# Resources-to-Cash: a Cautionary Tale from Mongolia


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**Research aims:**
This research project investigated the practice of direct distribution of natural resource wealth in developing countries using Mongolia as a case study, by carrying out:

- desk-top research and analysis
- interviews with government, NGO, academic and community representatives in Mongolia
- two focus group sessions in Mongolia


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# Summary of Action Research Activity

**Resources-to-cash: a cautionary tale from Mongolia**

Recently, the direct distribution of natural resource wealth through cash transfers ('resources-to-cash') has been recommended to help avoid the resource curse. The rationale is that by removing the resources from the hands of government, incentives which undermine strong institutions will be removed, accountability and transparency will grow and the benefits of natural resources will be more equitably shared. However, there is little evidence to test these claims.

This paper tells the story of Mongolia's experience with its resources-to-cash transfers. Mongolia is perhaps the only developing country that has actually introduced a resources-to-cash scheme. The findings of this study are based on desk research supplemented by fieldwork undertaken in Mongolia in September 2014. Interviews were conducted with government officials, international development organisations, civil society and academia, and several focus group sessions were held with different socio-economic groups in an urban area and in a rural district.

The overall finding is that direct distribution has been to date a failure in Mongolia. The universal program delivered significant short-term benefits, greatly reducing poverty and inequality for a couple of years, but it was poorly implemented and unsustainable. Once a political winner, it has since become deeply unpopular, and is viewed by the public as wasteful and unaffordable.

Overall, Mongolia is a cautionary tale. The potential benefits of resources-to-cash should certainly not be dismissed on the basis of one poorly designed and implemented instance. Rather, the lesson of the Mongolia experience is that resources-to-cash needs to take its place alongside, rather than be favoured over, other policy instruments that have been recommended for resource-dependent economies.

Australian National University

Development Policy Centre
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ANU College of Asia & the Pacific

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## Abstract

Recently, the direct distribution of natural resource wealth through cash transfers ("resources-to-cash") has been recommended to help avoid the resource curse. Mongolia is perhaps the only developing country that has actually introduced a resources-to-cash scheme. While the scheme has showed mixed results, overall it has been a failure, losing political and public support because of design and implementation flaws. One should not dismiss the potential benefits of resources-to-cash on the basis of one, poorly designed and implemented instance. Rather the lesson of the Mongolia experience is that resources-to-cash needs to take its place alongside, rather than be favoured over, other policy instruments that have been put forward to avoid the resource curse.

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**Resources-to-cash: a cautionary tale from Mongolia**

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## Introduction

The number of resource rich countries has grown rapidly. Countries rich in resources may suffer from the "resource curse", and develop at a slower pace than those without such resources (Auty 1993, Sachs and Warner 2001). Policy options for governments to avoid the resource curse are critical.

Recently, the direct distribution of natural resource wealth through cash transfers has been recommended as one way to avoid the resource curse. By removing resources from the hands of government and putting them in the hands of the people, incentives to undermine institutions will be removed, accountability and transparency will grow, and the benefits of natural resources will be more equitably shared. Or so the arguments run.

But what about the actual experience with so-called "resources-to-cash" transfers? There is virtually no literature on such transfers in developing countries.

This paper tells the story of Mongolia's experience with its resources-to-cash transfers. Mongolia is perhaps the only developing country that has actually introduced a resources-to-cash scheme. Yet its experience has been little studied. By summarising and assessing Mongolia's experience, this study aims to fill that gap.

Section 2 provides a brief overview of the relevant literature on the resource curse and resources-to-cash. Section 3 gives an introduction to Mongolia, and Section 4 describes its experiments with resources-to-cash. Section 5 analyses whether Mongolia introduced a resources-to-cash scheme (yes), and whether it should be regarded as a success (no). Section 6 discusses the lessons from Mongolia and concludes.

## 1. Resources-to-cash

When possession of natural resources confers automatic wealth, those with access to the resources, government officials or elites, are more likely to engage in rent seeking and corrupt behavior, preventing or undermining the emergence of democratic institutions that promote accountability and transparency (Liete and Weidmann 1999,

Aslaksen 2007, Petermmann, Guzma and Tilton 2007, Collier and Venables 2009). Further, since having resource wealth removes the need for a government to collect tax from the general public, citizens may feel less empowered to demand provision of public goods and services or demand that public funds are spent in an efficient way (Devarajan, Le and Raballan 2010, Robinson, Torvik and Verdier 2006). Hence, the resource curse.

The direct distribution of resources has been proposed by various authors as a way to avoid the resource curse. At its core, resources-to-cash involves the transfer of natural resource rents to citizens through cash transfers. This is argued to have a number of benefits (Moss 2011). First, by removing natural resource wealth from the hands of government, the incentives for rent seeking would also be removed. Second, citizens would have additional incentives to monitor government behaviour because of their direct stake in resource revenues. Third, lacking resource rents, governments would have to generate revenue in large part through income taxes, establishing accountability for the state as a provider in return for taxpayer money. Fourth, cash transfers would ensure a better distribution of natural resource wealth among citizens.

Sala-i-Martin and Subramanian (2003) and Birdsall (2004) were the first to propose the direct distribution of resource revenues to citizens. Devarajan, Le and Raballand (2010) advocated for the introduction of this type of scheme in some of Africa's new oil producing countries. The Centre for Global Development has been championing the initiative since 2010 with an ongoing series of working papers[1] and most recently published a book on the subject (Moss, Lambert and Majerowicz 2015). Other authors to endorse the proposal include Segal (2010), Diamond and Mosbacher (2013), and Donald Kaberuka, the President of the African Development Bank (AfDB).[2]

[1] For all of the Centre for Global Development's working papers on Oil to Cash, see www.cgdev.org/initiative/oil-cash-fighting-resource-curse-through-cash-transfers.

[2] Kaberuka endorsed distributing about 10-20 percent of oil revenues in cash at a forum in Addis Ababa in November 2014.

A few critics have spoken out against the proposal. Gupta, Segura-Ubiergo and Flores (2014) are sceptical because the hypothesis that transfers would change state incentives and institutions remains untested. Gillies (2010) cautions that the anticipated benefits of direct distribution rests on many assumptions that probably do not hold in the developing contexts for which the policy is targeted.

But what about the evidence? The most often cited case of success is Alaska. In 1980, the citizens of Alaska voted to amend the state constitution to establish the Alaska Permanent Fund, and since then a portion of realised profits from oil revenue investments has been distributed to all qualified citizens.[3] However, the size of these transfers is modest compared to actual oil earnings. Cash transfers are not taxed back by the Alaskan government. Significantly, at the time of oil discovery, Alaska was already a developed state with a strong institutional setting.

Iran has had an unconditional cash transfer program since 2011, funded by for the withdrawal of fuel subsidies (Tabatabai 2012). Bolivia, Timor Leste and Venezuela are all resource-rich countries with social protection programs.

In none of these developing countries has there been a stated link between cash transfers and natural resource rents. Mongolia attempted to put in place such a link. Indeed, as far as we are aware, it is the only developing country that has actually implemented a resources-to-cash model. However, Mongolia's experience has been little studied. While there are some analyses of its transfer schemes (Budragchaa et al 2007, Gankhuyag and Banzarch 2014) none approach the issue explicitly from the angle of what it has to say about resources-to-cash. The recent book by Moss, Lambert and Majerowicz (2015) gives a short and open-ended summary of Mongolia's experience with its cash transfers, refraining from making any overall assessment, saying only that the success of its scheme "remains to be seen" and that the program is "half-way there".

[3]For details of the Alaska Permanent Fund Corporation, see www.apfc.prg.

## 2. Mongolia

Mongolia is a landlocked country in east-central Asia, bordered by Russia to the north and China to the south. With a population of 2.8 million people and a landmass of 1.6 million square kilometres, it is the least densely populated country in the world. Less than one percent of the landmass is arable, and the country has extreme climate patterns that see winters regularly reach minus 40 degrees Celsius. Traditionally, most of Mongolia's population has been agrarian and nomadic or semi-nomadic, but in recent years Mongolia has become increasingly urbanised, with 60 percent of the population now living in the capital, Ulaanbaatar.

Mongolia was under foreign rule for centuries and one of the earliest countries to embrace communism in 1921. The country has undergone a rapid transition since 1990; the fall of the Soviet bloc ushered in an era of political and economic changes.

Mongolia peacefully transitioned in 1990 from one party rule under the Mongolia People's Revolutionary Party (MPRP) to a constitutional republic with a freely elected parliament. Since then, the MPRP and the Democratic Party have dominated Mongolian politics. A fragility of allegiances and fledging institutions have resulted in a relatively unstable political environment, characterised by frequent changes of governments and prime ministers.

The transformation from a centrally controlled planning system to a market economy occurred swiftly with harsh consequences. The collapse of external subsidies and traditional trade links with the USSR devastated the economy. GDP fell by more than 20 percent during 1990-1992, inflation peaked at 325.5 percent in 1992 and unemployment rose quickly. Extensive social service networks established during the Soviet years quickly eroded. Human development indicators that previously exceeded those of other low income countries also fell. Household surveys in 1998 recorded that 36 percent of the population lived in poverty, and 20 percent in extreme poverty (Fritz, Finch and Byambatsogt 2008).

Supported by international development institutions, the government adopted tough liberalisation measures and the economy started a steady recovery in the mid-1990s.

