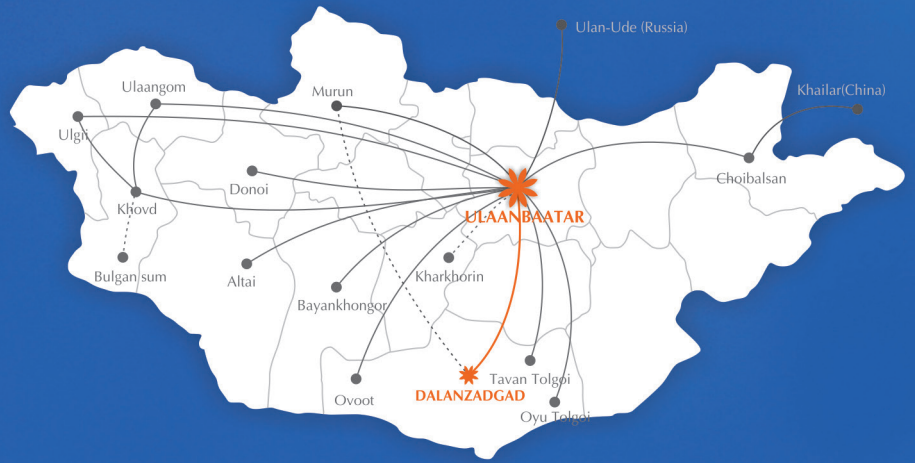


## WHERE IS THE SOUL OF THE MONETARY POLICY?





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ECONOMY

The National Statistical Office of Mongolia and the World Bank have announced that poverty rate in Mongolia has decreased to 29.8 percent. However, citizens are sceptical about the information released by officials. One doubted that the research was conducted with the assistance of the World Bank. The scepticism comes from the long queues that form each month in from of banks so people can collect their MNT 21,000 allowances from the Human Development Fund. People are also feeling pressed due to rising meat prices. A study from the National Statistical Office of Mongolia states that 36 percent of a total of 713 families surveyed were identified as “extremely poor” and one in every three people is “poor” (see Chart). Due to distribution of cash for every newborn child and quarterly subsidiary for children, poverty rate reached 27 percent).

FINANCIAL MARKET



**The Mongolian Stock Exchange** has introduced the T+3 systems, which allows the completion of a transaction within three-work days. The stock exchange said this system would enhance liquidity and improve trade prices, in addition to creating greater demand for trading on the Ulaanbaatar market. The T+3 systems create a convenient environment for investors to participate in securities trading. The agreement with banks was made with Mongolian Securities Clearing House and Central Depository.

**The firm E-trans Logistics** released a public offering on Mongolia’s capital market on 24 April, issuing 7.7 million shares to investors.

Orders from investors, however, reach 13.19 million shares. Total profits from the issuance reached MNT 924 million. The offering by E-trans was this year’s first for the stock exchange. The company transports goods through the Zamiin-Uud border point.

**Three-month copper** on the London Metal Exchange edged up \$7 to \$8,407 a tonne by 0024 GMT. Copper ended slightly lower on Monday as worries about Chinese demand pushed the metal off a session high of \$8,496.75, its loftiest since April 4. Large Chinese copper smelters and trading firms will export refined copper cathodes to the London Metal Exchange warehouses over the next two months to help ease tight global supplies and trim near-record stockpiles at home. Global demand for refined copper is expected to exceed production by 240,000 tonnes in 2012, but the market is

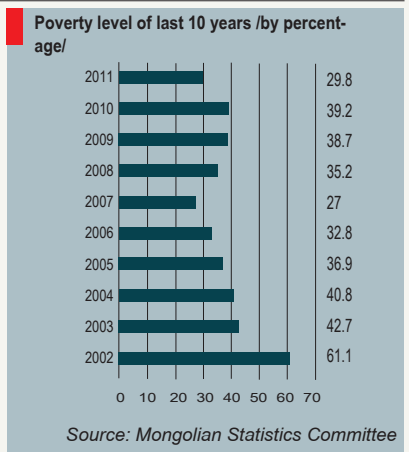
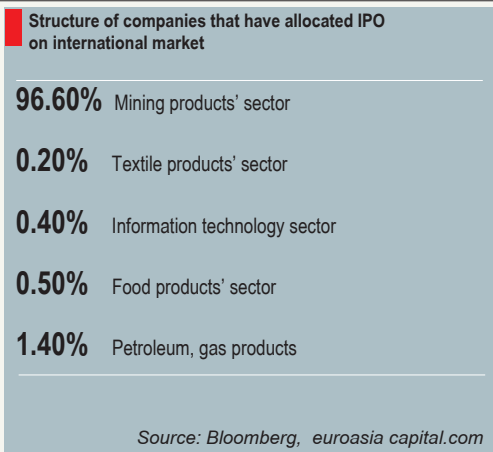
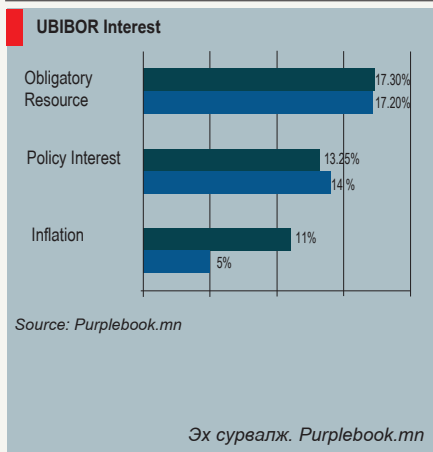
projected to move into a production surplus the following year, the International Copper Study Group (ICSG) said.

CHINA

**China’s Longan Law Firm**, in conjunction with Volvo Construction Equipment, will organise the Chinese-Mongolian Investors’ Conference-



2012 in Beijing on 18 June. The discussions will mainly focus on investment opportunities in Mongolia’s mining sector and issues surrounding the legal environment. Also, representatives of both countries will announce collaborative projects. Over 50 Chinese companies such as Shinhua Group, China Gold Group and the China Development Bank,



as well as over 40 Mongolian companies are expected to participate. The Mongolian Embassy in China, the Chinese Embassy in Mongolia, and the Mongolia Mining Association announced



they would attend the conference.

**China's official** manufacturing purchasing managers' index and which samples conditions in the country's vast factory sector before industrial production data, may have further improved to 53.6 in April from an 11-month high of 53.1 in March, according to analysts polled by Reuters. China's economy, the world's second biggest, is showing some signs of perking up this quarter after cooling consumer demand at home and abroad and tight domestic monetary conditions dragged the annual economic growth rate in January-March to 8.1 percent, the slowest in nearly three years.

#### JAPAN

**After plunging** in the aftermath of last year's earthquake and nuclear disaster, Japanese stocks may be poised for a comeback. Profits for the large-cap companies in the Stock Average will rise 69 percent this year

after plunging 31 percent in 2011, according to more than 2,600 analyst estimates compiled by Bloomberg. "The worst is over for Japan in terms of earnings," says Masafumi Oshiden, an investment manager at ING Mutual Funds Management (Japan). "Consumer spending is improving and corporate earnings are rebounding. The cautious mood following the quake is gone." Investors are betting the profit forecasts will turn out to be accurate. Trading at 24.5 times reported earnings, Japanese equities are the most expensive among the world's 60 biggest markets, data compiled by Bloomberg show. If profits rebound as analysts forecast, Japanese price-earnings ratios will fall back in line

with global stocks.

