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## ECONOMIC FREEDOM AND “RABBITS CLUB”

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## ECONOMIC FREEDOM AND “RABBITS CLUB”

There is a volcanic archipelago, 150 kilometers away from the northwest shore of Africa. These islands with 3 million inhabitants, the Canary Islands, are a Spanish territory. Christopher Columbus used the islands as a last preparatory stop before his long journey to discover new territories. Later a large amount of gold was found on these islands making the Spanish empire even richer.

Today, millions of tourists come to these tropical islands with permanent warm temperatures throughout year.

The southern shore of the largest island, Las Palmas, was just empty hills and desert 20 years ago. But today, elegant villas, golf courses, race car circuits, congress halls, and luxury hotels are built here, and it became a destination for international events and tourism.

What is the mystery behind big Mongolian big projects almost all failing, while big projects in western countries usually finish on time and become economically efficient as planned? The main reason is economic freedom.

### ECONOMIC FREEDOM IN MONGOLIA

We can see it clearly from the World Economic Freedom Report 2018 by the Fraser Institute. Over the past two decades, the report shows that people have a better standard of living in countries (Hong Kong, Singapore etc.) with a higher degree of economic freedom, but in those countries (Venezuela, Libya etc.) with low freedom, there is more poverty and unemployment.

*The basics of economic freedom are personal choice, voluntary exchange, freedom to enter and compete in markets and protection of private property. Mongolia ranks 48th out of 162 countries with a 7.4 score out of 10. This is an average score of economic freedom in five broad areas including: size of government (8 points, 15th); legal system and property rights (5.5, 62nd); access*

*to sound money (9.39, 42nd); freedom to trade internationally (6.68, 104th); state regulation (7.26, 70th). Russia ranks 87th with 6.8 points, and China 108th with 6.4 points.*

And in the 5th area, state regulation, Mongolia received 8.44 points (88th) in the credit markets, 6.65 points (71st) in the labor market, and 6.69 points (62nd) in business regulations.

The main importance of [this index](#) is not just to show the comparison between the countries, but to determine in which areas of economic freedom a country has the lower points and to eliminate the reasons. In countries with economic freedom, people often live long in peace and prosperity. There is also a lower level of emigration of the people from the country.

## ► SWAYING RULE OF LAW

The rule of law means that all people and institutions equally obey the law and the state ensures equal enforcement for all. If this principle is not in place, a democratic country shifts gradually into a dictatorship, freedom of speech is restricted, the currency is depreciated, the economy goes bankrupt, the people are threatened by the armed forces and the country soon descends into chaos.

*The index shows that the main area where Mongolia's economic freedom is downgraded is the legal system and property rights (5.5). It is notable that Mongolia received a score of 3.8 in judicial independence; 3.77 for judicial impartiality; and 4.42 for the protection of property rights. All these areas have traditionally scored poorly.*

Today, the distribution of power between the parliament,

judiciary, and the executive branch of government have been indistinguishable since the Constitutional Amendment in 2000. A quarter of Parliament members are members of the cabinet. The President initiates laws and appoints the key members of the courts and the anti-corruption agency.

Mongolian citizens participate in democracy only on election day and in between elections just watch endless political "drama". Civil society is weak and does go beyond social media.

Equality before the law has not been the case for quite some time in Mongolia. Unexpected releases after sensational arrests or unenforced decisions of the court, and crime or corruption cases against policemen and judges has become a common social phenomenon.

## FREE RIDERS

The primary duty of the state is to protect a person's safety and property. There are many forms of property, such as individual, corporate, common, public and so on. If one gets exploited, it can directly influence other forms. Protection of property means property must be at least registered, which means transparency of ownership. However, the Mongolian government does not want to pursue this registration.

*When there is no registration or it is not clear who owns property, these assets are free and exploitable. In such situation, free riders usually come in, and Mongolians call the free riders "rabbits."*

The institutions that provide such opportunities to these "free riders" are the ruling political parties in Mongolia. These parties are converting our natural resources and land into goods for their own club. The club is closed, only for members, and their internal rules are precisely defined to protect their members interests. Members who break the rules are discriminated against, and hated by the

majority. The cases of fights between ex-MP Kh.Temuujin and his own DP and, between current MP L.Oyun-Erdene and his MPP are clear recent examples.

All state-owned enterprises, agricultural land, pastures, mining deposits, capital and aimag lands are owned by the MPP or DP. Today, the Erdenet Copper Corporation is owned 49 percent by the DP club and 51 percent by the MPP club and the two parties are fighting to take over each other. The heads or owners of law enforcement authorities, the Independent Authority Against Corruption, commercial banks, and large companies are all members of these clubs.

Mongols do not understand what they still own as almost all property is in the hands of these free riders. Thus, who will be responsible for our property and safety?

*Las Palmas, Spain  
2018.10.10* ■



### IS BUDGET PROPOSAL DEDICATED TO THE ELECTION?

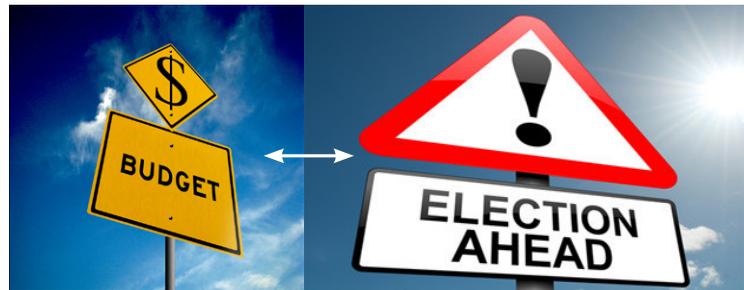
The state budget proposal to parliament involves months of negotiation until a compromise acceptable to all parties is reached. Parliament has begun their annual budget discussions but the President, who was present at the meeting critiqued the budget of putting an undue amount of emphasis on the 2020 election which is a year removed from the current budget proposal.

The president took particular exception to the proposal to allocate 5 billion tugriks to each constituency for the construction of kindergartens and schools among other infrastructure projects. He warned that such lofty aspirations will undoubtedly result in a multitude of unfinished projects by the time the election comes around. Hence, President said that he will veto the budget proposal if presented in its current state.

***While both revenue and expenses have increased, the disparity between expenditures and revenue is concerning. We are still spending more than we earn. The budget deficit decreased from 8% last year to 5.4% this year. This suggests that we are making progress, but we have to keep in mind that the government have significantly more foreign debt than last year.***

The government is coming up with new bonds with "beautiful" names: Mazaalai, Gerege, Khuraldai etc. Each bond is worth at least 500 million dollars and is earmarked for the payment of existing debts. The government is simply borrowing money to repay existing debts.

The Minister of Finance is now proposing budget deficits despite assurances of the contrary. In the European Union, the requirement is that budget deficits should not exceed 2 percent of the GDP.



The debt ratio of the government to the GDP is 70% in Mongolia and 60% in the EU. However, there is a substantial difference owing to exchange rates as our borrowings are in USD while our earnings are in MNT. This issue is in turn leading to draft legislation regarding exchange rates.

For a country like Mongolia, the devaluation of MNT is not an anomaly. There would have been a cushion if we had anything other than raw materials to export. The situation is exasperated by the fact that work on the new railway has not begun. It would have been a different story if the railroad, which would facilitate increased coal shipments to China would have been functional by 2019.

While the Minister of Finance said that the budget proposal was well-thought and calculated, President Battulga did not share his enthusiasm about the budget. Raw materials such as coal, copper and gold comprise 87% of our exports. Increasing coal production from 28 million tonnes to 42 million in a year is not feasible. Moreover, the question of whether the confidence in increasing copper prices is warranted remains to be seen.

Members of Parliament now have 5 billion tugriks at their disposal for projects within their constituencies. The fact that 70% of the 300 proposed 'objects' (e.g. kindergartens, hospitals and schools) planned using

those funds lack a feasibility study suggests that these funds are a form of corruption and an avenue for influencing votes. This exposes the irresponsibility of legislators who either assume that voters are stupid or apathetic. It is also disheartening to see the allocation of 10 times more funds to the constituency of the Minister of Finance than any other.

The impact of this budget on the private sector has not been discussed. Budget expenditures are 33 percent of the GDP, which is very high. An increasing budget deficit leads to more public debt which in turn increases domestic debt. The government spends more on the interest rates of those debts than any other project causing inflation and devaluation of the

tugriks.

Generally, this creates non-competitive sectors and businesses. One of the reasons why the budget and the economy are stagnant is the fact that the government sets the price for certain goods and services (e.g. utilities, education, healthcare). This regulation leads to the private sector lacking the motivation to get involved in those sectors as it becomes increasingly difficult to establish a competitive advantage. In addition to this, the exodus of private sector workers created by the non-competitive sectors and businesses is also detrimental to the economy.

## IS CURRENCY EXCHANGE RATE REGULATED BY LAW?

The exchange rate regulation legislation presented to parliament is a manifestation of an unsuccessful trend of Mongolian politicians seeking control of exchange rates through legislation. Exchange rates are like two goods and the government cannot control their prices although politicians tend to believe the opposite. Turkey, Venezuela, Zimbabwe and Russia have all attempted to regulate the exchange rate and failed.

When the President proposed this draft law to control exchange rates in June, it was rejected by the parliament. Now, parliament member Oyunchimeg is attempting to introduce another draft suggesting that the President is attempting to submit the legislation again. Four other members of parliament have also submitted a draft legislation that would regulate the exchange rate. If we restrict the exchange rate with this regulation, there will be a ceiling for money transfers to and from Mongolia and more currency control by the government. All of this would dull the economic dynamics in Mongolia and make the market less competitive. It is not a matter of believing in dollars as the government purports the legislation to be.

The government is becoming unreasonably large

and misusing our money. We don't have a full report on Chinggis and Khubilai bond spending's because the two leading parties have an agreement that the funds would be distributed within their own parties. As there are no measures to hold those politicians accountable the burden of the debt is placed on the taxpayers. The recent attempts to regulate exchange rates are little more than political maneuvers that if successful, would devastate and already stagnant economy.

***The only successful tool for keeping exchange rates stable is the establishment of a currency board. This currency board can be created within the Central Bank and tie the tugrik to the dollar by agreeing to an equivalency (e.g. 1 USD = 2500 MNT). This would put some sectors in a more favorable position than others but we would have to follow through.***

It is hard to convince politicians to change the draft law as they are more concerned with the short term effects i.e. their reelection rather than the long term consequences for the country and economy. A strictly regulated exchange rate might benefit them in this election cycle but the legislation will yield increasingly devastating effects as time goes on.

## THE MORTGAGE LOAN REFUSED BY THE GOVERNMENT



In 2019, the government was due to have a mortgage loans transfer back, on its own balance from Bank of Mongolia under the IMF's EFF program. However, it was decided that it would not happen. The balance of Bank of Mongolia remains at 4.2 trillion tugriks. The two possible options available is either for the government to take on the balance of the loan or for the Mongol Bank to write off the debt as bad loans which it is not willing to do.

The government can't take such a burden, even if it wanted to. The proposal was initiated by Mongol Bank, not the Mongolian government, so it has a more lobbying character. In 2013, Mongolia had borrowed a lot of money and introduced the bonds. Then they had the idea of introducing a mortgage scheme, which was most likely pressed for by construction companies that had built too many expensive buildings.

*Those companies soon realized that individuals that could afford the houses already had significant real estate holdings and the individuals that needed apartments could afford the prices. It was here that those companies decided to introduce mortgages at 8%, at more than twice less than the 20% market rate. However, this would result in real estate prices doubling. It is simply not sustainable to provide goods and services at below half of the market price. The end result is 40,000 unoccupied homes and 200,000 people seeking apartments in Mongolia.*

That is the paradox that we have come to, thanks to politicians. The refusal of the government to take on the portfolio will create more debts and it is not sustainable. The repayment is coming from a fraction of people that have managed to secure real estate and take out mortgage loans. The new initiative prioritizes people living in the Ger district, or apartments being built in the Ger district for the mortgages is however a promising one. If successful that program will increase the purchasing power of those most in need for housing.

The President has also mentioned a need to change the structure of our state. How long will it take, who will implement these changes and how, are currently open questions. It is probably the best to conduct a referendum during the elections in 2020, in order to find out which form of government people would support the most.

*This review has been edited here for space and clarity. You can watch the full 30-minute review on the Defacto website [\[HERE\]](#).*



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