

CRS Report for Congress

Mongolia and U.S. Policy: Political and Economic Relations

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Committees of Congress**

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Summary

On January 10, 2006, Mongolia's delicately balanced coalition government collapsed and the Mongolian parliament chose a new Prime Minister in accordance with constitutional requirements. Mongolia has seen several reshufflings of government since 1990, the year the Mongolian People's Revolutionary Party (MPRP) declared the end of a one-party communist state and initiated democratic reforms with U.S. assistance. Mongolia's profile has been raised further by the 2005 visits of President George Bush and Secretary Donald Rumsfeld, each of whom praised Mongolia's democratic developments and its aspirations to use its military forces for global peace-keeping missions.

The United States recognized Mongolia in 1987 and since then has sought to expand cultural and economic ties. At Mongolia's invitation, the United States began a Peace Corps program there in 1991, which by 2007 was maintaining about 100 Peace Corps volunteers in the country. Also in 1991, following the signing of a bilateral trade agreement, the President restored Mongolia's most-favored-nation (MFN) trading status — now referred to as Normal Trade Relations (NTR) — under the conditional annual waiver provisions of Title IV of the Trade Act of 1974. NTR status was made permanent for Mongolia effective July 1, 1999, obviating the annual trade status review process.

In FY2004, Mongolia became an eligible country for U.S. assistance through the Millennium Challenge Account (MCA), and submitted a proposal late in 2005. After several years of consultations, the Millennium Challenge Corporation (MCC) on June 14, 2007, issued notification to Congress initiating a 15-day consultation period prior to commencing MCA Compact negotiations with Mongolia. This report provides background information on Mongolia, including political and economic conditions, the status of U.S.-Mongolian political and economic relations, and key security and foreign policy issues.

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Mongolia and U.S. Policy: Political and Economic Status

Introduction

The United States established diplomatic relations with Mongolia in 1987, when it was still a Communist state, and since then has sought to expand bilateral cultural and economic ties. In 1991, following the signing of a bilateral trade agreement, the President restored Mongolia's most-favored-nation (MFN) trading status — now referred to as Normal Trade Relations (NTR) — under the conditional annual waiver provisions of Title IV of the Trade Act of 1974. That NTR status was made permanent effective July 1, 1999, obviating the annual trade status review process.¹

In 1990, the ruling Mongolian People's Revolutionary Party (MPRP) declared the end of the country's one-party communist state and initiated democratic reforms with U.S. assistance. Since then, the country has been an enthusiastic practitioner of democratic government, although not without some difficulty. Mongolia has seen several reshufflings of government, for instance — the most recent on January 10, 2006, when its delicately balanced coalition government collapsed and the Mongolian parliament chose a new Prime Minister in accordance with the country's constitutional requirements. Since then, Mongolia's profile has been raised further by the 2005 visits of President George Bush and Secretary Donald Rumsfeld. This report provides background information on Mongolia, including political and economic conditions, the status of U.S.-Mongolian political and economic relations, and key security and foreign policy issues.

Country Data

Population: 2.95 million (July 2007 est.)
Area: 1,566,500 sq km (slightly larger than Alaska)
Location: Sandwiched between Russia (north) and China (south)
Life Expectancy: 66.99 years (2005)
GDP: \$2.8 billion (2006)
Resources: oil, coal, copper, molybdenum, tungsten, phosphates, tin, nickel, zinc, fluorspar, gold, silver, iron
Primary export partners 2006: China (67.4%); Canada (11.1%); U.S. (7.7%)
Primary import partners 2006: Russia (36.7%); China (27.6%); Japan (6.8%)

Data from *CIA World Factbook*, May 27, 2007; Economist Intelligence Unit, May 2007, and IMF.

¹ See Section 2424 of The Miscellaneous Trade and Technical Corrections Act of 1999, enacted as P.L. 106-36, effective on July 1, 1999, by Presidential Proclamation 7207.