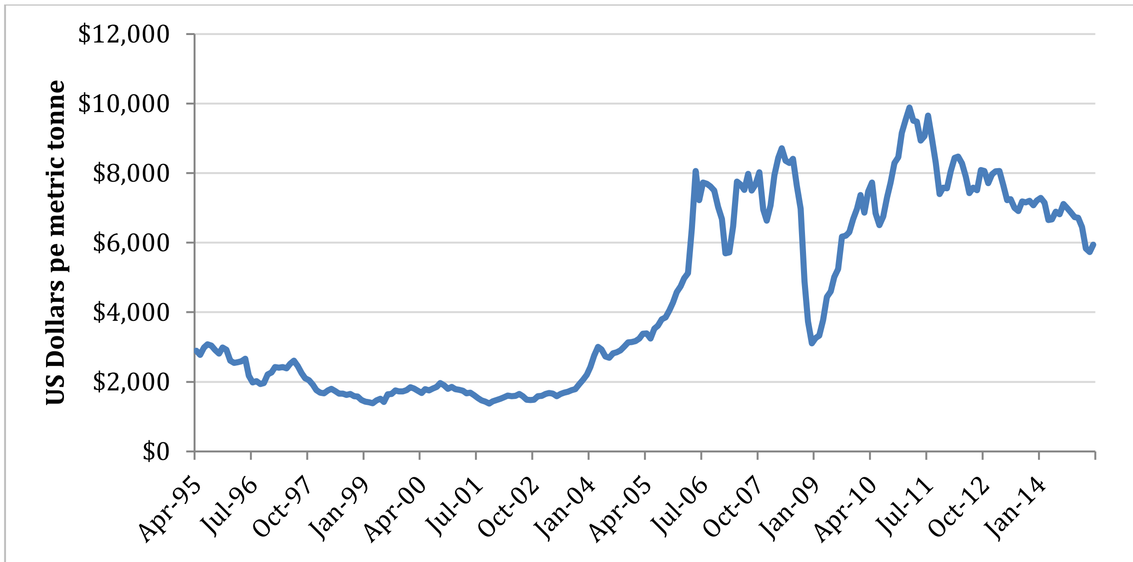
This growth was somewhat stalled by *dzuds,* extreme winters, in 2000/2001 and 2001/2002, during which significant numbers of livestock were lost.

Mining is very important to Mongolia. Past Soviet support enabled the initial discovery of significant deposits of coal, copper and gold in the 1970s and the development of several state owned mines.  The economic recession during the transition and low commodity prices in the early 1990s saw the mining industry stagnate. This was until the mid-1990s when, in line with other economic liberalisation measures, attractive foreign investment arrangements were put in place to revive the mining sector (Gankhuyag and Banzragch 2014).

In large part due to the rapid rise of copper and gold prices (see Figure 1), mining started accounting for an increasing portion of GDP (see Figure 2) and annual GDP growth averaged almost 9 percent between 2002 and 2008.

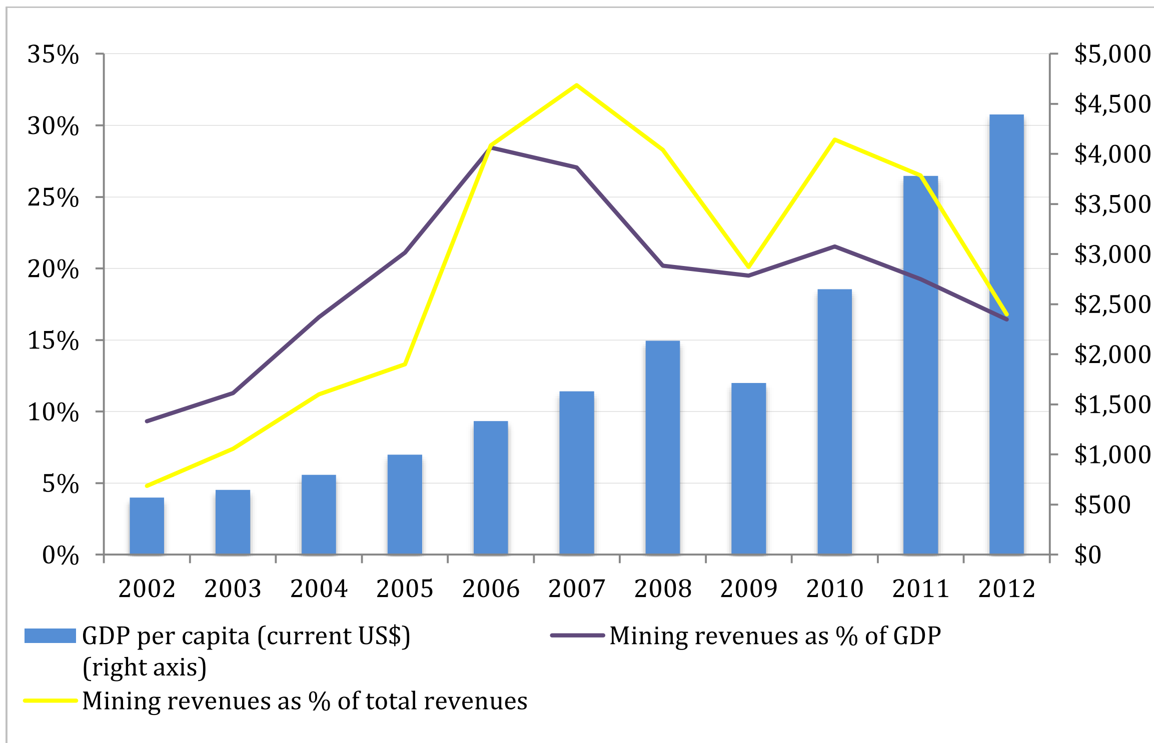
The global financial crisis and crash in copper prices in 2008 revealed Mongolia's vulnerability and mineral dependency. However, as the copper price rebounded in the following year, Mongolia's rapid growth rates resumed. In 2011, GDP growth of 17.3 percent made Mongolia the fastest growing economy in the world.

**Figure 1: Copper prices 1995-2014**




*Source: www.indexmundi.com*

**Figure 2: GDP per capita and mining revenues as % of total revenue and GDP**

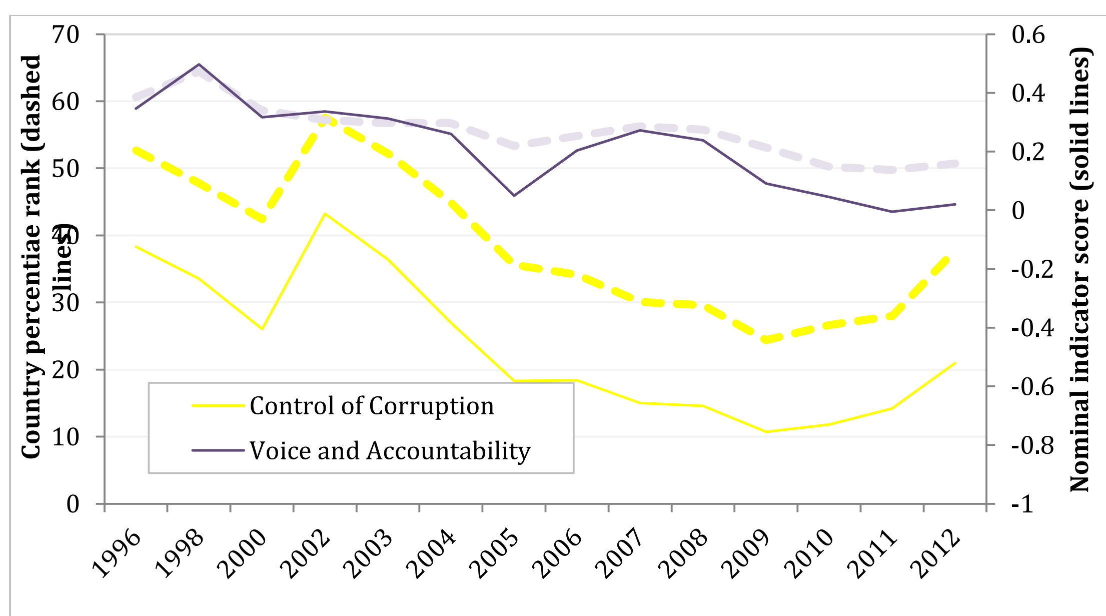



*Sources: Data for GPD per capita (current US$) from World Development Indicators, The World Bank, and for mining revenues as % of GDP and total revenues, from the Nation* www.1212.mn.

Simultaneously, concerns about the lack of shared benefits, environmental degradation and the perceived unchecked, rapid expansion of mining became increasingly common among the populace and government policies responded with a nationalist turn. In 2010 and 2011, exploration licenses stopped being issued and an international bid to develop Tavan Tolgoi, a major coal deposit, was cancelled. Development of Oyu Tolgoi, the largest copper-gold deposit projected to account for a third of Mongolia's GDP when at full production, was stalled for two years as the government attempted to renegotiate the contract for a bigger share of ownership. These events led to a marked decline in capital investment and corresponding shrinkage in mining output and growth.

In recent years, Mongolia has struggled to maintain the strength of its institutions and avoid corruption. In a 2011 study, Mongolia ranked amongst the highest of non-fuel economies in terms of vulnerability to the resource curse, based on its mineral dependence and economic and institutional development (Haglund 2011). Figure 3 shows Mongolia's performance against the 'Control of Corruption' and 'Voice and Accountability' World Governance Indicators from 1996 to 2012. It can be seen that Mongolia's scores and percentile ranks have experienced a downward trend, with a slight upturn for 'Control of Corruption' since 2011.

