

Mongolian Economy

November 2021 (178)

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Investment and development

Foreign investments over the last 30 years

National Development Agency

Kh. Batjargal: We need a comprehensive reform in our investment environment



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Country Manager

A.Mikhnev: The key thing we want to see is Mongolia becoming a prosperous country

World Bank in Mongolia

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Contents

Investment and development 6

Foreign investments over the last 30 years



In the spotlight 10

A light at the end of the investment tunnel?



National Development Agency 13

Kh. Batjargal: We need comprehensive reform in our investment environment



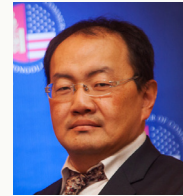
Infographic 16

Foreign investment

Questions from the Mongolian Economy magazine

18 / O.Adiya

The Executive Director of the American Chamber of Commerce in Mongolia



19 / Dr. Julien Lawrence

Chairperson for the Australian Chamber of Commerce Mongolia



20 / B.Naranzul

Policy Director of the Business Council of Mongolia



21 / Tomas Bravenec

The Executive Director of the European-Mongolian Chamber of Commerce and Industry



Opinion 22

Mongolia's Economy Needs Diversification, FDI Can Help



ANTONIO GRACEFFO
PhD,
China-MBA

Projects 24

Development incentives – Mega projects

Bank IPO 27

Immune Boosting Reform

Investment and development



Foreign investments over the last 30 years

In 2011, countries around the world were left in shock when Mongolia's GDP grew 11.5 percent. There are still many people who look back at that year with great pride. However, it would be more

appropriate to say that kind of growth was a tough lesson, not a success to be proud of. This record breaking economic growth was the result of a USD 7 billion investment into the Oyu Tolgoi Project under the investment agreement which was signed on October 6, 2009.

Investments in the Oyu Tolgoi Project accounted for 54 percent of the total foreign direct investment flow between 2010 and 2013.

The economists at the Bank of Mongolia estimated that investments in the Oyu Tolgoi Project accounted for approximately 54 percent of total foreign direct investment (FDI) flow between 2010 and 2013.

To be honest, until we signed an investment

agreement on the massive mine project which carried out under the partnership of the Government of Mongolia, Turquoise Hill Resources and Rio Tinto Group, we didn't have any clear idea regarding the current state of Mongolia's investment climate. Within the framework of transitioning to an open economy, Mongolia adopted its Foreign Investment Law in 1993 which further led to increased trade and played a pivotal role in the flow of investments. The number of new business entities kept growing but there was almost no company that could attract foreign investments. The annual FDI was on average USD 10 million and at its maximum USD 25-30 million.

Mongolia hadn't been at the center of global attention until the middle of 2000, when the price of minerals and raw materials began soaring on global markets and the trend shifted to the mining business. Between 2005 and 2008, approximately 5,636 newly



because of the huge influx of investments, Mongolia started to suffer from Dutch disease. As Mongolia's economy wasn't ready to absorb such massive investments which peaked at USD 4.2 billion, the country saw an excessive demand in some sectors, dramatic increase in government expenditure and social welfare support all of which caused a rise in inflation.

However, investors didn't continue pouring money into emerging countries. From 2013, when the first stage of the Oyu Tolgoi Project was about to be completed FDI started to drop. In addition, investors gradually lost their interest as the price of raw materials began to reduce from 2012. The weak macroeconomic data showed that the Mongolian economy had already become heavily dependent on external factors such as foreign investment and the price of raw materials. In other words it was getting harder and harder to steer the wheel of our economy. However, the authorities failed to notice it and made a political mistake on their investment policy. It was like adding fuel to the fire because it obstructed already declining investments. In May 2012, right before the Parliamentary election, public discussion and debate regarding national security and foreign investment took place.

Consequently, in order to stop the FDI flow into the mining sector, the Law on the Regulation of Foreign Investment in Entities Operating in Strategic Sectors was drafted and approved by the Parliament of Mongolia. The law stipulates that private and public foreign entities must apply for permission to the Government of Mongolia if they intend to invest in strategic sectors (mining, banking and finance, media, information and communications). Moreover, if a foreign investor is about to acquire a 49 percent interest in the shares of companies operating in strategic sectors it must obtain permission from the Parliament of Mongolia.

The above law ceased the purchase of companies that were causing major problems but at the same time it froze all other potential investments. Hence, it was believed that investors had lost confidence in Mongolia as the law created uncertainty around investments in Mongolia. In the Investor Protection Survey for Mongolia conducted by the World Bank, around 80 percent of the companies expressed that their investment was at risk due to uncertainty around investor protection. The total amount of ►

- established companies had foreign investors but Mongolia didn't experience a notable increase in its FDI flow.

From 2000, the flow of global FDI began to grow exponentially and its pattern began to change. According to the United Nations Conference on Trade and Development's (UNCTAD) report developing and transition economies received 12 percent of global FDI flow in 2000 and it reached an astronomical level of 35 percent in 2012. The FDI flow to Mongolia reached its peak during 2011 and 2012 largely due to investments in the Oyu Tolgoi Project.

Due to the steady FDI flow, illegal mineral and exploration licenses became a widespread business in Mongolia. This upheaval in the mining industry became the root cause of environmental issues and the spread of patriotism. It was indeed one of the major challenges faced by our decision makers. Eventually,

During the 11th annual conference “Invest Mongolia” in 2017.



► investments at risk was estimated to be around USD 1.9 billion which was equal to 90 percent of their total investments. The law that was pushing investors away was abolished six months later. Instead the authorities decided to update and make amendments to the Foreign Investment Law which was adopted back in 1993. The basic principles of international investment were covered by the Foreign Investment Law. Therefore, the amendments were more focused on promoting investments in non-mining sectors and regional development to avoid urban concentration, and ensuring that investors run their businesses without incurring any risks. Furthermore, the General Law of Taxation, Customs Law on Tariff and Duties, Intellectual Property Law and Minerals Law were amended accordingly. Unfortunately, economist S. Javkhlanbaatar points out that we are still not receiving the benefits of such amendments because of the slow process of legislation. For instance, the amendments to the key tax laws only came into force in 2020.

Mongolia does not only support foreign investors through a domestic regulatory framework but also through separate investment agreements. In addition to that under the new Foreign Investment Law, investors are now able to obtain tax stabilization certificates. Experts recommend that in order to attract foreign investments, Mongolia needs to address the issues identified in Doing Business, an annual report published by the World Bank, speed up the dispute resolution process and specify the strategic sectors that require foreign investments. On top of that, investors demand greater certainty and clarity in the investment environment.

Khan Resources Inc.'s USD 70 million and Erdenet Mining Corporation's USD 112 million

cases were submitted to international arbitration. This news has given investors a negative impression of Mongolia's investment climate. In fact, it was a bitter experience that closed new opportunities and further slowed our economic growth. If you look back 30 year ago, there were numerous examples of companies that succeeded and played a significant role in the development of Mongolia owing to foreign investments. To name a few, Gobi JSC which introduced Mongolian cashmere to the world was established with investments from Japan. Also, after the establishment of a pioneering company in the telecommunication industry, Mobicom Corporation, new mobile network operators began to emerge and now Mongolia has a global standard telecommunications infrastructure.

Nowadays, to attract foreign investments every country designs their unique policies and strives to turn it into a key to prosperity. Countries such as China, South Korea, Malaysia and Singapore achieved high economic growth by harnessing foreign investments. Countries like Mongolia which barely invests in research and innovation can gain managerial experience, knowledge, skill and new technologies with help of foreign investors. This means next time when we discover a new mineral deposit and open another large mine it won't be necessary to invite mining experts and engineers from Canada, Australia or the United States if we learn from our investors. That is the type of investment that can't be measured with money.

Putting it briefly, all the aforementioned data and past lessons show that for Mongolia, a small country with an open economy, an underdeveloped industrial sector and low levels of export diversification, FDI is like the heartbeat that keeps its economy alive. ■



Mongolian Economy

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In the spotlight

A light at the end of the investment tunnel?



The slogan “We will improve the legal environment for foreign investments” can be heard from many leaders. But this statement lacks in specifics and can be confusing. In fact, the current Investment Law of Mongolia is really not all that bad. However, it should be realised that the legal environment and the law are two separate things. Laws are the basic rules of the game for foreign investors, while the legal environment is referring to how the laws will be enforced and how the system will actually work in providing fair and transparent opportunities for investments. Just having a good law is only one part of the foreign investment landscape.

So, the main point regarding most of the issues related to foreign investment is linked to enforcement of the investment law and regulations. Foreign investors and representatives of international organizations in Mongolia stated “Capability to enforce investment laws is weak and insufficient”.

National security or dangerous domestic trends?

Mongolians are very sensitive to the idea of how foreign investment would affect national security. But, if you cannot be open and realistic and provide up-to-date and

concise information, the main danger comes more from domestic issues rather than from foreign investment issues. Ahead of the parliamentary elections in 2012, foreign investments came to a halt as a result of the pressure of nationalism, and significant restrictions were imposed on foreign investors in many strategic sectors (mining, banking, telecommunications and the media) by amendment to the investment law. Authorities (governors), recognizing their mistakes, abolished that law a mere five months later.

Subsequently, a new law was passed in 2013, updating provisions about dividing investor support into taxation and non-taxation issues, providing the stability to the tax environment, and amending the law regarding support for non-mining related investments. However, the pace of legal reforms in the areas of taxation, customs, justice, and some others that are essential in improving the foreign investment environment is to say at least slow, and the legal ramifications are still not be fully effective.

According to statistics, since 2011, mining sector investment accounted for about 70 percent of foreign direct investment, trade and catering just over 17 percent, and the remaining sectors just under 13 percent. ►

► Of these, 40% of the total investments relate to the Oyu Tolgoi project. In terms of the number of foreign investors, according to data from the Office of Foreign Citizens and Nationality, there are only 1,834 foreign investors registered in Mongolia.

From this, we can see that the notion of foreign investment being detrimental to national security is not supported. Researchers have clearly found that the public controversy about the foreign investor's rights of residing in Mongolia is not posing a threat to national security. In addition, there are other laws that can regulate how many foreigners can have a residency permit.

Investment equation

The most important change in the investment law today is to review the provisions that discriminate between foreign and domestic investors.

According to the current investment law in force, foreign investors are required to invest at least \$ 100,000 to establish a business entity in Mongolia. There are no such requirements for domestic investors. Therefore, Kh. Batjargal, Chairman of the National Development Agency, stated that regulations to protect the interests of investors will be added to the current draft amendments. The draft law also introduces the term "priority sector". Mining, tourism, creative industries, infrastructure, agriculture and information technology will be the leading sectors for attracting foreign investments, while tax and non-tax support will also be provided.

Investors see that the biggest risks are political and policy instability. According to international best practice, large-scale public-private partnership projects require about three years of consideration to do a proper assessment, preparation and selection. However, the average life expectancy of our government in recent times has only been about 2 years, so there is no track record of the ability to implement large-scale projects. Leaders have repeatedly said "This will not happen again", and the current Prime Minister, L.Oyu Erdene has even said "We are very sorry" during a meeting with investors.

Another thing that investors are rather fearful of is the dispute resolution process. In Mongolia, it takes a long time both in resolving disputes in court and then enforcing the court decision. But, time in business is a valuable resource just as money is. According to investor's comments posted on the website of the US Embassy in Mongolia, judges tend to avoid business disputes and delay trials as long as possible, sometimes

for several years. In some cases, the case was delayed for too long, which allows enough time for the defendant to sell his property and disappear.

Moreover, the law is not enforced equally at the capital, aimag, soum and district levels. This is especially obvious from the actions of local state inspectors responsible for taxation, inspections, health and safety. Investors are also concerned that there is a lack of a clear definition of what powers of state and local government may lead to the loss of property or the use of them. For example, In the Mineral Law, the power between provinces, and soums in terms of the use of land permits and special-use permits are not clearly defined. Investors have reported that certain high level government officials and politicians have intervened in the administrative and judicial processes involving government disputes. For example, in disputes between investors and the Mongolian government, some government officials seek to pursue some undisclosed business interests and do not follow the proper and applicable legal rules and regulations. In doing so, it pursues these interests through various state-owned companies that have the power to interfere in any business under the guise of the government. Investors warn each other that those officials may use government, judiciary, law enforcement, media, and public prosecutor's office acquaintances and contacts to force foreign businesses to accept their claims. It lacks fairness as well as accountability and is not transparent.

The need to remedy this opaque situation is often mentioned in recommendations from international organizations and in research papers. Therefore, the draft law contains provisions to eliminate the risk of bureaucracy and corruption during the dispute resolution phase, according to Kh.Batjargal, head of the National Development Agency.

It would be untrue and unfair to say that the government doesn't care about improving the foreign investment climate. Relevant ministries and agencies will conduct various studies regarding the investment environment with the aid of international organizations, and the research results will be reflected in the upcoming draft law. In an effort to establish a "One window policy of investment" the National Development Agency has ►

Leaders have repeatedly said "This will not happen again", and the current Prime Minister, L.Oyu Erdene has even said "We are very sorry" during a meeting with investors.

- been tasked with implementing a best practice foreign investment policy.

What is proper and what is not right in the investment environment has already been comprehensively researched by both international and domestic organizations. One of them is the “Investment Reform

Map” developed in cooperation with the World Bank. The report covers the entire legal and economic environment of Mongolia's foreign direct investment. This is an excellent guide for all government authorities.

Second, there is a common international practice in which a

government issues a statement on the investment environment and thereby sends a clear message to any potential foreign investors, “This is the way we want to work with you.” The Mongolian government is currently preparing to make such a statement, and no clear message has been delivered yet other than the prime minister's apology.

Thus, the investment climate is becoming more politically stable and promising than it has ever been before.

If the message is clear and concise, it is important to have a law that supports that message, as well as an implementing agency, and most importantly, the institutional capacity to enforce it. One thing foreign investors do not like is an investment climate that lacks stability and consistency. The National Development Agency is the place to bear all these burdens. This agency, which will soon be working at a ministerial level, has done some work in order to improve the investment climate. For example, in 2016, the government established the Investor Protection Council and appointed the head of the National Development Agency as its Secretary.

It has also launched an electronic system for resolving investors complaints known as SIRM. According to the agency, a number of investor complaints have been resolved and about \$ 3.2 million of investments that were at risk of being withdrawn have been retained in Mongolia. It also aims to launch a “One stop shop service” for investors to provide all the necessary services at one point such as advice, inquiries, registration, taxes, social security and visas. The most advantageous thing is the service digitization. For example, a service process that used to take as long as 15 days before, now only takes 8 hours, stated by B.Bulganchimeg, deputy director of the NDA

Thus, the investment climate is becoming more politically stable and promising than it has ever been before. But, as mentioned before, a good law is only the first step. Even though there are currently no major investors knocking on the door or are waiting in line to make an investment, when the rules of the game are clear and transparent and will not be changed overnight, the outgoing messages will improve and interest in investing will increase.

We still have a vast amount of work to do in the future to increase investor returns, especially for the support regarding increasing the investment in the non-mining sectors. The amount of investing is just only one of the many factors that affect an investor's decision-making. This is followed by a long list such as transparent taxation procedures, improving the legal environment, investing in infrastructure, identifying labor opportunities, exploring market opportunities, and aligning customs policies and free zones with international standards. The investor will only decide whether or not to invest in Mongolia after considering the total equation that takes into account all these factors. ■



National Development Agency

Kh. Batjargal: We need comprehensive reform in our investment environment



Mongolian Economy Magazine spoke with the Chairman of National Development Agency Kh. Batjargal about the challenges faced by the foreign investors and how to overcome them.

-Due to the pandemic, the flow of foreign direct investment is declining. So is the number of foreign investors registering in Mongolia. How does our investment environment look nowadays?

-The foreign direct investment (FDI) reached USD 3.1 billion in 2019 but started to drop from last year. In the second quarter of 2021, the total FDI amounted to USD 1.3 billion which indicates a decline in the number of registered companies with foreign investment.

Due to COVID-19, not only Mongolia but also other countries are suffering from a decline in the foreign investment. For instance, globally, in 2020 the flow of FDI dropped by USD 1.5 trillion which is a 35 percent drop from the previous year. It is 20 percent higher than the contraction that occurred during the financial crisis of 2009.

About 10 years ago, the FDI to Mongolia reached its record high which was equivalent to 48 percent of the GDP. Following this trend, the economy grew by 17.3 percent in that year and the number

of companies with foreign investment increased by 1,600. However, last year there were only 80 foreign newly registered companies in Mongolia.

As of today, there are 9,054 companies with foreign investment but only one third of them are actively operating in Mongolia. That means 3,670 foreign companies are filing their tax returns but only 1,900 of them are submitting social insurance reports. In the past, foreign companies created around 66,000 jobs in Mongolia. In order to create more jobs and retrieve our economy we need more foreign investment.

-If you look at the flow of FDI to Mongolia, it is mainly concentrated in the mining sector. How can we attract foreign investors to other sectors to diversify our foreign investment?

-As you said, around 72 percent of the FDI to Mongolia goes to the mining sector. That means the stability of our economy is directly dependent on the price of commodities in the global market. For that reason, we need to attract investment to other sectors of our economy. Hence, the Government policy and measures are aimed at achieving this goal. We must put our effort in attracting foreign investors in economically important sectors for exports such as agriculture and heavy industries. ►

► Even if we prioritized the economic sectors, the Government needs to provide more support and tax reliefs or other benefits to foreign investors who are investing and carrying out projects which are beneficial to Mongolia. In other words, tax and non-tax incentives for investors could lead to stability and expansion of our business climate. It also could lead to additional or new investments. If we can create a favorable investment environment, the government revenue from tax and employment will increase. Most importantly, our national competitiveness can improve only if we introduce international best practices, know-how and technology,

-How should we include the tax and non-tax incentives for investors in the law and regulations?

-The flow of investment will accelerate if we make a comprehensive reform in our investment environment. Only after making that reform, will foreign investors begin to invest in Mongolia. One

As of today, there are 9,054 companies with foreign investment but only one third of them are actively operating in Mongolia.

of the urgent issues which needs to be addressed is the improvement of the investment climate reflecting the pandemic and economic situation and providing regulatory support to investors. As the FDI flows to other countries and the economic growth is shrinking, countries are fiercely competing for opportunities to revive the economy

faster. Therefore, we are looking at the policies and regulations that are adopted by other countries in terms of attracting FDI so that we can create more suitable and unique policies for Mongolia.

-The reform in the investment law is attracting so much public attention. What changes will be made to the concession?

-The amendments to the investment law include improving protection of investment, quality of civil services, creating the necessary operational environment for business entities with special license and abolishing overlapping workload of government agencies on supervisory works. Furthermore, we plan to eliminate overlapping and contradictory laws. Public agencies tend to grant special licenses. To carry out seasonal activities such as mining, construction and infrastructure, the legal entity is required to sign a contract with local authorities and get approval on environmental evaluation, report and plan. In

some cases, the local and governmental agencies do not issue the final decision on special licences within the specified time frame or ask for additional documents which in turn makes it impossible to start the operations timely thus incurring additional costs.

Therefore, the government agencies that are responsible for granting a special license to investors should have a system to protect investors. In addition to that we need to eliminate the overlapping supervision of business entities with special licenses. In short, Mongolia needs to take into account the policy and regulatory reform which is occurring due to global digitalization.

-It is believed that it is important to put restrictions on certain sectors while attracting foreign investors. What policies are you considering in that regard? When will the reform in law be realized?

-We aim to clarify the articles on regulation and banning and restricting certain sectors in investment law. In the case of projects which can be carried out by our national wealth creators, the Government must put certain limits on foreign investments. Within the framework of reforms in the regulation, we plan to organize a public discussion with all of the key stakeholders before we approve the key principles of the draft law.

-The ceiling of USD 100,000 in investment is causing lots of controversy and criticism. What type of changes will be made in the investment amount?

-According to the Foreign Investment Law, a foreign legal entity is defined as an business entity that has an overall equity of USD 100,000 or more with no less than 25 percent being invested by a foreign investor. Due to this requirement, Mongolian investors or startup founders also have to acquire a financing equivalent to that.

Moreover, before establishing the company each shareholder puts USD 100,000 in his or her bank account. After obtaining an approval they tend to withdraw the money back. This does not comply with requirement set forth by the FATF, an organization combating money laundering and the financing of terrorism, proliferation, and other international organizations.

The most important factor is whether the money deposited in the bank account is becoming a real ►

► investment. We need to pay careful attention to this matter.

-Singapore is a prime example of a country which developed as a result of foreign investment. The system and quality of the Singapore International Arbitration Centre is considered to be one of the top in the world. How is Mongolia addressing the method of dispute resolution which has become a deterring factor for prospective foreign investors?

-It is indeed an important issue. Even though we have an Investment Protection Council, the scope of its operation is limited. If you look at the complaints and disputes referred to the Council, investors complain that working with government agencies is time-consuming and the decision of the Council is not effectively enforced due to the limited number of staff and lack of coordination. On top of that investors point out that Mongolia has not sufficiently clarified the rights and responsibilities of the Council. Other countries are creating various unique mechanisms, and their leaders give special attention to the protection of investors. In general, the higher the Government role, the more opportunities that parties will have to resolve their disputes in a timely manner through local public authorities before going to arbitration. Thus, we are working on updating and improving the system for resolving and addressing any issues submitted by investors and clarifying the activities and rights of the Council.

One of the best examples is the South Korea and Kazakhstan's Ombudsman, an independent organization for resolving investment disputes under the President and Prime Minister's supervision. Thereby, we aim to make the operation of the Investment Protection Council similar to the above mentioned Ombudsman.

-How many arbitration cases are there between the Government of Mongolia and foreign investors? What are the disadvantages of such disputes?

-Mongolia joined the Convention on establishing the Multilateral Investment Guarantee Agency and Convention on the Settlement of Investment Disputes. Also, Mongolia entered into Foreign Investment Promotion and Protection Agreement with 43 countries. Thus, if a dispute between an investor and the Government arises, the parties have

rights and possibilities of submitting their claim to international arbitration or domestic court.

There are six cases in which foreign investors are going to international arbitration against the Government of Mongolia. Despite the fact that the court decides in favour of the Government, when it comes to investment disputes the entire world perceives that country as unfavourable to investors. Furthermore, arbitration is expensive and time consuming and if the tribunal decides in favour of the investor the country must pay the compensation which is worth a few million dollars.

-Not only the regulatory framework but also the infrastructure plays an important role in investment. How does the lack of infrastructure affect foreign investment?

-In terms of Mongolia's side, the key obstacle in the implementation of large-scale projects is infrastructure. Especially, energy, heating, road, railroad and capacity of border crossings which tend to become a huge problem. We can attract investment only after resolving this problem. Even if we improve the regulatory environment and protection of investors, we cannot make progress without addressing the infrastructure issues.

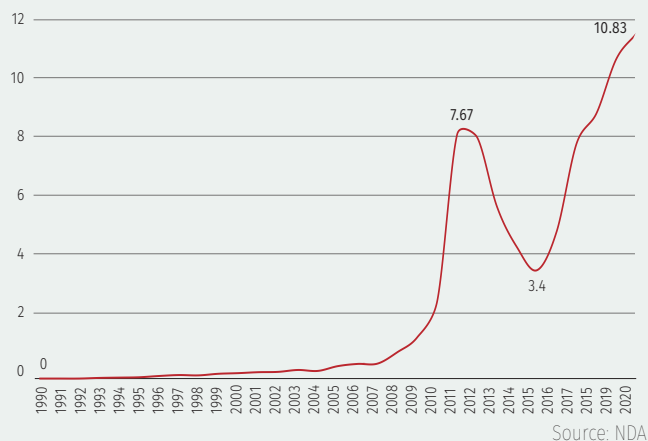
-How do you see the importance of strengthening institutions responsible for investment and re-establishing the Ministry of Economic Development?

-Since the investment law of Mongolia entered into force, the structure and operation of institutions responsible for investment have been unstable and have gone through several changes. The amendments to the Constitution helped to ensure the stability of the Government policies. By creating a Ministry of Economic Development, Mongolia can create and implement an integrated economic and social development policy at national, sectoral and regional levels. I strongly believe that with foreign investment, trade, economic cooperation and public private partnerships being referred to a single Ministry will bring about many positive changes in the future. ■

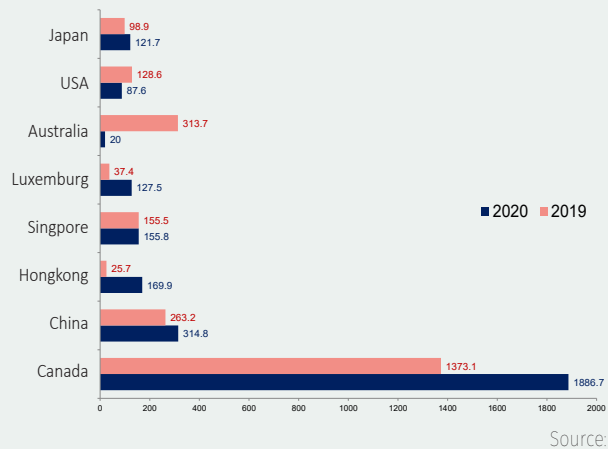
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Infographic

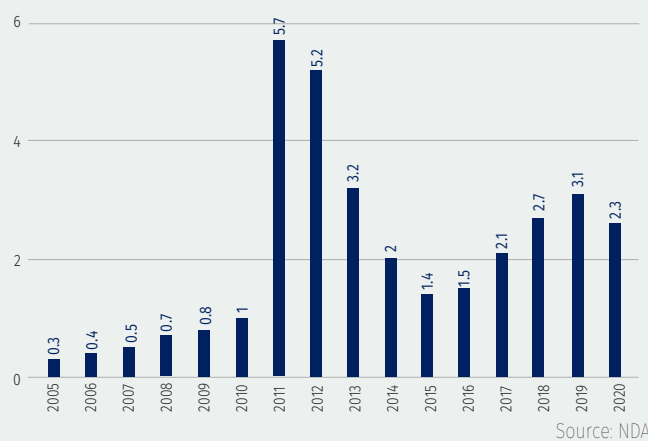
Foreign investment (trillion MNT)



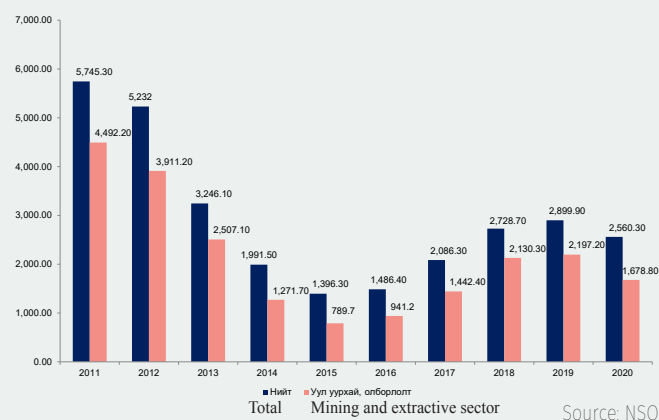
Inbound FDI, by nations (million USD)



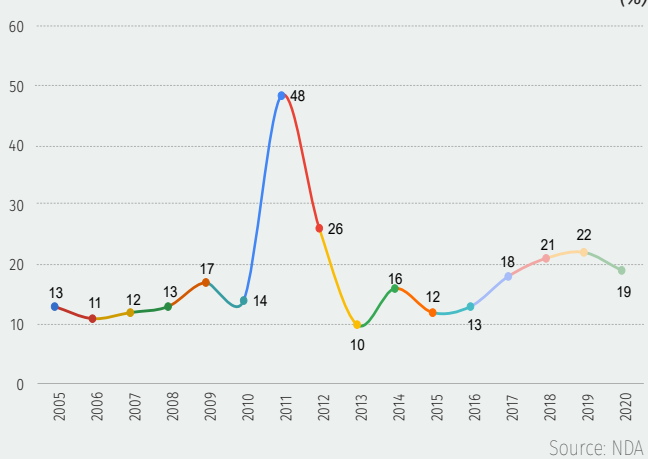
Inbound FDI (billion USD)



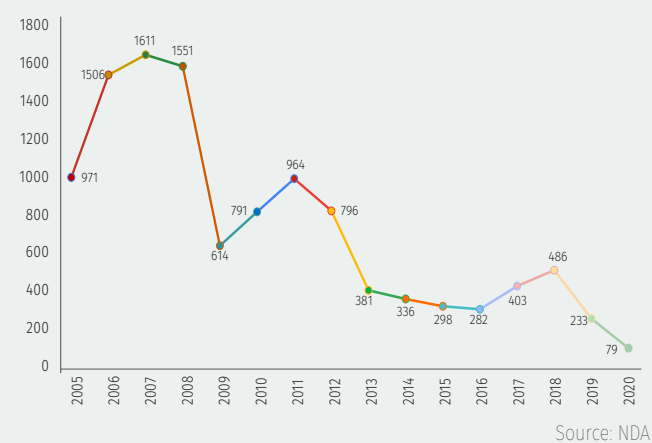
Mining and extractive sector percentage in the inbound FDI (million USD)



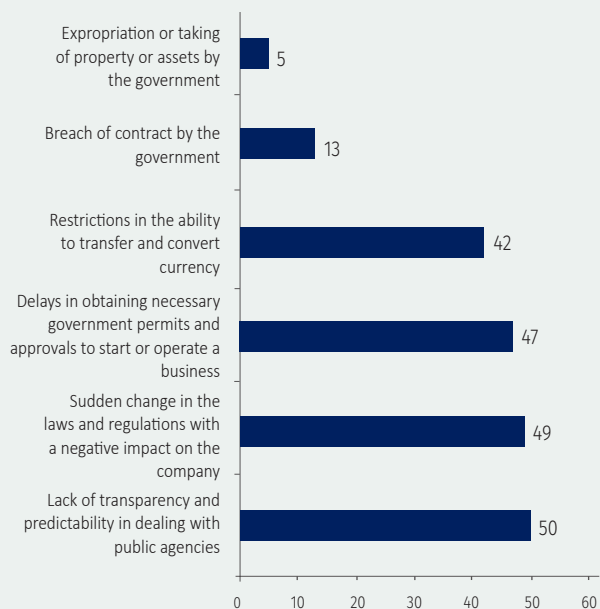
FDI in GDP (%)



Newly registered foreign entities

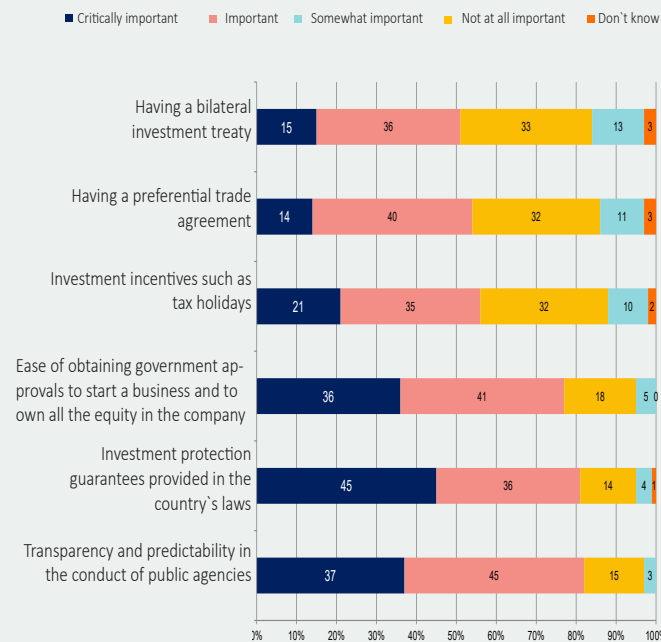


Investor experience with political risk (percentage)



Source: Investment reform map for Mongolia 2018

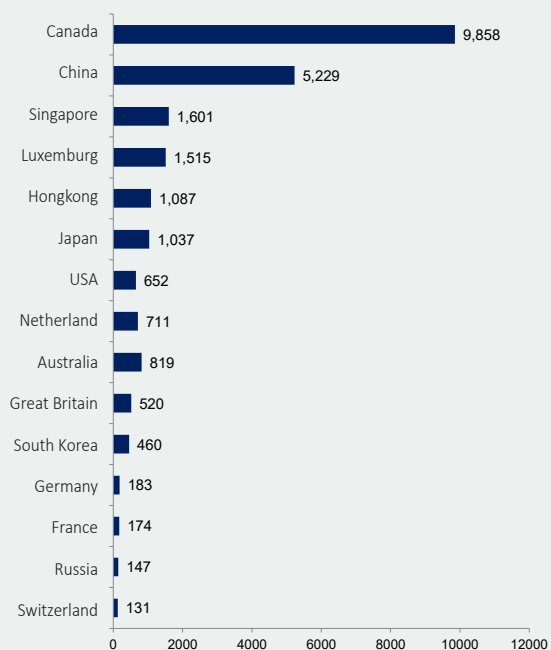
Importance of investment climate factors



Source: Investment reform map for Mongolia 2018

Foreign direct investment, stock

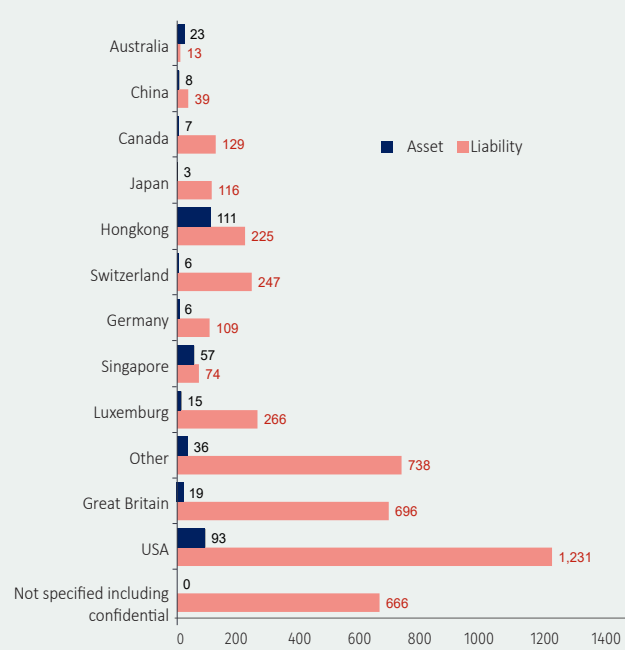
(million USD) 2021.II



Source: Bank of Mongolia

Portfolio investment, stock

(million USD) 2021.II



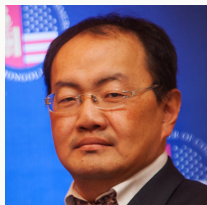
Source: Bank of Mongolia

Questions from the Mongolian Economy magazine

1. What is your opinion of Mongolia's investment environment? What has Mongolia been doing right and wrong in attracting investors?

