Sovereign Wealth Fund: Case of Mongolia

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Summary

- Mongolia: Overview
  - Fiscal and Economic performance
- Mining revenue management issues
  - Mining taxation
  - Attempts to establish a wealth Fund
  - Challenges and Problems
- Recent reforms in fiscal frameworks
  - New legislations, FSL and IBL
  - Special Fiscal Requirements
  - Fiscal Stabilization Fund
- Current Considerations on Sovereign Wealth Fund issues



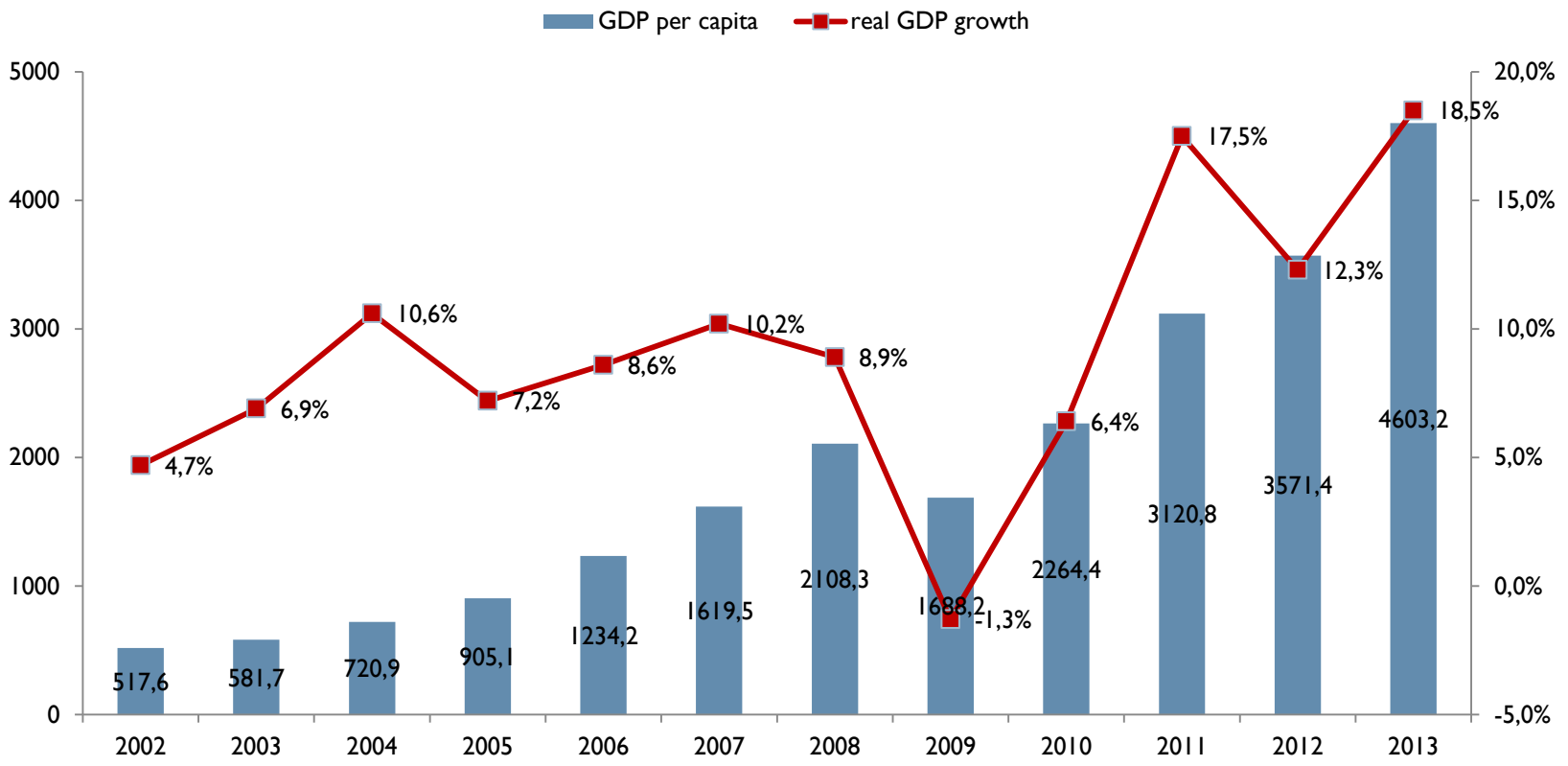
Mongolia: Overview of its economy and fiscal performance

Mongolia – country profile



- **Capital:** Ulaanbaatar
- **Land Area:** 1,564,000 sq.km
- **Population: 2.8 million** (with density of 1.7 per sq.km)
- **GDP per capita:** 3571 USD (2012)
- **Major industries:** Construction and materials, mining (coal, copper, molybdenum, and gold), Agriculture(food and beverages, processing of animal products)
- **Main export partners:** China 92.1%, Russia 2%, others 5.9%
- **Main export products:** Coal, Copper, iron ore, gold, and animal processing products.

