

CHAPTER 2

FISCAL SECTOR

2.1 FISCAL POLICY

2.2 GOVERNMENT DEBT SUSTAINABILITY

2. FISCAL SECTOR

OVERVIEW

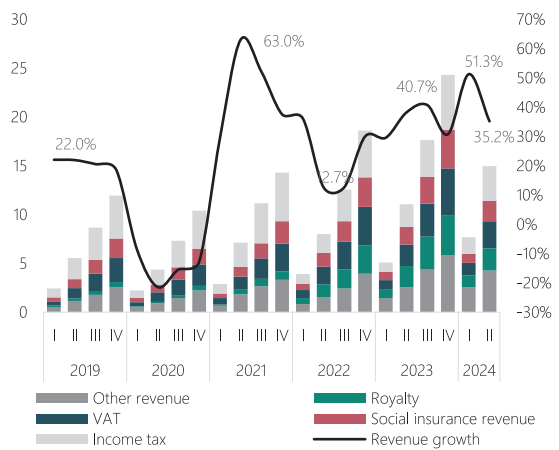
Although the overall fiscal balance recorded a surplus of MNT 57.9 billion in the second quarter of 2024, driven by strong domestic economic activity and increased demand for coal, the seasonally adjusted balance was at a deficit of MNT 40.4 billion. The increase in salaries for public sector employees—aimed at supporting civil servants, encouraging regional development, and creating a favorable living environment in rural areas—positively impacted household real incomes, which grew by 17.3 percent in the first half of 2024. The government's debt-to-GDP ratio, expressed in nominal terms, fell to 38.3 percent in the first half of 2024. However, due to the issuance of securities in both domestic and international markets by the capital city, the government's debt is expected to rise in the medium term because of pending issuances of new external and domestic bonds by Ulaanbaatar City.

26. The growth of the budget income was mainly influenced by the high activity of the domestic economy and the increase in the volume of exports of mining products. Budget revenue reached MNT 14.9 trillion in the first half of 2024, an increase of 35.2 percent from the same period last year. The domestic demand of the economy has become active, and in the first half of 2024, government consumption has expanded by 46.9 percent and household consumption by 16.9 percent, respectively, compared to the same period last year. As a result, VAT revenue reached MNT 2.8 trillion in the first half of 2024, an increase of 27 percent from the same period last year (Figure 2.1). In addition, due to the decrease in China's coal production, the demand has increased and the volume of coal exports reached 40.6 million tons in the first half of 2024, which is a 27 percent increase from the same period last year. Consequently, CIT's income increased by 74.4 percent and royalty's income increased by 21.7 percent, respectively. (Figure 2.1)

27. The multiple increases in wages and pensions has had a positive effect on household income. Total budget expenditure in the first half of 2024 reached MNT 12.9 trillion, an increase of MNT 3.9 trillion, or 42.9 percent, compared to the same period last year. As part of the government's policy to reform the civil service and enhance social security for civil servants, which is indicated in the New Recovery Policy, the salaries of civil servants were increased by an average of 40 percent starting from July 1, 2023. Additionally, from April 1, 2024, salaries for general public service employees increased by 20 percent. The wage floor for civil servants of public service was also raised by 20 percent, while other civil servants' salaries increase by 10 percent. Furthermore, as part of the decentralization policy, the salaries of district civil servants in remote provinces and sums have been increased by 20-40 percent. These policies and actions contributed to a 17.3 percent increase in real household income. (Figure 2.2)

Figure 2.1. Budget revenue

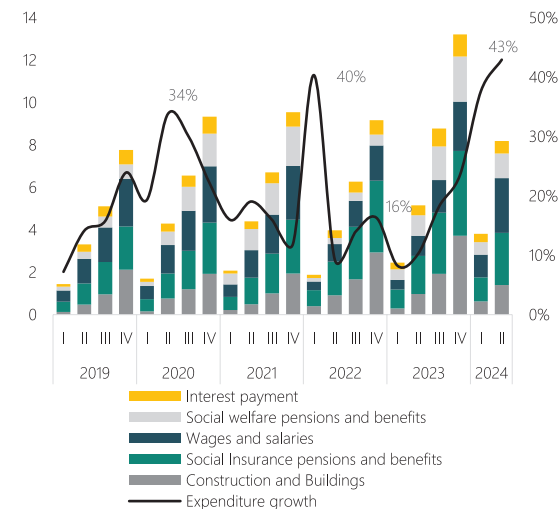
(in trillion MNT: left axis, percent: right axis)



