



investment policy review



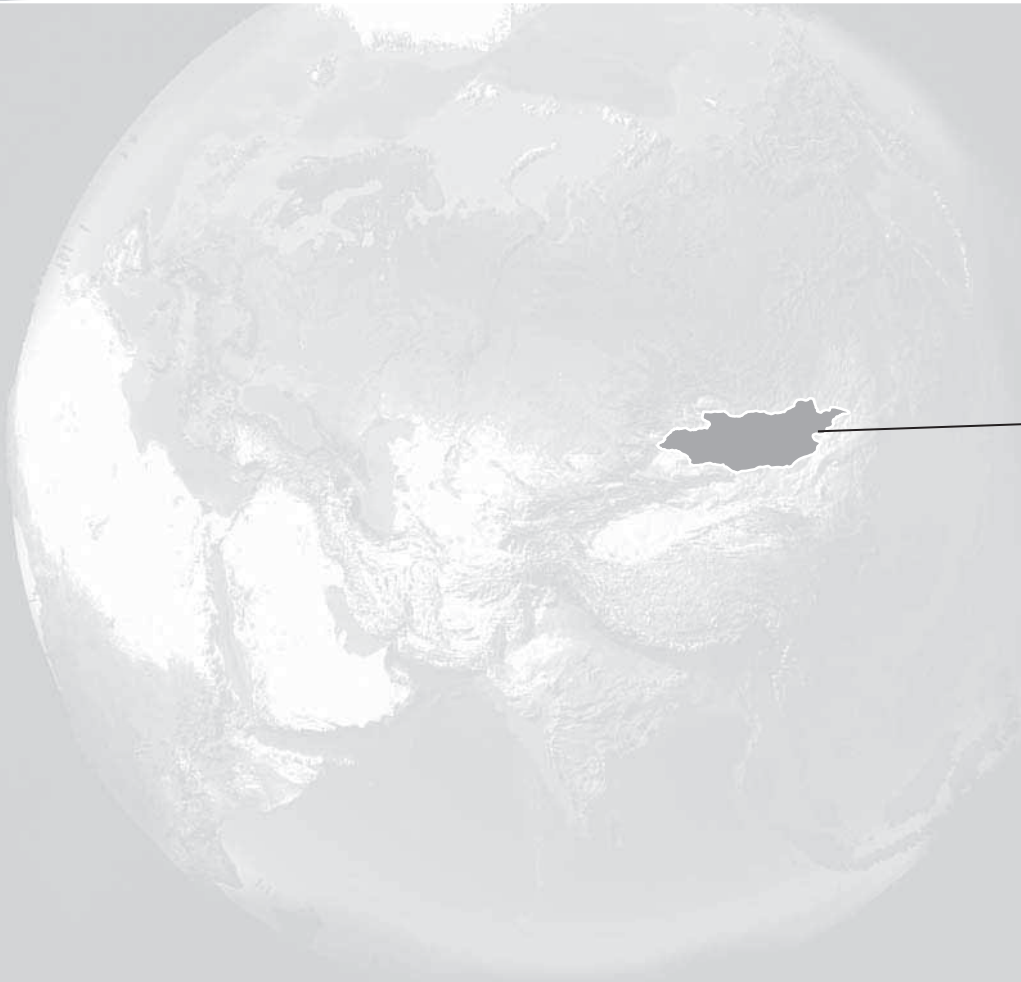
MONGOLIA



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investment policy review



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Preface

The UNCTAD Investment Policy Reviews (IPRs) are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered by the UNCTAD Commission on Investment, Enterprise and Development. The recommendations of the IPR are then implemented with the technical assistance of UNCTAD. The support to beneficiary countries is delivered through a series of activities which can span over several years.

The Investment Policy Review of Mongolia, initiated at the request of the Government, was carried out through a fact-finding mission in October 2011, and is based on information made available to UNCTAD until May 2013. The mission received the full cooperation of the relevant ministries, departments and agencies, in particular the Foreign Investment and Foreign Trade Agency (FIFTA), now Department of Foreign Investment Regulations and Registration (DFIRR) of the Ministry of Economic Development, and of the Ministry of Foreign Affairs (MFA). The mission also benefited from the views of the private sector, foreign and domestic, bilateral donors and development agencies. A draft version of this report was discussed with stakeholders at a national workshop in Ulaanbaatar on 26 March 2013.

The relevance and effectiveness of the regulatory regime is informed by UNCTAD's Investment Policy Framework for Sustainable Development (UNCTAD, 2012) and assessed against several related criteria: (a) whether the regulation adequately promotes and protects the public interest; (b) whether the regulation adequately promotes investment and sustainable socio-economic development; and (c) whether the policies employed are effective and well administered, given their public interest and development objectives and the legitimate concerns of investors that rules and procedures do not unduly burden their competitiveness. International benchmarks and best policy practices are also taken into account in making the assessment and recommendations in this report.

Building on an analysis of Mongolia's economy and a critical assessment of the investment framework, this Review proposes an investment and FDI strategy that focuses on promoting economic diversification, regional development and more broad-based and inclusive growth. Chapter I presents Mongolia's national development objectives, including in respect to FDI, before analyzing the key economic and social determinants for FDI and assessing the recent FDI attraction performance and its impact on the economy. Chapter II evaluates the legal and regulatory framework for FDI and domestic investment. Chapter III proposes a comprehensive FDI strategy, including recommendations stemming from the analysis of the previous chapters. A table summarizing the recommendations of the report is contained at the end of chapter III.

This report was prepared by the Investment Policy Reviews Section under the supervision of Chantal Dupasquier, Chief of the Section. Joerg Weber, Head of the Investment Policies Branch in DIAE, and James Zhan, Director of DIAE, provided overall guidance. The report was drafted by Hans Baumgarten, Massimo Meloni and Stephen Young. Irina Stanyukova provided statistical support. Cletus Dordunoo provided editorial support. It also benefited from comments and suggestions from UNCTAD colleagues under a peer review process. It was co-funded by the Government of Sweden and the Government of Mongolia.

Geneva, June 2013

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Abbreviations and Glossary

| | | | |
|--------------|--|----------------|--|
| ADB | Asian Development Bank | GFCF | Gross fixed capital formation |
| AFCCP | Authority for Fair Competition and Consumer Protection | GI | Geographical indication |
| AIMAG | Provincial unit of Mongolia | GoM | Government of Mongolia |
| BCM | Business Council of Mongolia | IAAC | Independent Authority against Corruption |
| BIT | Bilateral investment treaty | ICC | International Chamber of Commerce |
| BoM | Bank of Mongolia | ICSID | International Centre for Settlement of Investment Disputes |
| BOO | Build-operate-own | ICT | Information and communication technology |
| BOT | Build-operate-transfer | IFC | International Finance Corporation |
| CAIS | Customs Automated Information System | IFI | International financial institution |
| CIM | Chartered Institute of Marketing | IGE | Intergovernmental group of experts |
| CIPFA | Chartered Institute of Public Finance and Accountancy | IMF | International Monetary Fund |
| CIRM | Centre for International Research and Marketing | INFOTEP | Instituto Nacional de Formación Técnico Profesional |
| CSR | Corporate social responsibility | IPA | Investment promotion agency |
| DBM | Development Bank of Mongolia | IPO | Initial public offering |
| DFIRR | Department of Foreign Investment Regulation and Registration | JICA | Japan International Cooperation Agency |
| DTT | Double taxation treaty | JV | Joint venture |
| EBRD | European Bank for Reconstruction and Development | KOICA | Korean International Cooperation Agency |
| EIA | Environmental impact assessment | LDCs | Least developed countries |
| EPCRC | Economic Policy and Competitiveness Research Center | Mbps | Megabyte per second |
| EU | European Union | MCC | Millennium Challenge Corporation |
| FAO | Food and Agriculture Organization | MCST | Ministry of Culture, Sports and Tourism |
| FDI | Foreign direct investment | MED | Ministry of Economic Development |
| FIFTA | Foreign Investment and Foreign Trade Agency (former) | MES | Ministry of Education and Science |
| FIL | Foreign Investment Law | MFA | Ministry of Foreign Affairs |
| FSIG | Financial Services Investment Group | MFAT | Ministry of Foreign Affairs and Trade (former) |
| FZ | Free zone | MFN | Most-favoured nation |
| GASI | General Agency for Specialized Inspection | MMRE | Ministry of Mineral Resources and Energy (former) |
| GASR | General Authority for State Registration | MNCCI | Mongolian National Chamber of Commerce and Industry |
| GATS | General Agreement on Trade in Services | MNET | Ministry of Nature, Environment and Tourism (former) |
| GDP | Gross domestic product | MNEGD | Ministry of Nature, Environment and Green Development |
| GER | Traditional felt-lined tent | | |

| | | | |
|-------------------------|--|-----------------|--|
| MNT | Mongolian Tughrík | TEFL | Teaching of English as a Foreign Language |
| MNTC | Mongolian National Tourism Centre | TNCs | Transnational corporations |
| MoF | Ministry of Finance | TRIMs | Agreement on Trade-Related Investment Measures |
| MoL | Ministry of Labor | TRIPs | Agreement on Trade-Related Aspects of Intellectual Property Rights |
| MoM | Ministry of Mining | TVET | Technical and vocational education and training |
| MSE | Mongolian Stock Exchange | UB | Ulaanbaatar |
| MTA | Mongolian Tax Administration | UNCC | United Nations Convention against Corruption |
| MTO | Mongolian Tourism Organization | UNCITRAL | United Nations Commission on International Trade Law |
| NDIC | National Development and Innovation Committee | UNCTAD | United Nations Conference on Trade and Development |
| NDS | National Development Strategy of Mongolia | UNDP | United Nations Development Programme |
| NSO | National Statistical Office | USAID | United States Agency for International Development |
| PFS | Pre-feasibility study | VAT | Value-added tax |
| PPP | Public-private partnership | WEF | World Economic Forum |
| R&D | Research and development | WIR | World Investment Report |
| SBA | Stand-by-Agreement | WOS | Wholly-owned subsidiary |
| SCM | Agreement on Subsidies and Countervailing Measures | WTO | World Trade Organization |
| SEFIL | Law on Foreign Investment in Strategic Sectors | ZHUD | A drought followed by an unusually harsh winter |
| SEW | Single electronic window | | |
| SMEs | Small and medium enterprises | | |
| SPC | State Property Committee | | |
| SOE | State-owned enterprise | | |
| STATE IKH KHURAL | Parliament of Mongolia | | |

Executive summary

Mongolia is a resource-rich country with formidable growth prospects. Having adopted a democratic system and a market economy, the country is today at a turning point, as the discovery of huge mineral resources could pave the way to rapid economic and social development. While many of the building blocks of such development are in place, further efforts are required to ensure that the revenues derived from the mining industry are used effectively and geared towards sustainable development. In this regard, the UNCTAD Investment Policy Review (IPR) of Mongolia focuses on how to attract and use foreign direct investment (FDI) and other forms of transnational corporation (TNC) involvement to foster economic diversification, which is recognized as fundamental to achieving inclusive growth and poverty reduction.

Due to the mining boom, Mongolia is in the group of countries with the highest growth potential over the next decades. The developmental gains that could be generated by the mining boom are however not automatic. Sound macroeconomic management will be fundamental to achieve sustainable and inclusive development. FDI has a crucial role to play in economic diversification and avoiding a resource curse. To date, however, FDI is skewed by sector (mining), country of origin (China), and region for non-mining FDI (Ulaanbaatar). There is limited FDI in services and manufacturing, and the number of global TNCs outside mining remains very low. Without urgent and forceful policy action, these imbalances could grow.

Although there are many opportunities, a "wait-and-see" attitude prevails among foreign investors, especially outside mining and beyond traditional source countries of investment. The attraction of FDI to new sectors and from new countries of origin will depend, to a great extent, on the capacity to maintain a stable macroeconomic environment, significantly improve governance and efficiently deliver public services. The IPR of Mongolia thus proposes a comprehensive FDI and foreign operations strategy informed by UNCTAD's Investment Policy Framework for Sustainable Development and focusing on three pillars of diversification:

- a. sectoral diversification designed to generate economic growth outside mining;
- b. geographical diversification designed to promote regional development within Mongolia and the crowding-in of domestic investors; and
- c. source country diversification aimed at reducing dependency on a small number of FDI-supplying nations.

1. New objectives and tools of a comprehensive FDI strategy

The Government of Mongolia recognizes FDI as a major contributor to the long-term development of a knowledge economy. The objectives established in various policy documents for FDI lack cohesion and ambition, and fail to address the basic weaknesses of the economy. Implementing the strategy proposed in this IPR requires the adoption of new policy objectives as well as a new approach to FDI, based on the quality of the investment climate, and on professional investment promotion.

Mongolia should seek to increase FDI from non-traditional sources by significantly improving the investment climate, particularly in terms of governance, public sector efficiency and legal certainty. Accordingly, limiting FDI inflows from any one country in order to achieve

Due to the mining boom, Mongolia is in the group of countries with the highest growth potential. The development gains from mining are however not automatic

a more balanced distribution of source-country investment would be inappropriate and counterproductive. In this regard, the foreign investment legislation should be revised to reflect Mongolia's open stance and practice towards FDI. Furthermore, the comprehensive investor screening mechanism stipulated in the law (although not used in practice) should be abandoned. This also applies to the new Law on the Regulation of Foreign Investment in Entities operating in Strategic Sectors. The national security concern expressed by the law could be better protected through the adoption of a proper national security test based on explicit objectives and criteria. The remaining concerns regarding the impact of investment on competition or the environment should be addressed by the relevant agencies at the permitting stage.

Mongolia's investment promotion agency has a central role to play in the implementation of many of the programmes for achieving diversification through FDI presented in the IPR and mentioned below. Thus, the Department of Foreign Investment Regulations and Registration (DFIRR) of the Ministry of Economic Development (MED) should become a proactive, private sector-led and state-of-the-art investment promotion agency. Two issues are highlighted:

Mongolia should seek to increase FDI from non-traditional sources by improving governance, public sector efficiency and legal certainty

- First, the redesign of the Department to assign it a new role as the lead institution to promote FDI and inward internationalization. This entails: i) adopting a new structure as an independent public-funded agency with a private sector outlook; ii) revising its mandate to include image building; investment generation; investment facilitation; aftercare; monitoring and performance evaluation; and policy advocacy; iii) transferring its regulatory functions to other government institutions, such as the General Authority for State Registration (GASR); iv) staffing the agency with professional and experienced personnel, including secondments of young executives from the private sector; v) upgrading office facilities and establishing regional offices; and vi) adopting a new name to clearly signal its new role and mandate.
- Second, emphasizing the agency's central role in the implementation of many of the FDI-related diversification proposals developed in the IPR, namely: i) analyzing the pool of foreign operations which can take place in Mongolia, including non-equity modes of international production, to better exploit the related opportunities; ii) launching linkage and entrepreneurship programmes; iii) implementing diaspora attraction programmes.

2. Regulatory and institutional reforms for foreign and local private sector development

Due to an impressive reform effort undertaken since 1992, the legislation is modern and up to standards in most areas affecting business. The transition to a market-based economy is largely achieved. Few legal and regulatory deficiencies requiring policy attention remain, including: 1) permitting and controls, which are often focused on sanctioning rather than ensuring compliance with the safety and public interest legislation; 2) the regime for the entry of foreign skills, which does not foster the attraction and diffusion of skills necessary to the country's development; 3) the minerals law, which needs to better protect public interest; and 4) the concessions regime, where stricter project selection criteria are needed.

On the implementation and institution side, stronger deficiencies persist regarding the capacity of the public administration to absorb, monitor and enforce the new legislation. Key institutions such as the Ministries in charge of environmental protection, mining and tourism, as well as the Judiciary and the Independent Authority Against Corruption (IAAC) often lack the capacity, skills or financial resources necessary to carry out their mandate and properly implement the law. Others, such as the Competition Agency, the GASR, the Division on Concessions of the MED and the General Agency for Specialized Inspection (GASI) also need capacity building and strengthening.

In this context, the regulatory bodies are in urgent need of modernization to effectively regulate the economy and support private sector development. The related governance problems, represented by high levels of corruption, are endemic and represent a major barrier to progress in Mongolia. Public sector reform is also essential to facilitate the strategy of diversification through FDI. The booming mining sector will provide Mongolia with abundant financial resources, thus removing a key obstacle to institution building. A two-pronged approach is proposed encompassing both institutional and governance reforms:

- A comprehensive *institutional reform programme* should be enacted for the public sector, while at the same time addressing specific challenges facing certain agencies and ministries. Reform and redesign of the planning function is a special target given the importance of an efficient and powerful planning agency to drive Mongolia's national development strategy.
- The recommended *governance reform programme* focuses on: i) reforming the IAAC according to international best practices; ii) fully implementing the provisions of the United Nations Convention against Corruption, including protection for whistle blowers; and iii) supporting other reforms such as introducing UNCTAD's e-regulations programme, encouraging public participation in the anticorruption drive, and establishing special anticorruption courts with specially trained judges.

3. Programmes for achieving diversification through FDI and other activities of foreign companies

Deriving from the actual or potential opportunities that exist within Mongolia, six programmes are identified to achieve the diversification objectives. Two of these — *Tackling the infrastructure challenge* and *Building knowledge and skills* — are directly aimed at overcoming major impediments facing all investors in the economy, and utilizing FDI for this purpose. Three programmes focus on sectoral and source country diversification — *Developing financial and business services in Ulaanbaatar*, *Unleashing the potential of tourism*, and *Promoting niche market programmes in international marketing of livestock-related products*. The latter two and programme on *Promoting SME development and entrepreneurship* will also assist regional development and diversification, both in the mining areas and more generally across the country.

a. Tackling the infrastructure challenge

After a long period of under-investment, the infrastructure challenges facing Mongolia are considerable. The current infrastructure objectives of the Government of Mongolia are to promote mining and industrialization. For the future, this focus should be widened to include the financing of roads, railways, water, energy, housing and schools to improve

The legislation is modern and up to standards in most areas affecting business. On the implementation side, deficiencies persist

competitiveness, support diversification and eradicate poverty. Progress in attracting private investment into infrastructure is fraught with difficulties but the potential payoff is large, both in terms of eliminating bottlenecks facing the economy and in improving foreign investor attitudes towards Mongolia as a place to invest. At the same time, realistic expectations regarding the capacity to attract private investment into infrastructure should be set. In this regard, infrastructure projects outside the scope of concessions and likely to generate positive development impact should be financed by public investment, including through the revenues derived from mining.

In this context, while the 2009 concessions law provides a clear and comprehensive framework for concessioning, successful attraction of private sector investment will require:

- improved project planning, identification and prioritization to avoid selecting “priority projects” based on patronage rather than economic and development benefits;
- resorting to public-private partnerships (PPPs) only for commercially viable projects;
- establishing clear systems for planning, promoting and implementing FDI attraction efforts;
- creating a task force, probably requiring expatriate sectoral experts, to overcome the problem of ‘false starts’ in some projects and sub-sectors;
- substantially increasing the human and financial capacity of the Division on Concessions to create a specialized concessions agency with functional independence; and
- enhancing efforts to encourage competition and active enforcement of the recently adopted competition policy, since powerful monopolies in some infrastructure sub-sectors may act as barriers to progress.

b. Building knowledge and skills

Mongolia’s small population together with its rapid development means that knowledge and skills will be a major determinant of FDI attraction and of the long-term success of the economy; but FDI itself also has a significant role to play in filling skills gaps which exist at all levels — vocational, professional, public sector and university — and two sets of programmes are recommended.

First, the *People quality programme* proposes:

- establishing a professional and technical training institution focusing on languages, tourism, information technology (IT), financial services and public sector skills and financed through the “Employment Fund”; and, in the longer term, the establishment of separate institutes in these areas as well as a Civil Service College;
- establishing partnerships with internationally-recognized professional institutes to achieve international standards of qualifications;
- devising foreign language exchange programmes for language teachers; and launching an attraction programme targeted at individuals with TEFL (teaching English as foreign language) qualifications and experience; and
- targeting collaboration with a world-class business school.

Infrastructure challenges are considerable and projects outside the scope of concessions should be financed by public investment

Second, the *Skills attraction and diaspora programme* proposes:

- identifying skills and competence requirements for the economy;
- facilitating the entry of needed skilled expatriate personnel; while tightening controls over immigration of low skilled workers with effective monitoring procedures; and
- targeting the Mongolian diaspora to address specific skills shortages, as well as introducing a business talent scheme for the Diaspora to encourage new small firm formation. In both cases, various incentives would be offered.

c. Developing financial and business services in UB

The NDS includes the objective to transform Ulaanbaatar into a banking and financial centre. If progress is to be made on this objective, FDI will need to play a role. While the concentration of economic activity and population in UB is a challenge for the country, it could also offer significant opportunities for financial and business services development for the domestic market, building on the requirements of the burgeoning mining industry. FDI is vital to the successful exploitation of these opportunities.

An integrated programme is proposed which begins in *Stage I* by mapping the sector and identifying market opportunities relevant to the country and to UB; and subsequently targeting leading financial services clusters globally and specific companies.

In *Stage II*, opportunities will be explored for developing UB as a regional headquarters hub for relevant activities in North-East and Central Asia. A private sector-led Financial Services Investment Group (FSIG) is recommended to be established to advise the Government of Mongolia.

d. Unleashing the potential of tourism

The tourism sector in Mongolia is still in its infancy, yet it is already a significant contributor to the economy. It has considerable potential, and it has so far grown in spite of limited Government support. The institutional foundations for supporting the growth of the sector are generally inadequate, and various challenges need to be overcome to exploit the large potential, especially in the context of regional diversification and poverty reduction. There are also considerable opportunities to develop the sector through the involvement of different forms of FDI and foreign operations. However, achieving this requires wide-ranging reform of the sector and the implementation of an ambitious reform programme, including:

First, *Institutions and planning*: i) strengthening the tourism development and promotion functions of MCST; ii) transforming the Mongolian National Tourism Centre (MNTC) into a proper Mongolian tourism organization, involving private sector partners and industry associations and covering planning, marketing, promotion and advocacy functions; and iii) developing a comprehensive national tourism plan. The latter should focus on: niche market products for international tourism; the introduction of a single brand message and enhanced international promotion and the establishment of international standards for planning, environment and conservation in the national parks.

Second, *Growing FDI and foreign operations in tourism* by: i) targeting niche market opportunities in adventure tourism, eco-tourism, and other special interest groups; ii) promoting FDI in high-end lodges and backpacker hostels or equivalent Gers, with 'eco-tourism' labels for compliance with high environmental standards; iii) providing assistance

With stronger institutions and better planning, tourism could contribute greatly to regional development and economic diversification

to initiatives aimed at increasing local supply sourcing; iv) improving access to finance for small and medium-sized enterprises (SMEs) in tourism.

e. Promoting niche markets — meat and cashmere

Livestock-related products industry, and especially cashmere and meat, is highly important for a diversification strategy in Mongolia since it supports large numbers of vulnerable and dispersed nomadic herders and rural communities. The central problems of the livestock industry concern, first, improving the quality of the raw materials; and second, improving branding and international marketing. The required improvements in these areas should positively impact the entire value chain and international assistance is being provided by a number of cooperation agencies. Three smaller scale programmes are recommended, which can attract foreign interest and be the launch pad for wider programmes:

- First, the establishment of a Centre for International Research, Design & Marketing (CIRM) to assist the internationalization of Mongolian enterprises through market research, design, branding and international marketing.
- Second, the Mongolian meat niche market branding and marketing programme based on an international marketing study into meat market potential, and a follow-up pilot export programme to the selected country market and potentially specific meat retail outlets.
- Third, a Cashmere international marketing programme involving: i) the use of the 'Made in Mongolia' label on all cashmere products; ii) the development of a Mongolian brand for export products; and iii) an international marketing and advertising campaign, designed to assist Mongolian producers of branded and private label products to internationalize.

f. Promoting SME development and entrepreneurship for regional diversification

Promoting SME development and entrepreneurship is highly significant for the attainment of Mongolia's diversification objectives. These small local firms provide a mechanism to enhance the benefits of FDI through linkages, spillovers and entrepreneurial capabilities. Generally, while the sector is receiving policy attention and some progress is evident, the capacity to support SMEs and entrepreneurship remains inadequate and needs to be expanded considerably to make the desired impact on diversification and sustainable development. Three programmes are recommended:

- First, Supplier linkages programmes for SME-TNC collaboration involving supplier/buyer identification; mechanisms to ensure criteria-based selection of participants; training and skills development; and information sharing. The aim is to supply inputs to TNCs which would otherwise have been imported through long-term relationships between SME suppliers and TNCs.
- Second, Entrepreneurship and SME development for regional diversification, a programme to establish an Empretec Centre, based in UB but with training centres across the country. It would support sectoral programmes including, for instance, entrepreneurs from rural areas or women entrepreneurs in tourism. Expanding the regional coverage of the business incubators' programme with proactive assistance to selected individual or sectoral groups of SMEs should also be explored.
- Third, Utilizing mining as growth pole: specific linkages and entrepreneurship programmes should be launched in the mining areas supported by amendments

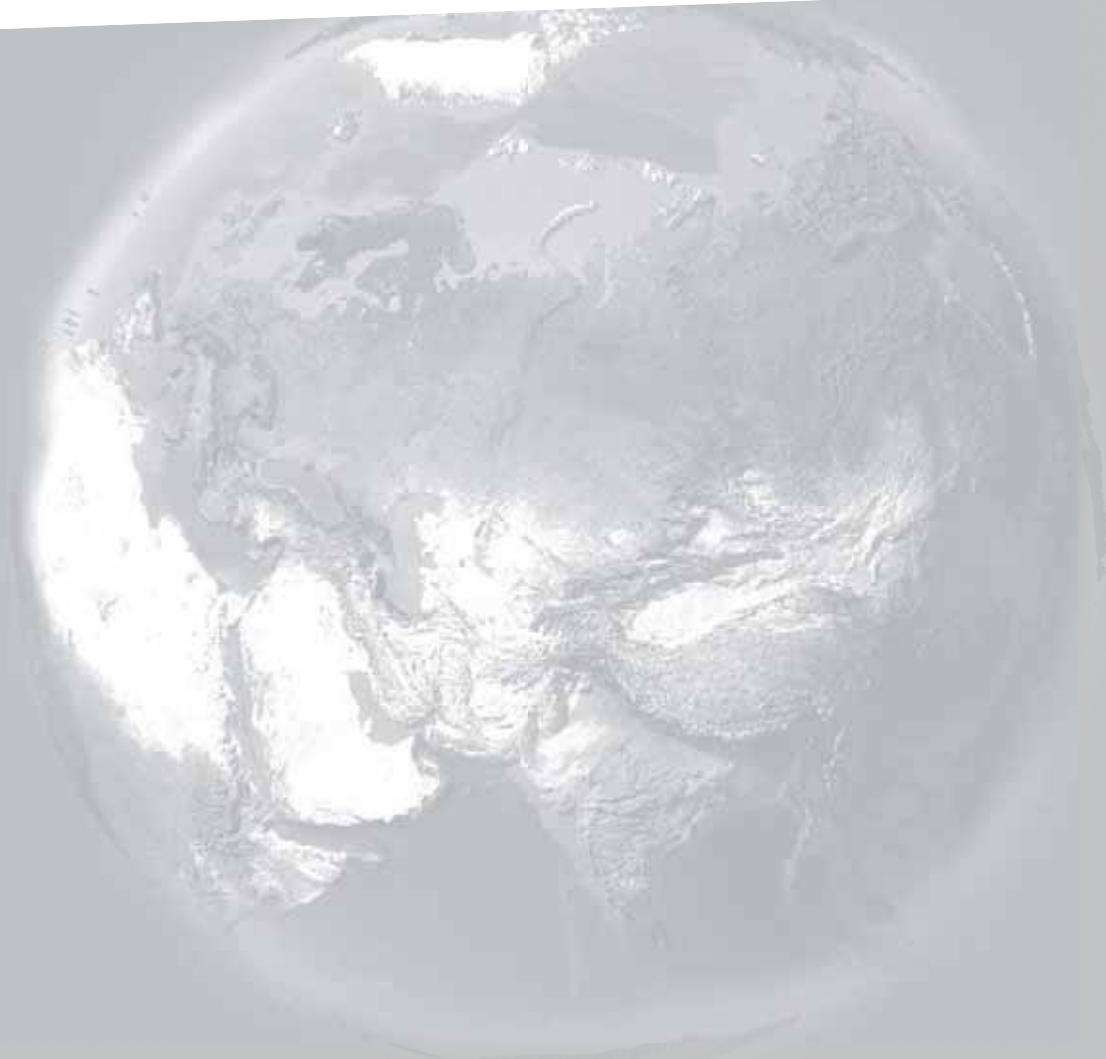
Support to SMEs and entrepreneurship needs to be expanded to attain Mongolia's diversification objectives and sustainable development

to the Mineral Law including the requirement for formal social impact assessment and community development programmes in granting extraction licences. Government financial relocation assistance should be provided to entrepreneurs willing to move to mining areas, with loans available on attractive terms.

It is hoped that the analysis and recommendations presented in this IPR will contribute to improve policies, promote dialogue among stakeholders, catalyze investment and the beneficial impact of FDI and ultimately help Mongolia achieve its development objectives.

CHAPTER 1

FDI determinants, trends and impact



Mongolia transitioned from a centrally-planned economy to a market economy in the 1990s and today it is one of the most open economies in the region. The country has been successful with its market reforms albeit challenges in implementation and governance remain. Mongolia has also moved away from a one-party rule and has been able to establish a vibrant multi-party democracy that has seen successive peaceful transitions of power. This double transition is a remarkable success story.

While agriculture and, in particular, herding are still important components of the economy and a source of cultural identity, a boom in mining has been the main driver behind recent economic growth. Buoyed by favourable international commodity prices and strong demand, the mining industry has led Mongolia's impressive economic performance in the past ten years. It has attracted significant foreign direct investment (FDI) and increased exports. Mongolia is poised to continue on a high-growth trajectory due to its immense mineral wealth and is expected to be one of the world's fastest growing economies in the next ten years, with significant poverty reduction potential. However, there are risks associated with this fast-paced growth that will require careful macroeconomic policy as well as a diversification of the economy.

At the moment, Mongolia's economic growth is dependent on the export of few commodities, chiefly copper and coal, and as such, it is vulnerable to volatile international prices. The country's exposure to external shocks became painfully evident during the economic and financial crisis that began in 2008, with the economy contracting by 1.6 per cent in 2009. This situation is indicative of the risks associated with the projected mining boom, which include high inflation and the resource curse.¹ The Government of Mongolia (GoM) has rightfully decided to adopt a diversification strategy for the economy in order to reduce the aforementioned risks. It has set the long-term goal to move Mongolia's economy towards higher value-added activities that will transform the country from a resource-based to a knowledge-based economy.

¹ Increased export revenues in extractive industries can lead to exchange rate appreciation and domestic inflation, and hence result in a loss of competitiveness in other sectors (so-called Dutch disease). There is some evidence that countries rich in oil and minerals have been worse off based on various economic, social and political indicators and, paradoxically, are considered "cursed" by their natural resource endowment.

The GoM recognizes that FDI can play a key role in promoting economic diversification. Thus far, however, Mongolia has attracted FDI mostly in mining and to a much lesser extent in construction, tourism and other services. Outside of mining, foreign investment originates predominantly from other developing countries with higher risk tolerance. Very few global TNCs from developed countries are present, although some have recently shown interest by setting up representative offices. So far, however, a "wait and see" attitude prevails.

Furthermore, outside mining, most economic activity, including FDI, takes place in Ulaanbaatar. The capital will continue to attract FDI in services catering to the mining companies and a growing middle class with increasing purchasing power; but without proactive policies, non-mining FDI is unlikely to spread to other regions of the country. For FDI to play a greater catalytic role in developing traditional and new industries, and contribute to the formation of a dynamic and competitive economy, policy reform and targeted strategies will need to be implemented to diversify FDI by sector, source and geographical location.

Following a brief review of the government's developmental objectives, this chapter provides an overview of Mongolia's potential in attracting foreign investment by evaluating the key FDI determinants, including market size, production factor costs, quality of infrastructure and availability of natural resources. This analysis, together with an overview of Mongolia's recent FDI performance and the impact of such investment on the local economy, are the background to an assessment of the FDI-related challenges and opportunities.

A. National development objectives and the role of FDI

After the transition to democracy, Mongolia suffered from a lack of medium to long-term planning, as each administration would devise an action plan that set out development goals to be achieved during a given term. The plans would seldom be carried on by the next administration. This situation has changed in recent years, however, with the introduction of a comprehensive

and long-term development strategy. Challenges remain in respect to the prioritization of objectives and projects, and to inter-agency coordination and cooperation for the implementation of strategies that often encompass various sectors.

The *Millennium Development Goals-Based Comprehensive National Development Strategy of Mongolia* (NDS) sets a medium-term objective of achieving the MDGs during the first phase of implementation (2007–2015), and a long-term one of transforming Mongolia into a dynamic knowledge and high technology based economy during the second phase (2016–2021). The NDS foresees the gradual reduction of government involvement to give way to a strong private sector. In this regard, it identifies FDI as playing a key role in improving the country’s competitiveness and includes broad FDI-related objectives, such as using FDI to introduce advanced technologies and to develop human capital.² In the Programme on Enhancing the Economic Orientation of Foreign Relations (Annex 1 to Government Resolution No. 324 of 2009), priority for FDI promotion is to be given to higher value added production, the introduction and localization of advanced technology

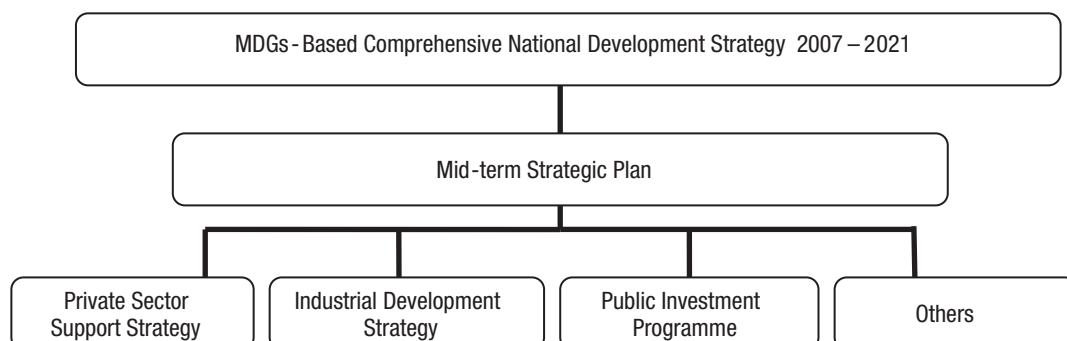
² The NDS vows to foster “advanced technologies in production by creating a favorable economic and legal environment to attract foreign direct investment and prominent transnational corporations” (NDS, p. 31) and specifically encourage the establishment of “vocational training centers with international methodologies and foreign investment” to enhance Mongolia’s human capital (NDS, p. 20). In addition, the NDS expects 75 per cent of the \$21 billion needed for the achievement of real sector growth goals for 2007–2021 to come from private and foreign investment (NDS, p. 64).

and know-how, and production of import-substituting goods in food, agriculture and light industry.

In the GoM’s Concept of National Security (2010), there are three important additions to the above concerning the role of FDI in the economy: first, to design a strategy whereby the investment of any foreign country does not exceed one third of overall foreign investment in Mongolia, and to implement restrictions to investments by foreign state-owned companies; second, to utilize FDI to enhance competitiveness through the introduction of capital, management and technology; and third, to promote exports and assist local enterprises to invest abroad through enhanced competitiveness.

In 2009, the GoM established the National Development and Innovation Committee (NDIC) under the Office of the Prime Minister to ensure continuity in the implementation of strategies for national economic and social development (figure I.1). The NDIC developed, for the first time, a medium-term strategy to carry out policies and projects into the next political term. The new administration (following the 2012 elections) created a Ministry of Economic Development (MED) which took over the strategic planning functions of NDIC, including reviewing the “Mid-term strategic plan” and overseeing its implementation (see chapter III). Financing the planned projects, valued at nearly \$20 billion, will require private and foreign capital and the GoM has announced that it will pursue public-private partnerships (PPPs) in order to complete them successfully, particularly in mining and infrastructure development.

Figure I.1. National development policy of Mongolia



Source: UNCTAD

Finally, in October 2012, the new administration presented the Government Action Plan 2012–2016, which reaffirms the continuity of the Mongolian State policy and introduces a number of new planned reforms. The need to establish a business enabling environment features as one of the priorities. The Plan does not make reference to new FDI-specific objectives or policies but confirms the commitment, contained in the Concept on National Security, to restrict investment by foreign State-owned companies.

B. Determinants of FDI attraction

This section provides an overview of Mongolia's resources and capabilities in FDI attraction, taking into consideration various factors that determine the country's potential, and compares it to the best performer in a group of similar countries. The comparator group is composed of natural resource-rich developing countries that share certain characteristics with Mongolia, including economic size, growth or geography.³

Located in North-East Asia, Mongolia is a large and sparsely populated landlocked developing country of 2.8 million people sharing a border with the Russian Federation to the north and China to the south. The climate exhibits large temperature fluctuations with harsh winters and low annual rainfall, adding pressure to scarce water resources. There are some forests in the

³ The methodology behind the comparator group was to select two countries for each of the following sub-categories of natural resources-rich developing economies: landlocked (Azerbaijan and Kyrgyzstan), small economy (Gabon and Namibia), diversified economy (Chile and Peru) and regional (Kazakhstan and Uzbekistan). The comparison is based on the most recent data available for the period 2008–2011.

north while the Gobi desert extends to the south, and mountain ranges to the west and southwest. Much of the territory is covered by vast steppe grasslands with limited agricultural potential but well suited for livestock production.

1. The economy at a glance

Mongolia is also extremely rich in mineral resources. In 2009, it was responsible for 0.8 and 0.2 per cent of the world total production of copper and coal, respectively (British Geological Survey, 2011). These shares are expected to increase significantly in the near future. Two large mining projects backed by FDI: the Oyu Tolgoi mine, which started production in January 2013, and the Tavan Tolgoi, in the tendering process. They are among the largest copper/gold and coal deposits in the world, respectively. Large deposits of rare earths also exist, which have attracted significant international interest.⁴ Mongolia produces oil in modest amounts but the size of proven reserves is unknown.⁵ Potential also exists for thermal coal generation and renewable energy, including solar and wind.⁶

⁴ According to a 2009 estimation by the U.S. Geological Survey, Mongolia has 31 million tons of rare earth reserves, or 16.8 per cent of the world's total, exceeded only by China, currently the world's largest producer of rare earths.

⁵ There are plans to build an oil refinery and reduce dependency on imported fuel from the Russian Federation.

⁶ The Ministry of Mineral Resources and Energy estimates that the Gobi desert's solar power generation potential is equivalent to 67 terawatt hour, more than 16 times the country's current production (Enebish, 2009). Meanwhile, more than 10 per cent of Mongolia's total land area (about 160'000 square km) has been considered as "windy land" and estimated to have good-to-excellent wind potential for utility scale applications, with wind speeds between 6.4 and 7.1 m/s (Enebish, 2005).

Table I.1. Basic macroeconomic indicators, 2011

| Population | | GDP by sectors | |
|---|-------|--|------------|
| Total (millions) | 2.8 | | |
| Major city: Ulaanbaatar (millions)* | 1.0 | | |
| Urban (% of total)* | 67.6 | | |
| GDP | | Top economic activities (% of GDP) | |
| At current prices (billion \$) | 8.6 | Mining and quarrying | 21.7 |
| Per capita, PPP (current international \$) | 4'764 | Wholesale & retail trade | 18.9 |
| Annual average growth (% , 2000–2011) | 7.4 | Agriculture | 13.0 |
| GDP growth rate, 2000–2011 (% over previous year) | | Manufacturing | 9.2 |
| | | Transportation & storage | 7.3 |
| | | Real estate activities | 6.7 |
| Trade | | Macroeconomic environment | |
| Exports and imports (billion current \$) | 13.0 | Central Government debt (% of GDP) | 46.9 |
| Exports of goods and services (% of GDP) | 63.5 | Inflation (CPI, annual %, avg. 2000–2011) | 9.2 |
| Imports of goods and services (% of GDP) | 86.1 | Real interest rate (% , avg. 2000–2009) | 12.8 |
| | | Land resources | |
| | | Main mineral resources | |
| Agricultural land (% of land area) | 73.1 | Gold | Coal |
| Natural meadows and pastures (% of agricultural land)* | 97.8 | Copper | Uranium |
| Arable land (% of land area) | 0.4 | Fluorspar | Molybdenum |
| | | Oil | Iron ore |
| | | Gross domestic savings (% of GDP) | 35.8 |
| | | Tax revenue (% of GDP) | 22.7 |

Source: World Bank, NSO

Notes: (*) = 2010. PPP: purchasing power parity. Industry corresponds to ISIC Rev.4 divisions 05-43 and includes mining, manufacturing, construction, electricity, gas, water supply and waste management. Wholesale and retail trade includes repair of motor vehicles and motorcycles. The real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator.

