PROSPERITY IN DEPTH: MONGOLIA

The Paradox of Riches

By Peter Murrell and Chuluunbat Narantuya
THE LEGATUM INSTITUTE

Based in London, the Legatum Institute (LI) is an independent non-partisan public policy organisation whose research, publications, and programmes advance ideas and policies in support of free and prosperous societies around the world.

LI’s signature annual publication is the Legatum Prosperity Index™, a unique global assessment of national prosperity based on both wealth and wellbeing. LI is the co-publisher of Democracy Lab, a journalistic joint-venture with Foreign Policy Magazine dedicated to covering political and economic transitions around the world.

PROSPERITY IN DEPTH

To complement the Prosperity Index, we commissioned 12 specialists—economists, political scientists, journalists—to provide additional analysis of selected countries. Their studies vary from essays putting contemporary challenges into historical context (Iran, China, Mongolia) to up-to-the-minute surveys of the barriers to economic growth (Egypt, Japan, India) to controversial alternatives to the conventional policy interpretations (Iceland, Colombia, Vietnam). In each case they represent highly original work by distinguished experts that adds depth and insight to the statistical analysis of the Prosperity Index.
It is safe to say that most of what people know about Mongolia is that it had something to do with Genghis Khan and the Mongol Empire. That empire, which at one point included much of what is now China, Russia, Pakistan and the successor states to the Soviet satellites in both central Asia and eastern Europe, collapsed in the 14th century. A majority of the remaining ethnic Mongolians now live in China. A Mongolian state reemerged in 1912, but endured in either the Russian or Chinese sphere of influence until the collapse of the Soviet Union.

The republic has a population of less than 3 million and a GDP of about $15 billion—a bit less than that of Nicaragua. But, as Peter Murrell (a development economist at the University of Maryland) and Chuluunbat Naratuya (a lecturer at the National University of Mongolia) suggest, it is a far more important place than the numbers suggest.

For one thing, Mongolia is chock full of extractable minerals, everything from copper to coal to rare earths. For another, it is a natural experiment of sorts, a laboratory for social scientists seeking to understand why nations succeed (or fail). To date, by the way, it is doing remarkably well, scoring 59th on the latest Legatum Prosperity Index™ in spite of the fact that Mongolia’s average income is less than that of Bolivia or Egypt. Last but hardly least, it is an immensely attractive culture that elicits empathy from everyone who values social cohesion, moderation, dignity and the spirit of compromise.

Peter Passell, Editor
ABOUT THE AUTHORS

Peter Murrell is a Professor in the Department of Economics at the University of Maryland specialising in development issues in post-Soviet transition economies.

Chuluunbat Narantuya is a lecturer at the National University of Mongolia and advanced PhD student at the University of Maryland. She received her initial training in political economy from the Moscow State University.

ABOUT THE EDITOR

Peter Passell is a senior fellow at the Milken Institute and the editor of its quarterly economic policy journal, The Milken Institute Review. He is a former member of the New York Times editorial board and was an assistant professor at Columbia University’s Graduate Department of Economics. Passell is the economics editor of the Democracy Lab channel at ForeignPolicy.com, a joint venture between the Legatum Institute and Foreign Policy magazine offering analysis and opinion on the issues facing countries in transition from authoritarianism to democracy.
Mongolia, a lightly populated, landlocked country that was buried in the Soviet empire for most of the twentieth century, has emerged in far better shape than most analysts could have imagined. Indicators of political and economic institution-building over the last two decades paint an impressive picture. The successor to the old communist party has just surrendered power—a second time—in an orderly and fair election. The economy is booming, with 17% (no misprint) GDP growth in 2011 and a similar pace expected this year. If all goes as planned, the completion of mammoth gold, copper, and coal projects will double GDP before 2020.

Yet the source of Mongolia's new economic fortunes—abundant mineral wealth—gives pause. History offers few examples of countries riding a resource boom from poverty to affluence without mishap. In fact, that road is so commonly bumpy that it has a name: the resource curse.

