

**Fiscal Policy Decisions
for the 2010 Budget**

**Fiscal position before copper price boom
was solid:**

	Average 2001-05
in percent of GDP	
Revenue & grants	32.7
mineral revenue	2.6
non-mineral revenue	30.1
Expenditure & net lending	35.3
Overall balance	-2.6
Foreign financing	2.2
Domestic financing	0.6

During the boom, parliament decided to raise expenditures and lower the tax burden:

	Average 2001-05	2008	Change 2008 to average 2001-05
in percent of GDP			
Revenue & grants	32.7	35.4	2.7
mineral revenue	2.6	10.0	7.4
non-mineral revenue	30.1	25.4	<u>-4.7</u>
Expenditure & net lending	35.3	40.2	<u>4.9</u>
of which:			
Wages	6.7	8.9	2.2
Goods & services	10.9	8.3	-2.6
Subsidies & transfers	7.4	11.2	3.8
Capital expenditures	9.2	11.5	2.3
Overall balance	-2.6	-4.8	-2.2
Foreign financing	2.2	0.6	-1.5
Domestic financing	0.6	4.2	3.6

Some points to be noted:

- ✓ Lowering social contribution rates for employers can be justified in light of the high tax burden; raising pensions can be an effective way to reduce poverty. However, both measures create a very large financial burden, in particular if an obligation to move towards a fully-funded system is added.
- ✓ Raising wages can strengthen the civil service and be an effective distributive policy. But it also creates a lasting financial burden.
- ✓ Ditto for lowering VAT rates and increasing social transfers: these can be worthy policies, but they are expensive and cannot be easily reversed.

Bottomline: If the copper price boom had made Mongolia permanently richer, these could have been good policy choices. But with the copper price bust, it is likely that Mongolia will not be able to afford these policies (at least until OT starts up production, which could take another 3-6 years).

Fiscal constraints:

- ✓ Fiscal boom created imbalance of about 10 percent of GDP split about equally between revenue and expenditure side;
- ✓ Consolidation in 2009 improved expenditure side, but only somewhat: cuts fell on capital expenditures and goods & services (where expenditure growth was constrained during the

boom) whereas transfers actually increased;

	2008	2009 rev. proj.	Difference
in percent of GDP			
Revenue & grants	35.4	30.8	-4.7
mineral revenue	10.0	5.6	-4.4
non-mineral revenue	25.4	25.1	-0.2
Expenditure & net lending	40.2	37.3	-3.0
of which:			
Wages	8.9	9.4	0.6
Goods & services	8.3	5.9	-2.4
Subsidies & transfers	11.2	13.5	2.3
Capital expenditures	11.5	7.9	-3.6
Overall balance	-4.8	-6.5	-1.7
Foreign financing	0.6	5.0	4.3
Domestic financing	4.2	1.5	-2.7

- ✓ Mineral revenue could decline further in future because windfall profit tax may not be sustainable and Erdenet could become unprofitable;
- ✓ Banking sector restructuring will add sizeable fiscal burden;
- ✓ From a financing viewpoint, it would be difficult to sustain deficits that are much larger than 2 or 3 percent of GDP;

Need for fiscal consolidation: high-quality adjustment of about 4 percent of GDP is needed over next two years

- ✓ Expenditure measures:
 - Lower wage bill (but: sizeable changes should take place in context of more comprehensive

reform, e.g., pay-and-grading review; review of staffing levels; measures to address ghostworkers)
→ in short run, keeping nominal wages constant may be the best that can be achieved;

- Rolling back pension benefits: would need to consider social impact and take place in context of larger pension reform;
- Rolling back subsidies: should be feasible, but savings are not sufficient



Revenue measures:

- Reversing reduction in VAT rates
- Reversing reduction in social contribution rates: this would be part of any pension reform because

of the size of the gap (T150 billion in 2009 budget)