Source: Ministry of Finance

Figure 2.2. Budget expenditure

(in trillion MNT: left axis, percent: right axis)

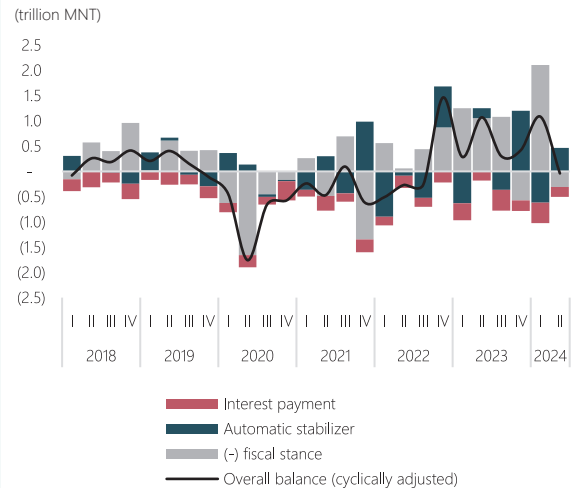


Source: Ministry of Finance

28. As of the first half of the year, the performance of public investment has been slow. As of the first half of 2024, the performance of investment financing is 15.5 percent. Due to this underperformance, capital adjustments have been made based on the progress of ongoing projects. Funding for stalled projects, which are no longer capable of receiving financing, is being reallocated to projects that are progressing well.

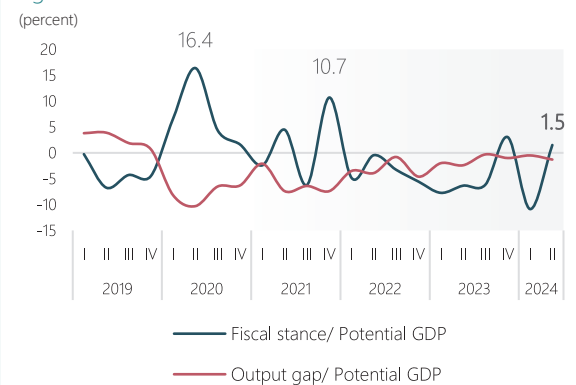
29. In the second quarter of 2024, the total budget balance showed a profit of MNT 57.9 billion, but if seasonal effects are removed, there is a deficit of MNT 40.4 billion. Although the effect of the automatic stabilizer, which represents the economic overall performance and economic cycle, was positive, cyclically adjusted budget balance resulted deficit due to the implementation of expansionary budget policy compared to the previous fiscal year. Figure 2.3 shows the contributions to the budget balance, the effects of the economic cycle which is fiscal policy as a fiscal stance, and the debt burden as interest costs. The impact of fiscal policy related to fiscal expansion on the seasonally adjusted gross balance deficit MNT -309.4 billion, the impact of interest expenses had a negative impact equivalent to MNT -193.3 billion, while the effect of the economic cycle related to internal economic activity had a positive impact of MNT 462.3 billion. As a result, fiscal impulse or the variance of the fiscal policy, calculated as the annual change in the fiscal stance, reached MNT 1.3 trillion, which is the highest change since the COVID-19 pandemic.