The economy is small but growing rapidly due to a booming mining industry. Nominal GDP grew more than six-fold in the last decade and peaked at \$8.6 billion in 2011 (table I.1). Consequently, GDP per capita at purchasing power parity increased from \$1,950 in 2000 to over \$4,760 in 2011. The international economic and financial crisis which started in 2008, coupled with harsh weather conditions, a phenomenon known as a *zud*,⁷

⁷ This natural phenomenon is a drought followed by an unusually harsh winter that tends to decimate livestock.

caused a sharp, though short-lived economic downturn. A \$263 million Stand-by-Agreement (SBA) with the International Monetary Fund (IMF) and rebounding international commodity prices helped Mongolia restore real GDP growth of 6 per cent in 2010. Data for 2011 registered a record 17 per cent real economic growth, confirming the country's strong recovery and growth outlook which is expected to quadruple GDP per capita by 2018 (IMF, 2011 and 2012). In 2012, Mongolia's economy continued to experience, with 12.3 per cent,

one of the highest growth rates in the world. This was, however, lower than anticipated as coal exports dropped significantly due to economic slowdown in China. The growth forecast for 2013 is 13 per cent.

Still, the country's sovereign risk ratings are not investment grade⁸ and recurrent inflation is a threat to Mongolia's macroeconomic stability.⁹ Notwithstanding the commitments to fiscal austerity including a "Fiscal Responsibility Law", government spending continued to soar in 2011 and in 2012 (IMF, 2012). The increase in government spending includes ambitious plans to finance, through expected rising revenues due to mining activities, large infrastructure projects as well as wage increases to public workers and universal cash transfers.

Despite recent growth, the domestic market remains small and purchasing power is low. To address this limitation, Mongolia has adopted a very open trade policy. Although Mongolia is not part of any regional trading block,¹⁰ upon accession to the WTO in 1997, it

⁸ Fitch rating: B+, Moody's: B1, and S&P's BB-

⁹ The IMF estimates an inflation rate of 15 per cent during 2012 (IMF, 2012). This contrasts the BOM's stated objective of a single digit rate.

¹⁰ A Mongolia-China free trade agreement is in the early planning stages, according to Mr. Zhou Changting, counselor of the Asian affairs department under the Commerce Ministry of China, as reported by China Daily on 12 May 2010.

eliminated all tariffs on imports for a two-year period. Since then, most-favoured nation (MFN) tariffs of 5 per cent have applied across board. Still, as a landlocked country with limited infrastructure (subsection B.3), Mongolia faces high trade costs. Its geographic location also means that it heavily relies on the infrastructure and policies of China and the Russian Federation to access trade with major markets outside the region, a dependency which is reflected in the trade patterns (table I.2).

In the last decade, Mongolia's trade has grown considerably and its trade deficit has widened as well. Almost the totality of the country's exports is commodities and a large share, more than 80 per cent, is mineral resources; making vulnerability to international price volatility a serious policy concern. Most imports are composed of fuel and industrial and consumer manufactured goods needed for domestic consumption and investment. China is by far the main trading partner, destination for over 85 per cent of Mongolia's exports and source of 43 per cent of its imports. Other important trading partners include Canada, which has grown in prominence as the second biggest destination for Mongolia's mining exports and the Russian Federation, second largest country of origin for its imports.

Table I.2. Trade by major partners and products, 2000 and 2011

(Million dollars and percentages)

| | 2000 | 2011 | | 2000 | 2011 |
|--|------|-------|--|------|-------|
| Exports (million \$) | 536 | 4,774 | Imports (million \$) | 615 | 6,526 |
| By product (%) | | | By product (%) | | |
| Copper ores and concentrates | 33.7 | 52.2 | Petroleum and petroleum products | 17.9 | 18.4 |
| Other base metals ores | 1.4 | 10.8 | Road vehicles | 9.7 | 9.1 |
| Gold | 0.8 | 9.9 | Printed matter | 0.5 | 6.3 |
| Coal | 0.0 | 8.0 | Industrial machinery and engineering equipment | 7.8 | 6.5 |
| Wool and other animal hair | 14.3 | 7.9 | Textile yarn and fabrics * | 10.1 | 5.2 |
| Articles of apparel and clothing accessories | 28.2 | 0.5 | Cereals and cereal preparations | 7.2 | 4.3 |
| Other | 21.6 | 10.7 | Other | 46.8 | 50.2 |

Table I.2. Trade by major partners and products, 2000 and 2011

(Million dollars and percentages)

| | 2000 | 2011 | | 2000 | 2011 |
|--------------------------|------|-------|--------------------------|------|-------|
| Exports (million \$) | 536 | 4,774 | Imports (million \$) | 615 | 6,526 |
| By partner (%) | | | By partner (%) | | |
| China | 50.5 | 85.7 | China | 17.8 | 43.4 |
| Canada | 0.1 | 6.3 | Russian Federation | 33.6 | 23.3 |
| Russian Federation | 9.0 | 2.1 | Korea, Republic of | 9.0 | 5.6 |
| Korea, Republic of | 0.6 | 1.4 | Japan | 11.9 | 5.1 |
| Italy | 3.6 | 1.2 | United States of America | 4.6 | 5.0 |
| United States of America | 24.8 | 0.3 | Germany | 4.8 | 3.1 |
| Other | 11.4 | 3.0 | Other | 18.3 | 14.5 |

Source: UNCTADstat.

Note: (*) - including related products and made-up articles

Services represent half of GDP (table I.1). Major sectors are wholesale and retail trade, accounting for 19 per cent of GDP, followed by transportation and storage and real estate which contribute to GDP in approximately equal shares — 7 per cent. Industry generates 35 per cent of GDP and is concentrated mostly in extractive industries. Mining is the largest contributor to GDP and accounts for about 70 per cent of industrial output. Despite the introduction (by the President of Mongolia in April 2010) of a moratorium on new exploration and mining licences, justified by governance and environmental concerns (chapter II), mining as a share of GDP is expected to grow even more in the near future. Manufacturing is small at 7–9 per cent of GDP over last few years, and more than 50 per cent of gross output comes from food and beverage products alone. Finally, agriculture's share in GDP varies between 13 and 16 per cent while the sector employs a significant proportion of Mongolians (subsection B.2 below). Mongolia's GDP composition illustrates its heavy reliance on mineral extraction and commodities, the low industrialization of the economy and its limited diversification.

According to the UNDP, Mongolia's HDI is 67.5 (table I.3), which gives the country a rank of 108 out of 187 countries with comparable data. The HDI of East Asia and the Pacific as a region increased from 50.2 in 1990 to 68.3 today, placing Mongolia below the regional average. Despite 15 years of continued economic growth, poverty started reducing only recently. Still in 2009, around 40 per cent of the population lived below

the national poverty line,¹¹ compared to 36.1 per cent in 2003. As a result of the development of the mining sector and the expansionary policies adopted by the Government, however, poverty declined significantly in 2011 (table I.3).¹² Nonetheless, income inequality is high and has increased over time. The mass migration of herders to the capital, following the 2009 *zud*, and the mushrooming of *ger* districts¹³ in Ulaanbaatar's outskirts are a stark reminder. The city is struggling to absorb this mass migration which has already caused important environmental and social impacts, including a rise in pollution and crime. Without the appropriate policy measures, the gap between the urban rich and the traditional nomadic herders is likely to widen even more as the economy grows fuelled largely by capital-intensive investment in mining. In this regard, Mongolia will need to implement decentralization policies to help reduce some of the strains on the capital, including the promotion of FDI to the provinces (chapter III).

¹¹ The national poverty line estimated by the NSO is defined as the income necessary to purchase a daily 2100 kilo-calorie diet and it is revised annually to account for inflation and differentiates between rural and urban settings.

¹² The "poverty gap" measuring the difference between the average level of consumption of poor households and the national poverty line has been reduced from 11 per cent in 2003 to 7.6 in 2011. Similarly, the "poverty severity" indicator has declined from 4.7 to 2.8 during that same period.

¹³ The *ger* is the traditional Mongolian home preferred by nomads, a round tent made of a wood structure and felt that is easily assembled and disassembled. Since 2009, over 200,000 *gers* have permanently set in the outskirts of Ulaanbaatar where 700,000 people or 60 per cent of the capital's population live. The *ger* districts are generally not connected to the electric or water supply and rely on wood or coal stoves for heating, a major source of air pollution.

2. Human capital and social development

Table I.3. Social development, education and labour

| INDICATOR | Mongolia | Best available in group | Year |
|--|----------|-------------------------|------|
| Social development | | | |
| Human Development Index (0=low to 100=high) | 67.5 | 81.9 | 2012 |
| Poverty headcount at national poverty line (% of pop.) | 29.8 | 8.2 | 2011 |
| Gini index (0 - 100 = highest inequality) | 36.5 | 29 | 2009 |
| Education | | | |
| Public spending on education (% of GDP) | 5.5 | 8.3 | 2011 |
| Literacy rate, adult (% of people ages 15+) | 97.4 | 99.8 | 2010 |
| Quality of the educational system (1=low to 7=high) | 2.4 | 3.36 | 2012 |
| Labour | | | |
| Employment to population ratio (% of ages 15+) | 57.6 | 71.3* | 2011 |
| Employment (% of total employment): in agriculture | 40 | 19.5* | 2009 |
| in industry | 14.9 | 19.8* | 2009 |
| in services | 45 | 60.6* | 2009 |
| Unemployment (% of total labour force) | 9.9 | 8.1 | 2011 |

Sources: World Bank, NSO, WEF, UNDP

Notes: (*) = simple average of comparator group. Working-age population includes ages 15 and above. Labour force comprises working age citizens, both employed and unemployed, but actively looking and available for work.

Mongolia invests 5.5 per cent of GDP in education. Both the total number of people receiving formal education and the proportion of the population obtaining higher levels of education has steadily increased over time.¹⁴ Still, the quality of higher education has been questioned as private higher education institutions have proliferated amidst a lack of regulatory control. The low score in the perception of the educational system reflects that, generally, academic curricula do not meet the skill set demanded by the business community. Graduates from vocational and higher education institutions are ill prepared to work in their technical field because they lack practical know-how and ultimately need to be trained by their employer. The shortage of foreign language skills is also severe. In recent years, however, many Mongolians who studied and worked abroad have returned to the country as economic prospects improved. This influx of experienced high-skilled workers is contributing to local skills dissemination and is on high demand from companies, either foreign ones or their domestic partners.

Although over 45 per cent is employed in services, a considerable share of the labour force remains employed in agriculture as a third of the population are nomads that live off subsistence herding (table I.3). The total labour force, estimated in 2010 at 1.1 million, or 62.5 per cent of the working-age population, is small. Labour costs remain competitive, which could be an asset for attracting FDI, particularly in labour-intensive activities like niche light manufacturing and services.

¹⁴ The number of students enrolled in technical and vocational schools has grown from 21,574 in the 2003/04 school year to 46,071 in 2010/11. Similarly, the number of students enrolled in universities and other higher education institutes increased from 108,738 in 2003/04 to 164,773 in 2009/10.

3. Infrastructure

Table I.4. Transportation, electricity, telecommunications and sanitation

| INDICATOR | Mongolia | Best available in group | Year |
|--|----------|-------------------------|------|
| Transportation | | | |
| Paved roads (% of total) | 12.3 | 88.7 | 2011 |
| Quality of (1=low to 7=high): roads | 1.9 | 5.6 | 2012 |
| railroad infrastructure | 2.5 | 4.2 | 2012 |
| overall infrastructure | 2.7 | 5.4 | 2012 |
| Electricity | | | |
| Access to electricity (% of population) | 67.0 | 98.5 | 2009 |
| Electric power consumption (thou. kWh per capita) | 1.4 | 4.4 | 2009 |
| Electric power trans. & distr. Losses (% of output) | 11.8 | 7.6 | 2009 |
| Power outages in firms in a typical month (number) | 2.6 | 1.7 | 2009 |
| Cost of electricity (\$ per kWh) | 0.07 | 0.05 | 2011 |
| Telecommunications | | | |
| Mobile subscriptions (per 100 people) | 105 | 155 | 2011 |
| Price of local mobile call (off-net, prepaid, \$ per minute) | 0.07 | 0.07 | 2009 |
| Internet users (per 100 people) | 20 | 53.9 | 2011 |
| Fixed broadband Internet subscriptions (per 100 inhabitants) | 2.3 | 10.5 | 2011 |
| Sanitation | | | |
| Improved sanitation facilities (% of pop. with access) | 51 | 96 | 2010 |
| Improved water source (% of pop. with access) | 82 | 96 | 2010 |

Sources: NSO, World Bank, WEF, ITU.

Notes: Hereinafter Mongolia's score is highlighted if it is the best in the comparator group.

Mongolia's transport infrastructure is one of the main obstacles to attracting FDI. Only 12 per cent of the country's road network is paved, a large performance gap relative to the best in group (table I.4).¹⁵ The GoM has adopted the 2008–2020 Road Master Plan to expand and upgrade the national road system by public and private investment through concessions. There is interest from the private sector to build roads that can withstand heavy load traffic from the mines to the Chinese border. Small population and low traffic densities make it difficult however to justify, in terms of rates of economic return, the construction of new roads outside mining areas. To date, only one concession has been successfully tendered and is under construction (subsection C.2).

¹⁵ Mongolia's road network consists of 49,000 km of which 12,000 km is state-owned. Only 4,000 km of roads (8.2% of total) have asphalt and cement cover, and 2000 km (4.1%) are graveled. The GoM plans to pave an additional 2,500 km by 2020.

Rail is the preferred means of transport for most of Mongolia's international trade, but its coverage and freight capacity is limited.¹⁶ It needs to be upgraded to manage increasing mining output and support diversification by sector and region. Essentially, there is one main line running North to South operated by a 50-50 joint venture between the State-owned companies Mongolian Railways (Ulaanbaatar Tomor Zam) and Russian Railways. The GoM has an ambitious expansion plan for the national railway system.¹⁷ The priority is to

¹⁶ The rail network comprises 1,815 km of broad gauge track, of which 1,110 km are on the main line linking the Russian Federation to China. 238 km on a separate network link Eastern Mongolia to the Russian railway.

¹⁷ The first phase in the railway expansion will connect Tavan Tolgoi to Sainshand on the existing main line and Sainshand to Choibalsan on the existing Eastern line. This will serve as the gateway to Russian ports in the Pacific. Construction work on the Tavan Tolgoi-Sainshand line began in April 2011. The second phase will consist of several lines connecting mines to the Chinese border. The first two phases are estimated to cost \$5 billion. The third phase will see the expansion of a line connecting the western provinces to the Russian Federation (Ministry of Road, Transport, Construction and Urban Development).

open a new route for Mongolia's mineral exports through the Russian ports in the Pacific. Although this route is more than four times the distance to the nearest port in China,¹⁸ Mongolia is negotiating a discount transit rate with the Russian Federation that would make it a competitive alternative. The country's railway system has been built with the Russian broad gauge and all new lines will use this same gauge which is incompatible with the standard international gauge used in China, creating an additional impediment to trade.

Mongolia has one international airport — Ulaanbaatar's Chinggis Khaan International — with the capacity for international air cargo trade but with poor air links outside East Asia.¹⁹ Other regional airports operate short-distance flights to neighbouring cities in China and the Russian Federation. The Civil Aviation Office has drafted a strategy for the sector which has been submitted to the Government. This foresees the liberalization and opening of new international airports by 2016. There are plans to build a second airport for the capital and Mongolia has received a \$290 million soft loan from the Japan Bank for International Cooperation (JBIC) to finance the project. In May 2013, two Japanese companies (Mitsubishi and Chiyoda) reached an agreement with the GoM to construct the new airport. Although foreign carriers are still banned from Mongolia's domestic flight market, the sector has been liberalized and private Mongolian companies are operating scheduled internal flights as well as some short-haul international destinations in neighbouring countries.

Poor transport infrastructure and the country's geography result in high transportation costs. The average cost of container transport by ship to the United States, for example, is \$150 per cubic metre while for air cargo it is \$350 per cubic metre. The high cost of fuel is a major contributing factor. Russian oil companies virtually supply the entire Mongolian market

and shortages in the past have increased fuel prices in the domestic market. For example, an estimated 30 to 40 per cent of total air cargo costs come from fuel alone which amounts to nearly \$1,500 per ton. In addition, the infrastructure bottlenecks at the border also hike up the trade costs. One freight transport company reported that the average import cost of clearing a shipment at the border is \$156 per container with a delay of two days for rail transport, and \$194 and four to six days delay for road transport. With the assistance of UNCTAD, Mongolia has for long been seeking a tripartite transit agreement with its two neighbours to facilitate the flow of goods and mitigate some of the burdens on trade since 2000.

The electricity infrastructure is adequate, in terms of generation, as installed capacity can meet current demand.²⁰ Nearly 94 per cent of generation is thermal coal, while hydro (0.8 per cent) and diesel (0.5 per cent) are the other sources of domestic generation. Transmission and distribution losses are relatively high and power outages are frequent.²¹ However, electrification is low and the nomad population has no access to the national grid system and relies on self-generation (table I.4). The cost of electricity is subsidized by the State and appears to be at par with the best in the comparator group (table I.4).²² Mongolia's installed capacity will need to keep up with increasing demand from mining. Large mining projects with foreign participation are planning to invest in thermal coal generation to supply their operations but will also service local communities and eventually connect to the national grid.

Mongolia also has the potential to develop renewable energies like wind and solar power. A wind farm is the only project in renewable energy to date and, if realized, it will be the first fully private-owned investment in electricity generation in the country. In this regard, a "Baseline paper for low carbon FDI into the electricity sector of Mongolia", was prepared in the context of a joint UNCTAD-UNECE-UNESCAP project on "Mitigating climate change through attracting FDI in advanced

¹⁸ Tianjin is the nearest major sea port with rail connection. It is roughly 900 km away from Mongolia's border entry Zamin-Uud and more than 1280 km away from Ulaanbaatar. Meanwhile, the Russian ports of Vladivostok and Vostochny are more than 4,000 km away from Mongolia's border by rail.

¹⁹ Direct international flights from Chinggis Khaan International to cities in East Asia include Beijing, Hong Kong, Seoul and Tokyo. There are only two direct international flights outside the region servicing Berlin and Moscow. In addition, there are 17 small domestic airports few of which comply with the standards of the International Civil Aviation Organization — and only four of the domestic airports have paved runways.

²⁰ Mongolia has a total installed capacity of 923MW with a utilized capacity of 729MW; it generates 4.1tWh and consumes 3.9 tWh. <http://www.erranet.org>

²¹ In 2009, the duration of interruptions in service reached 294 hours per consumer, 34 per cent of which were planned. On average a given final consumer experienced 16 interruptions a year.

²² By comparison, industrial electricity tariffs in other Asian countries are: Thailand (\$0.07/kWh), China (\$0.04-0.09/kWh), Philippines (\$0.10/kWh) and Cambodia (\$0.12-0.15/kWh) (World Bank, 2005).

fossil fuel technologies". The study concluded that the transition to a low-carbon society in Mongolia requires a new energy policy based on a more liberalized energy market and a well-functioning regulator (EPCRC, 2012).

Among a mix of public and private operators in the Mongolian power sector, the former still dominate, although over 200 private firms are licensed to undertake repairs and maintenance on electricity. Reforms of the regulatory environment in the early 2000s laid the foundation for private participation; and Government policy aims to encourage further private investment and management of the sector.

The poor landline telecommunication infrastructure does not represent a major constraint to business any longer, considering that there are 105 mobile subscriptions per 100 people, and costs of domestic mobile phone calls are very low (table I.4). This "technological leap" in telecommunications follows a common pattern in other developing countries with deficient landline networks. Coverage in rural areas is still an issue but at least one provider has specialized in offering services in remote areas and the introduction of new technologies has helped increase the use of mobile telephony outside urban centres.²³ Following privatization, FDI has played an important role in developing the industry both in the fixed-line market and pioneering in mobile telephony.²⁴ Internet penetration is low as there are only 20 users per

²³ In order to overcome distance and infrastructure issues, the use of wireless local loop (WLL) technology has been introduced. In 2008, the Mongolian company G-mobile entered the market to cater for rural areas.

²⁴ Korean Telecom has a 40 per cent stake on the State-owned Mongolia Telecom Company (MTC) that controls the fixed-line market. There are four mobile operators: Mobicom, the largest and pioneering company, is a Japanese-Mongolian venture while Korean companies had interest on two of the other operators up until 2010.

100 people compared to 54 for the best in group. The cost of a monthly internet subscription can range from \$25 for 4Mbps to \$100 for 10Mbps.²⁵

Lastly, in terms of the provision of sanitation facilities to its population, Mongolia clearly underperforms. It must be stressed that nearly a third of the population are nomads but the low levels of access to sanitation also shows that even in urban areas like Ulaanbaatar, the ger districts are without access to basic utilities, including water and electricity. As mentioned above, water is a scarce resource and high efficiency and environmental standards will need to be demanded from industries to ensure a sustainable clean supply to the general population. Water management issues should be taken into consideration for heavy industry projects that require large amounts of water (i.e. copper smelters).

4. Regulatory environment and public governance

Governance issues are among the main disincentives to FDI diversification in Mongolia. Although the overall regulatory environment is open and conducive to business and no major entry restrictions to FDI exist, uncertainty in regulatory implementation, corruption and conflict of interest are all important obstacles. The WEF's 2012–2013 Global Competitiveness Report, for example, finds that inefficient government bureaucracy was cited by 14.9 per cent of those surveyed as the most problematic factor for doing business in Mongolia. A more comprehensive assessment of Mongolia's regulatory environment and related issues is found in Chapter II.

²⁵ Price estimates taken from a local private investment firm's website <http://www.mad-mongolia.com/> and refer to the end of 2010.

Table I.5. Regulatory environment, corruption and security

| INDICATOR | Mongolia | Best available in group | Year |
|--|----------|-------------------------|------|
| Regulatory environment | | | |
| Ease of doing business index (out of 185 economies) | 76 | 37 | 2012 |
| Regulatory quality (0=low to 5=high) | 2.3 | 4.0 | 2011 |
| Government effectiveness (0=low to 5=high) | 1.9 | 3.7 | 2011 |
| Judicial independence (1=low to 7=high) | 2.6 | 5.5 | 2011 |
| Strength of investor protection (0=low to 10=high) | 6.3 | 8.0 | 2011 |
| Corruption | | | |
| Corruption perceptions index (0=worst to 100=best) | 36 | 72 | 2012 |
| Informal payments to public officials (% of firms) | 33.4 | 0.7 | 2009 |
| Security | | | |
| Business costs of crime and violence (1=worst to 7=best) | 4.9 | 5.2 | 2012 |
| Reliability of police services (1=worst to 7=best) | 3.8 | 6 | 2012 |

Source: World Bank, WEF (2013), Transparency International (2013)

The perception of corruption is high as the low score in the Transparency International scale shows (table I.5). The WEF 2012–2013 Report cites corruption among the top five biggest obstacles to doing business in Mongolia (after the inefficient government bureaucracy and the lack of skills in the workforce) and 9.2 per cent of respondents found it as the most problematic issue. Conflict of interest is another key issue, the country's business elite being closely linked to government at the highest level. This dimension of political interference in business creates uncertainty and is a major concern and deterrent to FDI. The GoM has taken several initiatives to tackle corruption, including the creation of an anti-corruption agency and the adoption of a conflict of interest law, but these have yielded mixed results so far (chapter II).

Although crime has increased in Ulaanbaatar in recent years, it is not a significant cost to businesses. Mining companies operating in the provinces do hire private security but aside from theft, they do not report having to deal with violent crime. Less than 1 per cent of respondents to the WEF survey cited crime as the most

problematic factor to doing business. This is confirmed by UNCTAD's interviews with different stakeholders in the country.

5. Domestic enterprise development

After the privatization process of the 1990s (box I.1), Mongolia has opened up considerably to the private sector, which now represents about 75 per cent of GDP. State presence remains strong in some areas, notably in the national airline and in utilities like electricity, telecommunications and railways. There is also evidence that the State is increasing ownership in some strategic sectors, particularly in mining, where by law it is entitled to a significant share of large deposits (chapter II). Aside from these exceptions, the domestic private sector is composed of few large conglomerates and a large number of SMEs, most of which are active in wholesale or retail trade. Out of the active 40,921 registered businesses, 85 per cent employ between 1 and 9 employees, while less than 3 per cent employ more than 50 (NSO, 2010). In total, the SME sector was responsible for 57.4 per cent of GDP in 2011.

Table I.6. Private sector, finance and quality of domestic firms

| INDICATOR | Mongolia | Best available in group | Year |
|--|----------|-------------------------|------|
| Size of formal private sector | | | |
| Gross fixed private capital formation (% of GDP) | 40.2 | 40.2 | 2011 |
| Market capitalization of listed companies (% of GDP) | 18 | 108.7 | 2011 |
| Firms formally registered when operations started (% of firms) | 90.1 | 97.4 | 2009 |
| Finance | | | |
| Domestic credit to private sector (% of GDP) | 51.6 | 71.2 | 2011 |
| Domestic credit provided by banking sector (% of GDP) | 40.3 | 71.2 | 2011 |
| Firms using banks to finance investment (% of firms) | 26.5 | 31.0 | 2019 |
| Characteristics of private sector development | | | |
| ISO certification ownership (% of firms) | 16.7 | 22.1 | 2009 |
| State of cluster development (1=low to 7=high) | 2.9 | 4.5 | 2012 |
| Local supplier quantity (1=low to 7=high) | 3.9 | 4.9 | 2012 |
| Local supplier quality (1=low to 7=high) | 3.4 | 4.9 | 2012 |

Source: World Bank (2013), WEF (2013)

The financial sector is not well developed and it is difficult for companies to raise capital in the domestic market. Financial services outside of banking, which accounts for 95 per cent of the sector, are inadequate. Insurance is expensive and domestic insurers have insufficient capital to cover large investments, while mutual and other investment funds are a nascent industry. Two banks have defaulted in recent years.²⁶ The Bank of Mongolia (BoM) has, however, reacted swiftly to ensure the stability of the banking industry by increasing capital adequacy requirements and

temporarily guaranteeing 100 per cent of bank deposits. Banking has recovered from the crisis and is growing fast; total assets were up 30 per cent in October 2011 compared to the previous year's closing number. The banking industry also registered a 70 per cent increase in current account deposits and a 50 per cent increase in loans. Still, market interest rates are high (above 20 per cent) and access to credit remains difficult, particularly for SMEs due to the lack of credible credit evaluation, high levels of non-performing loans and the risk of high inflation.

²⁶ In December 2008, the failing Anod Bank was taken over by the GoM, followed by the Zoos Bank in November 2009.

Box I.1. The privatization process

The privatization process in Mongolia began in 1990. During its first phase, covering 1990-1995, the GoM issued vouchers worth MNT 10,000 to allow each citizen to participate in the process. Large enterprises were restructured into joint stock companies and the purchase of their shares was conducted through the voucher system, while smaller enterprises were publicly auctioned also accepting vouchers as part of payment. As a result, properties worth MNT 21 billion were privatized in this period, including trade and catering services, light manufacturing, construction, and forestry and agriculture businesses. Moreover, 24.5 million heads of livestock were privatized and given to individual herders free of charge.

In 1996, the GoM created the State Property Committee (SPC) to oversee the privatization process. The voucher system was discontinued in the second phase of privatization (1996-2000) when over 1,000 immovable properties were publicly auctioned. In addition, after adopting the 1996 Law on Privatization of Residential Units and the Law on Condominium, over 83,800 apartments valued at MNT 2.4 million were transferred to their lawful

residents free of charge. Thus, over 80 per cent of housing in the provinces and 95 per cent in Ulaanbaatar are privately owned.

During the third phase 2001–present, the GoM adopted a policy to seek FDI in the privatization process. Increasing efficiency of the State-owned enterprises in order to sell them at higher prices was prioritized; international accounting standards, modern management and market mechanisms, and company auditing were all introduced to this end. In 2001–2007, 122 companies were privatized for a total value of MNT 108 billion; out of these companies, 29 were large enterprises accounting for 82.4 per cent of privatization revenue in this period.

In February 2011, the Parliament of Mongolia passed a resolution including a list of ten assets up for full or partial privatization for 2011–2012. These include the remaining 60 per cent GoM stake in Mongolian Telecom, Erdenet and the Thermal Power Plant-3 via concession agreements, and the Mongolia Stock Exchange through management contracts. The GoM has taken a different approach to privatization in mining where it plans to create holding companies that bundle major assets and retain a controlling 70 per cent share in them and publicly trade the remaining 30 per cent in domestic and international stock exchanges (i.e. IPO). This is true for copper and silver, iron, uranium and coal assets excluding the Tavan Tolgoi project. The GoM will have at least a 34 per cent ownership in each mine controlled by the holding companies.

Source: UNCTAD interviews, Parliament Resolution no. 11 of 2010 and ADB (2009)

Despite the recovery and strong growth outlook, the BoM is reluctant to issue new banking licences. As of 2011, there were 14 commercial banks, all of them Mongolian and the top had a combined 85 per cent market share of total assets estimated at MNT 800 trillion. Foreign banks²⁷ have shown interest in entering the market and Mongolia could benefit from an international bank to help finance large projects. The BoM is not keen, however, on allowing foreign banks to undertake commercial banking, claiming they would crowd out the smaller local banks. It would like to see foreign banks offer other types of services like trade finance, corporate lending, or bond market transactions. The GoM has also inaugurated the Development Bank of Mongolia (DBM) in May 2011 with a mandate to stimulate the lending market to the private sector and raise capital to finance large projects (chapter II).

The Mongolian Stock Exchange (MSE) has over 400 listed companies and although their aggregate value is a sizeable share of GDP (table I.6), traded volume is low and there are few large companies listed aside from mining and State-owned enterprises. Growth prospects, however, are strong. In 2011, the MSE

signed a cooperation agreement with the London Stock Exchange to modernize its services and improve its operations and this way expect to attract more of the foreign investors and large Mongolian conglomerates that currently look to raise capital elsewhere. A new integrated trading system was adopted in July 2012 and the first nine months of 2012 saw an increase in trades of \$60 million, or 2.3 times compared to the same period of the previous year and the FTSE Group has recently announced on its watch list for promotion to “frontier market” status.²⁸

Only a small percentage of firms in Mongolia are internationally certified as domestic companies have difficulties in meeting the required standards to export their goods (i.e. phytosanitary for meat). The Office of the President of Mongolia has undertaken an initiative to adopt EU standards across board but it is unclear how this massive project will be implemented. Cluster development is very low, and the quality and quantity of local suppliers is also poor (table I.6). All these conditions act as disincentives to FDI as they make it difficult for TNCs to establish business linkages with the local private sector. Furthermore, the low scores suggest that companies have low absorptive capacity for technological transfers that may come from FDI, reducing potential dynamic effects. On the other hand,

²⁷ ING of the Netherlands and Standard Chartered Bank from the United Kingdom have set up representative offices in Mongolia and have approached the BoM. Macquarie from Australia is in the process of establishing a representative office as well. Chinese banks have also shown interest in entering the market.

²⁸ Mongolia Stock Exchange website, at: <http://www.mse.mn/news/>

the lack of quality suppliers might encourage other TNCs to enter the market, especially to cater for the large mining companies.

C. FDI trends and impacts

There are two sources of FDI data in Mongolia and possible discrepancies in the following FDI analysis must be taken into consideration.²⁹ The BoM reports FDI statistics based on the balance of payments accounts (inflows are net of disinvestments). In addition, the Department of Foreign Investment Regulations and Registration (DFIRR) of the Ministry of Economic Development, which took over the functions of Mongolia’s investment promotion agency, FIFTA, in July 2012, reports FDI statistics based on its database of registered foreign investors. The advantage of these statistics is that it disaggregates FDI flows by country of origin, sector and lists the top foreign investors. However, the data collected by the DFIRR, and until recently by FIFTA, are not entirely accurate as they

²⁹ The largest disparity between the two databases was registered in 2010 when the BOM reported FDI inflows worth \$1,574 million, while FIFTA reported \$1,026 million.

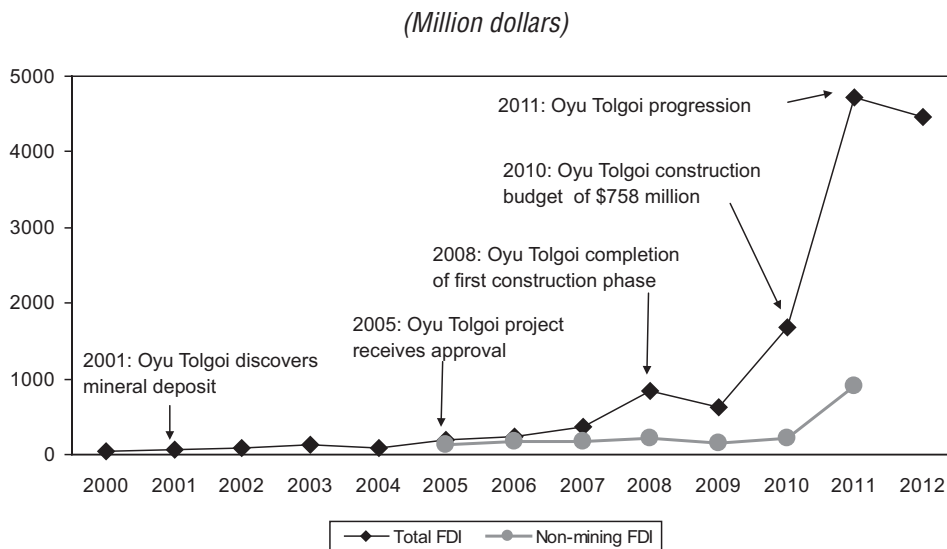
depend on the annual business plans prepared by the foreign companies estimated at the beginning of the year. Finally, there are no data on outward Mongolian investment.³⁰

1. Recent performance

Since its transition to a market economy in the 1990s, Mongolia has received modest amounts of FDI with annual inflows not surpassing \$100 million until 2003 (figure 1.2). In the latter half of the 2000s, however, inflows began to increase dramatically as the GoM opened its mining sector to foreign investment. One such project, the Oyu Tolgoi mine, has significantly contributed to this recent increase and helps explain the spikes in the volume of FDI inflows. This massive undertaking has helped raise Mongolia’s profile as an investment destination (box 1.3). As a result of the mining boom, FDI inflows grew almost nineteen fold in the last five years.

³⁰ In the context of the “Project for Capacity Development for Promoting FDI”, the Japan International Cooperation Agency (JICA) has conducted an assessment of FIFTA’s data collection and their conclusions supports the need for better FDI statistics.

Figure 1.2. FDI inflows into Mongolia, 2000–2012



Source: UNCTAD FDI/TNC Database and DFIRR/FIFTA estimates for non-mining FDI

Note: For 2012, only preliminary data on total FDI flows are available.

Mongolia was hit hard by the international economic and financial crisis: inflows to the country fell 26 per cent in 2009, which compares poorly to the East Asia regional average decline of 16 per cent. FDI inflows quickly recovered in 2010 with a phenomenal growth of more than 170 per cent, compared to 24 per cent in East Asia, and reached the record level of \$4.7 billion in 2011. A noticeable increase in non-mining FDI also occurred in 2011, largely explained by a rise of FDI in trade and catering services (see below). Data for the first six months of 2012 show that FDI in non-mining sectors kept a positive trend, while contraction was observed in mining, as reflected in the decline of total FDI inflows for that year. The downturn, which is in line with the regional trend for the year, also reflects domestic developments, such as the Oyu Tolgoi project reaching maturity. It also translates the impact of the introduction in 2012 of a new Law on Foreign Investment in Strategic Sectors (SEFIL), which established comprehensive permitting requirements on FDI entry and operation by private and state-owned enterprises (SOEs) in a number of sectors, including mining.

The dramatic increase in FDI inflows over time is reflected in the country's relative FDI attraction performance. In the last 15 years, Mongolia has caught up to and even surpassed other comparable economies (table 1.7). FDI inflows, which averaged only \$29 million annually in 1996–2000, surged to \$4.6 billion in 2011–2012, the highest growth among the comparators. The increase is even higher in relative terms. FDI inflows per capita, for example, averaged only \$12 per person in 1996–2000, but stood at \$1,625 in 2011–2012. Similarly, Mongolia's FDI inflows per \$1,000 GDP averaged only \$26 in 1996–2000 and reached \$496 in 2011–2012, making it the best performing economy among the list of comparators. It is also showing that FDI has grown to become an important component of Mongolia's economy, as it is equivalent to 88 per cent of the country's gross fixed capital formation (GFCF) and to about 50 per cent of GDP in 2012, the highest shares for any of the selected comparator countries. Yet, Mongolia's FDI stock is still modest at \$13 billion in 2012, reflecting its relatively recent FDI history.

Table I.7. Comparative FDI flows in selected countries, 1991-2012

(Dollars and percentages)

| Country | Absolute performance | | | | Relative performance | | | | | | | | | | | | FDI Stock | | |
|---|----------------------|-----------|-----------|-----------|----------------------|-----------|-----------|-----------|-----------------|-----------|-----------|-----------|---|-----------|-----------|-----------|-----------------|----------------|-----|
| | Average FDI inflows | | | | Per capita (Dollars) | | | | Per \$ 1000 GDP | | | | As percent of gross fixed capital formation | | | | Per capita (\$) | Percent of GDP | |
| | 1996-2000 | 2001-2005 | 2006-2010 | 2011-2012 | 1996-2000 | 2001-2005 | 2006-2010 | 2011-2012 | 1996-2000 | 2001-2005 | 2006-2010 | 2011-2012 | 1996-2000 | 2001-2005 | 2006-2010 | 2011-2012 | 2012 | 2012 | |
| Mongolia | 29 | 111 | 756 | 4,583 | 13,151 | 12 | 43 | 273 | 1625 | 26 | 68 | 157 | 496 | 10 | 24 | 39 | 101 | 4,624 | 131 |
| Botswana | 72 | 304 | 524 | 353 | 1,318 | 42 | 172 | 300 | 173 | 14 | 38 | 42 | 20 | 6 | 15 | 17 | 7 | 642 | 7 |
| Chile | 5,667 | 5,043 | 12,590 | 26,627 | 206,594 | 377 | 315 | 748 | 1534 | 74 | 58 | 73 | 103 | 32 | 28 | 34 | 43 | 11,857 | 78 |
| Gabon | -196 | 143 | 190 | 699 | 4,269 | -166 | 105 | 132 | 451 | -33 | 18 | 16 | 29 | -20 | 8 | 8 | 11 | 2,730 | 18 |
| Kazakhstan | 1,268 | 2,729 | 11,090 | 13,963 | 106,920 | 83 | 184 | 749 | 857 | 64 | 86 | 98 | 72 | 39 | 36 | 34 | 34 | 6,527 | 54 |
| Namibia | 99 | 254 | 643 | 587 | 3,491 | 55 | 128 | 304 | 251 | 25 | 54 | 68 | 47 | 14 | 27 | 30 | 17 | 1,476 | 28 |
| Peru | 2,001 | 1,763 | 5,757 | 10,236 | 63,448 | 80 | 65 | 196 | 346 | 36 | 27 | 47 | 53 | 16 | 15 | 20 | 20 | 2,134 | 31 |
| Uzbekistan | 118 | 120 | 625 | 1,281 | 7,855 | 5 | 5 | 22 | 46 | 8 | 10 | 22 | 27 | 3 | 5 | 11 | 10 | 280 | 15 |
| Zambia | 156 | 302 | 923 | 1,087 | 11,994 | 15 | 27 | 75 | 80 | 46 | 63 | 71 | 55 | 33 | 27 | 32 | 23 | 864 | 59 |
| Landlocked countries (LLCs) | 4,546 | 8,458 | 20,461 | 34,481 | 239,409 | 14 | 23 | 51 | 81 | 35 | 53 | 50 | 54 | 17 | 25 | 21 | 22 | 558 | 36 |
| All developing economies, excluding China | 160,274 | 182,695 | 455,871 | 596,486 | 6,911,641 | 46 | 48 | 112 | 138 | 29 | 27 | 38 | 35 | 13 | 13 | 16 | 15 | 1,589 | 40 |

Source: UNCTAD, FDI/TNC Database (WIR, 2013), UNCTADstat.

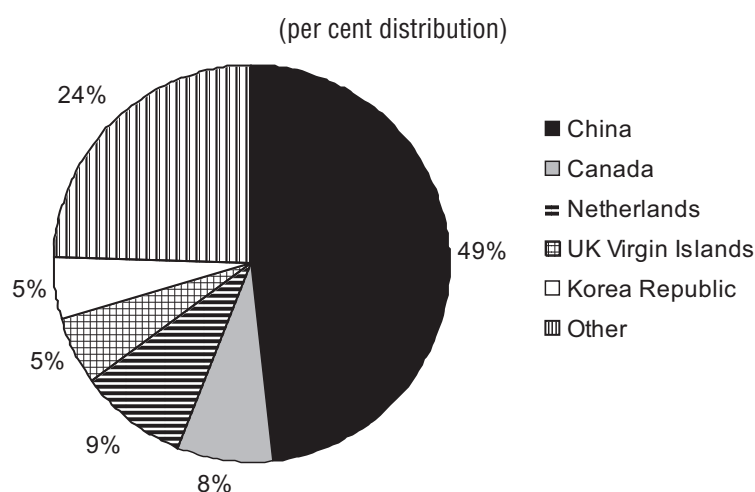
China is by far the largest source of FDI inflows with a 32 per cent share in 1990–2012, followed by the Netherlands, Luxemburg, the British Virgin Islands and Singapore (figure I.3). However, the reliability in terms of the nationality of investments is questionable, as data are compiled solely on the basis of immediate investors (and not the ultimate beneficiary owner/investor).³¹ In any case, there are over 5,500 Chinese firms registered in Mongolia, accounting for half of all registered foreign enterprises in the country.³² Some large Chinese companies — usually State-owned — are operating in mining and construction (i.e. Qing Hua, Chalco), but the bulk of Chinese investors are SMEs in wholesale or retail commerce.