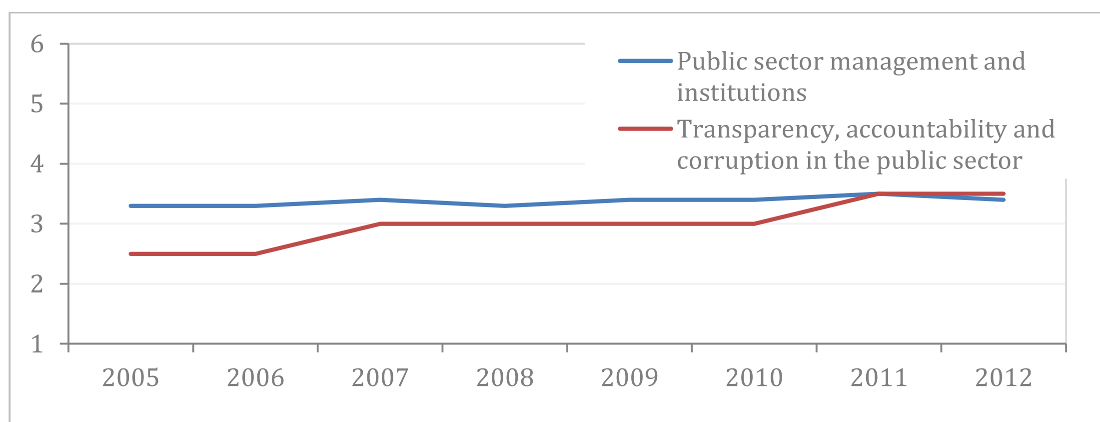
**Figure 3: World Governance Indicators, Mongolia 1996 – 2012**




*Source and notes: Worldwide Governance Indicators, The World Bank.. The solid lines correspond to the right axis which shows the raw score (between -1 and +1), with higher scores indicating better outcomes. The dashed lines correspond to the left axis, showing the percentile rank of the country, or the percentage of countries that rank below it. The first four entries are biennial.*

There has also been a modest improvement in recent years in Mongolia's rating for "Transparency, accountability and corruption in the public sector", one of the World Bank's Country Policy and Institutional Assessment (CPIA) indicators, though not in the "Public sector, management and institutions" (Figure 4).

**Figure 4: Country Policy and Institutional Assessment scores, Mongolia 2005 – 2012**



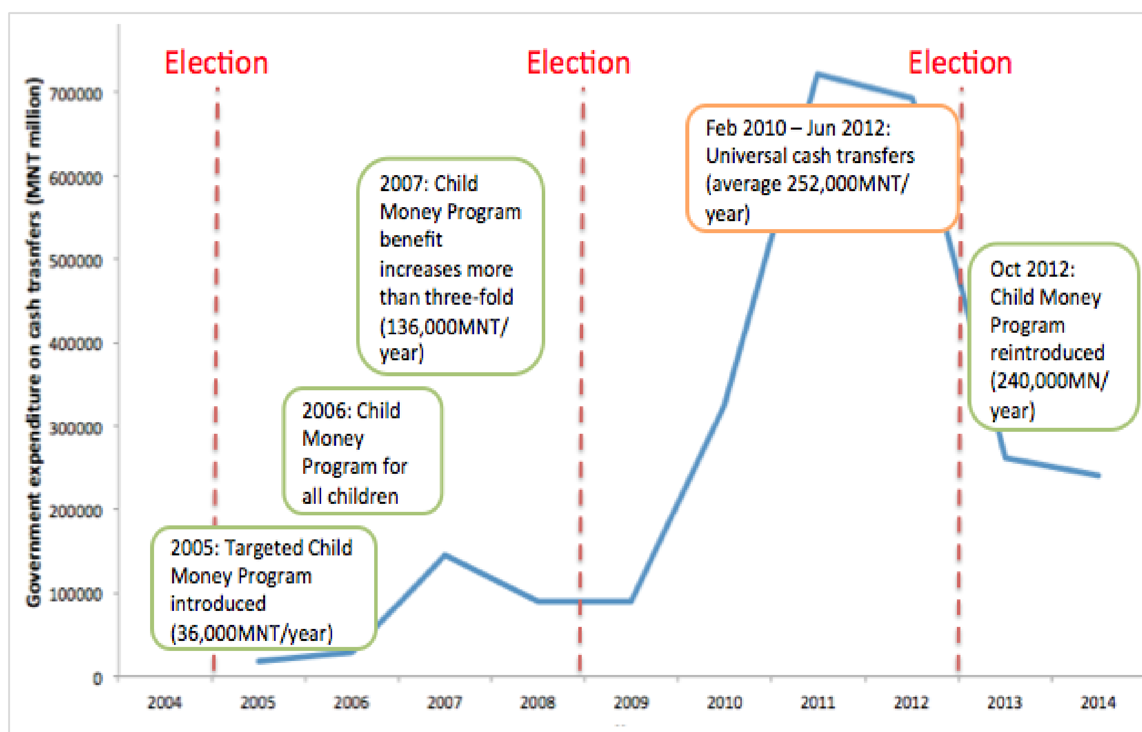

*Source and notes: Worldwide Governance Indicators, The World Bank. CPIA scores are between 1 to 6, with higher scores corresponding to better outcomes.*

In 2011, the Government established an Independent Authority against Corruption, and in 2012 Parliament passed Anti-Corruption and Freedom to Information laws. Mongolia has also reached full compliance with the Extractives Industries Transparency Initiative (EITI), and made significant improvements in its Open Budget Index. Whether these measures can make a real difference remains to be seen, but they may explain these recent improvements in accountability scores.

## 3. Resources-to-cash in Mongolia

As summarised by Figure 5, Mongolia's experiment with resources-to-cash has been through several phases. Annex A has a more detailed summary, and the text below tells the story.

**Figure 5: Major phases of the 'resources-to-cash' program in Mongolia**




## Targeted Child Money Program: January 2005 – June 2006

By 2004, the prospect of a mining boom had become well known. The Democracy Party's campaign platform for parliamentary elections in 2004 included a proposal for the introduction of a new social benefit, the Child Money Program, under which every child would receive 10,000 Mongolian tugriks (MNT), about US$8.30, per month. The popularity of this policy put the Democracy Party a close second in votes to the Mongolian People's Revolutionary Party for the first time, forcing the formation of a coalition government.

Climbing copper prices and increased tax revenues delivered Mongolia its first surplus budget in 2005, and the Child Money Program was introduced.[4] In line with the newly endorsed Social Security Sector Strategy Paper, the program provided targeted rather than universal assistance. The program gave 3000MNT (US$2.50) per child per month

[4]For a complete review and impact study on the initial Child Money Program, see Budragchaa et al 2007.

to families with at least three children who lived under the Minimum Subsistence Level.[5] The transfers were also conditional. Children had to be up to date with mandatory vaccinations, living with their parents, not engaged in harmful forms of child labour and enrolled in school if older than eight years of age.

Procedures for enrolment in the program were set out under the 2005 Social Welfare Law. Citizens had to register with the local administrative office, complete a proxy means survey at the district office to pass the poverty criteria, and supply documentation including parents' national identification cards, marriage certificates, children's birth certificates and verification of vaccinations and school enrolment. If approved, the household would receive a booklet, which would be stamped monthly by the social welfare officer to authorise benefits collected at designated banks.

The lengthy administrative process was problematic. It was Mongolia's first use of proxy means testing methods and high inclusion and exclusion rates hampered the credibility of the system (Fritz, Finch and Byambatsogt, 2008). In addition, the time taken to travel to district centres to submit applications and collect benefits often deterred the most vulnerable from accessing the system. Many did not have all the required paperwork and costs to have copies reissued were prohibitive.

Due to these problems and other public complaints, from July 2005, the requirement that eligible households had to have at least three children was dropped. Other conditions for eligibility were retained.

[5] The minimum subsistence level is the official measure of the poverty line, defined by the National Statistics Office of Mongolia.

### Universal Child Money Program: July 2006 to December 2009

In May 2006, as copper and gold prices and government revenues continued to climb, a new law made all children eligible and also introduced benefits for newly married couples and newborn children.[6] Universal benefits commenced in July 2006.

Concurrently, the Windfall Profits Tax Law was introduced to capture a higher share of mining profits. All revenues entered the newly created Mongolian Development Fund (MDF), the government's first attempt at a sovereign wealth fund. The Law held that MDF funds would be used equally for: (i) stabilising unplanned budget deficits; (ii) investments aiming at increasing domestic economic capacity and at supporting small and medium enterprises; and (iii) support of children and families. The MDF was the first effort to legislate the link between government resource receipts and cash transfers.

In January 2007, the MDF supported an increase to the universal Child Money Program by an additional 25,000 MNT (US$21.36) per quarter, nearly quadrupling the annual benefit, from 36,000MNT (US$30.76) to 136,000 MNT to (US$116.19) per child per year.

### Human Development Fund / Universal Payments: February 2010 to June 2012

The popularity of the Child Money Program campaign four years earlier, and the fact that mineral revenues had since doubled to 28 percent of GDP, resulted in the Democratic Party campaigning for a policy under which *every* Mongolian would receive benefits of 1 million MNT (US$855.17). The Prime Minister and MPRP leader at that time criticised the policy, arguing that Mongolia's economy could not afford such a scheme. Yet, shortly after, the MPRP itself announced a policy to distribute benefits of 1.5 million MNT (US$1,282.75) to each citizen. Neither party released any details of how

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[6] Law of Mongolia on Granting Child Benefit and Rendering Pecuniary Aid for Children and Families, passed on 5 May 2006.

they would fund such a policy, the implementation of which would have equated to 65 percent of Mongolia's GDP in 2008.