Background

Once part of the Chinese empire, Mongolia achieved independence in 1921 in a revolution backed by the Soviet Union. After this, the communist Mongolian People's Revolutionary Party (MPRP) ruled for almost 70 years, maintaining a tenuous balance between the Soviet Union and China and receiving substantial financial assistance from each. Public demonstrations for political pluralism in 1990 led to the resignation of the Communist MPRP government, whose leaders declared the end of a one-party Communist state. Since then, Mongolia has been undergoing a political and economic transition to a parliamentary democracy under new constitutional rules adopted in 1991. After decades of dependency on Soviet aid (at one point worth nearly 40% of the country's GDP), Mongolia has sought to broaden its foreign contact and trade.

Political Trends and Conditions²

Despite the official demise of Communism in Mongolia in 1990, the formerly communist MPRP has continued to play a dominant political role.³ In the first popular elections ever for Mongolia's parliament in 1990, the formerly communist People's Great Hural, the MPRP won 80% of the seats. In turn, the same year, this MPRP-dominated parliament elected an MPRP member, P. Ochirbat, as Mongolia's first president. While a new constitution in 1992 created a new parliament (the State Great Hural) to replace the People's Great Hural, the MPRP also won a significant majority in the new body. Its 71 out of a total of 76 seats gave it firm control while Mongolia's fledgling opposition parties remained essentially powerless. But the balance began to tip away from the MPRP in 1994, when the party turned against Ochirbat after he vetoed legislation passed by the parliament. When Ochirbat lost the MPRP's backing in Mongolia's first direct presidential election in 1993, he ran and won as an opposition candidate.

Weak Governmental Institutions, Corruption. Mongolia's legal and financial institutions remain underdeveloped and are a serious impediment to improving the country's economy and business climate. In part because of these weak institutions, the existence and enforcement of laws protecting private property is extremely limited even though the government passed a land ownership law in 2002 that allows the sale of farmland to individuals. Governmental corruption also is becoming a more acute problem and was the subject of demonstrations and protests during the 2005 presidential election campaign. In some respects, and with considerable assistance from western democratic organizations, the fledgling government has made great strides in the 15 years since it adopted multi-party

² Sources for this section include the *Far Eastern Economic Review*, the *Wall Street Journal*, and the Foreign Broadcast Information Service.

³ The MPRP, having shrugged off Communism, nevertheless did not officially adopt a new, Socialist agenda until March of 1997, when it amended its party platform.

politics.⁴ Still, Mongolia's legislative processes remain in their infancy. It was only in 2004, for instance, that Mongolia's parliament, the State Great Hural (SGH), passed measures giving parliamentary committees separate budgets, staff, and rules of procedure. The first public hearing by a parliamentary committee was held only in 2002, although western groups providing assistance are encouraging the SGH to hold public hearings as a routine part of the legislative process.

Legislative Elections of 1996

Mongolia's parliamentary elections on June 30, 1996, were the first in which an effective, organized opposition existed to challenge the MPRP's 75-year rule. The "Democratic Union," formed over a period of about five years by a coalition of eight opposition parties, was the only party to field a clear, recognizable political platform to challenge MPRP candidates.⁵ It achieved a stunning electoral victory in what was widely regarded as a free and fair election. With 91% of the electorate turning out to vote, the Democratic Coalition took 50 of the 76 seats, giving it a majority in the parliament as well as the support of President Ochirbat. The new Mongolian leadership was quoted as crediting the victory to help from U.S. political strategists and to study of American political devices — the "Contract with America" in particular.

Economic issues, political reform, and foreign relations dominated the 1996 election campaign. In a political strategy that many came to view as the cause of the MPRP's downfall, the party offered no firm prescriptions for Mongolia's political problems or for its relations with other countries. Democratic Union coalition candidates, on the other hand, put forward a more specific policy agenda, vowing to make government more transparent, sell state-owned media organizations, establish pension plans, increase teacher salaries, and reform Mongolia's judicial system. Finally, the coalition placed a strong emphasis on friendship with the West — primarily with the United States, which Mongolia calls its "third neighbor."