#### INSURANCE

**Insurance companies** earned over MNT 28.2 million last month. Damage-analysis companies earned MNT 49.1 million while companies that specialise in accidental damages gained MNT 6.9 millions. Over the past month, earnings from premiums increased MNT 5.5 billion compared to the same month last year. Compensation from insurance compensation increased by MNT 284 million and double insurance fees grew by MNT 4.4 million.

#### RUSSIA

**The board** of Russia's top crude producer, Rosneft, recommended

company pay out 3.45 rubles per share in dividends for 2011. This is a 25 percent increase from year-ago payments of 2.30 rubles a share, said the company. That brings the sum-total payout to 36.6 billion rubles (USD 1.25 billion).

Lukoil, Russia's biggest private company, announced it would pay out up to 75 rubles dividends, a 27.1 percent increase from last year. Moreover Lukoil plans to distribute dividends not once but twice this year.

Oil firm Gazprom also intends to increase the volume of its dividends. The company's management recommended paying out 8.97 rubles a share. If this is approved, Gazprom's total payout would total 199 billion rubles.



## MONETARY POLICY

## WHERE IS THE SOUL OF THE MONETARY POLICY?



*In addition to highly anticipated elections, there is also monetary policy to think about. Actually the decision to raise the policy rate is not meant to anger the nation. This country can truly appreciate the independence of the central bank. Its independence allows it to function as if it were from a completely different world, however. Lame promises, cash distributions, and expanded state spending has unleashed inflation.*

*Now inflation soars even higher. The Bank of Mongolia has been doing its best to tame the inflation*

*that strangles the economy. Loans become more expensive as the central bank raises the policy rate. Is there no other regulation available to us aside from a higher interest rate? Who is responsible for sky-rocketing meat prices?*

*The Bank of Mongolia is confident that it has made the right decision. Where do we find the true, non-political answer to monetary policy? Economists can guide us through this incomprehensible issue. For that reason, Mongolian Economy has chosen monetary policy as the leading issue in this edition. »*

1. The central bank has increased its policy rate by 0.5 percent and increased its funding to commercial banks. Apparently the Bank of Mongolia consider these measures acceptable in Mongolia's current state. Is there any guarantee that inflation will not rise again?
2. The Mongolian economy is expanding very fast. Some believe using interest rates to control inflation is inconvenient, and say the central bank should change its interest rate policy. Is this really the best method?
3. The Bank of Mongolia has been given the government a loan to pay for the MNT 21,000 monthly allowances from the Human Development Fund after it ran short on Funds. Was this legal? How does this affect the independence of the central bank?
4. What effect will elections have on interest rates?



TS. BATSUKH,  
The head of the Economics department at the School of Economic Studies

### As One Hand Gives, the Other Takes Away

1. The only way for the Bank of Mongolia's to tackle inflation seems to be with its policy interest rate. There is no other option left for the central bank. As a result of its policy, inflation can be maintained at a reasonable level.

However, the negatives could outweigh the positives because increased interest rates make loans more expensive. Investment resources will get more expensive too, which would disturb business and the of the market balance that makes credit possible.

They also put pressure on the market. The reasons for inflation must be carefully considered. According to economic theory, there are two criterium to consider. On the one side is demand and the other is supply. Supply shocks create inflation. Today's monetary policy is eroding demand and closing wallets. It's possible to tackle inflation by reducing assets with an interest rate policy. However, inflation can't be solved by

monetary policy alone.

2. Wage rises and cash distributions are creating inflation. Also people who are taking advantage of the sensitivity of the market are part of the problem.

For example, there is the price of meats. Every spring prices rise and push up inflation because it depends purely on supply. So employing a monetary policy for inflation that is created by conditions within the economy itself is useless. It won't be effective. For that reason, the causes of inflation must be separated and quantified by their influences on supply and demand.

It is the responsibility of the government, not the central bank, to wipe out the causes of inflation. In addition to monetary policy, government regulation is another market influence.

The government must take responsibility for meat scarcity. The central bank and the ▶

▶ government must reach a mutual agreement. Distributing cash leads to an underdeveloped industry that can't produce anything. It is concerning that the government does not explain its supply policy, which would increase product provisions.

Thus, the central bank has decided to close demand, which is a preventive action against inflation and product scarcities. In the end, all of the reasons for a policy must be agreed upon. Introducing a policy that distributes on one side and restricts on the other is ineffective, as we've witnessed for the last four years.

3. The winners of the election will lead the government and enforce its policies. Money plays a crucial role in a country like Mongolia, where the government operates only to fulfill the promises it made. When huge sums of money rush into the

market, the results is a bubble because no real industry has been developed anywhere else.

To prohibit policy makers from acting on their own free will, the central bank holds onto the money. Its regulations allow it to give loans to government. If the government has the final word, then the central bank is left as the creditor.

However, the government must repay its loan within three months. It is uncertain if it can repay the loan it recently took out so soon. Even the next government might not be able to manage. The prime minister and the president of the central bank have equal standings. The prime minister is not allowed to give orders to the central bank president. That's illegal. If the president of the Bank of Mongolia was not chosen by Parliament and was regulated by a different law, it would be even more independent.



O. CHULUUNBAT

(Member of the Parliament, head of the Budget Stading Committee)

### After the Elections, We Might Have More Intelligent Government Policy

1. I have different views on affecting inflation with the monetary policy's interest rate. I used to have the same opinions, since I collaborated on policies at the Bank of Mongolia. If the policy rate increases the market supply is then decreased. These principles are used in big financial markets such as America, Japan and China. We've tried to do the same here, but those teachings appeared to be inappropriate for Mongolia.

2. We must focus on the stability of the currency instead of the policy rate. It is important.

We import up to 80 percent of our production, which effects inflation. People think that inflation is caused only by money. If there's too much money then inflation rises. However, it is a misunderstanding that if the circulation of money is reduced, then inflation would fall.

A small country like Mongolia, which manufactures nothing, has many problems on the supply side. No matter how much the circulation of money is reduced, if a substitute to

a particular product is not introduced then its price will naturally grow. Intentionally or unintentionally created scarcity will create artificial demand. Thus, accounts must be made of where products in the market come from, which happens to be the duty of the government. It is especially important that goods from China maintain rapid supply, changing hands as few times as possible. Without government control, taxed goods would reach the market as close to real prices as possible.

We're currently handling the situation insufficiently. That is what has locked in inflation.

3. The MNT 21,000 monthly allowance programme was ratified when the coalition government introduced its plans and methods to Parliament and will end in June.

It was the wrong decision to begin with. We had to give it to those who really needed to be taken care of. Subsidiaries have to be well targeted and directed. It wasn't so necessary to take care of you and me, right? We are in perfect conditions ▶

▶ for work. Children and elders need care in direct and indirect ways. Mongolia couldn't establish the infrastructure it needs to make men out of its children. Today, only a maternity house is being built.