Figure 2.3. Overall balance, fiscal stance, automatic stabilizer



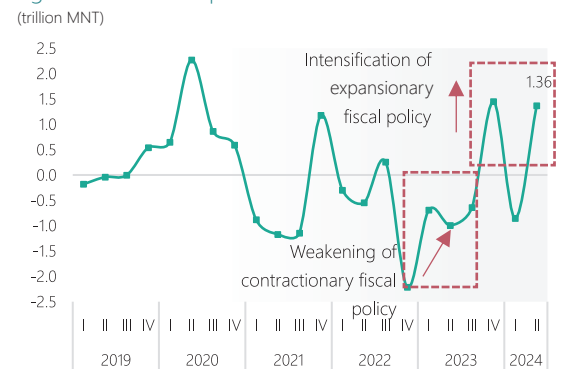
Source: Ministry of Economy and Development estimation
Note: All variables in the estimation are calculated on a non-cumulative basis

Figure 2.4. Fiscal stance



Source: Ministry of Economy and Development's estimation

Figure 2.5. Fiscal impulse



Source: Ministry of Economy and Development's estimation

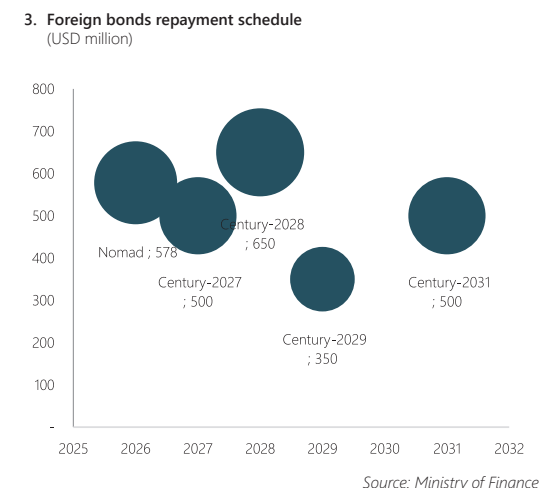
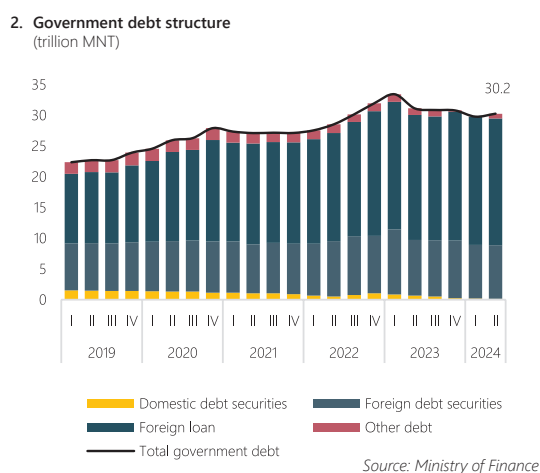
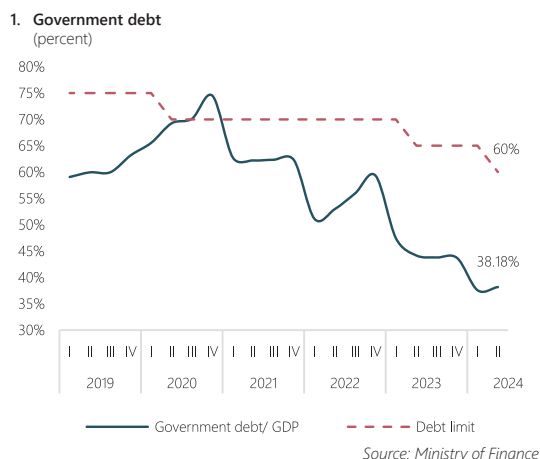
GOVERNMENT DEBT SUSTAINABILITY

30. The government debt in nominal term decreased by 2.8 percent compared to the same period last year but increased by MNT 475.4 billion from the previous quarter. By the first half of 2024, the government's total debt stood at MNT 30.2 trillion, reflecting a decline of MNT 863 billion from the same period last year. This reduction was driven by a decrease in domestic debt by MNT 510 billion and contingent liabilities by MNT 490 billion. However, compared to the previous quarter, government debt increased by MNT 475.4 billion, primarily due to a rise in government-guaranteed debt by MNT 225.3 billion and an increase in local loans by MNT 500 billion.

31. In the short term, budgetary pressures from bond repayments remain low. As of the first half of 2024, the balance of the government's foreign securities stands at MNT 8,716 billion. The Nomad, Century-2027, Century-2028, Century-2029, and Century-2031 bonds, which were issued since 2020 and traded on international markets, were exclusively for debt refinancing purposes. Through the implementation of debt management measures, the the bonds maturing between 2022-2024, Chingis, Gerege, and Khuraldai, were succesfully paid under the Century program, totaling USD 2.2 billion, of which USD 281 million was covered by state funds. Although no foreign securities are due for repayment until 2026, a total repayment of USD 2.6 billion is planned over the next five years, starting from 2026.

32. The share of foreign debt in the government total debt is high. As of the first half of this year, foreign loans accounted for 70 percent of the government's external debt and 68 percent of its total debt. The balance of foreign loans increased by MNT 334 billion compared to the same period last year, totaling MNT 20,630.2 billion. Meanwhile, MNT 582.0 billion was paid for foreign loan servicing, or interest payments, with a total of MNT 2,719.5 billion expected to be paid this year. Over the past two years, a total of MNT 1,941.2 billion

Figure 2.6 Government debt situation



has been paid in foreign interest payments. In 2024, a total of 106 projects and initiatives are being financed through foreign loans, including 44 construction projects related to electricity and heat supply.

33. The primary balance has a significant impact on the medium-term outlook for government debt.

Debt sustainability analysis can illustrate how sensitive the government's debt stability is to key macroeconomic indicators. For the purpose of this analysis, the following assumptions are made: 1) there are no policy or structural changes; 2) all variables except those affected by the shock remain constant; 3) the base level remains unchanged in all years except the year in which the shock occurs.

Based on the baseline projection from 2024 to 2027, GDP growth is forecasted at 5.6 percent, 8.0 percent, 6.5 percent, and 6.5 percent, while inflation is projected at 6.5 percent, 7.5 percent, 5.0 percent, and 4.0 percent. Currency depreciation is assumed to remain at the average level of the past 10 years, and other macroeconomic indicators are expected to remain stable at their 2023 levels.

By 2027, government debt is projected to equal 42.7 percent of GDP. The impact of shocks on key indicators is estimated at 1 standard deviation for the years 2025 and 2026. The analysis shows that if such shocks occur, there is a 25 percent probability that government debt in 2027 will increase from the baseline projection by 15.4 percent and 28.8 percent, respectively.

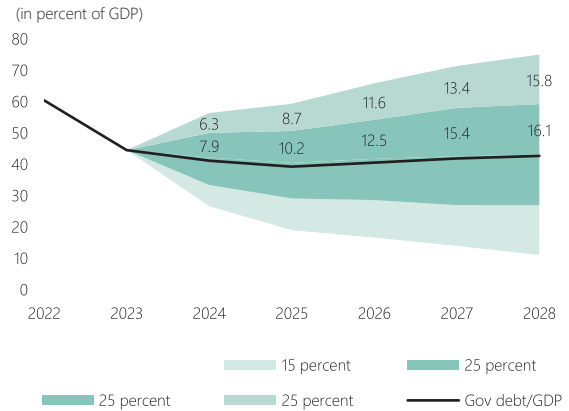
34. Maintaining the primary balance at a sustainable level is crucial for ensuring the stability of the public debt.

The factors influencing government debt are assessed through debt dynamic analysis, as illustrated in Figure 2.7. In 2016, the nominal government debt-to-GDP ratio increased by 30.6 percent, with the primary balance deficit contributing 11.2 percentage points to this rise. In 2020, the primary balance deficit accounted for 6.9 percentage points of a 10.1 percent increase in public debt.

In 2023, the nominal government debt-to-GDP ratio decreased by 15.8 percent, with changes in real interest rates contributing 6.4 percentage points, and the primary balance surplus accounting for 4.3 percentage points of this decline. Looking ahead, real GDP growth and the primary balance are expected to have significant impacts on debt sustainability.

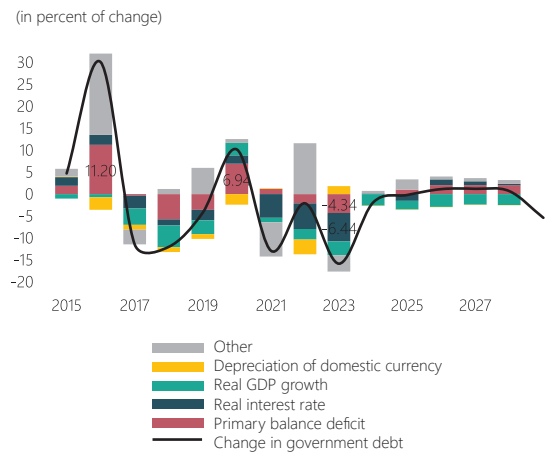
Figure 2.7. Stability of government debt

1. Effects of adverse shocks on government debt and nominal foreign interest rates and exchange rates



Source: Ministry of Economy and Development estimation

2. Factors affecting government debt



Source: Ministry of Economy and Development estimation

BOX 2. CHANGES TO THE LAW ON FISCAL STABILITY

The Law on Amendments to the Law on Budget Stability was approved at the special session of the National Assembly on August 29, 2024. The amendment has modified the following special fiscal requirements of the law.

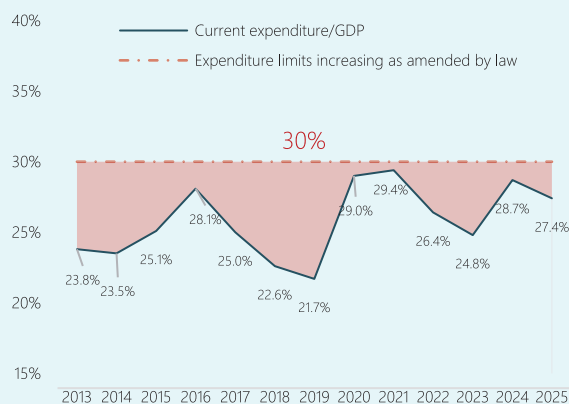
Table 2. Changes and amendments to the Special fiscal requirements

Special fiscal requirements	In accordance with the previous version of the law	Amendment on 5 th of June, 2024	Amendments to the 2024 Budget Amendment
Budget revenue	To calculate the budget revenue, average price projections of the main mining products for the coming years calculated by the international organization should be used.	No changes	No changes
Budget expenditure	Not to exceed the previous year's growth of the non-mining sector and the average growth of the last 12 years	No changes	<ul style="list-style-type: none"> Budget current expenditure should not exceed 30 percent of GDP. The growth of total budget expenditure will not be restricted by the growth of the non-mining sector.
Budget Balance	Structural budget balance deficit should not exceed 2 percent of the gross domestic product of the current year, or a surplus	Starting from 2025, the budget deficit limit had been abolished.	<ul style="list-style-type: none"> The structural balance limit has not changed. The base balance, which is new concept to the budgeting balance, is additionally calculated. The base balance should be +2 percent of GDP or more.
Government debt	The amount of government debt should not exceed 60 percent of the gross domestic product, expressed in present value	The government debt should not exceed 60 percent of GDP starting from 2025	The government debt shall be calculated in nominal terms and the amount shall not exceed 60 percent of the GDP.

1. Repeal the provisions limiting the growth of total budget expenditures and ensure that current expenditures do not exceed 30 percent of GDP. The average current expenditures of consolidated budget of Mongolia over the past 10 years amount to 25.4 percent of GDP. According to the recent amendment, current budget expenditures are now capped at 30 percent of GDP. While this change increases the government involvement in the economy in the short term, it poses a potential risk of reducing the role of the private sector (as illustrated in Figure 2.8).

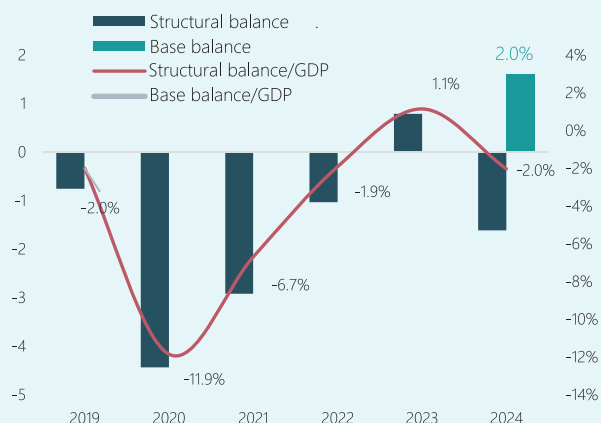
2. Calculate the base balance of the budget and maintain it at a surplus of 2 percent of GDP or more. Base balance is determined by subtracting the base expenditure from total revenue. Base expenditures are defined as the total expenditure minus "expenses financed by securities and foreign loans." This approach risks leading to fiscal instability, increased government intervention in the market, a rise in debt, weakened fiscal discipline, a potential downgrade of the country's credit rating, and excessive issuance of securities by government and local budget managers to fund capital expenditures. Such imbalances in the financial market could result in a loss of macroeconomic stability.

Figure 2.8. Current expenditure
(in percent of GDP)



Source: Ministry of Finance

Figure 2.9. Fiscal balance
(percent: right axis, trillion MNT: left axis)



Source: Ministry of Finance

3. The government's debt should not exceed 60 percent of the gross domestic product, calculated as a nominal amount.

According to the "Fiscal Discipline" indicator of the Economic Freedom Index announced by the World Heritage Foundation, the country's debt-to-GDP ratio is calculated as the average of the last 3 years. For Mongolia, the above-mentioned indicator is 71.9 percent as of 2023, or ranks 125th out of 195 countries in the world. According to this assessment, in order to be in the first half of the world, our country should limit the share of government debt to GDP to no more than 50 percent and take measures to gradually reduce the share of debt to GDP.

Table 3. Public debt

Indicator	2019	2020	2021	2022	2023	2024.II
Government debt, in nominal value, in trillion ₮	24.1	27.9	26.9	32.0	30.7	30.2
<i>Share of GDP</i>	65.3%	75.5%	62.6%	60.5%	44.6%	38.3%
Government debt, in present value, in trillion ₮	20.5	23.0	21.8	27.7	26.5	26.2
<i>Share of GDP</i>	55.6%	62.3%	50.8%	52.4%	38.5%	33.2%

Source: Ministry of Finance

BOX 3. THE IMPACT OF DIGITIZATION ON FISCAL REVENUE

Over the past two years, several initiatives have been implemented to enhance budget revenues by broadening the tax base and improving budget expenditure control through digitization and technological advancements. These measures include:

- **Enhancement of VAT Reporting:** By integrating goods, services, and works funded by budget investments into the tax registration information system, and shifting all budget-related cash flows to an e-payment receipt system, the efficiency of budget revenue collection has improved significantly. (Figure 2.10)
- **Improvement in Budget Expenditure Control:** A systematic requirement was introduced for enterprises financed by the budget to be connected to the tax registration information system, increasing the flow of tax income. As a result, in the first half of 2023, 51,199 entrepreneurs working with 4,939 budget-financed organizations reported sales income totaling MNT 2.3 billion. In the first half of 2024, this figure rose to 56,946 enterprises reporting sales income of MNT 3.1 billion. (Figure 2.10)
- **Excise Duty Control on Alcoholic Beverages and Tobacco:** Under the scope of the Law on Controlling Excise Goods, the collection of excise duties on domestic and imported goods has been streamlined. Agencies such as the General Department of Taxation, MOF, Customs and other relevant ministries exchange information to determine the origin of goods. Approval certificates for each commodity are now issued electronically, customs clearance has been simplified, and tax reporting has been automated. (Figure 2.10)

Figure 2.10. Tax revenue