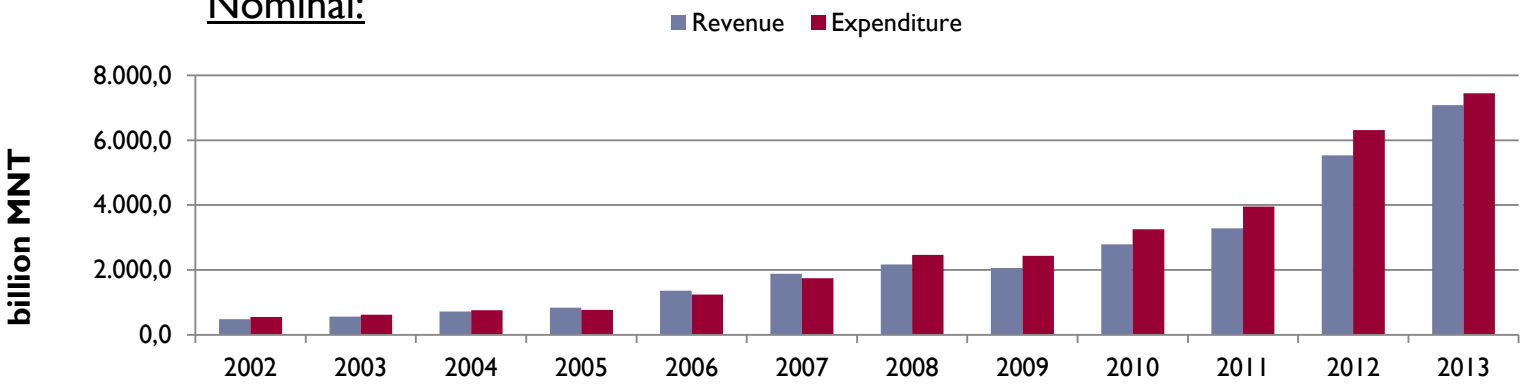
Economic performance:2002-2013*



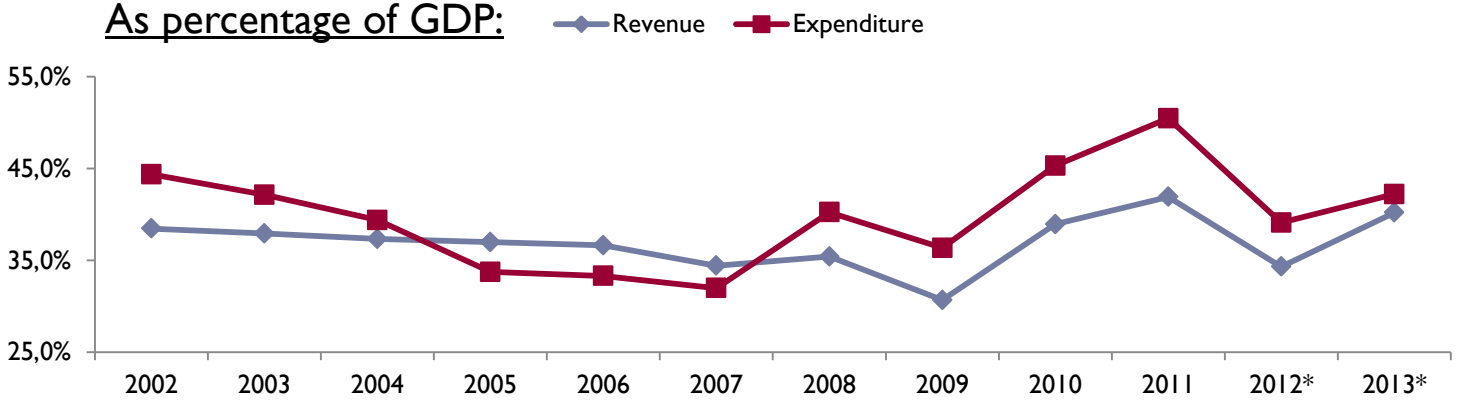
Recent years, Mongolian economic has been expanded enormously and all this growths are mostly accelerated by the mining industry boom.