Typically, in less-developed countries suffering the resource curse, the weakness of governance institutions gives the ruling elite the opportunity to use the new wealth to cement autocracy (as in the Middle East) or the polity is fractured by corruption and conflict over the spoils—a familiar story in Latin America and sub-Saharan Africa.

Mongolia, alas, is showing signs of the impact of the curse even before the serious wealth arrives. Its impressive efforts in the partial vacuum left by the receding communist empire has given way to a less laudatory performance. Mongolian democracy is showing signs of stress, and the economy is overheating, with monetary growth, fiscal policy, lax banking regulation, and corruption to blame.

Much, then, turns on the resilience of Mongolian society in the face of very rapid change. Certainly, it passed a big test in dealing so effectively with the difficult conditions encountered on exit from communism. It remains to been seen, though, whether the institutions forged in the times when there were doubts about Mongolia’s viability as an independent state, are up to the challenge of managing suddenly acquired riches.
REBIRTH OF A NATION

When public protests erupted in mid-1990, Mongolia was emerging from 70 years of (a sometimes brutal) communist regime that had replaced theocracy in a distant corner of the Qing Empire. Its chief benefactor/oppressor, the USSR, was crumbling and precipitately withdrawing its massive economic support. Relations with its other giant neighbour, China, had been frozen for a quarter-century—and, less than two years after Tiananmen, China was in no mood to embrace a new democracy next door. Who in their right mind would expect success from plans to create a liberal state in Mongolia?

Yet, the Mongolians seem to have pulled off the impossible. Seven parliamentary elections accomplished on schedule and 17 years of more or less steady economic growth might not seem all that remarkable an accomplishment until one remembers both how isolated Mongolia was and how dependent on crumbs from the Soviet table. The authors both witnessed that transition, Narantuya as a citizen and resident of the capital city, Ulaanbaatar, and Murrell as a frequent visitor, teaching economics to policymakers and analysing the impact of economic reforms.

Narantuya, a junior lecturer in Marxist political economy at the Medical University of Mongolia in the winter of 1989–90, remembers the deep, pervasive fear when demonstrators challenged the 70-year rule of the Mongolian People’s Revolutionary Party (MPRP). Surprisingly, the MPRP eventually opted for a peaceful transition, and scheduled multi-party elections for July 1990. (One rumour had it that there was substantial support in the politburo for using violence to disperse demonstrators, but it melted away when the Party’s leader insisted that all in favour sign a public statement to that effect.) A reformist government took over, with little understanding of the economic catastrophe it was about to confront.

Soviet aid was withdrawn. Trade collapsed as Eastern Europe turned to the West and the USSR disintegrated. Hyperinflation threatened and living standards plummeted, with even staples in short supply. Murrell remembers searching for food in late 1991, going from one store to another and finding only one item—massive chunks of Bulgarian feta that were apparently one of the last purchases under Communist-bloc trade agreements. In the months following, Ardyn Erkh, the government newspaper, led the news with the list of commodities available that month. Supplements to the staples were sporadic: one time powdered milk from Japan, other times loose tobacco or vodka, very rarely some fruit.

Consider how ill-prepared Mongolia was to deal with such a crisis. In spring 1990, the political economy faculties from Ulaanbaatar’s universities stopped teaching the old curriculum and gathered to study the only available market-economy textbook, an edition of Samuelson’s Economics in Russian. That spring, the country’s leading economics journal serialized a summary in Mongolian. Since printing capabilities were poor, graphs were described in words, creating immense confusion. That fall, faculty members were specialising in specific chapters, doing the rounds of all the local universities. By this means, demand and supply came to Mongolia.

Not surprisingly, the new democratic reformist government struggled to come to terms with reality. While hyperinflation loomed, government expenditures increased, the state-owned airline pursued a dream of becoming world class, central bank officials lost a
large share of foreign exchange reserves speculating in global currency markets, and a utopian vision of mass privatization emerged. The privatization program would involve every citizen, down to the last nomad, in trading stocks—this, in a country where one frequently encountered important government officials asking, "What are shares?"