4. We might finally get rid of politics after the elections. There was only a 3 percent loss to the

budget, and if it continues this way it won't directly affect inflation. The number of risky loans approved by commercial banks would stabilise.

First, inflation won't sky rocket in a short time. Second, the government should run a wiser policy after the elections. We can only hope for a more responsible government.

1. The government has planned to



**B. TUVSHINTUGS**  
(Director of Economy and Research Institute, economist)

## The Government Has Infringed on the Independence of the Bank of Mongolia

increase its expenses by around 35 percent and the distribution of cash will perpetuate price pressures.

Looking from the angle of the monetary policy, the Bank of Mongolia is having a hard time. Policy that is meant to tackle inflation is translated through financial policy and creates price bubbles because of expanded demand. Thus, there is no other option than to strengthen the policy rate.

Since the budget is expanding a great deal, the expectations for a fall in prices is minimal. For that reason, the current monetary policy might not discontinue, but instead be strengthened.

The main contribution to today's price bubble is budget expansion. If this expansion is not reduced, then there won't ever be any improvement to prices.

2. A stabilised budget law will be enforced beginning 2013. Thus, we might be taking an offensive action. Based on real growth, it is true that the economy is expanding very fast. However, we must understand the channels.

How is the interest policy affecting inflation. A lot of people have reached the wrong conclusions because they don't understand it. The restrictions being used now is the classic approach. I disagree with those who say it's out of date. It's possible for us to employ a monetary procurement policy through a proper ratio indicator. People who argue against the monetary policy and say it has to be

different must explain their opinion. They have to specify what policy and which methods they prefer.

The choices to a monetary policy are very specific. It's a decision between the direct and indirect. Though a proper ratio method can affect the immunity of the economy, it has not been studied for Mongolia yet. However, we don't have any other options other than these two methods.

3. In case of economic crisis, the central bank is responsible for supporting the government financially. Currently, there is no such crisis. So it was not right for the central bank to allow credit. It is an infringement to the independence of the Bank of Mongolia. This is regression. Furthermore, the central bank's funding of the government must be put to an end. Its independence must be kept intact.

4. According to the central bank, the ratio between budget expansion and economic growth can be kept within the single digits. There is no evidence that the situation could escalate.

I expect it will be the same as last year. I'm guessing the elections won't affect inflation rates because programme funding expenses have already been included in the budget. They also might have included it their inflation calculations.

However, if new social activities arise and the budget is amended then inflation could rise. ■

LAW

## AGREEMENTS ON DOUBLE TAXATION RUN AFOUL

Issues derived from double taxing agreements are causing headaches for Ministry of Finance. There are plenty of reasons to say so.

BY BAYARAA

**M**ining is the engine to Mongolia's economy. However, the legal environment is acting as a dead weight creating a jam for the development train.

The double taxation agreement, which is the second-most important contract after an Investment agreement, might have less beneficial results for Mongolia than its partners. A double taxation agreement—a tax claim by two or more jurisdictions on the same income—is the basic protection to a country's national foreign trade and economic security.

Mongolia has agreed to such contracts within 35 countries. At present, 30 of them are officially valid. Twenty-six double taxation agreements were ratified between 1991 and 1998, with about eight more passed from 1997 to 2007, meaning about three-quarters of all double taxation agreements were legalised before 1999.

At the time Mongolia was not at the centre of attention like it is now. The government was more willing to make concessions then, hoping to attract investment to Mongolia. Mongolia promised a secure environment by creating a flexible taxing environment for foreign investors. There was little economic growth in Mongolia back then.

Mongolia had little experience with economic agreements and did not

fully understand the consequences a contract could have. Thus, the authorities signed double taxation agreements with almost any country that applied without reviewing the contract clauses or doing much research. It is a common that developed countries benefit more than developing countries from double taxation agreements.

### Three Strikes

Mongolia is like a company seeking great profits. Its owners are hoping for big gains with few losses. But what should he do when a competitor comes in and wants to expunge his company from the market, take all the profits with him? This is the fear that Mongolians have. Obviously Mongolians should respond by protecting their income.

Every country and company seeks profits for their products. Who would want to work without making any gains? But what should be done if big transnational companies want to snatch up the market? What if they want to play a game with their weaker partners, looking for a way to pay the least amount of taxes possible using loopholes in domestic laws, regulations and agreements with other countries?

"We have made rather poor agreements compared to those made by the United Nations, as



well as double taxation agreements signed by countries similar to or even more underdeveloped countries than Mongolia, like the Philippines and Ghana", said J. Ganbat, the head of Income Division of the Budget Policy Department at the Ministry of Finance.

Issues derived from double taxation agreements are causing headaches for the Ministry of Finance. It cannot collect taxes from some entities existing within Mongolia due to double taxation regulations. The Mongolian Domestic Income Taxing Law for Enterprises orders that a non-residential individual or entity must set aside 20 percent of earnings fo

► taxes. However, previous double taxation agreements state that one country (India) is responsible for paying just 15 percent tax, while around 10 others need pay only 10 percent tax. There are also four countries that do not have to pay any taxes at all.

This law also orders 20 percent royalty payments be taken from non-residential tax payers. But those that signed double taxation agreements leave only one country (Russia) left to pay that 20 percent, while 10 other countries pay 10 percent. Even more surprising, the double taxation agreement with Switzerland allows it to avoid paying taxes completely. Mongolia has given too much freedom to its foreign investors.

The amendments made to the Mongolian Domestic Income Taxing Law for Enterprisers, passed on 26 November 2011, has non-residential tax payers responsible for paying 20 percent tax on their Mongolian income. The double taxation agreements signed with Canada, North Korea, India, Italy, Luxembourg, Malaysia and the Netherlands give the Mongolian governments the right to take taxes for money incurred from technical service payments. However, Mongolia can't collect from any other country.



Non-residential tax payers have to pay 20 percent taxes on their income from interest. However, Belgium, France, Luxembourg, the Netherlands and Switzerland are exempt from taxes from interest derived from any banking or financial organization in Mongolia. In addition, countries such as Kuwait and United Arabian Emirates do not pay any kind of tax on interest. The double taxation agreement itself contains lots of foulds and a claim could be filed to World Trade Organisation (WTO).