Budget performance:2002-2013*

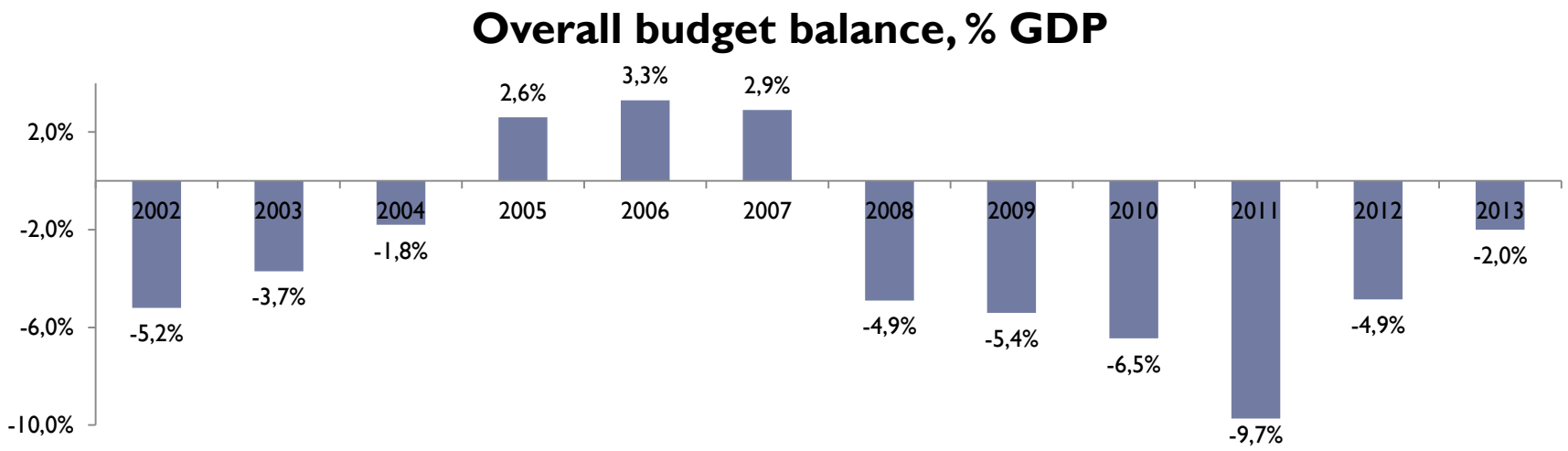
Nominal:



As percentage of GDP:



Budget performance:2002-2013*



- Budget revenue accounts for 30-40 percent of GDP over the years.
- There was a tendency to increase spending more on social welfare as budget revenue increased during 2005-2009.
- Due to the political promises made during parliamentary elections, the government have been spent heavily to increase salaries, and to distribute cash-handouts for citizens.