Despite the MPRP winning a slight majority of seats in the June 2008 elections, protests and unrest around claims of election fraud led to another coalition government being formed. Against the strong advice of international development institutions, a cash transfer of 1.5 million MNT benefit to each citizen was included in the Government of Mongolia Action Plan 2008-2012.

In late 2008, a dive in copper prices and the global financial crisis triggered a domestic economic emergency. Government revenues plunged and new policies were frozen. Parliament approved official loans of US$200 million and the IMF contributed US$187 million in an emergency loan, conditional on an agreement to rescind untargeted social transfers.

By late 2009, the copper price had rebounded and optimism returned with the signing of an investment agreement with Rio Tinto for the Oyu Tolgoi mine, one of the largest unexploited deposits of copper in the world.

The government responded with the Human Development Fund (HDF) Law in November 2009. The purpose of the Fund was to "create and grow sustainable permanent resources to collect and evenly distribute". The HDF was to have the same function as the MDF but on a much larger scale. Like the MDF, the HDF was both to accumulate funds and to fund distributions. However, the legislation did not delineate boundaries or set limits for either function. Expenditures were to be for health insurance and pensions, housing payments, cash, and medical and education service payment. The 2010 cash transfer was set at 120,000MNT (US$89.08) per person. This would cost 324 billion MNT, more than three times as much as the 2009 Child Money Program.

Universal transfers commenced in February 2010. Citizens had to provide personal identity documents to register for the program. This caused some logistical delays but largely prevented fraud or multiple benefit collecting.

In early April, protests broke out when transfer payments fell behind schedule. In what may have been an early attempt to curb cash expenditures, the government tried to offer provision of extra social welfare services instead, but negotiations with protesters stalled until the government agreed to constitutional amendments, transparency reporting requirements and a timetable for cash handouts.[7]

Monthly transfers of 10,000MNT (US$7.42) were distributed between August to December 2010, and of 21,000MNT (US$16.57) from January 2011 to June 2012. Transfers occurred on the 15th of each month. Whenever a delay occurred, protests would result (The Economist, 2012).

HDF revenues from realised dividends and royalties were far below committed expenditures. Initially this gap was filled by advanced payments from mining investors.[8] However, as development of the country's two biggest mines, Oyu Tolgoi and Erdenes Tavan Tolgoi, stalled, financing became increasingly unsustainable.

In 2012, US$310 million was transferred from state-owned mine, Erdenes Tavan Tolgoi, into the HDF, leaving the company technically insolvent. To continue operations, Erdenes Tavan Tolgoi was forced to borrow from the Development Bank of Mongolia and to enter into a heavily discounted forward contract with its trading partner, Chalco (Infomongolia 2015).

Recognising how costly the program had become, the Election Law was amended in December 2011 to prevent mineral funded cash transfers from becoming a campaign issue again. Both major parties signed agreements to reinforce the ruling.

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[7] It was agreed that 500,000MNT would be distributed in cash and 1 million MNT in in-kind benefits to fulfill the 1.5 million MNT commitment by 2012. In-kind benefits included tuition fees for students, pensions for the disabled or retired and deposits for housing purchases.

[8] US$100 million was received from Ivanhoe Mines as a prepayment with the exploration rights for OyuTolgoi.

In early 2012, a new Social Welfare Law was passed, which "mandate[d] the provision of a targeted poverty benefit replacing the existing system of universal cash transfers" (World Bank, 2012).

### Child Money Program: October 2012 onwards

Although universal cash transfers were discontinued after the June 2012 elections, the Child Money Program, which had been included in the policy plans of both major parties, was reintroduced in October 2012, with a benefit of 20,000MNT (US$14.72) per month per child under 18. As the program has bipartisan support, it is likely to continue until at least the next election in 2016, paid for out of the HDF.

### Future Heritage Fund: from 2018

In October 2014, The Office of the President of Mongolia introduced to Parliament a draft law for a Future Heritage Fund (FHF) to come into being in 2018. This bill will abolish the HDF. The FHF will be a traditional sovereign wealth fund with a sole focus on savings and investment. As currently drafted, there will be no withdrawals from the FHF until 2030, and there will be no earmarking of withdrawals.[9] Discussions on the draft law are ongoing, but slowly, with enthusiasm possibly sapped by low commodity prices (Valigura, 2015).

## 4. Analysis

### Did Mongolia introduce a resources-to-cash scheme?

If we are to draw lessons from Mongolia's experience, we need first to decide whether it actually introduced a resources-to-cash program. We argue it did, beginning in 2006 with the MDF universal child payments, followed by the 2010 to 2012 universal payments, paid from the HDF.

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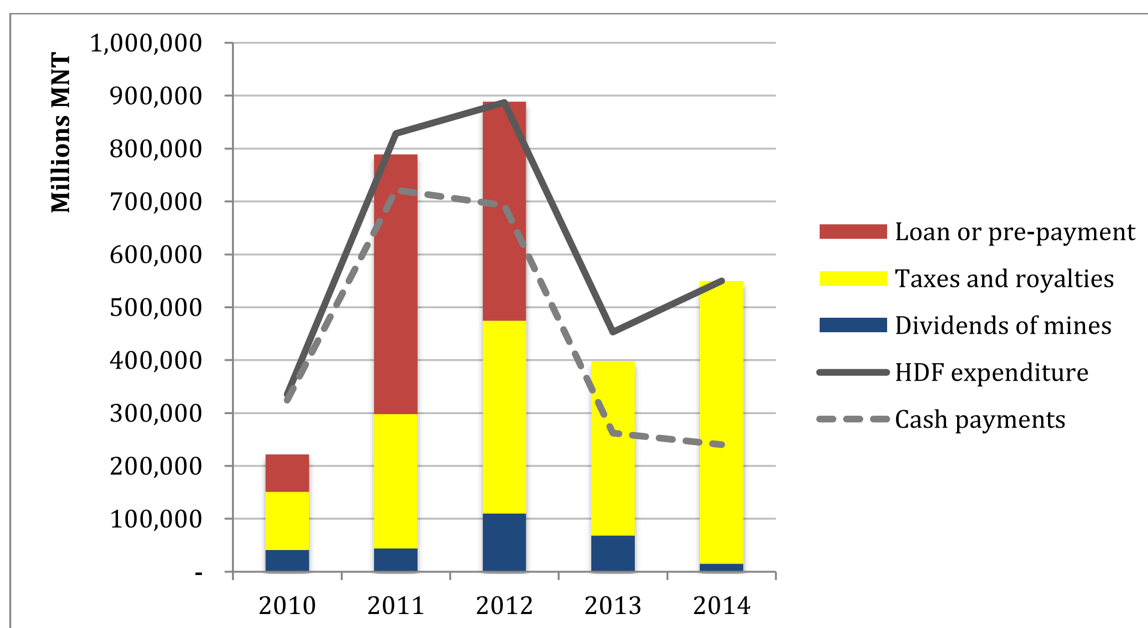
[9] For an analysis of the Future Heritage Fund, see "Discussion of Mongolia's Draft Future Heritage Fund Law", Natural Resource Governance Institute May 2015 http://www.resourcegovernance.org/sites/default/files/NRGI_MongoliaFutureHeritageFund.pdf.

Mongolia's scheme departed from the resources-to-cash ideal in several respects. In particular, the link in practice, as against in intent, to resource revenues, was weak. Payments were based on election promises rather than an assessment of what revenues actually were at the time of the distribution. This meant that, as Figure 6 shows, at some points, cash transfers actually exceeded mineral revenue, and the HDF had to be topped up by borrowing. In 2010, when the universal transfers began, total cash transfers amounted to 324 billion MNT, more than treble the amount distributed in the previous year and almost twice the amount of HDF revenue from dividends, taxes and royalties collected from mining operations. In 2011, when regular monthly transfers began, annual HDF expenditures more than doubled again to almost 800 million MNT, while HDF revenue from dividends and taxes stood at 300 million MNT (Figure 6). In both years, the gap had to be met by borrowing.

**Figure 6: Human Development Fund revenue and expenditure**




*Source and notes: Budget implementation reports of the Government of Mongolia, www.itlod.gov.mn. The bars show HDF revenue and its components.*

Another departure from the ideal is that Mongolia's cash transfers have never been taxable. According to Moss et al (2015), minerals-to-cash cash transfers should be universal, from resource revenue, and taxed. Since one of the aims of resources-to-cash is to increase the state's reliance on taxation of its citizenry, Mongolia's failure to tax its transfers is an important shortcoming.

However, resources-to-cash schemes should not be defined so narrowly that only extremely well designed schemes can qualify as such. Such an approach might lead to the conclusions that there are in fact no such schemes anywhere in the world. Note that Alaska's direct transfers are also non-taxable (by Alaska). A broader definition, such as the one we use – cash transfers explicitly based on resource revenues – seems more helpful.

Does Mongolia still have a resources-to-cash scheme in place? This is less clear, but a scheme which provides funds for every child (rather than every person) could still be counted as such as a resources-to-cash scheme (Moss et al p. 66). Importantly, however, Mongolia is planning to break the link between resource revenues and the transfers, as its new draft sovereign wealth legislation will abolish the HDF. The new sovereign wealth fund, the FHF, will not be used to finance cash transfers (or any other specific expenditures for that matter). If that happens, then, even if the child payments are retained, the link between resource revenues and payments will be severed.

In summary, momentum has swung away from Mongolia's resources-to-cash scheme. It has become less universal, and the link to resource revenues is planned be terminated.

## Did it work?

Earlier analysis by UNICEF estimated the extent to which the conditional Child Money Program (2005-2006) reduced poverty (Budragchaa et al 2007), and the effect of social transfers on children between 2002 and 2010 (Gankhuyag and Banzarch 2014). We estimate the impact of the universal cash transfers from 2010 to 2012 (see Annexes C and D for details). Using the same methods as the earlier studies (that is, assuming that the cash transfer was fully consumed and had no labour supply effects), we find that poverty was significantly lower because of the Human Development Fund than it would have been otherwise. Depending on the year and which poverty line is used, the transfer reduced poverty by as little as 10 percent or as much as one-third (see Tables 1 and 2).

**Table 1: Poverty rates (lower poverty line) 2010 - 2012**

| Lower poverty line | 2010 | 2011 | 2012 |
|---|---|---|---|
| Poverty line (lower) | 84,923MNT | 92,238MNT | 108,462MNT |
| Poverty rate – actual | 38.7% | 33.7% | 21.6% |
| Poverty rate - absence of cash transfers | 46% | 47.1% | 32.6% |
| Difference (percentage point) | -7.3% | -13.4% | -11% |
| **Fall in poverty (%)** | **15.9%** | **28.5%** | **33.7%** |

*Note: See Annexes C and D for sources and notes.*

**Table 2: Poverty rates (upper poverty line) 2010 - 2012**

| Upper poverty line | 2010 | 2011 | 2012 |
|---|---|---|---|
| Poverty line (upper) | 97,156MNT | 111,484MNT | 120,968MNT |
| Poverty rate - actual | 47.6% | 46.0% | 23.6% |
| Poverty rate in absence of cash transfer | 54.0% | 57.9% | 28.8% |
| Difference (percentage point) | -6.4% | -11.9% | -5.2% |
| **Fall in poverty (%)** | **11.8%** | **20.6%** | **18.1%** |

*Note: See Annexes C and D for sources and notes.*

Tables 3 and 4 estimate the impact of the universal transfers on inequality, using the Gini coefficient and the Palma ratio (the ratio of the income share of the top 10% to the bottom 40%). In all years, the HDF transfers reduced inequality; for example by 7.6 percent (35.02 percent to 32.27 percent) in 2010 when measured by the Gini coefficient, or 12.8 percent (1.48 to 1.29) when measured by the Palma ratio.

**Table 3: Inequality rates (Gini-coefficient) 2010-2012**

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| **Gini-coefficient (%)** | 32.37 | 33.1 | 33.02 |
| **Gini-coefficient in absence of cash transfer (%)** | 35.02 | 38.19 | 34.78 |
| **Difference (percentage point)** | -2.65 | -5.09 | -1.76 |
| **Fall in inequality (%)** | **7.6%** | **13.3%** | **5.1%** |

*Note: See Annexes C and D for sources and notes.*

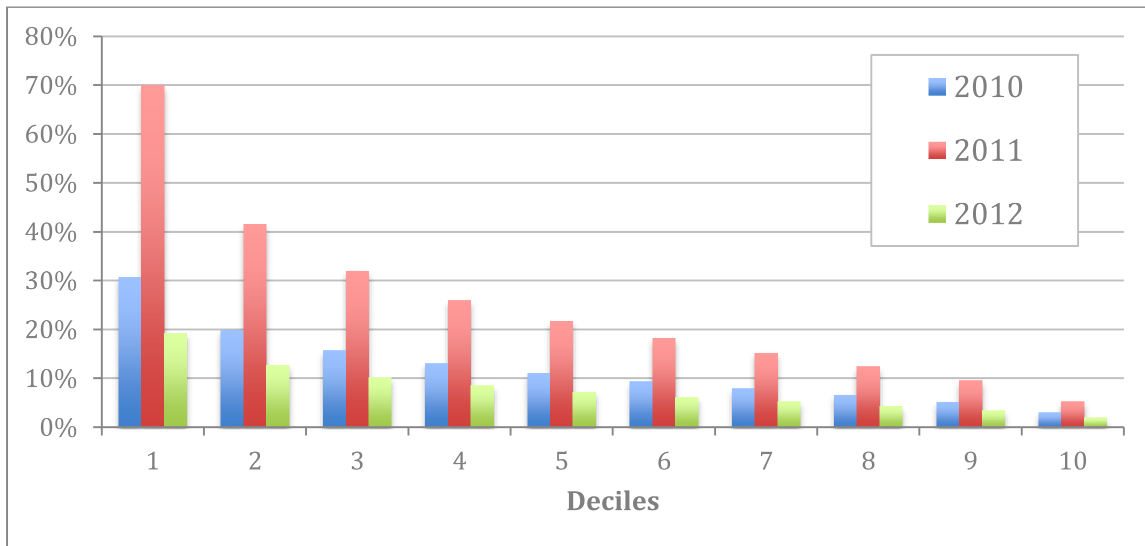
**Table 4: Inequality rates (Palma ratio) 2010-2012**

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| **Palma ratio** | 1.29 | 1.39 | 1.34 |
| **Palma ratio in absence of cash transfer** | 1.48 | 1.76 | 1.46 |
| **Difference** | -0.19 | -0.37 | -0.12 |
| **Fall in inequality (%)** | **12.8%** | **21.0%** | **8.2%** |

*Note: See Annexes C and D for sources and notes.*

The transfers reduced poverty and inequality because of their progressive nature. Figure 6 shows the proportion of the benefit compared to pre-benefit consumption, which fluctuated due to the size of the annual benefit amount. In 2011, for example, when the benefit was at its highest, the transfer amounted to 70% of pre-benefit consumption expenditure for those in the bottom decile, compared to only 5% for individuals in the top decile.

**Figure 7: Human Development Fund benefits as a % of per capita consumption, by decile**

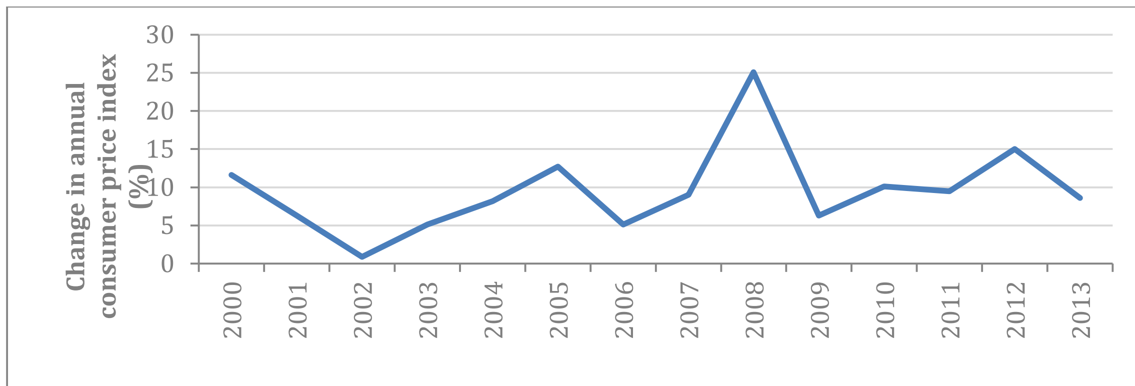



*Note: See Annexes C and D for sources and notes.*

While the above analysis has clear limitations (it allows for no behavioural or macroeconomic impacts, and is based on aggregate data), it does show that Mongolia's resources-to-cash scheme had clear poverty and equity benefits. However, the scheme also had macroeconomic costs. Public external debt rose from 30.8 per cent of GDP in 2010, to 48.3 percent of GDP in 2012 (IMF, 2013). Since the universal cash distribution concluded, a significant portion of HDF expenditure has been on paying the interest and principal of these loans. It can be seen in Figure 6 that in 2014, cash payments accounted for approximately half of the HDF expenditure; a bulk of the remaining expenditure has gone towards servicing debts. Current debt in relation to the HDF stands at around $1 trillion MNT or 6% of GDP.

It is also likely, and certainly widely believed, that the cash transfers contributed to higher inflation. Figure 8 suggests relatively high inflation in the 2010-12 period (Shlilegmaa, Gombosuren, Batsuuri, Lee and Goh 2013).

**Figure 8: Inflation measured using the Consumer Price Index 2000-2013**




*Source: World Development Indicators, The World Bank.*

The most important claimed benefit for resources-to-cash is that it enhances accountability. This is a benefit that would likely take decades to materialise, and which we are therefore unlikely to see in Mongolia due to the loss of support for the scheme. Note also that in Mongolia neither the accountability mechanism based on increased taxation nor that based on the link between resource performance and benefit could have been effective since transfers were neither taxed nor linked in practice to the size of revenue.

Demands for accountability were shown, however, as protests broke out whenever there was a delay in distribution of the HDF payments, and major protests in April 2010 were successful in forcing the government to commit to a payment timetable. This suggests that citizens are more likely to be politically active and hold government to account when they are expecting a dividend.