Instability in 1997

Mongolia held two related elections in 1997. In the presidential election on May 18, the results of the 1993 presidential election were reversed, and the presidency was won by Natsagiin Bagabandi, the MPRP candidate, leaving the government divided between the executive and the parliament. Bagabandi won with 60.8% of the vote against two other candidates: the incumbent of seven years, President Ochirbat, from the Democratic Union coalition, which retained its majority in the Great Hural from the 1996 elections; and Gombojav, from the Mongolian Unity Party (MUP). On August 20, 1997, Mongolia held an interim parliamentary election to replace Bagabandi, who had to give up his seat in the Great Hural in order

⁴ The International Republican Institute (IRI), in particular, has an extensive democracy-building program in Mongolia, conducting election training programs and assisting with parliamentary development.

⁵ The two largest parties in the coalition were the Mongolian National Democratic Party (MNDP) and the Mongolian Social Democratic Party (MSDP).

to become president. Bagabandi's former parliamentary seat was won by MPRP member Nambaryn Enkhbayar.

To some extent, political analysts at the time regarded Bagabandi's election as a symbolic gesture of public frustration over the drastic and painful economic reforms imposed by the new government after the 1996 elections. Under those reforms, unemployment, crime, and taxes rose, while other financial and economic policies were not entirely successful. In addition, some believed that the Democratic coalition majority elected in 1996 did not communicate its goals and policies effectively enough to the public to sustain its popularity in the 1997 presidential election cycle. Most believed that Bagabandi's election would not change the overall direction of democratic development and reform in Mongolia. For one thing, Mongolia's 1991 Constitution reserves only limited powers to the President — in principle, the power to veto — while giving most political power to the Great Hural, including the power to appoint government ministers. Nevertheless, the Democratic coalition's 50-seat majority in the Great Hural, though substantial, was still one vote short of the margin needed to override presidential vetoes.

Break-up of Democratic Coalition, 1998-2000

Mongolia's political situation became more tumultuous in 1998, with a series of political crises leading to much legislative maneuvering between the MPRP-led government and the ruling Democratic coalition. On April 17, 1998, Prime Minister Enkhsaikhan announced his resignation in the wake of public discontent over harsh reform measures he had adopted to strengthen Mongolia's economy. On April 23, 1998, Enkhsaikhan was replaced as Prime Minister by MNDP member Tsakhiagiyn Elbegdorj, the majority leader in parliament, who was elected with 60 votes out of the 76 members in the Great Hural. Elbegdorj, in turn, was forced to resign by a no-confidence vote in the Great Hural on July 24, 1998 — making his government the shortest in Mongolia's brief democratic history — because of his controversial decision on May 27, 1998, to allow the state-owned Renovation Bank to merge into the privately held Golomt Bank. The parliamentary group of the MPRP charged that the decision on the bank merger violated the Mongolian constitution and posed a threat to national economic security. In the ensuing months, the ruling parliamentary coalition struggled with President Bagabandi over the naming of a new Prime Minister, with Bagabandi repeatedly rejecting the Great Hural's choice of Davaadorj Ganbold.

In December 1998, the new MNDP leader, Janlavyn Narantsatsralt, became Prime Minister. But his government fell in scandal in July 1999. On July 30, 1999, the Great Hural endorsed as Prime Minister Rinchinnyamyn Amarjargal, another Democratic coalition candidate. Ultimately, in 2000, the strain of these political crises proved too much for the Democratic coalition. It collapsed, setting the stage for a dramatic comeback by the MPRP in parliamentary elections in July, when MPRP candidates won 72 out of the 76 seats in the Great Hural. That month, the MPRP leader, Nambaryn Enkhbayar, became Mongolia's 5th Prime Minister in two years. In December 2000, the remnants of the former Democratic coalition, including the MNDP and the MSDP, merged to form the Democratic Party (DP). President Bagabandi was elected to a second term as president in May 2001.

Coalition Government Collapse, 2006

Mongolia's latest political crisis was born in the 2004 parliamentary elections when an assortment of democratic-minded parties under the umbrella title Motherland Democracy Coalition (MDC) won 34 parliamentary seats (out of a total of 76) to the MPRP's 38 seats. After weeks of political gridlock, the two groups compromised to form a workable coalition government: the Democratic Party leader, Tsakhiagiyn Elbegdorj, became the new Prime Minister and the MPRP assumed 10 positions in Elbegdorj's 18-member cabinet. But the troubled government struggled with growing unemployment, allegations of corruption, and factional differences.

