

## Industrial Diversification of Mongolia

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Before 1990's Mongolian economy was closely integrated with the economy of the former Soviet bloc countries, with very little interaction with the rest of the world. After the collapse of socialism, domestic industry was subject to sudden disruption owing to external markets and suppliers. Mongolia's macroeconomic, trade and investment policies, since the country's transition to a market economy, was aimed at promptly adapting to the changing economic environment, as well as resolving the country's economic challenges, mitigating the impact of transition and integrating with the world economy.

In the mid 1990's, the Government of Mongolia, with the objective of stabilizing the economy, opted for a transition strategy, which is popularly known in economic literature as "shock therapy". Prices were liberalised, state-owned enterprises were denationalized, and a free trade regime was introduced. Such a strategy not only created unfavorable economic environment for the domestic industry but also led to a substantial decline in its production. The industrial sector was affected by "predatory" imports and industrial output gradually decreased. The share of industrial sector in the country's GDP fell from 26.1 to 6.1 percent between 1990 and 2000.

As a result of privatization many industrial enterprises found themselves in inexperienced hands and some of them even became insolvent and went bankrupt, while some others become unprofitable. These unprofitable enterprises were allowed to go out of business, reducing output, employment and income. Measures taken to stabilize the economy and to encourage foreign and domestic investment have enabled Mongolia to salvage its economy from deep crisis in the early years of transition. The economy has been on an upward trend since 2000, and average annual GDP growth rate during 2001-2004 was 8.3 percent. Subsequent decline in global commodity prices eroded those gains, and put an end to the commodities gold rush. Mongolia is now suffering from double-digit fiscal deficit, depleted international reserves and a severely weakened currency owing to falling commodities prices and economic slowdown in China. The World Bank estimates that Mongolia's economic growth will further slow down to just 0.7% in 2016 from 2.3% in 2015.

Although Mongolia's economic performance had been successful during the first decade of the new millennium, it remains dependent, to a large extent, on external factors, including price and demand of raw materials, and in particular on the state of the economy of its major markets. In this regard, it is widely recognized in Mongolia that although the country has come a long way towards restructuring its economic system, the under-development of the domestic industry remains a serious challenge that is directly linked with the present balance-of-payment crisis and national currency depreciation.

In an increasingly globalized world, for a small country like Mongolia, it stands little chance of competing with its much larger and stronger competitors because of the scale of its economy, caused by the small size of production and high transportation cost, resulting from its unique geographic location. This clearly raises the question as to what Mongolia needs to do in order to overcome the present challenges and how to manage the diversification of its industry. Development experience from around the world has shown that the determinants of industrial competitiveness are many and complex. However, in such a huge world of production there should be certain commodities in which this small economy could have a comparative advantage. It is clear that as Mongolia pursues fairly open trade regime, the economy should be based on the industrial sector in which the country has a certain comparative advantage.

The creation of industrial linkages through clusters could be the best way to diversify Mongolia's industrial sector. Clusters give opportunity to utilize comparative advantage of the country and to increase domestic value added. In Mongolia, comparative advantage lies in natural resource-intensive industries such as mining and agriculture, of which mining is capital intensive and generates large part of income necessary for further economic growth, while agriculture is labor intensive and generates jobs for people. However, despite the leading role played by mining as the engine of growth in recent years, agriculture has not been successful in its growth and productivity. With the exploitation of world-class mining projects, Mongolia can assure development opportunity that could help develop powerful industrial cluster and ensure the country enters into a new era of its development.