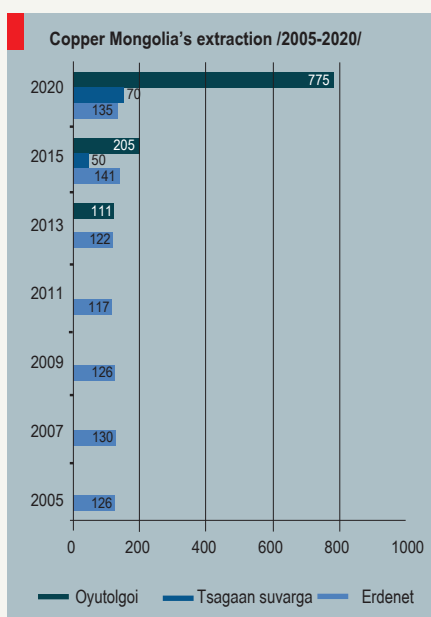
A recent example is the case of South-Gobi Sands. Changes in laws are being made so Mongolia can have the power to regulate mine transfer and taxing issues. However, Article 13 in the double taxation agreement with Canada, prohibits Mongolia will from collecting any taxes. The article says that Mongolia can take taxes from shared profits both directly and indirectly related

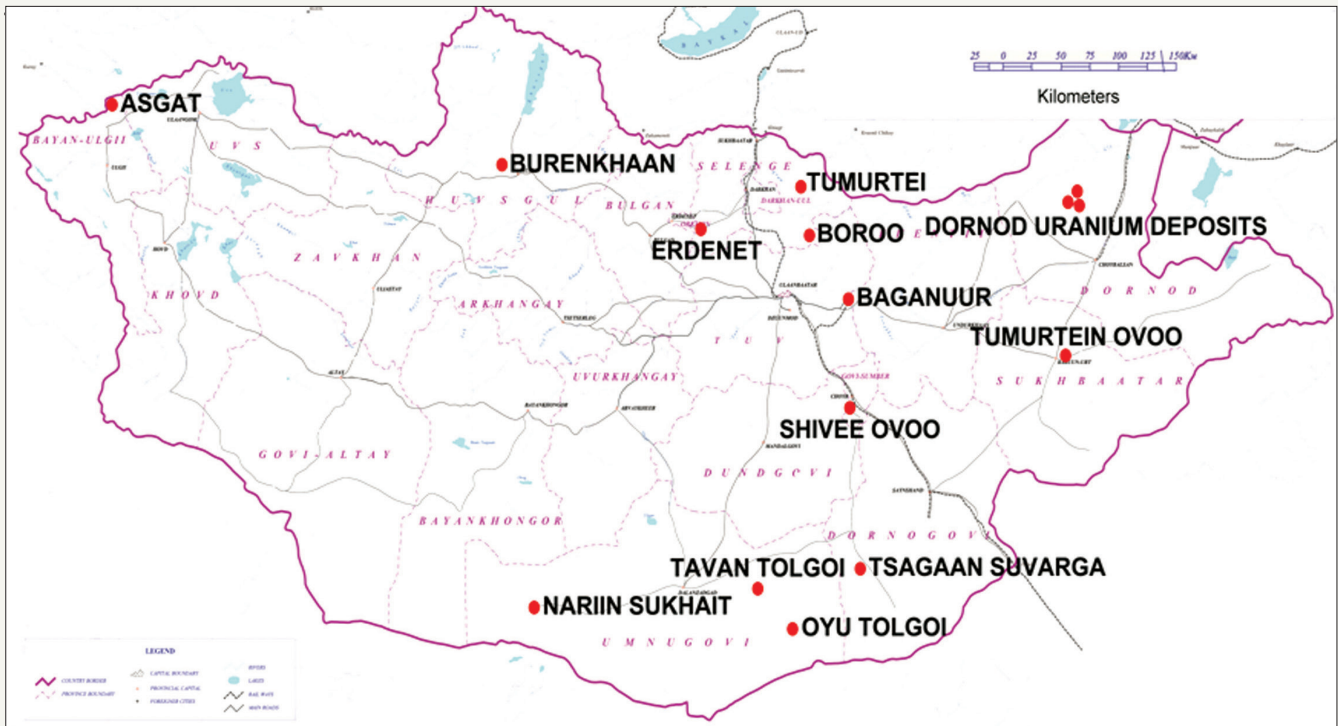
to real estate located in Mongolia. It is only enforced, however, on rented estates used for "real estate" purposes. For that reason, Mongolia cannot benefit from taxes from these kinds of assets. Thus, changes to the double taxation agreement with Canada must be made.

## Foul

Taking advantage of weakness in the double taxation agreement, foreign companies register their head office in the Netherlands or Luxembourg to avoid taxes. There are statistics revealing that 27 percent of direct investments made from 1999 to 2010 to Mongolia were from companies registered in the Netherlands.

The Mongolian National Foreign Investment Authority states that the Netherlands allowed investments worth USD 232.9 million in 2010. According to Mongolian Natural ►





▶ Resource Authority, 23,502 exploration and exploitation licences have been granted. Of those special licences, 26 percent (6,125) are owned by foreign enterprises. Among these foreign invested companies, the Netherlands possesses 80 licences, while Luxembourg holds four. Mongolia is losing huge sums of tax income to foreign countries.

It would require too much time and effort to correct all these agreements. The Ministry of Finance has sent several petitions requesting changes to Luxembourg and the Netherlands since last year. However, neither replied until the ministry sent a message stating that if they refused to accept the petition Mongolia would cancel the agreement. Shortly afterwards Mongolia's foreign counterparts agreed to negotiate. Even though Mongolia has been trying to make changes and improve the terms of the double taxation agreement, there is still the risk that companies could hold their head offices abroad to avoid paying taxes.

"Even if we could revise and renew the tax laws and regulations, there are still too many flaws in the double taxation agreement", said budget policy head at the Ministry of Finance B. Batjargal. "And these are the main issues to tackle with that create tax exemptions. Non-residential tax payers have to pay a 20 percent tax on dividends,

royalties, services and interest. But we are in a position that we can't collect from most of them".

The Ministry of Finance has developed a draft law that would replace the current double taxation law. According to the ministry, all double taxation agreements could be annulled. After some revisions to the domestic tax law, agreements applicable to the reformed double taxation law could be conducted with foreign countries in a diplomatic way.

Batjargal explained if the gap within the law is not filled soon, then Mongolia won't be able to collect on some taxes once the mining industry gains momentum.

The Ministry of Finance and the General Department of Taxation have collaborated on a revision of the Mongolian Domestic Income Taxing Law. It grants that if more than 10 percent of shares of a company with exploration licences is sold, Mongolia could tax the profits from the transaction.

The essence of the double taxation law lies in the fact that the associate must pay tax to the government from where an income comes from. If a Chinese company is making money on Mongolian territory, it has to pay taxes. It is crucial to fix the problem now, when mining is booming and transnational companies are operating in Mongolia.

## The Getaway

When introducing the 2012 budget to Parliament in October last year, Prime Minister S. Batbold said that if the double taxation law was found to be detrimental to national security then it must be revised and changed.

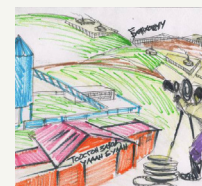
Depending on the effect it has on the nation, annulments can be made. Parliament may cancel double taxation agreements beginning at the second quarter of this year. All double taxation agreements are planned for cancellation by 2013. Those affected will be notified before 30 June.

There are examples from abroad of annulling such agreements when impacting on revenue earned. For example, on 30 June 2008 Argentina annulled its double taxation agreement with Austria because the former was not receiving any tax revenue. Both countries' investors were displeased with the decision. On 29 June 1987, America also cancelled its agreement with the Netherlands. The end agreement was a great win for America because a third party could not abuse the agreement.

Although nations have been negotiating for resolutions to problems with amendments to laws for about eight years, Dutch authorities have refused to change their country's status as a paradise for tax collection. ■

REPORT

## THE NEEDS OF RAPID ECONOMIC DEVELOPMENT



JAN HANSEN  
Senior financial specialist of ADB

Government expenditure in 2011 increased by 55.6 percent, or 44.2 percent of GDP, for spending on social transfers, wages and cash transfers surged. While the Bank of Mongolia has significantly tightened monetary policy since early 2010, inflation increased to 15.3 percent in March 2012 and is expected to remain in double digits in the coming two years.

