For a green development
MONGOLIAN ECONOMY

Mongolia for Sale

Governance for Development

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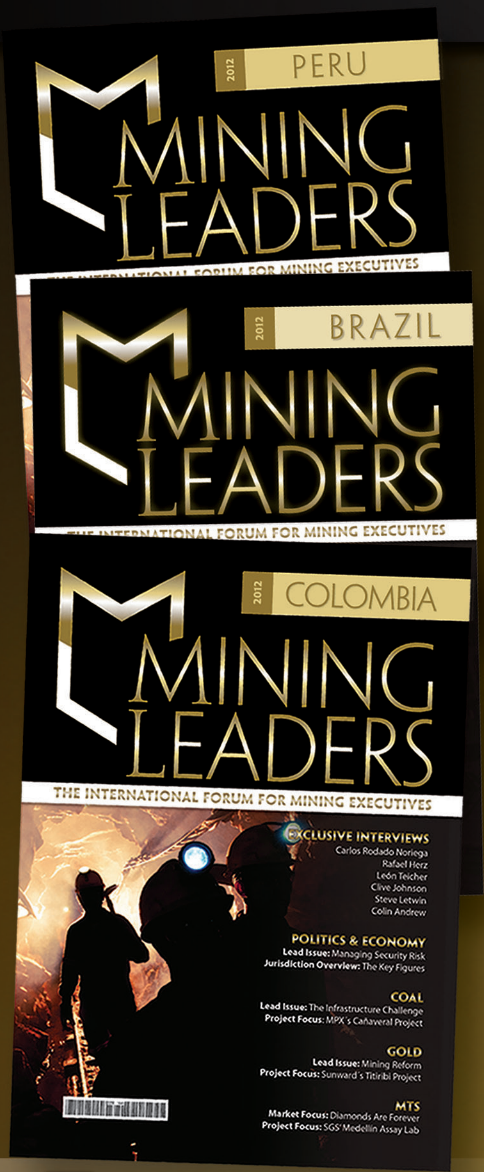
RETOOLING THE CAPITAL MARKET

MINING LEADERS

2013 MONGOLIA

THE INTERNATIONAL FORUM FOR MINING EXECUTIVES



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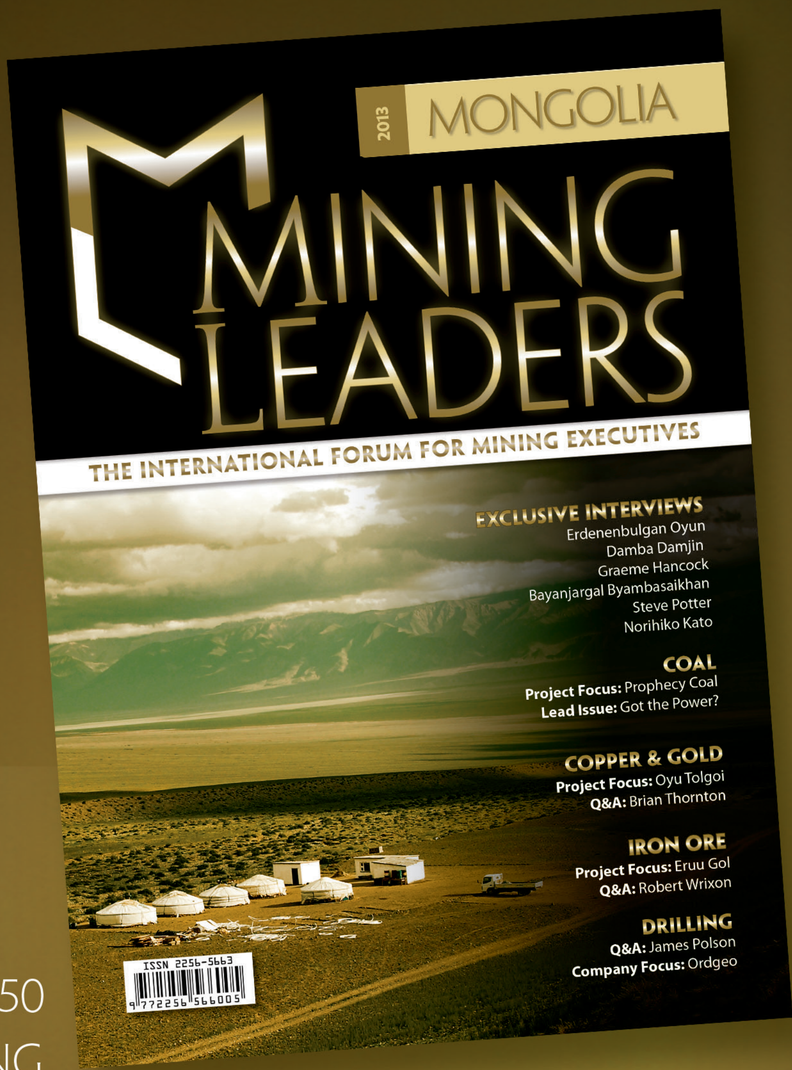

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Thousands of Mongolian youth are participating in the development of the OyuTolgoi project, and hundreds of businesses and suppliers are making their contribution, creating a proud legacy to hand onto future generations. A total investmentof MNT 7.8 trillion (US$6 bln) is committed to the first phase of the OyuTolgoi project. During this period, over MNT900 bln (US$700 million) in taxes and fees will be paid to the Government of Mongolia.

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FOR A GREEN DEVELOPMENT

For a green development

MONGOLIAN ECONOMY

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LABOUR MARKET

According to a recent study from the National Development Institute, approximately 34,000 people enter the labour market each year. Yet, only some 40 percent of them are able to land a job.

POPULATION GROWTH

A projection for population growth from the Ministry of Economic Development reports that then number of working-age Mongolians is expected to grow by 157,000 in 2015, 151,000 from 2016 to 2020 and 238,000 from 2020 to 2030.
Areas near mines and roads, too, are expected to experience population growth. Cities such as Darkhan, Erdenet, Dalanzadgad, Khanbogd and Zamiin-Uud will need urban planning as well as policies for infrastructure.

ECONOMY

As of May 2012, foreign trade in Mongolia reached USD 8.87 billion, a 1.3 percent increase of USD 110.7 million compared with last year. From this trade, exports comprised USD 3.41 billion and imports USD 5.46 billion. Copper comprised 43.9 percent of all exports, refined copper was 19.4 percent, and iron ore was 11.9 percent.
The euro-zone debt crisis and downturn in financial markets will have lesser impacts on the economic growth of developing countries, reported the Ministry of Finance.
The global economy is projected to grow by 3.5 percent this year and 3.9 percent in 2013. According to the ministry's report, developing economies will show growth of 5.6 percent in 2012 and 5.9 percent in 2013.
However, due to slower economic growth, there could be a difference of 0.2 percent.

RUSSIAN

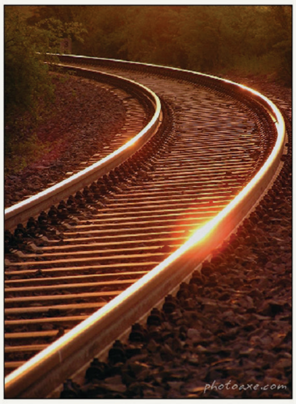
Russian oil exporter Rosneft has raised its fuel prices due to a 6.4 percent tax hike imposed by the Russian government in early October.
The price of A 80 petrol and AI 92 will cost USD 1,133 and USD 1,345 a tonne, respectively. The price of AI 95, however, has not yet changed.
The price growth has triggered concerns among citizens. Thus, the Ministry of Mining is set to discuss issues related to oil production with the rest of government, said ministry officials.

FINANCE

Since the transition to a market economy, Mongolia has officially accepted donations totalling 165 percent of its gross domestic product (GDP). GDP growth last year of USD 8.2 billion reduced that figure to 2.3 percent, reported the Project Finance and Regulation Department of the Ministry of Finance.
Currently, around 120 projects worth USD 1.6 billion are being implemented. The World Bank lists Mongolia as a middle-income country, making it ineligible to receive non-repayable subsidies and eased loan terms.

MINING

The "Macroeconomic perspectives of Mongolia 2013" report by the Ministry of Finance, noted that Mongolia will export 556,000 tonnes of refined copper from the Oyu Tolgoi mine in 2013. The mine will have produced up to 1.9 million tonnes of refined copper by 2016. Coal extracted from Tavan Tolgoi is expected to double next year.
Resolving issues concerning energy and infrastructure would dramatically improve the efficiency of trade and production. According to the ministry's projection, coal production would reach 35 million tonnes a year, while iron-ore would grow by 23.3 percent. Crude oil production would experience a rise of 0.6 percent.



INFRASTRUCTURE

A new railway construction project has received approval for implementation.
Construction is located near Bogd Uul Soum.
The 170-kilometre railway, which would connect Mandal and Bagakhangai stations, is targeted for completion in 2016 and will require USD 326.8 million for funding. The 35 kilometres of railway passing through Ulaanbaatar could also functions as a form of public transportation. ■

WILL FLOWERS FLOURISH?

BY I. OTGON

Although the euro-zone crisis and economic decline of the United States and China have had certain consequences for Mongolia, its economy is still afire. Predictions for next year project Mongolia's economy will continue to grow to the double digits. In this latest issue, *Mongolian Economy* highlights the financial market.

Mongolians were given the chance to receive 1,072 shares of the tremendous Tavan Tolgoi coking coal mine. But last spring they were faced with the choice of whether to wait for greater profits or take fast cash by selling their shares to the government. It was a big decision to make for so many people who never owned stocks in their life.

After the previous government set the unit price of MNT 933 per share, 1.4 million citizens opted to sell their shares back to the government. However, the most important issues were lost during the election, and citizens forgot to ask about their shares.

A year and a half ago, the Mongolian Stock Exchange signed a bilateral agreement with the London Stock Exchange, drawing international attention. This past summer the Mongolian exchange launched the Millennium Exchange trading software. How have operations changed since then? There are many answers people could give, but there is no apparent change other than the colour of the stock exchange building changing from salmon to grey.