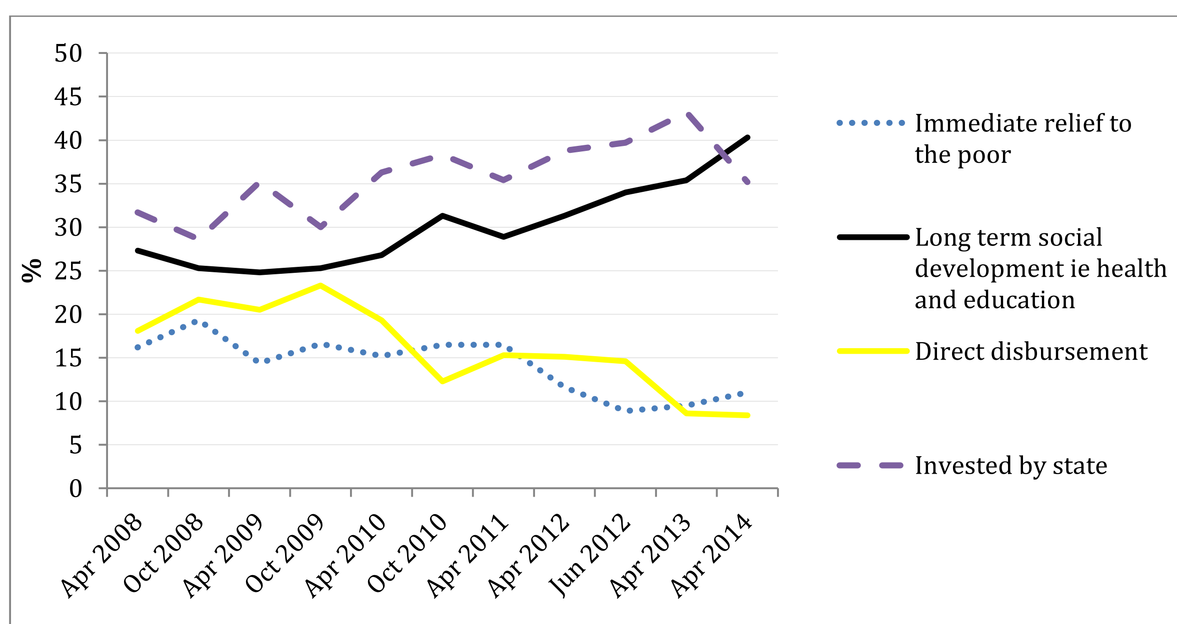
In summary, Mongolia's resources-to-cash scheme had a positive impact on poverty and inequality, a negative macroeconomic impact, and possibly a small positive impact on accountability.

None of these impacts will likely last, however, as Mongolia's resources-to-cash has lost political and public support, and is likely to be discontinued.

The Sant Maral Foundation conducts an opinion poll of political and social issues in Mongolia biannually with 1,200 respondents. Figure 9 shows the responses from 2008 to 2014 to the question: "Through recent development of the mining sector Mongolia has gained considerable wealth. How should this money be used?". It can be seen that

"direct disbursement" reached the peak of its popularity during the financial crisis and when the idea was first publicised. Since then, it has largely experienced a downward trend and its popularity has halved from about 20 percent to about 10 percent. Even at the height of its popularity, direct disbursement has received much less support than the use of funds for either "invested by state" or for "long term social development", and these gaps have widened over time. The latter two options are now about four times as popular as direct disbursement.

**Figure 9: Public support for different uses of mineral wealth in Mongolia, 2008-2014**




*Source: Sant Maral Foundation (2008-2014)*

Why did direct distribution lose political support? Interviews with government representatives, civil society organisations and academia and two focus group discussions with ordinary citizens (see Annex A for details) suggest a number of reasons.

First, many focus group participants and interviewees expressed the view that cash transfers should have been distributed to poorer citizens only, as the benefit did not have a significant effect on the living standards of more affluent groups yet added significantly to government expenditure. Participants expressed quite different views of the importance of the transfers depending on their level of income and vulnerability. For the poorest families, the HDF became a significant, if not the main source of income.

They said they spent the income entirely on food, clothing and household goods. In contrast, other groups said it made little difference to their lifestyles. Some wealthier individuals said that they did not even collect their benefits from the assigned bank account, as it simply wasn't worth it.

It should be noted from the public opinion surveys that "direct disbursements" and "immediate relief to the poor" are now equally unpopular options (Figure 9). The general population would much rather see investments in physical or human capital than either universal or targeted transfers.

Many interviewees felt the cash transfers were not affordable. One academic said: "People knew it wasn't a good policy, because, where was the money coming from? Everyone knew the economy was in trouble but still the government kept giving money." And, as reflected in the Sant Maral surveys, many focus group participants said they would have preferred that the funds were spent on "investments in the future", such as building school kindergartens or creating more jobs.

Third, there was a view among academic and technocratic interviewees that the process represented an abuse of the political process. It was said during interviews that the policy was always "purely political", and "an abuse of the savings fund." This sentiment is reflected in the amendment of the Election Law and agreement by the two major parties to stop competing on the basis of cash payments.

Fourth, there was a view both in the interviews and in the focus group sessions that the cash handouts disincentivised school leavers and first-time job seekers to look for work as they were regularly receiving "free money".

Lastly, in every interview conducted, it was reported that some citizens would spend the entire monthly cash transfer on alcohol. One said "on the day of the month when cash was given, you could see people coming out of the bank and walking straight to the alcohol store." A Bloomberg article (Humber 2013) echoed this claim, claiming "[the] government sends cash handouts, which has only encouraged more bars and karaoke parlours". More research would be needed to substantiate either of the above two claims.

Our main finding is that design and implementation flaws undermined the sustainability and therefore any lasting impact of Mongolia's resources-to-cash scheme. It is not entirely a negative story. There was political learning in the form of an agreement between parties not to compete on the size of the transfers. The scheme was progressive and reduced poverty and inequality. But it also increased debt and possibly inflation. More problematically, Mongolia's resources-to-cash experiment came to be seen as wasteful and irresponsible. It lost political and public support. As a result, the universality of the scheme was watered down, and there is now a commitment to do away with the link between resource revenues and transfers by abolishing the HDF. It is too early to write off resources-to-cash in Mongolia (there might always be a recovery of support), but at this stage it certainly appears to have been a failure.

## 5. Discussion and conclusion

Moss et al. (2015, p. 144) write that the Mongolia experience "demonstrates the potential popularity of Oil-to-Cash and its political feasibility under a competitive electoral system". While this is a fair reading of the 2008 elections, one might also say that subsequent experience demonstrates the ultimate political unpopularity and unfeasibility of resources-to-cash. Such a conclusion would be too strong, but Mongolia's experience certainly points to the risk of support for resources-to-cash being undermined by poor design and implementation. In Mongolia, it would seem that there was always a certain scepticism regarding universal transfers, and that the experience of the scheme heightened that scepticism.

Our findings provide backing for Gillies (2010 p16), who writes: "policy mechanisms tend to reflect the environment from which they emerge. Direct distribution [resources-to-cash] may offer the greatest expenditure efficiency gains in countries where governments fail in providing public goods[;] however, its implementation will be the most difficult in these same contexts"(p.15). As a young democracy, Mongolia has fledging, weak institutions and a political environment prone to short-term decision-making. These weaknesses pervaded and undermined, probably fatally, many aspects of its resources-to-cash scheme.

We are particularly sceptical of the idea that resources-to-cash schemes will strengthen accountability by enhancing taxation. We are only aware of two resource-to-cash schemes: Alaska's and Mongolia's. In neither are the transfers taxed, nor have their tax regimes changed as a result of introducing the payments. In any case, in developing countries, systems of direct taxation are very weak, and typically applicable only to the formal sector. Even if transfers were taxable, most recipients would not pay that tax.

Various mechanisms have been put forward to solve the resources curse: investment in infrastructure and human capital; sovereign wealth funds; and now, resources-to-cash. If implemented well, these mechanisms should all help avoid the resources curse. But there is no reason to think it is easier to implement oil-to-cash than the other proposed mechanisms. Perhaps it is easier to give away cash than to build infrastructure, but, as Mongolia shows, the very ease of handing money out also makes it easier for this option to blow the budget.

Overall, Mongolia is a cautionary tale. One should certainly not dismiss the potential benefits of resources-to-cash on the basis of one, poorly designed and implemented instance. Rather the lesson of the Mongolia experience is that resources-to-cash needs to take its place alongside, rather than be favoured over, other policy instruments that have been recommended for resource-dependent economies.

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## Annex A: Evolution of resources-to-cash in Mongolia

| Year | Economic/Political/Legislative Environment |
|---|---|
| **2004** | Inclusion of a Child Money Program (CMP) in the election platforms of the Democratic Party (DP) and Mongolian People's Revolutionary Party (MPRP).<br><br>Election produces a Coalition Parliament of DP and MPRP; CMP included in Government Action Plan 2004 – 2008. |
| **2005** | *January*<br><br>First introduction of Child Money Program (CMP), 3000MNT (US$2.49) per month per eligible child (36,000MNT per year), conditional on:<br><br>• family income below the minimum subsistence level<br>• at least 3 children in family<br>• children<8 years enrolled at school<br>• children vaccinations up to date<br>• children not involved in harmful form of labour<br><br>*July*<br><br>CMP condition that the family have at least three children is removed. |
| **2006** | *January*<br><br>CMP becomes universal, living with family and being in school remain conditions.<br><br>Approval of the Mongolia Development Fund (MDF); funded by the Windfall Profits Tax.<br><br>Mongolia becomes a full signatory to the Extractive Industry Transparency Institute. |
| **2007** | CMP transfer increases by 25,000MNT (US$21.36) per quarter per child funded from the MDF (totaling 136,000MNT per year). |