Mongolia's economy is developing rapidly, but fiscal policy must balance the need for macroeconomic stability and support for long-term economic growth that benefits all Mongolians.

Economic growth in Mongolia is forecast at 15 percent in 2012 and 17.5 percent in 2013, driven by mining-related investment and output, according to the Asian Development Outlook 2012 released on 11 April. Mongolia's economy however remains highly vulnerable to commodity price fluctuations and developments in international financial markets. Continued uncertainties surrounding the resolution of sovereign debt problems in the euro zone pose the biggest threat to the world economic outlook.

Gross domestic product (GDP) expanded by 17.3 percent in 2011. Economic growth was mainly driven by infrastructure spending related to mining activity. Gross capital formation increased by about 60 percent in real terms, including for equipment, buildings and intermediate goods, and public infrastructure. The first phase of investment in the Oyu Tolgoi copper and gold mine is projected to total \$5 billion and the mine is nearing commercial production. Domestic consumption, such as the sum of private and public consumption, was another important driver last year, rising by about 15 percent in real terms.

External trade soared in 2011. The value of

exports, driven by increases in the volume and value of coal production attributable to demand from China, rose by 64.4 percent. However, imports more than doubled, largely related to the equipment and machinery needs of the mining sector. Net exports were negative and, therefore, significantly reduced the national accounts measure of overall growth.

While economic growth primarily originated in the mining sector, it was quite broad-based. Domestic trade (wholesale and retail) rose by 42.5 percent, stimulated by large government cash payments to all citizens. The mining and manufacturing sectors rose by 8.7 percent and 16.0 percent, while construction increased by 14.3 percent. Agriculture, which accounts for more than a third of total employment, was flat.

Macroeconomic management of an economy characterized by very rapid development of its natural resources often leads to what is called "Dutch disease"—that is, high inflationary pressures, upward pressure on the exchange rate, crowding out of the private sector, and increasing vulnerability to external shocks. In Mongolia, substantial public investment in infrastructure is needed to develop the natural resource sector in an environmentally friendly and equitable manner; diversify the economy; and create jobs and increase access for all people to essential services like health and education, housing and water and sanitation. However, overly expansionary fiscal policy, in

particular universal cash payments from the Human Development Fund, have created inflationary pressures and made the economy vulnerable to external shocks. Government expenditure in 2011 increased by 55.6 percent, or 44.2 percent of GDP, for spending on social transfers, wages and cash transfers surged. While the Bank of Mongolia has significantly tightened monetary policy since early 2010, inflation increased to 15.3 percent in March 2012 and is expected to remain in double digits in the coming two years.

The need for expenditure policies that support inclusive growth without undermining fiscal sustainability and macroeconomic balance requires re-direction of government expenditure towards long-term investments. The recent introduction of a mean-tested poverty benefit under the amendments to the Social Welfare Law, replacing the universal cash transfers, represents a major step toward a fiscally sustainable social protection system that effectively supports the poorest. The government has also strengthened the legal framework for fiscal policy and budget management through enactment of the Fiscal Stability Law in June 2010 and the Integrated Budget Law in early 2012. The fiscal law aims to ensure that mining revenues are better managed in the future by putting in place three complementary fiscal rules to ensure fiscal discipline: (i) a ceiling on the structural deficit; (ii) a ceiling on expenditure growth and (iii) a debt ceiling. Implementation and enforcement will make an important contribution to insulating fiscal policy from commodity price shocks and smoothing the economy's adjustment to higher mineral output. In turn, this will facilitate development of the non-mineral economy. The budget law is a comprehensive law which aims to reform the entire budget process

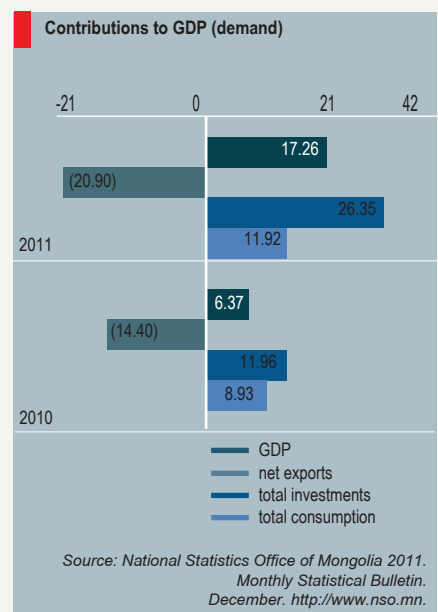
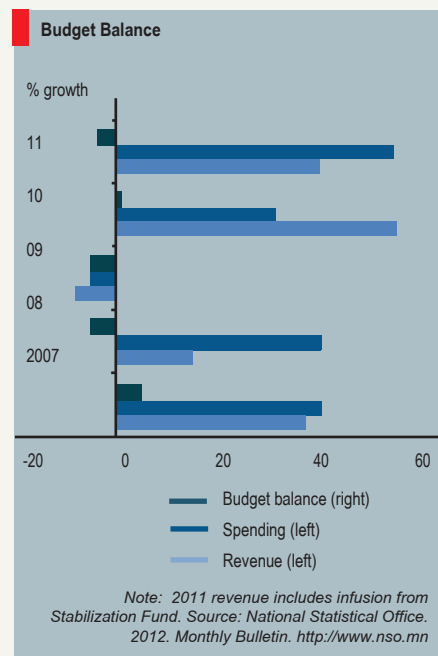
from investment planning to budget execution and auditing, and puts in place a new framework for fiscal decentralisation. It is vital that both these laws be implemented in spirit and practice.

The banking sector has recovered considerably since 2009 when it experienced a period of severe financial distress. However, rapid expansion in bank lending – up by around 55 percent year-on-year in March 2012 – is fueling demand and increasing the banks' vulnerability. It is critical that the central bank closely monitors financial risks and enforces full compliance of Mongolian commercial banks with current prudential regulations.

Worldwide, countries have shown that, paradoxically, an abundance of natural resources can hinder long-term development by increasing macroeconomic volatility, thus reducing incentives to invest in physical and human capital and undermining economic and political institutions. Resource dependence often leads to growing income disparities, as resource extraction creates relatively few jobs and a small proportion of the population may secure most of the income. Mongolia, in recent years has experienced a trend towards increasing inequality which eventually could undermine social cohesion and stability. The mining sector creates 90 percent of exports, 30 percent of government revenue and 20 percent of GDP, but only 1.6 percent of employment. For Mongolia, two important medium-term challenges will be to (i) further improve its economic and political institutions so as to ensure transparent, accountable and equitable management of natural resource revenue and (ii) encourage diversification of the economy and create employment by supporting investment in non-resource sectors.