Proposal for 2010 budget: using MTFP and updated projections as starting point, there is a gap of about T275 billion to deficit target of 4 percent of GDP; if about T150 billion of this gap were to be closed through high-quality measures, we could agree to close the rest through a higher deficit target and relatively easy low-quality measures;

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Options for 2010 Budget Savings

Low-quality measures	Approximate savings potential relative to SBA proj.:	Medium-quality measures	Approximate savings potential relative to SBA proj.:	High-quality measures	Approximate savings potential relative to SBA proj.:
- cut capital expenditures (project loans appear overestimated in SBA projection)	T100 billion	- cut subsidies	T33 billion T12 billion T16 billion T5 billion	- reverse cut in VAT rates e.g., raise VAT rates by 2 percentage points:	T70 billion
			eliminate wheat subsidy: half transport and energy subsidies: eliminate private production subsidy:	- reduce pension gap e.g., by raising social contribution rates by 3 percentage points:	T45 billion
		- raise excise taxes	double vehicle excise rate: raise domestic alcohol excise by 50%: double imported alcohol excise rate:	- reduce wage bill in real terms e.g., keep nominal wage bill at 2009 level	T60 billion
		- reduce miscellaneous transfer items reduce 'Employment, SME grants, support and training' by one third reduce 'Tuition grant' by one third reduce 'Living allowance for students' by one third reduce 'Lunch program' by one third		- reduce social welfare expenses through welfare reform	T60 billion

Illustrative budget table—revenue:

	2009			2010		comments
	Program March 09	Budget July 09	revised forecast	SBA Request	revised forecast	
in billion togrogs						
Total revenue and grants	1,936.1	2,054.7	1,909.5	2,269.2	2,082.9	
Mineral revenue	241.0	346.8	348.2	362.7	276.9	
Nonmineral revenue	1,695.0	1,707.8	1,561.3	1,906.5	1,806.0	
Current revenue	1,911.7	2,030.3	1,867.8	2,241.4	2,056.1	
Mineral revenue	241.0	346.8	348.2	362.7	276.9	
Nonmineral revenue	1,670.7	1,683.4	1,519.6	1,878.7	1,779.2	
Tax revenue and social security co	1,583.1	1,697.7	1,523.2	1,887.3	1,777.3	
Income taxes	375.7	451.8	425.6	484.9	518.2	
Enterprise income tax	221.0	223.5	177.9	284.3	203.7	
i. Erlendet	13.8	13.8	9.6	90.4	15.7	
ii. Others	207.2	209.7	168.4	193.9	188.1	
iii. OT	-	-	-	-	-	
Personal income tax	98.7	98.7	134.1	112.6	149.8	
"Windfall" tax	56.0	129.7	113.6	87.9	164.7	
Social security contributions	244.6	251.7	268.4	279.2	344.8	Increase in social contribution rates to 23%
Sales tax and VAT	392.3	414.0	342.7	431.5	380.6	
Domestic VAT	143.4	143.4	167.9	163.7	187.6	
VAT on imports	319.1	340.8	238.1	348.0	271.5	
VAT rebates	70.2	70.2	63.2	80.2	78.5	
Excise taxes	203.4	198.3	166.6	260.3	189.1	
Excise on domestic alcohol and tobacco	73.2	70.1	69.6	83.5	77.8	
Excise on imported vodka and tobacco	23.1	20.4	20.1	29.2	23.6	
Excise on imported beer	7.5	8.2	4.0	9.6	4.7	
Excise on vehicles	33.6	33.6	32.0	42.5	37.5	
Excise on petroleum	58.6	58.6	33.1	87.0	36.8	
Excise on domestic beer	7.5	7.5	7.7	8.5	8.6	
Customs duties and export taxes	155.1	163.2	115.6	170.9	165.0	
Customs duties	143.5	151.6	106.9	157.7	155.3	
Export taxes	11.6	11.6	8.7	13.2	9.7	
Other taxes	212.0	218.7	204.3	260.6	179.5	
Petrol and diesel tax	9.2	9.2	7.1	13.7	8.0	
Vehicle license fee	7.8	7.8	9.9	8.9	11.0	
Tax on private property	10.3	10.3	11.7	11.8	13.1	
Other	184.7	191.5	175.6	226.3	147.4	
of which:						
State Stamp Fee (incl License)	37.4	37.4	10.7	42.7	12.0	
Royalty	86.7	118.9	130.1	108.8	96.6	
Nontax revenue	328.6	332.6	344.6	354.1	278.8	
Interest and fines	18.3	18.3	35.9	20.9	40.1	
Own budget revenues	140.6	140.6	116.6	160.4	130.3	
Dividends	94.4	94.4	104.9	86.8	11.1	
i. Erlendet	84.5	84.5	95.0	75.5	0.0	
ii. Others	9.9	9.9	9.9	11.3	11.1	
iii. OT	-	-	-	-	-	
Receipts from renting state property	1.7	1.7	1.0	1.9	1.1	
BOM profit transfer	5.0	5.0	5.0	5.7	5.6	
Other nontax revenue	68.6	69.8	81.1	78.2	90.6	
Capital revenue and grants	24.4	24.4	41.7	27.8	26.8	
Capital revenue	2.4	2.4	2.6	2.7	2.9	
Grants	22.0	22.0	39.1	25.1	23.9	

