channeling funds to the general budget. This requires a clear division between the SWF as a savings vehicle and other funds and institutions funding domestic investments (i.e., development banks, infrastructure funds, and etcetera).

The establishment of SWFs may have significant advantages on political economy grounds. Running fiscal surpluses is often politically difficult as decision makers may be subject to pressures for additional spending when revenues are plentiful. A fund can strengthen the political acceptance and support for savings by focusing attention on the non-resource budget balance and highlighting that nonrenewable revenues are not like other revenues and should, in general, be saved rather than spent.

Sovereign wealth funds should be integrated with the budget process

SWFs should be integrated with the budget process to avoid fragmentation of the budget and the emergence of “dual budgets”, namely the traditional budget and a separate expenditure programme financed by the fund. All domestic spending funded by the SWF should be channeled through the national budget and executed by the treasury. A unified budget process facilitates prioritisation of expenditure across all government operations and supports an efficient allocation of resources, including an integration of the investment budget and expenditure on operations and maintenance. If spending is undertaken outside the formal budget process, possibly without parliamentary approval and oversight, it could result in nontransparent practices and give rise to governance concerns.

On occasions, resources transferred to the budget are earmarked for particular expenditures. Earmarking is sometimes seen as making it easier to resist political pressures to use natural resource revenue for less appropriate purposes. However, earmarking would result in resources being placed outside the regular budget process which might lead to inefficient expenditure allocation and management. The impact of earmarking is also uncertain insofar as budgetary resources are fungible.

Sound governance structure ensures transparency and accountability

An important part of the governance structure of a SWF is the decisions on who should be the owner and the operational manager. A clear allocation of responsibilities is important to ensure transparency

and accountability. The owner of the SWF is normally the Ministry of Finance on behalf of the government as it is responsible for the overall management of public resources. The owner, or alternatively the parliament, determines the investment policy of the SWF and exercises oversight over the SWF’s operations. The operational manager of the SWF, on the other side, implements the investment guidelines in accordance with the overall investment policy and is responsible for the day-to-day management of the fund assets. Operational independence is essential to prevent political interference in the management of the fund, while ensuring accountability to the government and the public.

Two institutional arrangements regarding the operational management of the SWF are most common. The first approach, chosen by a majority of countries, is to establish an independent investment authority outside the government structure as a fiscal agent. The second approach is to delegate responsibility to the central bank, which according to good international practice should operate independent from direct government interference. One major advantage with the latter approach is that the central bank already exists as an organisation and has some relevant experience through the management of the countries’ foreign exchange reserves. For both institutional arrangements, management of some of the fund’s assets can be subcontracted to private investment managers.

Investment policy should define the risk profile of the sovereign wealth fund and eligible asset classes

It is essential that the SWF invests in foreign assets in order to isolate the domestic economy ►►

▶ from the aggregate demand effect and volatility of natural resource revenue. Investing the savings in domestic financial assets would transmit resource revenue volatility to the economy. The SWF should not invest in the government bonds which would mean that the government is issuing debt to itself.

The investment policy is either established by law (i.e., the Parliament) or the executive (i.e. the government) as the owner of the SWF, within the scope defined in the legislation. The investment policy should be consistent with the overall objectives of the SWF and define the risk profile of the investments (i.e., the eligible asset classes).

Investment decisions should aim to maximise risk-adjusted financial returns of the fund's assets. According to standard finance theory, expected risk and expected return are interlinked. The higher the expected risk the higher is the expected return. Thus, it is important when preparing the investment policy to strike the right balance between risk and return, i.e., decide on the exposure to each of the main asset classes, including cash deposits, debt instruments, equities and real estate. Some SWFs are solely invested in cash deposits and debt instruments in order to minimise the risks and volatility, whereas other SWFs have included a broader range of asset classes in the portfolio. Including equities and real estate in the portfolio increases the expected return of the portfolio, but increases also the risks and short-term volatility in investment return.

Managing a portfolio highly exposed to the international financial market requires capacity and skills to ensure sound portfolio management. In developing countries, these skills must be built up and developed. A strategy which several developing countries have chosen is to establish a low-risk investment policy from

the outset, which may for example include cash deposits and debt instruments only, and subsequently include more risky assets (i.e., global equities) when experience and capacity is developed. It is important that the stakeholders and wider society understand the risks that the SWF is exposed to. At the beginning low investment risks and stable returns should be the most important goal for the investment policy.

The Norwegian SWF, for example, was invested in bonds only during the first two years of its existence, and a minority share of global equities was added to the portfolio when the organisation, skills and competence were developed. Today, the strategic benchmark index comprises 60 percent global equities, 40 percent debt instruments less the share allocated to real estate, which shall not constitute more than 5 percent of the portfolio. In Timor-Leste, only government bonds were included in the portfolio for the first four years, whereas global equities have been gradually added to the portfolio over the last three years in line with increased experience and knowledge about international financial markets. A similar approach might be advisable for Mongolia.

The investment policy and strategic asset allocation also depends on the investment horizon of the SWF. Saving funds are able to bear considerable risk and can hold a variety of risky and illiquid asset classes, including equity and real estate, because of the inter-generational investment horizon. A stabilisation fund, on the other side, might need to draw down its assets at short notice—for instance, during sharp commodity price downturns—and would therefore invest in more liquid and lower risk assets. In particular, SWFs must have a sufficient level of understanding and acceptance by the domestic population such that the fund will have the latitude to invest over the

long-term and have loss-making years. With public support, the fund's investment horizon can remain long-term, and it will not be forced to sell assets at a discount because domestic stakeholders change their minds about a certain investment strategy.

Transparency and accountability ensures legitimacy and public support

Rules and operations of a SWF should be transparent and free from political interference and lobbying, in particular pressures to increase spending following rising commodity prices. Transparency and accountability ensures legitimacy and public support for the objectives of the wider fiscal policy framework and the SWF. Ensuring transparency and accountability requires regular and frequent disclosure and reporting. It is common that the operational manager of the SWF presents quarterly performance reports to the owner and the public. In addition, the owner of the SWF usually prepares an annual report that is submitted to the Parliament and made public.

Mongolia is highly dependent on the mining sector which in 2012 generated 89.2 percent of exports, 17 percent of government revenue, and 18.6 percent of GDP. The currently high uncertainty for the global economic outlook, uncertainty about the pace of growth in the People's Republic of China, and falling commodity prices pose risks for the prospects of the Mongolian economy. A well-designed SWF can shield the economy from volatile commodity prices, ensure fiscal sustainability and preserve wealth for future generations.

International experience shows that SWFs have been the most successful when there was strong political support for the pursued fiscal objectives. ■

DEVELOPMENT

GREENING THE HUMAN DEVELOPMENT INDEX: ACCOUNTING FOR ALL PILLARS OF SUSTAINABILITY



Chuluun Togtokh is the science secretary of the Sustainable Development Institute at the National University of Mongolia, science director of the Green Development Policy Institute and Vice Chair of Mongolia's Global Change National Committee

Economic growth is an engine for development. However, there are two key issues from the sustainability point of view that need to be addressed; that of the equal distribution of wealth among populations within countries, and whether economic growth itself can be green. In order to address these issues, I am proposing a new sustainability index composed of wealth, equity and environment.

In 1992, the first Earth Summit defined sustainable development as having three pillars: economic, social and environmental. As a global species we have had remarkable success with the first two pillars. But, ultimately, our failure to address global sustainability lies in our inability to tackle all three dimensions simultaneously. Reductionism, fragmentation, division, and self-interest to keep one's "own territory", are reasons for such failure. The UN Human Development Index (HDI) is indicative of this fragmented approach, as it does not account for the environmental dimension.

The HDI has set straightforward targets for countries and international organisations for more than 20 years. Its success and influence owe much to its simplicity. It brilliantly summarises quality of life in a given country using health, education, and income levels. Yet it fails to cover an increasingly vital question for humankind: how sustainable is that development? In the current HDI, developed nations and oil-rich countries are placed highly without regard to how much their development paths are costing the planet and humankind's future development. There is little regard for the resulting fundamental changes to the Earth System.

As the United Nations prepares for Rio+20, it must lead by example. It should include an environmental indicator and so change the HDI to a Human Sustainable Development Index. Nations' CO2 emissions per capita provide a simple, avail-

able and measurable indicator of environmental impact. They also reveal a somewhat unsurprising dynamic—that countries with faster HDI improvements also experience a more rapid increase in CO2 emissions per capita. The bottom line: recent progress in the HDI has come at the cost of global warming.