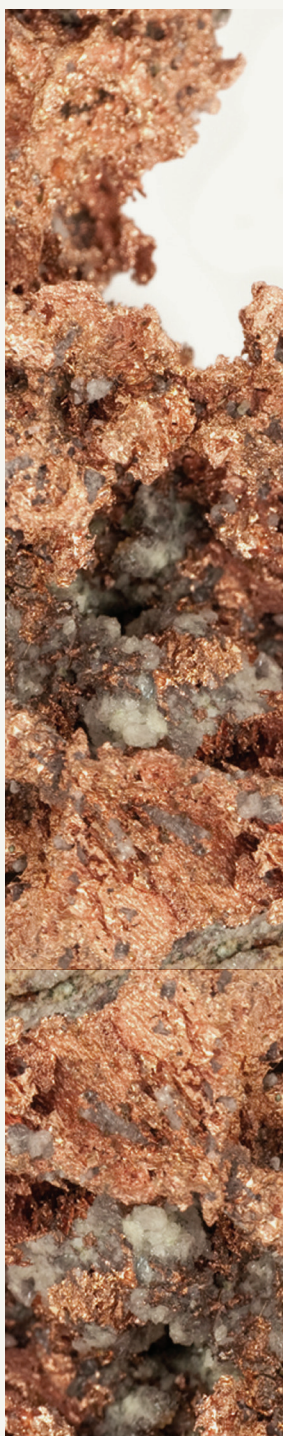
The Asian Development Bank (ADB) is a multilateral development

bank owned by 67 members, 48 from the region and 19 from other parts of the world. ADB has been Mongolia's largest source of development finance for two decades and provided financial and technical assistance for projects in agriculture, education, energy, finance health, industry, telecommunications, transport, and urban development. ■



OYU TOLGOI COLUMN

# 2013



Some are suspicious of Ivanhoe Mines and the 64 percent it holds in the prized Oyu Tolgoi project. Has Mongolian entered into a fair deal?

BY B. BAYARTOGTOKH

The Asian Development 2012 report from the Asian Development Bank estimates that Mongolia's gross domestic product will grow 17.5 percent by 2013. That growth will be triggered by investments into the mining sector and profits from industrial activities. The report delivers facts on a country's macro economics and is considered one of the most important economic documents.

Mongolia is among the few counties with rapid economic growth in the coming years, and Oyu Tolgoi and its surrounding mines are the reasons for this. An economist at the Asian Development Bank, L. Amar, said that Mongolia can expect economic growth of 15 percent this year. Oyu Tolgoi is said to become the world's third largest mine in just four to five years. Mongolia is expected to grow similarly.

Currently, the majority of state budget revenue comes from the mining sector. In March mining products represented 98 percent of all exports. With rapid economic growth, the state budget income has increased as well, meaning that investment into mining is running parallel to the direction of the nation's development.

During the Metals Mongolia-2012 conference, Oyu Tolgoi Chief

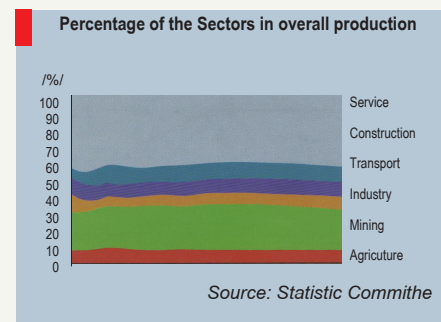
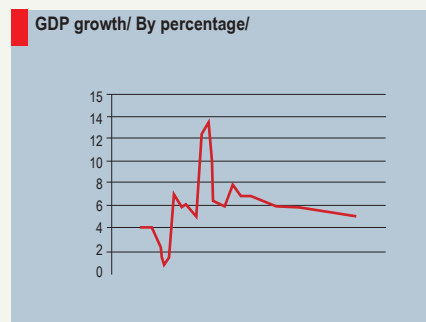
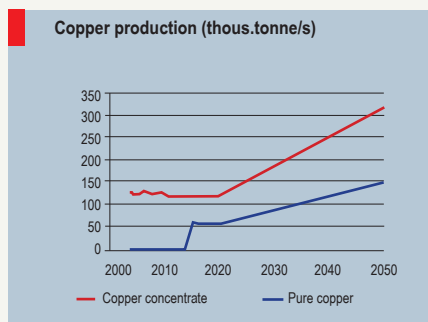
Executive Officer Cameron McRae said the world's copper production demand could reach up to 27 million tonnes. He added proudly that the global copper market would partly depend on Umnugobi Aimag's copper production. Around 14 percent of the world's copper resources have been discovered in Asia, with 2 percent of that found in Mongolia. What is next in store for Mongolia in 2013?

## Ramping up Production

Mongolia could enter 2013 with a new government. Political elections are not good for the economy. But next year offers a whole new chapter for the Mongolian economy. The Oyu Tolgoi processing plant will be commissioned in August. Exploitation of Oyu Tolgoi will begin soon and the project developers will repay those who first invested into the project four to seven years ago.

The copper ore at Oyu Tolgoi has six percent copper concentration, which is considered the purest in the world. China, the world's biggest copper consumer, waits. It would be beneficial to Mongolia to bring added value to its production.

"If the Oyu Tolgoi project operates at full capacity and comprises 30 percent of gross domestic product, »



► then Mongolia's economy would grow even faster" said economist L. Oyun.

In an article, economist D. Jargalsaikhan notes "Let's make economic growth our development".

A report on the economic implications of the Oyu Tolgoi mines states that commissioning the Oyu Tolgoi project would create an additional 35 percent economic growth. This means a third of the Mongolian economy would become dependent on the project.

According to the investment agreement, Oyu Tolgoi's mine should begin operating at full capacity in 2017 with production of 450,000 tonnes of copper as well as great amounts of other metals such as gold.

International trade circulation is also expected to increase. Last year, Mongolia's international trade circulation increased 85 percent. The mine will operate for at least 59 years. Thus, issues on infrastructure must be solved immediately. The government should focus on finding environmentally friendly cost-saving solutions for transportation using railways. The global market will not wait for Mongolia.

Robert Friedland, the former chief executive officer of Ivanhoe Mines, the company which holds 64 percent of the Oyu Tolgoi mining firm's shares, was recently replaced by Kay Priestly. McRae has vowed that development of the project will continue as planned,

despite the installment of a new company head.

"Rio Tinto's 57 percent hold of Ivanhoe Mines shares won't affect the ownership of the Oyu Tolgoi project", said McRae. Having the Ivanhoe Mines board and management structure changed has simplified issues". Promising to provide financial support to the Oyu Tolgoi project, he added, "It enables long-term, stable funding instead of a short-term, transitional financing".

The company's advisor to the Australian consumer economy, BA Economics, estimated that Mongolia's economic growth would reach 7.1 percent by 2030 and 5.4 percent by 2043.

## The Benefactor

The International Monetary Fund (IMF) has named the Mongolian government as the major benefactor of the Oyu Tolgoi project. It also said that 55 percent of total revenue will be given to Mongolia.

Mongolians are the ones who would suffer most from a change in direction to the mining sector. For that reason there have been fears that mining revenues might not be as secure as they once thought. But the deal is considered to be a fair one.

Thus, the agreement should function as a development and economic engine for the country. This is why politicising Oyu Tolgoi is inappropriate. Who benefits from

bringing politics into the situation? Oyu Tolgoi states on its website that at the peak of operations, it will employ 15,000 people, of which 10,000 will be Mongolians.