The increasing popular disillusionment with the coalition's rule was reflected in presidential elections in May 2005, when MPRP candidate and former Prime Minister Nambaryn Enkhbayar won the presidency (a less influential, though still powerful, position than that of Prime Minister) with 53.4% of the vote, compared to the 19.7% garnered by his Democracy Party rival, Mendsaikhani Enkhsaikhan. On January 11, 2006, the fragile government collapsed altogether when all 10 MPRP cabinet members resigned in protest to what they said was the alliance's ineffective governance and loss of public support. The collapse was followed by days of protests in the capital — some protesting government corruption and economic deprivation, some accusing the MPRP of attempting to seize power for itself. The official government response to the MPRP resignation, however, followed established political procedures. On January 25, 2006, the parliament chose Miyegombo Enkhbold, MPRP chairman, as the new Prime Minister succeeding Elbegdorj. According to reports, the Democratic Party declined the MPRP's offer to join in a "national unity" government and instead chose to function as an opposition and establish a "shadow cabinet."⁶ The next parliamentary elections are in June 2008.

Economic Trends and Conditions⁷

Mongolia's economy is relatively poor and agrarian, with few industries but extensive mineral deposits. About one-third of Mongolia's people live in poverty. Its gross domestic product (GDP) in 2006 was \$2.8 billion, and per capita GDP on a purchasing power parity (PPP, a common measurement of living standards), was \$2,735 (equivalent to about 6.2% of U.S. levels).⁸ Agriculture is a major economic

⁶ Innes, Claire, "Democratic Party rejects offer to join new coalition government in Mongolia," *Global Insight Daily Analysis*, English, January 19, 2006.

⁷ Sources for this section include the Economist Intelligence Unit and the Foreign Broadcast Information Service.

⁸ Purchasing power parity (PPP) data attempt to factor in price differentials between countries (which do not get reflected by nominal exchange rate data) in order to determine the actual purchasing power (expressed in dollars) of a country's GDP. Using nominal exchange rates, Mongolia's per capita GDP in 2006 was only \$870. However, the PPP data indicated that because the cost of goods and services is much lower in Mongolia than in the
(continued...)

sector (especially herding), accounting for about one-fifth of GDP (2005); it employs about half of the population. Mineral production accounts for 68% of industrial output, 46% of foreign direct investment (FDI), and 59% of Mongolia's export earnings.⁹

The collapse of the Soviet Union in the early 1990s had a severe impact on Mongolia's economy, which had employed Soviet-style economic policies and heavily relied on Soviet assistance.¹⁰ After that aid abruptly ended, the economy suffered; real GDP fell by 9.2% in 1991 and by 9.5% in 1992, leading to a significant decline in Mongolian living standards.¹¹ Subsequently, the central government moved to privatize its state-owned economy and adopt other free market reforms. From 1990 to 2006, the proportion of GDP accounted for by the private sector rose from 4% to 80%. Such reforms enabled Mongolia to join the World Trade Organization (WTO) in 1997.

Mongolia has struggled to reform the economy while promoting economic growth. From 1997 to 2002, real GDP growth averaged only 2.8%.¹² In 2003, Mongolia agreed to pay Russia \$250 million, an enormous sum for the government, to resolve most of its debt obligations in an effort to strengthen investor confidence. From 2003 to 2006, real annual GDP growth averaged 7.5%; much of that growth resulted from increases in global metal prices (such as copper and gold), and relatively mild winters (which affects livestock). Global Insight, an economic forecasting firm, estimates that real GDP rose by 7.3% in 2006 (over the previous year) and projects that it will grow by 7.0% in 2007 (see **Table 1**).¹³ Among the major economic challenges currently facing Mongolia are: a weak banking system, sharp fluxes in global mineral prices, growing costs for imported energy, high unemployment, weak rule of law, government corruption, harsh weather conditions, and inadequate infrastructure.

⁸ (...continued)

United States, the actual purchasing power of its per capita GDP is actually much higher (\$2,735).