However, the changes that have taken place inside are still vague. The public has not been informed of much other than the number of brokers able to trade. However those who are most directly involved in the capital market have felt some changes strongly.

The Development Bank of Mongolia can also contribute to the development of an innovative financial market. Having debuted six months ago, there has not been a single visible result or benefit from the bank's activities to help drive infrastructure projects. International standards also dictate that commercial banks and the stock market create stability for investments in the financial market. However, banks make up 95.6 percent of the financial sector, while only 4.4 percent consists of insurance and other sectors. Although discussions circulate around solving this issue, the current situation remains unchanged.

Changes to infrastructure are just as necessary in the banking and insurance sectors as they are in the financial.

Time will show how the flowers will flourish on the Mongolian Stock Exchange. ■

CAPITAL MARKET

OVER THE HILL

BY B. ENKHTSETSEG

Mongolia's capital market is picking up steam but it has a long way to go before investors will be coming in droves to invest

Once called a capital market cemetery, the Mongolian Stock Exchange, has been brought back to life. Although the exchange still has some lingering issues, somehow it has gotten its engine started again. Looking at some other countries that had a late start getting their capital market up and running, they developed their markets gradually by preparing the needed infrastructure and legal environment over a period of some 10 years. '

But the countries that grew by leaps and bounds did not have the time to build their reforms step-by-step as others did.

To trigger economic growth the Mongolian government renovated the capital market all at once rather than one step at a time, with participation from both local and foreign groups. In the first nine months of this year, the stock exchanged experienced MNT 142.4 billion of trade activity, or 2.3 times more than the same period of the previous year and 1.3 times more than the entirety of 2011. Daily trade turnover of MNT 463 million in the first six months of 2012 grew to MNT 1.4 billion following the transition to the exchange's current system on 2 July using new trading software and regulations.

As of October 2012, market capitalisation on the exchange was MNT 1.79 trillion. Before the transition, 80 brokers traded on the market daily. Since the introduction of the new system, brokers have struggled to meet their requirements, delaying market activity quite a bit. The number of brokers able to trade currently stands at 48, representing an average of 95 percent of the market share in terms of trading activity over the last several years. This number will increase further, with the number of brokers to grow to 100 after Erdenes Tavan Tolgoi lists on the exchange.

In 2010, London and Mongolia's stock exchanges signed bilateral agreements worth MNT 14 billion to reform the market.

Raising the Mongolian capital market up to international standards means achieving five short-term goals named in the agreement. On the technical end, the transition is nearly complete as market officials hammer out the details over controls with software. New regulations, however, are needed urgently via a new financial law.

According to, Temuujin Uurtsaikh, a public relations specialist for the Mongolian exchange, there are plans to introduce greater transparency and risk-management capabilities, and encourage better practices from companies. In this regard, the exchange is moving step-by-step to develop the financial exchange by establishing better credibility, creating more liquidity, and raising the minimum requirements for companies.

Although the transition process has nearly come to an end, the London Stock Exchange (LSE) Group will continue to aid in advanced training.

"The capital market's growth won't stop, although the two years of time contracted has expired", said Temuujin.

One example of how the Mongolian capital market is growing more attractive is FTSE Group's decision to put the country on its "watch list" for the "Frontier Markets" list. FTSE compiles global indexes and provides analytical solutions for investors. Chris Woods, The governance and policy director at FTSE, stressed in an official letter to Khangai Altai, the chief executive of the Mongolian Stock Exchange, that traders on the capital markets have made good progress within a short period of time, developing it in line with international standards and opening it up to international investors.

FTSE will observe how the Mongolian market performs in the coming year before deciding whether or not it should be officially added to the list. It is clear that getting Frontier market status would be a big step in terms of gaining international acceptance from a wider audience of investors.

Clearing the Obstacles

The government action plan passed for 2012 to 2016 lists developing a center for banking, securities trade, and finance as one of its aim. In order to do that, Mongolia needs to pursue international standards.

In addition to the legislation, the country will need a clearing system for securities trade and other infrastructure. A crucial missing piece to today's capital market in Mongolia is a custodian bank. The custodian bank provides services for the transfer of information and clearing securities trade on a capital market. A market can house any number of these types of banks as long as it continues to expand.

"We have to ensure that clearing, depository and ownership issues are cleared up for foreign investors", said S. Tsevegmid, an officer at the Securities Market Department of the Financial Regulatory Commission. "The Financial Regulatory Commission is working on developing the regulations for a custodian bank".

Despite the gains made to the capital market, there are still some lingering barriers that need to be addressed. For instance today's capital market is trading under a new system quite well using international standards, but the clearing system is still complicated and troublesome, experts admit. While the Securities Clearing House and Central Depository is responsible for clearing the trade of securities, another agency should oversee monetary clearing.

In many countries, cash is cleared by an independent organisation called a clearing house. It is a financial institution that provides clearing and settlement services for financial and commodities derivatives and securities transactions.

For the Mongolian capital market, four banks will set out to provide these

services. However, banks typically charge more for these expenses and the work takes more time because of its complexity.

"We needed to choose one of those four banks. But 40,000 of our clients are not happy with the choice we made", said Enkhtungalag Lkhamjav, managing director of MWTrading Securities. "Big investors in particular are terribly unhappy with this issue because trading information passes through these banks".

The market reforms have allowed clients to participate in the trade while the real cost is sustained within the market. A capital market is the best method to effectively propel investment. Market experts who have evaluated the exchange's performance since the change have noted it was a big step for establishing links with international networks and attain opportunities for transnational trading.

But how far can the market go without a clear legal environment? A long-awaited new securities law is currently being held by the Ministry of Justice for further review. However, it is still unclear when this law will be come before the Stake Great Khural.

Though the law will have little effect on the companies already listed and active on Mongolia's exchange and companies currently planning to list there, the market will not see any other forms of securities from the stocks and bonds it already has until the law is passed.

"We are here today without a law. We need a law, but not a perfect law", said Ganzorig Ulziibayar, a member of the Mongolian Stock Exchange's board of directors.

"In 2012, insurance companies still won't have the right to invest. Meanwhile, there is not even a draft law for how they are to use funds. If you want to have people participating in trade, pass the law".

Exiting Development

The number of companies planning for a public offering has been growing. Further, this shows that there are large opportunities to attract large investment to the capital market than there was a few years back.

Economist and television personality Dambadarjaa "De Facto" Jargalsaikhan is optimistic for the future of the capital market.

"Mongolia's GDP [gross domestic product] is close to reaching 10 billion dollars" Jargalsaikhan said. "There are no greater possibilities for establishing a capital market than a country that is generating 10 billion dollars of value."

If we could develop domestic capital market so that companies could finance themselves through bonds and stock offering, they would not have to depend so heavily on banks. But before we get ahead of ourselves, investors will need a better selection of securities available to them.

"If the barriers ahead of the MSE are taken care of, next it would need to attract investors and convince companies that they can bring high-quality products, or securities, to sell. Then bigger investors will become interested and knock on the door" said, B. Dulguun, vice president of the brokerage department at Tenger Capital.

Savings and state funds typically play the greatest roles in capital markets. In other countries, the money from health and social insurance funds is circulated into the capital market.

"Capital markets are based on information", said Tsevegmid of the Financial Regulatory Commission. "Mongolian shareholding companies do not disclose their information... [T]hat makes it impossible for foreign investors to come in and determine how much it should invest in a company".

The ability to obtain information and make decisions regarding how much to invest is an indicator of market quality. A closed system will continue to keep investors away.

For developing countries, removing barriers is easy. But simply developing the infrastructure a capital market needs is not how to remove those barriers completely. The capital markets that tries to do everything at once, however, will never reach the top of the hill. ■

DEBT

MONGOLIA FOR SALE

BY B. ENKHMART

With Mongolia's debt mounting, the country must decide whether it will follow in the footsteps of Western economies currently drowning in their fiscal deficits.

MNT 8.6 billion—the sum of Mongolia's foreign debt. Last year's budget suggested that 2012 lending would equal 47.7 percent of gross domestic product (GDP) and that economic growth would reach 25.6 percent. However, economic growth currently stands at just 13.2 percent and the budget deficit is 4.8 percent of GDP. The government is trying to make up for its miscalculations by releasing bonds.

Some economists claim that although Mongolia's debt is 47.7 percent of GDP, it will not put great pressure on the economy. But others argue the country is drowning in debt. Many fear debt might exceed MNT 8.6 billion this year. The interest due on the Development Bank of Mongolia's offering only adds to the country's debt payments.

Mongolia's total debt is in the billions of tugrugs. However, officials say that up to USD 12 million is paid back annually. Some worry if debt exceeds 40 percent of GDP it would be a matter of economic crisis as well as national security.

However, the experts of the Ministry of Finance and the Bank of Mongolia stated, "Foreign debt has not exceeded the standard limits. Thus it is not endangering the national security. There was a time when foreign debt equaled 90 percent of GDP. That was a serious threat".

"But now, with a huge flow of income entering the economy, Mongolia should not fear such debt".

However, international experts warn Mongolia's debt could double by 2020.

Down with Debt

Although total foreign debt has not infringed upon Resolution 19.3 of the Law on Fiscal Stability, it does not give reason for much relief. The government must pay MNT 44.1 million toward its debt this year, 9.6 billion of which is interest.

According to the Ministry of Finance, Mongolia plans to borrow MNT 708.1 billion this year and MNT 180 billion next year from donor countries and international finance organisations. And in 2014, the country plans to borrow at least another MNT 200 billion.

This year alone the Mongolian government must pay MNT 111.2 billion for interest to its foreign loans and MNT 167.4 billion for interest from bonds. On top of all this, the government has also decided to release bonds worth MNT 7 trillion with a projected 4 percent interest.

Mongolia cannot compare to the United States, Germany, France or Greece in terms of history of sovereign bond sales. Mongolia could have learnt from their experiences. Prior bond offerings will leave Mongolia with payments of MNT 1.99 million this year, MNT 154 million next year and MNT 86 million in 2014, as long as no other bond offering is released before then.