Notes made by Murrell in the fall of 1991 captured this dissonance:

“In the [hard-currency] bar of Mongolia’s Ulaanbaatar Hotel, one could still buy beer brewed in the German Democratic Republic [East Germany] fully a year after unification had laid the German communist state to rest. The hotel had priced Radeburger Pils considerably higher than its rivals, celebrated Western European beers brewed in Hong Kong. Was the higher price a vestige of times when socialist products commanded a respectful premium? Or, did the Pils now claim antique value?

“To be in Mongolia now is to be stuck between two worlds, never sure in which one stands. The old communist structures are decaying day-by-day, but their death throes are protracted by the slow, and uncertain, arrival of the new dynamics of market democracy.”

The Mongolians seem to have pulled off the impossible.
Mongolia is situated some 1,600 kilometres from the Pacific Ocean via China and twice that distance via Russia. Its population (just short of 3 million) is spread across an area the size of Western Europe. In a country with low rainfall and temperature extremes, nomadic pastoralism was the universal occupation until the communists brought industry and arable farming in the 1960s. Virtually every Mongolian, however urbane and worldly wise, feels an intimate tie to the countryside and the nomadic life; indeed, for most Mongolians, that life has been a part of their own experience.

The communist MPRP overlaid this nomadic culture with an orthodox socialist system. The nomads were forced into large animal-husbandry cooperatives (negdels); Ulaanbaatar and a few other cities became industrial centres. Markets were abolished, and all economic life fell within the plan.

Industrial development came via very large state enterprises; small businesses virtually disappeared. Some tentative liberalization occurred in the 1980s with the advent of perestroika, but this did not venture as far as full blown capitalism. Indeed, early liberalization left big enterprises largely unregulated, lacking the disciplining force of either planners or market competition.

The MPRP won the first multi-party election comfortably, the new democratic forces being disorganized, without resources, and unable to field candidates in many rural constituencies. Yet, driven by the fear of being on the wrong side of history (or perhaps just worried about future demonstrations), the MPRP selected an eager reformer and staunch anti-Soviet, Byambasuren, as prime minister. In forming a coalition cabinet, he placed economic reform in the hands of the more radical members of the new democratic parties.

Coalition government in times of crisis has proved to be something of a pattern. This suggests Mongolia’s inclination toward broad political cooperation—but it is also a telling sign of the weakness of party structures lacking platforms that drive policy.

The first real economic reform occurred in January 1991 with the freeing of many prices, the adjustment of other prices to better reflect costs, and a doubling of salaries to offset the resulting increase in the cost of living. This was the first time that some prices had been changed since the 1950’s—Murrell remembers the hubbub as deputy ministers and their subordinates arrived (by public transport) at the seminar he was teaching, the participants in great confusion about what had happened to bus fares.

But this was just the beginning: the government was using the printing press to finance expenditures. Inflation reached 270%, while living standards fell dramatically.

Inflation peaked in 1993 and was contained to single digits by 1998. GDP, down by a relatively modest 22%, began to grow again in 1994. Foreign government assistance, together with IMF and World Bank aid, training, and conditionality, helped Mongolia surmount this early challenge. But success in stabilizing prices also reflected the depth of the government’s political will and rapidly growing technical competence, along with lots of forbearance on the part of ordinary citizens.

Macroeconomic stability may have been the greatest challenge early in the transition, but reformers focused on privatization. The avowed aim was to turn a proletariat with nothing to lose into owners with a real stake in the political and economic system,
while depriving politicians of control of the country’s resources.

Large-enterprise privatization was seen as a buffer against the risk of reversal of democracy. Equally important, privatization was designed to train Mongolians in the nuts and bolts of market capitalism—to claim their birthright, citizens would need to buy enterprise shares using government-issued vouchers. Thus, in 1992, Mongolia would spend less on antibiotics than on equipping a state-of-the-art stock exchange and a far-flung brokerage network.