⁹ Economist Intelligence Unit, *Mongolia*, May 2007.

¹⁰ Such aid accounted for about one third of Mongolia's GDP.

¹¹ Per capita GDP on a PPP basis fell from \$4,575 in 1991 to \$1,326 (a 245% drop), and although living standards have improved, they were still 67% lower in 2006 than they were in 1991. Source, Global Insight, *Mongolia, Detailed Analysis*, March 2007.

¹² Economic growth was hampered by a number of factors, including severe weather conditions in 2000 and 2001, which damaged the agriculture sector. As a result, real GDP grew by only 1.0% in 2000 and by 1.1% in 2001.

¹³ Note, the Mongolian government reported even faster growth for 2006 at 8.4%

Table 1. Selected Economic Data for Mongolia

	2000	2005	2006	2007 (projected)
Real GDP Growth Over Previous Year (%)	1.1	6.2	7.3	7.0
Per Capita GDP (PPP \$ Basis)	1,796	2,503	2,735	2,958
Inflation (Consumer Price Index) (%)	6.2	8.9	5.3	5.0
Exports of Goods & Services (\$billions)	0.6	1.5	2.0	2.1
Imports of Goods & Services (\$billions)	0.8	1.6	1.9	2.2

Source: Global Insight.

Trade and Foreign Direct Investment

Mongolia's merchandise exports and imports in 2006 totaled \$1.5 billion and \$1.3 billion, respectively (see **Table 2**). The top three Mongolian exports were copper, gold, and animal hairs. Its top three imports were oil; machinery, equipment, and electrical appliances; and transport equipment. China is Mongolia's largest export market (accounting for 67.4% of total, mainly minerals), followed by Canada (11.1%) and the United States (7.7%). Russia is Mongolia's largest source of its imports (36.6% of total), followed by China (27.6%) and Japan (6.8%).¹⁴

According to the Mongolian government, at the end of 2004, there were 3,042 registered foreign investment companies from 73 countries with cumulative FDI of about \$1.2 billion.¹⁵ Around \$237 million was invested in Mongolia in 2004; of which 46% went into mining and oil exploration (the United States was the third largest foreign investor in this sector), 13% into trade and services (e.g., wholesale and retail trade, restaurants, and cafes), and 8% into light industry (mainly textiles and apparel). China was the largest foreign investor in Mongolia in 2004, followed by Canada and the United States (at \$135.4 million).¹⁶

¹⁴ Economist Intelligence Unit, *Mongolia*, May 2007

¹⁵ Foreign Investment and Foreign Trade Agency (FIFTA), government of Mongolia.

¹⁶ *Ibid.*

**Table 2. Major Mongolian Merchandise Exports and Imports:
2006**

Major Commodity	\$millions	Percent of total
Total Exports	1,531.1	100
Cooper concentrate	635.2	42.7
Gold and gold products	270.1	17.6
Cashmere and cashmere products	143.3	9.4
Total Imports	1,334.5	100.0
Mineral products (mainly oil)	446.3	33.4
Machinery, equipment, and electrical appliances	270.6	20.3
Transport equipment, vehicles, and spare parts	158.5	11.9

Source: Economist Intelligence Unit, Mongolia, May 2007.

U.S.-Mongolian Relations

Since the early 1990s, Mongolia has pursued an open and non-aligned foreign policy, seeking supportive friendships more broadly in Asia and around the world and taking a more active role in international organizations, particularly in the United Nations.¹⁷ Not surprisingly given its geographical location, the land-locked country maintains good relations with Russia and China, its two giant neighbors. As a new democracy, Mongolia also places a high priority on cultivating good relations with the United States, which government officials in Ulaan Bator have referred to as Mongolia's "third neighbor."