Now there are talks about releasing a bond offering for the City of Ulaanbaatar.

"Releasing bonds on an international market means that a ship is ready to sail the ocean", said economist and television personality Dambadarjaa "De Facto" Jargalsaikhan.

He added, "It is not an individual or a private company, but a government that collects taxes and releases those bonds".

Spending the money from loans on poorly planned social welfare programmes is a big problem. One clear example of this is the great pains politicians have gone to make good on their election promises. This meant selling Mongolia's coal resources to Chinese state-owned Chinalco with a USD 250 million offtake agreement to provide funds to the Human Development Fund. That money did little for the development of the country

nor did it bring much wealth to Mongolians.

In addition to this, there is the USD 580 million loan with 5.75 percent annual interest sitting and waiting to be used for railway and other infrastructure projects. The delay costs the nation USD 91,000 in interest daily.

Loans, loans, loans...

According to the Bank of Mongolia, the government holds MNT 3.2 billion in total foreign debt, while the central bank holds MNT 275 million, commercial banks hold MNT 609 million, and private entities hold another MNT 4.3 billion.

One thing is certain, debts must be repaid. However, holding debts is not so terrible because it indicates a level of competitiveness that the country is able to raise the money. Foreign debts can exceed almost 70 percent of GDP in some countries. These countries do not place great significance on that either. Instead they put importance on how productive and profitable those loans are to the country.

Global debt has reached USD 210 trillion. That is triple the world's GDP. Yet big developed countries continue to add more debt each year. While debt is not necessarily something to be terrified of, countries can learn from the missteps of countries such as Greece.

About 75 percent of China's USD 785 billion worth of debt comes from short-term loans, reported Xinhua News Agency. Most of the United States and Europe's debt consist of long-term credits. Mongolia has a mix of both, but short-term loans with high interest are more common.

Long-term loans are often thought of as more applicable to underdeveloped or developing countries. There is an advantage to the lower-interest and smaller regular payments. Although this would be helpful to Mongolia, most of its debt comes in the form of short-term high-interest loans.

In addition, none of Mongolia's 14 commercial banks are able to provide long-term loans. Their returns only allows them to give out short-term loans, said Jan Hansen, senior financial specialist of Asian Development Bank.

In the first half of 2012, the government owed MNT 702 billion to the central bank and other banks. About 45.4 percent of its debt must go to the central bank, while the remaining 54.6 percent is due to commercial banks.

The euro-zone crisis and sudden economic downfall to Asian giants have started to impact Mongolia. International experts warn that those signs could soon trigger an economic hurricane.

The five countries with most loans wordlwide

Countries	Debt volume /USD/	Percentage in GDP
Japan	-	211
Greece	-	132
USA	17 trillion	103
France	2.4 trillion	87
Germany	2.9 trillion	80
Mongolia	8.1 billion	47.7

Chart 2. Total Debts held by government agencies, according to the National Statistical Office (MNT)

State Budget Income and Monitoring Office	21712941.8
City Taxation Office	2969431.9
Taxation Department of Bayangol District	40668.0
Taxation Department of Bayanzurkh District	464414.7
Taxation Department of Sukhbaatar District	8211314.3
Taxation Department of Songi-nokhairkhan District	208707.7
Taxation Department of Khan-Uul Dis-trict MNT	298165.7

Countries with the most debt

Country	Debt amount /USD/	Percentage of GDP
Japan	-	211
Greece	-	132
USA USD	17 trillion	103
France	2.4 **trillion**	87
Germany	2.9 trillion	80
Mongolia	8.1 billion	47.7

Chart 1. The five greatest debts held by Mongolian companies, according to the National Statistical Office.

1.	AMH LLC	11062186.1
2.	Altandornod Mongol LLC	9754142.5
3.	Jump LLC	6739989.8
4.	Mongol Gazar LLC	2878476.6
5.	Erdes Holding LLC	2133829.0

Foreign Debt Mid-Term Projection

Indicators	2013	2014	2015
Foreign Debt held by the Government	3,236.3	3,850.7	4,242.7
Foreign Loan Use	572.5	703.7	477.4
Foreign Loan Repayment	87.0	89.3	85.4
Foreign Loan Interest Payment	27.5	28.7	26.7
Foreign Debt Service Payment	114.5	118.0	112.1

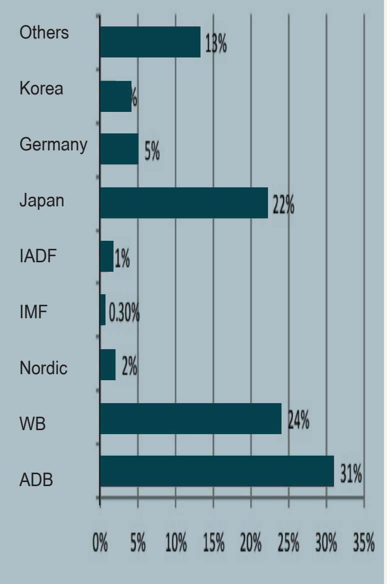
Foreign Debt byb the Government

Loans held by the Bank of Mongolia	-152.0 billion
Government bonds	-455.7 billion
Housing programme to provide 4,000 homes	-84.0 billion
Structural changes to banking	-60.0 billion
Support wool, cashmere and SME	-221.6 billion
Deficit	-89.7 billion
Total	607.4 billion

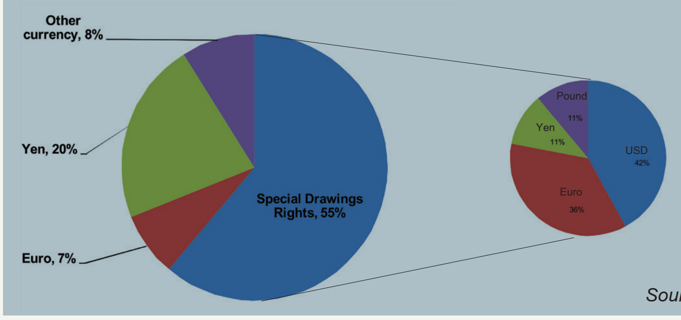
Foreign Deby by the Government, Export

Year	Foreign debt held by the government	Exports
2000	576.8	919.6
2001	572.4	936.5
2002	581.8	1,108.10
2003	719.2	1,448.80
2004	1,033.60	1,644.40
2005	1,270.00	1,601.40
2006	1,819.70	1,647.90
2007	2,210.20	1,788.40
2008	2,969.20	2,013.80
2009	2,741.30	2,609.00
2010	2,741.30	2,209.60
2011	6,234.10	2,669.40
2012	7,522.10	2,750.80

Loan grantiing countries, institutions



The structure of government debt



Source: General Tax Office

BANKING

GOVERNANCE FOR DEVELOPMENT

BY B. BAYARTOGTOKH

Who wields power over the Development Bank?

The government has three financial tools at its disposal; the central bank, the Development Bank of Mongolia and state owned commercial bank Toriin Bank. These organisations are the financial core that support government and enforce its operations in terms of monetary policy.

In times of emergency, the Bank of Mongolia comes as a saviour, while in times of peace Toriin Bank and the Development Bank act to maintain that peace. However, their basic aims and purposes are different from each other. Toriin bank strives to profit with its commercial characteristics, and the central bank aims to maintain stability to the national currency. Meanwhile, the Development Bank aims to finance infrastructure and large projects.

However, according to N. Munkhnasan, a researcher at the World Bank, governance over the Development Bank is still very weak.

“In addition to financing the budget, the bank is spending too much money on other debts. This lessens the significance of the Law on Sustainable Budgets”, noted Munkhnasan.

The USD 600 million raised by the Development Bank amounts to six percent of the country’s gross domestic product (GDP) and 50 percent of total domestic investment. A majority of the projects financed by the Development Bank have zero returns, requiring it to find more financing for the budget, reported the World Bank.

“There are quite a lot weaker points in the law over the Development Bank,” said Munkhnasan.

“First of all, there is no specific article referring to any regulations over the bank’s operations. Financing certain projects is directly or indirectly influenced by government and the powers of the State Great Khural. Its board members are not fully independent from the government”.

The development banks of other countries typically hold assets worth up to 30 percent of the bank’s real capital. In Mongolia, however, the ratio is just six percent.

Mongolia is facing great challenges while directing its natural resources to the country’s development. USD 600 million would not be enough to build the rail roads, apartments, and factories it needs. It is really only enough to get these sorts of projects started.

According to an official statement by the bank,“The Development Bank will have to get additional financing next year. However, there are no specific plans on when, how and how many bonds will be released, or where to find the financial resources at the moment”.

The sale of bonds is one way to generate capital. The Development Bank has the right to allocate funds from debt offerings, but who will lead the bank has been the question hanging over the bank for the last three months. It’s a decision that should remain outside political influence and should be based on a person’s abilities to master his or her duties.

The Development Bank’’s board of directors has changed its leadership four times since its conception. B. Shinebaatar, who currently is the temporary executive of state secretary at the Ministry of Economic Development, led it last.

“Ministries have tried to get financial support from the bank. Unfortunately, their respective associates have not fully understood each other”, said Vice Minister of Economic Development O. Chuluunbat

“For that reason, the assets raised haven’t yet been used. As for the Ministry of Economic

Development, it doesn't have any other intentions than to implement projects that would have great effects on the economy. Thus, the ministry will introduce those projects that are ready for financing to parliament first".

The Development Bank differs from commercial banks In terms of the policies enforced upon it. By releasing bonds, the bank aims to create social wealth that can contribute to the economy by financing profitable projects and programmes. Bank officials have expressed their interest in providing financial support to the Sainshand industrial complex. However, the technical and economic analysis, and the needed planning for infrastructure is still uncertain.

As for railway construction, the bank must wait until the government has made its final decision on how the Development Bank can be involved. The government resolution on this matter has changed three times before it was decided that its role would be determined via concession agreements. Financial issues need more discussion, also.