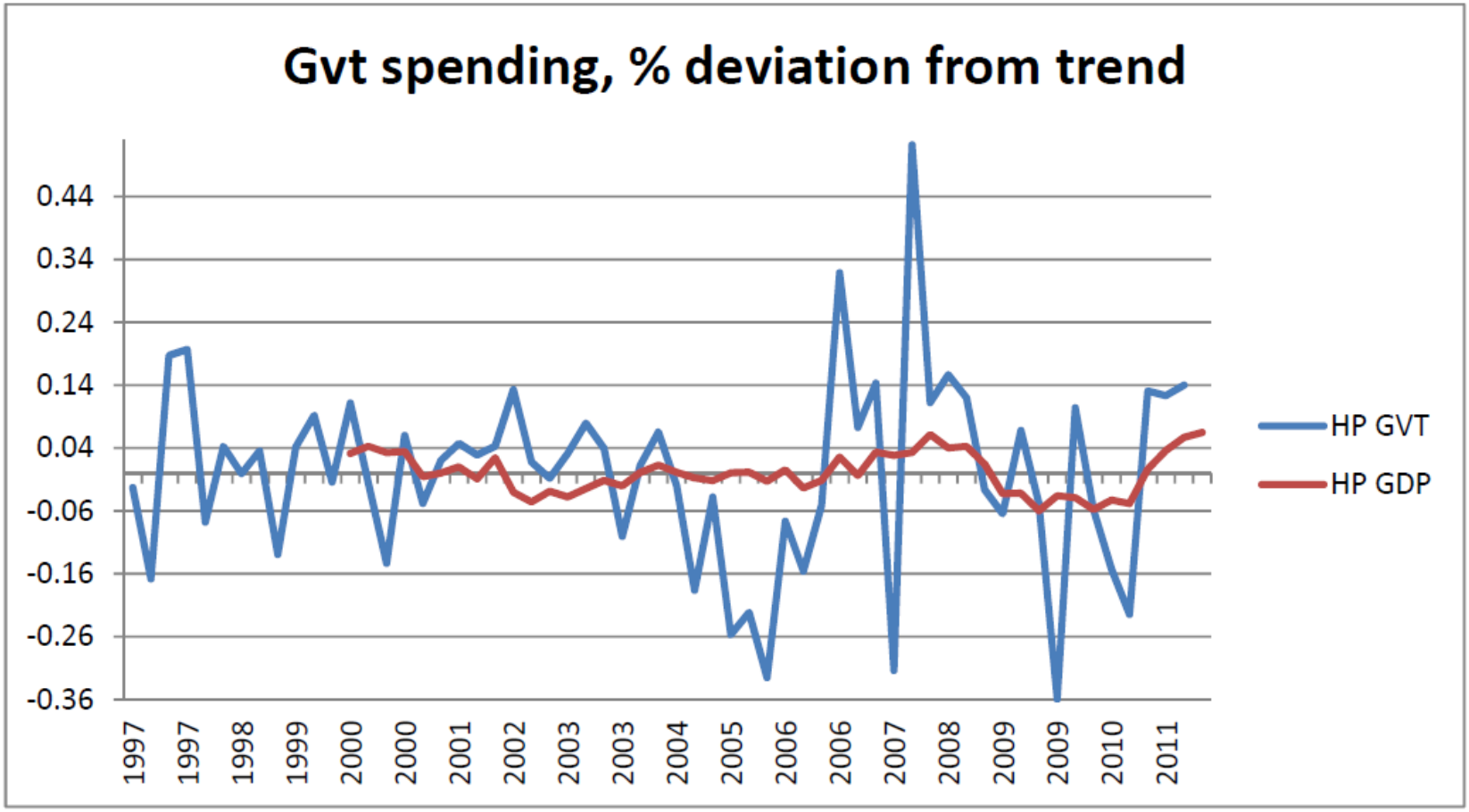


Figure 6: Percentage deviation from trend, GDP and government spending

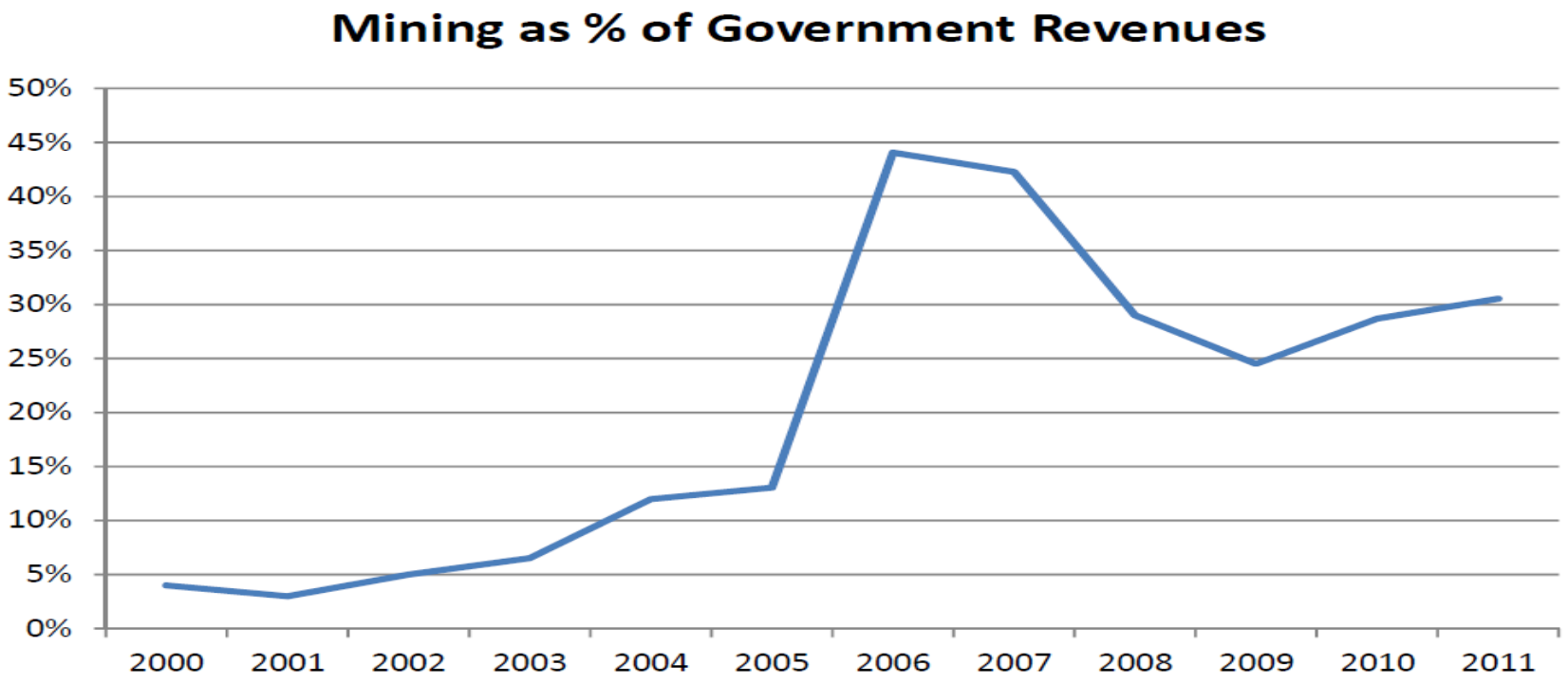
Mining revenue management issues

Mining taxation in Mongolia

- The current mining tax situation :
  - Business profits are taxed at 10% below 3 billion Tugriks ($2.3 million) and 25% above; salaries and work income are taxed at 10%;
  - The Windfall Profit Tax was repealed in 2010;
  - There has been a doubling of the royalty rate on some minerals from 2.5% to 5% in compensation for the loss of revenue coming from the repeal of the Windfall Profit Tax. Such payment is deductible for income tax purposes;
  - Mining license fee: $15 per hectare;
  - Mining license land use fee per hectare: $0.10 the first year, $0.20 for the second, $0.30 for the third, $1 for the fourth to six and $I.5 for the seventh to nine;
  - 20% withholding tax on dividends remitted abroad;
  - Import duty on foreign equipment, 5%;
  - A value-added tax of 10%. Because it is a consumer tax and commodities are traded globally, most mining nations including Mongolia eliminate the impact of such tax on mineral export sales and equipment purchases;
  - A variety of payroll taxes.



Mining contributions to the budget revenues



- In 2006, the wind-fall tax was introduced in mining sector;
- In 2010, the wind-fall tax was replaced by royalty tax;
- As of 2011, revenue from the mining sector accounts for 1/3 of total budget revenue.

Attempts to establish a Wealth Fund

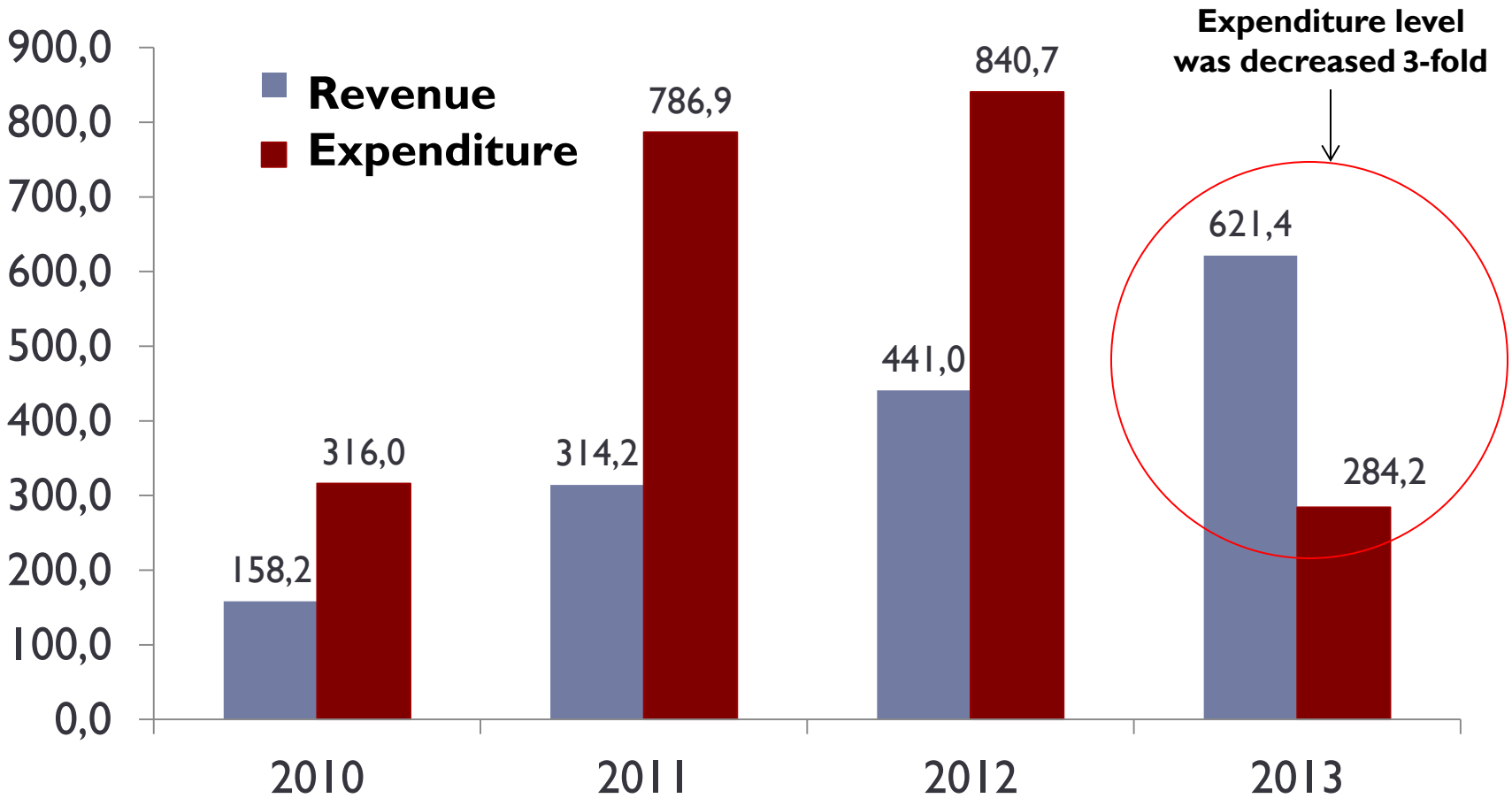
- Since 2007, the Government have tried to establish a Fund that accumulates revenue from the mining sector and can be used for the development of the country:
  - **The Mongolian Development Fund**(MDF) was set up by law in 2007
  - **The Human Development Fund** (HDP) was established by law, and replaced the MDF, in 2009.
- The main purpose of these funds were to accumulate the excess revenues from mining sector, and to target the resource for the economic /human development of the country.



Attempts to establish a Wealth Fund

Name of Fund	MDF	HDF
Legal environment	Mongolian Development Fund Law, 2007;	-Human Development Fund Law, 2009;
Objectives	To support economic development /targeting SMEs/, and to finance budget deficit due to a force major condition, to support children;	Accumulate the mining sector revenue as deposit, and distribute it to the citizens, equally;
Source of the Fund	Windfall tax revenue (gold, copper), Budget surplus;	70% of the Royalty tax, dividends pertaining to the Government, return;
Spending rule	distribute child money, cover budget deficit, and reserve wheat, fuel.	spend for cash-allowances, tuition fee, health and education service payment to the citizens
Institutional arrangement	Ownership - MOF, asset management-Central Bank.	Ownership - MOF, asset management-Central Bank.
Current status	Ceased	Still operating

HDF Performance (figures in bln MNT)



Challenges and problems

- During parliamentary elections in 2004, 2008, political parties compete with one another to give political promises such as cash-allowances, untargeted social welfare measures, etc;
- The MDF and HDF have been used as vehicles to fulfill these populist political promises;
- High inflation, and economic overheating due to the large amount of cash-allowances, and social welfare spending;
- In ability to implement counter-cyclical fiscal policies;
- In efficient public resource spending;
- Increasing public debt rather than accumulating a wealth. This creates intergenerational inequity.



Recent reforms in fiscal frameworks

3. Recent reforms in Fiscal Framework

- **Increasing Public Awareness** on flat cash-allowances, untargeted social welfare spending
  - In 2011, the leaders of all political parties signed a memorandum that stipulates not to compete with one another by giving political promises such as cash handouts to the citizens.
  - The idea of a fiscal stability mechanism is at the centre of the economic policy debate in Mongolia.
- During the term of previous parliament/2008-2012/, **several laws have been passed** to that goal, especially:
  - **Fiscal Stability Law, in 2010,** which sets principles on macro-fiscal management framework, special fiscal requirements, and establishes Fiscal Stability Fund, and puts certain limits on power of parliament in regard to budget approval.
  - **Integrated Budget law, in 2011,** which provides comprehensive principles and guidance on budgeting process.
- The purpose of these laws is to provide a framework for fiscal responsibility in the country.