The United States recognized Mongolia in 1987 and since then has sought to expand cultural and economic ties. At Mongolia's invitation, the United States began a Peace Corps program there in 1991, which by 2007 was maintaining about 100 Peace Corps volunteers in the country.¹⁸ Also in 1991, following the signing of a bilateral trade agreement, the President restored Mongolia's most-favored-nation (MFN) trading status — now referred to as Normal Trade Relations (NTR) — under the conditional annual waiver provisions of Title IV of the Trade Act of 1974. NTR

¹⁷ Aside from U.N. organizations, Mongolia's participation in international organizations also includes: the Asian Development Bank, the Asian Regional Forum, the International Atomic Energy Association, the Pacific Economic Cooperation Council

¹⁸ According to the Embassy of the United States in Ulaanbaatar, Mongolia.

status was made permanent for Mongolia effective July 1, 1999, obviating the annual trade status review process.¹⁹

Mongolia remains a relatively minor (though growing) U.S. trading partner. According to International Monetary Fund (IMF) statistics, in 2005, U.S. exports to Mongolia totaled \$21.5 million, while imports totaled \$144 million.²⁰ According to the U.S. Department of Commerce, the most promising sectors for increased U.S. exports to Mongolia include mining, construction, franchising, information technology, tourism, and meat processing. On July 15, 2004, the United States signed a Trade and Investment Framework Agreement (TIFA) with Mongolia to boost bilateral commercial ties and resolve trade disputes. Since 1991, the U.S. Agency for International Development (USAID) has provided around \$150 million in assistance to Mongolia. Major USAID programs have focused largely on promoting sustainable private sector-led economic growth and more effective and accountable governance.

One primary U.S. interest in Mongolia is in supporting the country's ongoing transition from a communist state to a nation with a market-based economy and a democratically elected government. U.S. support for both Mongolia's political and its economic reforms has been tangible. The United States strongly supported Mongolia when it joined the IMF, the World Bank, and the Asian Development Bank in 1991. Congress annually has earmarked U.S. assistance amounts for Mongolia to signal its support. In addition, in 2007, the House Democracy Assistance Commission initiated a program of parliamentary assistance to Mongolia's parliament, the State Great Hural.

Millennium Challenge Account Eligibility. In FY2004, Mongolia became an eligible country for U.S. assistance through a Millennium Challenge Account (MCA). After a consultation process, Mongolia submitted an official MCA proposal to the Millennium Challenge Corporation (MCC) late in 2005. Since then, the MCC has been conducting "due diligence" on Mongolia's proposal (assessing it for its suitability, technical viability, and compliance with MCC environmental and other guidelines), after which bilateral negotiations are expected to begin on a final MCA Compact agreement. During her visit to Mongolia in January 2007, the Managing Director of the MCC, Frances Reid, reaffirmed that it was the U.S. intent to conclude an MCA agreement with Mongolia in 2007. On June 14, 2007, the MCC issued notification to Congress initiating a 15-day consultation period prior to commencing Compact negotiations with Mongolia.

Anti-Terror and Peacekeeping Support. Mongolia was an early political supporter of the U.S. global anti-terror effort, as well as an early logistics supporter, offering training opportunities and overflight clearances for U.S. forces. Mongolia has contributed troops, engineers, and medical personnel to Operation Iraqi Freedom since April 2003. At the request of the United States, Mongolian forces also are participating in training artillery units of the Afghan National Army. U.S.

¹⁹ See Section 2424 of The Miscellaneous Trade and Technical Corrections Act of 1999, enacted as P.L. 106-36, effective on July 1, 1999 by Presidential Proclamation 7207.

²⁰ Source: U.S. Department of Commerce and U.S. International Trade Commission data.

appreciation for this assistance led in part to last year's visits to Mongolia by Secretary of Defense Donald Rumsfeld (in October 2005) and President George Bush (in November 2005) — the first U.S. Defense Secretary and U.S. President ever to visit Mongolia. President Bush's visit resulted in a Joint Statement reaffirming the U.S.-Mongolian “comprehensive partnership between their two democratic countries based on shared values and common strategic interests...”²¹ In 2006, Mongolia expanded its global peacekeeping activities by sending a contingent of 250 soldiers to protect the U.N. war crimes tribunal in Sierra Leone, a platoon to participate in the NATO mission in Kosovo, and by helping to serve as U.N. observers in Sudan and Ethiopia/Eritrea.



²¹ November 21, 2005, [<http://www.whitehouse.gov/news/releases/2005/11/20051121-1.html>].