But according to Munkhnasan, the Development Bank is governed more by political powers than laws. ■

REPORT

GLOBAL ECONOMIC SLOWDOWN EXACERBATES VULNERABILITIES

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Economics Officer Mongolia Resident Mission

JAN HANSEN
Senior financial specialist of ADB

The global economy has weakened more than was expected earlier this year, according to the Asian Development Outlook (ADO) 2012 Update which was released on October 4 2012. Economic growth in the major industrial economies—the United States, the euro area, and Japan—is expected to recover next year, but will continue to hold back global economic activity.

The People's Republic of China (PRC) and India are still expected to achieve robust gross domestic product (GDP) growth rates, but the pace of economic expansion in both countries now falls short of the high rates achieved in the years preceding the global financial crisis. The possibility of a shock emanating from the unresolved euro area sovereign debt crisis or a sharp fiscal contraction in the US pose the biggest downside risks to the global economy. The global economic slowdown is increasing the vulnerability of the Mongolian economy.

The economic outlook for major industrial economies has proved to be more subdued than anticipated earlier this year. Lacking a strong rebound in private domestic demand, GDP growth is expected at 1.1 percent in 2012 and 1.5 percent in 2013, while weakening growth momentum in the PRC and India further exacerbates the global growth outlook. The rising shares of world GDP and import demand of the two countries is evident in the greater influence their economies have on regional and international business cycles.

The "Fiscal Cliff"

Although considerably stronger than the euro area, U.S. economic growth is expected to remain modest at 1.9 percent in 2012 and 2.1 percent in 2013. Beyond uncertainty originating from outside the country, the state and direction of fiscal policy and high unemployment rate pose major challenges for the economy. In early September 2012, the Federal Reserve announced another round of quantitative easing to keep the economy from slowing further and to revive the dragging labor market.

The major uncertainty for the US economy is the looming "fiscal cliff". After the financial market turmoil in 2008 and 2009, U.S. policy makers implemented numerous fiscal programs to soften the impact of the subsequent recession. While many of these temporary measures have been extended over the years, stimulus measures amounting to roughly 4 percent of the U.S. GDP are scheduled to expire at the beginning of 2013. Although U.S. policy makers

are likely to agree to extend some of the temporary tax cuts into 2013, fiscal tightening equal to about 1.7 percent of GDP will almost certainly be implemented. Failure to prevent all temporary fiscal measures from expiring might push the U.S. economy back into recession in 2013.

Europe's Drag on the Global Economy

The sovereign debt crisis in the euro area continues to weigh down economic activity in the currency union. Fiscal consolidation and rising interest rates for public and private borrowers have deepened the recession in southern Europe, most notably in Italy and Spain. Whereas the euro area as a whole contracted only mildly over the first half of the year because of relatively strong growth in Germany, economic growth is expected to contract considerably over the remainder of the year, indicating annual GDP contraction of 0.6 percent. For 2013, a mild recovery is expected with GDP growing by 0.5 percent.

Several European and global summits have spurred some promising action to tackle the sovereign debt crisis in the euro area, such as a road map to full banking union and changes in the rules of the European Stability Mechanism. However, no definite plan that would remove the underlying structural problems of the currency union has been adopted. The decision by the European Central Bank (ECB) to intervene directly in sovereign debt markets with the goal of keeping interest rates for affected countries manageable has brought some temporary relief. If the highly indebted economies of southern Europe however fail to implement market-oriented reforms that can raise long-term growth prospects, financial market participants may continue to invest elsewhere or demand higher risk premiums. Although the ECB left the volume and duration of its interventions unspecified to bolster the effectiveness of its plan, opposition to ECB activities, particularly in Germany, limits the window of opportunity for European policy makers to shape the future of the euro area.

Moderate growth of the Japanese economy

The recovery of the Japanese economy after the earthquake in March 2011 has gained momentum in 2012, reflecting increased government expenditure and reconstruction efforts. The Japanese economy is forecast to expand by 2.3 percent this year before slowing to 1.6 percent in 2013. Deflation has resumed, with Japan's consumer prices falling slightly in July. Core consumer prices have fallen each month since the start of the global financial crisis, though the pace has slowed since mid-2011. The Bank of Japan will continue its highly accommodative policies.

Lower growth in the People's Republic of China, but strong fiscal position and scope for further monetary expansion should ensure softlanding

Weaker external demand compounded by deceleration in domestic drivers of growth caused slower-than-expected GDP growth in the PRC, down to 7.8 percent year-on-year (y-o-y) in the first half of 2012 from 9.6 percent in the same period a year earlier. A contraction of real estate investment and a reduction in the pace of infrastructure development are behind lackluster domestic demand. Consumption also slowed from a year earlier because of deepening uncertainty about the economy.

Export growth declined to 7.1 percent over the first 8 months of the year, while import growth fell to 5.1 percent and contracted by 2.7 percent in August (y-o-y). Sluggish imports reflect falling commodity prices and lower imports of intermediate goods and raw materials such as oil, steel, copper and coal, tracking to some extent plummeting exports because half of all imports are intermediate goods that feed into the export cycle. The government announced additional stimulus measures in September, including 13 rail projects and 12 rail feasibility studies in major urban hubs requiring an estimated investment of CNY800 billion. In addition, some local governments have announced major infrastructure-related stimulus plans.

Decelerating inflation provided room for easing monetary policy to support growth after months of monetary tightening in 2011. Economic growth is expected to fall to 7.7 percent in 2012, down from 9.3 percent in 2011 and to increase to 8.1 percent in 2013. The higher growth forecast for 2013 is explained by the expected positive effect of continued countercyclical fiscal policy, as well as by expected improvements in the global economy. Growth in fixed asset investment of about 20 percent is projected to remain the major engine of growth in the forecast period, boosted by government expenditure on infrastructure projects. The fiscal position remains strong, and receding inflation gives confidence that there is scope for further monetary expansion if needed. Together, these should ensure a softlanding of the economy.

Largest Downsides to Economic Slowdown

The unresolved euro crisis and the threatened US “fiscal cliff” pose the biggest downside risks to the global economic outlook. New stress emanating from sovereign debt markets could deepen the recession in the euro area. Failure in the US to extend expiring fiscal programs into 2013 could further erode private demand and cause the US economy to contract in 2013. The damage to global economy from such negative developments could be amplified by volatility in capital flows. Even without a major adverse global event, risk premiums might increase and capital leave for conventional safe heavens as investors change their perception about economic prospects in the major industrial economies.

Vulnerabilities

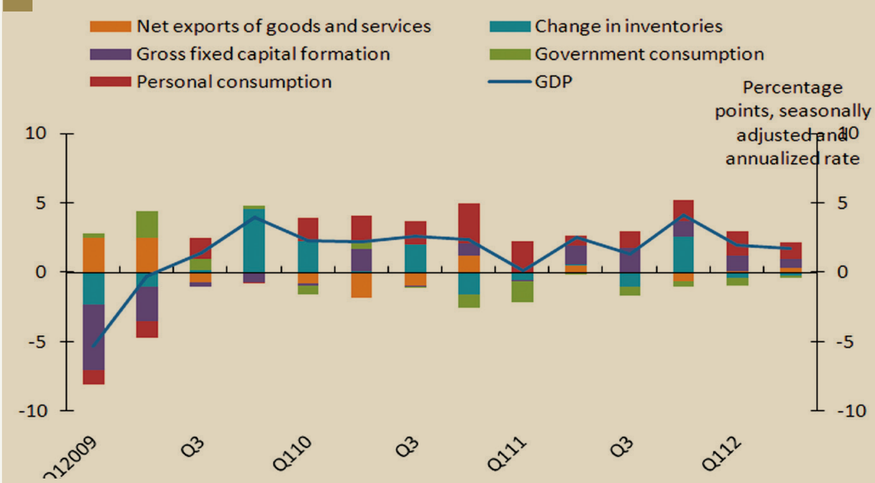
Deteriorating global economic conditions, in particular the surprisingly abrupt slowdown in the PRC, have negatively impacted exports resulting in a deterioration of overall economic growth and external balances of the Mongolian economy. Economic growth fell from 20.0 percent (y-o-y) in the fourth quarter of 2011 to 16.5 percent in the first quarter of 2012 and 5.6 percent in the third quarter of 2012. Exports (in current prices) fell by 6.1 percent (y-o-y) during the first 9 months of 2012, while import growth slowed to 8.7 percent. Both annual export and import growth fell over the year and were -39.3 percent and -7.7 percent (y-o-y) in September 2012. During the first half of the year, the current account deficit increased by 30 percent (y-o-y) to around $1.4 billion, while foreign direct investment increased by 2 percent to about $1.9 billion. Notwithstanding the weakening global economy, GDP is forecast to grow by 11 percent in 2012 and 12 percent in 2013 when commercial production from the Oyu Tolgoi mine is scheduled to begin.

Fiscal policy has remained pro-cyclical in 2012. Government expenditure, in nominal terms, was 38.0 percent higher in September 2012 (year to date, YTD, basis). Revenues have failed to grow at the same pace, rising by only 10.9 percent. This has flipped the fiscal balance into a deficit of MNT535.5 billion from a surplus of MNT236.7 billion in the same period of 2011. (The budget deficit in 2011 was MNT391 billion, or 3.6 percent of GDP.) Budget estimates for 2012 report expenditure growth of 32 percent and revenue growth of 40 percent. In mid-September, Parliament amended the budget by cutting the annual revenue estimate by 10.6 percent, while the expenditure estimate was cut by 1.8 percent. The government deficit was revised to 4.2 percent of GDP. The 2 percent structural deficit ceiling under the Fiscal Stability Law (FSL) becomes binding in January 2013 and the government will have to undertake a very substantial amount of fiscal tightening to achieve the target. The persistent revenue shortfalls in 2012 underscore the risk of basing the budget on overly optimistic revenue projections.