| Year | Economic/Political/Legislative Environment |
|---|---|
| **2008** | Inclusion of a universal cash payment in election platforms of DP (1 million MNT per citizen) and MPP (1.5 million MNT per citizen).<br><br>MPP wins the election though forms a Coalition Parliament following post-election violence.<br><br>Universal payment of 1.5 million MNT (US$1,282.75) per citizen included in Government Action Plan 2008-2012.<br><br>Falling copper price reduces government revenues. |
| **2009** | Oyu Tolgoi (OT) investment agreement signed; lead investor Ivanhoe Mines agrees to prepay royalties.<br><br>Mongolia Development Fund and Windfall Profits Tax abolished.<br><br>Human Development Fund (HDF) law approved; funded by:<br>• Dividends and revenues from the sale of government-owned equity in strategically important mining projects<br>• Royalties<br>• Net profits from investments of Fund's resources<br>• Loans and advance payments from strategically important mining projects |
| **2010** | HDF universal cash transfers commence and replace CMP; 70,000MNT (US$51.96) in February; 10,000MNT (US$7.42) per month (August – December) per person. |
| **2011** | HDF cash transfer of 21,000MNT (US$16.57) per person per month.<br><br>Amendment to the Election Law that cash transfers may not be included in future election campaigns. Heads of major parties sign agreements to not campaign on cash in future elections. |
| **2012** | *January - June*<br><br>HDF cash payment of 21,000MNT (US$16.57) per person per |

| Year | Economic/Political/Legislative Environment |
|---|---|
| | month.<br><br>*June*<br><br>Parliamentary elections – DP gain slight majority and form a Coalition Parliament.<br><br>*Octobe*r<br><br>Child Money Program recommences; 20,000MNT (US$14.72) per child per month. |

## Annex B: Mongolian consultations

### Interviews

Interviews were arranged with government, civil society organisations and academia to understand how the cash transfer system began and evolved, views on its impact and future direction.

Interviews were conducted in English and recorded with the participant's permission. Interviews began with an introduction of the research topic and then invited the participants to express their knowledge and views in an open manner. As such, questions varied according to the participant's area of focus.

| Name | Role | Date |
|---|---|---|
| **Erdenechimeg Tserendorj** | Executive Director, Centre for Social Work Excellence | 18/9/2014 |
| **Khandaa Gonchighand** | Research Officer, Centre for Social Work Excellence | 18/9/2014 |
| **Zoljargal Nyamjav** | Australian Scholarships Director, Austrade, Ulaanbaatar | 19/9/2014 |
| **Mandakhbat Sereenov** | Acting Director, Mongolia Australia Partners for Development and Research Associate, CIMEL | 19/9/2014 |
| **Enkhnasan Nasan-Ulzii** | Chief of Social Policy, UNICEF | 25/9/2014 |
| **Tuguldur Baajiikhuu** | Director of Sovereign Wealth Funds, Ministry of Finance Mongolia | 26/9/2014 |
| **Bolormaa Purevjav** | Environmental Program Director, The Asia Foundation | 26/9/2014 |
| **Mark Bezemerand,** | Senior Country Economist, Asia Development Bank | 29/9/2014 |
| **Amar Lkhagvasuren** | Economist, Asia Development Bank | 29/9/2014 |

| | | |
|---|---|---|
| **Claude Bodart** | Principal Health Specialist, Asia Development Bank | 29/9/2014 |
| **Tungalag Chuluun** | Social Protection and Labour Operations Officer, World Bank | 29/9/2014 |
| **Tuvshintugs Batdelger** | Economist, Economic Research Institute Mongolia | 29/9/2014 |

**Focus group sessions**

Focus group sessions were arranged with citizens to garner beneficiary views on cash transfers. Two focus group locations were chosen to capture differences in urban and rural citizen views. Within each locale, groups were divided into civil servants, unemployed, and social welfare dependents to capture the potential range of opinions given different income levels.

The *Centre for Social Work Excellence* assisted in arranging the groups by firstly contacting the local governors to seek permission for the activity and secondly asked the local social worker to contact those available on the specified day to attend the focus group sessions hosted at the governor's office. Social workers were each given 20,000 MNT mobile phone vouchers as a token of appreciation, and focus group members were provided with chocolates and tea during the session.

Focus groups were held in Mongolian and recorded for translation and reference with the participants' permission. Each focus group started with an introduction on the research topic followed by a set of questions. The facilitator translated the responses into written English responses following the sessions.

| Location | Participants | Date |
|---|---|---|
| **Khoroo #5, Ulaanbaatar** | Civil Servants (3)<br>Unemployed (8)<br>Social welfare dependents (14) | 22/9/2014 |
| **Tov aimag** | Civil Servants (7)<br>Livestock herders (6)<br>Unemployed (4) | 25/9/2014 |

## Annex C: Methodology of poverty and inequality estimates

Prior to this study, no estimation of the impact of the cash transfers via the Human Development Fund (HDF) on poverty and inequality had been attempted. This section details this paper's methodology to estimate the impacts of the HDF.

**Poverty**

Poverty is typically measured by calculating the percentage of the population that fall below the poverty line, a minimum level of income for basic living in a particular setting. This is calculated on from household survey data which is collected.

In Mongolia, the poverty line is based on a minimum subsistence basket of food and non-food items calculated for each region.[10] As regional poverty lines did not aggregate to national poverty data, two national poverty lines were constructed to form the lower and upper poverty lines. Given the absence of a definite poverty line, poverty dominance techniques were used to generate poverty headcount rates (discussed below).[11]

### *Poverty line construction*

Poverty rates can be calculated by drawing a poverty line through a given consumption profile. As there was no *national* poverty line and only national consumption data, upper and lower poverty lines were constructed.

Two approaches were taken:

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[10] The country is divided into five regions; Central, Eastern, Western, Khangai and Ulaanbaatar.

[11] http://www.fao.org/docs/up/easypol/431/povetyanddominance_035en.pdf

1. **Extrapolation from poverty rates and consumption data (lower poverty line)**

Given the national poverty rate data, a poverty or minimum subsistence line (MSL) was extrapolated from average decile consumption deciles. An assumption was made that consumption between each decile was linear.

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| National MSL (MNT) | 84,923.35 | 92,237.81 | 108,62.40 |

2. **Weighted average of regional poverty lines (upper poverty line)**

The average national poverty line was calculated by taking the weighted average of regional poverty lines:

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| National MSL (MNT) | 97,156.08 | 111,484.47 | 120,967.85 |