Large-enterprise privatization was, on its own terms, an impressive success, a significant organisational accomplishment in a country lacking the infrastructure of a market economy. Moreover, in contrast to privatization initiatives in Russia, corruption was minimal.

Research later showed that the privatization failed to increase the productivity of the affected enterprises, but was successful in lessening the state’s economic influence. One unanticipated
development: managers and workers were able to amass controlling ownership positions by using the vouchers of their extended families. By the end of the privatization process, half of the enterprises were controlled by insiders. Both the process itself and this unexpected outcome are evidence of a feature of Mongolian society that appears throughout the transition—an inclination and capacity for collective action.

Vouchers were also issued for use in buying smaller enterprises in public auctions. These vouchers could be traded freely; sceptics noted that the price readily settled on the cash needed to buy a bottle of vodka. Many groups of workers and extended families amassed vouchers to purchase shops and repair facilities, again evidence of that propensity for collective activity.

The most controversial aspect of privatization involved the negdels (the rural cooperatives). Government reformers met stiff opposition in the countryside—and lost the battle. Each negdel carried out its own privatization scheme, resulting in large inequalities and frequent allegations of corruption. Some nomads accumulated huge herds while others sank into the poverty, eventually migrating to the cities. But markets did eventually make a big difference to productivity: the number of animals increased from 26 million in 1990 to 44 million in 2009, and herd composition changed radically in response to export prices.
The decline in output, combined with runaway inflation and opposition to privatization, brought the early reformers into disrepute even though the economy's poor performance was largely beyond their control. A parliamentary election in 1992—the first under a new constitution—led to a big win for the MPRP, which ruled alone until 1996. The MPRP government was pragmatic and centrist, but proved cautious in furthering reforms.

It did, however, complete the privatization plan and the deregulation of market prices, and made the currency convertible—that is, it allowed individuals and companies to exchange Mongolian currency for dollars and yen. The government also continued fundamental institutional reforms, whose effect would only be felt in the long-term. Most importantly, despite the MPRP’s control of over 90% of the seats in parliament, it never reversed the thrust of the reforms. Market democracy, it seems, had become an uncontested goal.

Meanwhile, the new reformist parties had been able to forge a united platform. And they adopted decidedly Western campaigning techniques, offering a “contract with the voters” that, not coincidentally, looked like a knockoff of Newt Gingrich’s “Contract with America”. It worked: the reform parties captured two-thirds of the seats in the 1996 parliamentary elections.

The new government set about revitalizing reform. The centrepiece was, again, privatization, but this time of the very large (and much more valuable) companies omitted from the first round. From 1996 to 2000, nearly 1,000 enterprises were privatized through a variety of schemes, all requiring the new owners to pay cash up front. The ersatz voucher-finance capitalism of the early years, it seems, had led to real finance capitalism.

This was not without its costs. The 1998 global financial crisis, which had its origins in east Asia, precipitated a Mongolian banking crisis. But yet again the government found the will to do what needed to be done, putting banking on a surer footing.

This first non-MPRP government was ultimately caught up in a political brawl catalysed by ambiguities in the powers of the president under the constitution. The issue was, in the end, resolved by the passage of constitutional amendments—but not without a slow-motion crisis in which the country suffered through four prime ministers and several months without a government at all. Significantly, economic reform stayed on track during the crisis; no political party had the desire to revert to central planning or autocratic government.
Mongolia’s political culture really is different. Although it was in the bottom quarter of all nations in per capita GDP in the late 1990s, it was easily in the top half of all nations on all six Worldwide Governance Indicators compiled by the World Bank. This was the case even for the category of regulatory quality (an aspect of institutional development with which Mongolia had no experience prior to 1991) and for control of corruption (in which the transition countries have generally fared badly).

Those superior scores in governance, combined with the potential of the country’s natural resource base in an era of booming commodity prices, paid off. It took eight years to recover from the 22% decline in GDP in the aftermath of Soviet withdrawal. The eight years from 2002 to 2010, by contrast, saw cumulative growth of 73%.

The gains were felt broadly. Maternal mortality in childbirth was cut in half between 1990 and 2010; infant mortality fell by a remarkable 70%. And while the early years of the transition threatened to disrupt the comprehensive educational system—a real achievement under communism—decent schooling was quickly re-established. In a country that has the lowest population density in the world, secondary education is universal and female literacy is 98%, facts that help to explain Mongolia’s relatively high score (52nd out of 142 countries) on the PI’s sub-index for education.

All this begs a key question: What made Mongolia different from a slew of post-colonial and post-communist economies that made much less progress toward free-market democracy in their early years of transition? Indeed, what can Mongolia tell us about the fundamental issue of why some countries develop, while others do not?

A number of advantages followed from what was absent (rather than what was present) in the Mongolian experience. In the departure from communism, there was no strong or charismatic leader—no Yeltsin or Nazarbayev—who could dominate the political scene. The army and security services were weak and had no political designs. Ethnic homogeneity eliminated the chance for the type of internecine conflict so common in other former Soviet-dominated states.

The list goes on. Although there are more Mongolians living outside Mongolia than inside, there were no prominent irredentists. No foreign country had designs on its territory. No religious group distracted attention from the pursuit of the immediate, earthly benefits that would flow from capitalism and democracy.

But there was also plenty on which to build. Mongolians have a strong sense of national identity, particularly when emphasizing

**Significantly, economic reform stayed on track during the crisis; no political party had the desire to revert to central planning or autocratic government.**
their differences from their two powerful neighbours. Everybody understands what it is like to lose national autonomy and how geopolitics makes independence fragile. In early economic reform debates, these feelings always surfaced, particularly the fear of coming into the Chinese orbit if a failing economy led to political collapse. By the same token, adoption of Western-style democracy had advantages beyond the usual ones: it was a useful ingredient in creating close ties with the US, EU, and Japan, which offset Mongolia’s vulnerability to Russia and China.

Thus Mongolians came to view the early transition as a period in which their society was under threat—a shared challenge to their way of life. In Ulaanbaatar in the early 1990s, the term *transition* came to refer to a dire situation that required extra fortitude on the part of citizens (as in, “How could he do that in the transition?”).

Thus to politicians in the 1990s, the costs of failure were obvious. By contrast, opportunities for major corruption—selling out the
nation for personal gain—were scarce. The state sector had some potentially valuable enterprises, but only if husbanded carefully after privatization. Foreign direct investment—often a source of easy pickings for corrupt politicians—was minor until the late 1990s. This is not to say that corruption was entirely absent; rather, the potential benefits of corruption weren’t great enough to dominate incentives for more benign activity.

There was widespread support for the transition process and an understanding that times of privation were to be endured. Tight budgets, supported and monitored by the IMF, offered little scope for largesse. Where transition policies did create inequality—privatization of the negdels and of city apartments—a respect for customary property rights muted objections. What’s more, the older generation of politicians, imbued with the socialist ethic, made the social safety net a high priority.

Mongolians are bound together by a culture that celebrates the wide-open spaces and fosters pride in their nomadic roots. Indeed, into the late 1990s over 45% of the labour force was still in pastoral agriculture, meaning that virtually every family had ties to the nomadic life. This reinforced a pragmatism rooted in both a strong sense of personal property (the animals) and the rights of others (to shared pasture and water).

Nomadism, despite its bucolic image, creates the constant possibility of conflict over prime grassland and scarce water as herds and families change in size and needs. Established arrangements are challenged, and must be renegotiated in a flexible process that aims to keep costly conflict to a minimum. Serendipitously, this type of cooperative give-and-take translates easily into skills useful for market capitalism.

The threat of disaster—in particular, weather that freezes animals out of access to pasture—is a fact of life in nomadic Mongolia. (In 2010, just such a disaster killed 11 million animals, one-quarter of all livestock.) Tradition dictates that the unaffected share their pasture and wells with other herds, which have sometimes travelled great distances to reach better conditions. And arguably, such traditional practices bred a spirit of cooperation that facilitated collective action in the two decades of transition from communism.

Consider, too, that Mongolians’ self-confidence facilitates mutually profitable interaction with foreigners. Mongolia’s openness to Western ideas and eagerness to develop ‘third-neighbours’ to counterbalance Chinese and Russian influence were instrumental in attracting aid (technical and financial, from individual countries, the IMF, and World Bank) along with quick entry into the World Trade Organization. The results can be seen

Adoption of Western-style democracy was a useful ingredient in creating close ties with the US, EU, and Japan, which offset Mongolia’s vulnerability to Russia and China.
in myriad ways ranging from Mongolia’s outreach in upgrading its national airline to its receptiveness to advice in buttressing fragile financial systems.

Last but not least, consider some more familiar explanations for Mongolia’s success. Levels of literacy and education—notably, female education—are very high, compared to other countries at similar levels of economic development. And both educational attainment and gender equality are good predictors of success in building market democracy.

**BUT WILL IT BE ENOUGH?**

All that said, Mongolia’s polity and economy are showing the stresses of change. While the last decade has seen rapid growth in average living standards, Mongolia has been much less successful in other ways. Most importantly, the development of governance institutions has stalled. Mongolia’s rankings on all six of the Governance Indicators have actually declined since 2002. Corruption has increased to the point where Mongolia now ranks in the lowest quarter of countries—worse even than China.

The consequences can be seen in the deteriorating performance of its political system. The constitutional amendments of the late 1990s removed presidential checks on parliament, leaving it with the broadest set of powers of any of the world’s legislatures. This, combined with poor party discipline, has made it difficult for governments to construct coherent policies, especially on budgetary matters.

From 2004 to 2008, a coalition between the MPRP and the new parties ruled indecisively; by no coincidence, it was the slowest period of economic reform to date. The new parties had expected to win the 2008 election, but the MPRP boasted of a landslide in its favour. Some prominent members of opposition parties claimed fraud (not subsequently backed by international observers), and street demonstrations followed. The police overreacted, killing five, injuring many more, and arresting 700 people—a shocking outcome in post-communist Mongolia. The president temporarily banned demonstrations and censored private news media. The opening of parliament was delayed for two months.

Eventually, all parties stepped back from the brink. In an echo of the first years of democracy, they formed yet another coalition government despite the MPRP’s overwhelming parliamentary majority. Members of the Democratic Party (DP) held leading positions in the government until the beginning of 2012, when election preparations necessitated a break. The parliamentary elections of mid-2012 passed without incident, resulting in a defeat for the MPP, the successor party to the MPRP, which had dropped Revolutionary from its name. The DP now leads a coalition government that includes three smaller parties. It will face strong opposition from the MPP.

The 2008 crisis certainly suggested that Mongolia’s political institutions are more fragile than many thought. And while the system righted itself, it was too late to rescue Mongolia’s fairytale, happily-ever-after reputation that had been instrumental in attracting foreign investors, donors and the like.

Since this incident, a number of policy decisions have reinforced concerns that Mongolia’s road to affluent democracy will be bumpy. Party discipline is fraying, and accordingly, governments seem less committed to fiscal prudence than to short-term political gains.
In campaigning for the 2008 election, the DP promised to give 1 million tugrik ($850) worth of mining shares to each citizen; the MPRP upped the ante, adding cash handouts and other benefits to bring the total to 1.5 million tugrik. And the government has since papered over the resulting fiscal problems, using advance royalty payments from mining companies to narrow the deficit.

The budget deficit amounted to 5% of GDP in 2009, closed to zero in 2010 thanks to strong mineral-revenue growth—but then opened again in 2011 as the government fulfilled its election promises. The macro stability earned the hard way in difficult times is now jeopardized by the sort of populist political behaviour Mongolia had managed to avoid in the early years of the transition.

More generally, there has been an erosion of the sense of collective responsibility and individual self-sacrifice that allowed the imperilled state to get through the 1990s. Rising corruption is especially corrosive because it is happening against a backdrop

A number of policy decisions have reinforced concerns that Mongolia’s road to affluent democracy will be bumpy.
There has been an erosion of the sense of collective responsibility and individual self-sacrifice that allowed the imperilled state to get through the 1990s.

of ongoing poverty and inequality. Mongolian inequality is not extreme by the standards of sub-Saharan Africa, or even Brazil—the bottom-fifth of the population garner about 7% of total income. But inequality has grown since the 1990s, and the number of very poor people in Mongolia has been rising.

For one thing, the loss of government subsidies by inefficient state enterprises after privatization increased poverty. So, too, did the privatization of herds, which led to fierce competition and drove some herding families out of business. This resulted in migration to the cities, particularly Ulaanbaatar, where 18% of the current population arrived in the last five years. Some 60% of Ulaanbaatar residents live in tent settlements or permanent housing lacking clean water, sewage and electricity. The low-quality coal they burn for heat in winter has made Ulaanbaatar one of the world’s most polluted cities. And though the official unemployment rate is low, one-quarter of the working-age population is reportedly not employed in the formal economy.

It is one thing for the poor to be passive when everybody is struggling, as was the case early in the transition. It is quite another when they are reminded daily that the elite are busy feathering their nests.

THAT RESOURCE CURSE

There is more uncertainty today about the direction that Mongolia will take than at any time since the early 1990s. This is ironic, since the magnitude of the wealth expected from the mining projects (underway, or on the horizon) is astounding. Consider, for example, Oyu Tolgoi, a copper and gold project in the Gobi desert. Even before production begins in 2013, the sum invested in the mine will equal two-thirds of current GDP.

Nearby, Tavan Tolgoi, an open-pit coal mine, straddles one of the largest high-quality coal reserves in the world. In 2020, export earnings from this coalfield will likely exceed today’s GDP. And almost everybody expects that most of Mongolia’s mineral wealth has yet to be found. The latest discovery: substantial quantities of rare earths, which are critical to a variety of modern industrial processes and are in very short supply globally.

But a giant problem looms in the form of the aforementioned resource curse. One piece of the problem is called Dutch Disease (which took its name from the unanticipated downside to the Netherlands’s discovery of natural gas in 1959). Rapid increases in foreign exchange earnings from mineral exports drive up the value of the currency, making other potential exports uncompetitive on world markets. This leads to deep structural unemployment, rising
inequality, and the inability to follow the tried-and-true path of East Asia in powering long-term growth with manufacturing exports.

Dutch disease can be managed, but only by a polity able to look far down the road in making fundamental policy decisions. Which is why the less esoteric aspects of the resource curse are so pernicious. Windfall wealth creates temptations to corruption. Arguably worse, the new wealth undermines the discipline and institution-building needed to raise productivity and to create jobs.

But Mongolia is not Venezuela or Equatorial Guinea—it possesses the social capital to fight back. (Note that Mongolia ranked 33rd on the PII’s sub-index for social capital.) The Election Law of 2011 prohibited political parties from making promises with major fiscal implications, and that prohibition seemed to stick in the 2012 election. Meanwhile, the Fiscal Stability Law of 2010, modelled after Chile’s approach to managing dramatic swings in copper export revenues, requires that budgetary decisions be based on a long-term average of mineral prices. The law also mandates the government to invest a portion of its mineral revenue in foreign assets, which should help to suppress the symptoms of Dutch Disease.

THROUGH A GLASS, DARKLY

Mongolians are justifiably proud of the free-wheeling democracy and market economy they’ve created from the wreckage of communism. It is a work in progress, though, one that will be mightily tested by the avalanche of mineral wealth in the coming decade.