Inflation picked up further in 2012 and was 14.8 percent in August – much higher than the Bank of Mongolia (BOM) inflation target of below 10 percent - reflecting rapidly increasing demand and supply side constraints in the labour market. Price pressures are likely to continue given strong demand and the two stage increase in pensions and civil servant wages » implemented in the first half of 2012. Inflation is forecast at 15 percent in 2012 and 12 percent in 2013. Monetary policy has been tightened since early 2010. The BOM has raised the policy rate by a total of 2.25 percentage points to 13.25 percent and the reserve requirement for banks by 7 percentage points to 12 percent. Tighter monetary policy explains why the annual growth rate in commercial bank lending fell from about 75 percent (y-o-y) in November 2011 to about 37 percent in July 2012. The official exchange rate of the togrog against the US dollar depreciated by about 5 percent to MNT1380 in mid October from MNT 1316 in end May this year. Pressure on the togrog, derived from the increasing current account deficit intensified towards mid-October and BOM intervened in the foreign exchange market by supplying USD and CNY.

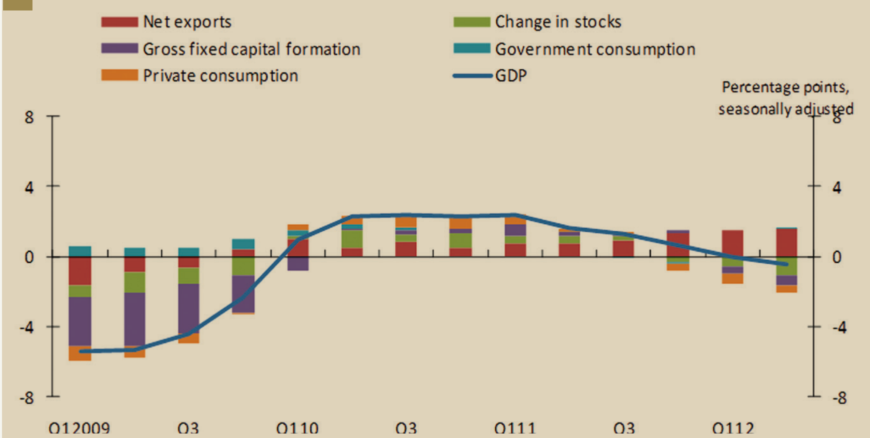
Economic policy need to be set against the continued uncertainties in the global economic outlook. Further significant falls in global commodity prices would severely impact on Mongolia's economy, while putting strong pressure on public finances and current account position. One major risk is significant weaker growth momentum in the economy of the PRC, which accounts for almost all of Mongolia's exports. The main priority for economic policy should be to restrain fiscal spending to contain the fiscal deficit, ensure funding for core government expenditure and create buffers in the event of further commodity price shocks. In particular, it is vital that the FSL will be implemented in spirit and practice to ensure that Mongolia's resource wealth not only sustains economic growth, but ensures that economic development results in inclusive growth and reduction in poverty. ■

A1.1.1 Contributions to GDP growth, United States



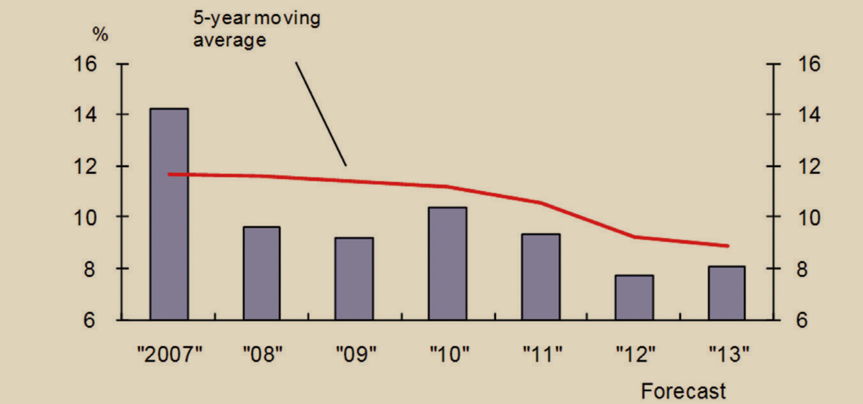
Source: US Department of Commerce. Bureau of Economic Analysis. http://www.bea.gov (accessed 18 September 2012).

A1.1.4 Contributions to GDP growth, euro area



Source: European Central Bank. Statistical Data Warehouse. http://sdw.ecb.europa.eu (accessed 18 September 2012).

Peoples Republic of China: GDP growth



Sources: National Bureau of Statistics of China; ADB estimates.

GUEST INTERVIEW

"WOMEN HOLD UP HALF THE SKY"

BY B. ENKH

Roza Otunbayeva, Kyrgyzstan's first female president, visited Mongolia for four days in July to participate in the Women's Leadership Forum in Ulaanbaatar. A former foreign minister and head of the parliamentary caucus for the Social Democratic Party of Kyrgyzstan, women's participation in government is a personal cause for Otunbayeva in her own country and beyond.

How many times have you been to Mongolia and what is your impression during this latest visit?

This is my second time, and I was here during the Soviet days. It was 1990 probably. I was the chairwoman of the national commission of UNESCO for the USSR. I was working for the foreign ministry of the USSR and came to Mongolia.

I have seen new development since those perestroika days. Mongolia has a lot of parties and so many youths. Each youth is for a separate party. That was the wakening process when people started to think outside of the influence of the Communist Party.

After 22 years, there have, of course, been dramatic changes. Unfortunately our routes have been very passive between us. We have been meeting with Mongolian people at many international forums and conferences. We are in different groups in everything. In the United Nations you belong now to the Asian group. In the European Bank, World Bank, and Asian Bank we are in different groups so we never come closer to each other. In other words we lost touch with each other. I came on the flight from Istanbul, to Bishkek, and Ulaanbaatar, which will become a regular flight of Turkish Airlines. This has really opened up the routes to each other.

Photo by B. Byamba-Ochir

What are some of the biggest changes you have seen since you first visited Mongolia 22 years ago?

I've heard from Mongolian people that economics suffered dramatically and there was tremendous hardship during the transition period.

But now, in 2012, I do feel you have had successful political as well as economic development. First, parliamentary democracy is in effect. I do see that parliamentary democracy works successfully. This is the sixth parliamentary elections, which was very peaceful. The president pointed out that in nine years power was handed over from one party to another.

My country has just entered into parliamentary democracy. It is absolutely unknown to autocracies, but we do know what this is all about. When parties come, they win seats, then build these governing coalitions. This is, from a political view of development something, that will take many years to come. But you are struggling forward.

Parliamentary democracy in my country brings transparency, openness, and consensus for governance in society.

What opportunities do you see for Mongolia and Kyrgyzstan for economic cooperation?

There is a lot of room for cooperation. I just returned from the Ministry of Agriculture. Your minister and president visited my country and they decided [Mongolia] should share its cashmere goods with us. Kyrgyzstan badly needs the development of this new type of product, also. We have a lot of herders also in my country. We have 10,000 to 12,000 herdsmen, seven million sheep and goats. You have five times as much as us.

I remember in the Soviet days we were the same. [Now,] we have a shortage of wool. Wool is taken by Chinese and Turks, but handicrafters have a problem with wool production. I think it would be important to buy wool and have new types of wool and cashmere.

What we can do is export lots of fruits and vegetables. I understand you want to be self-sufficient for vegetables, but I have a proposal from the Ministry of Agriculture about vegetables and all types of dried fruits from my country. We produce a lot of dried fruits, from apricots to apples. Like you have investment into Oyu Tolgoi, we very much want investment for the production of jam and juices, and so on. We still badly need production investment.

How would you evaluate this year's Women's Leadership Forum in Mongolia? How is this year's event different from other events for women's leadership?

The world faces a worldwide financial crisis. At the beginning of this decade we watched how dramatic the development Europe faces is, as well as the United States and others in the West.

The whole world is trying to find new avenues to get out of this crisis. Women are such a hidden tool for this. This year I've been in three or four women's forums. I've been to the annual meeting of the EBRD [European Bank for Reconstruction and Development] where they had a panel of women from the knowledge economy—women engineers, women graduates of universities—to see if their real potential is used.

We discussed a lot of problems for small and medium sized businesses and the ways to develop. In London, at the annual meeting of the EBRD, your deputy minister of trade and industry, [Tseden] Garamjav has since been replaced by Khaltmaa Battulga with the ministry reformed into the Minstry of Industry and Agriculture -ed], was awarded as the head of a mining company at a world value.

At the end of this year, I will go to Little Rock, Arkansas. I am a member of a club of ex-presidents and ex-prime ministers, which is also a meeting for women. There are so many women involved in production, helping to bring growth in every country. How many women sit at home in the world, deprived of the current economic development? This is half of the planet. As the Chinese proverb says, women hold up half the sky.

Involvement of women in economies, small and big, is vital. I raised two issues. One, which I think is relevant to our societies, is the challenge to fight corruption. At this stage, not to fight corruption, we will fail. Twenty years ago our countries went through extremely rapid change. Ownership completely changed. Everything that had belonged to the nation now belonged to parts of society? How did some people become extremely rich overnight while others are poor?

Like in my country, you have 30 percent of your country living below the poverty line. How did this happen? We used to live in very egalitarian societies, where everything was distributed equally to everyone. In this regard, I do believe that everyone, means, methods, and tools to fight corruption are very important and should be used.

State tools should do everything within their means to fight corruption. Every family should too. Every family should ask how is it possible to get so much wealth overnight when working for the state. Everyone knows in this society what government salary is, so it's impossible that they gained so much wealth. People in parliament work to protect their wealth and became members of ministries. Meanwhile the nation watches.

I think it's important to talk about the membership of women in the boards of state-owned companies and joint stock companies, where the shares belong mostly to the government. Why don't we have any women in the board of directors. Why are they deprived from that? I believe we should fight for that and be sure the appointment of those members of boards are transparent, just, and based on quality such as education and professionalism. Still we have industries run by boards that generate a lot of money, like the telecom and railroads. We should know if they are run properly or not, for the sake of the people.

What was your impact on women's participation in government?