Illustrative budget table—expenditures:

	2009		2010			
	Program March 09	Budget July 09	revised forecast	SBA Request	revised forecast	comments
in billion togrogs						
Total expenditure and net lending	2,316.1	2,418.9	2,314.7	2,559.3	2,395.4	
Current expenditure	1,793.7	1,824.5	1,824.5	1,918.4	1,853.9	
Wages and salaries	566.0	585.7	585.7	645.6	585.7	Wage bill kept at 2009 level
Purchase of goods and services	343.9	347.1	367.1	392.3	432.1	Allocation increased
Subsidies to public enterprises	47.2	49.2	49.2	53.8	24.2	Cut in subsidies
Transfers	752.6	798.7	788.7	807.3	751.3	Transfers kept at level in March 2009 budget
Interest payments	84.0	54.5	33.9	19.3	60.6	
Foreign interest	80.7	51.2	30.5	13.7	31.6	BOP forecast
Bank restructuring bonds				0.0	14.2	Anod restructuring
Treasury bills				0.0	0.9	
Other internal	3.4	3.4	3.4	5.6	13.9	Gold-financing operation
Capital expenditure and net lending	522.4	583.7	490.2	640.9	541.5	
Capital expenditure	421.0	482.3	431.4	477.8	448.3	
Domestically-financed	391.4	450.3	405.2	425.1	425.1	
Foreign-financed	29.6	32.0	26.1	52.8	23.3	BOP forecast for project loans
Net lending	101.4	101.4	58.8	163.1	93.2	
On-lent foreign project loans	122.0	122.0	87.6	186.6	116.7	BOP forecast for project loans
Lending				0.0	0.0	
Repayment				0.0	0.0	
Domestic lending minus repayments	-20.6	-20.6	-28.7	-23.5	-23.5	
Overall balance (incl. grants)	-380.0	-364.2	-405.2	-290.1	-312.4	
Current balance (excl. privatization receipts)	118.0	195.1	43.3	322.9	202.2	
Primary Balance	-296.0	-309.7	-371.3	-270.8	-251.8	
Nonmineral primary balance	-537.0	-656.5	-719.5	-633.5	-528.7	
Nonmineral overall balance	-621.0	-711.1	-753.4	-652.8	-589.3	
Memorandum item:						
Overall balance in percent of GDP	-6.0	-5.8	-4.5	-4.0	-4.5	Fiscal target relaxed
Nominal GDP (billions of Togrogs)	6,294.4	6,294.4	6,209.4	7,179.8	6,930.9	

Measures for 2009 budget:

- ✓ Reinstating petroleum excise tax'
- ✓ Ensuring that commercial banks repay gold-financing loan before year end;
- ✓ VAT refund system for exporters may need to be revisited