At present, construction at Oyu Tolgoi is 80 percent complete. The proceedings are six months ahead of scheduled development, which began in 2010. This means 33 months of planned-construction has completed within just 27 months.

"The enrichment factory will be commissioned in August 2012. The first sales will take place in the first quarter of next year. An estimated 500,000 tonnes of enriched copper is planned for production during the first shifts. We have set the goal to quadruple that figure in four to five years", said Oyu Tolgoi head McRae.

All of the company's initial profits will be dedicated to the factory's expansion. By doing so, the Oyu Tolgoi mine will be able to operate more efficiently. Oyu Tolgoi will have spent USD 6 billion before ever producing any copper. In the next four years, the company plans to spend up to USD 5 billion.

The added investment will mainly be spent on expanding the enrichment factory, constructing deep mines, and building power plants.

The foreword to this next chapter of the market continues. ■

BRAND

## PRELIMINARY STEPS TAKEN TO CREATE A BRAND



*Natural, undyed Mongolian yak down, as used in this soft and lofty semi-worsted "Mongolian Beach Blanket" from American luxury brand QuitMadStop, is as exquisite and exotic – and functional – as textiles come.*

BY B. UUGANBAYAR

*You might relate the word brand to quality, prestige or value. It is almost unimaginable to think of Korea without kimchi, Holland without cheese; and France without fragrances such as Dior, Chanel or Gucci, and Japan without Sony, Hitachi or Panasonic.*

*Just as an olive is a symbol to Greece, an apple with a bite to it—as seen on iPhones, iPads and iPods—has become a trademark to America. In this context, a brand is the name card of a country on the global market. For that reason, Mongolia is seeking to create brands for its own agricultural products.*

*The Asian Development Bank (ADB) has developed a project in support of this goal to develop a marketing scheme for the country's agricultural products along with a brand. Mongolia is striving to create a marketing campaign for its national cashmere and wool products under the banner Mongolian Noble Fibres*

*Project's director Juergen Mendritski and Mongolian Vice Director B. Erdenebileg spoke on these developments. Yurgen Mendritski has over 30 years of experience in this sector, having worked in South America and throughout Asia.*

**Why have you specifically chosen the agricultural sector for a marketing campaign?**

Mendritski: Not everyone knows that Mongolian cashmere and wool have the world's second best quality. So promoting this advantage could attract investors. The main purpose is to manufacture products with added value and offer them at the global market.

For this we are working to create opportunities for rural enterprisers and businesses to export their products by giving them advices on brand marketing and product quality. If these businessmen and entrepreneurs make progress and meet our requirements, then they will be able to label their goods under the Mongolian Noble Fibre title. The project is called so because it includes all types of yak wool and camel materials.

Furthermore, we consider leather, milk products, fruits and sea buckthorn as highly competitive products for future brands. For example, we have experimented with producing leather using plant extracts instead of chemicals, which is an eco-friendly method. That's very important. Sea buckthorn appears to be a fruitful product as well. We can make juice and other products out of it.

Erdenebileg: Light industry within agriculture has been developing very rapidly. We chose the most productive sector, which is wool and cashmere. That is why we have set the goal to establish a world brand for this sector, considering the fact that it is the most organised sector that appeals to standards of quality.

In recent years, economic growth has become so dependent on mining that many have advised the country to diversify the economy. The agricultural sector has the advantage of having added value and the ability to recycle raw materials. Thus, we have to introduce our brand to the world based on this advantage.

**Associates of the cashmere and wool sector gathered together to discuss the Mongolian Noble Fibre label last March. The logo will be introduced at the 81st Wool in the City international conference for wool and textiles in New York in May. Can you any provide specific information?**



Erdenebileg: A few years ago, cashmere and wool companies agreed unite under a single logo. However, the decision was delayed for a while. The failure was because the logo's representation, guarantee and its acceptance were unclear. In addition, companies had to buy the rights.

For that reason, we cooperated with the Mongolian National Cashmere and Wool Association and the Ministry of Food, Agriculture and Light Industry for its introduction to companies. We also held a logo competition among local artists. At last submissions by B. Enkhbat and J. Batbayar, titled "Khaan" and "Gerege", were selected. We decided to make a few improvements, however.

According to experts, the most appropriate representation of the brand logo would be the word khaan (king) written in Mongolian script and decorated with a national cultural pattern and ornamental design. The word khaan is used to create the idea that the cashmere and wool products created are luxurious enough for kings. It also has a respectful meaning, referencing a time when ancient rulers wore these on important occasions for government.

During the up-coming conference in New York, we will announce the launch

of the Mongolian Noble Fibre label of cashmere and wool products. However, companies that are willing to use this label must at least meet the standards and qualities required by us for raw materials and final products.

**When will the companies be able to use the label and launch their products?**

Erdenebileg: Launching a brand on the global market usually requires a minimum of five-years' time. But we are planning to release it within three years. Beginning in September last year, we have implemented the first stage of the project for completion in March next year. At the moment, we're working on the general design of our logo. We're also offering a training programme directed on improving the capacity of the companies involved regarding the quality and standards of these products. Doing so allow us to see where and what mistakes we are making in meeting international standards.

Mongolian National Fibre will be registered in September and act as an official certification for the domestic market. Thus, the Mongolian companies that have received approval will be able to use the brand's name. This means we will be ready to launch our products on the world market. »



Also, we plan to open the Brand Management Agency. However, the selection of the affiliates involved is still uncertain. The agency's propose, aside from improving the brand's quality, will be to help create brands for other sectors.

The Asian Development Bank and the government have negotiated the implementation of the second phase of the project for three to four years from now. If they can reach an agreement, then issues on quality and logistics could be legally solved.

#### **What are the most crucial problems hindering the launch for international export?**

Mendritski: The main markets are the European Union, Japan and the USA. The European Union puts strict requirements on cashmere and wool products. Thus, it is important for us to deliver high-quality products just as our customers request. To do so, raw materials productions must follow the standards. Legally we might face some difficulties, which we will be researching and solving at that time.

Erdenebileg: Releasing a brand into the world market normally requires up to 10 years and investments of around USD 20 million. However, we don't have the time or the resources. Thus, we only

have two options.

The first option is the widely used joint-marketing method. This enable us to place our label side by side with other popular labels. If customers approve of the Mongolian brand, then we could expand manufacturing.

Currently, we are researching the possibility for collaboration with the American firms Patagonia, Quit Mad Stop, Canada's Cashmereness and England's Pure Cashmere. We could cooperate with small enterprisers such as Tsas Sogoot and Swiss in order to improve our brand's quality as well.

The most important thing is to choose the most suitable method. Also research on the domestic and international markets is crucial. We are very interested in America, Japan, and England, in addition to the French, German and Italian markets. For that reason, we will explore the demands of these markets and launch the desired brands.

Although we said that we would first choose the product then begin sales, now we will first find out what products are needed and then launch those in-demand products. Improving raw materials and production quality is a priority.

**What is the advantage of using joint marketing and a brand? What**

#### **are the future prospects of the agricultural sector?**

Erdenebileg: The brand will be a great lift to the economy. If Mongolia exported 80 percent of its unfabricated cashmere, a brand would add value to 50 percent of those exports.