Women have been at the forefront of all changes. We never had a governor oblast as a woman, now we do. We want more women as the head of cities and as ministers. One deputy prime minister is a woman. We have two vice speakers of parliament as women in my country. We have heads of committees in parliament who are women. Twenty-three percent of our parliament is women.

The number of women serving as members of the State Great Khural has grown from three to nine. What does this tell you?

I congratulate you, it's tripled. But at the same time the rules are not progressive for women. We have proportional elections in our parliament and every fourth [on a party list] is a woman in my country. You can't change her after she's on the list. I think you should go ahead with something like this. ■

PROJECT

THE TROUBLE WITH TAVANTOLGOI

BY B. BAYARTOGTOKH

Development has begun at West Tsankhi at Tavan Tolgoi, but the issues plaguing the project are far from settled.

Much of 2011 was spent determining who would be the investor to lead exploration at the Tavan Tolgoi West Tsankhi coal deposit. The second round of bidding left the United States' Peabody Energy, China's Shenhua Energy, Japan's Mitsui & Co Russian Railways, Korea's Kores, Australia's Xstrata Coal, Brazil's Vale, and Luxemburg's Arcelor Mittal.

But in 2012, none of those companies were given the right to develop the coal project. The government proposed a consortium dividing the project between Shenhua with 40 percent interest, Peabody with 24 percent, and a before-unmentioned Mongolian-Russian consortium. But the results of the tender selection was eventually reneged by the National Security Council.

"The opening ceremony of the Baruun Tsankhi mine will be soon", said Ya. Dolgorjav, executive director of Erdenes MGL, the state-owned holding company that owns the project. "We will open it by mid April, without waiting for investors".

"After the official opening, the excavation process will start. This preparation by the company will attract interested parties as well as hasten the policy decision-making process".

2012.10.01: Operations began at West Tsankhi, a sign that Mongolia was making an economic turn. The on-going investor selection process had been stalled because of uncertain political conditions. Low coal prices on the international market may have soured investor interest, too.

2012.10.15: Baasangombo Enebish, executive director of Erdenes Tavan Tolgoi, the state-owned company that holds the mining licenses to the project, resigned. Former Member of Parliament Yaichil Batsuuri was appointed as his replacement.

2012.10.16: A working group was established to monitor the activities at Tavan Tolgoi. Led by Minister of Mining Davaajav Gankhuyag, the working group focuses on infrastructure and development of the project in light of falling coal prices in China and elsewhere.

Erdenes Tavan Tolgoi has since proposed that it contract exploration duties to Peabody Energy until a consortium is finalised.

In the Hole

Meanwhile, at East Tsankhi production is currently under way. However, it faces its own set of obstacles.

The calculations and survey for the infrastructure, workforce, investment, sales, and marketing are not yet finished. The Development Bank of Mongolia has stated the State Great Khural must determine its policy decisions concerning exactly where the railways should be placed and the where they should head first before development of the rail system can begin.

Located at Tsogttsetsii Soum, the deposits total reserves are estimated at 7.4 billion tonnes of coal, 1.4 billion of which is coking coal and 4.6 billion is thermal coal.

It was Mongolia that initiated development of the deposit, not foreign investors. Now that the new government has gotten its bearings, it can direct the project towards greater profits and achieve some of its goals, which include its continued sale of coal to Chinalco, as per its USD 250 million offtake agreement, and the beginning of exploration at West Tsankhi.

2013

The task of listing Erdenes Tavan Tolgoi on the Hong Kong and London stock exchanges is ongoing.

Right now, however, may not be the best time for a public offering, given the debt crisis in Europe and sinking commodity prices.

The design of the coal enrichment factory for Tavan Tolgoi is being undertaken by Australian and American companies. The first phase of operations at the factory is planned for 2015. It is projected to process 15 million tons of coal for total production of 5.5 million tonnes of coking coal a year and 3.7 million tonnes of thermal coal.

Batsuuri stated that Tavan Tolgoi will distribute its dividends once the company becomes profitable.

"We will work to start the mine's operation. We are studying the possibility for receiving additional loans from the domestic and foreign markets in order to correct the mistakes made", said Batsuuri.

Once the global and the Chinese economies get back on track, Erdenes Tavan Tolgoi can begin exporting coal, he said.

INVESTMENT

MAPPING OUT THE MINING SECTOR

Matt Youkee has been a journalist for nearly a decade in South America and reported as a business journalist in various countries. Today he is spearheading a new book for Mongolia's mining sector for the *Mining Leaders* series.

Tell us about your publication.

Mining Leaders is an annual publication focusing on particular countries we consider a frontier market in the mining industry. They are 130 to 140 pages long and they feature interviews, analysis and focuses on the key executives from the mining and financial sectors leading the growth of the industry for that country.

Our focus previously has been in South America. We've been in South America for three years now, focusing on countries such as Columbia, Brazil, Peru, Mexico, and now we're moving to new markets, with Mongolia being our first Asian country.

This will be our fifth country.

What sets your publication apart from all the others that have visited Mongolia that you must compete with?

The simple answer is we'll have to wait and see how [the book] will be received here. There are publications which talk generally about the economy. That fulfills an important part of the sector. *The New York Times* and Bloomberg can provide that up-to-the-minute day-by-day, and even monthly stories about the country. There's a lot of interest and investors do need a daily news source.

What we're trying to do is something different, which is provide a No. 1 resource for people investing in a particular country or sector—mining—

to be able to access and understand who the players are in the market, and what the main projects are.

We include the pictures of everyone we meet, so it can be very useful to know at a conference who is the CEO of a particular company, or who's the partner of a law firm. We try to act as a forum for these international mining sectors and legal and financial sides to give their opinion on the market.

Some companies writing about Mongolia have a tendency to editorialise. We will give our own analysis but also give an open mic to people from different sectors to talk about different aspects of the industry. We also focus a lot on individual projects. We included lots of maps, graphs and statistics, which we take from different sources. We try to provide one single publication which can be used as an investment tool and a book of reference for the mining sector.

We've had great feedback from places like Columbia and Peru because they haven't had something like this previously. We are aware that people say it's only a yearly thing. We also have a monthly Internet newsletter sent to our readers with the latest news, including interviews and that kind of thing.

Why did you choose Mongolia this year?

The decision to come to Mongolia was made quite early on in the year. Obviously the economy is growing quickly, probably more than any large country. This is a country with the economy fueled by the boom from mineral resources. We have two world-class deposits—Tavan Tolgoi and Oyu Tolgoi— combined with the fact that it's a very under-explored country.

There are lots of opportunities for finding world-class discoveries. That gives the book a nice mix between existing legacy players in the mining sector, new producing companies, and also a group of junior explorers, both Mongolia and foreign, undertaking exploration campaigns in the more remote parts of the country that haven't been explored yet.

What are your thoughts on the rapid growth in Mongolia you've seen?

I am a journalist and most of my experience comes from South America. So I won't claim to be an expert in Mongolian politics, economics, or culture. The advantage I do have is I have worked in South America and other emerging markets in the Middle East and Africa. I do have the ability to contrast and compare. So although I can't claim to be a Mongolian expert, I can see it in the context of other areas.

When I arrived here in Ulaanbaatar, of all the places I've been to I thought this is a place undergoing massive change. You just see it in the city with everything going on—new constructions for real estate; you can drive out into the Gobi and drive past gers with solar panels and wind farms. As a place with an emerging economy, it has huge potential. People might compare it to others. I've heard it called the Saudi Arabia of coal or the Kuwait of Central Asia.

You've seen the growth of countries such as Qatar or Abu Dhabi achieved since the 1970s and 1980s. You look at Mongolia and you think there are very good reasons. It seems very well placed. You have a highly literate, homogeneous society. There are no ethnic or regional conflicts, or separatist movements. You also have democracy, which is important.

If you're asking me about the direction of growth for the future, the simple answer is nobody knows that. It comes down to politics.

From my limited knowledge of Mongolian history, it seems like next year is going to be a very important year in the politics of the country. One of the frustrating things about us producing the book now is that we know there is going to be major changes in the next six months with mining laws, mineral laws, and water laws. We'd like to come back next year and see how the changes have developed.

Now that Mongolia's mining sector is starting to really take off, what differences do you see between Mongolia and some of the other countries you've covered in your books?

It's not that every other country is a major mining country. Somewhere like Columbia, for example, is a country which for years had a serious guerrilla insurgency, which is calming down. That's a country that, like Mongolia, is relatively unexplored. Brazil has a developed mining industry but at the same time is so vast. It has the Amazon and other areas so unexplored that there is a lot of exploration going on there as well.

When you contrast it to Mongolia, obviously there is a potential for world-class deposits. But in someplace like Colombia, where you have a lot of unexplored areas, some of the places where they found minerals, with gold in particular, are places with high residency of local communities, indigenous groups or Afro-Colombian communities. The social side has been very difficult in that respect.

Here in Mongolia, not to down play the social sides, it's often much more sparsely populated. The Gobi Desert is a very large area—and I know there's some displacement going on down there—but it's not such a major issue as it is in Colombia.

The elephant in the room is the issue of resource nationalism. This is something when comparing all the countries I'd like to say there is a revision process going on for the mining code. In Colombia they recently redesigned their mining legislation and introduced a new agency to overlook the licensing and titles. They've encountered similar problems as Mongolia with land speculation. People buy a title, do the bare minimum to hold onto it and wait for a boom to take off.

Peru as well. That was a country that introduced very mining-friendly policies in the 1980s and 1990s. It experienced a mining boom and now, on the back of high commodity prices, the government is trying to increase taxation on mining companies through windfall taxes.

Brazil is changing its royalty regimes and its local content requirements for mining.

The difference is in all those cases there has been a high level of exchange between the government and private sector. All this has occurred when there was enough cash in the economy that they could boost the development of their mines from other areas should foreign investment become less in the country.

In Peru, when the government renegotiated its windfall tax they did it very openly in collaboration with leading mining companies. They were very clear that they thought the state wasn't receiving enough from high copper and gold prices. Through the negotiation process the government developed its windfall tax which gave the government an additional USD 1 billion in additional revenue. But it was done through consultation with the private sector and mining companies.