2. During the pandemic, foreign direct investment has become a "vaccine" necessary to stabilize and boost the economies around the world. Bearing that in mind, Parliament is discussing amendments to the Foreign Investment Law of Mongolia. How does your organization see the proposed amendments to the law?

3. The amendments to the law are only the beginning. What do you do to retain investors who have already started a business and how do you attract potential future investors? What changes have been brought on by the pandemic to attract foreign investment around the world?



O.ADIYA

The Executive Director of the American Chamber of Commerce in Mongolia

1. Even though it has been 30 years since Mongolia transitioned to a market economy, we still need to discuss the core concepts of the market economy, competition, role of the private sector and property. We need to keep passing on a message that the private sector is the key driver of economic development. The state should not compete with the private sector.

We need to carry out reform boldly in the state-owned enterprises and improve its corporate governance. Moreover, we also should not just talk about mega projects because there are numerous small and medium projects in Mongolia. We need to share the success stories of such projects.

Furthermore, I think that we need to change the attitude towards the foreign investors. It is largely affecting the regulatory framework. For instance, due to the "Law of Mongolia on Prohibiting Mineral Exploration and Mining Operations at Headwaters of Rivers, Protected Zones of Water Reservoirs and Forested Areas" and "Windfall Tax Law" quite a number of projects and investments stopped, and investors left Mongolia. Pushed-away investors take a long time to return. If you look at the years after 1990, Mongolia lost everything by adopting a strict policy and pushing away foreign investment. This is mainly due to political instability. On the other hand, nothing can be perfect. That means it would be enough to just have sustainable, predictable and stable regulation and the Government's decisions. It is alright to have a contract that levies high taxation but it should not be changed whenever the Government changes.

An issue that must be mentioned here is the Oyu Tolgoi Project. This project is the largest third neighbour project and became a benchmark for other investors. The Oyu Tolgoi Project must not end. The successful investment of Rio Tinto may bring more investment to Mongolia. We believe that the two parties can resolve their issues in order to balance our economy by reducing the heavy dependence on our two neighbouring countries, China and Russia. ►

2. The amendments to the Foreign Investment Law of Mongolia were proposed by the Members of Parliament. The proposal to amend only a few articles drew significant attention from the public. It is quite unfortunate that this was misused. We hope that the National Development Agency will carry a comprehensive legal reform and accelerate its work regarding the matter.

The American Chamber of Commerce in Mongolia has submitted its proposal for legal reform to improve the investment climate and will keep working closely with the Government of Mongolia.

3. After the outbreak of the COVID-19 pandemic, the developing countries have been fiercely competing for foreign investment. Therefore, Mongolia needs a clear strategy and policy on what the country can offer to investors, how it can protect the current and future investors and how it plans to attract investments in the future.



DR. JULIEN LAWRENCE
Chairperson of the Australian Chamber of Commerce Mongolia

1. Often the interest is in attracting foreign investment to business in Mongolia, and the country has had great success in this in the past. However since 2014 there has been a substantial decline in interest from foreign investors to invest in Mongolia. Some of this is due to the need for Mongolia to address why foreign investment would be attracted to Mongolia.

We in Mongolia must understand that foreign investment has global opportunity, and if Mongolia wants to attract foreign investment it must compete to win the attention of those investors.

Investors must have an incentive to re-invest dividends to grow the business – which delivers long term value to all stakeholders including government

Predictable regulatory environment doesn't have to be the best regulatory environment available, but must be predictable so that investors can make a reasonable assessment of their likelihood of return, especially on taxation of transactions which is not consistent, compliance audits and licensing.

An investor must feel secure when committing serious funds for an investment – without this, the investment value will be considered “higher risk” and as such less attractive

compared to more stable investment opportunities that provide a secure return to the investors.

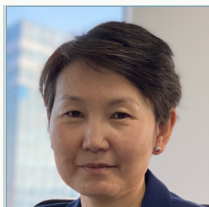
Red tape and regulation – Sometimes regulatory processes required in business in Mongolia are ambiguous and unfavourably labour intensive considering the value these processes bring to business or the government – this is wasted time, effort and resources and detracts from the value proposition and certainty of return.

Our members from a variety of sectors have faced investment restrictions in Mongolia. Such restrictions have included ambiguity of regulations with frequent changes with little/no consultation, and unfair application of regulation, whereby foreign investors are disadvantaged. The investment law continues to ensure an unfair position for foreign investors. Risk has faced our members also due to uncertainty of political climate, the reality of return and lower performance of their investments with respect to key investment metrics.

2. Our Organisation has considered this law and more broadly the performance of Mongolia with respect to attracting foreign investment. Let me start with the current status of foreign investment in Mongolia. In the 2nd quarter of 2021, FDI net inflows to Mongolia were just over US\$1.3 billion, this is a \$1.3 billion decrease when compared to the year before. Investment from major economies such as the USA and China declined during this period.

According to certain indices on investment performance, we are seeing some small improvements in the ranking for Mongolia, however those improvements are not in all areas. Mongolia scores well in areas such as the openness of its market for investment, however scores relatively poorly in areas such as the Rule of Law and the Regulatory Efficiency. This is where the government should focus to improve the overall investment climate, which will lead to stronger FDI.

3. Australian Chamber of Commerce Mongolia (AustCham Mongolia) is a non-governmental organization as contemplated by the NGO law of Mongolia. Since 2013, AustCham has promoted the interests of Australian and Mongolian business in the region which it pursues through business-to-government relations with the support of the Australian Embassy, Austrade, leading institutions, professionals and “thought leaders”. The Chamber uses its ability to provide high level interaction through advocacy thus offering long term economic and social contributions to Mongolia and its people.

**B. NARANZUL***Policy Director of the Business Council of Mongolia*

1. There are a number of flaws in the way our country is trying to attract foreign investments. Even though we have provided a general background for the legal environment of investments, some of those reforms have as yet not been fully implemented. The provisions in the law are not always consistent and often incoherent. Rather than adhering to a policy based on a well-developed vision, political or socially acceptable decisions are having a negative impact on attracting and retaining foreign investments. In the past, political instability had a negative impact on the investment environment. But now the problem is that we have unqualified government officials, each department doing their own thing, meaning there isn't a comprehensive and unified approach in dealing with potential foreign investments across all sectors. As a result, officials might not have the right skills to do their job and issues that need to be looked at are falling through the cracks. .

On top of that the Investment Promotion Agency, which was responsible for receiving and diversifying investments, was disbanded in 2016. The end result of all these decisions is that various ministries and agencies are now overlapping each other in the investment area and some issues are not dealt with while others are not implemented.

There are also many stages in the court proceedings. Issues such as judicial independence have affected the investment environment in a negative way. The two main things investors are looking for are transparency and consistency.

There is also a shortage of public infrastructure and engineering facilities. Transportation, logistics and infrastructure are underdeveloped, energy supply is insufficient, and equipment and technology are outdated. The weak business environment and an underdeveloped supply chain increase the costs of doing business and make it impossible to generate a profit. . In addition, along the market principle, the slow speed of bureaucracy and the inability to compete with other countries have caused investors to look towards other countries to avoid wasting time.

Furthermore, the development of human resources is weak, and there is a severe shortage of production and technical professionals. Not enough attention is paid

to training qualified personnel. As a result, it requires additional costs and time to prepare personnel for investors.

In the end, even after attracting an investment, having the expectation that investors will handle all of the issues without being aware of possible pitfalls, will result negatively on the entire process.

2. As far as I know, a group of parliamentary members headed by Kh.Gankhuyag submitted some amendments to the Investment Law, and they were discussed but rejected by Parliament. We have not yet received the investment law amendment that the government is discussing.

3. Foreign investment has decreased in most countries due to the pandemic. In addition, external factors such as global financial instability, rising oil prices, and decreasing cross-border integration are putting pressure on many countries. Globally, public spending on health, education and social security has been increased in order to reduce the direct impact of the pandemic and support potential growth. Various tax incentives have been introduced for industries and companies affected by the pandemic.

Regional organizations and countries are actively concluding free trade agreements to attract foreign investment.

Certain incentives are provided in the logistic field to attract foreign investments in order to overcome transportation and logistics difficulties and prevent the problems from reoccurring. Investment in pharmaceutical, medical equipment research and development, innovation, new technologies such as robotics, driverless car development, construction technology, biotechnology, fintech and semiconductors have also increased significantly.

Countries have begun to attract large amounts of investment in the renewable energy sector, like green hydrogen and electric vehicle batteries associated with the COP26 meeting in order to mitigate climate change and attract green funds. Some countries are promoting favorable investment conditions in this direction.

Many countries are pursuing a comprehensive policy of reform in order to increase economic growth. Long-term reform priorities pay more attention to improving governance, infrastructure investment, land issues, labor reforms, and the quality of education. These are regarded as the basic indicators of a liberalizing investment environment ►

**TOMAS BRAVENEC**

The Executive Director of the European-Mongolian Chamber of Commerce and Industry

1. We see great potential in Mongolia and opportunities for foreign investors to contribute to sustainable, technological, and socio-economic advancement in many areas, from mining and infrastructure, energy and transport, to agriculture and manufacturing, export-oriented industries. However, as I have said numerous times before during interviews, talks, and forums – Mongolia needs to realize that we are not the only country with potential and abundant natural resources. The country needs to change its mindset and compete for FDI. We have missed several years in this respect.

We are well aware of the concerns and the general public perception of foreign investment and investors. Without education and transparent, balanced information, this position can quickly turn into suspicion or jealousy. Dangerous outcomes can come from this and we do not believe that the people of Mongolia should suffer the consequences simply because of lack of knowledge or one-sided information. Therefore, we are keen on helping raise awareness and better educating everyone to help get them on the same page.

Investors expect long-term and stable development policies, which go well beyond the four-year election cycle. Domestic and foreign businesses need to be treated equally. Efficient law and policy enforcement and implementation is a critical component of keeping existing and attracting new investors. Without trust, we cannot build anything...

2. My position or we should better say our – EuroChamber- position with over +150 members remains very much the same, in line with our FDI Climate Position Paper published in October 2021. We believe our detailed recommendations in the paper will help the legislature amend the laws in a more trustworthy and accountable bill being passed.

The currently proposed amendments to the Investment law seem very insufficient. It is our understanding that the Government, in particular, the NDA is working on a comprehensive overhaul of the Investment Law, and our Chamber stands ready to comment on it, once a draft will be released.

Mongolia itself recognizes the importance of foreign investment as you said, now more than ever. Landlocked between two giant economic powerhouses, the country needs to diversify its prospects and opportunities. The Covid-19 pandemic crippled not only our but many other countries' economies, but the ones with the larger and more curated environments will recover faster while countries like Mongolia will need to pay close attention to the revival of the economy and make the decisions that benefit the country, not individuals. As you used the metaphor for 'vaccine', I think it is the right time to get the body (country) well aligned to get an effective jab (investment) to fight back the recession with a healthier mind and body. I always believed that both the mind and the body that carries it needs to be healthy to ward off viruses, quite literally in our cases on both levels.

3. Legislative updates alone cannot guarantee investors will come running back with open arms. We have lost their trust and now we have to earn that back, it is a long road but the good thing is no investor will turn a blind eye to an amended relationship. We, as a country, need to "walk the talk" and demonstrate tangible improvements and desire to attract know-how, technology, and investment through a partnership with international investors.

In terms of our activities, EuroChamber develops policy dialogue between public and private stakeholders for the betterment of the main aspect of the FDI climate. We are working on improving the international perception of Mongolia as an investment destination, among others via our membership in the European Business Organization network <https://eboworldwide.eu/>. We established several 'working groups' on FDI, Sustainability & Renewable energy, Hospitality & Tourism, Wine & Spirits, Labour law, etc. to come up with more research, more recommendations and insight which our member organizations, as well as potential investors, may use to deal with matters at hand.

On the global stage, we are not only experiencing foreign investment becoming more diversified but also more demanding with other aspects gaining prominence, such as climate change, sustainability, and technological advancement. A broad range of requirements is now present to attract and offer investment. I trust and hope Mongolia will embrace its potential and approach the matter with a clear mind and open heart, for the country to prosper. ■

Opinion



DR. ANTONIO GRACEFFO
PhD, China-MBA

Mongolia's Economy Needs Diversification, FDI Can Help



Mongolia's economy is extremely dependent on foreign direct investment (FDI), for the funding of new projects, as well as ancillary benefits such as bringing in new technology, improving human resources, and enhancing the competitive environment, which helps improve the quality and standards of local firms. In 2020 and 2021, Covid-19 lockdowns slowed the general economy, making the country more susceptible to economic instability caused by overdependence on the mining sector. An increase in FDI, along with a government-directed FDI policy could help more-evenly distribute FDI across the economy, developing sectors other than mining, increasing Mongolia's overall wealth and future economic stability.

In 2019, Mongolia received FDI totaling \$2.4 billion, equal to about 17.46% of GDP. In 2020, global FDI decreased by 35% due to the pandemic lockdowns. This year, FDI is making at least a partial comeback. In the first half of 2021, developed economies experienced an increase in FDI, while developing economies experienced further losses. Developed economies more than doubled quarterly FDI inflows, recovering 70% of their losses, while in

developing countries FDI decreased by an additional 9%.

Around the world, investors showed growing confidence in infrastructure investment, with international project finance deals up 32% in number. This is partially due to infrastructure's favorable long-term financing conditions, supported by government stimulus packages and overseas investment programs. Investor confidence in industry and global value chain investment, by contrast, remains low. Greenfield investment projects declined by an additional 13% in number, while new projects in electronics, automotive, and chemicals declined even further.

Since 1990, when Mongolia transformed from communism to democracy, and moved from a centrally planned economy to a market economy, the government has prioritized attracting FDI, but it has not been able to achieve sustainable results. As a result, both the economy and the FDI situation have been somewhat unstable. Steady flows of FDI would be beneficial for the country's development, but achieving this will require improved government policies towards inbound FDI. ►

► The top five countries that have invested in Mongolia since 1990 are Canada, China, Netherlands, Luxembourg, and Singapore. In 2011, a year of tremendous economic expansion, FDI was the largest contributor to GDP growth. About 70% of Mongolia's FDI flows into the mining sector, much of which comes from China and Canada. But FDI in the mining sector has many negatives consequences, including the lack of development in other sectors and the importation of foreign companies.

Currently, the economy of Mongolia is heavily dependent on the mining sector. About 90% of Mongolia's exports are composed of coal, copper, mineral fuels, iron ore, and gold, which account for about 40% of GDP. In the first six months of 2020, exports fell by more than 40%, with economic output contracting 9.7% year-on-year. These declines were largely caused by a sharp decrease in demand, particularly in China, for raw materials and coking coal. To prevent similar downturns in the future, other sectors of the economy need to be developed. This can be achieved through FDI, if a well-planned FDI policy regimen is implemented.

Carefully managed FDI, in one sector, can have a positive spillover effect in other sectors, amplifying the benefits. FDI in construction, the financial sector, and the service sector have a high positive effect on other sectors of the economy. This in turn, attracts increased FDI into those sectors. The influence of FDI on construction sector and other sectors is high, while the impact of FDI in the mining sector provides very little spillover benefits in other sectors, apart from construction, transport, and management support.

FDI in Mongolia is largely dependent on a single sector, the mining sector, which makes Mongolia particularly vulnerable to economic instability. Generally, countries which are resource-dependent have greater, macroeconomic volatility, but Mongolia's macroeconomic volatility is higher even than most other commodity exporters. According to Investment Monitor's Mining Vulnerability Index, Mongolia is the country most at risk country in a mining downturn.

One of the development hurdles Mongolia faces is a lack of lendable funds. According to a report by the World Bank, since 2004, Mongolia has produced \$28 billion worth of mineral outputs. Of that amount, as of

2019, \$200 million remained saved as deposits in the Stabilization Fund and the Future Heritage Fund. As most of Mongolia's resources have been consumed, Mongolia is falling into "the resource curse," becoming too dependent on raw-material exports and failing to develop other sectors of the economy. As a result of this low retention of mineral income, there is less domestic capital available for future investment, making FDI even more important for the country's development.

Mongolia's small- and medium-sized enterprises (SMEs) pay a loan interest rate of roughly 16.5%, while the savings interest rate was only about 10.26% in 2020. This creates disincentives to save and invest, particularly with about 28.5% of the population living below the poverty line. While 92.7% of Mongolians over the age of 14 have a bank account, only about 23.7% of the population has a savings account. Therefore, FDI is particularly important in Mongolia because of the low savings rate and high investment needs. Banks do not have enough money to lend out, so investment has to come from FDI.

The 13 registered commercial banks in Mongolia account for 96% of total financial system assets. Mongolia's ratio of total bank loans to GDP is about 50%. This makes it very difficult for SMEs to obtain loans from banks. Consequently, the SME sector is more dependent on external finance than are large enterprises.

The impact of FDI in the financial sector is evenly distributed across other sectors. Promoting FDI through the financial and manufacturing sectors will effectively diversify FDI in Mongolia. This will help Mongolia with innovation, technology, knowledge transfer, productivity expansion, economic connectedness, and vertical diversification. FDI diversification would also result in diversification of exports, as well as economic diversification. By improving the availability of loanable funds, SMEs could grow, in a variety of sectors, and increased FDI could be attracted and distributed more evenly throughout the economy. ■

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Projects

Development incentives – Mega projects

By 2030, globally, investment in energy, infrastructure, mining and real estate will double.