I am also proposing the inclusion of a social index, which accounts societal equality, instead of health and education as in the HDI. Societal equity can provide a good indication of wellbeing, for example, in societies where the income differences between rich and poor are smaller, health trends and life expectancy are better, and numeracy and literacy scores tend to be higher. Community life is also stronger, with more trust between citizens, and smaller prison populations. In summary, societal equality is critical for social resilience, and better captures social sustainability. »

To find out how the inclusion of environmental and social indices affects the HDI, I included per capita carbon emissions and equity levels, and recalculated the sustainability index, using the UN's published methodology. My resulting Human Sustainable Development Index shows very interesting results, when compared with the HDI:

- Australia, the US and Canada fall straight out of the top ten
 - US drops from fourth to 64th;
 - Australia slides by 52 places from second to 54th;
 - Canada falls from sixth to 38th; and
 - More equal societies such as Sweden, Norway, Denmark and Japan received the highest rankings
 - Sweden rises from 10th to first;
 - Denmark moves from 16th to second;
 - Japan from 12th to the fourth position;
- The implications of the Sustainability Index go be- »

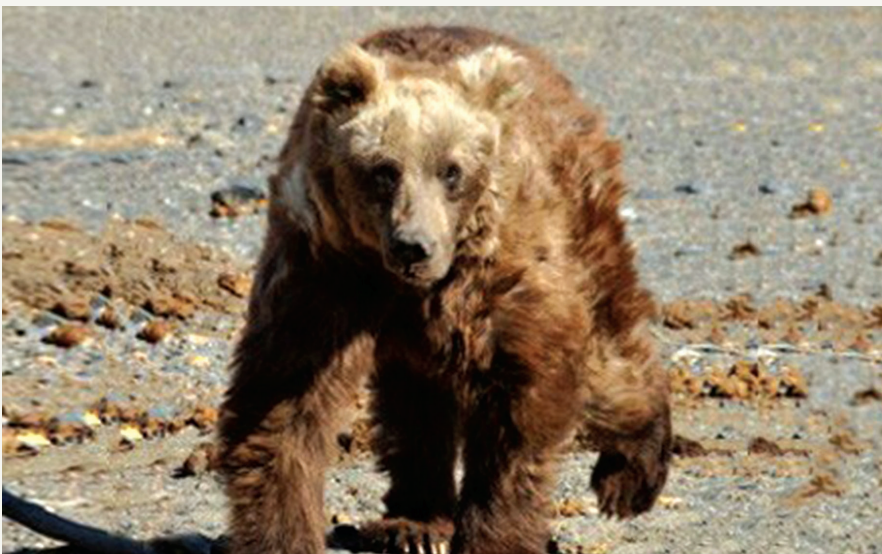
► yond the symbolic. The HDI has shifted the target of development beyond the almighty dollar, but the new Human Sustainable Development Index, or Sustainability Index completely shifts development targets into social and environmental resilience building, addressing

challenges such as climate change and societal equality. It brings new insights into governance for sustainability because better societal equality and green development pathways depend on policy decisions made by the government and institutions. ■

<http://www.stakeholderforum.org/>

ENVIRONMENT

BARELY A CHANCE



BY TERENCE EDWARDS

Last May a nature reserve ranger at one of the secluded protected areas of Gobi Altai visited a lifeless pile of hair and flesh lying atop the desert scrub. The ranger confirmed that it was indeed a dead female Gobi bear that had earlier been reported to the ranger's office. Her death was a devastating blow to what is believed to be a severely threatened sub-species of the brown bear.

The loss of just that one bear brings the sub-species even closer towards

extinction, reducing the population count by one and removing the possibility of her rearing any children. Any cub she may or may not have already had would not likely survive without its mother.

Mongolia's Gobi bear, or Mazaalai as it is known locally, is teetering on the edge of extinction. The population of this mysterious beast could be as low as 22, but two bears have been found dead since the population survey was conducted in 2007.

Perceiving the threat the Mazaalai

faces, the government declared 2013 as the "Year to Save Mazaalai". In an effort to build up awareness, the government partnered with the UN Environmental Programme (UNEP) to launch a worldwide campaign, which recently made a visit to Mongolia for World Environment day last June. Nick Nuttal, a spokesperson for UNEP, noted that the impact of climate change on Mongolia's fragile environment was likely a heavy factor contributing to Mazaalai's plight.

"Mongolia is experiencing three times the average global temperature rises. Already it has to deal with water scarcity and a naturally fragile environment, and climate change is like a great hammer coming down from on top", said Nuttal.

"Ultimately, if it [the world] doesn't deal with climate change, then I think the Gobi bear will have a very bleak, if not zero, future".

Shy bear

Part of the reason so little can be done for Mazaalai is because experts still know very little about the shy creature. The animals is rarely seen by humans and is most often observed by motion capture cameras.

According to Nathan Conaboy, a project coordinator with the Zoological Society of London and the Steppe Forward Programme who has worked with the Mongolian Academy of Sciences, even the best estimate of how many live in Mongolia is unreliable.

"Numbers are very hard," said Conaboy.

"A tiger has its stripes and a leopard has its spots, and they're like fingerprints, but the Gobi bear doesn't have that—it's very difficult to distinguish one from another".

A population survey was made in 2007 when the academy's Project Gobi Bear team installed numerous posts bears could use to scratch their backs. Researchers then collected hair samples left behind for DNA analysis to get an idea of the population size.

But, as Conaboy notes, there is ►►

▶ no guarantee that every bear will visit those posts, no matter how many snacks are left for them or other tricks used to lure them over. Fortunately, they still can learn quite a lot from those small hair samples.

Because so little is known about Mazaalai still, the bear has still yet to have been listed as endangered. The simple reason is, says Conaboy, is more study needs to be done, and usually that work is done as part of a thesis. Filling that role is Tumendemberel Odbayar, a genetic analyst working on her Master's by identifying Mazaalai as a sub-species for the International Union for Conservation of Nature (IUCN) authorities.

"Basically, genetic analysis needs to be done by an institute, it then gets placed in a species or sub-species, and then a case is made to have it classified in terms of threat level", said Conaboy.

Making the List

Odbayar's goal is to have Mazaalai listed on IUCN's list of extremely threatened species. She says though there is some question to a definite number of bears in Mongolia, the number is most likely less than 50. And like UNEP, she believes climate change is largely responsible for the

bear's dwindling numbers.

"We need to measure the level of water as it's very low. It's most likely because of climate change", said Odbayar.

She believes she can prove to IUNC that Mazaalai is a unique sub-species of bear. To do that she will have to convince a panel of experts that the bear is distant enough genetically from its closest relatives, the Himalayan brown bear or the Eurasian brown bear.

"Analysis shows the bear belongs to a separate cluster. It's a very ancient strain", said Odbayar.

This summer Odbayar's team plans to install up to 100 trap cameras through the protected area to study the bear's behaviour and help answer some of these mysteries such as how many live in Mongolia, what does it eat during the different seasons, and how often does it mate. When those questions are resolved and Mazaalai makes the red list, it will have a host of new opportunities afforded to it.

"Once it's listed in IUCN, that's when the gates open for international funding," said Conaboy. "It's very hard if someone asks, 'Well, what's the threat level? Is it endangered?'"

"If you send around a proposal without that information, then there's

a risk is all it is under surveyed".

Conaboy said it was quite common to declare a species extremely threatened only to find a whole new community in another, unobserved, area. With so many mysteries surrounding Mazaalai, it is certainly possible this could be true for it. There is still no proof that the bear never leaves the confines of the protected area to cross the border to China or other bears are living in an even more remote corner of Mongolia—but nobody will know until the work is done, said Conaboy.

Mazaalai would join the Saker falcon and Przewalski's horse as species where humankind has intervened to save Mongolian species. Taki, as the wild horse is known commonly in Mongolia, was involved in a Zoological Society of London breeding program where horses in captivity throughout Europe were bred and reintroduced to Mongolia in 1990 after its brethren in the wild went extinct. For the Saker falcon, conservationists have installed 5,000 artificial nests to sustain the population.

However, Odbayar said she was hesitant about the idea for reintroduction because she was anxious about removing bears from the wild. She also dismissed the idea of introducing the Eurasian brown bear to this environment".

"The Gobi bear lives in the most extreme conditions compared with other brown bears," said Odbayar. "I'm not sure others could survive such a harsh environment."

As Mongolia charges towards the next stage of development, it has taken on an important duty that many countries before it have failed to live up to. It is easy to get lost in the money, but Mongolia has set itself to a higher standard because of its past traditions and ties to the environment. Mazaalai is a creature like not other, just like Mongolia is a country like no other, and it should mind not to forget treasures such as Mazaalai while it exploits the treasure buried deep beneath the ground. ■





NEWSWIRE HIGHLIGHTS

NewsWire is a weekly news aggregate sponsored by the Business Council of Mongolia. Each week NewsWire delivers breaking and significant news from local and international news sources for a Mongolian and foreign audience alike. The following are news highlights from the month of July:

BUSINESS

OYU TOLGOI CEO TO STEP DOWN IN NOVEMBER AFTER TERM ENDS

Cameron McRae, chief executive officer of Rio Tinto PLC's Oyu Tolgoi LLC, plans to step down from his job, three years after taking control of Mongolia's biggest company, according to a person familiar with the matter.

McRae's departure at the end of his three-year contract, which comes due in November, has been communicated within the company, said the person, who asked not be identified because the information is not public. A successor has yet to be named, the person said.

McRae has steered Oyu Tolgoi through an inception that has included shareholder clashes over cost over-runs, tax payments and a lack of local participation in the management of the USD 6.6 billion copper and gold mine. Enough of the disputes were resolved to allow the project to begin copper shipments earlier this month, after two postponements as Mongolia sought to ensure revenue from the mine is passed through domestic banks.

Source: Businessweek

MONGOLIA GRANTS 1-YEAR CONTRACT TO MINE TAVAN TOLGOI WEST BLOCK

Mongolia has lined up three local firms to mine the West Tsankhi block of the giant Tavan Tolgoi coal mine for a year, an executive at the

state-owned mining company said on Friday, as the country aims to boost coal output.

Mongolia is racing to start producing coal from the long-delayed project as it is under pressure to plug a budget gap and help pay down debt to Aluminum Corp. of China (Chalco) amid a sharp downturn in coal prices. Delgersaikhan Tsagaan-Uvgun, head of mine planning and technical coordination of state-owned Erdenes Tavan Tolgoi LLC, said the company has finalised a one-year contract for mining at the 888 million-ton West Tsankhi block to a consortium of three local companies. The deposit is owned by Erdenes TT, which has contracted work at its East Tsankhi deposit to Australia's Macmahon Holdings and Germany's BBM Operta.

The company said it expects to mine a total of up to six million tonnes this year at the east block and two million tonnes at West Tsankhi. Chief Financial Officer Batdorj Enkhbat told Reuters that the company was in talks to export coal to new international markets, such as Japan or Korea, as the landlocked country looks to ease its dependence on China.

Source: Reuters

ECONOMY MOODY'S ADJUSTS COUNTRY Ceilings FOR MONGOLIA

Moody's Investors Service adjusted the local currency (LC) country risk and foreign currency (FC) bond and deposit ceilings for Mongo-

lia as well as Thailand and Oman. The sovereign bond ratings are not affected by the changes in the ceilings.

The changes in ceilings refers to the highest rating that can be assigned to a domestic issuer in these countries. For Mongolia this means the LC bond ceiling was changed to Ba3 from Baa1; (2) the long-term LC deposit ceiling was changed to Ba3 from Baa2; (3) the long-term FC bond ceiling was changed to Ba3 from Ba2; (4) the long-term FC deposit ceiling remains at B2; and (5) the short-term FC bond and deposit ceilings remain unchanged.

Moody's decision to adjust the LC country ceilings for Mongolia is based on application of the rating agency's Currency Country Risk Ceiling for Bonds and Other Local Currency Obligations methodology published earlier this year. The adjusted local currency ceilings are consistent with the methodological framework which positions the ceiling against Mongolia's sovereign bond rating of B1 and sovereign bond methodology factor scores, three of which are the key drivers of the ceiling. In Mongolia's case these consist of a "low" assessment of economic strength, a "low" assessment of institutional strength, and a "high" assessment of susceptibility to political, economic, or institutional risks. Moody's decision to adjust the LC country ceilings for Mongolia is also influenced by specific risks inherent in the country's operating environment: A his-

tory of boom-bust economic cycles and uncertainties affecting the predictability of the foreign investment regime.

FC ceilings were adjusted to reflect Moody's assessment of moratorium risks given the country's ability and willingness to service both its public and private cross-border debt obligations. The ceiling takes into account Mongolia's sizable financing needs on the one hand and its traditionally open economy with few capital controls on the other.

Source: Moody's Investors Services

FOREIGN TRADE FALLS 7.3 PERCENT Y-O-Y AS OF 15 JULY

Foreign trade fell 7.3 percent on July 15 from the year before, amid shrinking exports and imports.

Mongolia has a current foreign trade balance deficit of USD 1.2 billion, a 0.5 percent decrease year-on-year. Although the weak foreign trade data is indicative of an overall weakening of the economy, the year-on-year gap decreasing slightly from 8.5 percent to 7.3 percent does provide some encouragement.

Mongolia has seen fewer imports of diesel fuel along with heavy machinery which are likely a result of a flagging mining sector. However, the fall in imports of consumables such as flour and vegetables indicates that domestic production is stronger than previous years.

Source: Mongolian Investment Banking Group ■