In Mongolia it doesn't seem that there's been that level of consultation. Laws can be enacted, then they realise there is a fundamental flaw (like in the case of the forestry and water law), or enacted and then rescinded (like the windfall profits tax). Or contracts get signed and then renegotiated less than a year later.

Also, without serious foreign investment many of the projects in countries will not be able to be developed. That is the argument from the foreign investors' side.

Is resource nationalism as big a problem in some of the other countries you've covered as it is in Mongolia. How does it affect investors?

Resource nationalism is an issue in all those different countries. But it's not a keystone issue as it is in Mongolian politics.

As my understanding is resource nationalism was one of the major topics defining how the major parties set themselves apart. It's an issue in South American countries but the mining industry typically only accounts for 5 to 10 percent of the economy in those countries, so it's not the key No. 1 issue. Yes, we've seen massive protests in Peru about foreign investment for a number of major mining companies.

It's a major issues in other regions such as Indonesia, and in developed markets such as South Africa and Australia. South Africa is moving towards the nationalisation of mines; Australia is putting up added royalties and taxes on major coal and iron ore companies. So you see that as a global trend.

I think the difference at those areas is they already have an established mining industry. They will still be able to develop their resources without the foreign capital. People I've spoken to here say it's going to be a trickier issues. Developing something the size of Oyu Tolgoi will take some USD 7 billion to get to production, which is beyond the annual revenues of the government.

It's clear that foreign capital in some way will be necessary to develop these projects.

Are companies worried? I think what's more concerning to a company is not whether a country is pro-investment or nationalistic. I don't think that's the issue. People just want to know if they've made a decision based on a certain set of principles they can make sure it will still be worthwhile to invest. If they make there economic forecast, make their investment, but those prerequisites change, that's when uncertainty can make people reluctant to invest in a country.

How far in advance have you planned for your books about Mongolia?

Whenever we enter a market we always intend to go back next year. For us it's better to be established in a market, to get better and have a more profound understanding of what happens over time. In the second and third books we've produced in other countries we've introduced new editorial features that we haven't introduced in this one because it's the first book.

These things all add to the value of the publication in the future. ■

BUSINESS STRATEGY

CLUSTERS

BY KH. KHULAN

> A person with a new idea is a crank until the idea succeeds.
>
> Mark Twain, American Author

Mark Twain, an American author once wrote, "A person with a new idea is a crank until the idea succeeds". Josef Floh of Austria was one such crank.

The "66-radius" principle caused a sensation when people first heard about it. An innkeeper of a tavern, Floh said he would not serve any food that came from a distance of more than 66 kilometres from his inn. Floh kept that promise and used only regional products. He even started placing photos of his suppliers in the menu. Floh initiated this idea 15 years ago, explaining, "I don't need organic fish from Belgium".

Economics is full of theories and formulas. One theory that has conjured magic for the business sector comes from Professor Michael Porter of Harvard University, who introduced his cluster theory for first time in the 1990 in his book *The Competitive Advantage of Nations*.

Porter defines clusters as a "geographical concentration of inter-connected companies and institutions that work in a particular field, linked by commonalities and complementaries" in the book *On Compeition*, published in 1998.

In other words, clusters are a network of service provider companies in a region. A cluster has the structure of a triple helix, cooperating within a value-adding chain with educational and research institutions as well as with public organisations.

The cluster theory aims to improve the competitiveness of business enterprises. Currently it is applied to increase the efficiency and innovation of companies under a cluster initiative. A professor and scientific secretary at the Mongolian Development Institute, MDI), I. Tsedendamba pointed out the benefits of development using clusters.

In the article "Methods to Enhance the Development of Mongolia Based on Clusters", L. Tsendendamba writes,"The production and service costs of companies within a cluster would be reduced. The framework for increasing competitiveness would be set. There would be greater possibilities for access to domestic and international markets".

"Cooperation between the government, businesses and science should be put on a higher level. The investment and technological potential of the firms within a cluster network would be greater".

The Cluster Core

Many countries within the European Union and both of Mongolia's neighbouring countries have applied the cluster method into their development strategies.

Small and medium enterprises can

benefit from synergies with large firms, too. Every success story of a cluster initiative reinforces the message that solving business problems through cluster networks can create more productivity. Why? These networks provide easier access to international markets for the products and services of domestic companies.

Companies that cooperate with universities and research institutions have better chances and opportunities to develop innovative products for the market. One example of this is Silicon Valley in the United States.

Yet, in order to flourish, a network needs involvement from all stakeholders.

The 2012-2016 government action plan begins with the article "The Employed Mongolian", which determines the goal of bringing the development of the public-private partnership to a new stage and creating a framework that is favourable to business. In response, the Ministry of Economic Development (MED) has launched an elaborate cluster policy. D. Anudari, an expert at the Innovation and Public and Private Partnership Department at the ministry says that there are plans to create cluster initiatives for the meat, wool, cashmere, leather and hide, seabuckthorn and mining sectors. Not only would this strategy created greater competitiveness for Mongolia, she said, it would also play a key role in strengthening regional economic development.

German Development Agency GIZ's Integrated Mineral Resource Initiative (GIZ-IMRI) held a study tour on Cluster Management in Germany and Austria in September, inviting members of various ministries, NGOs and university lecturers from Mongolia.

In Germany there are two main types of cluster initiatives. The first is a "top-down" approach dependent on public funding—making political influence quite high. The state provides financing for a certain period of time, with the intention of later making it self-sustainable.

The second type is the "bottom-up" strategy implemented through private partners and low political influence. Interestingly, almost a quarter of the most innovative cluster networks in Germany use the bottom-up technique. They are also more likely to cross national borders.

There is also a mixed form that utilizes both, but most follow these two general outlines.

Photo by Kh. Khulan

With Prof. Dr. Alexander Bode in Berlin

With Simon Alig at the TU Darmstadt, Germany

Success in Germany

The first federal state in Germany that applied the cluster policy is Hessen. Although there has been support for cluster strategies since 1993, statewide cluster development has been enacted since 2007. The federal and state-level budgets alloted 7 million euros for the cluster network in 2012. The European Union provided an additional 10.5 million euros for regional development in Hessen.

Heike Basse of the Regional Economic Conversion Department at Hessen's Ministry of Economy said that its cluster programmes are focused on the regions with the weakest economic development. Currently over 1,100 firms are engaged in 35 cluster networks in Hessen, including services for information technology, optics, automobiles, microsystems technology, health, environmental technology, and mobility.

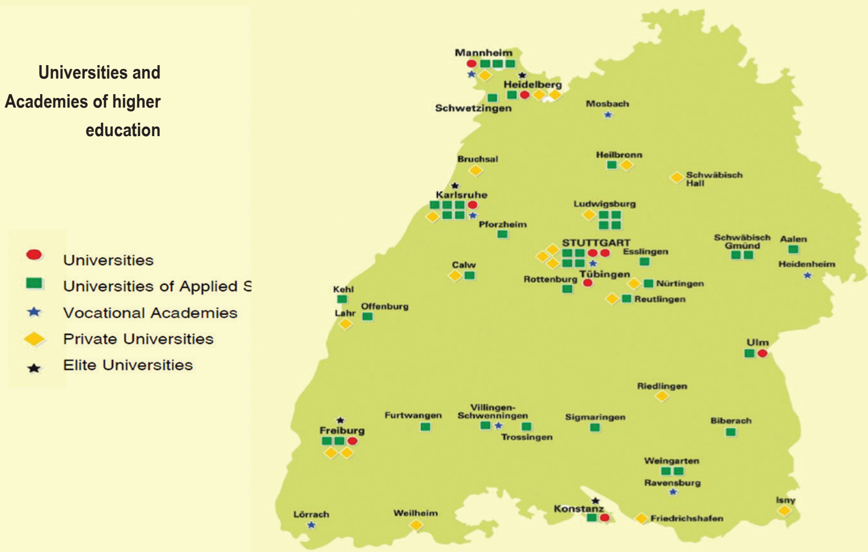
The cluster policy at the state of Baden-Wuerttemberg was introduced by Michael Hagenmeyer, Ministerialrat at the Ministry of Finances and Economics in Stuttgart. All the states of Germany have their own characters. Yet Baden-Wuerttemberg is perhaps the most innovative region within Europe. Its GDP of 380 billion euros exceeds that of countries such as Belgium, Norway, and Austria.

Hagenmeyer noted that investment in education, science, and research is crucial because of the lack of natural resources in Germany. It means the term innovation plays a pivotal role in national and economic development.

Baden-Wuerttemberg is home to some of Germany's most elite universities and renowned research institutes, such as the Frauenhofer Institute and the Max-Planck Institute, which cooperate with various companies. Baden-Wuerttemberg has 103 regional cluster networks, all with the common goal to develop and implement long-term innovation. The state is famous for its fields in the automotive industry, environmental technology, forestry, biotechnology, and the energy sector.

Look for more success stories of clustering strategies in Germany in the next issue of Mongolian Economy.

A Unique Scientific and Technological Infrastructure – The Basis for Successfully Meeting the Challenges of the Future



Baden-Wuerttemberg has the most dense and the most modern structure of Universities and Academies for higher education, including:

Nine Universities (of which, four "Elite Universities" in Heidelberg, Freiburg, Karlsruhe and Constance – have won the award in the „Excellence Initiative" 2006/2007)

41 Universities of Applied Sciences Eight Vocational Academies 21 Private Universities

A network of technology transfer centers (Steinbeis-transfer centers) provides the bridge between private industry and research institutes and guarantees rapid access to new results.

Source: Ministry of Economics Baden-Wuerttemberg

“MONGOLIAN ECONOMY” QUESTIONS

What benefits do clusters bring to the development of the Mongolian economy? What have you learnt during the Cluster Management study tour in Germany?

L. Tsedendamba, Professor, PhD, scientific secretary at the Mongolian Development Institute (MDI):

U.N. member countries that use the cluster development can contribute significantly to the dynamic development of small and medium enterprises, resulting in the creation of many new workplaces and a framework to reduce poverty.

Mongolia has a great need and necessity to improve its economic competitiveness, reform its economic structure, apply innovation policies, improve partnerships between the public and private sectors, properly develop production and services regionally and nationally, and reduce unemployment and poverty. The development of production and service clusters plays an essential role in reaching the above mentioned objective.

Germany’s experiences developing clusters tell the same. Developed countries and nation-states with rapid development can improve their competitiveness and expand their markets globally by developing clusters for production and services. If we could develop clusters in every branch suitably, then the production and export of high-tech products and services with added value would grow and new jobs would be created.

Also a knowledge-based economy could be formed, while developing the rural regions.

B. Battsetseg, senior officer at the Department for Coordination of Light Industrial Policy Implementation at the Ministry of Industry and Agriculture (MIA):

Clusters are based on cooperation. From the cluster management training in Germany, I understood that it is completely possible to set up clusters in light industry. Because the cashmere market of our country is limited, we have to implement policies directed at foreign markets. Yet, it doesn’t mean we should export the products of large enterprises alone. Instead we should unite the activities of small-and medium-sized companies, too. That would achieve more results.

Also research institutions are struggling to find financing for their research, but they don’t have any experience cooperating with companies for production on how to apply technology and innovative projects into production.

The biggest challenge when performing an innovation survey and transferring the initiative into the production process is a lack of financing. The financial issues of research institutions can be resolved by networking within the cluster initiative. Producers will have opportunities to apply the results from their research in their work. Moreover, innovative products have a broader opportunity for the export market. Trade organisations play an important role in clusters. In order to initiate a cluster, there must be a common goal, policy, vision and objectives. The close cooperation between universities, the private sector, and a state government lead to success.

D. Anudari, officer at the Innovation and Public Private Partnership Department at the Ministry of Economic Development (MED):

The Integrated Mineral Resource Initiative (IMRI) by Deutsche Gesellschaft fuer Internationale Zusammenarbeit [GIZ] has worked out a plan for the cluster study tour in Germany. For this programme, we met with policy makers experienced with cluster networks from the economic ministries of the states of Hessen and Baden-Wuerttemberg, and received information about the policies that support those state’s clusters, trends, the policy development processes, and cooperation between research institutions and companies for production.

It was a very important experience for us to get to know cluster management because we are currently working on developing policy for a cluster strategy. Heike Basse of Hessen’s Ministry of Economy said that Germany managed to pass the 2008 global economic crisis with fewer losses with support from the cluster networks. Our country lacks such cooperation, and I am sure that cluster development can strengthen the trust and communication among business entities.

Unquestionably, cluster networks will contribute a great deal for the development and economic sustainability of Mongolia. Clustering would enable us to bring the development of public-private partnership development to the next level and strengthen cooperation between research institutions and groups of industry. Prior to the development of a cluster policy, there needs to be more knowledge of clusters among the ministries and public institutions.

It is possible to create policies and strategies for the implementation of cluster initiatives after all stakeholders have gotten a single understanding of them. ■

OPINION

A BASE FOR ECONOMIC AND SOCIAL MODERNISATION

Dr. Stefan Hanselmann, Programme Director, GIZ's Integrated Mineral Resource Initiative Programme

Mobility is a fundamental human need. It enables us to be independent, to exercise our individuality and to take part in society and social interaction. Mobility is a prerequisite for everyday economic life and thus essential for trade and the supply of goods to individuals.

Logistical processes facilitate the exchange of goods. Efficient logistical networks underpin economic growth and enable nations to participate in international markets. Germany's logistics industry, for instance, is the country's third largest sector, with a market value of 222 billion euros (USD 290 billion), and employs 2.8 million people. At the same time, logistics is also a high-tech industry offering substantial opportunities on both domestic and global markets.

Mobility and logistics contribute to the prosperity and quality of life. Mobility ensures that people are able to move from one physical location to another, while logistics is the business of planning, managing, optimising and implementing the flow of material, energy and information via systems, networks and processes. Logistical services include not only transport and the handling and storage of goods and information but, increasingly, also value-added services, such as client-specific packaging, installation, or data storage and information management.

Logistics provides the functions essential for value creation and commercial relationships. Alongside the planning, coordination and management of procurement, production and distribution, logistics—either as an in-house function or as an external service—also includes supply and waste management processes for industrial plants and the processes that underpin the distribution of goods to commerce and services. The most immediate impact of logistics is its role in supplying people with goods and services, providing access to basic goods, such as food and household goods, and to services, including doctors, pharmacists and restaurants, among others. Access to the full range of goods, services and contacts available to consumers is a key component to our quality of life.

Commercial logistics permits this, both via physical retail outlets and, increasingly, in industrialised countries through e-commerce and web-based services. Online commerce encourages individualistic consumer behaviour: consumers expect the goods they want to be available where and when it suits them and in line with their individual preferences. These growing demands have not (yet) been systematically questioned, yet their impact is increasingly bringing them into conflict with the demands of efficient resources use and environmental and climate concerns. Further adaptation will be necessary here. Transport is what enables us to achieve this routine mobility and participation in trade and commerce.

The key to social, societal and economic development is not simply an expansion of transport, but also high levels of mobility: individuals should be able to choose between different ways of participating, while in the context of the economy it should be possible to ensure the distribution of labour and the sharing of innovations.

Passenger transport and the transport of goods are in a substitutive and inductive relationship with each other, so one of the key challenges in designing modern logistic and transportation systems is facilitating individual mobility and the transport of goods efficiently and sustainably, and to design them taking into account the prevailing economic, environmental, social and cultural conditions. Fundamental to moving both passengers and goods is a transport system that relies on shared infrastructure: passenger and goods transport and economic trade share the diverse transport infrastructure—road, rail, water and air—and compete for access to its limited capacity.

The quality of logistics and mobility is a key issue for societies and governments. Quality means both a comprehensive provision of goods via logistical services to satisfy individual needs and the opportunity for people to participate in society, in social life and in the economy via individual mobility. ▸▸

We experience mobility and logistics directly when we purchase goods or benefit personally from services—when we use public transport, fill our car with petrol at a service station or shop in a supermarket, for example. However, we mostly experience logistic and transportation services indirectly; the necessary logistical and technological systems and skills operate in the background to ensure that commerce, services and industry function smoothly and that society is supplied with its essential needs.

In common with other countries, Mongolia has been experiencing substantial growth in passenger and goods transport over a number of years, especially in the region around Ulaanbaatar. This is the result of trends such as increasing urbanisation but is also due to the growth of domestic and international trade.

However, the need to take account of environmental protection, energy efficiency and climate change is also changing the framework, and both passenger and goods transport must now reflect such concerns. Available mobility and logistical services, and the transport infrastructure need to be assessed in line with the demands society is making of them; the criteria by which they will be judged includes service quality, reliability of service provision under conditions of heavy infrastructure use or disruption, efficiency, sustainability, environmental impact and land use.

Action is needed at both technological and policy level if we are to continue to ensure individual mobility and a reliable and sustainable supply of goods and services. The priority is to ensure that society is able to benefit from both mobility and logistics. The focus of attention must, therefore, be on residential areas, in particular the Ulaanbaatar conurbation but also on rural areas.

Adequate and reliable transportation infrastructure is essential to individual quality of life and to viable economic and business processes. If mobility and logistics are to continue to expand as described above, much-needed investment in maintenance and development is, therefore, essential. Technological development, individual services, and the economic advantages of bundling effects and economies of scale are not mutually exclusive; indeed, they are all essential if environment and natural resources are to be protected. The objective must be to make the delivery of individual contracts, supply relations and mobility provision more efficient.

Appropriate approaches include the shared use by companies and service providers of transport and logistic infrastructure, including handling areas, distribution arrangements and delivery systems, and more effective management of transport. All this requires the networking in operational terms of all those concerned at the process level and collaborative business processes.

Furthermore, logistic and transportation systems need both to be more resilient to the impact of disruption and to have a greater capacity for change and development in the medium and long term. Real-time capable systems with the ability to monitor events and status using AutoID and sensor technologies form the basis on which system disruption can be detected and localised promptly, and a response formulated. Meanwhile, flexibly scalable materials handling and storage technology can make logistical structures easier to modify and develop.

It is also essential to consider the requirements for passenger and goods transport as a whole when planning and operating transport infrastructure. Integrated models that cover both forms of transport are, therefore, essential if transport planning is to be future-proof. Planning must be tailored to new demands for civil involvement and joint public-private planning and design processes.

Different spatial structures require different logistical systems, services and infrastructures. Consequently, the quality of supply, the range of logistical services, mobility services and logistical and transport infrastructures need to be analysed in a location-specific way and necessary planning options identified.

The list below summarises key points in relation to the medium-term development of a modern logistics system:

1. The specific capacities of passenger and goods transport need to be optimised, particularly the capacity of rail transport.
2. The technical, regulatory and fiscal framework needs to be designed to cover all forms of transport.
3. Local and regional transport development planning needs to take account of logistic and goods transport as well as passenger transport.
4. Future transport policy planning needs to be linked with incentives to make use of innovations in mobility and logistics.
5. Public—and private-sector decision makers in the fields of mobility and logistics need to be better networked so that viable strategies—for example, public goods delivery points—can be put into operation.
6. Collaborative commercial processes and platforms for cooperation need to be promoted through incentive systems and pilot projects.
7. Exchange with European logistics technologies and services, transport system solutions and transport management strategies needs to be supported and promoted. This also includes the development and harmonisation of standards in relation to information and communications processes and the standardisation of technical components of logistic and infrastructure chains.

The sustainable development of mobility and logistics, for the transport of both passengers and goods, requires close coordination with those responsible for town planning and spatial development, and with location development for trade and industry, commerce, leisure facilities and social infrastructure.

This is vital if people are to be able to participate and trade in the economy in a way that reduces the demands both on resources and on the environment. ■