Developing countries maintain the sustainability of their development by identifying key sectors of the economy which attract foreign investors. In our country, 70 percent of foreign direct investment is related to the mining and oil sectors.

There are obviously several reasons to attract foreign investment in the mining sector. However, infrastructure issues inevitably arise in the development of this sector.

Infrastructure development in the mining sector has opened many opportunities attracting potential investors. Experts emphasize that attracting investment

from both neighboring and distant countries in the areas of construction of energy, power plants, roads, transportation, manufacturing and irrigation systems is entirely possible.

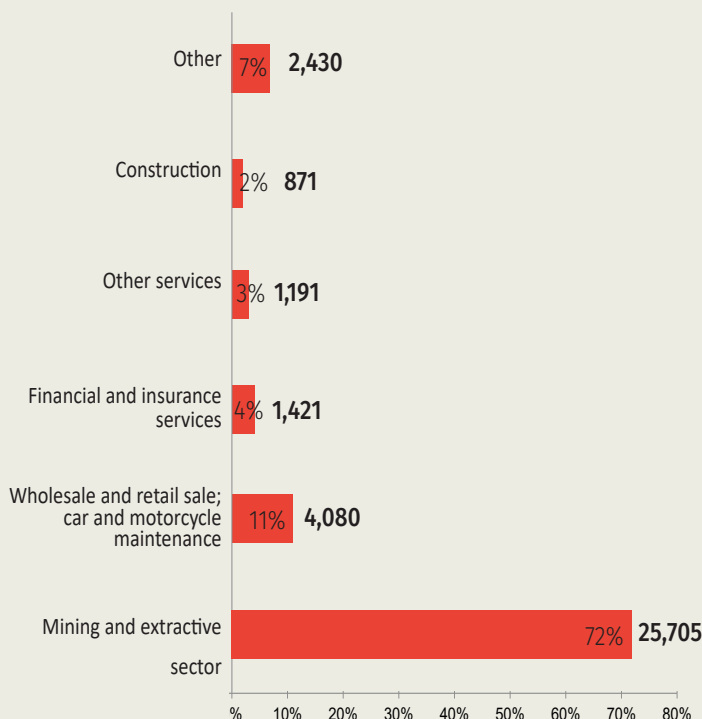
The investment in mega-projects and funding per project has been growing rapidly in recent years. According to a study by the McKinsey Institute, global investment in energy, infrastructure, mining and real estate is expected to double by 2030. The study states that, investment in infrastructure, mainly concentrated in mega projects, is expected to reach an average of US \$3.4 billion per year.

Internationally, a project which requires an investment of more than US \$1 billion is a mega project. However, in some countries, projects which require more than 500 million U.S. dollars are called a mega project. In Mongolia, either project can be considered a mega project due to our smaller population and market size, said former Prime minister M. Enkhsaikhan. The mega project however differs from simple projects by the results, duration, negative consequences of failure and the financial capabilities of the implementer.

There is a common tendency for mega-projects to go over the estimated cost, run past the forecast due date and produce less than initially projected. A survey by the Research and Statistics Department of the Bank of Mongolia mentioned that this tendency has been termed as “Iron law of mega project”. We need to develop a good plan and do a lot of research without rushing while still managing to implement the mega projects on a timely basis. In order to attract foreign investment, there is a need to make a strong legal framework and create a politically risk-free environment while solving problems prudently. There are many factors which affect a mega project. The most important are policy planning, the readiness of human resources, project management and the legal environment.

In 2013, Mongolia re-enacted the Investment Law which has to date been amended six times. Each time ►

Top 5 sectors that attract FDI



Source: National Development Agency



A construction contract of the plant will be signed with the contractor in the first quarter of 2022.

- ▶ the law was amended, there were superficial changes made regarding structural changes, such as changing the terminology of the law and changing the institution in charge of investment.

Regarding the on-going need to amend the Investment Law, Kh. Batjargal, Head of the National Development Agency, said, “This is not just a matter of changing a few provisions of the law. It is about the comprehensive renewal of fundamental change of the investment. In addition to the Investment Law, the Tax Law, the Land Law, and the Diplomatic Service Law also need to be amended.”

Amendments to the Investment Law are just the first steps of what needs to be done. There is no need to pay attention to the \$100,000 limit in investment in the current law. What matters most is how many jobs the investor has created in Mongolia, how much tax they have paid, and how stable the operation is. Attracting investment in mega projects will be easier once all these issues are realized and solved comprehensively.

Although there are over 30 projects which highly impact the social, economic and state budget, even these projects have a budget of less than one billion USD in our country. Among them are many mega-projects which could possibly attract investment of more than USD 1 billion. Feasibility studies for some of them are currently in progress and other mega-projects are at the stage where an investment agreement is ready to be signed.

Tavan Tolgoi Power plant construction project

Oyu Tolgoi is one of the few projects which attracted

foreign investment during the pandemic. The project purchased electricity to the amount of USD 650 million from China's Inner Mongolia power system from the years 2016 to 2020. This indicates that approximately US\$160 million is spent on energy every year. If the Tavan Tolgoi power plant is put into operation, the same amount of funds will be retained in Mongolia.

This project will also provide reliable mining energy for South Gobi and save coal transportation costs. In addition, this is an important project which has a positive impact on the development of small and medium-sized enterprises, creates job opportunities and reduces the loss of transmission lines. The government will focus on launching this project in the near future, said Tavinbekh.N, Minister of Energy, in his statement earlier this month. In this context, an international tender has been announced for 90 days to select the contractor for the construction with a turnkey agreement of the Tavan Tolgoi power plant. Subsequently, once the tender has been successfully organized, a construction contract will be signed with the contractor in the first quarter of 2022.

The signing of this agreement will result in 450 MW new thermal power plants and 220 kV overhead transmission lines being put into operation in 2025. Erdenes Tavan Tolgoi will fund 30% of the project and the remaining 70% will be funded by bidders on the basis ▶

In Mongolia, either project can be considered a mega project due to our smaller population and market size, said former Prime minister M. Enkhsaikhan.

► of government guarantees.

The successful implementation of this project will surely send a message to investors that will have a positive impact on the future of many unimplemented projects in the energy sector.

Copper Smelting and Processing Plant Project

According to the preliminary feasibility study of the copper smelting and processing plant, the project requires an investment of USD \$190-210 million to generate funds and as the result of implementing this project, 1 million tons of copper concentrate 57,000 tons of pure cathode copper, 5.7 tons of gold, and 57 tons of silver. Refined gold and silver will be supplied to the Bank of Mongolia, with estimated sales of US\$1.6387 billion.

With the commissioning of the Oyu Tolgoi underground mine, 180,000 to 200,000 tons of copper concentrate will be produced annually from 2022 to 2025 and 99,999 percent gold and silver will be produced. Trading copper in a fully processed form rather than a

concentrated form is important as it increases the foreign exchange reserve.

China alone accounts for 45% of copper consumption. Therefore, Chinese investors are highly interested in investing in copper smelting plants according to the project unit. At present, with the purpose to solve the investing and financing issues, investor selection is processed in accordance with internationally accepted methods. Seven companies from China, Germany and Japan have submitted bids. In the sense of ensuring the supply of raw materials, a copper smelting plant can attract many investors. The government tends to deal with an agreement holding not less than 10% of the company's shares without an investing cost and the project unit is planning to organize the selection in the first quarter of 2022.

Coal bed methane project

The state-owned Erdenes Methane LLC started exploring for coal bed methane in the Tavan Tolgoi deposit in 2017. The study determined that there was a methane reserve in the Tavan Tolgoi coal deposit. In 2019, an exploration was conducted by Erdenes Methane LLC which an Australian company, Jade Methane LLC funded 100-percent without any cost to the state budget. As a result of the open tender, the project unit emphasized that Australia's Jade Methane LLC is obliged to complete the exploration work within three years in accordance with the financing agreement. Once the reserves are determined, methane can be mined from the coal bed, a certain amount of energy can be supplied to the country, and then exported, creating numerous job opportunities and completely solving the problem of urban air pollution.

Jade Methane LLC raised US\$5.4 million by issuing a share on the Australian Stock Exchange last October. The project administration emphasizes that the raised funds may be utilized only for project related purposes according to the stock exchange rules. Also, the investor's registration on the Australian Stock Exchange should be viewed from two perspectives. First, the activities of investors and the expenditure of any funds have become more transparent and open. In other words, all costs associated with the project become "glassy". On the other hand, registering gives companies the right to openly trade and increases the financial capabilities of investors. Therefore, the necessary funds of the project and the conditions to continued success are being provided. ■



Investor selection process of the copper smelting and processing plant project is underway.



Jade Methane LLC started its drilling to determine a methane reserve on 28 November.

Bank IPO

Immune Boosting Reform



As of June 30th, this year, total assets of the banking sector increased by 17% compared to the same period of the previous year, reaching 39.7 trillion tugriks. Over 90 percent of these funds are controlled by the 5 major commercial banks.