There are solid reasons for optimism: the institutions created in the last two decades, the high-education levels, stable borders, the absence of an ambitious military, a nomadic culture that is both flexible and inclined to compromise. But on the other side of the coin, the imminent threat of disaster no longer binds the nation. In the end, the country’s fate will turn on whether the culture that preserved civility and unity through the long, dark days of Soviet colonialism (and the post-colonial institutions that are a product of that culture) can mute the centrifugal forces of capitalism and globalism.
COUNTRY OVERVIEW

<table>
<thead>
<tr>
<th>Metric</th>
<th>Mongolia</th>
<th>Global Av.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (million) (2010)</td>
<td>2.80</td>
<td>N/A</td>
</tr>
<tr>
<td>Life expectancy (years) (2010)</td>
<td>68.2</td>
<td>69.6</td>
</tr>
<tr>
<td>Birth rate (per year per 1000 people) (2010)</td>
<td>23</td>
<td>22</td>
</tr>
<tr>
<td>Fertility rate (births per female) (2010)</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Life satisfaction* (rated 0 &gt; 10) (2011)</td>
<td>5.0</td>
<td>5.5</td>
</tr>
<tr>
<td>Female representation in legislature (2011)</td>
<td>3.9%</td>
<td>19.5%</td>
</tr>
<tr>
<td>Internet access at home? (2011)</td>
<td>9.0%</td>
<td>34.2%</td>
</tr>
<tr>
<td>Satisfied with job/work* (% yes) (2011)</td>
<td>82.0%</td>
<td>73.3%</td>
</tr>
<tr>
<td>People are treated with respect in your country* (% yes) (2011)</td>
<td>73%</td>
<td>85.1%</td>
</tr>
<tr>
<td>GDP per capita (ppp) (2010)</td>
<td>$4,035.87</td>
<td>$14,774.73</td>
</tr>
</tbody>
</table>

ECONOMY

<table>
<thead>
<tr>
<th>Index</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entrepreneurship &amp; Opportunity</td>
<td>98</td>
</tr>
<tr>
<td>Education</td>
<td>59</td>
</tr>
<tr>
<td>Safety &amp; Security</td>
<td>43</td>
</tr>
<tr>
<td>Personal Freedom</td>
<td>92</td>
</tr>
<tr>
<td>Social Capital</td>
<td>33</td>
</tr>
</tbody>
</table>

PROSPERITY INDEX: DATA IN FOCUS

<table>
<thead>
<tr>
<th>Index</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 year growth rate (2010)</td>
<td>4.9%</td>
</tr>
<tr>
<td>Confidence in financial institutions** (% yes) (2011)</td>
<td>73.0%</td>
</tr>
<tr>
<td>Satisfaction with living standards** (% yes) (2011)</td>
<td>63.4%</td>
</tr>
<tr>
<td>Business start-up costs (% of GNI) (2011)</td>
<td>2.9%</td>
</tr>
<tr>
<td>Mobile phones (per 100 ppl) (2011)</td>
<td>105.1</td>
</tr>
<tr>
<td>Will working hard get you ahead?** (% yes) (2011)</td>
<td>83.6%</td>
</tr>
<tr>
<td>Confidence in the government?* (% yes) (2011)</td>
<td>32.5%</td>
</tr>
<tr>
<td>Confidence in the judiciary?* (% yes) (2011)</td>
<td>31.9%</td>
</tr>
<tr>
<td>Government effectiveness</td>
<td>-0.61</td>
</tr>
<tr>
<td>Pupil to teacher ratio (2010)</td>
<td>30.1</td>
</tr>
<tr>
<td>Satisfaction with education quality?** (% yes) (2011)</td>
<td>62.1%</td>
</tr>
<tr>
<td>Perception children are learning** (% yes) (2011)</td>
<td>73.2%</td>
</tr>
</tbody>
</table>

NOTES:
1. Gov. effectiveness: values range from -1.73 to 2.25, higher values indicate higher effectiveness.
2. Human flight: values range from 1 to 10, higher values indicate higher levels of human flight.
3. Civil liberties: values range from 1 to 7, lower values indicate lack of civil liberties.
4. Survey data are taken from Gallup World Poll.