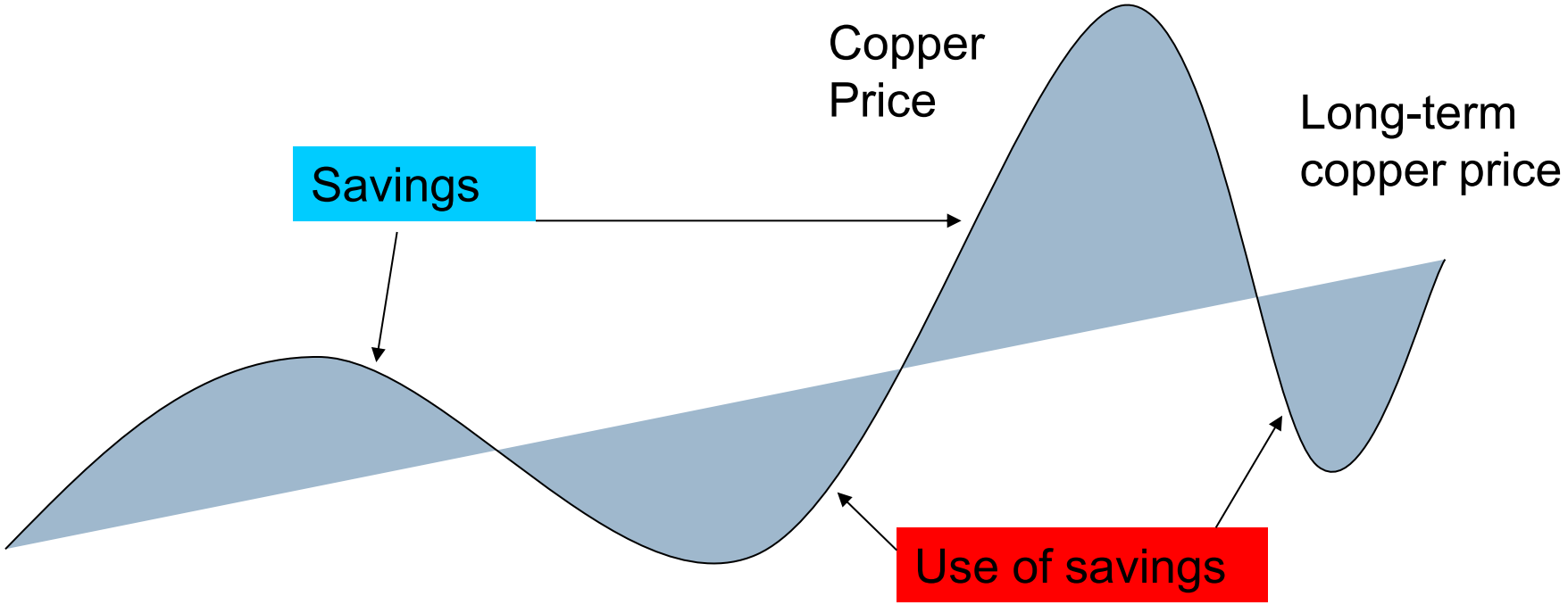
Special Fiscal Requirements by FSL

1. Budget revenue shall be estimated on structural basis;
   - Major minerals: Coal, copper (more than 3% of total budget revenue)
   - Prices of MMs are estimated based on past 12 years moving average, plus 3 year's projection.
2. The structural balance(SFB) of consolidated budget shall have a deficit of no more than 2% of GDP;
   - SFB >= -2% of GDP
3. Total Budget expenditure growth rate shall not be greater than the greatest of the non-mineral GDP growth rate of that particular year and the average of non-mineral GDP growth rate for 12 consecutive years;
   - Expenditure Growth(t) =< Greatest of [Non mineral GDP(t)] or [Average of Non-mineral GDP growth of past 12 years].
4. NPV of Government debt shall not exceed 40% of GDP.