³¹ For example the Brazilian mining giant Vale is the parent company of Tethys Mining in Mongolia but it is registered as Swiss investment. Likewise, Peabody Energy, an American mining company is registered as Dutch investment. The same is true of investments in banking and mining coming from the British Virgin Islands (table I.8).

³² Chinese companies are predominant in Mongolia due in part to their geographical proximity, their higher risk tolerance, and their expertise in sectors including construction and mining, which are booming in Mongolia. Furthermore, in some cases, they enjoy the direct support from the Government of China.

Although the Netherlands and Luxemburg are the second and third largest sources of FDI, there are no major corporations from these countries among the registered companies; rather, some investors have opted to register subsidiaries in Luxemburg or the Netherlands (or in the Netherlands Antilles) to invest in Mongolia and thus appear as investments from these two countries in the database. Meanwhile, about 140 Singaporean and just over 100 Canadian companies are registered in Mongolia. Canadian enterprises are mostly concentrated in mining and related industries, notably Ivanhoe Mines is a main shareholder of Oyu Tolgoi. There are also over 2,000 firms from the Republic of Korea, and like Chinese companies, the majority of them are SMEs in retail, restaurants, travel agencies and other services. Some larger Korean companies are involved in construction, real estate and in telecommunications. The largest groups, such as LG and Samsung, are just beginning to explore investment opportunities, and have opened representative offices in the country.

Figure I.3. FDI inflows by country of origin, 1990–June 2012



Source: DFIRR/FIFTA

Note: Data are based on the nationality of the immediate investors, not the ultimate parent company.

The extractive industries have received the lion's share of FDI with a 67 per cent of total FDI inflows in 1990–2010 (figure I.4). As the most recent sectoral data reveal, mining will continue to be the main recipient in

the future, with increasing shares in the total, unless Mongolians decide otherwise. The moratorium on new exploration and mining licences will have an impact on FDI inflows, though FDI from businesses with

valid licences continues. Moreover, in October 2011 some Members of Parliament (MPs) announced their intention to reconsider the terms of the Oyu Tolgoi agreement to increase the GoM's share in the project from 34 to 51 per cent. The news received international coverage and generated a feeling of uncertainty among both established and potential investors, even beyond the mining sector. This was aggravated by the introduction of the SEFIL in May 2012. In the end, the GoM officially confirmed the intentions to honour the original Oyu Tolgoi agreement.³³ However, a number of MPs are still calling for an immediate renegotiation of the agreement while the Government Action Plan 2012–2016 calls for continued talks to renew it on mutually beneficial terms, but only after recoupment of the initial

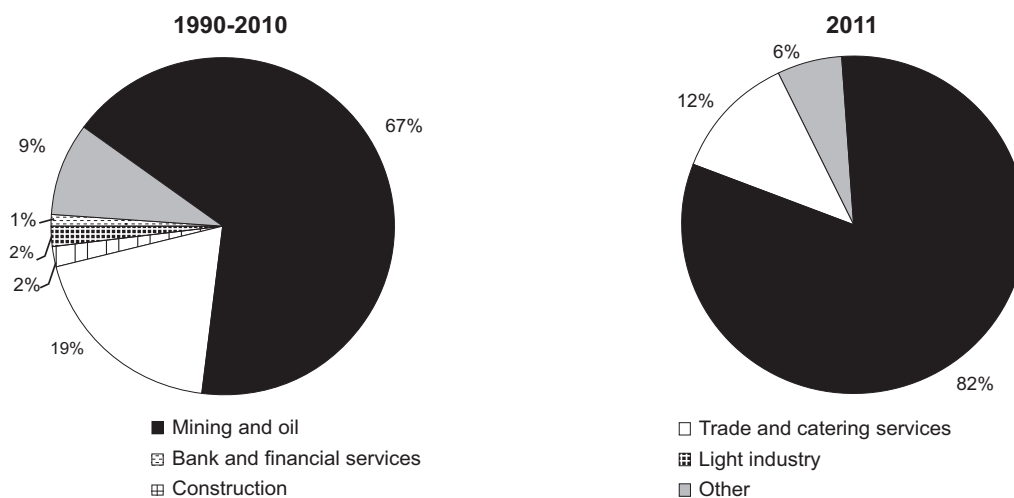
³³ See the "Joint Statement by the Government of Mongolia, Ivanhoe Mines and Rio Tinto" of 6 October 2011.

investment put into Oyu Tolgoi. Finally, in May 2013, the GoM also decided to limit the scope of application of the SEFIL with the explicit objective of addressing investors' concerns (chapter II.A).

Outside of mining, services are the second largest recipient of FDI, a large share of which is likely to be mining related. Trade and catering services is traditionally the sector that received the highest inflows, as well as the largest share — 65 per cent — of total registered foreign companies, corresponding to over 7,000 of them. To a significantly lesser degree, there is FDI in other services like construction and banking. FDI in manufacturing is very limited, and the little foreign investment in light industry appears to be catering for the domestic market.

Figure I.4. FDI inflows by sector, 1990–2010 and 2011–June 2012

(per cent distribution)



Source: DFIRR/FIFTA

The top 20 companies with foreign participation registered with DFIRR/FIFTA account for \$318 million in FDI (table I.8). Mining companies, which represent 56 per cent of aggregate FDI for the group, are followed by companies in banking, textiles, beverages, telecommunications and tourism. The majority of these investments are joint ventures. In several cases, the Mongolian partner owns a larger share of the project, suggesting that the foreign partners tend to contribute expertise and knowledge rather than capital. The local

partner's ability to navigate the business environment becomes a valuable asset in a country with regulatory ambiguity. There is also evidence of increasing domestic participation in profitable foreign businesses, and in some cases Mongolian partners gradually increase their ownership share and ultimately take over, although it does not appear to be a generalized trend across all sectors.³⁴ Although China is by far the largest source

³⁴ The telecommunications industry, for example, was one of the first to open to FDI and up until quite recently, three out of the four mobile carriers in the country were joint ventures with foreign

of FDI, there is only one investment listed in the top 20 coming from the mainland.

Table I.8 also highlights the limited number of global TNCs outside of mining. Many TNCs from developed countries recognize the business potential behind Mongolia's fast growing economy and appear increasingly interested in investing, as the booming

investment. Two carriers, Unitel and Skytel, had participation from Korean investors up until the end of 2010 when both companies became 100 per cent Mongolian owned. The only remaining company with foreign investment, Mobicom, has also seen the increase in the ownership of the Mongolian partner from 9 per cent upon establishment to 40 per cent in 2011.

number of representative offices in the country suggests (figure I.5). At the end of 2012, FIFTA had registered 227 representative offices in Mongolia and 40 per cent of these are companies from developed countries. These include well-known TNCs such as General Electric, Mitsubishi, and Intel in addition to the banks mentioned before. Such companies are taking a cautious "wait and see" approach by studying opportunities in the market and policy developments before entering Mongolia. In this regard, governance issues act for many as a major deterrent. Developed country TNCs tend, in general, to be more risk averse and subject to more strict anti-corruption laws in their countries of incorporation.

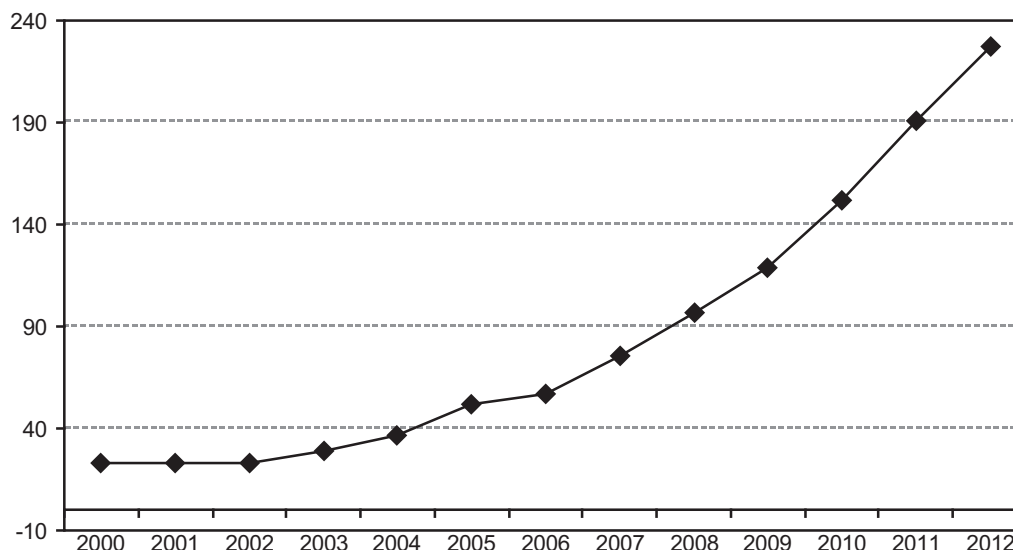
Table I.8. Top 20 companies with foreign participation, 1995–2011

| Rank | Company | Entry year | Total equity (million \$) | Foreign share (%) | Activity | Participating economy* |
|------|-----------------------------|------------|---------------------------|-------------------|--------------|--|
| 1 | Oyu Tolgoi | 2000 | 108.5 | 66 | Mining | The Netherlands, British Virgin Islands, Mongolia |
| 2 | Peabody Winsway Resources | 2007 | 61.0 | 100 | Mining | The Netherlands |
| 3 | Chinggis Khaan Bank | 2006 | 32.6 | 100 | Banking | British Virgin Islands |
| 4 | Tethys Mining | 2004 | 26.9 | 100 | Mining | Switzerland |
| 5 | Boldtomor yoroo gol | 2004 | 18.9 | 100 | Mining | British Virgin Islands |
| 6 | Goyo | 2006 | 18.0 | 100 | Cashmere | Singapore |
| 7 | Khan Bank | 2004 | 20.6 | 66 | Banking | Japan, Mongolia, China, Hong Kong Special Administrative Region, United States |
| 8 | MCS Asia Pacific | 2005 | 23.0 | 55 | Beverages | Singapore, Mongolia |
| 9 | Areva Mongolia | 2005 | 12.5 | 100 | Mining | France |
| 10 | Mobicom Corporation | 1995 | 10.7 | 79 | Telecom | The Netherlands, Mongolia |
| 11 | Ulaanbaatar University | 1995 | 6.7 | 98 | Education | Republic of Korea, United States, Mongolia |
| 12 | Wagner Asia Equipment | 1996 | 6.4 | 100 | Machinery | United States |
| 13 | Sky Resort | 2008 | 20.9 | 26 | Tourism | Mongolia, British Virgin Islands |
| 14 | Central Asian Cement | 2003 | 5.5 | 98 | Construction | China, Hong Kong Special Administrative Region, United States, United Kingdom, Mongolia, Belgium, The Netherlands, Singapore |
| 15 | Mongolrosvestment | 2007 | 10.5 | 49 | Mining | Mongolia, Russian Federation |
| 16 | Trade and Development Bank | 2002 | 3.8 | 80 | Banking | Luxembourg, Mongolia, United States |
| 17 | Qing Hua-MAC-Nariin Sukhait | 2002 | 3.6 | 50 | Mining | China, Mongolia |
| 18 | National Investment Bank | 2006 | 3.2 | 44 | Banking | Mongolia, Cayman Islands, China, Hong Kong Special Administrative Region |
| 19 | Sunjin Group | 2006 | 2.3 | 100 | Tourism | Republic of Korea |
| 20 | Seoul Group | 1996 | 1.1 | 95 | Real estate | Republic of Korea, Mongolia |
| | Total | | 405.5 | 79 | | |

Source: DFIRR/FIFTA

Notes: The ranking of the top 20 companies with foreign participation is based on the value of foreign equity.

* As mentioned, DFIRR/FIFTA data records the participating economy, not the actual parent.

Figure I.5. Total number of foreign representative offices in Mongolia, 2000–2012

Source: DFIRR/FIFTA

2. FDI impact

FDI has shaped the sectors where it has entered in Mongolia. For example, FDI has turned mining into a competitive modern industry and has created the possibility to expand into related up- and downstream industries, including heavy manufacturing (i.e. copper smelters, iron and steel production). Investment in this sector has also served as an anchor that makes large-scale infrastructure projects viable especially in railroads and electricity generation. In light manufacturing, FDI in cashmere production brought in technology and know-how to access foreign markets at an initial stage. Likewise, FDI in telecommunications introduced new technologies, pioneered mobile telephony and later internet services to transform Mongolia's ICT sector. In tourism, FDI is helping develop Mongolia as a high-end eco-tourism destination and the projected entrance of hotels should help bring the hospitality sector to international standards. The same can be said of foreign investment in construction which is contributing to the real estate boom in Ulaanbaatar.

Direct impact

FDI is a significant source of capital in Mongolia, equalling 88 per cent of GFCF, the highest among the comparator group. During 1991–2012, the country has

attracted more than \$13 billion in FDI, the share of GDP generated by foreign companies has reached 55 per cent. In particular, FDI in mining is expected to bring in large amounts of capital and the GoM is planning to finance ambitious projects partly from the revenue generated by these investments.

FDI has had a significant direct impact on fiscal revenues. Companies with foreign investment have contributed well over \$4 billion in tax revenue over the last fifteen years.³⁵ In 2011–2012, their contribution to tax revenue reached over MNT 2 billion (~ \$1.5 billion) or 48 per cent of total tax revenue per year. As mentioned above, revenues from FDI in mining is expected to increase dramatically in coming years.

In terms of employment generation, by the end of 2012, companies with foreign investment employed 59,000 people,³⁶ or roughly 7.7 per cent of total employment in the country. Recent policy measures have aimed at fostering local hire in mining where, outside of the construction phase, few direct jobs relative to the size of the investment are typically created due to the capital-intensive nature of the industry (chapter II). Similarly, high-end tourism FDI is not likely to generate massive direct employment but, in both cases, significant

³⁵ Note that the exchange rate used is \$1 = MNT 1238.

³⁶ Data source: General Authority of Social Insurance.

indirect employment and economic opportunities for local communities will be created (chapter III).

However, with the entrance of more foreign companies the demand for skilled labour seems to be outpacing supply (particularly at the technical and administrative level). There is evidence that the large mining companies for example are absorbing most of the English-speaking talent in the labour market by offering higher wages. This is one of the early symptoms of the resource curse, which the GoM is trying to confront. As discussed in the next chapters of this report, there are a number of yet unexplored policy options to utilize FDI to better contribute to the attraction and diffusion of skills to the local economy.

FDI has had a major impact in changing Mongolia's trade patterns, but its impact has been low in terms of diversification of exports thus far (with the exception of cashmere). The volume and value of copper, coal and other mineral exports has grown dramatically and are expected to grow even further with the opening of large mines in the near future. At the same time, foreign companies have also contributed to the increase of imports of industrial and capital goods yet the overall effect on the trade balance is positive (table I.2). The bulk of FDI outside of mining is concentrated in services catering for the domestic market. Furthermore, an increasing trend of imports in intermediate goods (i.e. plastics, tools, base metal products, construction material) gives an indication that FDI has not had a strong impact in promoting local sourcing.

Lastly, FDI has played a role in Mongolia's infrastructure development and the future contribution could be even greater. Russian investment helped build Mongolia's existing railway system and FDI in telecommunications have helped expand the country's mobile telephony coverage and internet fibre-optic connections. Mining companies can contribute to the local development in

their communities by supporting infrastructural and business development projects (chapter III). In addition, the GoM will seek the participation of FDI through concessions in a number of infrastructure development projects. If the tenders are successful, which would require careful project selection and promotion (chapters II and III), FDI would have a massive direct impact in the future development of the country's road, rail, energy and telecommunications infrastructure.

Indirect impact

Assessing the indirect impacts of FDI is generally a difficult task and the quality and availability of data make it particularly challenging in Mongolia. The following analysis is limited to the information gathered from the interviews with the private sector during UNCTAD's fact-finding mission.

Technology transfers and spillovers from FDI appear to be concentrated in targeted industries and were often accelerated by the establishment of joint ventures. FDI in mining has introduced the latest technology to Mongolia, and the subsequent FDI in mining-related services has also brought in world-standard equipment suppliers and mining consulting services that benefit both foreign and domestic companies. Japanese FDI in textiles was essential in the initial development of Mongolia's modern cashmere production and in its growth as an export industry.³⁷ As mentioned above, FDI in telecommunications was also instrumental in bringing in modern technology to the ICT industry (box I.2).

³⁷ Japanese FDI invested in the then State-owned textile manufacturer Gobi Cashmere and installed computerized knitting machines to modernize the production process in 1987. They also founded a separate joint venture retail subsidiary in Tokyo known as "Altai" to market Gobi's production in Japan in 1993. The Japanese investment helped to open new export markets for Mongolian cashmere that was previously limited to the former Soviet Union.

Box I.2. Mobicom transfer of technology and skills

Established in 1996, Mobicom was the pioneer in mobile telephony in Mongolia and today it is the largest provider with 1.2 million subscribers and a 51 per cent market share. An investment of MNT 593 billion (\$479 million), Mobicom is a joint venture company between Mongolian Newcom Group which owns a 40 per cent share and Japanese partners KDDI (30 per cent) and Sumitomo (30 per cent). The company employs 334 permanent staff and over 1,402 employees in its eight subsidiaries in the country. Mobicom has expanded coverage to reach 94 per cent of the country's population and has contributed over MNT 273 billion (\$220 million) in taxes, accounting for 30 per cent of total tax revenue from the ICT industry.

Mobicom introduced GSM mobile telephony technology in Mongolia, leading the way in mobile satellite services and an array of broadband internet services. The company spends 2 to 3 per cent of its annual budget in R&D and has a subsidiary that develops mobile and media content adapted to the domestic market. It also develops software, including online banking systems that enable e-money transactions via mobile phones. Domestic and foreign companies are benefiting from the technological innovations made possible by FDI and that were not previously found in Mongolia.

Aside from the R&D and technology transfer undertaken, Mobicom has launched the "Leadership Institute", an initiative to improve managerial skills. Initially, the company hired international experts to come and teach specialized high-level business management courses to its staff. Now, it hopes to expand this initiative to include managers from other companies that are willing to co-finance the institute. This will give Mongolian managers the opportunity to receive training from reputable international professors without needing to go abroad and, in the process, help develop managerial skills in Mongolia's workforce.

Source: Interview and corporate power point presentation

More recently, FDI in services like accounting and tourism are introducing international standards and managerial know-how that are likely to set the benchmark in the country and be adopted by domestic companies. There is also some transfer of technology in agricultural production through international cooperation that might lead to future FDI.³⁸ As one of its priority projects, the GoM plans to create a \$400 million High Technology Industrial Complex centre with the aim to host research and development (R&D) operations of private companies, although it is unclear what the expected role of FDI will be at this point.

As mentioned above, indigenous enterprises are at an early stage of development across most sectors, with some notable exceptions. Manufacturing, for instance, where FDI has been mostly absent, is largely underdeveloped, aside from few successful export-oriented industries (i.e. textiles). Consequently, the

³⁸ The Korean International Cooperation Agency (KOICA) has a successful agribusiness development project in eastern Mongolia to cultivate potatoes. This is introducing new technologies and might lead to private investment from Korean firms in the future.

absorptive capacity for potential spillovers of FDI and linkages is still low (table I.6). Domestic companies have begun to supply some basic goods to foreign mining companies (box I.3) and at least one bank is collaborating with mining companies and SMEs to help those suppliers obtain credit.³⁹ However, productive capacity at the local level is limited and the majority of mining companies continue to source inputs from Ulaanbaatar.⁴⁰

³⁹ Golomt Bank has signed an agreement with Oyu Tolgoi whereby it commits to extending credit to SMEs that have a supply contract as long as the mining company guarantees it will purchase the order. If the supplier does not meet the requirements, the credit line is suspended.

⁴⁰ This is the case with South Gobi Sands, a Canadian mining company in the South Gobi region which contended that the entire local potato production only covered a month's worth of their demand.

Box I.3. The relevance of the Oyu Tolgoi mine for Mongolia

The Oyu Tolgoi copper and gold mine is the single largest project in Mongolia's history. The site was discovered in the South Gobi province, 50 km from the Chinese border, in 2001 and it is believed to be the largest deposit of its type in the world. Estimates indicate that it contains approximately 81 billion pounds of copper and 46 million ounces of gold in measured, indicated and inferred resources. Once in full operation, the mine is expected to employ 3,000 persons and account for 30 per cent of Mongolia's GDP.

After several years of negotiation, an investment agreement for the development of Oyu Tolgoi between the GoM and Ivanhoe Mines of Canada was reached and came into force in March 2010. Under the agreement, the GoM is entitled to a 34 per cent share on the mine with the option of increasing its interest to 50 per cent in 30 years.

The mine came into operations in 2013. Oyu Tolgoi employed over 10,000 workers during its construction phase and the company expected to have invested over \$6 billion and paid \$700 million in taxes by the time the mine became operational. In addition to the mine, the company is building key infrastructure, including an airport, a 100km paved road, and three vocational schools. Oyu Tolgoi signed an agreement with the Ministry of Education and pledged \$58 million toward a five-year plan to build training facilities and fund scholarships. Furthermore, the company has committed over \$1 billion worth in contracts to local suppliers and Mongolian companies hold 80 per cent of all purchase orders.

Source: Ivanhoe Mines (<http://www.ivanhoemines.com>) and Oyu Tolgoi (<http://en.ot.mn/home.shtml>) corporate websites.

No structured programme exists to promote business linkages between TNCs and domestic companies. To address this issue, the GoM has created a SME support agency that operates business incubators, provides soft loans and training for capacity-building (chapter III). FDI has yet to stimulate the creation of industrial clusters in Mongolia but the GoM is planning to build an Industrial Complex in Sainshand, East Gobi province, which aims at establishing a mining processing industry cluster.⁴¹ The GoM is expecting to finance some projects of the Sainshand complex with private capital through concessions and there is room for foreign companies to invest in the building and operation of some of the industrial plants on site.

In the absence of clear guidelines for a local community development strategy from the GoM, mining companies have launched various spontaneous community development initiatives and infrastructural works as part of their corporate social responsibility (CSR), in an attempt to maintain good relationship with local communities affected by their activities (box I.3).

⁴¹ This large industrial park would consist of a thermal coal power plant, a copper smelter, an oil refinery, a coal gasification plant, a cement plant, a coke processing plant and an iron pellets plant. The entire project is expected to cost over \$10 billion and, on 31 May 2011, it was announced that Bechtel Corporation from the United States won the bid to prepare the construction master plan for the park.

D. Challenges and opportunities for FDI attraction and strategic priorities

Mongolia has changed dramatically over the last 30 years. The country represents a success story under many points of view, having introduced an open and liberal political and economic regime since the early 1990s. The recent discovery of large mineral resources and the entry of some of the leading international mining companies have opened previously unimaginable development opportunities. Forecasts by Citigroup (2011) place Mongolia in the group of eleven countries with the fastest growth potential over the next four decades to 2050. This may make it a unique example with a rapid and complete transformation of the economic and social landscape.

The benefits associated with the mining boom, however, are not certain and it is possible to postulate two radically different scenarios to 2021, the last year of the NDS implementation.

Scenario 1: Sustainable and inclusive development — Macroeconomic stability is attained; mining revenues are put to productive use; the regional development strategy is successful and the economy diversifies; large-scale improvements in infrastructure are undertaken, leading to prosperity for all.

Scenario 2: A resource curse — Macroeconomic instability occurs, associated with the resource curse; mining developments are hampered by national and international political and economic difficulties, and ever increasing corruption; investment in infrastructure is constrained; and Ulaanbaatar counts a large number of migrants with rising unemployment and crime, and further inequality.

Currently, outside of mining, and with few notable exceptions, industrial activity is modest. If services are experiencing a boom (in good part mining-related), agriculture is still based on the subsistence model. Concentration of economic activity in the capital city, skills shortages, changes in the traditional way of life, increasing income inequality and the risk of resource curse are all challenges for the current generation of Mongolian leaders.

Furthermore, without an adequate governance structure, increased revenues can attract rent-seeking behaviour and lead to rising levels of corruption (WIR, 2007), increasing the risk of resource curse. As discussed in details in chapter III, public policy has an important role in minimizing those risks and ensuring that the regulatory regime adequately protects the public interest and promotes investment and sustainable socio-economic development.

Given the capital and technology required for large scale mining exploration, but also the infrastructure and skills development needs of a country of the size of Mongolia, FDI is and will remain critical to its development. So far, however, FDI has been highly concentrated to one sector (mining), one city (Ulaanbaatar) and one source country (China). It is expected that FDI in mining will raise the

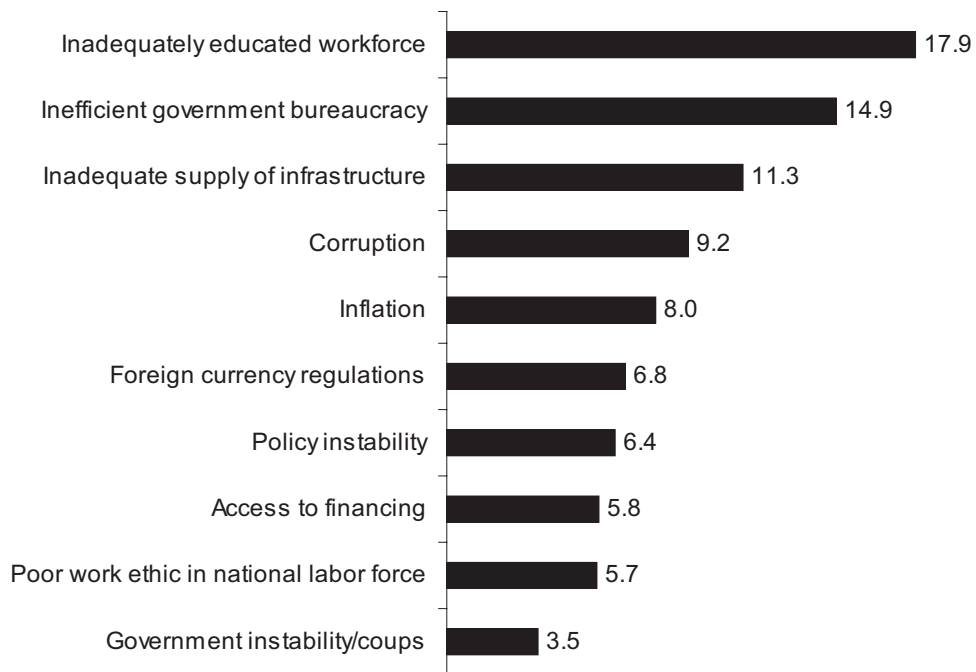
profile of Mongolia as an investment destination and create opportunities beyond mining-related goods and services. Mongolia's income per capita is expected to increase sharply and a growing middle class will demand more goods and services and attract more foreign investors. The current construction boom in Ulaanbaatar suggests that the process has already started, and opportunities for FDI in business and consumer services will continue to develop naturally as the city does.

This report, however, considers that FDI has a potentially much more prominent role to play in fostering the diversification of the economy, both in terms of sectors and of regions of economic activity. FDI can also assist Mongolia in diversifying its investment and trading network beyond the immediate neighbours and open new channels for trade. Its contribution to skills and infrastructure development could be much higher, and so could be its impact on crowding-in local entrepreneurs. These objectives should constitute the basis for the adoption of a comprehensive FDI strategy as will be discussed in chapter III of this report. The key challenges that the GoM will need to address through the strategy, as introduced in this chapter, are also reflected in investors' perceptions (figure I.6) and were confirmed during UNCTAD's interviews during the fact-finding mission.

The governance and institutional weaknesses and the recent uncertainty surrounding FDI-specific legislation (Chapter II), together with infrastructure and skills inadequacies, are considered the main obstacles to the diversification of FDI. As will be discussed in the following chapter of this report, which analyses the specifics of Mongolia's legal and regulatory framework for investment, improving transparency and accountability in government-business relations should therefore be a priority in Mongolia's development strategy.

Figure I.6. Top 10 most problematic factors for doing business in Mongolia, 2012

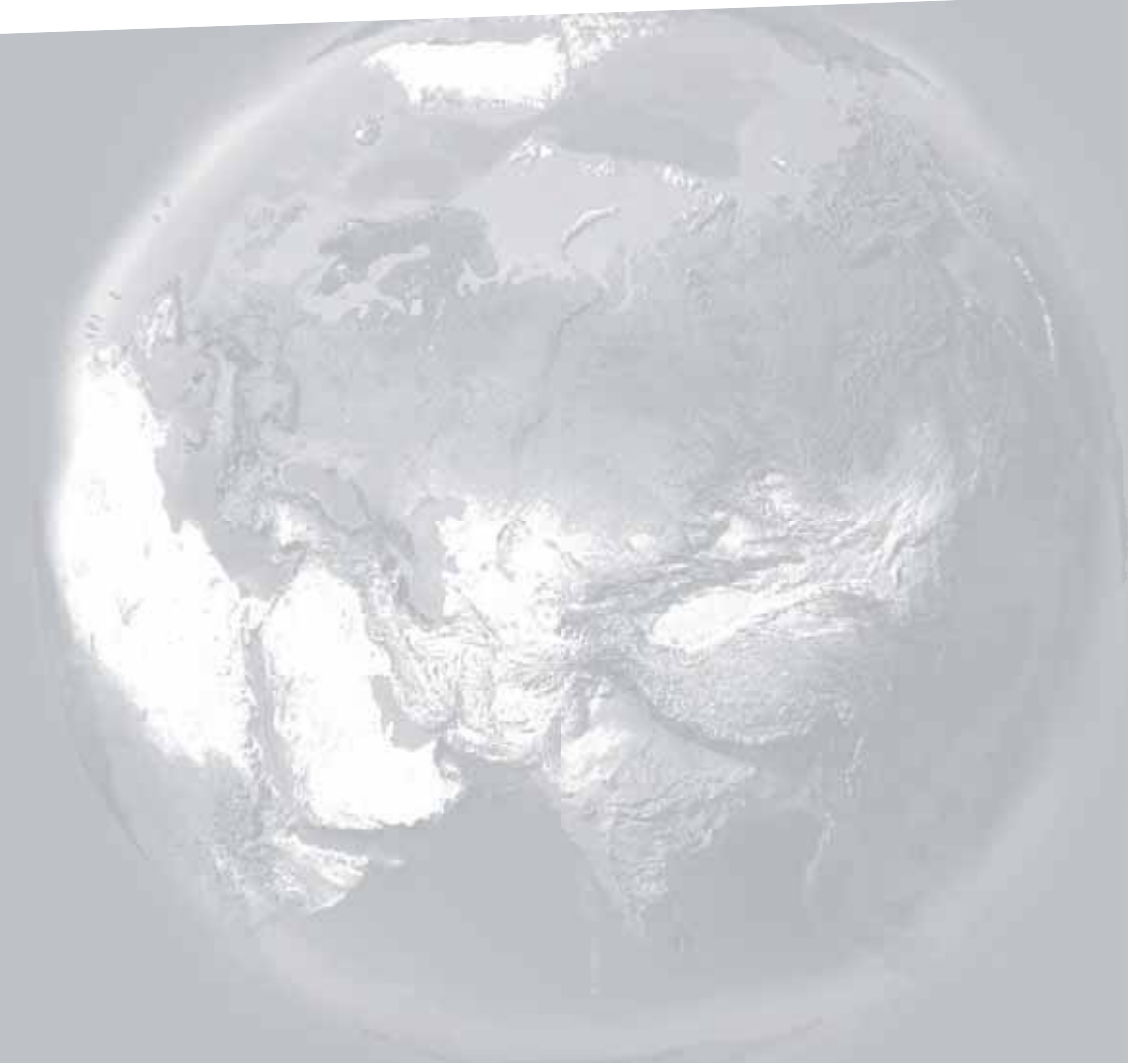
(per cent of responses)



Source: WEF Global Competitiveness Report 2012-2013.

CHAPTER 2

Regulatory and institutional framework for investment



Trade and investment liberalization have been pillars of Mongolia's development strategy since the early 1990s. An impressive body of new laws affecting all aspects of corporate life has been introduced in the recent past, which is generally clear and up to standards. As a result of this consistent effort, Mongolia is today one of the most open economies in the region, including in its approach to foreign investment.

As will be described in this chapter, however, institutional weakness affects most regulatory areas and important policy implementation challenges remain, which limit the effectiveness of the reform process. A related governance problem acts as a major obstacle to private sector development as well as investment and economic diversification. This chapter presents an assessment of the situation and raises issues regarding the investment framework. The recommendations are integrated into chapter III.

A. FDI-specific regulatory framework

Consistent with its free-trade stance, Mongolia has been very open to foreign investment since the early 1990s and offers foreign investors high standards of treatment and protection. However, the Foreign Investment Law of Mongolia (FIL) of 1993, last revised in August 2012, contains a number of provisions which, though never implemented to date, send contradicting signals to investors and create an inconsistency with the liberal approach to investment adopted by the public administration in its dealings with the entry of foreign investors. Moreover, the discovery of important mining deposits (discussed in chapter I) has raised legitimate policy concerns related to national security and economic interests, including control over national resources. Nonetheless, a comprehensive screening approach adopted in the new Law on the Regulation of Foreign Investment in Entities operating in Strategic Sectors of May 2012 and amended in May 2013 risks adding uncertainty and arbitrariness to an investment climate already characterized by important governance issues, as discussed later in this chapter.

1. Entry and establishment

According to its general provisions, the purpose of the FIL is to “encourage foreign investment, protect the

rights and property of foreign investors and regulate matters related to foreign investment” (art. 1). Following a very liberal approach, the law opens “all areas of production and all services” to foreign investment, unless prohibited by other laws. No such prohibitions are in place with the exception of those contained in the Law on Licensing of 2001, which lists a standard range of activities that are closed to all investors, foreign and domestic alike. These include weapons or drugs manufacturing and trading, pornographic activities, financial pyramid schemes (so-called “Ponzi” schemes) and gambling outside of the free zones (FZs) (art. 8).

Foreign investors can establish wholly foreign-owned business entities as well as joint ventures and they can conclude concession, product sharing or management and marketing contracts (art. 6). The FIL gives them the right to purchase shares or other securities in any business entity operating in Mongolia (art. 7).

Some restrictions to private investment (both national and foreign) result from the presence of State monopolies. These include fixed-line telecommunications (joint venture between the GoM and Korean Telecom), electricity (production, transmission and distribution) and railways (joint venture between the GoM and the Government of the Russian Federation). There are no plans to remove these monopolies while in recent years new State-owned companies have emerged in sectors considered strategic, including mining and energy.

The openness to foreign investment is reflected in practice, and confirmed by foreign investors operating in the country.

The FIL, however, contains a number of provisions which contrast sharply with both its general spirit and stated purpose and the liberal practice. In particular, it introduces a comprehensive *ex-ante* screening of every foreign investment, and subjects investors' entry to permission. The Department of Foreign Investment Regulations and Registrations (DFIRR), of the Ministry of Economic Development (MED), which replaced the Foreign Investment and Foreign Trade Agency (FIFTA) in 2012, is mandated to issue “investment certificates”, as approved by the Minister of Economic Development (art. 12 of the FIL) upon verification by a specialized office of a number of documents and evaluation of the investment based on a set of broadly defined criteria. These include “compliance with national laws and regulations, impact

on the environment, compliance with standards and hygiene requirements and evaluation of the technical and technological level of the investment". The DFIRR has 14 days to review investors' applications and issue or deny the permission needed to obtain an investment certificate.

The operations of a company with foreign investment can also be suspended or terminated if the Ministry determines that the investor has breached the above criteria (art. 16). Before the latest amendment to the FIL, in August 2012, this was the prerogative of FIFTA. Finally, according to the FIL, foreign investors need to prove that they have at least \$100,000 (or the equivalent in MNT) in available capital at the time of registration, by means of a temporary deposit in a local bank, which must remain in the account until registration has been completed.

While FIFTA before and now the DFIRR have been issuing investment certificates and renewing them on an annual basis, to date no screening such as that described above has taken place in practice. This is partly explained by the fact that the specialized office mentioned in the law was never established and also because of the difficulty to properly evaluate compliance with the criteria of article 12 at the pre-establishment phase. Consequently, no investor has so far been refused permission to establish based on these grounds. However, the possibility for the authorities to effectively filter any foreign investment or to terminate at any time the operations of companies with foreign investment based on a set of unclearly determined criteria raises severe concerns over legal certainty and sends investors a negative signal regarding the stability of the investment climate.

Specific conditions apply to investment in petroleum and mining, as is common elsewhere. Obtaining a licence in these sectors requires foreign companies to incorporate locally. Also, Mongolian law requires oil extraction companies to enter into production sharing contracts with the Government as a precondition for exploration. In mining, regulations have been subject to frequent changes in recent years and, since 2006, joint ventures with the GoM are required in cases where strategically important mineral deposits are found, i.e. deposits that may account for more than 5 per cent of GDP (section

D.1).⁴² These conditions, nonetheless, apply equally to domestic and foreign investors.

In addition, the Law on Regulating Foreign Investment in entities operating in Strategic Sectors (known as SEFIL), adopted in May 2012 and amended in May 2013, further tightened access to a number of sectors. It requires Government approval for foreign companies wishing to operate in a strategic sector or to make transactions with companies operating in strategic sectors to obtain Government approval. Approval from the Parliament is needed if the foreign investor's share in a strategic sector exceeds 49 per cent and the investors are "entities or international organizations owned partly or fully by a foreign State, as well as the persons and parties with common interests with them". This formulation is general and makes it challenging to clearly ascertain the type of investors concerned, including non-SOEs.

The strategic sectors defined in the law include the minerals sector, media and information as well as banking, finance and telecommunications. In the case of the last two sectors, the recent Government decision seems to contradict Mongolia's objective to develop financial and business services through FDI (see chapter III). The implementing regulations to the SEFIL passed by Government in May 2013⁴³ clarified that business activities falling within a relevant strategic sector are determined according to the classification adopted in the VAT law. This follows the International Standard Industrial Classification of Economic Activities (ISIC) of the UN. Under ISIC, however, there is no "minerals" category, but a "mining, extraction and refining" one. Further clarification is therefore needed (Hogan Lovells, 2013).

The transactions requiring Government permit include investment (according to art. 6.1.1, permit is required to acquire one third or more of the shares of an entity in a strategic sector) as well as an extensive list of other post-establishment company operations. These include, among others, transactions that: confer management rights; ensure the right to veto a management decision; are likely to impact directly or indirectly the market price of a mining product for export; or that would result in a "decrease of shares" in the company.

⁴² An exact definition of what constitutes a strategic deposit under the 5 per cent rule is still missing.

⁴³ The text of these regulations was not available to UNCTAD for review.

In order to implement the new permitting procedure, additional regulatory functions have been assigned to the DFIRR. It is mandated to examine the proposed transactions falling under the scope of the law based on a new set of broad criteria (art. 7), including:

1. Compliance with the National Security Concept of Mongolia;
2. Compliance with the national laws, regulations and business rules;
3. Competition-related risks of the investment;
4. Impact on the “budget income, and other policies and activities in Mongolia”; and
5. Impact on the “operations of the concerned sector”.

Upon completion of its review, the DFIRR delivers its recommendation regarding a transaction to the Government for final decision. In this regard, the explicit reference to the National Security Concept is noteworthy. As mentioned in chapter I, the 2010 revision to the document calls for a strategy whereby “the investment of any foreign country does not exceed one third of overall foreign investment in Mongolia” and “a policy to restrict investments by foreign state-owned companies and balance the volume of investments by neighbouring and highly developed countries within strategically important sectors” (art. 3.2.2.2). It further calls for “creating a legal environment and conditions to attract foreign investments with no harm to shares of Mongolia’s vital economic entities sold on international stock exchange markets” (art.3.2.2.3). Compliance with the new law on strategic sectors would effectively mean closing these sectors to traditional investors, who already account for the lion share of FDI to Mongolia (Chapter I). In a similar manner, the vagueness of the FIL’s screening criteria could extend the restriction to the entire economy.

2. Treatment and protection

Foreign investors in Mongolia are offered high standards of treatment and protection. In particular, they are accorded no less favourable treatment (art. 9 of the FIL) than Mongolian investors and no exceptions to national treatment could be identified in the national legislation, other than the restriction on foreign ownership of land (art 2 of the Constitution). Such restriction, common in other countries, does not preclude investors from

accessing land under different titles, including through leasehold agreements (section B.5).

As mentioned above, however, the recent introduction of the Law on Regulating Foreign Investment in entities operating in Strategic Sectors leaves scope for discriminating investors operating in strategic sectors, by requiring Government authorization for a range of company operations.

The rights and guarantees offered to foreign investors under the FIL also include:

- The right to manage or participate in the management of a business entity with foreign investment;
- The right to transfer their rights and obligations to others (art. 10);
- The right to freely transfer invested capital and the full proceeds of divestment, profit and dividends, debt and related interest, payments related to compensation in case of expropriation and other income gained in conformity with the law (art. 10); and
- Guarantees against nationalization or unlawful expropriation. Investments may be expropriated only for public purposes or interests, and only in accordance with due process of law on a non-discriminatory basis and on payment of full compensation. Compensation is paid without delay and at market price (art. 8).

The provisions of the FIL are complemented by the rights and guarantees offered under Mongolia’s extensive network of bilateral investment treaties (BITs). As of February 2011, Mongolia had signed 43 BITs, out of which seven are yet to be ratified. It signed its first BIT in March 1991 with the Republic of Korea and its most recent one in March 2009 with Tajikistan. Mongolia’s BITs network is geographically diversified and includes some of its largest trade and investment partners, such as China, the Russian Federation, the Republic of Korea, Italy and Japan. Notable exceptions include Canada, with which a BIT is being negotiated.

Mongolia’s BITs provisions are fairly standard and include most-favoured nation, national treatment of foreign investors, fair and equitable treatment and, at times, full protection and security standards. The Mongolia-Singapore BIT (1995) is a notable exception in so far as its protective standards are accompanied

by a public health exception and an essential security exception that help to preserve regulatory flexibility in sensitive policy areas.

In addition to BITs, Mongolia concluded three other international agreements with investment provisions. First, it signed a trade and economic cooperation agreement with the European Economic Community in 1992. The agreement encourages the parties to improve their investment climate, particularly through the conclusion of investment promotion and protection agreements, based on the principles of reciprocity and equitable treatment. As of 2011, 15 of Mongolia's 43 BITs were signed with EU countries.

Second, Mongolia signed and ratified the Energy Charter Treaty in 1999. The treaty protects foreign investments in the energy sector through the granting of provisions similar to those found in BITs. It provides foreign investors with national treatment, MFN and fair equitable treatment, and gives protection against expropriation and nationalization. The treaty also covers both State to State arbitration and investor-State dispute settlement.

Third, the 2004 Agreement Concerning the Development of Trade and Investment Relations between Mongolia and the United States of America establishes a United States-Mongolia Council on Trade and Investment with the objectives of monitoring investment relations, identifying opportunities for expanding investment and the removal of impediments to investment flows.

Finally, Mongolia joined the WTO in 1997. While the WTO is primarily concerned with trade issues, some WTO Agreements also have an impact on investment policy. Particularly, the GATS (FDI in services), TRIMs (performance requirements), TRIPs (intellectual property rights) and SCM Agreement (subsidies) contain provisions that are of relevance for the treatment of domestic and foreign investors.

Whereas the FIL determines that disputes involving foreign investors shall be resolved in the courts of Mongolia, unless otherwise provided in by international treaties (art. 25), access to international arbitration is guaranteed in all BITs. Mongolia has been a member of the International Centre for Settlement of Investment Disputes (ICSID) since 1991 but only one case has been brought to ICSID since then (Alstom Power Italia S.P.A.

in 2004). A settlement was agreed upon by the parties and proceedings discontinued at their request. Mongolia also signed and ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1994.

A recent case of international arbitration involving the State of Mongolia was brought by Khan Resources Inc. (Canadian mining company), and several of its subsidiaries, under the Energy Charter Treaty in January 2011. The proceedings were conducted in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). The claim seeks over \$200 million in compensation for losses and damages related to the cancelling of the company's uranium exploration licence following the introduction in 2009 of a Nuclear Energy Law requiring State participation in all uranium mining (section D.1).

In addition there are two other cases against Mongolia which are pending, both initiated under the UNCITRAL rules. In 2008, Russian investors, Sergei Pashok and Associates, brought a claim based on the Mongolia-Russia BIT (1995). The dispute arose out of the introduction of a windfall tax on the sale of gold. In 2010, China Heilongjiang initiated an arbitral proceeding against Mongolia pursuant to the China-Mongolia BIT (1991) challenging the cancellation of a mining licence.⁴⁴

While pointing at the inefficiencies of the domestic courts, which make contract enforcement a slow and expensive process (section C.2), foreign investors interviewed by UNCTAD reported no discrimination based on nationality in Mongolian courts. They also largely confirmed that national treatment is a cornerstone of the approach to FDI. Some investors, however, reported that after becoming profitable, they experienced pressures to enter into joint ventures with domestic enterprises or reduce their share in favour of the Mongolian partners. This is a factor of concern for an economy in which conflict of interest between business and politics is widespread (section D).

Aside from the rights and guarantees applying to foreign investors under the FIL and the BITs, individual stability agreements are available to investors that plan to undertake large projects. The agreement, limited to the

⁴⁴ For more information, consult the UNCTAD database on treaty-based investor-State dispute settlement cases: <http://www.unctad.org/jia-dbcases/cases.aspx>.

fiscal domain, provides stabilization clauses of 10 years for investments above \$20 million (or MNT equivalent), or 15 years for investments above \$50 million. The stability agreements are negotiated directly with the Ministry of Finance by interested qualifying investors (art. 19 of FIL). To date, few such agreements have been signed, primarily with mining companies (which can also benefit from individual investment agreements as discussed in section D.1). Stability agreements limit a country's policy space, create several administrative difficulties and are typically utilized to gain investors' confidence when the investment environment is characterized by significant uncertainty.

Finally, the FIL imposes a number of obligations on foreign investors, which are applied equally to everyone operating in Mongolia. They include observing domestic laws, respecting the customs and traditions of the people of Mongolia, implementing measures to ensure the protection and restoration of the natural environment and performing the obligations set forth in their agreements and statutes.

3. Institutional setting to implement the FIL

Further to the recent changes to the Government structure and consequent amendments to the FIL amended in August 2012, the formulation and implementation of foreign investment policy and legislation are responsibility of the "State Central administrative body in charge of foreign investment matters", i.e. the Ministry of Economic Development. Within the Ministry, as mentioned, the DFIRR is mandated to carry out a number of functions including to:

- Implement the medium- and long-term foreign investment policy;
- Review and implement the policies and legislation on foreign direct investment;
- Promote Mongolia as an attractive investment destination;
- Collect and compile FDI statistics from Government agencies in charge of labour, taxation, customs, social insurance and immigration;
- Register business entities with foreign investment and representative office (issuing investment certificates);

- Analyze foreign direct investment trends and forecasts; and
- Provide information and one-stop-shop facilitation services to investors;

Hence the DFIRR is both Mongolia's investment promotion agency and the gatekeeper of incoming investment. Like its predecessor FIFTA, DFIRR is a small agency of 23 staff sub-divided in two teams (Regulations Team and Registration Team). Its capacity to carry out such extensive functions is therefore limited. Furthermore, its policy implementation role is held back by the absence of an official foreign investment policy (chapter III). An early attempt to set up a one-stop-shop within FIFTA in the past was abandoned due to poor coordination with the line ministries in charge of permissions, which resulted in duplication rather than simplification. FDI statistics are collected primarily from the investor certification process (rather than from other government agencies), and they are often incomplete or unreliable (chapter I). In this context, investment promotion activities are focussed primarily on the organization of investors' fora (in or outside of Mongolia), on provision of some facilitation services and on the registration of foreign investors through the issuing of investment certificates. This is very limited compared to modern investment promotion standards.

4. Assessment of FDI-specific regulations and supporting institutions

Although the FIL allows for comprehensive and potentially arbitrary *ex ante* screening of foreign investment, to date, Mongolia has been, in practice, one of the most open economies to FDI in Asia. Foreign investors could enter and operate in virtually all sectors open to Mongolian investors, be treated on an equal footing and be offered modern standards of protection, in line with international practice under BITs.

The openness to foreign investment demonstrated by Mongolia over the years was recently questioned by both domestic and foreign investors in Mongolia further to the introduction of the SEFIL, which has left the authorities with ample discretionary powers to screen investors' entry and intervene in daily management decisions in a number of sectors. In this regard, a revision of the legislation on foreign investment is necessary to restore adequate legal certainty and provide a coherent

message regarding the country's openness to investors, while ensuring that the public concerns regarding competition, environment and health are adequately protected by strengthening the ministries and agencies with the relevant expertise.

The ultimate objective of the law on strategic sectors was "to ensure the orderly operations of foreign investment in the country in relation to national economy and security concerns...to ensure a healthy market system based on fair competition...and to prevent a foreign SOE from gaining a dominating position".⁴⁵ Likewise, in introducing the screening mechanism in the FIL, the objective of the legislator was presumably to control the quality of incoming investment and limit the entry of very small foreign companies which would be competing with local SMEs, thus putting a halt to the associated immigration.

However, from the policy perspective and good practices in countries around the world, compliance with existing legislation, including competition, health, environmental and safety standards can be more effectively ensured by the relevant permitting and monitoring agencies in the post-establishment phase. It would be neither feasible nor desirable for any single Government agency, let alone the one mandated with investment promotion, to perform the functions currently mandated to the DFIRR under both the FIL and the law on strategic sectors.

Moreover, with respect to the FIL, the deposit requirement may prevent the entry of small but potentially high-impact investors, such as those in the eco-tourism business, which is one of the priority sectors for FDI attraction. At the same time, the entry of foreign migrants is best dealt with through the immigration law, border controls and work permit procedures. It may also be more efficient to determine which activities should be shielded from competition from FDI on a sectoral basis, either entirely or upon determination of a minimum investment threshold.

On the institutional front, the investment promotion function should be significantly upgraded. The investment promotion agency in Mongolia could have a vital role to play in the future to support the country's economic development. It can promote economic

⁴⁵ As stated in *The "Golden Middle" in the interests of Mongolia and investors will be attained*, text by the MFAT accompanying the introduction of the Law on Regulating Foreign Investment in entities operating in Strategic Sectors, 24 May 2012.

diversification by helping to generate investment in new sectors through proactive investor targeting based on well-researched propositions. It can also increase the development gains from existing investment across the economy, through effective aftercare and business development services. Furthermore, it can foster regional diversification of economic activities by supporting FDI attraction efforts of local authorities. Many of these functions, however, are currently outside DFIRR's mandate and beyond its financial and human capacity. These considerations are particularly important in view of Mongolia's objective to diversify the source countries as well as the sectors for foreign investment. Detailed recommendations to revise the FDI-specific regime of Mongolia are contained in chapter III.

B. General investment climate

1. Company operations

Setting up a company

The procedures for starting a business in Mongolia have been the object of reform since 2009, when the introduction of the General Authority for State Registration (GASR) consolidated into one agency the property, civil and commercial registry functions. The ultimate objective, according to the "National Program to establish an aggregate system of registration and information in Mongolia" (Government Decree 78 of 2009), was to provide integrated registration services to citizens and companies alike. The programme, which received the support of both the Korean International Cooperation Agency (KOICA) and the Millennium Challenge Corporation (MCC), has significantly streamlined bureaucratic requirements for company and property registration.

Company formation is regulated by the General Law on State Registration of 2009 and the Company Law of 2011. Company types include most common form of business entities, including public companies (open or closed), limited liability companies, joint ventures, subsidiaries, branches and representative offices (Company Law art. 3 to 7). Any company becomes a legal person in Mongolia from the moment of its registration with the General Authority for State Registration. This

is also the case for companies with foreign investment wishing to incorporate locally, as well as branches and representative offices. As already mentioned, for companies with foreign investment, prior registration with DFIRR is required.

The implementation of the integrated registration system started with the upgrade of the GASR's facilities and the introduction of a law on e-signature, which makes it possible to process the relevant applications online. As a result of the efforts undertaken, Mongolia has progressed from 95th to 39th place globally in the "starting a business" ranking of *World Bank Doing Business Report*, 2013 (World Bank, 2012).

Notwithstanding progress in the commercial registry component, however, the digitalization of other registries and their harmonization is still incomplete (see section 4 on land and property rights) and the capacity of the staff of GASR to operate and maintain the new IT infrastructure is limited. Frequent staff turnover reduces the effectiveness of capacity-building efforts and weakens the project's execution. In this context, continued donor assistance is needed to complete the digitalization process and centralize databases within GASR. However, the effectiveness of such efforts will be at risk until adequate human resources are allocated to the functioning of the integrated registration system. Also, aside from its bureaucracy reduction effects, the centralized database should improve transparency by providing the possibility for individuals and companies to easily access the information needed to conduct due diligence analysis, which is currently very difficult to obtain without the assistance of specialized companies.

Obtaining construction permits

Obtaining construction permits is a heavily bureaucratic process in which rent-seeking opportunities flourish, at the expenses of efficiency, safety and environmental concerns. The MNCCI, for instance, reported its direct experience with the construction of a new headquarters, for which 133 signatures by different offices of the public administration were required. Not surprisingly, the Chamber has made the streamlining of construction permits a priority of its advocacy activities for the improvement of the business climate in Mongolia, in the context of the "Business Environment Reform Year" initiative of 2010. The Government has since committed

to slash construction-related permits and licences by 90 per cent but it is too early to assess compliance.

Accessing foreign exchange

The foreign exchange regime of Mongolia is very liberal and accessing foreign exchange, receiving or transferring funds from abroad is straightforward. Both current and capital account were liberalized in the early 1990s. Cross-border foreign currencies transfers are executed via customer accounts of domestic and foreign authorized banks and all 14 commercial banks in the country have been issued with special permission to process international transfers (Central Bank of Mongolia, 2011).

Mongolia accepted the obligations under art. VIII of the IMF in 1996. The exchange rate is flexible and the Mongolian authorities and the IMF concur that the exchange rate regime has and will continue to be appropriate for the Mongolian economy, in terms of containing inflationary pressure and providing a buffer to external shock (IMF, 2011).

Controls and inspections

In 2003, the Mongolian authorities established the "General Agency for Specialized Inspection" (GASI) with the objective of harmonizing and reducing often redundant and pervasive controls and inspections on business activities by a multiplicity of government agencies. GASI reports directly to the Prime Minister, and its main goal is to "implement the government policy framework" by conducting all inspection and monitoring activities in the country. GASI took over the control and inspection responsibility of 13 different government agencies in areas that range from finance, labour and welfare, food and agriculture, health and education to infrastructure, mining, tourism, environment and border inspection.

The reform followed an international trend towards the consolidation of inspection activities aimed at increasing their effectiveness while reducing the costs for the State and for business.⁴⁶ Nonetheless, according to a recent study by the International Finance Corporation, a number of problems persist:

⁴⁶ The Netherlands, Slovenia, Croatia, and Bosnia and Herzegovina are among the countries that recently merged control functions of different agencies (World Bank Group, 2011).

1. contrary to international practice, the revenue agency and the inspectorate that focuses on controlling other State agencies were integrated under the unified inspectorate;
2. inspections still routinely focus on trivial issues that have no impact on public safety;⁴⁷ and
3. the percentage of businesses that go through a follow-up inspection for a violation is nearly identical to the percentage of businesses that pay a fine as a result of non-compliance, suggesting that inspections focus on imposing sanctions at least as much as on fostering compliance with the rule (International Finance Corporation, 2011).

UNCTAD's fact-finding mission identified a number or additional problems in this area. First, given the large spectrum of specialized areas under GASI's responsibilities, its inspectors often lack the required level of competence. For instance, notwithstanding the 2,000 staff distributed between the headquarters and 135 local offices, GASI has often resorted to employing local civil servants without specific competences in critical areas such as environmental and mining inspections. Also, if line ministries or agencies want to initiate inspection or monitoring activities, they have to make an official request to GASI and await communication on its findings. According to many of the interviewed agencies, however, the level of coordination required in such circumstances remains unsatisfactory. Finally, the laws and regulations that businesses have to comply with are often unclear, due to the lack of implementation guidelines and secondary legislation.

Encouragingly, in March 2013, the Deputy Prime Minister of Mongolia announced plans to reform the GASI and refocus its activities on preventive measures by adopting a risk-based approach to inspections.⁴⁸ In this regard, the International Finance Corporation (IFC) is currently supporting the GoM in drafting a new Supervision Law. The draft law is intended to introduce several innovations in the inspections regime by proposing new governance in managing inspections (inspectorates), accountability through performance management and standardization

⁴⁷ The IFC reports that some of the inspections carried out in Mongolia are hardly related with safety issues. For instance: trade technology inspections often focus on issues such as how goods are placed on the shelves or the location of the cashiers and restaurants are required to start menus with appetizers and salads and to finish them with drinks.

⁴⁸ *UB Post*, 18 March 2013.

of inspections procedures. The draft Law is expected to be discussed in the Fall 2013 session of Parliament.

2. Taxation

The Mongolian corporate taxation regime has undergone major changes since January 2007, when a tax policy overhaul significantly reduced the tax burden on business and expanded the tax base by reducing the number of incentive schemes available. The value-added tax (VAT) regime was also reformed and tax administration was streamlined. Fiscal concepts and practices were aligned to international standards. Reforms have continued since, and are generally aimed at further streamlining tax administration and payment.

The principal taxes affecting business are the tax on corporate income, the VAT and the social security contributions. There is no net worth tax and no separate tax on capital gains. Taxpayers who reside permanently in Mongolia are taxed on their worldwide income; non-residents, including branches, are taxed only on income earned in Mongolia, generally under the same conditions applying to residents.⁴⁹

Among the key novelties of the 2007 reform, carried out with the assistance of the USAID, was the reduction of the corporate tax rates to 10 per cent on the first MNT3 billion (\$ 2.4 million)²⁰ and 25 per cent on taxable income in excess of that (previously 15 per cent on the first MNT100 million and 30 per cent on the balance). The reform also expanded the list of deductible expenses, which now includes all generally recognized items, provided they are properly documented.

Taxable income includes income from activities (e.g. business activities, the sale of shares and securities and the gains on foreign currency exchange rates) and income from property (including the sale of movable and immovable property, their lease, royalties and dividends and interest, etc.).

A withholding tax of 10 per cent applies to payments to residents, including dividends and gains from the disposal of shares, gross interest received from bank deposits and gross royalties. Dividend, interest and royalty payments to non-residents attract a withholding tax of 20 per cent on the gross amount. The same

⁴⁹ Non-residents are exempt from the tax on oil production-sharing income.

⁵⁰ Corresponds to 99 per cent of Mongolian businesses according to USAID, 2010.

withholding rate applies to income from the sale of goods, work and services; rent; income from tangible and intangible assets; technical or other service fees; for management and administrative expenses; and on profits remitted overseas to the parent entity. An ordinary tax credit is granted, both unilaterally and under tax treaties for foreign tax paid on foreign income (but excess credit cannot be carried forward or backwards). As of end of October 2011, Mongolia had ratified 30 double taxation treaties and 5 more treaties were awaiting ratification. Most treaty-based withholding rates are set at 5 or 10 per cent.

Depreciation is allowed for a standard range of assets on a straight line basis, as follows:

- Buildings 40 years
- Machinery and equipment.. 10 years
- Computers and software 3 years
- Other assets 10 years
- Intangible assets 10 years or useful life

Loss-carry forward of two years was first introduced in 2007, and it was recently extended to 10 years (effective since January 2010). The carried forward losses can be set off against a maximum of 50 per cent of the future taxable income each year.

Immovable property is taxed at 0.6 per cent of the initial value of property (not if owned by persons); property located abroad is not subject to the property tax and income from the sale of immovable property is taxed at 2 per cent. Lease of company-owned property attracts 10 per cent income tax (20 per cent in case the company is not incorporated in Mongolia) as well as 10 per cent VAT.

Excise tax is levied on a typical list of goods, including tobacco, alcohol and petrol, as well as on items such as betting games and gambling devices. Stamp duties are imposed on a number of permitting processes, including

company registration, granting of copyrights, decisions on matters of legal status by a court of law etc.

VAT is levied at a single rate of 10 per cent on domestic goods and services and imports of goods (down from 15 per cent and applied to a broader range of goods compared to before 2007). Exported goods and services provided abroad are zero-rated. A large list of goods and services are VAT exempted. These include several non-standard items, such as the income from the sale of an apartment used for residential purposes; equipment, materials and fuels used for oil exploration in a production sharing agreement with the Government; gaseous fuel and related machinery and tools and mining products. VAT payers have to file a monthly declaration. Excess VAT payment is refundable but reimbursement takes at least two months.

The Government agency in charge of tax administration is the Mongolian Tax Administration (MTA). There are no general anti-avoidance rules, nor specific transfer pricing rules. However, the tax authorities can determine the gross taxable income deriving from related parties' transaction, based on the value of similar transactions among non-related parties.

The fiscal year is the calendar year. Tax statements must be prepared on accrual basis and taxes are paid monthly.⁵¹ The result is a high number of payments per year (table II.1). Electronic payment was introduced in 2010. Tax filing can also be processed electronically, and with the introduction of the law on e-signature in 2012, it is expected that paper filing of tax declarations will be discontinued. Advance tax rulings can be obtained from the MTA (though they are not binding in court), and in case disputes with the tax inspectors cannot be solved by the legal department of the MTA, an administrative appeal culminating in a court decision is available.

⁵¹ Companies with annual taxable income below MNT500,000 (~\$370) are allowed to pay on a quarterly basis.

Table II.1. Comparative corporate taxation indicators, 2012

| Economy | Payments (per year) | Time (hours/year) | Profit tax (%) | Labour tax and contributions (% of profit) | Other taxes (%) | Total tax rate (% of profit) |
|-----------------|------------------------|----------------------|-------------------|--|--------------------|---------------------------------|
| Azerbaijan | 18 | 214 | 12.9 | 24.8 | 2.2 | 40 |
| Chile | 6 | 291 | 21.1 | 3.8 | 3.2 | 28.1 |
| Gabon | 26 | 488 | 18.4 | 22.7 | 2.3 | 43.5 |
| Kazakhstan | 7 | 188 | 15.9 | 11.2 | 1.6 | 28.6 |
| Kyrgyzstan | 51 | 210 | 6.2 | 19.5 | 43.3 | 68.9 |
| Mongolia | 41 | 192 | 10.2 | 12.4 | 2 | 24.6 |
| Namibia | 37 | 350 | 17.2 | 1 | 4.5 | 22.7 |
| Peru | 9 | 293 | 26.7 | 11 | 2.8 | 40.5 |
| Uzbekistan | 41 | 205 | 0.9 | 28.2 | 69.4 | 98.5 |

Source: World Bank (2012), *Doing Business Report 2013*.

A large number of incentives have been phased out since the introduction of the new fiscal regime in 2007. These include tax holidays for FDI in infrastructure (e.g. power and thermal plants, transmission networks, telecommunication networks etc.); in key sectors (oil and coal, metallurgy, chemical production, electronics, machinery, gas and fuel) and exporting foreign investors and for selected aimag (province) development activities. Few exceptions remain, including in respect to the Free Economic Zones (for which specific incentives are available), and agriculture (where a number of subsidies exist). According to the Government Action Plan 2012-2016, a new fiscal regime for SMEs will be introduced, whereby companies with annual revenue from sales below MNT1.5 billion (~\$1 million) will receive a refund of 90 per cent of their corporate income taxes. Some sectors, including mining, oil and telecommunications will be excluded from the scheme. The tax treatment of mining is discussed in section D.1.

The overhaul of the fiscal regime implemented in 2007 simplified corporate taxation, thus making tax administration easier. The reform was also successful in increasing overall tax revenue to the Government.⁵² As for the competitiveness of the fiscal regime, although

⁵² According to an assessment study carried out by USAID (2010), the number of corporate income tax returns increased by 25 per cent in 2009 relative to 2006. Corporate gross income reported increased by 43 per cent in 2007 from the previous year. The tax reform is responsible for 30 per cent of this increase, while the remaining 70 per cent is accounted for by normal economic growth. Also, corporate income tax revenues were 16 per cent higher in 2009 (year of the crisis), than in 2006. USAID estimated that distinct tax reform direct and indirect effects accounted for 42 per cent of the increase in corporate net taxable income, with underlying economic growth accounting for the remainder of the change.

the number of annual tax payments is still relatively high, the profit tax, the time required to pay taxes and the total tax rates are among the lowest in the group of comparator countries (table II.1).

3. Labour

Overall, Mongolia has adopted a solid and modern labour legislation and labour relations are generally good. The protection of specific workers' rights is a concern, requiring both better implementation of existing legislation and legislative revisions to ensure compliance with international standards.

Labour relations, workers' rights and employment conditions are regulated by the 1999 Law on Labour. Employment contracts or agreements can only be written. A contract is either time-limited or indefinite, when based on collective agreements (i.e. between employers and employees' representatives of a business entity) or collective bargaining (i.e. between the employers, the employees' representatives of a profession or economic sector, and the state representatives). These are agreements which can provide additional guarantees and conditions beyond those set by the Labour Law. There are no specific provisions on seasonal work, which falls under the definite time contract.

Both parties can terminate employment within defined conditions and upon provision of a one-month notice, independently from the duration of the contract (45 days in case of dissolution of the business entity). Among the reasons for lawful termination by the employer are downsizing and lack of professional qualifications (which generate a severance payment of at least one

month salary) or serious violations of the terms of the contract of employment, for which no severance is due. The employee can terminate the contract without cause and without liability. There is no provision for payment in lieu of notice, but the parties can agree to terminate the contract before the notice period.

Grievances regarding wrongful dismissal are settled by the court. Other disputes between individual employers and employees are settled in courts only if the conciliation mechanism within the company fails. Labour disputes regarding collective agreements should be settled first by means of intermediation between the parties. If this fails, the Governor of the relevant territory will establish a labour arbitration court, further to which, if agreement is not reached, the issue is referred to the judiciary. However, no specialized labour tribunals or judges exist, and case settlement can be very long.

The working week is a standard 40 hours and employers are required to provide employees with social security, basic wages, overtime pay and at least 15 days of paid annual vacation (the leave days increase to a maximum of 29 depending on the years of service, and can be more in case of abnormal working conditions). The total social security contributions by employers represent between 19 to 21 per cent of the employees' gross salary, depending on the industry.⁵³ The law also sets a standard array of guarantees and principles regarding working conditions, workplace requirements, health and sanitation, as well as provisions to foster the employment and equal pay of women and the integration of persons with disabilities.

The minimum wage law of January 2011 allows for both the general minimum wage and sectoral minimum wages to be determined by tripartite consultations between the Government, the employers' and the employees' associations, at least once every two years. The general minimum wage has been set at MNT140,400 (around \$100) since January 2011, much below the average market rates (around \$300 per month). It is set to increase by 36.7 per cent in accordance with Decree 7 issued by the Trilateral National Committee on Labour and Social Consensus on April 11, 2013. As of mid-2012, only the mining sector adopted a sectoral minimum wage of MNT220,000 (around \$160). During the preparation of this report, the construction sector

⁵³ See Art. 15 of the Law on Social Insurance of 1994, ILO, Country Brief (2011) and IBFD (2011).

was reportedly in the process of considering the introduction of its own minimum wage.

Specific labour conditions, including in respect to wages, can apply in the Free Economic Zones, as the Governor of the Zones can design and implement labour and employment policies for the Zones (art. 7 of the Law on Free Zones), but none have been adopted to date.

No official statistics exist on the number of strikes as confirmed by interviews with representatives of the trade unions. Before 1991, trade unions were essentially an extension of the State, and a part of the centrally-controlled economy. Since then, however, tripartite negotiations among Government, trade unions and employers' associations have been introduced and social dialogue has significantly improved. With the economic transition, and the labour laws that followed, trade unions gained an independent role, and were guaranteed freedom of association, collective bargaining and right to strike (ILO, 2011). More dialogue and consultations are needed, according to both trade union representatives and investors, in respect to draft laws affecting business and workers.

Mongolia has ratified the eight core ILO labour Conventions; nonetheless concerns have been raised regarding their implementation, in particular as regards trade union rights. For instance, the labour code prohibits discrimination, including on grounds of nationality. However, foreign workers, public servants and workers without employment contracts cannot join a union or bargain collectively. Child labour is also widespread, particularly in herding, coal mines and trading (ICFTU/WCL/ETUC, 2010). The authorities are aware of those issues and reported their intention to address them.

4. Employment of non-residents

Mongolia is investing sizeable resources in the education system (chapter I). However, the transformation into a market economy, the open trade and investment policies and the rapid economic expansion led by the mining sector have generated increased demand for skilled labour, including practical knowledge (English, IT), scientific knowledge, technical and managerial skills. The supply of these skills is increasing, but is still far from matching the demand. As will be discussed in chapter III, this constitutes a key bottleneck for investment and an obstacle to economic diversification

into sectors with greater value added. Mongolia could therefore find it extremely beneficial to revise the current regime to balance citizen job protection with the attraction of foreign skills in areas where domestic skills are limited, and foster their diffusion and absorption by Mongolians.

Although the FIL establishes that foreign investors shall primarily employ citizens of Mongolia and that foreign citizens may be hired for jobs requiring special or high qualifications, the procedures to hire foreign workers are the same for Mongolian or foreign companies, in accordance with the principle of national treatment of foreign investors. The matter is regulated by the Law on the Legal Status of Foreign Nationals of 2010 and Law on Sending Labour Force Abroad and Receiving Labour Force and Specialists from Abroad of 2001. As per the latter law, the Ministry of Labour (MoL) is responsible for proposing an allowed percentage of foreign employees and specialists that a company can hire, based on the sector of the economy and company characteristics including total employment and invested capital.

The relevant quotas are set through a government resolution on an annual basis. Resolution no. 348 of 2010 set quotas for more than 30 sectors, covering the entire spectrum of economic activity and ranging from 5 to 20 per cent of the total workforce (75 per cent in the oil sector), depending on both the invested capital and the total number of employees. In mining, the Minerals Law establishes that foreigners can reach 10 per cent of a company's total labour force.

Hiring skilled workers from abroad is time-consuming. Several investors interviewed by UNCTAD have expressed frustration with the restrictive and bureaucratic nature of the process.⁵⁴ Companies wishing to hire foreign labour or specialists need to obtain a work permit ("permission of employment") from the Ministry. In the application, they must justify, among other things, the need for foreign skills in details, the full profile of the selected foreigner, as well as the working conditions that will apply to them. Permits are granted upon satisfaction of the application and quota/number requirements.

Work permits are only valid for one year. Their renewal requires the company to repeat the full application

⁵⁴ PWC (2011) reports that obtaining work permits for foreign workers generally takes four weeks before entry and an additional two weeks after entry.

process. Renewals are based on continued compliance with the quota, as well as vaguely defined "results of the performed job and service and grounds for extended employment". Within seven days from receiving the work permit, the company must request a residence permit from the immigration authorities on behalf of the foreign worker. The decision to issue the relevant residence permit will take into account the Law on the Legal Status of Foreign Citizens of 1994, which limits the number of immigrants to maximum 1 per cent of the citizens of the country, and not more than 0.33 per cent from one single foreign country. At current population levels, this means a maximum of 27,000 foreign workers, which is unrealistic if Mongolia is to achieve and sustain the exceptional economic growth trajectory described in chapter I.

Mandatory contributions to an "employment promotion fund" increase the cost of hiring foreign employees. For each foreign employee hired, the employers are obliged to pay to the fund a monthly "workplace payment" of an amount which the law fixes at twice the minimum wage (Law and Government Resolution No. 139 of 2001). The resulting labour cost for each foreign worker may prove excessive should the mining-driven economic boom produce significant labour shortages, such as in mining. The employment promotion fund, which totalled around MNT30 billion (\$22 million) in October 2011, is used to finance employment generation initiatives, vocational trainings and small-scale loans. The obligation to contribute to the fund can be waived by DFIRR for up to three members of the management team of any company with foreign investment, and the payment does not apply in relation to professionals working in educational or scientific organizations.

The only exception to the quota system concerns individual investors or senior management staff of a foreign invested company. They do not need to hold work permits in order to work in Mongolia and they are issued "T type" visas. These are six-month or year-long multiple entry visas than can be renewed annually and give right to obtaining long-term residence permits.

The primary policy concern addressed by the current regime for the employment of non-residents in Mongolia is the protection of the local workforce from foreign competition, which has recently increased due to the large migration of low-skilled workers associated with the expansion in the mining and construction sectors.

However, Mongolia's labour force remains very small, and if the country is to achieve and sustain the projected levels of economic growth, it may need to rely more extensively on temporary foreign workers in the coming years. Moreover, the current quota system is not based on a formal assessment of the labour market needs and the type of skills required by the economy, but on political decisions. As a result, no differentiation is made between skills that are in need and those widely available locally. Finally, the regime does not provide for adequate mechanisms of diffusion and absorption of the foreign skills.

There are severe skills shortages in different areas of the Mongolian economy and the current transition of already scarce skills from less well-paid sectors of the economy to the servicing of the mining industry traditionally constitutes an early symptom of the resource curse, which the authorities should not underestimate. As discussed further in chapter III, a programme to attract migrants with needed skills and foster the diffusion of these skills to Mongolians should become a central feature of an FDI strategy for the country, and of its national development policy.

5. Land and property rights

The Constitution of Mongolia establishes that the land, including its subsoil and related resources, is property of the State. Private ownership is possible only for plots of land assigned by the State to Mongolian citizens and all land-related transactions require the authorization of the State.⁵⁵ Foreign investors, therefore, cannot own land. They can, however, access title to land under lease arrangements and they may own immovable properties and physical structures such as apartments and buildings. The registration of land rights is still problematic, but donors' assistance is expected to help the authorities streamline the process and improve the security of titles.

The Land Law and the Law on Mongolian Citizens' Ownership of Land, both enacted in 2003, regulate the allocation of land and detail the powers of the State and local authorities. Land management and policy implementation is the responsibility of the Administration of Land Affairs, Construction, Geodesy

⁵⁵ Private ownership is excluded for pasture lands, public tenure lands, land under roads and networks and land with water or forest resources, which shall be used for common purpose (art. 6 of the Law on Land of 2002).

and Cartography under the Ministry of Construction and Urban Development. The Governors of the aimags, the capital city, the soums (municipalities) and districts ensure implementation within their respective territories, and monitor compliance with the legislation by the possessors and users of land.

Titles to land include ownership, possession and use. Land possession and use are subject to issuance of the relevant licences. Possession licences last 15 to 60 years (with extensions of 40 years), and include the rights to manage the land. Use licences allow using some of the land characteristics for up to five years (with one extension) and cannot be alienated. Companies with foreign investment have the right to possess or use land. As mentioned, the transfer of land rights including possession rights also needs authorization of the issuing authority.

According to the Land Law of 2002, individuals and companies (including foreign ones) submit their requests for land possession licences to the Governors of the respective soums or districts. Their request should state purpose and duration. The decision is taken by the relevant Governor through a land auction process in which the highest bidder acquires the right to possess land. If the land is to be used for undertaking production and services, an environmental assessment is required within 90 days after receiving the right, further to which a licence and a contract on land possession are issued, and the right is recorded in the national registry. Transferring the licence, using it as collateral or renewing it also requires the Governor's approval, which is subject to verification of a number of formal requirements.

In practice, the most common modality of foreign investors' access to land in Mongolia is the purchase of the immovable property which sits on the land, as each certificate is locked to the underlying land. Immovable property ownership certificates are legal deeds to ownership of a property that can be freely transferred or used as collateral for loans and mortgages. All rights on immovable property (including ownership, possession and use) and all subsequent amendments regarding the immovable property, including collateral agreements, must be registered with GASR. Failure to register invalidates the transfer and attracts fines.

Registration, however, is not a straightforward process. According to a recent review of land tenure and property

rights in Mongolia, residential land privatization has resulted in multiple allocations of some land. Owners trying to register title are shuffled among several offices and the administration lacks capacity (USAID, 2011). Moreover, as mentioned in section 1, progress with establishing digital registries of land titles and cadastral information has been limited and a project started in 2007 to establish a centralized digital cadastre within the Agency of Land Affairs, Geodesy and Cartography failed to produce results.⁵⁶ In this context, land-related corruption is high (section E).

A new project by the MCC seeks to address these issues and improve the accuracy, accessibility and efficiency of the formal system for recognizing and transferring property rights. The MCC expects to complete the digitalization of the property rights database by 2013. Once operational, the database will be connected to the civil and commercial databases of GASR (section 1). Once more, the success of the project will depend on the Government's capacity to allocate and retain staff with the necessary training to operate the new system.

6. Environment

Mongolia's natural environment, renowned for its pristine beauty, is threatened by urban environmental degradation, overgrazing and overstocking of pastureland, climate change, illegal forest harvesting and environmentally unsustainable mining practices. Although a modern legal framework for environmental protection is in place, implementation is poor, due to institutional weakness and insufficient coordination between the enforcing agencies, inadequate monitoring and unresolved conflicts of interest affecting environmental management decisions.

In May 2012, the Mongolian Parliament consolidated the 18 existing environmental laws into eight laws and introduced two entirely new ones. The key components of the legal framework for environmental protection include the Constitution, the Law on Environmental Protection and the Law on Environmental Impact Assessment. The Law on Environmental Protection lays out the key principles guiding the use of natural resources, their protection, management and

restoration. Its recent revision introduced the polluter-pays principle, an environmental audit requirement and the right to access environmental information. The law also defines the institutional architecture responsible for environmental monitoring and enforcement. The Central State authorities include the State Ikh Khural (Parliament) and the Government, with the Ministry of Nature, Environment and Green Development (MNEGD, formerly Ministry of Environment and Tourism — MNET), who are responsible, respectively, for environmental policy design and implementation.

In an attempt to decentralize environmental responsibilities to the levels at which they are being implemented, the Law on Environmental Protection also assigned environmental policy making and policy implementation responsibilities to local Citizens' Representatives Khurals (Assemblies) and Governors, respectively. The latter, in particular, are responsible for supervising the activities of local business entities in respect to environmental protection and the restoration and use of natural resources in their territory. They can also take measures to eliminate breaches or suspend the activities of business entities with adverse environmental impact, and issue licences for the use of natural resources.

Business is required to respect a standard set of environmental protection rules. In line with modern practice, companies that intend to use natural resources must present an environmental impact assessment (EIAs) through certified experts, when their activities have potentially adverse environmental impact. Accordingly, the EIA Law requires all projects that use natural resources to undergo a preliminary screening based on the project description and related feasibility studies that the company must submit to the MNEGD. The screening is to be conducted within 14 days by an expert appointed by the MNEGD, and results in the decision to authorize the project, add specific conditions, require a detailed EIA by an authorized entity or reject it.

The detailed EIA will include the measures to minimize, mitigate or eliminate the adverse impacts that the project may produce. Those have to be reflected in an Environmental Protection Plan and Environmental Monitoring Programme which the company has to submit to the screening agency for approval. Final decision on authorizing the implementation of the project rests with the MNEGD. The recent amendments

⁵⁶ According to the relevant authorities, the Indian company which won the tender to implement the registry failed to deliver workable software. The Millennium Challenge Corporation estimated that it would be more efficient to develop a new application rather than trying to fix the existing one.

to the EIA law require that in preparing an EIA report, the project sponsor includes the minutes of the consultation meetings held with the population of the areas potentially affected by the activity. Investors are required to deposit a guarantee, corresponding to 50 per cent of the environmental protection budget for a particular year in a special environmental account that can be accessed by the GoM in case of failure to implement the Plan. Implementation progress is verified annually. Breaches of the Law on Environmental Protection and of the EIA Law can lead to criminal or administrative penalties.

To date, however, the implementation of the environmental laws has been lacking. In 2008, the UNDP conducted an investigation on the environmental governance which concluded that the existing government structure and resources available for environmental protection and management were not adequate. According to the report, institutional weakness in environmental management included inadequate financial and human resources, a lack of continuity and professionalism, absence of career perspectives in environmental protection and management, and curtailed responsibilities and mandate within the MNET (UNDP, 2008). Again in 2011, the World Bank's environmental overview of Mongolia concluded that despite the efforts of the GoM, environmental management capacity and coordination among ministries and government agencies was still very limited (World Bank, 2011).

UNCTAD's interviews with the relevant stakeholders have also highlighted important gaps in the institutional framework for environmental protection and enforcement. For instance, it is surprising that notwithstanding the importance of mining activities in the country's current and future development, and given their potentially adverse impact on the environment, only two staff within MNET were in charge of assessing the EIAs in the mining area. And their responsibilities included several other functions, alongside natural park management. Also, there were no experts on explosives and other techniques specific to the sector.

Furthermore, as mentioned in section A.1, since 2009 the Ministry of Environment has lost independent supervisory powers to the GASI, which itself lacks the human resources necessary to carry out adequate environmental supervision. Coordination and capacity gaps are evident, particularly in the mining area. For instance, although local environmental officers

under the Ministry of Environment have no inspection rights, they must produce a report, jointly with the local Governor and the Health and Land authorities, recommending or not the extension of a mining licence. Their report, however, must be validated by GASI, after the latter carries out its own independent evaluation. As mentioned, the new administration has recently carried out a restructuring of the Government structure, which refocused the mandate of the Ministry to deal exclusively with nature and the environment, providing an opportunity to strengthen environmental protection mechanisms.

7. Competition

Mongolia is a small market characterized by a few large conglomerate family businesses and a small universe of SMEs. A lack of competition culture and the concentration of economic ownership and control in a small number of hands are combined with the fact that many members of Parliament and Government hold key business positions. This blurs the lines between the public and private sector, produces systemic conflicts of interest and leads to (informal) barriers to the entry of both domestic and foreign investors, thus hampering economic development and diversification efforts. The implementation of a strong competition policy framework should, therefore, be a priority for Mongolia.

Mongolia adopted its first competition law (the Law on Prohibiting Unfair Competition) as early as 1993. However, the enforcement of the law only started with the establishment of a Competition Authority in 2005. The new Law on Competition of June 2010 provided more powers to the authority, including strengthened cartel enforcement mechanisms, and increased sanctions.

Though very concise, the Law on Competition provides the basic framework for sanctioning and restricting anti-competitive behaviour of market agents. Importantly, the law applies to both private and public entities participating in the market and prohibits all levels of Government from taking decisions aimed at restricting competition, including by prohibiting business entities from engaging in certain types of activities or restricting the entry of competitors in any area of business.

The key provisions of the law include the prohibition of: a) abuse of dominant position, where dominant position is defined as the supply of over one third of the sales

of products and services by a business entity, solely or jointly with other entities; b) cartels which contradict public interest or create circumstances restricting competition; c) other activities that restrict competition by all business entities, independently of their position in the market. The law also regulates merger and acquisition (M&A) activities of dominant entities, requiring them to obtain clearance of their intention to restructure through M&A or to purchase shares of their competitors beyond set limits.

The Authority for Fair Competition and Consumer Protection (AFCCP) is responsible for supervising the implementation of the law on Competition (as well as the Law on Consumer Protection since 2008). It has a number of specific powers, which include, among others: introducing the culture of competition; devising and implementing the State policy on competition protection and determining and supervising natural monopolies and dominant business entities. It was also assigned investigatory powers, and can conduct inspections to investigate anticompetitive practices, both on its own initiative and in response to complaints. Until the adoption of the new law in 2010, however, only very small fines could be imposed by the authority in case of breaches to the competition legislation. For instance, if a cartel was detected, the companies could only be fined a maximum of \$200. The new law increased fines to up to 6 per cent of the concerned products' sales revenue in the preceding year, in addition to confiscation of the illegal gains.

Since 2010, the Authority has stepped up its investigative activities, particularly in the area of cartels. Price fixing cases have been exposed in sectors including banking, petrol, auditing and driving schools, though the amount of the fines was still low. The Authority intends to develop a National Programme on Competition, which aims at producing national and sectoral competition policies. Given its broad mandate, however, the Authority, by its own admission, has insufficient capacity to carry out the market studies which should underline the Programme.

The 2010 law provides for the establishment of the AFCCP Board consisting of nine members — six are to be nominated by the Government (the Chairman, two staff and three non-staff members) and three non-staff members by the MNCCI, the Mongolian Trade Union and the non-governmental consumer organization, subject to Government approval. According to the new law, most

functions of the AFCCP lay upon the decisions made by this Board. Therefore, the appointment of the Board members in March 2012 was a welcome development, crucial for the strengthening of competition law enforcement in Mongolia.

While much progress has been achieved towards adopting a modern competition law, Mongolia still lacks a comprehensive competition policy and its competition culture is weak, as demonstrated by the fact that only one university offers a competition-specific course. The capacity of the competition authority is insufficient to deliver satisfactorily on its broad mandate and the 2010 law has yet to be fully implemented.

With UNCTAD's assistance, Mongolia has undergone a voluntary peer review of its competition law and policy at the twelfth session of the Intergovernmental Group of Experts (IGE) on Competition Law and Policy, in July 2012 (UNCTAD, 2012b). The review examined the challenges in the implementation of the competition law and policy in Mongolia. The outcome report includes detailed recommendations for strengthening competition law and policy implementation in Mongolia (as reflected in chapter III). UNCTAD has committed to provide further technical assistance in cooperation with development partners for the implementation of these recommendations.

C. Public governance

As already stressed in chapter I, governance issues are among the highest disincentives to FDI in Mongolia (figure I.5). Conflicts of interest, regulatory instability and institutional weakness in the public administration also act as obstacles to the economic diversification efforts, in particular as regards attracting non-traditional investors, more uncomfortable about investing at low levels of transparency and legal certainty. As further discussed in chapter III, with the booming mining sector poised to generate large new resources, it becomes ever more crucial for the GoM to address governance issues in order to be ready to manage revenues in a way that leads to inclusive growth and minimizes the risks associated with the resource curse.

This section presents three different aspects of public governance affecting business. These include corruption perceptions and the actions of the GoM to improve them; the efficiency of the judiciary, particularly as it

pertains to administering commercial justice; and the quality of customs, an area of the public administration particularly important for a country aiming to reduce impediments to trade.

1. Corruption

Corruption affects both households and businesses and the authorities have stepped up the policy efforts to tackle the problem. The 2013 “Study of Private Perceptions of Corruption” by the Asian Foundation, based on interviews and surveys with over 300 Mongolian and foreign businesses across all sectors of the economy found that 80 per cent of the respondents considered their business affected by corruption. According to prevailing perceptions, corruption extends to all levels of the administration and public life. Several stakeholders interviewed by UNCTAD have indicated, for instance, that although Mongolia presents business opportunities, new investors will not establish until the transparency of the investment climate and therefore the security of investments are improved.

Successive Governments have put in place several tools to fight corruption. Over the years, Mongolia passed two Anti-corruption Laws (1996 and 2006), joined international anti-corruption regimes and protocols (such as the Anti-Corruption Plan of the Asian Development Bank (ADB) and the United Nations Convention against Corruption), implemented National Anti-Corruption Programmes (2002) and established an Administrative Court to review alleged unlawful decisions and activities of civil servants. The Anti-Corruption Law of 2006, in particular, implemented an assets and income disclosure system for public servants and established the Independent Authority against Corruption (IAAC).

On the legislative side, progress in implementing the anti-corruption legislation is mixed. A pilot peer review on the implementation of several articles of the United Nations Convention against Corruption, carried out in 2009 by the Governments of Pakistan and Sweden, found that Mongolia has made progress in the adoption of several of the Convention’s articles in the national legislation, including in respect to mutual legal assistance, embezzlement and preventive anti-corruption policies and practice. However, several articles of the Convention, including in the areas of obstruction of justice, and bribery of national public

officials remain partially adopted. It also concluded that despite the dedication shown by Mongolian stakeholders in the fight against corruption, much of the relatively new legislative and institutional anti-corruption framework was partially implemented (UNODC, 2010).

The IAAC has the ability to conduct criminal investigations but it possesses neither the authority to prosecute nor the jurisdiction to investigate money-laundering and embezzlement or election-related crimes.⁵⁷ Investigations are largely initiated in response to complaints and information relating to corruption from the public, for the purpose of which an anti-corruption hotline was established. The agency, which has no regional presence, is relatively new and by its own assessment, the personnel needs to develop the skills necessary to investigate corruption-related crimes. The primary role and activities of IAAC, therefore, focus on implementing corruption prevention plans and public awareness campaigns.

Nonetheless, as of March 2011, the IAAC had investigated a total of 916 corruption cases and referred 186 cases for prosecution. These resulted in a total of only 69 convictions over four years of activity. While several cases involving MPs have been investigated, none has so far led to conviction, due to MPs’ right to invoke immunity. In March 2012, however, the first high-profile corruption case led to the conviction of the former President of Mongolia. This was followed by the conviction, in June 2012, of four senior members of the Mongolian police force.⁵⁸ Moreover, in May 2012, a new law came into effect, which expanded the staff of IAAC from 95 to 145, regulated conflict of interest and required public officials to produce electronic private interest declarations and disclosure of assets and income. It also introduced a number of restrictions applicable to public officials during and following their release from public office/service.

As a result of these reforms, Mongolia’s rank in Transparency International’s corruption perceptions’ index progressed from 120th (among 182 countries) in 2011, to 94th (among of 176 countries) in 2012.

⁵⁷ The Commissioner General and the Director General of the Agency were sentenced to prison in March 2011 for violation of the intelligence law and information on the case is covered by State secret. Both have appealed to the Supreme Court, but no final decision had been taken as of November 2011.

⁵⁸ Human rights associations, however, have expressed due process concerns with regard to the recent convictions.

2. Judiciary — rule of law, enforcement

Since 1992, Mongolia has adopted an entirely new body of legislation including a new Constitution, new civil and criminal codes and a new company law. Up until the early 2000s, however, most legal professionals had been educated under the old Soviet-dominated system, when courts were an instrument of state power. The first lawyer qualification examination (BAR-type exam) took place in 2004, and while much progress towards establishing an independent, modern and efficient judiciary has been achieved, the Mongolian judicial system still needs to acquire experience in enforcing commercial laws and regulations.

In 2009, the USAID and the German Agency for Technical Cooperation (GTZ) completed a nine-year long programme of technical assistance to Mongolia in this area, called “Judicial Reform Program” (USAID, 2009). Important achievements of the programme included legal and procedural reforms, trainings, courts modernization and automation and awareness-raising on the role of modern judiciary within society.

The Programme also led to the establishment of new institutions, such as the Special Investigative Unit, devoted to investigating crimes by justice sector officials, as well as the IAAC. Progress was achieved in all those areas; however, contract enforcement, bankruptcy or secured transactions have been largely neglected by Mongolia’s system of legal education.

Discrimination against foreign investors does not appear to be an issue and the time or cost required to enforce contracts compare relatively well within the chosen sample (table II.2). However, the absence of specialized tribunals in areas such as commercial justice, land, corruption, IP or labour, and the limited familiarity with commercial principles produce judicial uncertainty regarding the outcome of any litigation. In this regard, a new project backed by the European Bank for Reconstruction and Development (EBRD) and the International Development Law Organization (IDLO) started in late 2012. It is aimed at providing commercial law trainings for over 200 judges by the end of 2014.

Table II.2. Enforcing contracts: Mongolia and selected comparators, 2012

| Economy | Time (days) | Cost (% of claim) | Procedures (number) |
|-----------------|-------------|-------------------|---------------------|
| Azerbaijan | 237 | 18.5 | 39 |
| Chile | 480 | 28.6 | 36 |
| Gabon | 1,070 | 34.3 | 38 |
| Kazakhstan | 370 | 22.0 | 37 |
| Kyrgyzstan | 260 | 29.0 | 38 |
| Mongolia | 314 | 30.6 | 32 |
| Peru | 270 | 35.8 | 33 |
| Uzbekistan | 428 | 35.7 | 41 |

Source: World Bank Doing Business Report 2013.

As regards bankruptcy, the problems are even more severe, because the lack of familiarity with commercial issues is associated with a weak legal framework. Bankruptcy is regulated by the Civil Code, the Criminal Code and the Bankruptcy Law of 1997. In particular, the provisions relating to the avoidance of pre-bankruptcy transactions are brief and vague, and since existing liens against immovable property are not recorded and movable property is not registered, creditors face risk based on difficulty to assess collateral (EBRD, 2009 and USDS 2011). This is confirmed in table II.3, which

shows that the recovery rate in Mongolia is among the lowest in the sample. Encouragingly, a draft new bankruptcy law was being prepared by the Ministry of Justice with the assistance of international experts at the time of UNCTAD’s fact-finding mission.

Alternative dispute resolution mechanisms are increasingly available. The Law on Arbitration of 2003, based on the UNCITRAL Model Law on International Commercial Arbitration, established that permanent arbitration could be set up by the MNCCI

and other non-government organizations carrying out activities on protection of rights of manufacturers and consumers. The Mongolia National Arbitration Centre of the MNCCI is the oldest arbitration mechanism, established in 1960. The number of cases referred to it, however, is still relatively small. According to some investors interviewed by UNCTAD, reasons include inefficiencies in the process and the poor qualifications

of some arbitrators. According to MNCCI, however, the number has been increasing since the recent mining boom, and the Centre has received around 40 cases per year since 2009, compared to 12 before then. Two new arbitration tribunals were established in 2011, one by the mining association together with the mining workers' union and one by an employees' association.

Table II.3. Resolving insolvency: Mongolia and selected comparators, 2012

| Economy | Time (years) | Cost (% of estate) | Recovery rate (cents on the dollar) |
|-----------------|--------------|--------------------|-------------------------------------|
| Azerbaijan | 2.7 | 8 | 30.6 |
| Chile | 3.2 | 15 | 30.0 |
| Gabon | 5.0 | 15 | 15.2 |
| Kazakhstan | 1.5 | 15 | 43.1 |
| Kyrgyzstan | 4.0 | 15 | 9.1 |
| Mongolia | 4.0 | 8 | 22.7 |
| Namibia | 1.5 | 15 | 42.3 |
| Peru | 3.1 | 7 | 28.1 |
| Uzbekistan | 2.0 | 10 | 38.5 |

Source: World Bank Doing Business Report 2013.

3. Trade facilitation — customs

Since 2008, the GoM has put in place several initiatives to promote trade and improve the investment climate through customs reforms and modernization with the support of the ADB. The key initiatives include: acceding the International Convention on the Simplification and Harmonization of Customs Procedures (Revised Kyoto Convention); announcing the enactment of a new Customs Law, and moving toward a national single electronic window (SEW) service and e-government.

Also as part of these efforts, a new Customs Automated Information System (CAIS) was formally set up in early 2011.

The implementation of CAIS has started bearing fruits, and the time for customs clearance has declined. As table II.4 indicates, however, there is still room for improvement in respect to streamlining trade procedures, thus reducing the time required for import and export operations.

Table II.4. Trading across borders indicators, Mongolia and selected economies, 2012

| Economy | Number of documents to export (import) | Number of days to export (import) | Cost to export (import) per container in dollars |
|-----------------|--|-----------------------------------|--|
| Azerbaijan | 8 (10) | 38 (38) | 3,430 (3,490) |
| Chile | 6 (6) | 15 (12) | 980 (965) |
| Gabon | 7 (8) | 20 (22) | 1,945 (1,955) |
| Kazakhstan | 9 (12) | 81 (69) | 4,685 (4,665) |
| Kyrgyzstan | 8 (10) | 63 (75) | 4,160 (4,700) |
| Mongolia | 10 (11) | 49 (50) | 2,555 (2,710) |
| Namibia | 9 (7) | 25 (20) | 1,800 (1,905) |
| Peru | 6 (8) | 12 (17) | 890 (880) |
| Uzbekistan | 13 (14) | 80 (99) | 4,585 (4,750) |

Source: World Bank Doing Business Report 2013.

In this regard, the customs infrastructure still needs important upgrading. Customs inspection equipment and anti-smuggling detection facilities are inadequate in most customs border posts and the only customs laboratory is in the headquarters of the Mongolian Customs General Administration (MCGA) in Ulaanbaatar, to which samples of goods have to be transported for examination. In this context, risk management and post-clearance audits cannot be effectively or widely introduced. Corruption levels are also reportedly very high, all of which constitute bottlenecks to trade (ADB, 2011).

The Government Action Plan 2012-2016 puts great emphasis on trade facilitation and customs modernization, committing the authorities to border port modernization and to the implementation of a single window for exports. Upgrading the customs infrastructure will also remove one of the roadblocks on the way to regional customs operation, the benefits of which, in terms of trade facilitation would be major. In 2005, Mongolia and China commenced bilateral consultations and preparatory work for the pilot-testing of joint customs control at selected crossing points. They assessed that the difficulties in the way of its implementation included: lack of experience and of relevant laws and regulations; lack of financial resources and underdevelopment of infrastructure at the Mongolian side of the border (MCGA, 2009). In 2009, nonetheless, pilot joint customs control started in Zamyn-Uud and Erenhot, significantly contributing to reduction of clearance time.

D. Selected sector policies

1. Mining

Upon its introduction in 1997, the Minerals Law of Mongolia, which drew on western mining law models, was widely regarded as the most foreign investor friendly in Asia (Backer and McKenzie, 2010). At the time, Mongolia's vast underground resources were largely unknown and attracting investment to the sector was a primary concern. Since then, the mining regime has undergone a number of changes, generally aimed at increasing public gains from mining activity. However, the mechanisms in place to provide adequate protection

of the environment and of the local communities are inadequate and in 2010, a moratorium on new mining licences was introduced by the President of Mongolia in view of the adoption of a new minerals law.⁵⁹ Several existing licences were also suspended, pending a review on environmental grounds.

In Mongolia, the subsoil resources are property of the State (section B.5) and the Ministry of Mining (MoM) is charged with issuing exploration and extraction rights to private investors through licences.⁶⁰ The key features of the regime applicable to mineral licences in the Minerals Law are described below.

Reconnaissance

No licence is required and any legal person can conduct reconnaissance for minerals in areas already under exploration or mining licence upon notification to the State and local authorities and with the permission of the landowners/possessors/users.

Exploration

Exploration rights are granted on a first come, first served basis, except for the land explored with State funds or if the prior holder has forfeited exploration rights, in which case they are made available by tender.

Exploration licences, unlike extraction ones, are subject to the approval of the Governor of the relevant *aimag*. The size of an exploration area cannot exceed 400,000 hectares. The licences are valid for three years, extendable twice, each time for a period of three years. No surrender requirement applies and there are no limits on the number of licences per business entity. Licence holders are required to spend a minimum amount on exploration activities after the first year, and licence fees per hectare increase each year. These conditions proved insufficient to avoid speculative licence acquisitions. The fact that many exploration licence holders do not invest in any active exploration is one of the reasons behind the recent introduction of a moratorium on new licences.

⁵⁹ The moratorium was still in place at the time of preparation of this report.

⁶⁰ In 2012, with the adoption of the new Government structure, the former Ministry of Mineral Resources and Energy (MMRE) was unbundled into two ministries — the Ministry of Energy and the Ministry of Mining.

Extraction

Only the exploration licence holder is entitled to obtain an extraction licence, and according to its exclusive rights. The application for an extraction licence includes a verification of the performance of the duties with regard to environment protection during exploration work, an environmental impact assessment and an environmental protection plan. However, no additional preconditions on the grant of extraction licences are set, such as, for instance, a technical mine plan or a socio-economic impact assessment.

The authorities are given 20 days to approve an extraction licence application, which is far too short, particularly in case of large mining projects, as these involve several technical and social issues. The extraction licence is granted for an initial term of 30 years, extendable twice, each for a 20-year period. It cannot be sold, but it can be transferred upon sale of underlying materials and mine machinery and payment of applicable taxes. In the absence of a proper technical and socio-economic plan, licence renewal is subject to compliance with the environmental plan and with the fiscal obligations.

The recent revisions of the environmental legislation (section B.6 above) require mining and petroleum projects to prepare and submit a restoration and closure management plan. A plan for rehabilitation of alternative land can be submitted if the mining company is unable to rehabilitate or restore to its original form any land degraded because of its work. In the absence of implementation guidelines, however, it is unclear how the provision will be enforced or how many years will be allowed for rehabilitation. Industry associations have also expressed concerns regarding the lack of clarity with respect to the possible retroactive nature of the provision.⁶¹

Recent legal and regulatory changes

In 2006, in order to increase the public benefits from mining activities, a number of legislative changes to the Minerals Law were introduced. These included:

- A windfall profit tax of 68 per cent of gold and copper concentrate above specified prices. This was later repealed, as it was considered overly costly for investors (see below);
- State participation in the exploitation of any deposit of “strategic importance”. These are defined vaguely

⁶¹ See *Mongolian Mining Journal*, 25 September 2012.

as any deposit that may have a potential impact on national security, on economic and social development at the national or regional level, as determined by the Parliament, or which has the potential to produce more than 5 per cent of total GDP in a given year. The State may acquire up to 34 per cent share of any mineral deposit of strategic importance, and up to 50 per cent in case it has contributed to its exploration.⁶² For this purpose, “Erdenes MGL LLC” was established in 2007 as a State-owned company representing the GoM’s interests in strategic deposits (except uranium). Fifteen such deposits had been declared at the time of UNCTAD’s fact-finding mission to Mongolia, but no clear delineation was set. Also, the law is not clear as to the criteria for determining the exact State share in strategic deposits, which is to be the object of an exploitation agreement;

- Redistribution of royalties among the three levels of Government as follows: 70 per cent of the royalty payment to the State budget, 20 per cent to the aimag or capital city, and 10 per cent to the soum or district (see below);
- The requirement for licence holders of mineral deposits of strategic importance to trade at least 10 per cent of their shares on the Mongolian Stock Exchange. This provision has not been enforced to date, since the implementing regulations are still missing.

In 2009, a Nuclear Energy Law instituted a specific regime for uranium exploration and mining. The law, which established a “Nuclear Energy Agency of Mongolia”, made uranium a sector of “strategic importance”, thus requiring State participation in all mining operations with stakes ranging from 34 to 51 per cent. No compensation was foreseen and uranium rights holders have since contested the constitutionality of these provisions before the Constitutional Court. The Court dismissed their claims, based on the fact that all minerals are the property of the State, even if separated from the ground. This also led in 2011 to an international arbitration case at UNCITRAL (section A.2).

⁶² The Government Action Plan 2012–2016 sets the objective of enabling Mongolia to own up to 51 per cent of a company established to exploit strategically important deposits explored with financing from the local budget. It also calls for the introduction of energy and coxing coal, copper, iron ore and rare earth elements in the list of strategically important deposits and the development of a special policy for these minerals.

Also in 2009, the Parliament enacted the Law on “Mining Prohibition in Specified Areas”, but what constitutes a protected area remains unclear. The law prohibits minerals exploration and mining in headwaters and areas adjacent to rivers and lakes, and forests. However, no details have yet been approved by the GoM by means of secondary legislation. Some stakeholders interviewed by UNCTAD spoke of the difficulty to enforce this Law, which would result in an estimated \$1 billion in compensation disbursement.

Another landmark development for the mining sector in Mongolia was the closing of the Oyu Tolgoi deal. After several years of negotiations with Ivanhoe Mining and Rio Tinto, the GoM reached an investment agreement at the end of 2009 to exploit what is regarded as the world largest undeveloped gold and copper deposit (chapter 1). This agreement, the first of its kind, is now considered the template for future investment agreements in mining. Calls for its renegotiation, however, have been intensifying since 2010 (see chapter 1).

Finally, the Law on Regulating Foreign Investment in entities operating in Strategic Sectors adopted in May 2012, as amended in May 2013, requires Government approval (or Parliament in case of foreign State-owned enterprises) for foreign investment in mining as well as for a number of business transactions in the sector (see section A.1).

Fiscal regime

The general corporate tax applies also to mining (section B.2). In 2006, a windfall profit tax of 68 per cent was imposed on gold and copper ore when their marginal price exceeds \$500 per ounce and \$2,600 per ton respectively. This was abolished on January 2011, in conjunction with the agreement on Oyu Tolgoi, as many assessed that it was discouraging investment. The windfall profit tax was replaced by a revised royalty scheme which imposes a sliding scale on a variety of mineral and metal products, and depends on the market price of the commodity on a certain world exchange, as well as on the amount of processing that takes place in Mongolia.⁶³

⁶³ The standard royalty rates are 2.5 per cent for coal as well as for commonly occurring minerals sold in Mongolia, and 5 per cent for all other minerals, either sold in Mongolia or abroad. For copper, the surtax royalty rates range between 22 per cent and 30 per cent for ore, between 11 per cent and 15 per cent for concentrates, and between 1 per cent and 5 per cent for final products (Hogan-Lovells, 2011).

The recent reform also extended loss-carry forward to eight years. Mining production is depreciated over its useful life. Exploration costs should be capitalized and then amortized on a straight line basis over the first five years following commencement of production. License acquisition costs are amortized over the life of the licence. Equipment used to bring a mine into production is subject to VAT, unless the equipment will be used to produce highly processed mining products in the country. Exports of finalized mining products are zero rated.

Investment agreements with the Government specific to the mining sector can be negotiated for large projects (investment of \$50 million in the first five years). These can include tax stability clauses (in respect to corporate income tax, customs duties, VAT and royalties), as well as the right to export and sell products at international price. They may also include local development and employment commitments. The duration of validity of the agreement is linked to the invested amount (10 years for \$50 million, 15 for \$100 million and 30 for \$300 million).

Socio-economic issues

Mining companies can employ a maximum of 10 per cent of foreign workers. They must pay ten times the minimum wage per each additional foreign worker per month to the budget of the relevant soum or district. No other socio-economic requirements are set in the law, with the exception of a rather general indication that “licence holders shall work in cooperation with the local administrative bodies and conclude agreements on issues of environmental protection, mine exploitation, infrastructure development in relation to the mine-site development and jobs creation” (art. 42).

The law is also weak in respect of the public participation and consultation in the licensing process, which is left largely up to the discretion of the proponent. The law establishes that a public forum may be held only in respect to issues related to art. 42, discussed above, and only once a licence has been issued. In this respect, it is encouraging that according to the Government Action Plan 2012–2016 the minerals’ regime will be reformed to require the local resident’s opinion in the process of issuance of mineral licences.

In line with standard practice, the 2006 revision introduced the sharing of royalties from mining activities

between the central and the local Governments. Several stakeholders interviewed by UNCTAD, both in the public and private sector, however, indicated that the actual amount transferred to the local levels of Government is smaller, and often only the balance between the royalty payments and other transfers from the Central Government that the local administrations were otherwise entitled to.

To date, exploration and mining activities in Mongolia have not generated widespread controversies with local communities compared to experiences elsewhere in the world. This is due, to a large extent, to the specificities of Mongolia's economic geography and its low population density. Nonetheless, in parallel with the increasing mining interest in the country, concerns are growing regarding the socio-economic impact of mining activities on the communities affected by large-scale operations. The provisions of the law in this area are sub-par. In the absence of structured mechanisms such as the social impact studies and efficient royalty redistribution schemes, community development initiatives are largely the result of spontaneous corporate social responsibility activities of the individual companies seeking to address the multiplicity of demands from local stakeholders.

As will be discussed in chapter III, the adoption of a more modern and structured approach to mitigation and community support programmes would help address the socio-economic challenges related to large-scale mining activities and provide opportunities for much needed economic development outside the capital city, and beyond the servicing needs of the mining industry.

Institutions

In 2006, a comprehensive review of the mining sector in Mongolia carried out by the World Bank concluded that the institutional framework for managing the mineral resources was weak. In particular, it noted the poor coordination between the ministries of mining, environment, finance and between the state and local levels. It also reported the lack of an appropriate structure to ensure the timely enforcement of the rules at the Governor level, with the Governor responsible for granting rights to land use, for approving environmental notifications and for enforcing sanctions for licence violations (World Bank, 2006).

The institutional capacity of the former Ministry responsible for mining was very limited and it will take time, support and resources for the new MoM to develop the required competence. The light regulation of exploration and extraction described above has not given the Ministry the requirement or opportunity to develop appropriate technical capacity to regulate the industry. Indeed, the environmental legislation, rather than the mining law, is the prominent legal instrument for obtaining and assessing technical data for proposed mines. However, as mentioned in section B.6, the Ministry of Environment itself is not structured, manned or financed to adequately perform this role. Furthermore, the MoM has no local presence and both the MoM and the MNEGD have lost their supervisory functions to the GASI (section B.1).

Assessment

Mongolia's mining regime has traditionally been very liberal, characterized by commercial freedom, transfer freedom and ready availability of geological information. Over time, provisions to secure a fair share of the economic rent from the extraction of mineral resources for the country and to limit dependence from any one-source country of investment have been introduced.

However, the protection of public interest provided by the mining regime is still inadequate in respect to: 1) the process for granting licences; 2) the provisions for socio-economic development of the communities close to the mining areas and the redistribution of royalties; 3) public participation in the mining decisions; and 4) environmental protection. The latter, in particular, is due to issues of both regulatory and institutional nature. From the investors' perspective, various aspects of the mining regime are yet to be clarified, which generates high uncertainty. This refers, in particular, to the definition of strategic deposits, or the mechanisms for determination of the State's share therein, as well as the consequences of the Law on Mining Prohibition in Specified Areas and of the Law on Regulating Foreign Investment in entities operating in Strategic Sectors. Recommendations as to how to address these issues in the planned reform of the mining legislation are contained in chapter III.

2. Infrastructure concessions policy

Well-structured and well-implemented public-private partnerships (PPPs) can provide effective and efficient means for operation, maintenance and financing of infrastructure projects. Nonetheless, concessions are not a panacea for addressing the infrastructural requirements of a country, as they are typically successful when the concession object is a commercially viable project able to attract investors' interest, even if backed to differing degrees by Government support or guarantees.

Mongolia's overall legal framework for concession projects is good but its implementation will be problematic unless project selection, financing, and expertise issues are addressed. In particular, several items on the concessions' list are not bankable projects but rather infrastructural or industrial development projects which could be more successfully pursued through public investment (chapter III).

Further to the adoption of a state policy on PPPs in 2009, a modern law on concessions was introduced in 2010. The law provides a clear and comprehensive basic framework for concessioning which draws upon best practice internationally.⁶⁴ Among its key features, the law:

- Applies to assets of both the central and the local authorities and does not discriminate between domestic and foreign investors. Unlike similar laws in other countries, it does not provide special treatment to bidders that undertake to use national goods or employ local labour.
- Foresees a wide range of possible concession agreements.⁶⁵
- Requires all concession projects entering the list of concession items to undergo a cost-benefit analysis (though not necessarily by means of pre-feasibility studies).
- Requires concession projects decided at the local level by Governors and approved by the local Parliament to

obtain the opinion of the Division on Concessions. It must be noted, however, that a negative opinion does not invalidate the project.

- Stipulates that final decision and authorization on the granting of a concession rests with the Government and that concession agreements involving tax exemptions and waivers also need the ratification by the Parliament.
- Requires all concession projects to be granted by tender, with direct agreements only possible if: 1) conducting a tender will jeopardize national security; 2) there is one or group of entities that own intellectual or related property essential for the implementation of the concession; and 3) a tender took place and was fruitless.

A full analysis of the concessions regime and its implications on investment attraction is beyond the scope of this report. A number of general indications can nonetheless be provided following the application of UNCTAD's analytical framework for best practice in roads concessions (box III.4).

No structured multi-modal transport plan exists and projects selected and presented for concessioning by the GoM in transport as well as other areas are typically not anchored on a strategic development plan, nor have they undergone proper testing or pre-feasibility studies (PFS). Thus many of them are commercially non-viable. Several lists of projects for concession have been produced, but no pipeline of suitable projects ranked by priority or timescale exists.

The PPP law established a specialized concessions unit within the State Property Committee with the powers to evaluate and prepare proposals for concession projects to be approved by the Government. In August 2012, the unit was transferred under the newly established Ministry of Economic Development (see chapter III). Among its key functions, the Division on Concessions is to evaluate the cost-benefit of projects submitted for concessions and provide a non-binding opinion. As of February 2012, a total of 239 concession project proposals submitted by the different Government agencies at the central and local level had been reviewed. The review concluded that only seven of these projects were suitable for entering the official list of projects for concessioning. However, Cabinet members have the power to add projects to the list, which resulted in the list totaling 131 projects,

⁶⁴ The law was drafted following the "Instructions on legal regulation of projects in the infrastructure field with private entities" of the International Trade Commission of the United Nations; the "Basic articles on concession agreements" of the OECD and the "Green book on concessions in cooperation between the public and private sector" of the European Union (Khurelbald et al., 2010).

⁶⁵ These include: build-operate-transfer, build-transfer, build-own-operate, build-own-operate-transfer, build-lease transfer, design-build-finance-operate and rehabilitate-operate-transfer.

all of which to be submitted for concessioning. With the assistance of the World Bank, the concessions unit assessed that only 27 out of the 131 projects would be economically viable. The others, considered socially important but not bankable, would require significant Government financing and guarantees.⁶⁶

⁶⁶ As of October 2011, only one of the 27 bankable projects (the construction of Power Plant number 5 in Ulaanbaatar for \$1.5 billion) had advanced in the bidding process, with the tender announced in September 2011.

As mentioned in chapter I, within the framework of the 2008–2012 Action Plan, the GoM had also published a list of 26 top priority projects for the country's development (box II.1), 18 of which were meant to be submitted for concessioning. The list of 26, with few exceptions, was the outcome of political negotiations under a wish-list approach. It is illustrative, in this regard, that only three out of the 26 projects had undergone a complete PFS or feasibility study as of November 2011, and that none had received the relevant environmental approvals.

Box II.1. Priority projects for development and their identification

Within the framework of the 2008–2012 Action Plan, the GoM has published a list of 26 top priority projects to be implemented by 2015/16 (Government Decree No. 320). This list of large projects was prepared by the National Development and Innovation Committee (NDIC), and it centres around four main objectives: 1) developing the mining sector and setting the foundation for heavy industry; 2) industrializing the agriculture sector; 3) developing infrastructure; and 4) improving human capital and environment protection to ensure sustainable development. Financing these projects valued at nearly \$20 billion (see table below) will require private and foreign capital and the GoM has announced that it will pursue PPPs in order to complete them successfully, particularly in mining and infrastructure development.

| List of priority projects, 2010–2016 (Million dollars) | | |
|---|-----------------|-----------------|
| Priority Area | Estimated Value | No. of Projects |
| Mining and heavy industry | 10,200 | 8 |
| Agriculture industrialization | 650 | 4 |
| Infrastructure development | 7,740 | 10 |
| Human capital and environment | 1,100 | 4 |
| Total | 19,690 | 26 |

The NDIC was closely involved in the project identification process, at least in its early stages and the largest projects by far are those in mining and related infrastructure where the economic rationale can be justified. However, in other instances patronage and political influence have been significant in project selection.

Source: Government Decree No. 320, 2009

Secondary legislations on PPPs, including on the methodology for cost-benefit analysis of concession items and on tender evaluation guidelines were passed in 2010 (Resolutions 153 and 342). However, as noted in a recent review of Mongolia's PPP regime by the Korea Development Institute, they were not sufficiently comprehensive to provide a clear course of action regarding PFS and keep the line ministries or local

governments from deliberately underestimating costs to avoid PFS (KDI, 2011).

Furthermore, at the time of UNCTAD's fact-finding mission, the concessions unit consisted of only seven staff, including the Head. Capacity was therefore very limited, not only to conduct market studies, but also to assist the respective line ministries in their own analyses. Low wages throughout the public sector make

it difficult to attract professionals with the required expertise.⁶⁷ The Division on Concessions is trying to close the expertise gap, and it has signed an agreement with the concessions agency of the Republic of Korea to organize study tours and staff exchange programmes. For as much enthusiasm the staff of the Division on Concessions can deploy, it is however hard to see how it can fulfill its mandate within the existing resources. It is hoped that the change in focus of the Division on Concessions within Government will be accompanied by a significant strengthening in staffing and capacity.

Financing is also likely to be a serious issue. Western lenders are generally very wary of participating in pure project financing in Mongolia (Baker and McKenzie, 2010) and international banks are not present. Although much progress is being achieved on providing an adequate legal and institutional framework,⁶⁸ the local stock exchange market is still underdeveloped (see chapter I). In these conditions, it is difficult to see how the projects currently in the concessions list will be completed, particularly since the large majority of them have been deemed socially important but economically non-viable.

As mentioned in chapter I, a Development Bank of Mongolia has recently been established, which will hopefully contribute to providing financial discipline to projects selected on political grounds. The Bank, nonetheless, is structured more as a cooperation bank than a development bank and its primary source of funding will be the allocation of bonds on the market. Its first issuing of \$580 million took place in March 2012. A sovereign wealth fund, the Human Development Fund, was also recently set-up and could provide another source of finance. For the moment, however, its main activity is limited to the distribution of universal checks to the Mongolian population, based on credits from future mining revenues and it is yet unclear which institution will ultimately manage the fund. In this context, the only viable option for the majority of the projects, excluding those in mining or mining-related, will be to obtain finance through international development banks or via the public revenues from mining.

⁶⁷ The average wage in the public sector is \$300 per month.

⁶⁸ A new Securities Law was adopted in May 2013 and consultants from the London Stock Exchange are assisting the GoM in the management of the MSE.

E. Assessment of the investment climate

Since 1992, Mongolia has been carrying out major policy reforms generally aimed at introducing commercial legislation based on modern practice, often with the assistance of international donor agencies. Virtually all the laws currently in force, including the key laws affecting business, have been introduced over the last 20 years. Many of them are already undergoing a process of revision to ensure continued consistency with international best practice. In most regulatory areas, therefore, the basic legislation is modern and up to standards and the transition from a planned system is largely complete.

In effect, such impressive legislative reform effort was seldom accompanied by the institution-building required for the administration to absorb, monitor and enforce the new legislation. As a result, implementation is often partial or deficient. The limited budgetary capacity of the GoM, widespread governance issues and the lack of skills and familiarity with the principles of a market economy are among the key reasons for the current institutional weakness of many government agencies, and constitute serious impediments to entrepreneurship and private sector development. Poor inter-agency coordination is also an issue that the GoM is trying to address through the increasing use of IT solutions and common databases. Low wages and high turnover in the public sector, however, make it difficult to develop and retain the skills relevant to operate the new IT infrastructure.

Table II.5 summarizes the key findings of the analysis of the legal, institutional and regulatory framework for investment contained in this chapter. As shown in the table, while most laws are modern and foster an enabling climate for investment, few legal and regulatory deficiencies remain in areas such as:

- 1) the foreign investment legislation, which needs revision in line with Mongolia's liberal attitude to FDI;
- 2) company operations, where permitting needs streamlining (particularly in the area of construction) and controls are often focused on sanctioning rather than ensuring compliance with the rules;

- 3) the regime for the entry of foreign skills, which does not foster the attraction and diffusion of skills necessary to the country's development;
- 4) the minerals law, which needs to better protect public interest;
- 5) the concessions regime, where stricter project selection criteria are needed.

The authorities have started working towards addressing at least some of the above issues, including in the areas of inspections and mining, where new legislative initiatives are being discussed.

On the implementation and institution side, however, challenges are significant and span the entire public administration. Key government functions such as environmental protection, mining regulation, the Judiciary, anti-corruption, investment promotion and concessions are not assigned the skills and the financial resources required to ensure proper implementation

of the law and governance is a serious issue. Several public agencies, including the Competition Agency, the GASR and the GASI also need capacity building and strengthening.

The booming mining sector will provide Mongolia with abundant financial resources, thus removing a key obstacle to institution building. This should become a spending priority for the GoM, necessary to complete the transition to a well-functioning and well-regulated market economy and put the public administration in the position to protect public interest and manage the future revenues from mining in a way that leads to inclusive growth and prosperity for all. As discussed in the next chapter, the consequences of inaction would be dire and would expose the country to the worst risks associated with resource-led development. Concrete recommendations for each area are presented in the next chapter.

Table II.5. Summary of key findings on the legal and regulatory framework in Mongolia

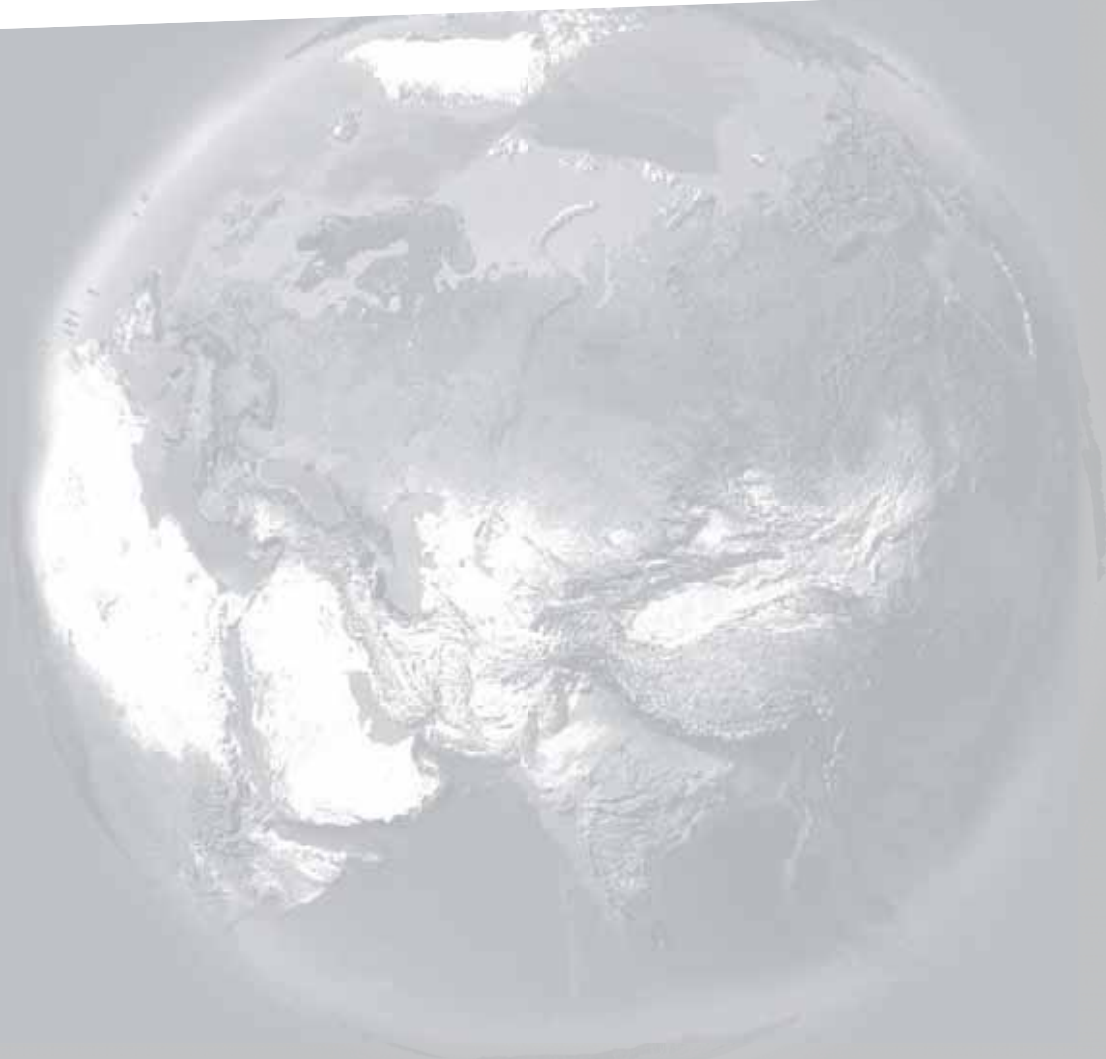
| Regulatory area | Laws | Implementation | Institutions |
|------------------------------------|------|----------------|--------------|
| Foreign investment | ** | ** | * |
| Company operations | ** | ** | ** |
| Taxation | *** | ** | ** |
| Labour | *** | ** | *** |
| Skills/employment of non-residents | * | * | n.a. |
| Land and property rights | *** | ** | ** |
| Environment | *** | * | * |
| Competition | *** | ** | ** |
| Public governance | ** | * | * |
| Mining | ** | ** | * |
| Concessions | *** | n.a. | * |

Source: UNCTAD

Notes: * = weak/requiring urgent attention
 ** = incomplete/to be improved
 *** = good/strong
 n.a. = not applicable

CHAPTER 3

FDI as a catalyst for diversification in Mongolia



Mongolia is in many ways a unique country with a small population largely concentrated in a single city within a large land area, surrounded by two powerful neighbours, and possessing huge mineral resources. While enormous opportunities derive from its vast mineral wealth, Mongolia also faces daunting challenges in exploiting these untapped minerals in a way that avoids the macroeconomic and competitiveness problems associated with the so-called resource curse, and for the benefit of the whole population. The minerals boom is further increasing the concentration of economic activity in the capital city and leading to rising income inequality, while crowding-out other public and private enterprise activity.

Diversification and adequate management of the natural resource rent are thus widely recognized as the core to inclusive growth and poverty reduction. Macroeconomic management is also fundamental to achieve the sustainable and inclusive development scenario described in chapter I; but so is public sector reform and strong implementation of the laws curtailing conflicts of interest.

FDI too has a crucial role to play, bringing direct contributions including capital, jobs and technology; and dynamic benefits derived from its catalytic role in stimulating the development of local enterprises. So far, however, as highlighted in chapter I, a key characteristic of FDI to Mongolia is its narrow focus by source country and especially sector. Equally important is the limited FDI in high value services and manufacturing, and FDI by global TNCs outside mining.

This chapter presents a strategic review of how FDI, and international business activities more widely, can act as a catalyst for diversification in Mongolia. It offers a comprehensive FDI strategy that aims at addressing both the policy concerns of avoiding dependency on any one country, as well as supporting socio-economic development by focusing upon three pillars of diversification:

- 1) sectoral diversification designed to generate economic growth outside the mining industry;
- 2) geographical diversification designed to promote regional development within Mongolia and the crowding-in of domestic investors; and

- 3) source country diversification aimed to reduce dependency on a small number of FDI-supplying nations.

Diversification by sector: Sectoral diversification incorporating FDI is critical, since mineral resources are finite, irreplaceable and locationally fixed. There are opportunities for diversification associated with mining as this review identifies; and efforts to create self-sustaining communities in the mining areas will assist geographical diversification too. But a wider economic base is essential for a balanced economy, and to provide a range of employment opportunities encompassing both the poor and unemployed and the growing numbers of highly educated young people. The programmes in section C are directed at a range of sectors, particularly financial and business services, tourism, and livestock-related activities.

Diversification by source country: The basic case for diversification by source country and firm rests on the well-known potential benefits accruing from FDI. The direct benefits encompass jobs in the TNCs themselves and crucially also in supplier firms (local and foreign); capital investment; and technology transfers. Indirect benefits accrue from the stimuli to entrepreneurship and innovation as local SMEs learn from the foreign investors. There are other benefits too, particularly associated with TNCs from developed economies, including new corporate governance standards which will spillover into local enterprises, especially joint ventures (JV). Such source-country diversification is already an official objective of the GoM. However, as will be discussed in section A below, a new approach should be adopted towards achieving it.

Regional diversification: The problems from the number of displaced nomadic people flooding into Ulaanbaatar (UB) are already leading to much increased unemployment, poverty, pollution and crime. So regional diversification is critical. Yet the capital has much to offer to the country and this report also offers ideas for helping to build a 21st century city with FDI as a core element.

This chapter is structured as follows: section A sets out new objectives for Mongolia's FDI policy focusing upon diversification, as well as the implications of a new policy on the FDI-specific laws and institutions. Section B

tackles the ubiquitous challenges to the overall economy derived from weaknesses in planning, regulatory framework, governance and institutions, where deep and wide-ranging reforms are necessary. It stresses that the actual process of diversification by source country will require a significant strengthening of governance and institutions. The diversification objectives are then supported by carefully designed targeting programmes built around the opportunities in Mongolia as assessed in section C. Finally, section D provides a summary of all the recommendations contained in this report.

A. New objectives and tools of a comprehensive FDI strategy

1. A new approach to FDI diversification

Chapter I presents the development objectives of Mongolia and highlights the role of FDI to meeting them (NDS 2007–2021). These objectives take into account many of the assumed benefits from FDI. However, the current policy statements on FDI often lack coherence and ambition. In particular, the Mongolian approach to FDI does not focus directly on its potential or expected role in overcoming the underlying weaknesses of the economy, which concern the need to exploit the mineral resources of the country effectively, and to ensure that mineral revenues are used for the benefit of the whole country.

In 2010 the GoM revised, the “Concept of National Security of Mongolia” with the objective to address the policy concerns related to the over-dependence on few countries of origin of investment by calling for a strategy to limit the share of investment from any one country to a maximum of 1/3rd of total foreign investment. The Concept also called for restrictions on foreign state-owned companies’ investment. As described in chapter II, the latter recently materialized with the adoption of the SEFIL, which mandates DFIRR to screen investment for compliance with the Concept of National Security as well as a range of other criteria.

The Foreign Investment Law of Mongolia also allows for a comprehensive screening of investment, making it feasible to implement the 1/3rd strategy mentioned in the “Concept of National Security”. As discussed in

chapter II, the possibility for the authorities to effectively filter any foreign investment or to terminate at any time the operations of companies with foreign investment based on a set of unclear criteria, raises severe concerns over legal certainty and gives investors a negative signal regarding the stability of the investment climate.

In addition, limiting the share of FDI from any one country could be counterproductive in achieving the source-country diversification objective of the GoM. Making the limit legally binding would result in a massive reduction of total FDI inflows to Mongolia. Such policy is also difficult to implement, given the difficulties related with identifying the ultimate parent companies in a globalized world. Furthermore, it contravenes Mongolia’s open approach to the entry of foreign investment, as manifested in practice over the past 20 years. Lastly, the Government of Mongolia should retain the flexibility to promote and attract those investments that could bring development benefits independently from the country of origin of the investment.

Rather than seeking to limit the share of FDI from any one country, Mongolia should therefore seek to increase FDI inflows from non-traditional countries of origin. In this regard, and as stressed in this chapter, Mongolia should urgently and forcefully address the governance issues which constitute a key obstacle to source-country diversification (section B), open new opportunities for investment in sectors other than mining and construction (section C); and adopt professional investor targeting strategies (section A.3, below).

Other policy objectives of the current legislation can be achieved more efficiently with different policy tools. For instance, the concerns regarding the impact of foreign investment on the environment, on competition or health can be better addressed at the permitting stage by the specialized Government agencies, which should have the expertise as well as the tools to effectively protect the public interest. Similarly, the deposit requirement of the Foreign Investment Law, aimed to shield local SMEs from competition and restrict the associated immigration is not proving effective. It may also prevent the entry of small and potentially high-impact investors, such as those in the eco-tourism business, which is one of the priority sectors for FDI attraction. In this regard, the entry of foreign migrants is best dealt with through the immigration law, border controls and work permit procedures (section C.2). It may also be more efficient

to determine which activities should be shielded from competition from FDI on a sectoral basis, either by closing the sector to FDI entirely, or upon determination of a minimum investment threshold.

Several Government representatives have indicated that a new Investment Law is under discussion to address the inconsistencies of the existing legislation and provide an enabling regulatory environment. The law, which would apply to both domestic and foreign investors, is expected to repeal the SEFIL and the FIL. In this regard, as discussed in chapter II, in order to restore legal certainty and ensure that a coherent message is sent to investors, a new law on investment should:

1. Remove the pre-establishment screening of foreign investment (art. 12 of the FIL), abolish the need for an investment certificate and replace it with the existing State registration process under GASR and better inter-agency coordination. In this regard, as stressed below, the capacity of the Government agencies in charge of competition, the environment, inspections and the regulated sectors should be significantly enhanced.
2. Review the minimum deposit requirement of the FIL in dealing with illegal inflow of migrant entrepreneurs and consider its replacement by a negative list of sectors closed to foreign investors, either entirely or below a minimum investment threshold.
3. Address the need for comprehensive and more reliable FDI statistics by legally requiring all companies to comply with annual investor surveys. The surveys should be based on a methodology for the collection of FDI statistics compliant with international standards and derived from cooperation between the BoM, DFIRR, GASR, and the National Statistical Office. UNCTAD can provide technical assistance in this area.

At the same time, in line with the assessment of chapter II, the FDI-related national security concerns can be better addressed with a more targeted and transparent approach. In this regard, the comprehensive pre-establishment screening mechanism of the SEFIL (art. 7) should be replaced by a proper national security test based on:

1. A clear definition of the national security objectives and of the review criteria. This would complement

the vague reference to the National Security Concept currently provided in the law. All other screening criteria would be removed (i.e. art. 7.3.2 to 7.3.5) and replaced by the relevant permitting at the post-establishment phase.

2. A better definition of the type of investors and investment to which the test applies. In this regard, the current law is unclear, leaving scope for discretionary decisions that could be influenced by protectionist pressures or corruption. Furthermore, the Government should refrain from direct interference in management decisions with respect to day-to-day business transactions. Again, the concerns regarding the effects on competition, such as those listed in art. 6 of the law, should be addressed by the competition authority once the relevant regulations are improved (see B.4 below).
3. A revised list of strategic sectors. The inclusion of financial services and banking to the list of strategic sectors requiring pre-establishment approval may be reviewed in line with the official policy objective to develop UB as a regional centre for financial services through FDI (see section C.3 below). Licensing in the sector by the Central Bank and the Ministry of Finance leaves sufficient space for ensuring the protection of public interest.

2. New opportunities from the activities of foreign companies in Mongolia

While the focus of this review is FDI, there are other activities in Mongolia by foreign companies which offer opportunities and potential benefits. Some of these may lead to additional FDI, or indeed become alternatives to it. The proposed diversification strategy thus recommends adopting a wider perspective on foreign corporate activities in Mongolia than FDI per se. This important message derives from the growing activity in Mongolia by foreign companies in a range of modes of market entry and development, including non-equity modes of international production. Some of these may be more appropriate than FDI where there are specific requirements, for example, for technology acquisition which may be handled through licensing agreements or from specific agreements concerning technical support.⁶⁹ In other cases, foreign companies

⁶⁹ For more details on non-equity modes of international production, see UNCTAD's *World Investment Report 2011* (UNCTAD, 2011 (a)).

establish representative offices which may, in due course, lead to the establishment of an enterprise. Policy-makers in the country (and local companies), therefore, should consider that there are alternatives available, for example, for acquiring technology; and, as with licensing and franchising, JV agreements may take a contractual rather than an equity form.

The establishment of representative offices by foreign investors are designed for:

- i) understanding and analyzing the business environment;
- ii) market screening and evaluation of market opportunities for imports (products as well as equipment and machinery) from home country or future inward FDI;
- iii) analysis of potential partners for JV operations in Mongolia;
- iv) monitoring sectoral regulations or opening up of the sector to FDI; and
- v) positioning the company to gain first or early mover advantages for FDI.

International evidence shows that it is not uncommon for representative offices to evolve into equity investments (including branch offices in banking); and proactive targeting is recommended to understand company requirements and overcome their concerns.

Some companies may start with exporting either directly or through distributors/dealers. Direct exporting or leasing of equipment may be associated with knowledge transfers and technical support from foreign suppliers. There are also examples of design and marketing consultancy contracts with foreign companies to improve design capability, marketing skills and successful access to international markets (in Mongolia, this is the case in cashmere). The distributorships and dealerships for sales and distribution of branded foreign imports (consumer and industrial) may be either locally- or foreign-owned; the latter being a form of FDI, as in the case of automobile dealerships in UB.

Licensing or franchising tends to be a follow-up step in specific sectors or an initial entry mode. In Mongolia, licensing is common in the drinks industry (brewing under licence) and in branded consumer goods, as well as in R&D-intensive industries such as pharmaceuticals and biotechnology; whereas franchising (along with

management contracts) frequently occurs in hotels, restaurants (offering opportunities for local entrepreneurs as franchisees), and brand retailing.

The establishment of JVs or wholly-owned subsidiaries (WOSs) may be part of a process, for example, the next step after representative offices or exporting. Bilateral donors and international financial institutions (IFI), particularly the EBRD and IFC, are playing a significant role by providing equity finance alongside local and foreign equity investors in private Mongolian enterprises. This co-financing provides confidence to foreign investors and reduces perceived risks; and promotes investment interest from other private institutional investors and development finance institutions. Such investments exist in agribusiness, cashmere/textiles, hotels and tourism, property and services; and are also undertaken in Mongolian enterprises where there is no foreign involvement.

The JVs are common and have benefits for both parties, with TNCs bringing capital, technology and management; and domestic investors bringing capabilities to manage an unknown environment. In Mongolia, FDI by global TNCs is currently largely limited to mining. In many countries, it is the investment by major global TNCs (or sometimes a single TNC) that provides the signal to the world business community that the country has opportunities and is "open for business". The small internal market and poor transport links have generally precluded such investments. However, the country is beginning to attract well-known international players in hotels, and also in financial services on the back of mining FDI and this offers significant opportunities.

Interviews undertaken by UNCTAD suggest a view among companies and in Government circles that FDI is a relatively short-term contributor to local enterprises through the provision of technical assistance to improve design capability, marketing skills, and successful access to international markets; once the desired contribution is achieved and/or the JV becomes profitable, then the foreign partner is no longer seen as necessary. This view is not appropriate. If there are specific concerns, such as market power, these should be handled by a strong competition policy. In fact, the concentration of ownership and control of domestic private sector industry in the hands of a small number of conglomerate family businesses is a greater concern; as is the fact that many politicians have significant business interests.

For foreign investors, equity JVs and WOSs are generally regarded as involving long-term relationships with the local partner and country. Thus FDI should be viewed positively as a long-term contributor to the economy and optimally as part of the fabric of the Mongolian economy and society. At present, however, the prevailing attitude of investors from non-traditional source countries of FDI is one of 'wait-and-see'. This attitude is accentuated by recent experiences related to the economic and financial crisis of 2008/09 and the uncertainty regarding the investment legislation. Interviews by UNCTAD highlighted losses incurred by foreign investors, investment disputes, and some withdrawals.

Four key lessons emerge from this assessment of the activities of foreign companies in Mongolia, namely, the requirement for:

- i. a wider vision concerning foreign corporate activity in the country, encompassing a range of modalities of international business — from representative offices to wholly-owned affiliates;
- ii. an improved understanding of foreign operations and what they can contribute to the economy;
- iii. a positive attitude towards FDI and other modalities of international corporate activity;
- iv. a recognition by the investment promotion agency that there are potential opportunities on their doorstep which should be actively exploited. This means specific targeted promotional and aftercare programmes directed at a range of modalities of international business, as discussed in the following section.

3. A new beginning for investment promotion in Mongolia

Mongolia's investment promotion agency (IPA) has a central role to play in supporting the FDI diversification objectives discussed above and in the implementation of the programmes recommended in this chapter. To fulfil this leading role in international marketing and business development, DFIRR must be radically reformed and its status enhanced, which in turn means stronger capacity and capabilities. Achieving this requires fundamental reform and culture change: DFIRR should be re-created as a proactive, state-of-the-art agency led by executives with private sector experience. It

should be independent, funded by the public sector but with private sector outlook and service standards. Its registration function should be removed because of the negative effects on investors, and a strong aftercare⁷⁰ function developed. Its name should be changed as part of the reincarnation process, and an image building programme implemented to support a new country brand. Its governing board should comprise both public and private sector members, as well as Mongolian and foreign company representatives.

Background and assessment

The first investment promotion agency of Mongolia, FIFTA, was established in August 1998 as the executing body for trade and FDI. In its early days, FIFTA operated with twin departments comprising promotion, and registration and service; the latter was estimated to occupy about 90 per cent of FIFTA's time. The agency did not have a defined strategy for investment promotion with specific objectives, priorities and targets. There was no clear articulation of the reasons of why the country was seeking to attract FDI, other than a general view of positive impacts on economic development and job creation. 'Servicing' investment clients tended to be equated with 'registration', and there was little aftercare activity.

As mentioned in Chapter II, the new Government formed after the 2012 elections has changed the location and the status of FIFTA, which has become the Department of Foreign Investment Regulations and Registration (DFIRR) of the new Ministry of Economic Development. DFIRR has lost FIFTA's export and SME promotion remit. However, in respect to investment promotion little has changed as DFIRR remains a reactive implementing department. Staff numbers have risen from under 20 in 1998 at FIFTA to 23 at DFIRR. Two divisions of 11 staff each were created: the Investment Registration Division and the Investment Regulations Division. The balance is assigned to the Director's office. These have replaced FIFTA's four divisions of investment promotion and cooperation, investment, project and aftercare; investment registration and service; and administration. Registration, as mentioned in chapter II, continues to be an important function, with regulatory functions

⁷⁰ The term 'aftercare' is used here to include both investment facilitation associated with the entry and start-up processes of foreign investors, and business development support for foreign affiliates in Mongolia (UNCTAD, 2007).

now made more prominent given the investment screening role assigned to DFIRR by the Law on Foreign Investment in Strategic Sectors.

Investment promotion is conducted within the Investment Registration Division. Eleven out of 12 staff are assigned to this function, effectively leaving one staff in charge of registration. Assuming the priority sectors for investment promotion have not changed, the focus of promotional activities are mining, agriculture, tourism, infrastructure, construction, banking (as defined by the Government's five priority areas) and the 26 priority projects. The countries targeted are essentially defined by the sectoral priorities and are mostly those in the region, that is, China, the Russian Federation, Japan, The Republic of Korea and China, Hong Kong Special Administrative Region, along with the United States and the European Union. Investment promotion activities take the form of the organization of investment fora and conferences, and matchmaking for both foreign and Mongolian businesses. Some promotional cooperation takes place with other Government agencies such as Tourism but there is no coordinated message or brand.

Typical functions of a modern investment promotion agency, such as investor targeting, business development (aftercare), facilitation or advocacy are not prominent among DFIRR's functions, nor is sufficient staffing assigned to them.

Reforming Mongolia's investment promotion agency

The activities of Mongolia's investment promotion agency should be driven by the proposed comprehensive FDI strategy for Mongolia which focuses on the three pillars of sectoral, source and in-country geographic diversification. This FDI policy also encompasses a wider vision of foreign operations in Mongolia, representing opportunities to provide wider benefits and integrate foreign companies more fully within the economy through a range of business modalities. These policy objectives pertaining to FDI and foreign operations reinforce the requirements for reform of DFIRR. The key elements of reform are as follows:

Name of the investment promotion agency

A crucial starting point for the reorganization and revitalization of the IPA is a review of the 'DFIRR' name. As an agency with registration and regulations as its

central functions, the image of FIFTA/DFIRR needs to be improved, in conjunction with overall reform of its role, structure and operations, and a name change is desirable.⁷¹ A new name should provide a clear representation of the agency's role and be easily recognizable to an international audience. It will also provide the necessary new beginning when dealing with foreign investors, local companies, and its range of stakeholders inside and outside of Government.

The mission of the investment promotion agency

The mission of the IPA is to be recognized domestically and internationally as the lead institution for promoting FDI and internationalization.⁷² It will have the responsibility for proactively implementing the FDI policy, which is designed to utilize foreign investment as a catalyst for diversification. In fulfilling this mission it will focus both upon attracting and maximizing the benefits from FDI and other foreign operations. Achieving this requires effective marketing and intensive aftercare support for the local private sector to enhance the spillovers from FDI. In pursuing its mission as lead promotional agency, it will collaborate with other Government ministries and agencies, as well as private and public sector stakeholders as appropriate.

Mandate of the investment promotion agency

The agency's mandate will include the following activities:

- a. Image building
- b. Investment generation
- c. Investment facilitation
- d. Aftercare
- e. Policy advocacy

Some of these functions are included within the present remit of DFIRR under the broader umbrella of investment promotion, but much greater sophistication is required in their implementation. For example, the agency will have a much stronger role in investment generation through sector, country and investor targeting as part of

⁷¹ Possibilities might include Mongolia Trade and Investment (MTI) or Mongolia Development International (MDI). These examples of names indicate that the agency would have both trade and investment roles. This important issue is discussed later in the section.

⁷² The term 'internationalization' encompasses the wide range of modalities of international business employed by foreign companies to enter and develop the market, as precursors or alternatives to FDI per se.

its diversification remit. Within the area of aftercare, the IPA will have responsibility (in collaboration with others) for the linkages and entrepreneurship programmes which are recommended in this chapter (section C). In addition, new functions are included such as image building, as well as performance evaluation and policy advocacy.

a) Image building — brand Mongolia

The NDIC (2009) highlights the requirement for a ‘unified policy to support Mongolia’s brand image on international markets’. Mongolia is unique and has an exciting tale to tell — from its turbulent history through to its potentially golden future. The development of a single coherent brand for the country is required: first, to provide a strong and consistent message to the outside world and hence overcome misconceptions and deficiencies in knowledge and awareness of the country. Second, it will avoid Mongolian institutions and enterprises presenting a variety of potentially confusing messages and images to the outside world (as in the case of tourism in section C.4). Third, it provides a basis for an image-building campaign by the investment agency targeted at potential investors.

Image building is an essential first step in promoting the country’s opportunities for foreign investors as well as for tourists and the worldwide public. As the principal international marketing organization, it will be appropriate for the IPA to take a lead role in developing the country brand in association with the tourism agency and other stakeholders. The creation of a single brand for Mongolia is a critical exercise since the brand needs to be compatible with separate messages for inward FDI, trade and especially tourism. The final task is to ensure that the brand and message are communicated consistently through all marketing and promotional materials, including the IPA webpage, which can be the first window to the country for many investors.

b) Investment generation

The culture of FIFTA, now DFIRR, is fundamentally reactive, and encouraged by its mandate as a policy implementation agency. There should be an enhanced role for the IPA in undertaking investment generation activities. This would entail a proactive approach focusing upon research-based targeting policies at country, sector and company level internationally, and including identification, tracking and follow-up

systems. The agency’s investment generation activities would derive from the overall FDI and foreign policy concerning sectoral, source country and geographical diversification. Close cooperation and coordination with the planning agency are required. But the IPA would have proactive responsibilities for detailed targeting and promotion, including at company level, and including FDI and other modalities of market entry.

Marketing and promotional tools should be appropriate for achieving the agency’s objectives and, therefore, not be limited to matchmaking and conferences and seminars. E-marketing, relationship marketing and value chain building (as in the programme to develop financial and business services in UB) all have a role to play. A challenge for Mongolia concerns the marketing of joint ventures as opposed to wholly-owned subsidiaries. The investment agency should have a neutral position on a decision which is that of the investor(s) alone; but the agency should be positively proactive in responding to requests from domestic enterprises concerning JV possibilities, and investor fora and matchmaking events can be useful.

A modus operandi is required to ensure effective collaboration with sectoral ministries and agencies which will inevitably have a role in attracting investment. This is because of the nature, for example, of the tourism product which includes attracting people as well as FDI in tourism; or the specialist, technical nature of the sector and indeed its huge investment possibilities, as in mining. Infrastructure FDI fits into this category too. Partnership building and closer ties are necessary with prominent private sector organizations, particularly with MNCCI and the BCM. Still the principle of the IPA having a coordinating role should be adhered to.

c) Investment facilitation

The investment facilitation process should be simplified and streamlined by the transfer of registration to the General Authority for State Registration (GASR). Facilitation processes are still cumbersome and time-consuming. A facilitation desk to act as one-stop for facilitating entry processes is appropriate; but speeding-up entry primarily requires institutional and governance reform as recommended in section B.⁷³

⁷³ ‘One-stop-shops’ for investment entry will not speed-up processes when government agencies are bureaucratic and inefficient. Best practice suggests the operation of a dynamic facilitation desk.

d) *Aftercare*

The IPA should have systems in place for investor identification, tracking and follow-up. It is widely recognized that a significant proportion of inward investment takes the form of expansionary and follow-on investment by existing TNC affiliates; and that maximizing the benefits from FDI requires building supply linkages and other forms of collaboration with local private sector companies (commonly SMEs). It is recommended, therefore, that the aftercare division in the Mongolian IPA should be responsible for:

1. Understanding and networking with the significant and varied pool of foreign operations (rep. offices, distributorships, licensees and franchisees etc.). The objective is to promote the modality of foreign business operations which is most beneficial for the country, meaning in cases such as representative offices, for example, a progression into other contractual activities or FDI. This will contribute to a learning process for the agency concerning future affiliate development activities.
2. Linkages and entrepreneurship programmes, including in target sectors such as tourism and mining. These programmes are focused upon local SMEs but collaboration with or supply to TNCs is the ultimate objective. Thus the investment agency should have a lead role in their design and operation in collaboration with the SME Agency (section C.6).
3. Diaspora programmes (section C.2), which comprise support for recruitment and the business talent scheme for the Mongolian diaspora. These entail targeting the diaspora abroad both to address skills shortages and establish businesses in Mongolia.
4. TNC affiliate development programmes. Inward investment is still in its infancy in Mongolia and so the potential for affiliate development programmes⁷⁴ is limited, but the requirement will grow.

e) *Policy advocacy*

The broad framework of investment objectives and goals underpinning the diversification pillars will be based upon the forecasts and plans developed by the Ministry of Economic Development, with the investment

agency translating these into specific targets. However, in being closest to the customer (i.e. the foreign investor) and related stakeholders, the investment agency has an important contribution to make to FDI policy and planning. Policy advocacy should, therefore, be included within the mandate of the IPA. The policy advocacy should involve the agency in, first, obtaining the views of investors, public and private bodies and other stakeholders on FDI-related issues, such as the investment climate and impediments to investment; and proposals presented by stakeholders for improving FDI policies. Second, developing the most effective policy remedy; and third, advocating the policy.⁷⁵

Implementing reform

a) *Structure of the investment agency: investment and trade promotion*

Further consideration should be given to the development of a revised structure and mandate. Options are as follows:

1. *Inward investment attraction agency*, incorporating the activities outlined above. As compared with the present DFIRR, the regulatory functions would be transferred to the Government and inward investment attraction would be extended to include non-equity modes of foreign operation. The IPA would have a strong aftercare remit, given its responsibility for implementing a number of the programmes recommended in this strategic review.
2. *Inward and outward internationalization agency*. Merging the functions of inward investment and trade promotion is becoming increasingly common to reflect their complementarities, but there are disadvantages as well as advantages of combined agencies which need to be considered (UNCTAD, 2009b). A big forthcoming issue for Mongolia is the outward internationalization of the large domestic enterprises in both trade and FDI forms. This is an inevitable business evolution process and should be supported, as part of deepening international involvement and commitment to enhance competitiveness and to increase market opportunities.⁷⁶

⁷⁴ For an example of a formal affiliate development programme (UNCTAD, 2009a).

⁷⁵ For the methodology of policy advocacy, see UNCTAD, 2008b.

⁷⁶ Included within the GoM Concepts of *National Security* (2010)

3. *Establishment of a Mongolian Development Agency.*

This would bring together all private sector business activities (foreign and domestic, inward and outward, larger and small firms). There are strong arguments for integrating all aftercare operations within a single body. First, it will strengthen the general private sector orientation of the economy; second, provide a single door for support (since logically the SME Agency would become part of this new agency); third, provide an impetus for the outward internationalization of large domestic enterprises; and fourth, assist networking between domestic and foreign firms.

On balance, option 1 is recommended since it ensures a focus on inward foreign investment and operations which is the critical objective of this strategic review. In itself, this focus will require a major overhaul of the IPA, not simply in terms of mandate and structure but equally importantly in respect of status, staffing, and culture. Allocating a wider remit to the IPA could prove counterproductive in the initial reform period.

b) Staffing

Reorganization to create a state-of-the-art investment promotion agency will require highly professional, private-sector experienced staff. This may be achieved by secondments from the private sector, and could be attractive in providing international experience to younger, ambitious executives. Such executives would be particularly appropriate for the international sales function, and could imbue a culture of pro-action, enthusiasm and target-driven ambition, even if their tenure with the IPA is only around three years. Specialized profiles are also required in order to perform the research function of the IPA, relevant to investor targeting, aftercare, as well as development and maintenance of the IPA website. Stability of staffing is potentially valuable for activities like aftercare where projects are longer term in nature.

c) Creation of regional offices

As part of the regional diversification component of the new FDI policy, regional IPA offices may be established to promote the specific resources and capabilities of Mongolian regions and provide aftercare support. It would be appropriate to have regional tourism offices sharing the premises.

d) Investment promotion agency offices

The offices of some Ministries located in UB are now of international standard; and the quality of IPA office facilities should similarly match those of an international company located in Mongolia. The IPA offices in Ulaanbaatar are the country's front door for foreign investors.

DFIRR's reorganization will require a number of legal changes to be considered in the new law on investment. These include:

1. assigning DFIRR a new investment promotion mandate reflecting its leading role in supporting Mongolia's development objectives by promoting FDI in priority sectors and fostering benefits to the domestic economy;
2. removing all regulatory functions, including the screening of foreign investment (which is already disused in the practice), and removing the possibility for DFIRR to decide on investors' establishment or termination of activities; and
3. introducing pro-active investment generation functions (including sectoral, country-based and investor-specific targeting); investment facilitation; image-building; aftercare; monitoring and evaluating performance and policy advocacy.

B. Regulatory and institutional reforms for foreign and local private sector development

Mongolia has made impressive progress in its transition to a market economy, with an array of valuable reforms to facilitate the growth of a strong private sector and encourage FDI. However, this process has not been paralleled by reforms in the institutions and workings of Government. Planning processes need to be strengthened; and public governance is weak, epitomized by high levels of corruption. Furthermore, the design, structure and organization of some ministries, agencies and departments are not fit for the purposes and few legal and regulatory gaps remain. Essentially, root and branch

reform of the public sector is required, since institutional weaknesses are a barrier to private sector development and FDI attraction. The overall objective is to complete the past and prepare for the future, and, thereby, support the strategy of diversification through FDI.

1. Seeking a model for public sector reform in Mongolia

Mongolia is entering its most dynamic economic era but also the most challenging since its transition commenced. And it is doing so with a public sector which is urgently in need of modernization to complement the successful transition in market reform, and to support FDI.

Different countries have used different sets of drivers to measure public sector performance and to frame modernization programmes. Qatar provides a helpful model, having recently developed a comprehensive public sector reform strategy based upon best practices in countries around the world (box III.1).

Singapore identified productivity, quality, timeliness, responsiveness, efficiency and accountability in their model to improve public services.

Mongolia could undertake a similar initiative to develop modern public sector institutions. For Mongolia, public governance would rate highly, although it is an outcome of drivers such as transparency and accountability. Projects to develop and modernize public sector institutions were developed broadly from the levers; and all had outcomes that directly affect the drivers of performance — efficiency, effectiveness, value creation, accountability, transparency, engagement and relevance. The Qatar model, tailored to the unique Mongolian situation, can be a starting point for the urgently required public sector reform in the country. The challenges are fundamental and the implementation of a Qatar-type model will impact fairly directly on all public sector officials. Hence a parallel change management programme should be given serious consideration (Melchor, 2008).

Box III.1. The Qatar National Development Strategy 2011–2016

The Qatar National Development Strategy 2011–2016 provides a very valuable model. It recognizes the need for strong public sector institutions to achieve the goals of its development strategy for social progress, human development, a sound and diversified economy and a sustainable environment. Achieving these goals requires institutional and organizational capacity building, efficient and transparent delivery of public services (essential for delivering timely and accountable services to citizens and respond to their concerns), fruitful public-private cooperation and partnerships, a vibrant climate for business and a larger space for civil society. Public sector development focuses on developing the capabilities of the State and on strengthening institutional collaboration. The model applied identifies the dynamic links between the drivers (i.e. factors that influence performance and the principles that serve as measures of institutional success) and levers (i.e. the mechanisms that institutions must apply to modernize) of institutional development and modernization and the dynamic links between them.

Drivers of modernization:

- Efficiency
- Effectiveness
- Value creation
- Accountability
- Transparency
- Engagement (inclusiveness)
- Relevance

Levers of modernization:

- Performance management
- Policy and planning
- Budget management
- Organizational alignment
- Human resources development
- Institutional processes
- Procurement
- Information and communication technology

A series of best practices are set out for each of the levers which are then translated into distinct projects for public sector modernization. Policy, planning and performance management emerged from previous studies and self-assessment exercises as requiring greatest capacity improvement.

Source: Qatar General Secretariat for Development Planning (2011)

2. Planning and supervision

An efficient and powerful planning agency should be a driver of the country's national development strategy, and the model for public sector reform should be tested on this agency before being rolled out across the public sector as a whole. Such an agency is necessary to ensure a proper prioritization and implementation of development and infrastructure projects (as noted in chapter II and in section C.1). In this regard, the establishment of a Ministry of Economic Development in 2012 is an encouraging development. The new Ministry is composed of several departments, including a Department of Development Policy, Strategic Planning and Monitoring (the successor of the NDIC), the DFIRR and the Department of Innovation and PPPs, encompassing the concessions unit. This new structure provides an opportunity to strengthen the policy planning function and have an enhanced authority and capability to pursue the recommendations of this strategic review. Indeed, evidence from other countries strongly suggests that the planning agency must be headed by an individual of ministerial rank (whatever the formal title) since the person has to coordinate the activities of other ministries, departments and agencies.⁷⁷

The former planning unit, the NDIC, had been established in 2009 under the office of the Prime Minister to advance the implementation of strategies for national economic and social development; and most critically to develop a series of mid-term strategic plans in the areas of private sector support, industrial development and public investment (chapter I). It had made an encouraging start but it was still to prove itself and get to grips with its existing role and the challenges, including the lack of a clear mandate, limited authority and totally inadequate funding and staffing.

The restructuring of the Government and the introduction of the new Ministry of Economic Development should provide the opportunity to redesign the planning and supervision function and avoid past mistakes. In this regard, a number of principles should drive the future orientations of the Ministry (Ikram, 2011):

1. The new Ministry should play a central role in the reform process, at least with respect to planning

and policy, providing leadership in preparing Mongolia's future.

2. Its mandate should include not only planning but also policy coordination. This includes improved coordination with the Ministry of Finance, the Central Bank and the Development Bank of Mongolia. At present uncoordinated policies adversely affect private sector development and FDI attraction (see chapter II).
3. Aside from policy coordination within Government, coordination with the private sector is essential since it provides the major impetus to growth. Central actors will include foreign investors, major private sector companies, and international financial institutions.
4. Sound economic analysis should be the basis for project identification and prioritization, backed by increased numbers of specialist staff. A key issue in regard to the latter concerns the planning of infrastructure projects.
5. Effective plan implementation is even more important than plan formulation. The experience of other countries bears out the point that plans exist on paper but can be ignored because of other priorities or are only fitfully implemented.
6. The planning function must be able to attract the highest quality of talent.

3. Public governance

The quality of host country institutions has a large impact on FDI attraction (Bissoon, 2012). Weak institutions breed corruption, which is arguably the most intractable problem facing investors, especially foreign investors who do not have experience of Mongolia. Although many international investors will have experience in other emerging and developing economies, still Mongolia ranks poorly on international corruption rankings; and interviews portrayed a picture of considerable uncertainty as to the high level issues likely to be faced, such as alleged pressures to reduce shareholdings or even withdraw. Moreover, governance problems and corruption appeared to be ubiquitous, affecting the judiciary and courts, taxation, customs, contracts, inspections, property rights, and legislative and regulatory transparency, as evaluated in chapter II.

⁷⁷ France, Republic of Korea and Malaysia are provided as examples in Ikram, 2011.

The IAAC has been in existence since 1997, and it has started having tangible effects on the level of corruption in Mongolia. A senior official in the agency described it as being systemic among Government officials and part of their mentality (chapter II). The assessment of anticorruption agencies elsewhere in the world is not encouraging: agencies may be obligated to politicians and so do not investigate corrupt officials; they may

lack the power to prosecute; quality and number of investigative staff may be inadequate; and the agencies face opposition from a massive wall of corrupt practices (Pope and Vohl, 2000). The guidelines for successful operation of anticorruption agencies, however, are quite clear, with the requirements described in box III.2. The preconditions concern institutional effectiveness and the rule of law, requiring therefore public sector reform.

Box III.2. Guidelines for successful operation of anticorruption agencies

1. Political will and total support from the national political leadership, including the President.
2. Independence to investigate at the highest levels of Government.
3. A powerful agency director with a high level of integrity and strong support from the President, including guarantees against intimidation.
4. Adequate numbers of well-trained staff with appropriate specialized skills.
5. Powers of coercion to ensure successful investigation and prosecution; and close links with public prosecutors to facilitate convictions.
6. Ensuring accountability in terms of legal standards, judicial review, public complaints and oversight.
7. Measuring performance, using indicators such as: per cent of investigated cases brought to judgement; per cent of complaints that result in greater transparency; specific institutional changes in response to complaints that result in greater transparency; per cent of requests for information that are granted; positive public survey results on agency performance; positive opinion poll results on the performance of the Anticorruption Agency.
8. Fundamentally public sector reform is critical to reduce the underlying drivers of corruption, including institutions that are a legacy of the past; the ineffective rule of law; effective immunity from prosecution for politicians and senior public officials; the lack of well-trained professionals; and low public sector salaries.

Source: USAID (2006); Heilbrunn (2004)

It is apparent that many of these guidelines are not fully applied in the Mongolian situation. For example, the IAAC staff requires training and specialized skills and the penalties imposed for violation of anti-corruption legislation are low (chapter II). The public sector reform programme as discussed at the beginning of this section will inevitably take time to implement, since it requires not simply legislation but a change of mindset.

Tackling corruption is, however, urgent as the mineral revenue flows accelerate and provide enhanced rent seeking opportunities; and as a means of reassuring foreign investors. Besides improving the implementation of existing anti-corruption and transparency laws, five interim measures are proposed below:

1. Promoting E-government initiatives to improve transparency and accountability. These are powerful tools in reducing corruption in government-business relations. In this regard, Mongolia should: a) implement the electronic signature law; b) complete the harmonization of Government databases including the land, tax and company database. Aside from its bureaucracy reduction effects, the centralized database should improve transparency by providing the possibility for individuals and companies to easily access the information needed to conduct due diligence analysis, currently very difficult to access; and c) consider implementing UNCTAD's E-regulations programme to simplify rules and procedures and eliminate unnecessary steps;

2. Encouraging public participation in the anti-corruption fight. An IAAC Hotline is currently available 24/7 to receive complaints concerning bribery and corruption. The IAAC indicated that the number of complaints rises when the Hotline is advertised. Increased advertising is thus obvious, although complaints must be pursued and responses provided to complainants if the public are to be reassured that their efforts are worthwhile;
 3. Raising awareness of corruption problems. There is an important role for anticorruption education, beginning at schools and extending to courses at universities. Such courses would emphasize the nature and characteristics of corruption and its negative effects upon both individual citizens and the wider economy;
 4. Addressing conflicts of interest. The adoption of the new law on conflict of interest is an encouraging step forward. Its implementation will be a crucial test of the credibility of Mongolia's anti-corruption efforts. In addition, the authorities should assess whether the privileges and jurisdictional immunities afforded under Mongolian law to MPs (who currently have immunity during any investigation for corruption) go beyond the protection necessary for public officials to perform their official functions; and
 5. Introducing Client Service Charters for the new IPA and the departments of the line ministries that service investors.
3. Improving the national coverage of IAAC and its capacity to reach remote areas and local levels of Government;
 4. Giving IAAC the full mandate to investigate all offences under the UN Convention against corruption (August 2011), including specifically money-laundering and embezzlement where, in both cases, the predicate offence relates to corruption, as well as corruption offences related to elections;
 5. Establishing criminal sanctions to prevent undue influence on the operation of IAAC, as a means to reduce room for interference by political, business and other interests;
 6. Establishing special anti-corruption courts that are staffed by judges given specialized training on matters related to corruption;
 7. Reviewing the existing law on elections that requires the reporting of financial contributions to political parties in excess of a certain threshold;
 8. Applying stricter sanctions, such as forfeiture of undeclared property, for violating the assets and income declaration requirements; and
 9. Taking appropriate measures to establish a Parliamentary Accounts Committee, a Parliamentary Investments Committee, and internal audit units in public ministries.

4. Wider institutional and regulatory reforms

Furthermore, derived from the analysis in chapter II and the peer review of the Conference of the State Parties of the United Nations Convention Against Corruption of August 2011, a number of other recommendations should be adopted to harmonize relevant laws with the Convention's provisions as follows:

1. Enacting comprehensive legislation on whistleblower protection;
2. Providing political support, adequate resources and relevant capacity-building in the form of specialized training for management and technical staff, particularly for investigators and prevention officers, noting that IAAC is a fairly new agency and there are presently nearly 160,000 public servants in Mongolia;

As stressed in chapter II on the policy implementation and institutional side, challenges are significant and span the entire public administration. Examples include planning, tourism development and mining, the Judiciary, anti-corruption, competition, concessions, and investment promotion. Problems include poor intra-institution and inter-institution coordination, with inadequate IT infrastructure adding to a persisting silo mentality; high turnover and low wages in the public administration, creating skills deficiencies, and a reactive, bureaucratic culture with frequent failures to understand or articulate the meaning of laws to business. The recent change in the structure of the public administration and the increased revenues accruing from mining provide a formidable opportunity to address these deficiencies.

On the legal and regulatory side, most laws are modern and foster an enabling climate for investment, but deficiencies remain in a number of areas. While reforms in planning and public governance are of principal significance, as discussed above, other areas of the legal, institutional and regulatory framework for investment require policy attention. These include:

1. company operations, with permitting and controls focused on sanctioning rather than ensuring compliance with the rules (see later in this section);
2. the regime for the entry of foreign skills, which does not foster the attraction and diffusion of skills necessary to the country's development (section C.2);
3. the minerals law, which needs to better protect public interest (section C.6); and
4. the concessions regime, where stricter project selection criteria are needed (section C.1).

The GoM is aware of these issues and several reforms are being considered to address them. In this context, the recommendations of this report are aimed at supporting existing and future initiatives. Other institutional and regulatory constraints were considered in chapter II and the recommendations are presented below:

Environment

UNDP's report on *Strengthening Environmental Governance in Mongolia* provided a range of prescriptions, some of which have recently been taken on board by the new administration. In particular, the mandate and structure of the Ministry in charge of environmental protection has been strengthened. Its capacity, however, is weak and there is need for training and retaining staff through career development strategies. To this end:

1. The MNEGD should adopt a corporate plan including new mission statement, goals, objectives and priorities.
2. The Local Government capacity to fulfil their environmental protection and management responsibilities should also be enhanced and coordination between the central and local level should be reviewed based on a detailed needs assessment.
3. In light of the specialized knowledge required in assessing EIAs and carrying out environmental

inspections, particularly in such hazardous areas as mining and oil exploration, the GoM should build the required expertise and review its decision to assign monitoring and inspection functions in the environmental area to GASI.

Inspections

Recognizing the deficiencies in the current inspections regime, the GoM has started working on new regulatory and institutional arrangements. It is recommended that the new regime takes the following into account:

1. Merging all inspections under one agency makes the existence of well-qualified staff with the training required to identify issues beyond their direct area of expertise a necessity. Significant capacity strengthening is required in this respect.
2. The streamlining of inspection activities will be incomplete until clear guidelines regarding safety and other standards are available to business, and obsolete requirements with no relation to safety are abandoned. Significant progress is expected in this regard from the implementation of a regime based on risk assessment.
3. The authorities should also consider ways to improve the coordination between GASI and the line ministries responsible for the environment as well as mining. This is essential to protecting public interest in a period of mining boom.

Competition

The peer review of competition law and policy discussed during the IGE 2012 presented detailed recommendations on how to strengthen the competition law enforcement in Mongolia. Among them, the most crucial ones included:

1. Building a competition culture and undertaking competition advocacy in the society as well as amongst politicians, Government officials, business and consumers;
2. Amending the law on competition and developing implementation guidelines and regulations to clarify key provisions on anticompetitive agreements, M&As, dominance, excessive pricing and others.
3. Amending public procurement rules and procedures to ensure greater competitiveness and transparency, including use of electronic bidding for Government orders;

4. Strengthening the independence of the AFCCP and expanding its investigative powers, particularly in dealing with cartels.
5. Improving the coordination between the AFCCP and the State Property Commission on privatization of entities controlled by the State and liberalization of regulated sectors, in order to avoid replacement of State monopolies with private ones and to ensure reasonable unbundling of State-owned companies and access to essential facilities so as to promote competition.
6. Fostering the participation of AFCCP in the development of licensing rules and criteria for granting concessions to ensure policy coherence with competition principles.
7. Providing capacity-building to the newly appointed members of the AFCCP Board and to the staff of the AFCCP to enable them to analyze and solve antitrust and complex competition cases.

Judiciary

1. Consider introducing specialized commercial tribunals and continue offering capacity-building on commercial justice.
2. Solicit the assistance of the International Chamber of Commerce in Paris and the Hong Kong International Arbitration Centre to train arbitrators for both long-established and new arbitration chambers.

Land

1. Clarify and streamline the legal provisions regulating access to land title by foreign investors, including land possession and utilization rights.
2. Complete the land registry digitalization process and encompass registration of cadastral information, including cadastral image of land use rights into the land database.

Customs

1. Maintain focus and efforts on regional cooperation and continue the customs modernization effort, including upgrading the facilities of border offices.
2. Reform the customs' regime to introduce risk management techniques and train officers.

C. Programmes for achieving diversification through FDI and other activities of foreign companies

Six sets of programmes are proposed to achieve the diversification objectives. In a number of cases the programmes are multi-faceted, focusing upon the attraction of FDI and other forms of TNC involvement, but also incorporating related initiatives designed to overcome some of the constraints facing potential entrants.

1. Tackling the infrastructure challenge

As outlined in chapter I, infrastructure and knowledge and skills are two of the principal policy challenges facing the economy and major determinants of FDI. They are also significant in that FDI in infrastructure and skills are crucial for improving the environment for all investment. Satisfactory progress in attracting investors to these sectors, and especially infrastructure, is fraught with difficulties; but the payoff, both directly in terms of eliminating bottlenecks facing the economy, and indirectly in improving foreign investor attitudes to Mongolia as a place to invest, are huge.

The current infrastructure development objectives of the GoM are primarily to support mining and industrialization (box II.1). The GoM places substantial weight on the private sector to undertake several of the top priority projects through concessions. However, while well-structured and well-implemented concessions can certainly contribute to infrastructure development and operation, private sector interest and involvement through PPPs is typically limited to commercially viable projects. In Mongolia, according to the NDS, 75 per cent of the total finance needed to implement infrastructural development objectives, which total around \$20 billion, is to be contributed by the private sector. However, as discussed in chapter II, the large majority of projects on the concessions list are not commercially viable.

Therefore, a priority for the GoM, in the years to come, should be to finance infrastructure development (roads, railways, public housing, schools, etc.) through the

vast resources generated by the mining sector. Other natural-resource rich countries, for instance Norway, Qatar or Saudi Arabia, provide good policy examples to increase competitiveness and growth opportunities beyond mining. At the same time, the mining boom has opened new infrastructure development opportunities related to the companies' need to access electricity, water and the international markets. The GoM should aim at leveraging these opportunities for the benefit of the population.

Furthermore, as indicated in chapter II, there are concerns over the method of prioritizing projects, and "priority projects" may be decided on patronage rather than economic analysis and development benefits. Developing an integrated strategic infrastructure plan and ensuring a rigorous project evaluation process without political interference are key ingredients of a successful PPP policy (box III.3). In this regard, a core recommendation (section B.2) of this report is for the strengthening of the planning agency and function, which will drive the country's national development strategy.

Box III.3. Best practices policy lessons for FDI in infrastructure

| Stage | Lesson |
|---|--|
| Laying the foundation for FDI in infrastructure | <ul style="list-style-type: none"> • Develop a strong legal and regulatory framework prior to the entry of FDI • Secure the capacity and skills to facilitate and regulate private investment in infrastructure • Empower high level task force to catalyze necessary reform • Develop an integrated strategic infrastructure plan identifying key needs • Proactively address community and stakeholder expectations |
| Promoting and facilitating the entry of FDI | <ul style="list-style-type: none"> • Create a 'pipeline' of pre-assessed, commercially attractive projects that can be actively promoted • Open the bidding stage to as many investors as possible • Ensure that contracts take into account key issues over the project lifespan • Help mitigate political and regulatory risks faced by foreign investors |
| Ensuring effective and efficient project implementation | <ul style="list-style-type: none"> • Monitor and follow-up on project implementation • Understand and pay attention to competition issues • Private and State-owned players can co-exist within a competitive framework |

Source: UNCTAD (2011)

Recommendations

Recognizing the challenges posed by infrastructure development, eight issues are of particular significance to foster private sector involvement and attract FDI into infrastructure:

1. Planning, project identification and prioritization require urgent reform (see section B).
2. The GoM should limit resort to concessions for commercially viable projects, rather than using PPPs as a tool of industrial policy. In this regard, introducing pre-feasibility evaluation of projects is required as well as more detailed operational guidelines regarding PFS. This would prevent
3. Infrastructure projects outside the scope of concession, but likely to generate development impact as tested in solid cost-benefit analysis, should be financed through the large revenue surplus from mining.

⁷⁸ Also see Korea Development Institute (KDI), 2011.

4. The GoM should also leverage mining-related infrastructure build-up for the common good, by ensuring that the relevant infrastructure or service can benefit the population, even if on a fee basis.
5. Clearly established systems are required for planning, promoting and implementing FDI attraction efforts. Box III.3 sets out international best practice lessons for FDI in infrastructure which should be pursued in Mongolia.
6. Governance issues, ubiquitous in the country, might be expected to be even greater in infrastructure where the finances involved are so large and opportunities enhanced by the size and complexity of projects. Apart from improving overall governance (section B) and transparency in decision-making, the GoM should introduce intermediate evaluation systems for infrastructure projects, such as total project cost management analysis.
7. Monopoly power: there are still powerful incumbent monopolies in some infrastructure sub-sectors. The country's efforts to inject competition must be supported by active enforcement of competition policy.
8. Experience and skills required for concessions: human resources capacity is (understandably) lacking and may account in part for the 'false starts' in a number of projects and sub-sectors. A strong task force, probably requiring expatriate sectoral experts, is a necessity (section C.2 following). In the area of PPPs, a substantial increase in the human and financial resources and capacity of the Division on Concessions of the MED is required to turn it into a specialized and fully independent concessions agency. In this regard, the examples of Chile and Peru, two countries with lengthy experience in the area, should be studied.

2. Building knowledge and skills

Mongolia's rapid development means that knowledge and skills will be a major determinant of the attraction of FDI and of the long-term success of the economy. As recognized by the NDS, FDI itself also has a significant role to play in building knowledge and skills. The basic challenges for Mongolia have been well-researched and include most fundamentally, first, the availability

of appropriate skills; and second, the level and quality of skills. The availability of skills will become an increasingly significant constraint because of the small size of the population and high levels of unemployment and job informality; it is also politically sensitive because of the increasing inward migration of low-skilled labour from neighbouring countries to work in the booming construction and mining sectors.

Professional skills are in short supply in several areas. These include:

- Financial services, including accounting and finance, auditing, legal, insurance. This sector is especially important in servicing the mining industry and in developing UB as a financial and business services hub (including through FDI attraction).
- Tourism, where international standards and practical training are required.
- Languages (especially English), which include various levels of requirement up to and including translation and interpretation.
- Information technology, identified by skills surveys as being a key weakness along with English language capabilities.
- Public administration. Chapter II highlighted a range of specific areas where commercial and IT training was required by the public sector, including inspections, property rights, governance, contract enforcement and bankruptcy, and arbitration; as well as mining and the environment.

Universities and other higher education institutions clearly have an important role to play in providing a skilled labour force which matches market needs. Data for Mongolia, however, indicate that universities are teaching-oriented and weak in research (publications and technology licensing) and the two are disconnected; university-industry links are also weak. In total, there are 49 public higher institutions and around 100 private institutions awarding degrees and diplomas. Generally, standards need to be improved and curricula reformed. Private provision boomed after liberalization in the early 1990s, reaching a peak of 200 but numbers are continuing to decline quite rapidly and many of the remaining institutions have few students and rely upon part-time professors. Although English is compulsory for all students, there are virtually no native English teachers.

In respect of FDI, there are a few foreign universities (from the Republic of Korea and chiefly the Russian Federation) but they have small numbers of students. One university from the United States has recently undertaken a pre-feasibility study, and there are growing numbers of collaboration programmes between foreign and Mongolian universities. According to the Ministry of Education and Science (MES), there is potential for Mongolia to become a regional education hub, offering improved quality education for students from the neighbouring Siberian region at a lower price.

Donor agencies (ADB, 2010; World Bank, 2010) have recently made fairly common proposals for reform, including concentrating resources and rationalizing based upon fewer higher education institutions of international standard; allocating funding on the basis of key performance indicators and labour market outcomes; strengthening accreditation and quality assurance mechanisms; and establishing a Tertiary Education Commission with multi-organization representation. With the support of other parties, the GoM has plans to build a campus town of 150,000 people outside of UB, which will include research institutes, a hotel and business parks.

Vocational skills are also in short supply and fail to meet the needs of the labour market. The quality and relevance of vocational teaching material is outdated and vocational specializations are obsolete. Technical and vocational education and training (TVET) is an area of emphasis for a number of donor agencies, through both emergency short-term skills upgrading programmes and increased longer-term provision. A new vocational education law has been passed, and an independent National Vocational Centre and Agency was established in 2009 with support from the MCC.

Recommendations

People quality programmes

Improving availability and raising standards of education and training at professional and university level requires a multifaceted approach, as follows:

a. Professional education and training: The requirements for professional skills are substantial but also very varied in terms of subject and level. In

meeting demand, in some instances short courses are appropriate; in others longer and more in-depth subject study is necessary, as provided, for example, by professional Diplomas and Degrees. As noted in chapter II, a substantial 'Employment Fund' exists in Mongolia derived from a levy on the hiring of foreign employees and is designed to finance employment generation initiatives, vocational training and small scale loans. It is proposed that this fund should be reoriented to assist finance an initiative in Mongolia with the following characteristics:

1. A professional and technical training institution established as an autonomous non-profit education and training college (following the examples discussed in box III.4). Ideally, this would be a new institution sited on the greenfield education campus being developed on the outskirts of UB.
2. Its main objectives would be to provide training courses, which may be standard or customized. Many would be short courses, but would include study for formal, internationally recognized professional and technical qualifications.
3. The focus would be on the critical areas identified above, namely, financial services, tourism, languages, IT and public sector skills. It would not, however, undertake vocational training activities.
4. In many areas of professional training, there are internationally-recognized professional institutes which would facilitate the achievement of international standards of qualifications. Partnership relationships could be established with such associations, whereby recognized courses are taught by a mixture of face-to-face, weekend schools and distance learning methods, and examined in UB. Examples include CIPFA (Chartered Institute of Public Finance and Accountancy) and CIM (Chartered Institute of Marketing), which are UK-based but have worldwide reach. In the early stages, reliance will be placed on part-time teaching contributions from expatriate and local staff in enterprises in UB. Different types of arrangements can be established, including assistance from donor agencies: an example in relation to public sector skills is a recent customized professional development course run by the Civil Service College of Singapore on anti-corruption training for judges.

5. English language training needs to cater for varying requirements, namely, speaking, writing, translation (e.g. Government laws and papers), and interpretation. For example, it will be possible to devise foreign language exchange programmes for language teachers. Again an attraction programme targeted at individuals with appropriate TEFL (Teaching of English as a Foreign Language) qualifications and experience is feasible. In addition, there are many recognized corporate providers, the largest being the Kaplan International Colleges network; but also providers, for example, from emerging markets like India where staff costs will be lower.
6. In proposing the development of an institute for professional education and training in Mongolia, consideration should also be given on a longer term basis for establishing separate institutes in the fields of hotels, tourism and hospitality, English-language training (especially for translators and interpreters), and even a Civil Service College.

b. University and college education: While there are already links with a number of foreign universities, a more ambitious possibility would be to attract a prime

business school to Mongolia. The market may be large enough to support such a business school, especially if it is a first step in promoting Mongolia as an international centre for business education focusing upon students from the Russian Federation. A number of foreign institutes are now setting up campuses in China, which are in effect self-contained expatriate communities, including shopping and leisure facilities. Expatriate staff is employed on home country terms with highly subsidized accommodation and other supplements, meaning high costs. Nevertheless other options exist, such as universities in Singapore and especially India, some of which are highly ranked in global league tables.

There are, however, a number of different modes of entry for foreign universities into global markets. This includes export modes (for example, distance learning products); collaborative modes through a range of association and partnership agreements; and joint venture modes. It is, therefore, proposed that the opportunities are investigated for establishing an agreement with a highly-ranked English-speaking university/business school, which will evolve in terms of commitment over time. Aside from promoting excellence, the reputation effects for Mongolia will be very strong.

Box III.4. Filling the skills gap: technical and professional training institutions

Countries have approached the challenges of multi-tier provision of professional skills and training in different ways. Good examples of technical and professional training institutions exist in a number of countries in Latin America. Common characteristics of such institutions are:

- Autonomous non-profit institutions created under the law to promote collaboration between the public and private sector.
- The objective is to cover a wide range of areas of industry and commerce (in Guatemala, sectors include IT, banking and insurance, textiles and meat technology).
- Both foreign affiliates and local companies use the institutions' training services which provide customized as well as standard courses. Education services may be qualification-based or designed to improve the capacity of employees.
- Successful completion of courses allows entry into the country's universities.
- Trainings are available across the country, via regional centres or mobile training units.
- Training activities are funded by a payroll levy on all private employers (in the Dominican Republic, it is one per cent payroll levy plus 0.5 per cent of employee bonuses; in Guatemala, it is a one per cent levy which is enhanced by government contributions, loans and service fees).
- In the Dominican Republic, the Board of the institution (INFOTEP) has a strong tripartite structure, including representatives of Government, business and labour. It is chaired by the Secretary of State for Labour.

Source: UNCTAD, IPR Dominican Republic and IPR Guatemala.

Skills attraction and Diaspora programmes

Other ways of remedying skills shortages include: the attraction of expatriate employees and other business talent, particularly from within the Mongolian diaspora. Two programmes are thus presented here: first, attracting foreign skills; and second, attracting diaspora skills and talent.

a. Attracting foreign skills: The starting point is to identify skills and competence requirements for the economy. Large numbers of immigrants have entered in recent years, to work in the construction and mining sectors. It is important to ensure that such workers enter legally and tighter controls over immigration are thus needed, together with effective registration and monitoring procedures and restrictions on accompanying family members. Also, companies employing workers without appropriate visas would be prosecuted. Given local shortages in these areas, however, the entry of expatriate employees for skilled professional, technical and managerial positions should be facilitated.

As proposed in chapter II, the current quota system and unwieldy permitting procedure should be replaced with a skills' attraction programme based on a 'scarce skills list'. This list, prepared by the Ministry on the basis of a periodic survey of the business and labour representatives, would determine the categories of foreign workers: i) who should be granted tightly controlled residence and work permits; and ii) who can be easily granted residence and work permits. Maximum annual numbers of foreign workers on the scarce skills list would be determined, but entrants within the quota should be granted temporary working and residence permits of at least three years or the total duration of the employee's contract, if shorter.

b. Diaspora skills and talent: The Diaspora initiative would focus on the approximately 110,000 Mongolians living abroad in over 30 countries, a significant number of whom might consider returning to their home country because of improved work and business prospects. Individuals and families will need advice and reassurance on the quality of life, social security, healthcare and education. This programme would have two components: first, to attract diaspora skilled workers into private sector companies in Mongolia; and second, to attract diaspora entrepreneurs with business ideas and capital.

Support for diaspora recruitment: This is designed to encourage local and foreign companies in Mongolia to address skills shortages by recruiting from the diaspora. Targeting of particular countries and sectors is required, which implies prior research on the diaspora populations and their skills. The Republic of Korea appears to be the largest destination, followed by the Russian Federation and Kazakhstan, then the United States and finally European countries; but information is limited. Attraction incentives vary. For example, Germany offers returnees tax relief schemes, 24 months compensation for differences in foreign salaries, and incentives to buy IT equipment. As with the business talent scheme following, pre-departure orientation programmes, and support for re-establishment in Mongolia could be offered.

Business talent scheme for the Diaspora: It is proposed that the current scheme which automatically permits work and residence for individual investors above a certain threshold be replaced by a business talent scheme targeted at diaspora business people. Such schemes focus on the business experience of applicants, and typically set minimum investment thresholds. In Mongolia, a minimum investment threshold of \$50,000 could be established to ensure the *bona fide* of the investment and the permit would be only issued upon presentation of a feasible business plan to the investment promotion agency. It would entitle investors and their families to residence and work permit for the duration of their investment. Adequate monitoring mechanisms to ensure that the investment has taken place within a set period of time should also be introduced. While such schemes are increasingly common, this programme differs in being available only to Mongolians in the diaspora.

Accompanying measures should be put in place to encourage the diaspora to establish and set up businesses in Mongolia. For example, pre-departure training should include setting up and doing business in Mongolia; together with measures such as duty-free import of personal belongings including office equipment; and support services for re-establishment in the country.

Implementation of the diaspora programmes should be the responsibility of the new investment promotion agency.

3. Developing financial and business services in UB

While the concentration of economic activity and population in UB is a challenge facing the country, the Capital city's role is absolutely vital to the success of the entire Mongolian economy. The city offers significant opportunities as a growth pole and in terms of financial and business services for the rapidly growing domestic market, building upon the requirements of the expanding mining industry. The NDS highlights the need to make efforts to transform Ulaanbaatar into a major banking and financial centre and FDI is vital to the successful exploitation of these opportunities.

The city is dynamic and increasingly modern with its wide range of shops, restaurants and consumer services driven by a growing middle class and rising incomes. FDI is growing as the city provides a base for the provision of an array of services for the mining industry. Foreign investment will continue in parallel with these drivers of expansion; but without policy direction it may be largely limited to construction and basic business and consumer services in the capital city, and the high value added opportunities may go unrealized. For example, unless UB makes proactive efforts to capture the opportunities in financial services, they may remain located abroad and imported.

The vision for Ulaanbaatar is that of a dynamic 21st century city, using as its model the leading cities of the world. Productivity growth and innovation in these cities are driven by high skills, effective institutions and quality infrastructure (Storper, 2010). With these core attributes, the classic advantages of such cities include accessibility, division of labour and competition, agglomeration benefits, positive externalities, and network effects from information exchange and the circulation of talent. Together, these factors can set in motion a process of cumulative causation, diversifying and strengthening the economic base, and producing a strong self-sustaining growth. UB does not have this internal stimulus, but it has the huge external stimulus from mining. While local service clusters exist, traded clusters are viewed as fundamental to building city competitiveness and growth; hence the development of financial and business services can indeed be a major aspiration for UB.

Ulaanbaatar faces major challenges — weather, as the coldest capital in the world (meaning *inter alia* difficulties of attracting needed skills); congestion within the city and poor transport links with the outside world; air pollution due to carbon-intensive activities and coal plants; plus growing levels of unemployment, crime and poverty. Major problems are associated with the recent large influx of nomadic herders and their location in slums in poor sanitary conditions on the outskirts of the city. Poorly educated and largely unemployed, they may be associated with rising crime levels in the city. Urban transport is facing significant problems too in respect of congestion, road safety and urban air pollution.

The financial and business services sector in Mongolia is quite underdeveloped. Despite the entry of some prominent players such as PricewaterhouseCoopers (one of the 'big four' accountancy firms worldwide), FDI remains limited. Within wider perspective on foreign corporate activities in Mongolia, ING and Standard Chartered have both recently established representative offices; and the London Stock Exchange has a contract with the Mongolian Stock Exchange (MSE) to revamp its regulatory framework, hardware and software and manage its development including privatization. There is optimism that the latter will make significant improvements in operations for the benefit of traders, brokers and companies listing on the market, and lead to improved reporting and transparency among companies. There are still institutional barriers to foreign companies listing on the MSE, ambiguity on the interpretation and administration of Mongolian laws and the discretion available to Government officials. It is expected that the entry into force in January 2014 of the long-awaited new Securities Market Law (adopted in May 2013) will contribute to addressing some of those issues.⁷⁹ Efforts are also being made to improve financial literacy among the population which will encourage interest in investing through the stock market.

The financial system is heavily dominated by banking, which accounts for about 95 per cent of assets in the sector. Other financial entities, such as insurance and fund management, make up the small balance. Mongolia's banking transition has been beset by crises in 1994, 1996 and 1998 as non-performing loans damaged the solvency of the system. In 2009, Anod Bank became

⁷⁹ The law was not made available for review in time for the publishing of this report.

insolvent and Zoos Bank taken into State ownership. However, the degree of prudence has increased in recent years, and the capital adequacy requirement in Mongolia is 15 per cent (the international standard under the Basel agreement is 8 per cent) according to the BoM. At present, the top three banks (Golomt, TDB and Khan) together have a market share of 85 per cent of assets. There is resistance by the local banks to the entry of a global TNC bank into the commercial banking business, and they appear to have the support of the BoM on competition grounds. However, the market is growing very rapidly — up 50 per cent from August 2010 to August 2011 — and competition issues should be dealt with under the Competition Law. Global TNCs would be more at ease doing business with a global bank, rather than with banks unknown to them.

As to future opportunities, there are reports of substantial interest by sovereign wealth funds, private equity and high net worth individuals in investment possibilities in mining and infrastructure. In interview discussions conducted by UNCTAD in Mongolia, FDI opportunities were highlighted in private and investment banking (although there were a number of foreign entrants together with local partners associated with the initial public offering of Tavan Tolgoi), asset management, trade finance, corporate lending, and bond market transactions. In particular, there appears to be potential in insurance, where the Mongolian firms are very small by international standards, do not have the finance to cover large international companies, and fees are high. The US insurance giant AIG was reportedly interested in entering the market before its collapse in the recent economic and financial crisis. The existing involvement of the LSE with the Mongolian Stock Exchange could lead to FDI involvement, thus opening the way for significant listings on the MSE for the first time.

Business services cover everything from legal, credit, consulting, design, advertising, market research and HRM services to warehousing, security, transportation and IT activities. There seems to be little FDI, except for a number of think-tanks and research organizations. Firms in these sectors will tend to follow the market in UB and many can be local enterprises.

There is also an expanding range of high quality property available. The market is generally working fairly effectively (although planning laws need to be tightened), and ICT connections are satisfactory.

Infrastructure and related services and knowledge and skills are deficient in financial services as elsewhere; and recommendations were presented in sections C.1 and C.2 on ways to tackle these through FDI and other forms of TNC involvement.

Recommendations

The objective is to develop financial and business services in Ulaanbaatar through an integrated programme. It begins by mapping the sector and identifying market opportunities and subsequently targets leading financial services clusters globally and specific companies. The opportunity for the foreign investor is to gain early mover advantages in a sector which will grow increasingly rapidly on the back of mineral resource exploitation and potentially, though on a much longer-term perspective, from international opportunities in neighbouring countries. It is recommended that the authorities proceed as follows:

1. Establishing a Financial Services Investment Group (FSIG) in partnership with the private sector to advise the GoM on general financial services issues and challenges, particularly in the areas of the legislative framework, infrastructure, skills and governance. This FSIG will report directly to the President on obstacles and barriers faced in the entry and growth process.
2. Funding industry-related consultancy to research and assess the dimensions of the financial services value chain in Mongolia, the analysis of market opportunities and the potential for FDI. Mapping the value chain is a first step in identifying service gaps so as to provide a full range of services. The value chain can be considered generically but will need to be broken down by subsector into different areas of, for example, banking and insurance:
3. Scenario planning on the future of UB and its infrastructure and skills requirements, involving the Ministry of Economic Development, think tanks in UB and universities;
4. Based on the outcome of the FSIG research, achieving buy-in and consensus from existing players and organizations, including the MNCCI, and BCM; and
5. Building high-level expertise in the appropriate ministry and in the IPA in order to carry out pro-

active investor targeting programmes based on the identification and targeting of specific financial services clusters and companies (e.g. City of London).

If successful, the project could continue in a second stage to evaluate opportunities for the regionalization of financial and business services, in line with the NDS stated objective of turning UB into a major banking and financial centre for the North-East and Central Asian Region. This would require a strong Government and agency involvement of the Ministry of Economic Development, both for planning and investment promotion functions and the Ministry of Finance/Financial Regulatory Authority, to ensure knowledge transfer. With the longer-term objective to have Government officials and executives who have specialist expertise; the financial services sector could be used as a pilot for extending this into other sectors with FDI potential.

4. Unleashing the potential of tourism

The tourism industry in Mongolia is still in its infancy, yet it makes a significant contribution to the economy. The country's vast landscapes offer enormous opportunities for growth and pro-poor development. The potential benefits for the country include:

1. Enhancing economic opportunities through jobs, revenues (and foreign exchange), new enterprises and skills, opportunities for rural communities, and funding for protected areas and local communities;
2. Protecting the natural and cultural heritage: conserve biodiversity and ecological processes; protect heritage resources; transmit conservation values;
3. Enhancing quality of life: encourage development of culture, crafts and the arts; encourage local people to value local culture and environment; and
4. Decreasing poverty by generating employment in tourism and related services.

Estimates of the size of the tourism industry differ, but a figure of around 10 per cent of GDP is often cited, including indirect and induced effects (WTTC, 2012). In 2010, exports from tourism were estimated at 8.2 per cent of total exports and the sector contributed to around 3 per cent of employment, while the Mongolian National Tourism Centre (MNTC) indicated 458,000 arrivals in 2011 generating in excess of \$200 million in

revenues (more pessimistic estimates indicate a number of tourist arrivals below 200,000). The major tourist sources, which have been fairly stable, are China, the Russian Federation, the Republic of Korea, the United States and Japan.

There are a variety of forms of foreign tourism-related operations in and with Mongolia. Key ones include Nomadic Expeditions, one of the first tour operators with FDI (box III.5); a planned joint venture (Shangri-la) and management contract (Hilton), plus current franchising arrangements (Ramada) in hotels; numerous small group activities including cycling, photography, and horse and camel riding (and usually including overnights in Gers) organized by foreign or local tour companies and booked directly online. Local companies are active, including Genco Tours in mass market tourism, with the giant Chinggis Khaan Statue and complex close to Ulaanbaatar, and more specialist products. According to the MNTC there are 500 tour operating companies, 320 hotels, and 300 tourist camps in the country in total.

Thus the sector is already a significant contributor to the economy and has considerable potential, and it has grown despite limited Government support. Assessment of the sector indicates that few of the best practice features of tourism organization and policy worldwide as described in box III.6 are being followed in Mongolia.⁸⁰

Government-related constraints

The main government-related constraints identified are as follows:

1. At the time of UNCTAD's fact-finding mission in October 2011, institutional arrangements were weak: the objectives of the Ministry of Nature, Environment and Tourism (MNET) appeared to be conflicting and incoherent; capacity was inadequate and turnover of staff as governments change reduced commitment. The Mongolian National Tourism Centre was established in 2009 as a state-owned, partially self-financing enterprise implementing the Government law on tourism by undertaking marketing and research, and has 11 staff in its UB headquarters. In 2011, it received funding of \$200,000 from Government for advertising (clearly limiting overseas promotion) and it has rent-free

⁸⁰ It should be pointed that a number of the constraints listed could be considered as attractive challenges for adventure tourists.

accommodation; otherwise finance is generated from organizing exhibitions and conferences, fees from hotels and tour operators, and from training. Funding and staffing are inadequate, and the MNTC lacks the capability to generate funds. With the adoption of a new Government structure in mid-2012, a new Ministry of Culture, Sports and Tourism (MCST) has been established. This should provide an opportunity to strengthen the institutional setting for the tourism industry (see below).

2. Agreement is lacking on the definition and nature of “tourism” in a Mongolian context, for example, between niche market and mass market tourism. The two are not irreconcilable, but there must be very clear demarcation lines in terms of objectives,

authority at Government and national tourism organization level, location of sites, environmental standards, and target markets and marketing.

3. Brand confusion exists at the national level with ‘Discover Mongolia’, ‘Majestic Mongolia’ and ‘Endless possibilities’ being among those used; while tourism operators employ their own advertising slogans because of the lack of uniform branding and promotion.
4. Around 30 NGOs have been involved in the establishment of National Parks in Mongolia, with their management being undertaken by the Ministry; they vary in quality and Ger camps located within some park boundaries are considered to have damaged the natural environment.

Box III.5. Environmental and cultural preservation: “Nomadic Expeditions”

Established in 1992, Nomadic Expeditions was the first tour operator with FDI in Mongolia. The founder and owner of the company, Mr. Jalsa Urubshurow, a Mongolian-American created the company with the purpose of promoting Mongolia as a sustainable tourist destination when the country transitioned from socialism and was still largely unknown to the American public. His work took on an almost philanthropic dimension and his office as a diplomatic liaison between Mongolia and the United States until an official representation was established. Today, Nomadic Expeditions’ primary business is organizing high-end adventure and nature tours in Mongolia and neighbouring Central Asian countries. In 2003, the company built the country’s first eco-friendly luxury *ger* camp, the “Three Camel Lodge” in the South Gobi province, which has since been consecutively voted among the world’s top 50 eco-lodges by National Geographic over the past five years.

Nomadic Expeditions upholds principles of environmental conservation and the preservation of cultural traditions as integral components of the sustainable and responsible tourism it promotes. The Three Camel Lodge, for example, has an environmental conservation partnership agreement with the Bulgan soum and the Gobi-Gurvansaikhan National Park. It serves as a base for scientific research and wildlife monitoring to fight against illegal animal poaching. The company also supports cultural events that in turn have become major tourist attractions like the Golden Eagle Festival that aims at preserving the Kazak minority’s heritage of hunting with trained eagles, and the Thousand Camel Festival to celebrate the herders’ traditional nomadic life and to raise awareness on the endangered Bactrian camel.

Due to the seasonality of tourism in Mongolia, Nomadic Expeditions only has 18 permanent full-time staff while the Three Camel Lodge has 14, of which over half come from the local soum. However, during the summer’s high season, the tour operator directly employs up to 200 temporary staff and the lodge an additional 40. Moreover, it is estimated that during the summer peak, the company supports roughly 1,000 indirect jobs. The eco-lodge in particular has had a significant impact on the local community as it is one of the few activities generating employment aside from mining and this allows the locals to remain in their homeland.

Nomadic Expeditions also initiated innovative projects to increase local sourcing and linkages. For instance, it has provided the initial investment for greenhouses which has enabled local agricultural production to triple and supply not only the lodge, but also other mining companies in the province. The company hopes to replicate the successful eco-tourism model and is in the process of obtaining permission to open two or three more lodges in the near future, an investment estimated at \$20 million.

Source: UNCTAD interview and corporate websites

Tourism company-related constraints

A number of tourism company-related constraints have been noted. The key ones include the following:

1. While there are many niche market operators in Mongolia, there appears to be little understanding or apparent lack of interest in Government circles concerning their development.
2. There is a requirement for improved training and service standards in the sector. About 40 educational institutions have specializations in tourism, together with a number of NGOs. But the quality of courses is perceived to be low and lacking in the development of practical skills. The sector is also facing competition for staff from the mining industry, especially English speakers; while seasonality reduces the attractiveness of employment.
3. Hotel capacity is insufficient in the peak season, although this will be alleviated somewhat when the Hilton and Shangri-La hotels open. The expected mining-related boom will require a rapid expansion of the business industry travel, both in Ulaanbaatar and in the mining regions.
4. Better environmental protection and general planning controls are required. There are concerns over the impact of mining on the environment, including in national parks and tourist attraction areas; and there have been allegations concerning high-level permitting corruption involving construction projects in National Parks.
5. There is a need to increase the quality and variety of gifts produced locally rather than importing them.
6. Entertainment is lacking in the capital city.

Box III.6. Best practices in tourism policy and sector's segmentation

Best practices in tourism policy and organization

- Trend towards national tourism organizations created as PPPs and acting as the lead marketing body in the industry. Tourism marketing is identified with a single unified agency. The Government's role is still regarded as significant in operating as a catalyst and coordinator for tourism development, with responsibility for policy, planning and inter-ministerial coordination.
- Clear links with private partners and, generally, close relationships and credibility with private sector bodies and companies.
- Creation of a strong, unified image and brand as well as marketing commitment, with buy-in from partners and stakeholders.
- Clear definition of marketing objectives and market segmentation, based upon the potential types of tourism and customer segments to be promoted. Balancing of mixed products broadens the national market opportunities, but can lead to conflict between Government and tourist companies.
- E-marketing and customer relationship management are central elements of promotion activities.
- Industry advocacy: need for the national tourism organization to support and advocate on issues critical to the industry's success.
- Training to improve standards and entrepreneurship, and to develop tourism as a 'career of choice'. Increased private sector participation to ensure skill applicability and transferability.
- Funding: sustainable funding sources for tourism marketing organizations are critical.
- Research: Typically performed by the national tourism organization, with findings disseminated among relevant parties.
- Development of key performance indicators: international/domestic tourism revenues; tourism balance of payments; share of GDP; international arrivals; nationality; length of stay; seasonal trends; principal existing markets and emerging markets; tourist satisfaction; direct and indirect job creation. And performance indicators for the national tourism organization: marketing expenditures; number of employees; overseas offices; marketing performance evaluation.

Typology of tourism market segments

- Niche market tourism:
 - Adventure tourism: incorporates an element of risk, physical exertion, or specialized skills; examples are backpacking, mountaineering, skiing, horse/camel riding.
 - Ecotourism: includes responsible / sustainable / pro-poor tourism; responsible travel to natural areas that conserves the environment and improves the welfare of local people.
 - Special interest tourism: includes a wide range of nature-based activities that rely on the natural environment for attractions or settings, such as ecology, wildlife, bird life, photography.
- Mass market tourism: tourism designed to appeal to a wide spectrum of the population. Only likely and desirable for domestic-oriented tourism and that from neighbouring countries and in carefully designated areas.
- Business and events tourism.

Source: Adapted from Eagles *et al* (2002); Lennon *et al* (2006); Deloitte & Touche LLP (2009).

Economic- and geography-related constraints

There are few economic geography-related constraints. The two most relevant ones are the following:

1. The tourism season is short because of harsh weather; so tourist companies have to diversify or develop all-year round products.
2. Both international and domestic air travel options are limited and expensive; and internal travel by

road involves long, uncomfortable journeys (see also section C.1).

There has been no survey of tourism sector since 2004, but at that time the most pleasant memories cited were: nature, landscape, people, and hospitality; as well as the open spaces, adventure opportunities, nomadic lifestyle, and festivals. Conversely, least pleasant memories were the quality of infrastructure, sanitary facilities, service

standards, and environmental issues. The MNTC commented that a new survey was planned for 2012.

Recommendations

The vision for Mongolia is for a growing tourism industry in which the natural environment and cultural heritage is protected and significant benefits accrue to the rural poor population. FDI has a significant contribution to make through investments by foreign tourism operators and hoteliers, and enhanced linkages to improve local supply sourcing, as well as through investments in the tourism infrastructure. There are possibilities for other modes of foreign operation too, including franchising and management contracts. Achieving this requires wide-ranging reform of the industry, beginning with a carefully crafted tourism plan and a strong institutional setting; these are prerequisites for improving the marketing of the ‘tourism product’, and stimulating tourism demand especially from developed countries.

As part of a pilot programme sponsored by the G20 to produce indicators for measuring and maximizing economic value added and job creation from private investment in specific industries, UNCTAD has recently carried out an indicator-based analysis of the tourism sector in Mongolia (UNCTAD, 2012c). The assessment reveals a sector which is at a nascent stage of development with many challenges to be overcome to exploit the very considerable potential, especially in the context of regional diversification and poverty reduction. As evidenced in section D following, the institutional foundations for planning and managing the public sector have been traditionally poor, and tourism is one area where particular challenges exist. The recommendations that follow are wide-ranging reflecting the all-embracing nature of the reforms and initiatives required, with a focus on the contributions which FDI and other foreign operations can make, and reflect the findings of the indicators’ approach:

Provide focus and support for tourism development and promotion

Tourism has traditionally been bundled within ministries with a multiplicity of mandates (first within the Ministry of Road, Transport and Tourism, then within the Ministry of Environment and Tourism). As a result of the lack of agreement as to the role of tourism within the economy, the tourism-related departments were often working in isolation, with little institutional support and

capacity. The current administration has also adopted an institutional vest which bundles tourism together with sports and culture. While there are apparent synergies to be exploited between the three functional areas of the new ministry, the Government should seek to avoid past mistakes and recognize the unique role that tourism could play in the country’s development, in terms of diversification of economic activity, capacity to bring economic benefits to remote and poorer regions, and preservation of Mongolia’s natural and cultural heritage. Tourism development and promotion should be assigned adequate funding and professional staff. The core competences and resources of the new ministry should be devoted to the implementation of the national tourism plan (see below). In this regard, strong Government involvement is essential to drive the development of sustainable tourism, together with strong relationships with the private sector.

Transform MNCT into a proper national tourism organization

The existing MNTC is clearly inadequate. It should be developed into the Mongolian Tourism Organization (MTO) and associated through a PPP with a foreign-owned tourist organization in line with the best practices identified above. The private sector partner will bring a market-driven and entrepreneurial philosophy and marketing and related capabilities. The MTO would be governed by a board of directors including representatives from the private sector partner and industry associations. The range of its activities would include marketing planning (including market research and market segmentation), advertising and promotion, advocacy and training, and possibly other activities, including statistics or product and infrastructure development. The funding and the level and form of private contributions to the MTO budget will need further consideration; but realistic levels of Government funding support are critical. In other countries, Governments provide contributions through budgetary allocations and from tourist-related taxes (for instance, sales tax, hotel bed-night taxes, and differential entry fees for foreign tourists in national parks and amenities).

Develop a comprehensive National Tourism Plan and Strategy

A draft Tourism National Programme for 2011–2016 and accompanying Strategic Plan were being considered

at the time of writing, setting out programmes for six different regions, a range of tourism products, tourism complexes and the development of associated infrastructure; FDI was considered to be important in implementing this strategy. This assessment indicated that this plan should comprehensively address the industry's challenges in the light of the best practices highlighted in box III.5.⁸¹ Central recommendations to be incorporated within the National Tourism Plan are:

1. The primary focus should be niche market products for international tourism.
 2. There should be a single brand message, and enhanced international promotions to both increase awareness of Mongolia abroad and encourage visitors.
 3. The National Parks should be the gems of Mongolia as they are in many other countries. Hence high standards, defined by international best practice, should be implemented. Planning rules and environmental standards must be strictly adhered to.
 4. The development of a tourism-friendly culture amongst all Mongolians. In implementing this, training and service standards must be improved in all customer-facing activities.
 5. A focus upon decreasing poverty by generating employment in tourism and related services; this means enhancing linkages which are very low at present.
2. Target niche market opportunities in adventure tourism; eco-tourism; and among a variety of special interest groups. Backpackers will most commonly book online, directly through Mongolian tour guides and agencies or sometimes their home country; hence website design is a critical issue, together with good English and fast response. The eco-tourism and special interest tourism groups will usually book through tour companies, and advertising in specialist journals will be appropriate.
 3. The expansion of business travel and the foreseeable growth of the hotel industry should encourage the Government of Mongolia to put in place a solid framework to facilitate and stimulate related investments, including luxury service provisions, leisure activities and other specialized services;
 4. Promote FDI in high-end tourist lodges and backpacker hostels or the equivalent Gers. Many visitors choose to stay in Gers in Mongolia, and foreign investment opportunities do exist, as shown in the case of Nomadic Expeditions (box III.6). Upmarket Gers can be developed to appeal to high-end tourism and "backpacker Gers" will also provide opportunities. Legislation could include an "eco-tourism" label for accommodation complying with strict rules on environmental protection.
 5. Evidence shows that linkages with foreign and domestic investors in tourism are very limited, with a high proportion of imported inputs. Alongside efforts to improve local supply sourcing, support should be provided to facilitate linkages between travel and tourism and Mongolia's leading economic sectors. In the case of mining, there is a potential to invest in additional leisure activities to offer to international staff and business travellers. Potential also exists in agriculture, with the quality upgrade of local food supply and services (see box III.5). Finally cashmere shopping can be promoted and directly linked to tourism as well as to other products and services supplied by nomadic herders, thereby enhancing the benefits from FDI (see also section C.6). For instance, a design input from specialists allied to training in the field should allow the production of local hand-made gifts for sale in villages and neighbouring hotels. New products could also be launched, for example, "A day/weekend with the Mongolian nomads" to learn about and become involved in

Grow FDI and foreign operations in tourism and increase linkages

Alongside existing foreign investments and other modalities of foreign operations, there are significant additional opportunities going forward:

1. Knowledge of Mongolia is quite limited and the country's image is weak, especially in developed, western markets. As discussed in section D, image-building as well as investment attraction-oriented promotion is essential. Improving the country's image and increasing visitors' number could have the added benefit of bringing additional investment beyond tourism.

⁸¹ The Republic of South Africa National Tourism Sector Strategy 2011 provides a potential model.

everyday nomadic life (UNDP, 2009). Improved SME access to finance is an important component of the support package required to establish and grow small successful tourism businesses.

6. Finally, there is an opportunity to increase the fiscal contribution of the “travel and tourism” sector to central revenues, currently limited at 0.7 per cent of GDP, and ensure that they benefit the populations in the location where the actual value generations take place, including the districts that host the *ger* camps.

At the national stakeholders’ workshop where this draft report was discussed, in March 2013, the MCST reported that it has started implementing several of the above recommendations.

5. Promoting niche market programmes

The livestock industry, encompassing meat, cashmere and leather, is extremely important for a diversification strategy for Mongolia since it supports large numbers of vulnerable, dispersed nomadic herders and rural communities and has significant job creation and economic growth potential. These sectors, and especially cashmere and meat which are the focus here, have been researched extensively by international donor organizations (UNIDO, 2006 and 2011; UNDP, 2009; USAID, 2007), and the ambitious programmes which they propose are highly desirable. Implementation is, however, long-term, highly costly and demanding in terms of human resource capabilities. To make progress, smaller scale initiatives are recommended here which can attract foreign interest, and by demonstrating success can be the launch pad for wider programmes.

The central problems which are recognized in research on the livestock industry concern, first, improving the quality of the raw materials through better standards and production facilities; and second, improving branding and international marketing, with the required improvements in these areas impacting the entire value chain.

In the case of meat, the challenges begin at the quality end, including poor quality assurance in meat plants, unsatisfactory meat handling from the meat plant to the market, and a single price paid for meat products regardless of quality specifications. The latter is exacerbated by a shortage of people who understand

meat quality specifications for demanding international markets, so severely limiting marketing opportunities. The recommendations are wide-ranging, including upgrading standards of meat plants, enhancing veterinary standards, and improving processes of production, handling, transportation and ultimately branding and marketing. There are proposals for the use of “Geographical Indications” (GIs) to build the reputation of Mongolian meat as natural and ecologically friendly (UNDP, 2010). The requirements for registration as GIs, while demanding are, however, the least of the challenge: the key is: 1) to ensure that adequate quality control systems are in place to back the GIs; and 2) to market the brands, which is an extremely costly and long-term exercise.

In respect of cashmere, there are proposals for a somewhat similar industrial strategy for the niche products of cashmere, yak hair, sheep wool, and camel hair. This is based around improving product quality, closing the technological gap in the processing of raw materials and, backed by a strong brand, aggressively promoting the products internationally (UNIDO, 2011). Recommendations begin with improving the quality of the raw material by empowering the herders, through, for instance, promoting regional cooperatives; and then the provision of support to producers through high-level testing laboratories and research institutes. Competition from China means that Mongolia has to enhance its own image, with a country brand being developed associated with specific characteristics of Mongolian cashmere. This would be associated with the proposed establishment of an international design institute in Mongolia, and by a series of international marketing initiatives.

Recommendations

The proposals recommended above are basically supported by this review. Integrated value chain programmes for meat in particular but also cashmere are necessary if the sectors are to achieve their potential in rural development and poverty reduction, as well as in international trade. The principle that Mongolian producers of these livestock-related products should be recognized for their quality and unique identity in international markets is accepted. Timescales are lengthy for such ambitious programmes, however, and very substantial funding will be required. Moreover

local capabilities appear to be particularly deficient in international business, and it is to this challenge that the recommendations here are directed.

Centre for International Research, Design and Marketing

There is the need to establish a Mongolian Centre for International Research and Marketing (CIRM) which will have capabilities in market research, design, branding, and international marketing to support internationalizing Mongolian enterprises. Its initial projects will relate to the meat and cashmere industries, but with capabilities to undertake projects for a variety of sectors and companies in the longer term.⁸² CIRM would be established to provide a centre of expertise in international marketing embracing all dimensions of the marketing value chain — from customer needs assessment and target market selection, through product/service design and development, to pricing, promotion and public relations. Included within this remit will be coordination with other initiatives in Mongolia regarding the introduction of European Union standards and norms.

CIRM would be formed with Government support, for example a specific allocation from the proceeds of mining; plus specific project funding (as with II and III following); and other finance from company and industry contracts and training. Recruitment of a number of key expatriate employees for key positions is essential. These may be secondees from international marketing consultancies, and part of their role would be that of capacity building within the Centre. These arrangements would be solidified by the establishment of a public-private partnership agreement with an international collaborator. For a foreign company, this would provide the opportunities to have a wide-ranging input into the internationalization of Mongolian business; these opportunities could prove similarly attractive to a local Mongolian partner.

Various interviews indicated that new opportunities existed for Mongolia in product areas such as herbal medicines and organic foods. The establishment of CIRM would provide a format for progressing such opportunities.

⁸² A Mongolian National Marketing Office has recently been established with the development of a national marketing strategy and national branding among its objectives.

Mongolian meat niche market branding and marketing programme

There are many knowledge deficiencies in respect of market opportunities and market requirements for Mongolian meat internationally. Hence the starting point would be an international marketing research study, funded by the Government and/or donors. The market characteristics to be researched include: a) potential markets and their attitudes to branded “Mongolian meat”; b) customer preferences for specific cuts, differentiated products (GIs), and potentially other segmentation characteristics;⁸³ c) pricing; d) packaging; e) hygiene, veterinary and other import barriers; f) distribution channels; and g) advertising and promotions to support branded sales. Assuming positive results from the market research, the follow-up would be a pilot export programme to the selected market and potentially specific meat retail outlets.

The second critical component of this initiative is its association with a particular meat plant(s). In return for support in implementing the pilot export programme, the Mongolian meat company would be required to undertake the required investment to bring the quality of the meat to export standards. Advertising and promotion would be very targeted and specific at least this early stage. The aim would thus be an iterative approach in which the meat producers and Government are partners in improving standards and in gaining a foothold in international markets.

Cashmere international marketing programme

The cashmere sector is different from meat in that there are already successful international companies, some marketing a number of their product lines through company brands. Examples include Gobi Cashmere LC; Goyo LLC, part of the conglomerate MCS group; and Altai cashmere operating within the conglomerate Altai Holdings LLC. Despite such company branding, the association of Mongolia with cashmere is still confused, and there is a need for an overriding Mongolian brand. The latter is especially important for Mongolian companies selling private label products. United States’ law requires that the country of origin (i.e. Made in Mongolia) should be shown on all imported clothing; but

⁸³ The focus on building consumer confidence and brand awareness is reflected in photos of the actual farmers being shown on packaged cuts of meat in supermarkets in some countries.

this not a current requirement in the European Union. The problems associated with the latter are evidenced by media coverage in 2011 of a United Kingdom company selling cashmere products from a large Mongolian producer labelled as “Designed in Scotland”.⁸⁴

The two branding-related issues to be tackled are thus, first, the use of the ‘Made in Mongolia’ label on all cashmere products, which should be possible through a Memorandum of Understanding with the European Union until legislation is changed. And, second, a Mongolian brand to be developed for export products, particularly important in cashmere to differentiate Mongolian from Chinese products. This needs to be consistent with the overall Mongolian country brand (as discussed in relation to tourism and to the investment promotion agency). In this regard, the Ministry of Industry and Agriculture, with the assistance of the Asian Development Bank, has started working on the development of brands for agricultural and textile products. A Mongolian Noble Fibre brand logo has been sent for registration to the Mongolian Patents Office.

The final element in the cashmere initiative is an international marketing and advertising campaign which should be planned through CIRM, and implemented in partnership with the new investment promotion agency (section C). Its aim would be to assist Mongolian producers of branded and private label products to enter and expand in international markets.

Certifications and quality controls

Mongolia has adopted a Trademark and Geographical Indications Law in 2003, and a Geographical Indication National Centre was since established under the MNCCI. The introduction of a GI-specific regulatory framework is encouraging. However, the success of GIs, branding and marketing strategies in securing or expanding international markets for Mongolian products will depend also on the existence of credible quality control systems backing the certification process, as well as mechanisms to ensure that producers of raw materials and inputs achieve and adhere to the standards required

⁸⁴ EU rules state that it is necessary to have a country of origin label if, without such a label, the consumer would be misled as to the true origin of the garment. Mandatory country of origin labelling received the overwhelming support of the European Parliament in a 2011 vote, and legislation may follow soon. The local company Eermel was also in the headlines because of its use of North Korean labour in its Mongolian factory.

for certification. This is true not only for livestock-related products, but also for other niche products with export potential, such as Mongolian vodka, organic foods, herbal medicines and cosmetics such as the Mongolian Sea buckthorn oil. A strong certification process would also make it easier to attract investment from both domestic and foreign companies in the relevant activities.

6. Promoting SME development and entrepreneurship for regional diversification

Promoting SME development and entrepreneurship is critical for the attainment of Mongolia’s diversification objectives. Local SMEs provide a key mechanism by which the benefits of inward FDI are maximized for the economy. By partnering with local firms including SMEs, TNCs can build networks of competitive local enterprises. The gains may translate into broader benefits and enhanced competitiveness for the economy through productivity spillover effects which contribute to upgrading value added activities, improved export performance and better employment opportunities. These spillover effects derive from linkages between foreign investors and supplier SMEs, which facilitate the diffusion of information, technology, skills and management practices. They also provide opportunities for suppliers to export and eventually to become overseas investors in their own right.

Backward linkages, which involve local firms supplying TNCs with parts, components and other goods and services are of special significance. Notably, various countries have developed supplier development programmes targeted at micro-, small- and medium-sized suppliers. The first objective of this section is thus to assist the development of Mongolia’s SME sector through linkages with TNCs.

Increasing the stock of SMEs through the creation of new small enterprises is equally significant for economic progress. Entrepreneurship, leading to business start-ups, requires individuals possessing the entrepreneurial competencies of risk-taking, innovativeness, proactiveness, networking and learning. Hence the second objective of this section is aimed at stimulating entrepreneurship in Mongolia. Together, SME development and entrepreneurship are

of fundamental importance for economic diversification and pro-poor development in Mongolia.

The third objective is directed at exploiting the potential of mining as a growth pole, through entrepreneurship and SME development including specific requirements to ensure long-term sustainability and environmental protection.

Mongolia's recognition of the importance of SMEs was reflected in the establishment of the Government Agency for Small and Medium Enterprises within the Ministry of Food, Agriculture and Light Industry (now Ministry of Industry and Agriculture) in 2008 (based on the SME Support Law of 2007). The SME Agency runs five Incubator Centres, two in UB, and three elsewhere in the country, each run by 3–5 staff. SME accommodation consists of 500 sq. metre units, and a two-year incubation programme is operated for 8-15 companies in each centre. Participating SMEs may be new starts or existing companies. The Agency also runs shorter training programmes which include self-employed persons, with around 1,500 trainees per annum. Separate from these incubators is the National Information Technology Park of Mongolia, which was established in partnership with the Government of the Republic of Korea in 2003 as a cluster approach to ICT development. This IT Park provides incubator services with an emphasis on promoting SME development in the area of IT offshore outsourcing. Aside from these developments, Oyu Tolgoi has its own incubators in South Gobi and East Gobi, established in 2010 and 2011.

Generally, while progress is evident, the capacity for support to SMEs and entrepreneurship remains inadequate and needs to be expanded considerably to make the desired impact upon diversification and sustainable development. The challenges concern the enhancement of linkages and the promotion of entrepreneurship within the mining areas and equally importantly, elsewhere in the country. A comprehensive entrepreneurship policy addressing the impediments to SME development is still missing. For instance, in planning for smaller firm development as a diversification strategy, there are still significant challenges to be overcome, as discussions with the SME Agency highlighted:

- In May 2011, the GoM issued a law to give priority to SMEs in procurement by SOEs; but companies have indicated problems in terms of capacity and ability of SMEs to reach the required production and quality standards. For example, Oyu Tolgoi was seeking to purchase 2,000 pairs of gloves from a local SME, which, unfortunately, could only produce 200 pairs.
- Product distribution channels are weak, especially in agriculture (e.g. potatoes).
- There is a lack of exhibition facilities where buyer-supplier relationships can develop.
- Training is required to enable SMEs to reach international quality and technology standards. SMEs face the same barriers as their larger counterparts, including bureaucracy and corruption, high costs of financing, a banking system that lacks the capacity to lend to SMEs, and ineffective support systems.
- At a wider level, demand from the mining and related sectors is pushing up prices and wages (especially for English-speaking labour) and crowding-out non-mining private sector activity. It is also leading to an influx of foreign workers, most noticeably in the south of the country.
- Access to finance is a big issue.

Recommendations

The programmes which follow address specific issues relating to the role of SMEs in enhancing the benefits of FDI. However, a number of the implementation challenges raise issues which are common to SMEs across Mongolia. They should be addressed in a comprehensive manner. In this regard, UNCTAD's recently published Entrepreneurship Policy Framework (UNCTAD, 2012d) provides governments with useful advice and implementation guidance. First, one of the major constraints facing all SMEs is improved access to finance which is a requirement for small- and medium-sized enterprises in tourism as well as in livestock and agriculture, and mining. Second, is the capacity of the SME Agency to take on the additional responsibilities which will inevitably arise in handling a growing small business sector in both rural and urban areas.

Linkages programmes for SME-TNC collaboration

Mongolia has made encouraging initial progress in supporting and growing its SME sector, particularly

through its establishment of a number of Incubator Centres. Training is included as part of the incubator package for SMEs, with consultancy assistance from JICA in the areas of business planning and marketing. Going forward, the Incubator Centre concept needs to be expanded considerably across Mongolia, with more proactive assistance to selected individual or sectoral groups of SMEs through external consultancy assistance.

The linkages programme which is recommended here has much more ambitious objectives, seeking to improve the capabilities of Mongolian SMEs to supply inputs to TNCs which would otherwise have been imported; this is achieved through the establishment of long-term relationships between SME suppliers and TNCs, and measures to enhance the absorptive capacity of participating SMEs. The linkages programme should seek to incorporate a number of activities in order to maximize its benefits:

1. Supplier/buyer identification through an information database on linkage opportunities, or by matchmaking through organizing exhibitions and fairs.
2. The development of a selection mechanism to ensure that only enterprises meeting selected criteria are selected; and that both parties are involved in the selection process.
3. Training which may be undertaken directly by government financing of external consultants; or preferably by the TNCs themselves (some countries provide tax credits or tax deductions against costs incurred in training).
4. Transfers of technology are dependent upon the SMEs' absorptive capacity, so skills development becomes critical, as do research programmes undertaken by the firm itself or in collaboration with universities or its partner TNCs.
5. Information sharing, including in respect of future orders and technical requirements.

With appropriate resources, the SME Agency could take responsibility for a Linkages programme(s) in Mongolia, providing the policy platform for SME selection and Government sponsoring. Support from the MNCCI will be valuable since it already promotes buyer-supplier matchmaking and holds a database of local suppliers (mostly for the mining sector). A holistic

approach to fostering linkages requires that DFIRR should pay attention, in investor targeting, to TNCs that have a strongly developed culture and capability for developing their suppliers in host countries. A strong base of competent suppliers can also be a significant determinant of FDI decisions by TNCs. As part of the aftercare functions of its new mandate (section C.5), the new Investment Promotion Agency would also present established TNCs with supplier information and matchmaking opportunities.

Lessons and advice on linkages programmes are available in a number of UNCTAD publications; and further technical assistance may also be provided by UNCTAD which has extensive experience in the successful development of linkage programmes in emerging economies.

Entrepreneurship and SME development for regional diversification

The recommendations above indicate a requirement for enhancing the number of Incubator Centres around the country. However, there is still a significant gap within Mongolia in the area of practical training of entrepreneurs. UNCTAD operates an integrated capacity-building programme, Empretec, which is recommended for introduction in Mongolia. Its major contributions derive from the programme's history and international reach, and from the use of international trainers who provide inspiration, ideas and knowhow from around the world. Drawing on the establishment guidelines in box III.7, the following is proposed:

1. The Empretec Centre will be based in Ulaanbaatar, largely for logistical reasons. However, Training Workshops will also be held across the country to reflect demand and need, and to support the regional diversification policy objective.
2. Discussions will be held with potential national partners, who are typically candidates in respected position within the business community and active involvement in promoting private sector development.
3. Empretec Centres internationally have freedom to develop programmes to meet the specific requirements of individual countries. For example, Empretec training has been adapted for use with communities and groups with low education levels,

to develop curricula at school level, and to assist large companies seeking to develop managerial “intrapreneurship”, or the creation of a conducive environment that allows the development of internal entrepreneurs within an organization. Most obviously the Empretec Centre in Mongolia should provide support for sectoral programmes recommended in this review. For instance, a programme for women

entrepreneurs in tourism or a programme for rural entrepreneurs could be valuable.

4. The Empretec Centre should operate in collaboration with the Linkages Programme proposed above. Indeed in some countries, Empretec provides specialist seminars and training courses for Linkages Programmes, focusing upon the technical and entrepreneurial skills required to achieve successful partnerships between SMEs and TNCs.

Box III.7. EMPRETEC: inspiring entrepreneurship around the world

The Empretec programme, operated by UNCTAD is an integrated capacity-building programme implemented through its national centres, which are currently in operation in 34 countries. Established in 1988, Empretec has successfully trained over 200,000 people, including potential entrepreneurs with promising business ideas, start-up companies with good bankable project proposals, and existing SMEs that have a track record of good business performance. Its trainees include aspiring entrepreneurs, women entrepreneurs, young people and employees of large public or private firms.

Empretec’s core programme is its Entrepreneurship Training Workshop designed to strengthen and enhance the entrepreneurial competencies of participants to be able to apply them in their own planned or existing businesses. Training Workshops offer different levels of instruction, with courses up to 10 days in length and interactive coaching based on the real business challenges of participants. Workshop fees vary from country to country, depending on local conditions and the availability of donor funding. Training is delivered by 600 local certified trainers and by a pool of 60 international master trainers.

The Empretec programme is established following an official request from a member state. UNCTAD then approaches the donor community to raise the necessary funds for start-up. With funding identified, approaches are made to potential national partners specializing in entrepreneurship and small business development. Implementation then requires: i) Selection of the national partner; ii) Selection of Empretec director/coordinator; iii) Use of experienced international master trainers to advise on programme sustainability and to train local trainers; iv) Establish an executive board drawn from the private and public sectors to provide strategic direction and ensure coordination among stakeholders.

Source: UNCTAD (2010)

Utilizing mining as growth pole

The potential multiplier effects of mining are substantial, with every \$1 in mining estimated to create \$1.84 in other sectors (NDIC 2011). This is realized first through the growth of related hard and soft infrastructure in energy, construction, and transportation involving railways, roads, and airports in rural areas. Second, the effects come from services growth, including finance, customs, education, and administration, and third, population movement to mining areas generating a requirement for housing, schools and hospitals.

Significant domestic supply chains could be generated through SME linkages with the mining TNCs (UNDP, 2009). The potential exists for SMEs to provide the basic goods and services of food, clothing (boots, hats,

gloves, glasses), catering, retailing and entertainment in the mining localities. The development of a mining support industry also offers significant opportunities for private firms in quarrying, haulage, equipment maintenance and repair, chemicals supply and utilities; and the provision of protective equipment for safety purposes. In addition, consulting services are needed in geological and environmental management.

Some of the above business opportunities require specialized and expensive equipment, many others depend less on finance than on entrepreneurial skills and drive plus accommodation and business training. Mining thus offers opportunities for regional diversification, given the location of the mines, primarily in southern Mongolia, with the challenge being to create self-sustaining communities going forward.

Based on the analysis of the mining sector policies in chapter II, best practices in the mining sector as discussed in UNCTAD (2011), and the objectives discussed above, this section proposes a policy approach for mining, which includes SME- and entrepreneurship-focused community development in the mining regions, and thus assist in the implementation of the vision of mining as a growth pole. It is hoped that these recommendations can inform the current efforts to revise the mining legislation:

1. To reduce speculation in the acquisition of exploration licences, the authorities should consider introducing technical and financial capacity requirements on the exploration licence applicant, as well as surrender requirements and/or increased licence fees.
2. Following international best practice, the grant of extraction licences should include requirements for submission and approval of:
 - Adequate technical and financial capacity of the licence applicant;
 - A good-practice mine plan (which among other things sets out the cut-off grade to prevent “high grading”);
 - A health and safety plan; and
 - A full reclamation/rehabilitation plan.
3. The grant of extraction licences should also include a community development programme, including local supplier development and an employment and skills development plan based on a formal social impact assessment. The plan would provide investors with a more structured approach to corporate social responsibility. It would also contribute to the socio-economic diversification of affected rural communities, thus reducing the migratory pressure on UB.
4. Land rehabilitation and restoration provisions should be brought in line with good international practice.
5. A specific Linkages Programme(s) should be designed and implemented in the mining areas. The challenges in mining relate to the fast pace of development and level of demand, making it difficult for SMEs to supply the mining TNCs, even when the latter are favourably disposed. With the design of a Linkages programme as recommended above, TNCs would provide outline details of plans and associated sourcing requirements to their partner suppliers and, thereby, enable SMEs to plan ahead with some certainty. Market mechanisms must be allowed to work so that TNC purchases are conditional on appropriate price, quality and delivery schedules, and competition should be encouraged. It is recognized that many supplier linkages will be limited to the provision of basic goods and services to mine sites, and machinery and equipment inputs will continue to be predominantly sourced from abroad. However, the linkages programme could be designed with an associated import substitution objective, with the potential, therefore, of developing higher value added linkages over time.
6. Government financial relocation assistance should be provided to entrepreneurs willing to move to mining areas, with loans available on attractive terms (adapting the loan scheme available through the SME Agency at present).
7. The Empretec Centre programmes should be offered in mining areas for free or at subsidized rates, as part of the community development programme. And technical and managerial skills training would also be available to SMEs participating in linkages programmes.
8. Public participation in mining-related decision-making should be improved by a formalized consultation process in the context of scoping and discussion of EIAs.
9. Concerns regarding the recent trend of increased State participation in mining largely relate to the risks and uncertainty in the legislation regarding the definition of “strategic deposits”, and the mechanisms for determining the State share in them. These should be addressed by adopting a much clearer definition of the stake reserved to the GoM in different types of mining operations. Government participation in the sector is a growing phenomenon worldwide⁸⁵ but while it is legitimate for the State to seek participation in the exploitation of its mineral resources, as it is frequently the case in the oil sector, it is also essential that this be done in a way that can be clearly budgeted in the business

⁸⁵ Recent examples are the renegotiation of mining rights in the Democratic Republic of Congo, the compensation for exhaustion of national patrimony in South Africa and the planned creation of South Africa’s state-owned mining company, the higher taxation on mineral profits in Nevada, United States of America, as well as Zambia and Uganda.

plans of the mining companies and that it does not dent their returns on the investment to an extent that would make their operations unprofitable.

10. The staffing, expertise and institutional capacity of the MNEGD and MoM should be upgraded significantly, including by assigning them independent inspecting capabilities, in order to ensure the proper regulation

and supervision of a sector on which the country's future is so inherently dependent.

On occasion of the discussion of the draft version of this report at a national stakeholders' workshop in March 2013, the MoM indicated that several of the above recommendations would be informing the ongoing revision of the Minerals Law.

D. Summary of IPR recommendations

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|--|--|----------------|--------------|---|------------------|
| 1. New objectives and tools of a comprehensive FDI strategy | | | | | |
| <i>Foreign Investment Law (FIL)</i> | 1.1 Upgrade the FIL in line with the liberal treatment offered in practice and remove the pre-establishment screening of FDI. | ★★★ | ST | Adopt a new Investment Law | MED |
| | 1.2 Abolish the need for investment certificates and replace them with the State registration process under GASR. | ★★★ | ST | Adopt a new Investment Law, and amend other relevant laws | MED |
| | 1.3 Replace the minimum deposit requirement with a negative list of sectors closed fully or partially to foreign investors. | ★★★ | ST | Adopt a new Investment Law | MED |
| | 1.4 Improve the methodology for the collection of FDI statistics and introduce a mandatory survey on business. | ★★★ | S-MT | Adopt a new Investment Law | MED |
| | 1.5 Limit resort to stability agreements to mining and other sectors characterized by high capital and sunk costs. | ★★ | S-MT | Adopt a new Investment Law | MED |
| <i>Law on the Regulation of Foreign Investment in entities operating in strategic sectors (SEFIL)</i> | 1.6 Replace the comprehensive pre-establishment screening with a proper national security test, including: | | | | |
| | 1.6.1 A clear definition of the national security objectives and review criteria; | ★★★ | | | |
| | 1.6.2 Replacement of all other screening criteria with the regular permitting process at the post-establishment phase; | ★★★ | | | |
| | 1.6.3 A better definition of the type of investors and investment to which the test applies, including removal of public interference in day-to-day business transactions; | ★★★ | ST | Adopt a new Investment Law/Amend SEFIL | MED |
| 1.6.4 A revised list of strategic sectors reflecting the official objective of becoming a regional services hub. | | | | | |

Notes: Priority level from ★ = not urgent to ★★★ = very urgent; S-M-LT = Short-Medium-Long term.

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|---|--|----------------|--------------|----------------------------|-------------------------|
| <i>Mongolia's Investment Promotion Agency (IPA)</i> | 1.7 Assign DFIRR a new mission and a new name as the lead institution for promoting FDI and internationalization, and structure it as an independent, public sector-funded and private sector-oriented agency. | ★★★★ | S-MT | Adopt a new Investment Law | MED |
| | 1.8 Remove all regulatory functions, including screening and registration and assign proper investment promotion and facilitation functions, including image building, investment generation and facilitation, aftercare and policy advocacy. | ★★★★ | S-MT | Adopt a new Investment Law | MED |
| | 1.9 Staff the agency with professional and experienced personnel, including secondments of young executives from private sector. | ★★★ | S-MT | n.a. | MED |
| | 1.10 Establish regional IPA offices to support FDI attraction outside UB. | ★★ | M-LT | n.a. | MED |
| | 1.11 Provide the IPA with secure and adequate financial resources to effectively deliver its mandate. | ★★★ | ST | n.a. | MED |
| 2. Regulatory and institutional reforms for foreign and local private sector development | | | | | |
| <i>Public sector reform</i> | 2.1 Adopt a public sector reform strategy. | ★★★★ | M-LT | n.a. | GoM |
| <i>Planning</i> | 2.2 Redesign and strengthen planning and policy coordination. | ★★★★ | S-MT | Amend relevant legislation | MED |
| <i>IAAC</i> | 2.3 Provide adequate resources and capacity building in the form of specialized training for management and technical staff of IAAC. | ★★★★ | S-M-LT | n.a. | IAAC |
| <i>Environment</i> | 2.4 Adopt a corporate plan, including new mission statement, goals, objectives and priorities for MNEGD. | ★★★★ | S-M-LT | n.a. | MNEGD |
| | 2.5 Clarify and streamline the environmental monitoring functions and mandate which are now spread across different agencies. | ★★★★ | ST | Amend relevant legislation | MNEGD |
| | 2.6 Enhance the capacity of local governments to perform the assigned environmental mandate. | ★★★ | MT | n.a. | MNEGD/Local Governments |
| <i>Mining</i> | 2.7 Significantly upgrade the mandate, staffing, expertise and institutional capacity of the Ministry of Mining. | ★★★★ | S-M-LT | Amend relevant legislation | MoM |
| <i>Competition</i> | 2.8 Strengthen the independence of the AFCCP, provide training to the staff and increase its investigative powers. | ★★★ | M-LT | n.a. | AFCCP |
| | 2.9 Clarify the competition legislation on anticompetitive agreements, M&As, dominance, excessive pricing. | ★★★ | S-MT | Amend the competition law | AFCCP |
| | 2.10 Amend public procurement rules and introduce use of electronic bidding for Government orders. | ★★★ | S-MT | Amend relevant legislation | AFCCP |

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|------------------------------|---|----------------|--------------|--------------------------------|-------------------------------|
| <i>Judiciary</i> | 2.11 Consider introducing specialized commercial tribunals and continue offering capacity-building on commercial justice. | ★★ | S-M-LT | n.a. | Judiciary |
| | 2.12 Solicit the assistance of the ICC in Paris and the Hong Kong International Arbitration Centre to train arbitrators. | ★★ | ST | n.a. | Judiciary |
| <i>Customs</i> | 2.13 Continue the customs modernization effort and improve facilities at border points. | ★★★ | S-MT | n.a. | Customs |
| | 2.14 Maintain focus and efforts on regional cooperation, train officers and introduce risk management techniques. | ★★ | S-M-LT | n.a. | Customs |
| <i>Inspections</i> | 2.15 Implement the planned reform of the inspections regime and issue clear guidelines on standards for business. Provide capacity-building support to GASI. | ★★★ | S-MT | n.a. | GASI |
| | 2.16 Improve the coordination between GASI and the ministries in charge of the environment and mining. | ★★★ | S-MT | n.a. | GASI |
| <i>Land/other registries</i> | 2.17 Complete the digitalization process and explore the possibility to connect the tax, land and company databases. | ★★★ | S-MT | n.a. | GASR/Land/ Tax |
| | 2.18 Require registration of cadastral information, including cadastral image of land use rights into the land database. | ★★★ | S-MT | Amend the relevant legislation | Land |
| <i>Concessions</i> | 2.19 Clarify and streamline the legal provisions on access to land title by foreign investors, including land possession and utilization rights. | ★★★ | S-MT | n.a. | MED/Land |
| | 2.20 Substantially increase the human and financial resources and capacity of the Division on Concessions and turn it into a specialized concessions agency with full functional independence. | ★★★ | S-M-LT | n.a. | PPP Department/ MED |
| <i>Public Governance</i> | 2.21 Implement the e-signature law and introduce UNCTAD's e-Regulations programme. | ★★ | ST | Adopt new law | DFIRR, GASR, GASI, IAAC |
| | 2.22 Harmonize the relevant laws with the UN Convention Against Corruption and improve the implementation of existing anti-corruption and transparency laws. | ★★★ | S-MT | Amend the relevant legislation | IAAC |
| | 2.23 Improve public access to commercial registries and to the information needed to conduct due diligence analysis. | ★★ | ST | n.a. | IAAC |
| | 2.24 Introduce Client Service Charters for the new IPA and the departments of the line ministries that service investors. | ★★ | S-MT | n.a. | DFIRR |
| | 2.25 Consider removing parliamentary immunity for corruption cases. | ★★ | MT | Amend the relevant legislation | GoM |

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|--|--|----------------|--------------|--------------------------------|------------------|
| | 2.26 Enact comprehensive legislation on whistle-blower protection. | ★★★ | S-MT | Amend the relevant legislation | GoM |
| | 2.27 Establish special anti-corruption courts. | ★★★ | S-MT | n.a. | Judiciary |
| | 2.28 Mandate the responsible public institutions for analyzing and verifying the information contained in the assets and income declarations of public officials and for passing it to IAAC. | ★★★ | S-MT | Amend the relevant legislation | IAAC |
| | 2.29 Apply stricter sanctions, such as forfeiture of undeclared property, for violating the assets and income declaration requirements. | ★★★ | ST | Amend the relevant legislation | GoM |
| | 2.30 Establish a Parliamentary Accounts Committee, a Parliamentary Investments Committee, and internal audit units in public ministries. | ★★★★ | ST | n.a. | GoM |
| 3. Programmes for achieving diversification through FDI and other activities of foreign companies | | | | | |
| | 3.1 Limit resort to concessions for commercially viable projects with social and economic benefits, and require pre-feasibility studies (PFS) for all projects entering the concessions list. | ★★★ | MT | Amend PPP law | PPP Department |
| | 3.2 Elaborate more detailed operational guidelines for PFS and introduce intermediate project evaluation systems. | ★★★★ | S-MT | n.a. | GoM |
| <i>Infrastructure</i> | 3.3 Employ the large forthcoming revenue surplus from mining to finance infrastructural projects with no direct commercial interest. | ★★ | S-MT | Amend PPP law | PPP Department |
| | 3.4 Leverage mining-related infrastructure build-up. | ★★★ | S-MT | n.a. | PPP Department |
| | 3.5 Require approval of the Division on Concessions for all concession projects. | ★★★★ | S-MT | Amend PPP law | GoM |
| | 3.6 Establish a vocational and technical training institution/college following international standards and partner with recognized foreign vocational institutes. | ★★★ | MT | n.a. | MoL/MES |
| <i>People quality programme</i> | 3.7 Devise English language exchange programmes for language teachers and an attraction programme for TEFL-qualified teachers. | ★★★★ | S-MT | n.a. | MES |
| | 3.8 Consider establishing separate institutes in the fields of hospitality and tourism, English-language training, and a Civil Service College. | ★★★ | M-LT | n.a. | MES |
| | 3.9 Target collaboration with a world-class business school. | ★★ | S-MT | n.a. | MES/DFIRR |

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|--|---|----------------|--------------|-------------------------|-------------------------|
| <i>Skills attraction programme</i> | 3.10 Tighten controls over immigration of low-skilled workers. | ★★★★ | ST | Amend relevant laws | MoL/ Immigration |
| | 3.11 Replace the current quota system with a 'scarce skills list'. | ★★★ | MT | Amend relevant laws | MoL/MES |
| | 3.12 Introduce pro-active diaspora programmes for high skills workers. | ★★★ | S-MT | Amend relevant laws | MoL/DFIRR |
| | 3.13 Introduce a business talent scheme for Diaspora entrepreneurs. | ★★★ | S-MT | Amend relevant laws | MoL/DFIRR |
| <i>Financial and business services</i> | 3.14 Establish a Financial Services Investment Group to advise Government on general financial services issues and challenges. | ★★★ | MT | n.a. | MED/Ministry of Finance |
| | 3.15 Carry out a comprehensive mapping of the sector, assessing the constituents of the value chain and identifying service gaps. | ★★★ | MT | n.a. | MED/Ministry of Finance |
| | 3.16 Conduct scenario planning analysis on the future of Ulaanbaatar and its infrastructure and skills requirements. | ★★★ | MT | n.a. | MED/MoL/ Universities |
| | 3.17 Identify and target specific financial services clusters and companies, based upon value chain requirements. | ★★★ | M-LT | n.a. | DFIRR |
| | 3.18 Evaluate opportunities for the regionalization of financial and business services. | ★★★ | M-LT | n.a. | MED/FSIG |
| | 3.19 Revise the draft National Tourism Plan to focus on niche market products for international tourism, adopt a single brand message, define standards for national parks and enhance linkages. | ★★★★ | MT | n.a. | MCST |
| <i>Tourism</i> | 3.20 Assign adequate funding and professional staff for tourism development and promotion. | ★★★ | MT | n.a. | MCST |
| | 3.21 Transform MNCT into a Mongolian Tourism Organization (MTO) in PPP with a foreign-owned tourist organization. | ★★★★ | MT | n.a. | MCST |
| | 3.22 Target FDI in niche markets, improve online booking, develop country brand and advertise in specialist journals. | ★★★ | S-MT | n.a. | MCST/DFIRR/ MTO |
| | 3.23 Promote FDI in high-end lodges and backpacker hostels (or equivalent Gers) and introduce an 'eco-tourism' label. | ★★★ | S-MT | n.a. | MCST/DFIRR/ MTO |
| | 3.24 Improve local supply sourcing and promote products and services supplied by nomadic herders. | ★★★ | MT | n.a. | MCF/DFIRR/ SME Agency |
| | 3.25 Establish a Centre for International Research and Marketing. | ★★★ | S-MT | n.a. | MED/MoF |
| | 3.26 Carry out an international marketing research study for meat. | ★★★ | S-MT | n.a. | MoF/CIRM |
| | 3.27 Introduce the 'Made in Mongolia' label on all cashmere products. | ★★★ | MT | n.a. | MoF/DFIRR/ CIRM |
| 3.28 Carry out an international marketing and advertising campaign. | ★★★ | MT | n.a. | MoF/DFIRR/ CIRM | |
| <i>Niche markets</i> | | | | | |

| Issue | Recommendations and actions | Priority level | Time horizon | Regulatory implications | Lead agency(ies) |
|--------------------------------|--|----------------|--------------|-------------------------|--------------------------------|
| <i>SME development</i> | 3.29 Expand the regional coverage of the business incubators' programme with more proactive assistance to selected individual or sectoral groups of SMEs. | ★★★ | MT | n.a. | MED/SME Agency/ MNCCI |
| | 3.30 Introduce a supplier linkages programme, to promote skills and technology transfer to local SMEs and raise their compliance with international quality standards. | ★★★ | S-MT | n.a. | DFIRR/SME Agency/ MNCCI/BCM |
| | 3.31 Establish an EMPRETEC Centre in Ulaanbaatar. The Centre will provide support for programmes in target sectors and will operate in collaboration with the Linkages Programme. | ★★★ | S-MT | n.a. | MED/DFIRR/ SME Agency |
| <i>Mining as a growth pole</i> | 3.32 Introduce technical and financial capacity requirements on the exploration licence applicant, as well as surrender requirements and/or increased licence fees. | ★★★★ | ST | Amend the Minerals Law | MoM |
| | 3.33 Subject the grant of extraction licences to approval of: a) The technical and financial capacity of the licence applicant; b) A good-practice mine plan; c) A health and safety plan; d) A full reclamation/rehabilitation plan; e) A social impact assessment. | ★★★★ | ST | Amend the Minerals Law | MoM |
| | 3.34 Align land restoration and rehabilitation provisions to good international practice. | ★★★ | ST | Amend the Minerals Law | MoM |
| | 3.35 Improve public participation in mining-related decision making and introduce a formalized consultation process. | ★★★ | ST | Amend the Minerals Law | MoM |
| | 3.36 Design a specific Linkages Programme(s) for the mining areas. | ★★★ | MT | n.a. | DFIRR/SME/ MoM |
| | 3.37 Provide financial relocation assistance to entrepreneurs willing to move to mining areas. | ★★★ | MT | n.a. | SME Agency |
| | 3.38 Offer EMPRETEC training in mining areas at free or subsidized rates. | ★★ | MT | n.a. | MED/ SME Agency |

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