The train has left the station

The main players in our country's financial sector are the banks. As of today, 12 commercial banks are operating in Mongolia and serving 1.4 million depositors and 3.1 million saving account owners through their network of 1,400 branches. The total amount of money circulating in the banking sector is almost triple that of the state budget. As of June 30th, this year, total assets of the banking sector increased by 17% compared to the same period of the previous year, reaching 39.7 trillion tugriks according to statistics provided by the Bank of Mongolia. Over 90 percent of these funds are controlled by the 5 major commercial banks.

Compared to 30 years ago, the banking sector scene is totally different now. Before the economic transformation, the Bank of the People's Republic of Mongolia operated independently, but from 1991 a two-level banking system was established in which the central bank and commercial banks coexisted. There

have been success stories and failures over those 30 years since 1991. This can clearly be seen in the fact that 35 new banks were established while over the same period more than 20 of them went out of business.

After the “evolution” of the 1990's, the banking sector was able to stay on a solid footing and develop into its current position. Now, it's time to take the next step. But there are still plenty of issues especially related to banking governance that need to be addressed. In particular it is not uncommon for just three major shareholders that hold over 90 percent of the total shares of a specific bank, and this is stifling the opportunity to grow. Therefore, the time is now to change the shareholding strategy at banks that are at a crossroad. They need to be more transparent and accountable as we progress into the 21st century.

The Banking Law of Mongolia has been updated and approved by parliament on 29th of June, this year, after much discussion about necessary banking

► sector reform over the last 3 years. So the movement to bring the banking sector into a new future has gained traction by providing the legal environment to implement those reforms which can be described as a truly historic achievement.

Reflection of a share...

The main goal of the banking sector's shot in the arm after 30 years is to drastically reduce the power of the major shareholders. To do this, commercial banks operating as limited liability companies will be transformed into joint-stock companies. The most important step in this transformation is the Initial Public Offering or IPO, a process by which banks sell their shares to the general public. Economists believe that this will reduce the dominance of the major shareholders. International experiences have taught us that having just a few influential shareholders will become a major obstacle for bank development in many ways.

For example, according to an international study, in the Middle East, the more shares that are held by just a few influential shareholders tends to increase the risk of decreasing financial capacity. In Europe, banks with just a few major shareholders will create credit risky funds based upon their own judgments and estimates in order to make the books look good. In addition, shareholders of many European banks that exist in the form of limited liability companies are actually the larger investors and non-financial

Having just a few influential shareholders will become a major obstacle for bank development in many ways.

companies, and that's why these types of banks tend to pursue riskier strategies and operations.

According to a report on the first half of this year, State Bank which is owned by the Ministry of Finance and the Saving Insurance Corporation is ranked fourth by fixed assets and second after the Trade and Development Bank by non-performing loans on its books.

In addition, commercial banks are not obliged to comply with the governance and transparency requirements of the Mongolian Stock Exchange. Also, inspections by the Bank of Mongolia are required to be implemented on a regular basis, thus it has limited control over the high risk operations of these banks which only have a few major shareholders.

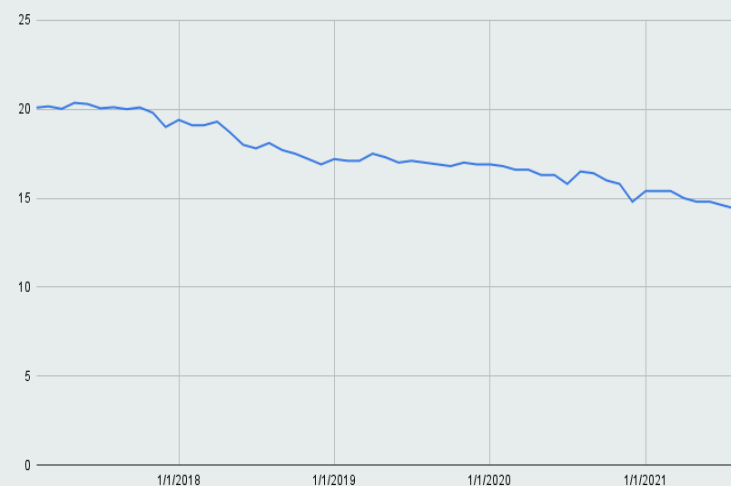
When a bank becomes a joint-stock company and thereby attracts new investments, the bank's equity structure and quality will be improved, and the bank will be more able to cope with stressful financial situations. Economists also believe that owners will now be able to avoid the negative impacts of major shareholders interfering with daily operations of the banks, working under political pressure, and granting loans that clearly create a conflict of interests.

Limiting interest charged on credit facilities

One of the biggest goals behind the banking sector reform is reducing the loan interest payable which has become the main target of populists. Over the past 30 years, loan interest rates have fallen from 300% to 15%, but they are still high in comparison to other countries. From 2010 to 2019, the average loan interest rate was 18.6% which ranks Mongolia in the first 20 countries from among the 140 countries listed in the World Bank's database. This is why our country has formulated a strategy to reduce loan interest rates and this strategy was implemented from 2018. In the last five years, interest rates have fallen from 20% to 15%. Mongol Bank predicts that if we continue on this path it might be possible to reduce rates to 12% by the end of 2023.

Since 2018, when the discussion about reforming the banking sector intensified, the strategy to decrease interest rate on loans has been implemented. At that time, an asset quality assessment of our country's banking sector was carried out, and on the basis of this assessment, a plan to reform the banking sector was initiated. However, banking reform is not the ►

Loan interest rate fall

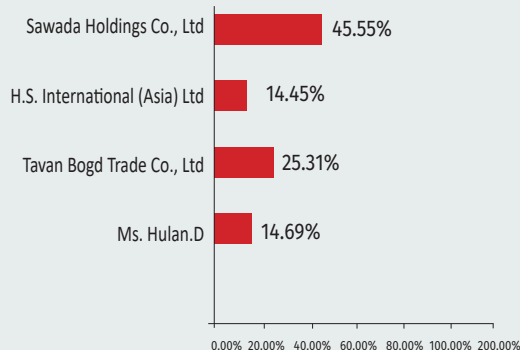


- only way to decrease loan interest rates. We need to have a look at the whole picture. There are three main strategic purposes: creating a macro environment for interest rate cuts, increasing the impact of monetary policy interest rate fluctuations and enhancing the risk tolerance of the banking industry, and most of all improving their governance.

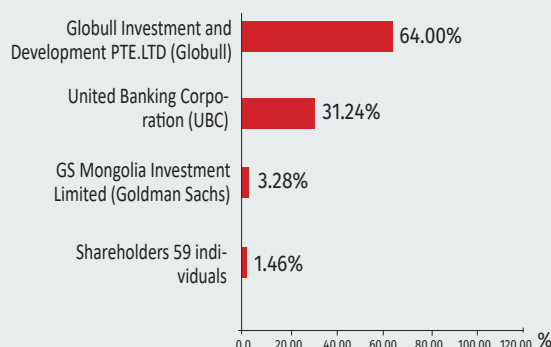
In particular, creating a legal framework to limit the maximum amount of capital that can be owned by a bank owner is a strategically important part of not only the banking sector reform, but also for reducing loan interest rates. Whether or not we will achieve this goal will to a large extent depend on the success of the bank's IPOs next year. ■

The shareholders of the five systemically important banks (D-SIB) in Mongolia

Khan bank beneficial ownership

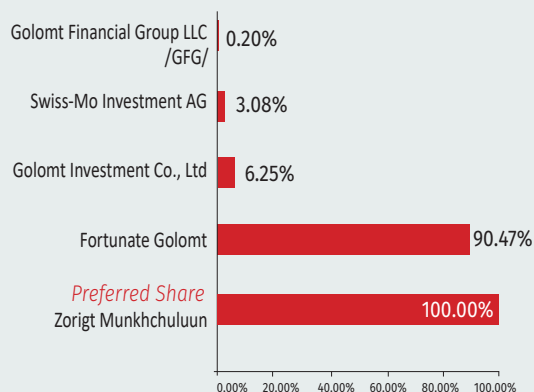


The shareholders of TDB



The shareholders of Golomt Bank

Share Premium

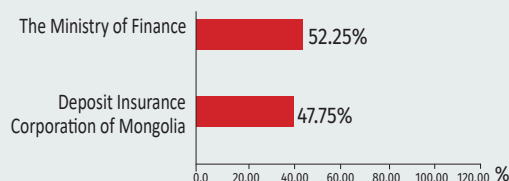


The shareholders of XacBank

Tenger Financial Group (TFG) is a sole shareholder and holding company of XacBank. The shareholders of TFG are:



The shareholders of State Bank



One of the biggest goals behind the banking sector reform is reducing the loan interest payable which has become the main target of populists.

Source:
Websites
of the
banks