Fiscal Stabilization Rule

Example: All income comes from copper



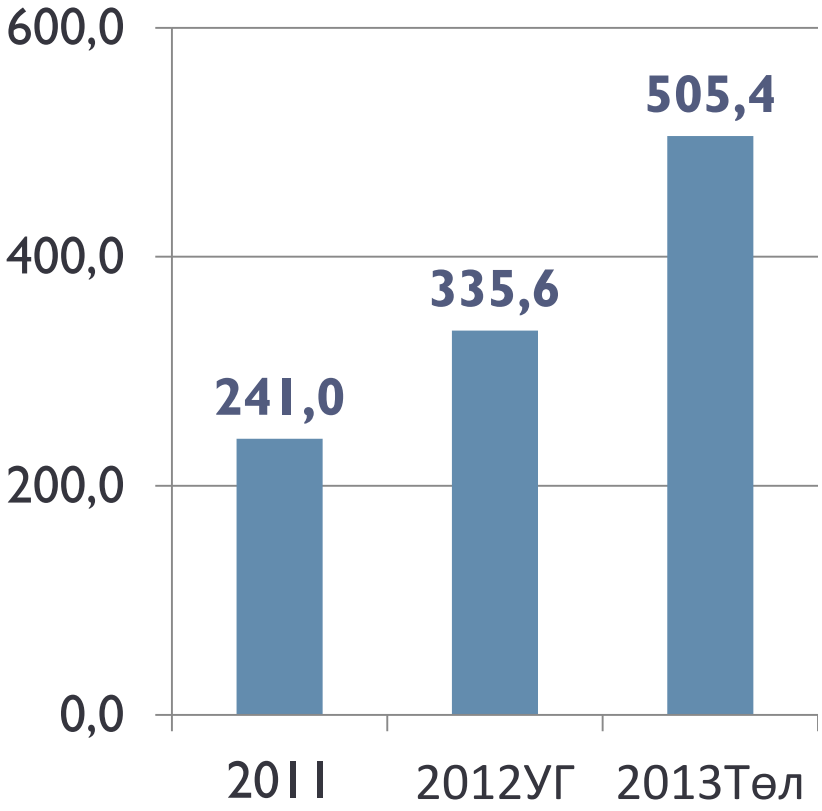
- The long-term copper price defines permanent income, contributing to have a countercyclical policy

The Fiscal Stabilization Fund

Rules in-revenue	Rules out-expenditure	Fund asset management
▪ Excess volatile revenue ▪ Budget surplus ▪ Unspent budget allocation from some special accounts(risk, reserve) in previous FY ▪ Return on investments from Fund Asset.	▪ Cover any gap in budget revenue if market price drops below the estimated structural price of minerals ▪ Transfer to the budget if the GDP growth rate equals to 0 or minus ▪ If there is a force major condition wich results a recovery cost from budget that exceeds the 5% of GDP	▪ Fund asset shall be more than 5% of the GDP in any fiscal year, and it must be liquid and safe. ▪ Central bank will manage the fund asset until it reaches to 10% of GDP. ▪ The amount that exceeded 10% of GDP, should be managed by joint decision of the MOF, and CB. It can be invested both in external and internal market for longer investment horizons.



The Fiscal Stabilization Fund



Since it's establishment, the Fund accumulated 335.6 billion tugrugs, which is equivalent to 300 mln USD, in 2 consequtive fiscal years. And it is expected to reach 500 bln MNT by the end of 2013FY.

The MOF is working with the Central Bank to start managing the asset in 2013.

Current Considerations on Sovereign Wealth Fund issues

Current considerations on SWFs in Mongolia

- The MOF has conducted a study "Managing wealth in Mongolia" with a support from the World Bank, and set of policy recommendations provided.

  As a follow-up of the study, the Government of Mongolia and the WB is jointly organizing an international seminar on SWF topic, in order to initiate policy debate in Mongolia.

  The main considerations for the Government now are as followings:

- Restructure the Human Development fund into a Saving Fund.
  - Ensure intergenerational equity, and avoid "Dutch desease"
  - To replace the depletable natural resources with interest earning financial assets.
  - Not allow the government to spend from the fund.
- Need for a fund future pension system reform, such as a Pension reserve fund.
  - To prepare and accumulate savings that can be used to fund the unavoidable pension system reform.
- Improve the institutional arrangements and governance settings of the SWFs in Mongolia.
  - New draft legislations are being prepared: draft laws on "Government financial asset and liability management" and on "Sovereign Wealth Fund management".
  - Current institutional arrangements is going to be revised.
- Institutional and personnel capacity building programs:
  - Need to build and improve national capacities in managing financial assets in global market.



THANK YOU FOR YOUR ATTENTION