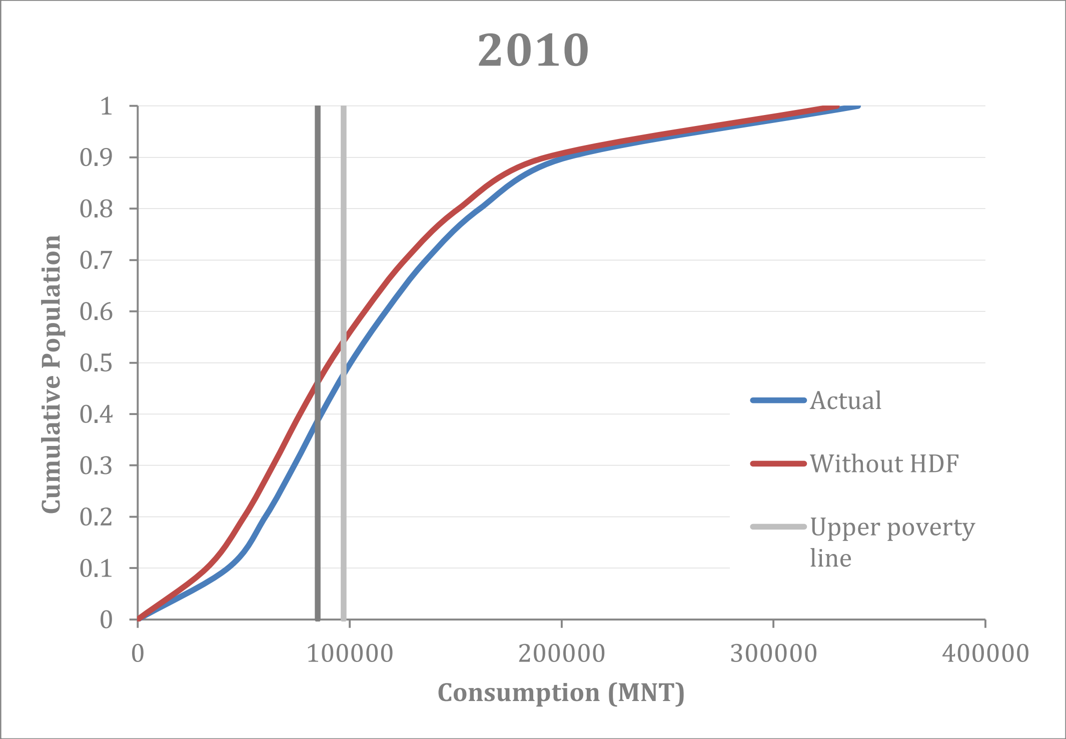
### *Poverty dominance analysis*

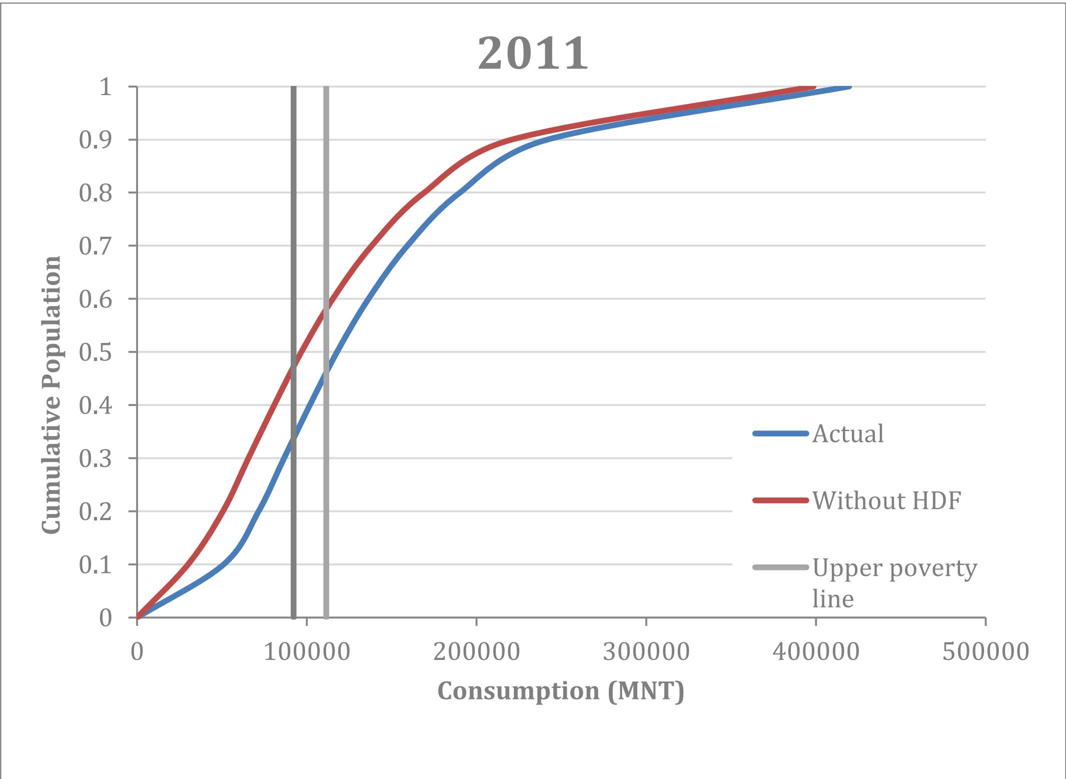
Given the absence of a definite poverty line, poverty dominance techniques were used to generate poverty headcount rates.

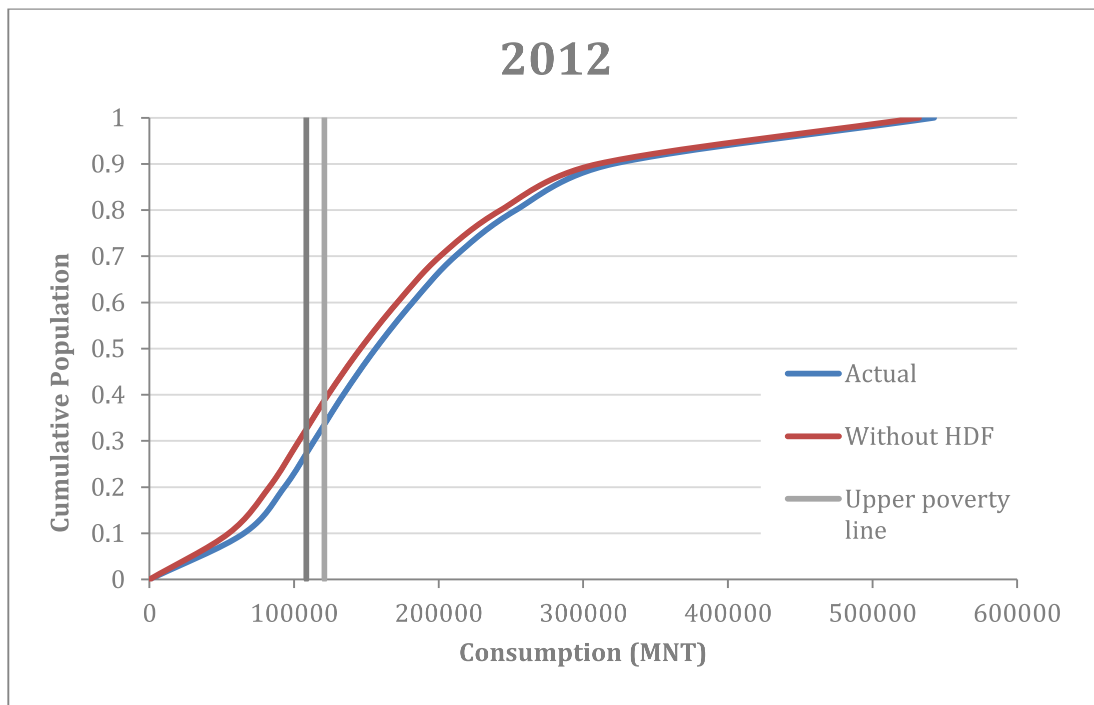
Firstly, consumption deciles are expressed as a cumulative distribution function (CDF). The cumulative distribution function $F(x)$, for any given income level $x$, gives the proportion of people who have incomes below that level. Therefore, if the income level is taken to be the poverty line $z$, the cumulative distribution function $F(z)$ gives the proportion of people who have incomes below $z$, i.e. the poverty rate.

By comparing cumulative distribution functions of actual consumption and simulated consumption in the absence of HDF, and measuring where a common poverty line would intercept both, the difference gave a measure of the impact of the cash transfers. Actual consumption data was obtained from the National Statistics Office, and simulated incomes were calculated by subtracting the annual cash transfer benefit from consumption.

**Figures A1-3: Cumulative density function for actual and simulated consumption with lower and upper poverty lines, 2010 – 2012**






**Inequality**

***Gini coefficient***

The Gini coefficient is the most commonly used measure of inequality. It measures the distribution of incomes for a given population, and represented by a number between 0 and 1, where 0 represents perfect equality and 1 corresponds with perfect inequality.

The formula for the gini coefficient is:

$$G = \frac{2\Sigma_{i=1}^{n} iy_i}{n\Sigma_{i=1}^{n} y_i} - \frac{n+1}{n}$$

We used the average decile consumption data for income and population, where *n* is the decile number, and *y*, the average income for the corresponding decile.

***Palma Ratio***

To measure inequality at the extremes, the Palma index measures the ratio of the income of richest 10 percent divided by the income of the poorest 40 per cent. This was a simple exercise as consumption data was grouped by decile.

## Annex D: Statistical Data

The following data for 2010 - 2012 was obtained from the National Statistics Office (www.1212.mn) in October 2014:

- National consumption data grouped into deciles
- Poverty lines for each region
- Poverty rates for each region and nationally
- Population of each region and nationally

**Table A1: Actual and simulated consumption by decile, 2010 – 2012**

| Average consumption per person (MNT) | 2010 | | 2011 | | 2012 | |
|---|---|---|---|---|---|---|
| | National average (MNT) - actual | Simulated average without HDF transfer (10,000MNT per annum) | National average (MNT) - actual | Simulated average without HDF transfer (21,000MNT per annum) | National average (MNT) - actual | Simulated average without HDF transfer (10,500TSH MNT per annum) |
| Decile 1 | 42,572.6 | 32,572.6 | 51,023.2 | 30,023.2 | 65,264.1 | 54,764.1 |
| Decile 2 | 60,234.5 | 50,234.5 | 71,616.2 | 50,616.2 | 93,281.6 | 82,781.6 |
| Decile 3 | 73,869.6 | 63,869.6 | 86,608.9 | 65,608.9 | 113,795.1 | 103,295.1 |
| Decile 4 | 86,574.1 | 76,574.1 | 101,822.2 | 80,822.2 | 133,971.2 | 123,471.2 |
| Decile 5 | 100,495.9 | 90,495.9 | 117,817.7 | 96,817.7 | 156,367.3 | 145,867.3 |
| Decile 6 | 117,098.9 | 107,098.9 | 136,345.1 | 115,345.1 | 181,910.0 | 171,410.0 |
| Decile 7 | 136,090.8 | 126,090.8 | 159,243.5 | 138,243.5 | 211,363.3 | 200,863.3 |
| Decile 8 | 161,446.6 | 151,446.6 | 190,195.0 | 169,195.0 | 253,368.2 | 242,868.2 |
| Decile 9 | 202,587.3 | 192,587.3 | 241,826.0 | 220,826.0 | 320,604.5 | 310,104.5 |
| Decile 10 | 339,871.1 | 329,871.1 | 419,579.5 | 398,579.5 | 542,620.9 | 532,120.9 |

### Table A2: Poverty line per region: 2010 - 2012

| Region | 2010 | 2011 | 2012 |
|---|---|---|---|
| Western region | 97,000 | 104,300 | 115,600 |
| Khangai region | 91,500 | 105,100 | 116,800 |
| Central region | 91,700 | 106,600 | 117,500 |
| Eastern region | 90,900 | 103,500 | 113,000 |
| Ulaanbaatar | 101,600 | 118,100 | 126,500 |

### Table A3: Population, 2010 – 2012

| Region | 2010 | 2011 | 2012 |
|---|---|---|---|
| Total | 2,760,968 | 2,811,666 | 2,867,744 |
| Western | 357,148 | 356,174 | 361,000 |
| Khangai | 430,797 | 432,268 | 530,193 |
| Central | 342,465 | 346,303 | 467,034 |
| Eastern | 186,916 | 188,443 | 191,387 |
| Ulaanbaatar | 1,244,449 | 1,287,100 | 1,318,130 |

### Table A4: National Poverty Rate

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| Poverty rate (%) | 38.7 | 33.7 | 27.4 |