As a result, profits will start to rise. It means if we make three jackets at the price of MNT 50,000, the profit would triple to MNT 150,000. Doing so will create beneficial, stable economic growth for manufacturers.

We stand wondering where all the profits from the mining industry went. But with this we will actually feel the economic growth. The government could provide us with the space to release our products or the opportunity to bargain with the European Union on taxes and customs. Or we could even collaborate with countries like Pakistan.

It is not a single company's job to launch a brand. Our project is just at the beginning and preliminary steps. To have satisfying results for manufacturers and herders, the government, the ministries and agencies all have to put their heart into the project and make structural changes.

Mendritski: Introducing a positive image of Mongolian products is a priority. In addition, they must join the Mongolian Noble Fibre project to manufacture more quality products by competing with each other. The agricultural sector would become a supportive boost to the Mongolian economy.

Along with this kind of growth, the tourism sector tends to develop too. This is because if someone really likes the cashmere or wool product they use, they might like to know where and how the product is made. For that reason, they will come to Mongolia.

However, Mongolia needs to invest in manufacturing, equipment and its labour force. European Union countries have been emphasizing their own agriculture for a long time. In the case of Eastern Europe, they tend to forget other important issues by only focusing on a few products. A raw material network and other activities must be monitored. The basis of sector development is monitoring quality that is developed collaboratively through research and auditing companies. One method is to organise auctions. ■

CASHMERE

## CASHMERE PRICE HITS THE GROUND



Uncertainty surrounds the cashmere trade. Will herders get the payday they are waiting for or are they in store for a rude awakening?

BY B. ENKHTSETSEG

The cashmere trade is thought to be the most known and visible industry in Mongolia. Although beneficial to both sellers and buyers, cashmere production faces the hard reality of price. Price is often hard to estimate and is just as sensitive to market swings as gold, copper or oil.

Herders are uncertain whether the price is likely to sky rocket or fall to the ground. Anticipations, however, are high. Last year cashmere reached its peak price of MNT 50,000, said G. Yondonsambuu, the vice leader of the Mongolian National Cashmere and Wool Association.

“Whether or not we accept it, the cashmere price could fall to MNT 40,000 [a kilogram] or even ▶▶

► MNT 36 thousand”, he said.

On 24 April the price had fallen to MNT 45,000 for a kilogram of cashmere. Yet, rumours that one kilogram of cashmere would grow to MNT 100,000 linger still. However, such expectations have been put on hold. Thus there have not been many who can sell their cashmere at initial prices.

A sudden drop in price has panicked herders who had hoped to sell their cashmere for MNT 100,000 a kilogram. Yet disappointment for herders is advantageous to producers. For that reason the Cashmere and Wool Association estimated the opening price for this year would be between MNT 56,000 and MNT 58,000. However, the initial price climbed past MNT 70,000, which has caught many by surprise.

The Chinese, who have dominated the Mongolian cashmere market over the past ten years, are to blame, for they have strayed from the association’s estimates. Mongolia’s basis for comparison in the global cashmere market is China. That’s why Chinese cashmere traders know where in Mongolia they can find the best cashmere.

The Chinese have offered to pay more so they can buy all of the available cashmere on the market. However, Yondonsambuu said that the Chinese have failed to dominate the Mongolian cashmere sector.

Apparently there will not be much strong competition within the Mongolian cashmere trade because the market’s major consumer, Europe, has been dealing with its own economic difficulties. Also, cashmere prices tend to experience four-to five-year cycles of up and down swings. It appears that this year has kicked off a period of descent.

In the middle of last year, combed goat cashmere, the market term for processed cashmere material, cost around MNT 130,000 a kilogram compared with prices hovering around MNT 100,000 a kilogram now. Keeping the rates of raw cashmere

in mind, the price of cashmere on the global market this year could fall as low as MNT 50,000.

In addition, the Chinese government has stopped supporting loan growth.

Thus, Mongolian companies to collect as much cashmere as they do from the domestic market. Even though Chinese traders come to Mongolia with tonnes of cash, domestic producers have experienced change for the better. Mongolian producers have improved their financial abilities with the bond offering that aimed to support cashmere and wool production as well as small-medium enterprises released by the Ministry of Finance last year.

The media has reported that

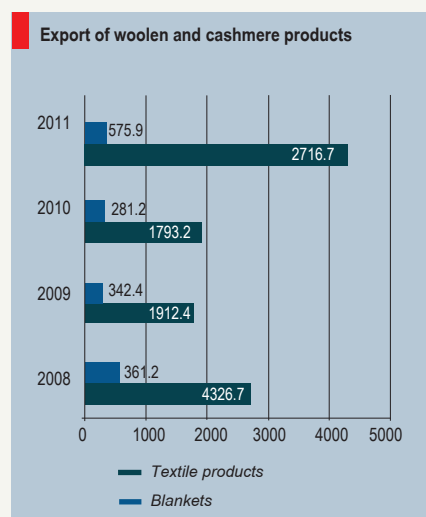
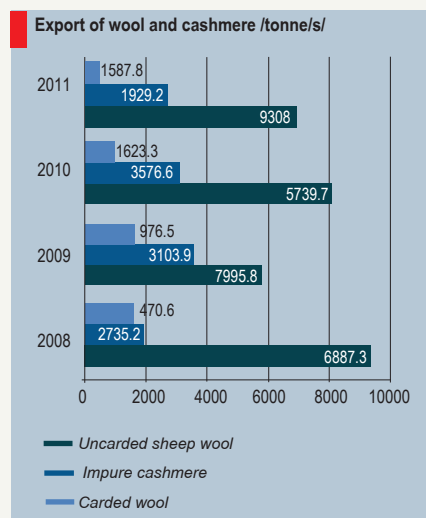
although Mongolian traders are not likely to declare war with Chinese sellers, their Mongolian competitors have the ability to purchase cashmere from herder campsites at fair prices. According to traders at the Emeelt raw material market, exposure to Mongolia’s cold and windy weather during transport is affecting the quality of cashmere. Cashmere is delivered from east to west, meaning that after paying high prices in the eastern provinces and passing through Khuvsgul to the western provinces, traders are likely to get less than they paid for with their damaged goods.

With implementation of the Agricultural Market Law beginning 1 June, the law will bring change to the domestic cashmere and wool trade. The deputy director of Eermel, A. Tumur-Ochir, said that it would require a lot of time to create a market and to establish cooperation.

“It’s difficult to complete the preparational work needed quickly enough. So direct enforcement would not be easy. It is impossible to implement it this year”, said Yondonsambuu. “But next year we start selling on the bourse”.

Cashmere and wool dealers have banded together to establish the National Cashmere and Wool Committee in conjunction with the proposed agricultural trade law. Advised by Japan to attempt to conquer the European market, industry associates have cooperated to enter the global market under the shared-name Mongolian Tansag Us (Mongolian for fine Mongolian cashmere).

It seems cashmere producers have finally rid themselves of their complaints of domestic market prices. Cooperation has created new possibilities. ■



	Production	Export	Import
2010	144.598.90	216.340.000	36.628.60
2011	215.674.50	241.384.50	49.441.60

Source: