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MONGOLIAN ECONOMY


Economic Collapse

Dutch Miracle

Mongolia's Economy Finance and Business Magazine

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E-mail: info@transwest.mn

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FOUNDER, EDITOR: D. Bekhbayar /9999-4248/
FOUNDER, DEPUTY EDITOR: I. Otgonjargal /8800-6228/

SUB-EDITOR: B. Enkhmart

ENGLISH EDITOR: Terrence Edwards
TRANSLATOR: R. Gantulga

JOURNALISTS: B. Bayartogtokh
B. Enkhsetseg
E. Zorigt
Kh. Khulan

DESIGNER: Sh. Oyundari
WEB ADMIN: B. Lkhagvachuluun

MARKETING MANAGER: D. Barianjav /8880-0825/
D. Battulga /9902-2279
B. Enkhsetseg /9901-5476/
S. Tsend-Ayush /8870-3633/

"ECONOMY" TV STUDIO
EDITOR: B. Uuriintuya
PRODUCER: Ts. Bat-Otgon

ADDRESS:
Tod Tower-604 Ankara Street-23
4th Khoroo Chingeltei District
Ulaanbaatar, Mongolia

Central Post Office, P.O.B 2762, 15160
Ulaanbaatar, Mongolia

URL: www.mongolianeconomy.mn
E-MAIL: info@mongolianeconomy.mn
TEL/FAX: 976 - 7011 5476

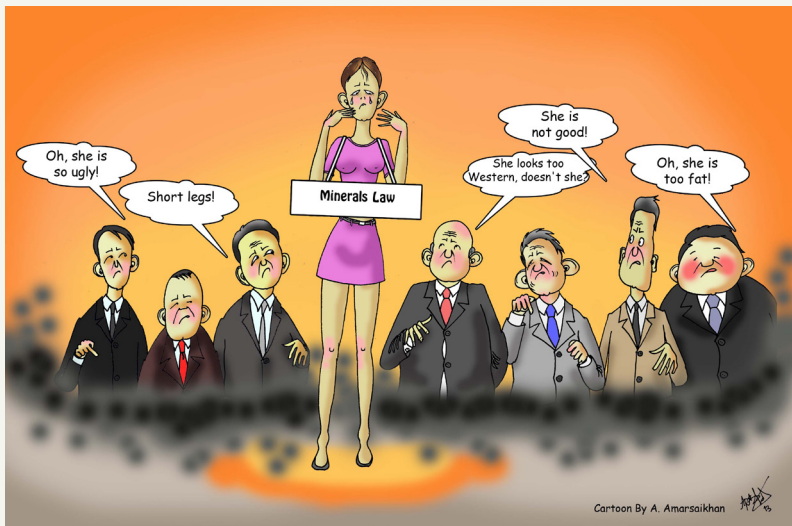
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Economic Collapse



... A fragile shape of mining-shielded and undiversified economy has been revealed and is shaking the state budget. On the one hand, this could be a lesson to learn from, but on the other hand, this would be a risk for Mongolians...

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Tavan Tolgoi Seeks Gateway

The halt in railway transport of Tavan Tolgoi's goods has created a halt in profits. A year ago the tremendous coking coal mine was attracting huge attention from mining observers and foreign investors. But where is it now?

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What the New Railway Project means

Mongolia was listed as 140th out of the 150 countries ranked in the Logistics Performance Index by the World Bank. What does this ranking tell us? Clearly, it shows that Mongolia needs to improve its infrastructure quality and to strengthen its logistics...24

24

Dutch Miracle

Willem Kok has been in leading government positions in the Netherlands for almost 13 years; first as minister of Finance and later as prime minister for two consecutive terms. He was invited this year to share his story of success and advice to Mongolia at the 2013 Mongolian Economic Forum as Mongolia experiences the resources curse for itself. Kok is well known as the first to initiate the "Polder Model", which was designed to curb the threat of the resource curse and "Dutch disease".



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MONGOLIA

Mining

According to analysis from BAEconomics, the draft Mineral Law submitted by the Office of the President would detriment both the mining industry and state budget. If passed in its current form, economic growth would fall by 4 percentage points over the next two decades, or MNT 358 trillion.

At the current rate of spending, Mongolia's budget deficit could reach USD 13.5 billion by 2022, which would prevent the country from paying back the money owed from the USD 1.5 billion Chinggis bond sale last year.

Energy

The government has agreed to import 10,000 tonnes of crude oil every month from China at a price of USD 100 to USD 150 less per tonne than the current price offered by Rosneft. Moreover, Mining Minister Davaajavyn Gankhuyag said that Mongolia is seeking supply from other countries to meet 50 percent of total oil demand. Mongolia consumes approximately 60,000 to 70,000 tonnes of oil per month.

Japan's Hitachi and the Mongolian Ministry of Energy will cooperate on the construction of a high-efficiency power plant. Kazuyoshi Akabane, Japanese deputy minister for agriculture, and D. Dorjpurev, Mongolia's deputy minister of energy, have together reviewed plans for the power plant.

Banking

The Standing Committee on Economy has tasked the Mongolian National Chamber of Commerce and Industry with drafting policy reform for the financial sector and to develop policy to cap inflation below 10 percent. According to the chamber, the interest rate of loans have not fallen mainly due to excessive state interference in major sectors of the economy and a weakness in market development.

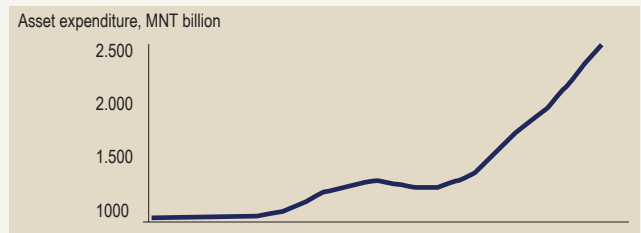
Observers

criticise that government has interfered too much with these areas of development. According to the World Bank, increased spending by government has come paired with poorly targeted and inefficient spending.

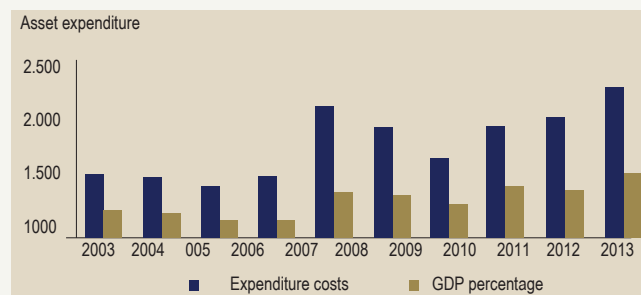
Small and medium enterprise

Creating more small-medium businesses is expected to inversely impact rising unemployment in the country. Government should reduce the expenses incurred by small and medium enterprises and provide opportunities for them to expand their operations while upgrading their technologies.

With the coming of spring is road construction in Mongolia. According to a survey by the World Bank, improvement of road infrastructure is necessary along with greater attention to repair.



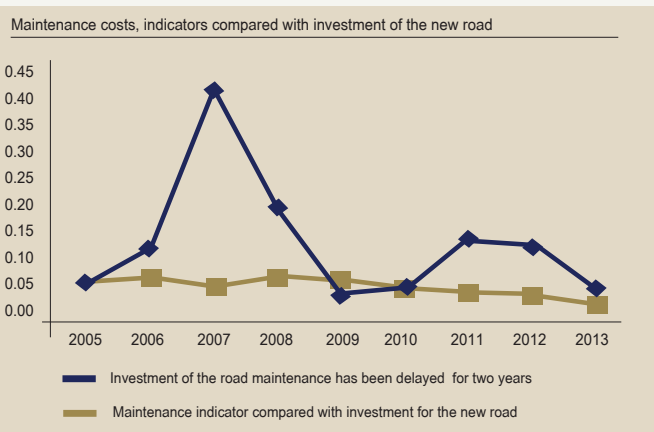
Source: Ministry of Finance and National Statistics Committee



The following are expenses of Mongolian enterprises:

Raw materials	42.5	31.4	33.4	38.8	39.3	25.4	33.1
Salaries	15.8	24.2	22.0	18.6	23.2	17.6	16.6
Other	21.8	15.4	9.9	15.8	31.8	35.1	10.7
Savings	16.4	19.3	12.8	11.0	10.6	20.3	11.6
Rent for commercial spaces	13.1	15.2	13.1	10.7	7.5	7.6	7.6
Equipment and technology	8.9	10.9	8.1	10.4	13.2	22.2	14.1
Loan interest	10.8	12.1	12.6	9.3	7.8	13.9	10.5
Transportation	11.9	10.0	7.1	8.3	10.1	20.8	12.7
Taxes	8.9	8.7	8.9	8.8	10.1	20.8	12.7
Energy	6.1	7.4	6.6	6.4	6.2	9.6	6.9
Fees, duty and payment	6.3	6.6	6.2	4.9	6.1	9.8	4.0
Heating and water	5.5	6.9	6.2	4.8	3.9	7.3	7.0
Communications	5.5	5.5	4.1	3.8	3.9	4.6	4.1

Source: Mongol Bank



WORLD

Russia

Rosneft will increase its exports to China by some 34 million tonnes to around 50 million tonnes by 2018, which is making China its top customer. Rosneft is planning to export oil to China via the Pacific port of Kozmino, pipelines through Kazakhstan and the East Siberia-Pacific Ocean pipeline.

China

China's Internet sales are forecast to exceed USD 420 billion annually by 2020, which will likely make the country the world's largest online retail market. Global management consulting firm McKinsey & Co said sales are expected to reach between USD 420 billion and USD 650 billion, driven by a growing consumer class and the world's largest population of Internet users, now more than 500 million people.

Japan

Japan has posted a trade deficit for the eighth straight month, underlining the challenge the new government faces in spurring the country's economy.

Exports fell in February, while imports rose resulting in a deficit of 777.5 billion yen (USD 8.1 billion) for the month. According to the Ministry of Finance, exports dipped 2.9 percent in February from a year earlier, while imports rose 11.9 percent.

The European Union's executive started a debate today on EU climate and energy rules as the crisis-

ridden bloc seeks a long-term plan to cut greenhouse gases and promote clean power technologies.

While the 27-nation bloc is making "good progress" toward its 2020 goals to boost the share of renewable energy and cut greenhouse gases, a framework for the subsequent decade is needed to give investors legal certainty, spur innovation and prepare for a global

climate deal, the European Commission said in a consultation paper published in Brussels.

The commission invited member states, the European Parliament, industry groups and non-governmental organisations to submit until July 2 their views on EU objectives for 2030.

"Despite of all the challenges, we need to start this new chapter of the European

climate and energy policies", Climate Commissioner Connie Hedegaard told a news conference. "The trick is to understand and reflect in all our policies that we do have three crises: an economic crisis, job and social crisis, but we also still have a climate, energy and resource crisis. The sooner we get this the better."

Source: Bloomberg



FEATURE TOPIC

THE MINING HEAT HAS COOLED OFF



B. ENKHMART
(Editor of *Mongolian Economy*)

The unpredictable climate of spring has arrived. Some days are cold and windy, but some are warm and shiny. The same is now true for Mongolia's mining sector.

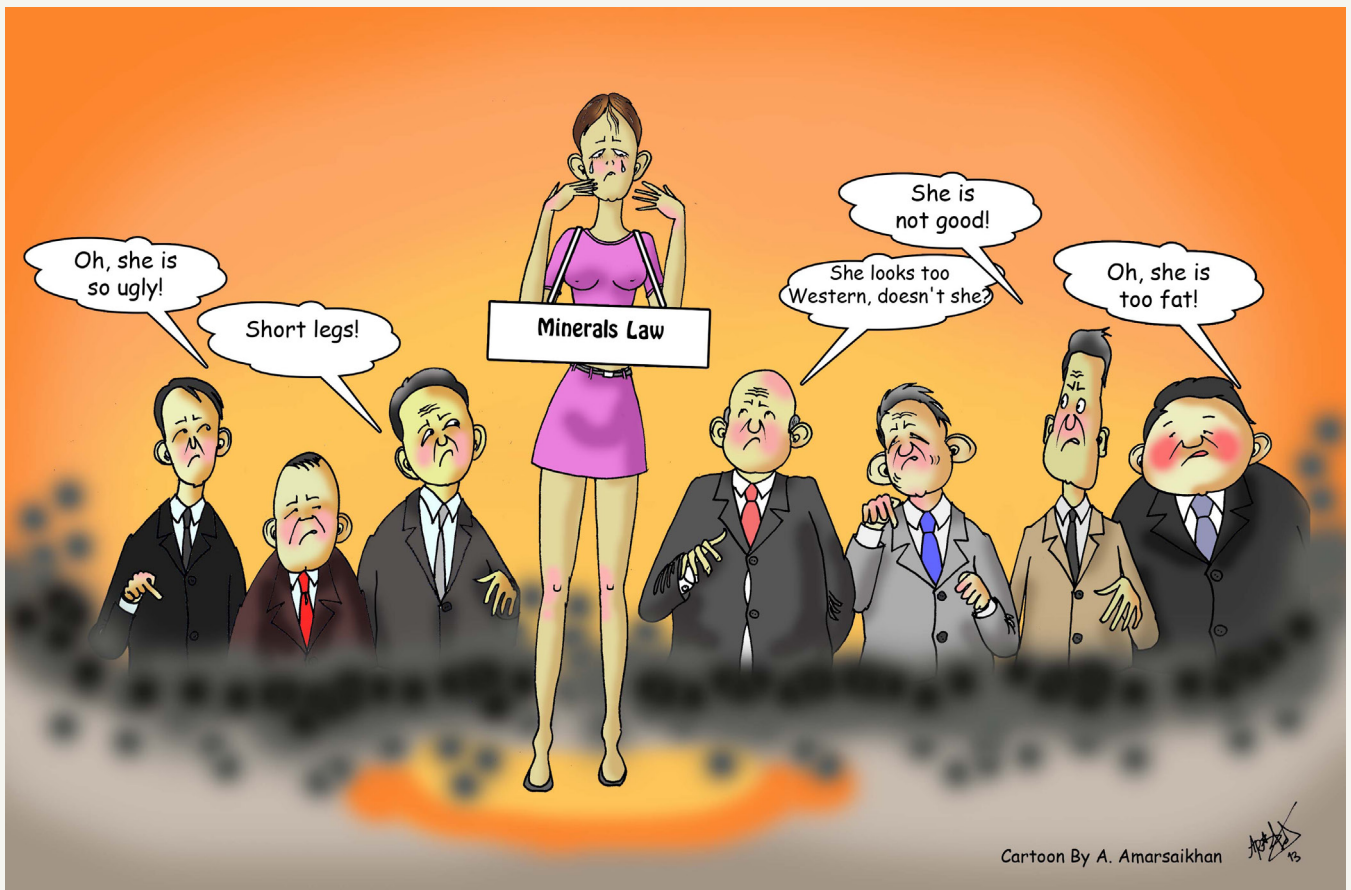
Unfortunately, the expectations of foreign investors on the appearance of an investment-friendly climate have been interrupted by Tsakhiagyn Elbegdorj, the President of Mongolia. A draft Minerals Law has not been backed by the president. "The bill must be accurate and very detailed", said the president. There are also troubles concerning the Oyu Tolgoi project, the mine that is likely to be the backbone of Mongolia's economy once it begins production. The situation has likely made some foreign investors feel like quitting Mongolia all together.

But the hopes and expectations for the investment climate of Mongolia is not to be exhausted so easily. This latest economic imbalance has shown that the withdrawal of investment is a serious threat not to be taken so lightly.

This edition of *Mongolian Economy* raises critical issues related to the uncertain legal setting of the mining sector and the recent fickleness of some investors. Also in this issue is a report that reveals the reasons for the complete halt of operations at Tavan Tolgoi. Also here is an exclusive interview with Willem "Wim" Kok, former prime minister of the Netherlands, on how he managed to transform the "Dutch disease" into a Dutch miracle.

This issue focuses on how the strong concentration of mining operations is hurting the economy just as the country is seeing a withdrawal of foreign investment and officials' concerns about the effect it might have on the budget deficit. Also answered are questions regarding why infrastructural development has frozen and what is need to resolve these issues.

Spring is coming with the snow melt on mountain peaks, and the flow is rushing down the mountain side, through to the valleys. New born livestock are making their cries at herding camps and birds that migrated out of the country last autumn are making their return. The season for growing harvests is near and the land is soon to change colour. Although the sunshine is not likely to reach the mining sector just yet, there is no doubt that good times will arrive soon. ■



...A fragile shape of mining-shielded and undiversified economy has been revealed and is shaking the state budget. On the one hand, this could be a lesson to learn from, but on the other hand, this would be a risk for Mongolians...

A PROBLEM

ECONOMIC COLLAPSE

BY B. ENKHMART

Mongolia's mining sector is at the centre of the world's attention again. But this time news is focused on its decision to back out of promises, its habit of passing blame onto others, and the absence of stable policy. Foreign investors who contribute a great deal to the creation of wealth through the extraction of mineral resources that sleep below Mongolia's soil have grown disappointed with Mongolia. Some may have lost faith in the country all together.

The root cause for the change in heart is the Strategic Entities Foreign Investment Law (SEFIL), the draft Minerals Law and perceived political

instability.

Does Mongolia really need mining? This is the question many have on their minds. It is hard to disagree that Mongolia's economy leans heavily on the mining sector. Mining represents 25 percent of gross domestic product (GDP) and 95 percent of exports. Since the end of 2012, talk has widely spread that Mongolia's economic growth would grow to be the second fastest in the world. That growth would be driven by the mining sector, and Oyu Tolgoi plays a large role. But for the moment foreign investment to the mining sector is growing stagnant. ▶

▶ The Minerals Law is being revised for a sixth time and Mongolian society is expecting good results. A working group established by the president is working to tighten regulation and introduce stronger mechanisms for the monitoring of natural resources.

Foreign investors are not likely to change their minds on investment opportunities in Mongolia, however, until the law is approved. Investors are also reeling from the disagreements that occurred during the Oyu Tolgoi shareholders' meetings. Some international media outlets have suggested the Mongolia is no longer the darling to investors that it once was and should no longer be lumped along with Mozambique and Myanmar as the "3M" investment strategy.

Consequently, the Mongolian economy, so heavily concentrated in mining activities, is shaky at best. While this could be an experience Mongolia could learn from, that is assuming the country will have future opportunities to act with this experience behind it.

Growing Concerns

"There are many countries such as China, Australia, South Africa, Russia, etcetera that are much richer in natural resources than Mongolia. We cannot act as if there are resources only in Mongolia", said B. Bold, chairman of the Mongolian National Mining Association's board and chief executive of Altan Dornod. "It is good that the government of Mongolia is making policy now, but it would be useful for us to properly evaluate the current circumstance and make the appropriate policy".

Darambazar Achit-Erdene, a board member of the Business Council of Mongolia, echoed this thought, saying Mongolia should act less rashly. "Laws are updated for the future and interests of Mongolia", he said. "This should be done in a timely manner, suitably and sensibly". He recalled the months of uncertainty investors have felt toward Mongolia since June last year, after the passage of SEFIL. The controversial law brought a halt to a number of projects and deterred any new investments from materialising he said.



Number of licence holding countries

CHINA	232	HUNGARY	2
RUSSIA	248	BULGARIA	8
Japan	141	BAGAMI	98
USA	12	FRANCE	14
ENGLAND	443	IRELAND	1
KOREA	70	BERMUDA	156
CANADA	76	LUXEMBURG	8
GERMANY	16	NEW ZEALAND	36
UKRAINE	3	ANTIGUA BARBUDA	30
CZECH	4	CAYMAN ISLAND	59
AUSTRALIA	28	MALAYSIA	1
		BELGIUM	1

"There haven't been nearly any IPOs released by Mongolia's companies on international stock markets. Their stocks are not sold as investors believe Mongolia's investment climate is deteriorating".

He added that the same damage was being inflicted on Mongolia's sovereign bonds as investment risk grew by 25 percent from a year ago. With investors gone, Mongolia has only international financial organisations and Mongolia's Development Bank to turn to for large-scale financing.

But Batkhuu, head of the Policy Implementation and Coordination at the Mining Ministry, argues the law was necessary to tightened regulations and protect Mongolia from "those who are irresponsible and sloppy". He also said the loss of foreign investment was not as devastating as some others have suggested.

"We are informed that some investors ▶▶



of an asset within one of the strategic sectors—mining, banking and finance, and communications—valued above MNT 100 billion. It also seeks to discard the MNT 100 billion threshold, instead requiring parliamentary approval for only state-owned entities for foreign investment above 49 percent.

To avoid economic tyranny by foreign nations over the country, Mongolia may have to keep state-owned companies at bay. Australia and Canada have acted much in the same way. But behaviour in the vein of cancelling the contract between Tavan Tolgoi and Aluminium Corp. of China (Chalco) threatens to taint Mongolia's reputation. Yet, at the same time, Mongolia should not forget that foreign investors hold ownership over the wealth of Mongolians.

Prudent Economic Growth

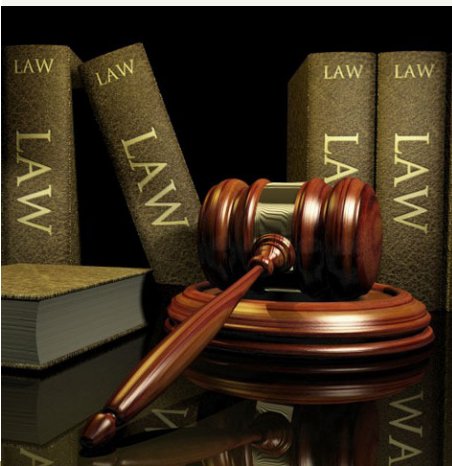
The time has come to cut off the steel chains to the interests of politicians. Until they quit their tirades to “save” Oyu Tolgoi and Tavan Tolgoi, not even amending SEFIL or redrafting of another Minerals bill can help. Politicians project that most of the state budget will be generated from the mining sector, especially from the Oyu Tolgoi copper-gold project, and great a deal of Mongolia's future falls on the back of the Tavan Tolgoi coal deposit. But politicians are looking to kill the goose before it has laid any golden eggs. Mongolia's economy looks to be very fragile and that table rests too heavily on the leg of mining. Unless the country manages to diversify the economy and tack on more legs, the table is likely to collapse.

In Mongolia there are 1,200 deposits with definite reserves, of which 200 to 300 are potentially of strategic importance. But only 15 have been declared as strategically important deposits, while another 39 deposits remain as possible candidates. These deposits are already owned by mining companies and a few operations have already reached their likely end. However, these deposits are here for the benefit of Mongolian society. Licences to strategically important deposits are owned by individuals and the stocks of mining units operating at deposits are traded in Hong Kong, Toronto ▶

- ▶ are withdrawing their investment, but not all of them”, said Batkhuu. “These withdrawals do not have a noticeable impact on the country's economy. This is the situation, but it is not hampering foreign investors”.

Although it is deeply regrettable to see foreign investors leave the country when its need them most, it should be understood that there should be protections for national wealth in state policy. The country should not allow bias simply because it does not have the equipment and technology to extract mineral resources itself. The country should not hand over huge debts to its future generations and should not develop more legislation that will need revision after just five years.

Some MPs have followed Ch. Saikhanbileg, the lead minister of the Cabinet of Ministers, to present a proposed amendment to SEFIL to the State Great Khural. Currently the law requires parliamentary approval for any transaction for more than 49 percent



Pull Your Reputation out of the Mud

Miner: Contemporary miners do not deserve the reputation of allowing foreigners deplete Mongolia's natural resources, destroying the environment, and permitting illegal wealth-thieving "ninja" miners. Many say that the mining sector's reputation has been tainted to the point that older miners feel embarrassed to be called a miner.

Unfortunately, they hope and expect the mining sector to bring diversification to Mongolia's economy and bring the development of infrastructure. This period in time is right to revitalise the tainted reputation and image of the sector with policy.

▶ and London. The licences are giving ownership over Mongolia's resources to international shareholders.

Eight deposits are owned by Chinese, Russian, and Canadian entities, including the Naryn Sukhait coal deposit, the Mardai, Gurvanbulag and Dornod uranium deposits, the Tumurtei iron ore deposit, the Burenkhaan phosphorous deposit, the Boroo gold deposit, and the Tumurtein Ovoo zinc deposit are owned by China, Russia and Canada.

Mongolia's oligarchs have not sat idle either. The Naryn Sukhait coal deposit has been divided into five parts, China's Qinhuai-MAK-Naryn Sukhait operates at one, Canada's SouthGobi Sands operating at two and Mongolia's Mongolyn Alt Corporation (MAK) operates in the remaining two areas. SouthGobi Sands, a subsidiary of Turquoise Hill Resources Ltd., mines at Ovoot Tolgoi Ord, which holds coal reserves of 188 million tonnes. It is a part of the Naryn Sukhait deposit. MAK also owns the Tsagaan Suvarga copper-molybdenum deposit. Of the 15 deposits of strategic importance, only Baganuur and Shivee Ovoo remain in the control of the Mongolian government.

Politicians drafted the 2013 budget with projections of how much the state

budget would collect from Oyu Tolgoi. However, they have unexpectedly backed out, criticising through media how bad the investment agreement was. It make little sense to appeal to investors that Mongolia has an investor friendly environment to finance the country's rail and industrial infrastructure such as an oil refinery amid all this political noise. The government should be responsible for separating the state from the mining industry.

Politicians must remember that that foreign observers also have eyes and ears, and they will not be quick to forget the poor treatment they received from Mongolia.

What to Take from Migratory-Birds?

Investors are very similar to the migratory birds that habitually fly someplace new when the climate grows inhospitable. 81 percent of total investment towards Mongolia is focused on the mining sector. Some criticise that this huge investment is not beneficial to Mongolian society. Has mining investment brought any development to local areas, regions, herders or school children? Citizens understand that the laws are being ▶



Volume of FDI in the mining sector, in USD

► revised as the state looks back on what happened in the past.

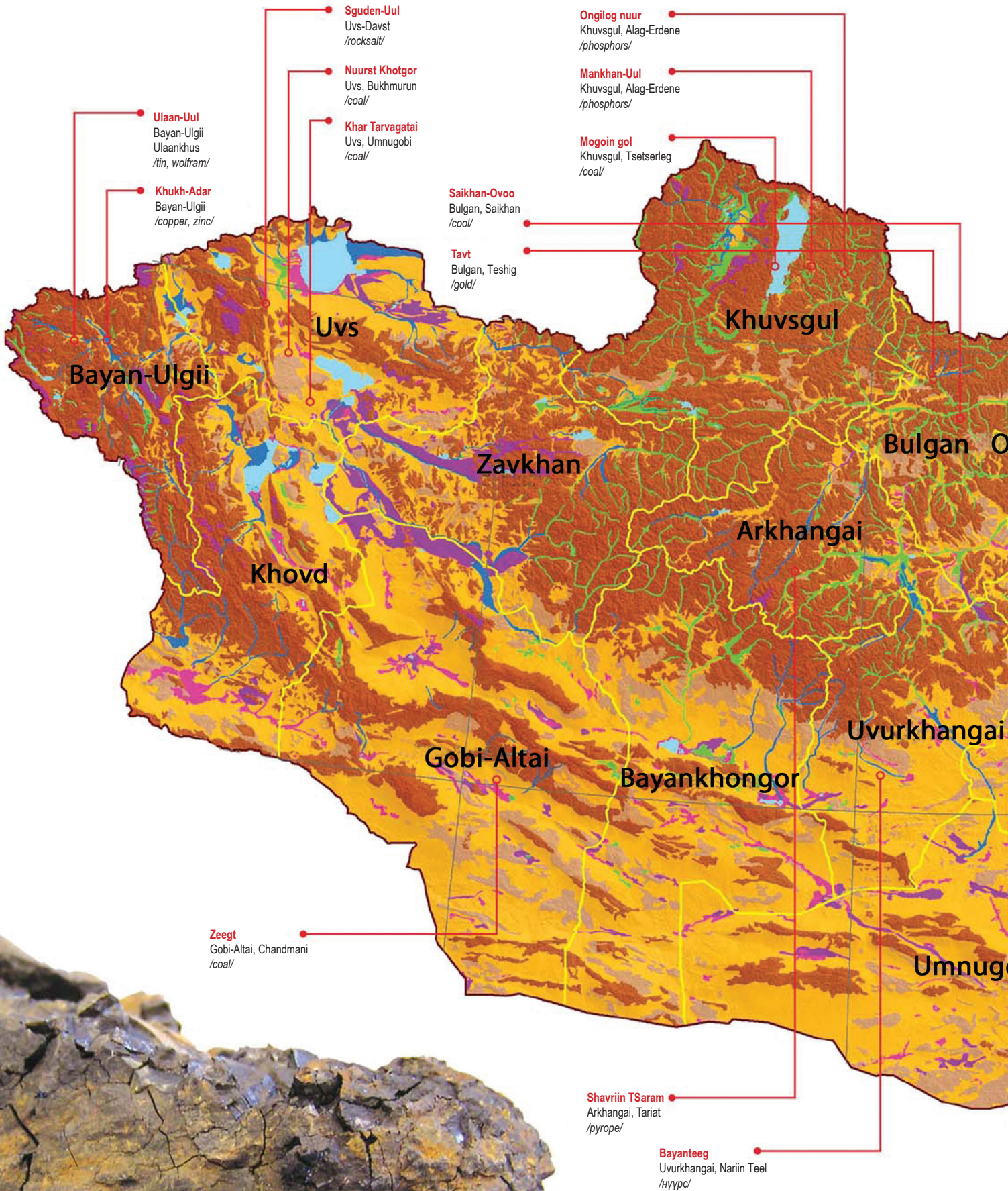
“The way some people hate and blame foreign investors is fundamentally wrong. We need foreign investors who will guarantee the independence of Mongolia”, said Bold of the Mining Association. “In Mongolia, infrastructure development and industrialisation are only on the negotiation table. We do not have a right to think or act as those promises are being implemented or to chase away foreign investors”.

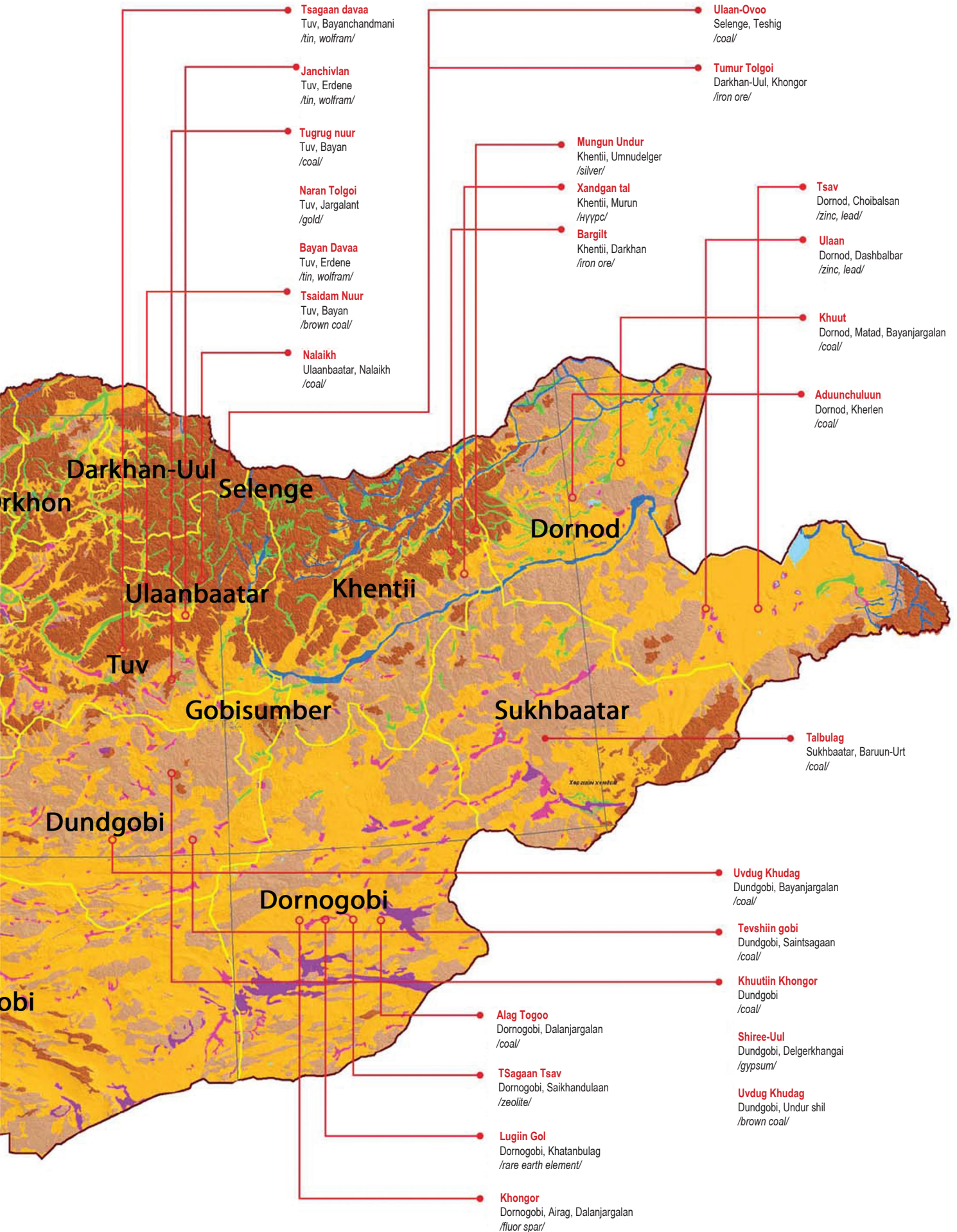
“Investors will choose an investment-

friendly climate for themselves. We should not forget that there are so many better environments than Mongolia”.

The reason for so many repeated attempts to improve these laws is to invite potential investors to cooperate to develop the economy and industry. Creating a fragile, easily disrupted economy should not be the aim of the country. The economy has to be fortified against collapse. Otherwise, Mongolia will never be able to push inflation down to the single digits, repay its sovereign debt or reach USD 3,000 GDP per capita. ■

39 STRATEGIC DEPOSITS





Tsagaan davaa
Tuv, Bayanchandmani
/tin, wolfram/

Janchivlan
Tuv, Erdene
/tin, wolfram/

Tugrug nuur
Tuv, Bayan
/coal/

Naran Tolgoi
Tuv, Jargalant
/gold/

Bayan Davaa
Tuv, Erdene
/tin, wolfram/

Tsaidam Nuur
Tuv, Bayan
/brown coal/

Nalaikh
Ulaanbaatar, Nalaikh
/coal/

Ulaan-Ovoo
Selenge, Teshig
/coal/

Tumur Tolgoi
Darkhan-Uul, Khongor
/iron ore/

Mungun Undur
Khentii, Umnudelger
/silver/

Xandgan tal
Khentii, Murun
/hypsum/

Bargilt
Khentii, Darkhan
/iron ore/

Tsav
Dornod, Choibalsan
/zinc, lead/

Ulaan
Dornod, Dashbalbar
/zinc, lead/

Khuut
Dornod, Matad, Bayanjargalan
/coal/

Aduunchuluun
Dornod, Kherlen
/coal/

Talbulag
Sukhbaatar, Baruun-Urt
/coal/

Uvdug Khudag
Dundgobi, Bayanjargalan
/coal/

Tevshiiin gobi
Dundgobi, Saintsagaan
/coal/

Khuutiin Khongor
Dundgobi
/coal/

Shiree-Uul
Dundgobi, Delgerkhangai
/gypsum/

Uvdug Khudag
Dundgobi, Undur shil
/brown coal/

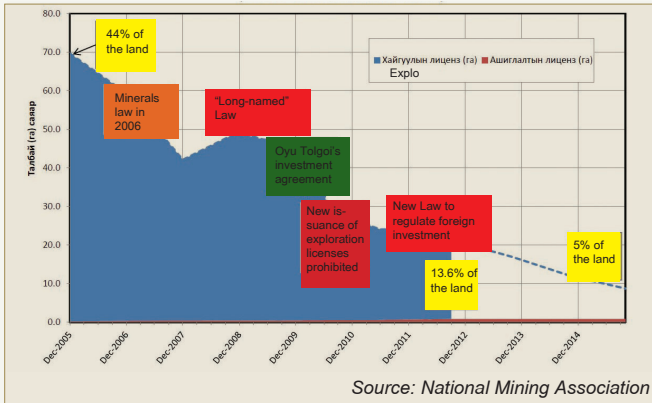
Alag Togoo
Dornogobi, Dalanjargalan
/coal/

TSagaan Tsav
Dornogobi, Saikhandulaan
/zeolite/

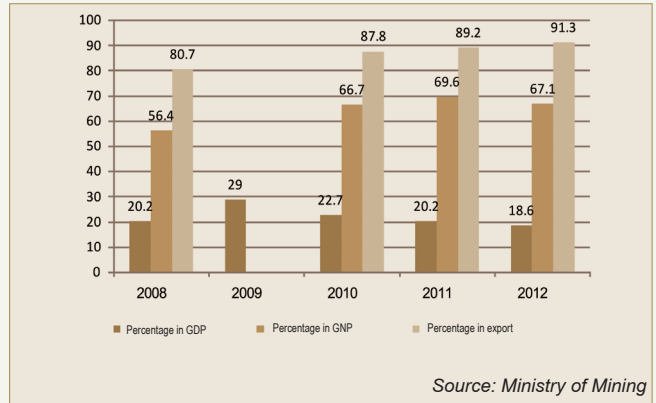
Lugiin Gol
Dornogobi, Khatanbulag
/rare earth element/

Khongor
Dornogobi, Airag, Dalanjargalan
/fluor spar/

Areas with mining license (2015 projection)



Mining sectors contribution to Mongolia's economy

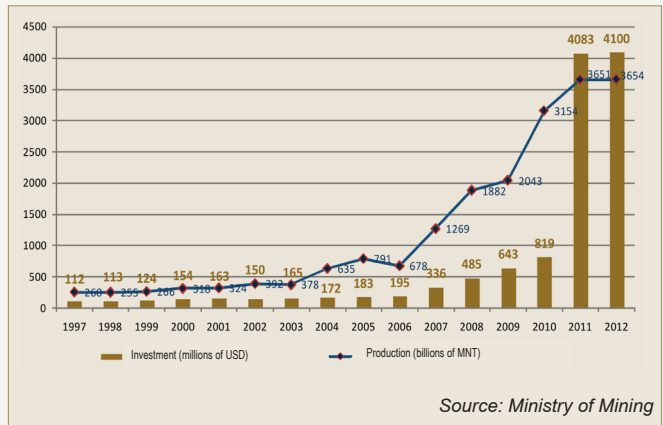


Direct dependent of Mongolia's foreign investment on Oyu Tolgoi

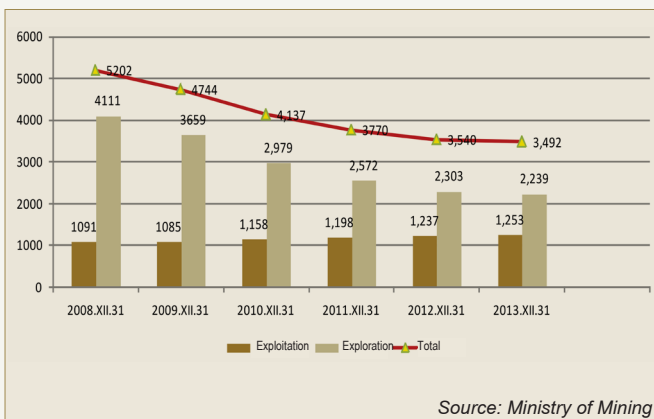
	(MNT billion)				
	2009	2010	2011	2012	2013
GNP	6,591	8,415	11,088	14,185	17,649
Nominal changes		1,824	2,673	3,097	3,464
Budget revenue	1,994	3,123	4,228	5,530	7,088
Nominal changes		1,129	1,105	1,302	1,558
Foreign investment	798	2,152	6,191	5,177	?
Nominal changes		1,354	4,039	(1,014)	?
Oyu Tolgoi investment	1,092	3,809	3,286	830	
Nominal changes		1,092	2,717	(523)	(2,456)
Percentage of Oyu Tolgoi		51%	62%	63%	

Source: National Mining Association

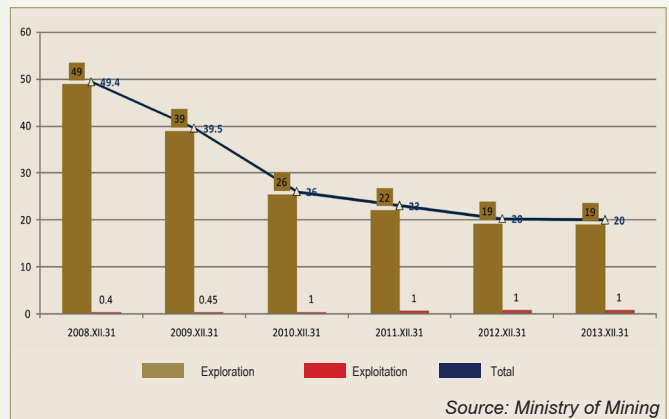
Investment and production in mining sector of Mongolia



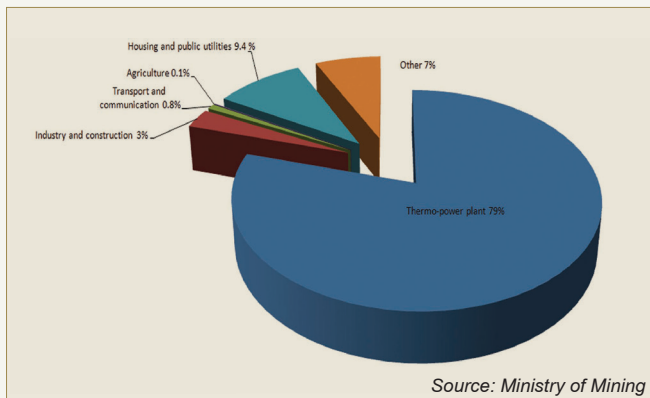
Number of valid special licenses in Mongolia (2008-2013)



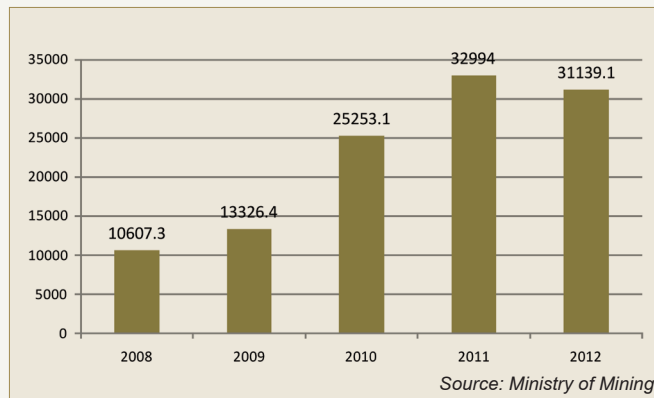
Mining sites under valid special license 2008-2013 (millions of ha)



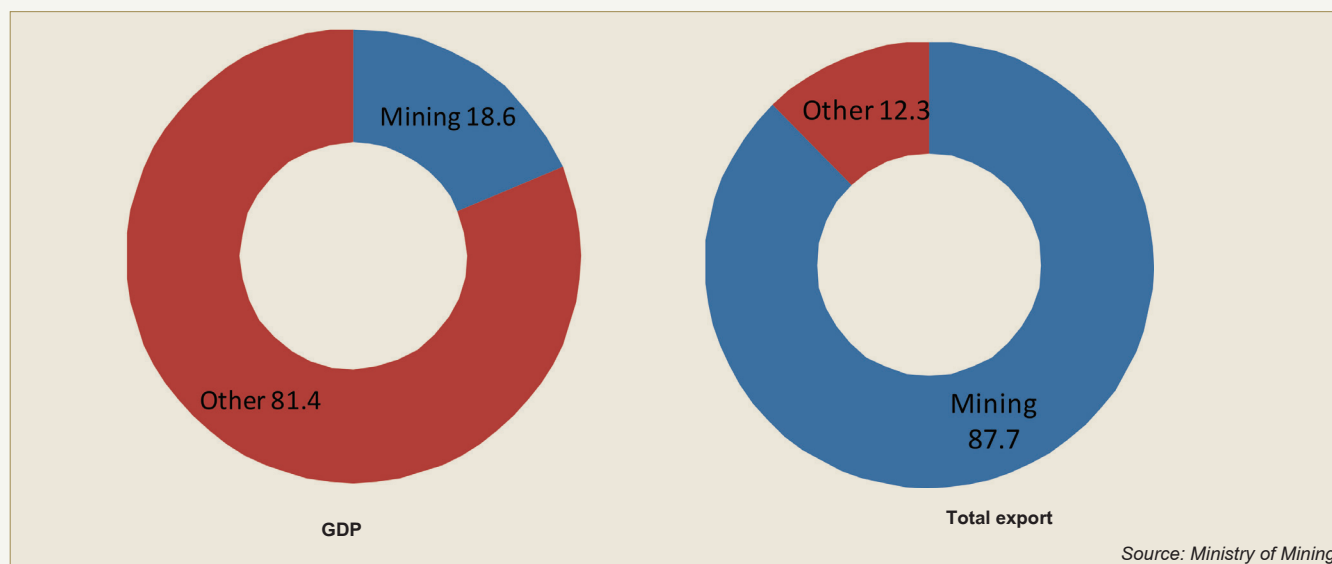
Mongolia's coal consumption



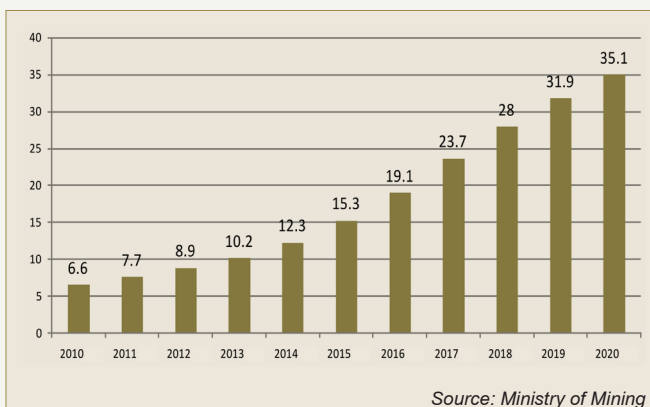
Mongolia's coal mining (thousands of tonnes)



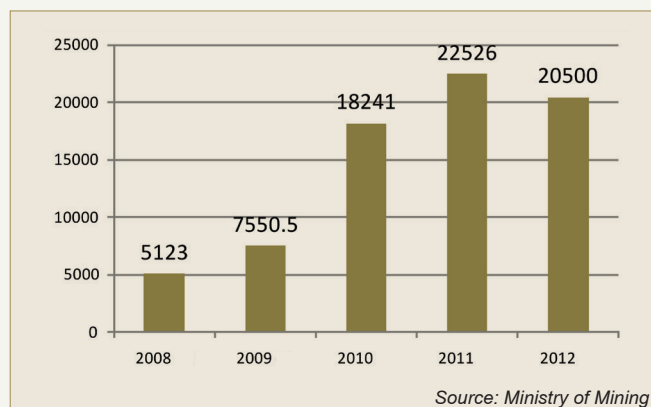
The current standing of the coal sector /Mining sector as of the end of 2012/



Mongolia's GDP projection (billions of USD)



Mongolia's coal export 2008-2012 (thousands of tonnes)



Is the mining sector falling into decline due to political uncertainty? Is the state policy on the mining sector clear? Some say that foreign investment is sluggish and Mongolian stock prices are declining on international stock markets. How can this be improved?



N. Dorjdari
(Researcher at the
Open Society Forum)

Mongolia is Still Investment-Friendly in Many Ways

There are plenty of problems in the mineral resources sector, especially in the legal and tax setting, as well as foreign investment coordination. But the mining sector itself has a number of problems such as environmental impact, restoration and social responsibility that need to be tackled. Now it is time to put these problems in order.

Also there are emerging expectations from the draft Minerals Law and the state policy on the mining sector. The fact that time is being wasted in Mongolia might worsen the existing problems in the mining sector. The draft legislation was being discussed at the right time, but the president of Mongolia has delayed the submission for approval in the next session of parliament. A specific policy and a law that regulates multiple relations is very important to the

mining sector. It will apparently take some time to have it approved and implemented. Thus, we should not delay the issue. We need a state policy that has a vision for the distant future. Its importance will be reduced without good policy.

In the meantime, it causes the decline in stock prices and sluggish project implementation. But the final determining factor is Mongolia's interests. And policy-making considering the country's interest is the most important. It would be a huge problem if the mining sector lacked the appropriate policy. But the government should work to create a better policy and legal setting.

Mining is not an endless resource. That's why the results are important for Mongolia. It could become not investment-friendly during this current mid-term period. But Mongolia is still investment-friendly in many ways. The conditions will be hopefully improved in the long run. To do so, the policy needs to be discussed in-depth.



D. Aчит-Erdene
(President of Mongolia's
Investment
Corporation (MICC))

Foreign Investors are More Informed by Negative Aspect of Mongolia

There is a significant decline in the stock prices of the companies that run operations in Mongolia. Mongolian companies have been issuing IPOs [initial public offerings] on international stock markets, but they are not likely to issue IPOs in 2013. Their stocks are not purchased by stock traders due to widespread concern that Mongolia discourages foreign investment.

In other words, the number of foreign investors who are interested in Mongolia is now reduced. This is an effect of the Foreign Investment Law of Mongolia, its political setting and sector policies. Government policy on the mining sector has been unclear. This uncertainty has a negative impact on foreign investment, in addition to mining and the economy. It seems that some expectations have emerged due to uncertainty in mining policy. Foreign investors cannot decide whether or not to invest in Mongolia.

The risk for investing in Mongolia has grown by 25 percent in 2013 from last year. Foreign investors have begun to conclude that Mongolia's investment climate has worsened since before last year's parliamentary election. Investment has declined by 40 percent according to a study by MICC [Mongolia International Capital Corp.].

Just recently, several investment funds shut down their operations. This contraction in their operations could lead investors to believe that Mongolia's investment climate is worsening. Wherever is lucrative or a good investment climate is created, the cash flows there. Mongolia was attracting the cash flow at first, but now is losing it. It seems the Foreign Investment Law has chased away foreign investors. Therefore policymakers should focus on creating a legal setting that considers the interests and relations of multiple stakeholders. A stable and clear legal setting can be the basis to attract foreign investors. Also one critical thing is that foreign investors are given more negative information about Mongolia than positive. It isn't a stretch to say that this affects the decisions investors make.

It is Time to Look at the Mining Sector with a Different Point of View

Mongolia is an independent country with its own state and laws. Therefore, it needs to make its property relations transparent and respect equality and social justice, and they need to be enforced together. We have never had an idea like this before. Our attitude towards the mining sector has been quite biased. It means that a biased and incorrect policy was implemented. What happened in the past has already proven that. We have also paid a huge price to learn that.

USD 1 billion in funding was spent between 2008 and 2012 because of promises from the parliamentary election campaign. The whole nation finally understood that it was wrong to grant allowances from the Human Development Fund. As a result of the Alt programme, the total mined is 200,000 tonnes over the past ten years, of which Mongolia has benefited very little. In other words, this reveals an absence of policy.

The foundation to the Sovereign Wealth Fund has just recently begun to be discussed. In addition to that, we do not respect or enforce the laws that we approved. That's why this problem cannot be resolved legally. Now we must deal with the aftermath from only focusing on the operations

Mongolia is Not Stepping Back from Democracy and a Market Economy

There is no state without policy. We had a policy for exploration and exploitation within the mineral resources sector. The problem is how optimum that policy was and whether it was suitable for the country's interests.

This policy has been absent for the past twenty years, meaning the policy was not put into practice. There has not been appropriate policy that meets the country's interest. Mongolia's president had the perspective to develop a new policy that met the country's interests. Accordingly, the mining ministry has established a working group to develop that policy. Now it is time to conclude the past twenty years.

There are more than 4,000 licences [in circulation], of which 1,255 are for exploitation. The licences permit the mining of 40 to 50 different

within the mining sector and determining regulations with only mining engineer professionals.

Mongolia lacks a legal policy that regulates social relations and protects the interests of society. The law is state policy. But the absence of this policy, which is the core of the state, means that there is nothing to do with enforcement of the law. The draft Minerals Law has been delayed by the president of Mongolia because of the lack of policy. Natural resources are a public wealth. But a few people spent those resources as if it was their own property and profited on capital markets. It was a business that was run by somebody before, but now it is out of our control. It has gone to the global market.

It was said that USD 32 billion was generated from the issuance of 26 licences in 2009 but the ownership is still with Mongolians. The problem of ownership is being raised in the mining sector. Mongolia has an insufficient legal setting for its public property. Also there is lack of investment professionals.

Mine is part of an economy. Thus, it is time to look at the mining sector from a different point of view. Natural resources are becoming purely an economic issue. Unfortunately, Mongolians are just beginning to comprehend it. The destination for the mining sector is uncertain, as there is an absence of policy in the mining sector.

types of minerals. It means that there are 1,255 mining sites in the territory of Mongolia.

This figure shows an absence of state policy. Under the current circumstances, it is unreasonable to establish such a number of mining sites. Mongolia also lacks geological study. The policy to attract foreign investment and develop Mongolia based on that policy was first implemented in 1996. Attracting foreign investment cannot be wrong at all. Some countries' basis for development is attracting foreign investment using the best international technology. In Mongolia's case in particular, the policy that encouraged foreign investment was developed when the country wanted to develop its economy using its mineral resources. At the same time, some bias and excessiveness was widespread under the name of foreign investment. There are Mongolia's interest and foreign investors' interests. It is important to properly combine these interests.

Fair and mutually beneficial conditions must be created. ■



B. Lkagvajav
(Leader of the National Soyombo Movement)



S. Avirmed
(Mining Engineer, Ph D)



PROJECT

TAVAN TOLGOI SEEKS GATEWAY

BY B. TOGTOKH

The halt in railway transport of Tavan Tolgoi's goods has created a halt in profits. A year ago the tremendous coking coal mine was attracting huge attention from mining observers and foreign investors. But where is it now?

The operator of the mining deposit, state-owned Erdenes Tavan Tolgoi, was then expected to release a public offering on international stock exchanges beginning from this spring. Instead, it is in financial crisis and has halted its mining activities. If things continue on like this, it will be difficult for the miner to meet its 20 million-tonne target for production. The miner has already begun to fail the action plan it developed when it was established.

Tavan Tolgoi is a strategic deposit located in one of the world's richest coking coal basins. But Mongolians' expectations for this deposit are not likely to result in development, but rather in debt troubles. The company was granted a loan of USD 300 million from the Development Bank of Mongolia, and USD 131 million from Golomt Bank and Trade and Development Bank.

"This is aimed at putting the deposit in eco-

nomical turnover and to recover the operating costs", said the company's management team in an explanation about the loans. Erdenes TT's debt is growing significantly while the project's progress stagnates.

The company borrowed USD 350 million from Aluminum Corp. of China Ltd. (Chalco). The coal deposit's available resources account for 7.4 billion tonnes. Davaajavyn Gankhuyag, mining minister, said in a statement last week that Erdenes TT's initial public offering on international stock markets would see the light of day before 2015.

"The securities cannot afford [their potential] value if infrastructure development is not resolved", said T. Naran, chief executive officer of the Mongolian Coal Association.

The reputation of the Tavan Tolgoi deposit has been discredited in the coal-mining industry in only one year. The selection of strategic investors to invest in the Baruun (west) Tsankhi site of the project is continually delayed. This is possibly explained by the sharp fall in coal prices on the global market. The company has admitted that the export of coal from the Zuun (east) Tsankhi has been halted

because of financial difficulties.

The financial strain forced the company now to request funding from the USD 1.5 billion so-called Chinggis bond sold last year. The working group tasked with allocating these funds has come out to say that the development of infrastructure was most important to the project.

"Prolonging the IPO is seen as Mongolia's voluntary refusal from the potential market. In other words, this halt in its mining activities is a voluntary deflection away from its path", said T. Naran, chief executive officer of the Mongolian Coal Association.

Erdenes TT is struggling to survive difficult conditions. It has requested from the government help while throwing a glance of trust towards investors. However it was heavily indebted. The same mistake is hopefully not going to be repeated. The coal from Tavan Tolgoi was sold to Chalco at a price of USD 70 per tonne, while the company experienced USD 500 million in losses in 2012 after coal prices fell by over 30 percent last year. More than 60 percent of its costs that year was for the Human Development Fund to finance the government's cash allowances program.

The company attempted to initiate negotiations concerning the Chalco agreement with the Chinese government, but so far those calls have gone unanswered.

"The contract between TT and Chalco was initially made to be mutually beneficial. Therefore, our stance is to continue the contract enforcement", said Wang Xiaolong, Chinese ambassador to Mongolia. He also indicated his support for Shenhua Energy Group to participate in the Baruun Tsankhi project.

There is reason to be sceptical about whether Mongolia will benefit from Tavan Tolgoi. The project is now unable to recover its operating cost and faces loss it never foresaw. It is unfortunate that Tavan Tolgoi, one of the world's largest coking coal deposits, is experiencing failure because of a false start.

Tavan Tolgoi has the potential to become a powerful company to represent Mongolia. Some say that the reason the coal project is in a bad situation is due to poor management. Also industry observers claim that the Tavan Tolgoi project is preoccupied by political motives. Tavan Tolgoi has bowed its knees before enormous debt and cannot stand on its own feet.

Khishig Arvin Industrial is now conducting soil removal preparatory work at Baruun Tsankhi. In 2012 Erdenes TT's mine

produced 2.5 million tonnes of coal. Yachil Batsuuri, chief executive officer, said that his company planned to mine seven million tonnes this year.

In 2011, the attentions of politics, economics and the mining sector of Mongolia were centred on Tavan Tolgoi when the bidding process for the rights to mine the Baruun Tsanki site were underway. Peabody Energy of the United States, Shenhua Energy of China, Japan's Mitsui & Co, Russian Railway, a Japanese consortium, South Korea's KORES, Australia's Xstrata Coal, Brazil's Vale and Luxembourg's Arcelor Mittal all competed for the tender.

Just one year ago, Erdenes TT was careless with its deposit, but now it is seeking a gateway. The deposit itself was a big advertisement for Mongolia's growth potential to investors as well as foreign nations.

Tavan Tolgoi really cannot step forward as it was hobbled by financial pressures and market downturn. Also clearly political influence has negatively impacted the mine. The former coalition government freely distributed money to every Mongolian citizen by tapping into Tavan Tolgoi's funds. Consequently, the miner has nothing today.

The coal mine is now playing a tiny role while under the thumb of mounting debt. Tavan Tolgoi failed to live up to the promises the former government made to get elected.

Prime Minister Norovyn Altankhuyag decided it was best to cancel the detrimental contract with Chalco, to compensate Chalco's payment using proceeds from the Chinggis bond and enter an agreement with another company. "After all this, Erdenes TT will be able to stand on its feet", quipped the prime minister. He is quite confident in the future of Tavan Tolgoi. The mining minister said that "It is in the pursuit of a gateway".

At the same time, M. Enkhsaikhan, head of the Mongolian National Democratic Party has been appointed to head the project team responsible for constructing a new power plant for the project. The government recently released a resolution to finance the construction of the power plant with USD 50 million from the Chinggis bond. This could be considered a gateway to pulling Tavan Tolgoi out of its deadlock. Also some believe the State Great Khural will discuss management of Tavan Tolgoi in the next session.

When will it be a convenient enough time for government to take action regarding Tavan Tolgoi? ■

COAL

THE KING OF ASIAN ELECTRICITY

BY B. BAYARTOGTOKH

Coal is a flammable sedimentary rock that in winter is burned for warmth by the thousands of residents in the ger districts of Ulaanbaatar. In Mongolia, there is no other fuel that produces more heat and is as economically beneficial as coal. Thus, the price of coal grows every year due to high demand.

Coal fuels one third of the world's power supply. Ulaanbaatar residents are provided with heat produced from coal-burning power plants. Luckily,

Mongolia is rich in coal deposits. But ger-district residents still buy coal at a higher price than for what exported coal is sold. They pay MNT 100,000 to 150,000 per tonne of coal while Aluminium Corp. of China Ltd. (Chalco) pays USD 70 per tonne for the more valuable coking coal.

As of 2012, Mongolia's total coal production was 31.1 million tonnes, of which 20.5 million tonnes was exported. Another MNT 828 million was collected into the state budget. D. Galsandorj, president of the Mongolian Exporters Association said that Mongolia's export volume was very low considering the country borders China, the world's largest coal consumer.

According to statistics by the Minerals Resources Authority, the nation holds 163.2 billion tonnes of coal resources, of which approximately 40 billion tonnes is indicated reserves.

"Mongolia's coal export volume is expected to grow steadily and to reach 80 million tonnes by 2020, of which more than 50 million tonnes is expected to be coking coal", said B. Altansukh, head of the authority's Coal Research Division. ▶



► Price Depends on Quality

China's economy is 860 times the size of Mongolia's. The giant market cannot be fully satiated even by combining the humongous volume of coal exports from Mongolia, Australia, Mozambique and Indonesia. In 2011 China imported 44.7 million tonnes of coal, which grew to 53.6 million in 2012. Mongolia's total coking coal export volume to China has overtaken that of Australia. But whether Mongolia can maintain this position for long is unforeseeable.

Last year Mongolia was still one of the largest coal exporters to China. However, conditions were poor. In the future, only Mongolia's competitiveness is likely to resolve whether it can succeed in China's giant coal market. That competitiveness includes coal processing capabilities and infrastructure development.

In 2012, Mongolia comprised some 36 percent of China's coking coal imports. In the past few years, the distance between Mongolia and China has felt nearer, but has only grown further away in development. However, Mongolia has the greatest advantage in terms of geographical location, but it is not able to completely tap into the potential afforded by its close proximity to China. Thus, industry observers claim that Mongolia's dilemma is how well it can take advantage of this opportunity.

The main global energy source is now shifting from oil to coal. Peabody Energy projected that total coal demand is likely to reach nine billion tonnes by 2017, and the International Energy Agency (IEA) has concurred. China as well as Japan and South Korea are the main coking-coal consumers in the Asia-Pacific region and have expressed interest in cooperation with Mongolia.

"Mongolia's coal is of a good quality which is competitive with the world's leading brands of coal, such as Australia's Bowen Basin and China's Sanxi", said G. Battengel, chief executive of Mongolian Mining Corporation.

One-Stop Policy

The State Great Khural approved the Mongol Coal programme in 2010, and a new policy to continue that programme is expected within the mining ministry. It is a one-stop export policy.

Mining Minister Davaajavyn Gankhuyag said that

forming a legal setting to develop a "coal exchange" programme within this policy is under way. He also promised investors that a more-open policy would be introduced. Thus, there is a growing expectation for the state to keep from interfering with this industry.

"China's imported coal volume is expected to reach 230 million tonnes by 2015, of which 58 million tonnes is expected to be coking coal", reads the Brief Study on Mongolia's Coal Market.

According to T. Baasanpurev, an economist and researcher of mineral resources, "Mongolia's coal has the possibility of gaining more power in overall exports towards China by improving its railway and customs capacity. However, the domestic coal market could be competitive. According to a preliminary calculation, Mongolia is expected to comprise 33 percent of China's imported coal and 70 percent of coking coal by 2015".

A Positive Economic Approach

"Mongolia is predicted to be the king of Asian electricity. However, there are some emerging energy sources", said Randolph Koppa, president of Trade and Development Bank.

There is a high probability that what he said may come true in coming years. Both the IEA and World Coal Association expect coal demand to grow. They reason this will be a result of world population growth plus China and India's economic growth.

Another factor to likely lead to greater coal demand is the inevitable depletion of the world's oil resources, leading to a 25 percent increase in the world's coal demand every three years. In 2011, IEA suggested that the world's coal demand would grow by 40 percent until 2035. As mentioned earlier, total coal reserves are 861 billion tonnes, which is likely to be exploited over the next 150 years, at today's level of consumption.

Although coal consumption is not likely to end any time soon, it is rejected by some because the effect burning coal has on the environment. As of 2012, all the world's coal mines held 7.8 billion tonnes of resources, and that figure is expected to reach eight billion tonnes by 2015. It seems too early to tell whether or not the world can still turn without burning coal.

Although today's circumstance are unfavourable, tomorrow's coal forecast is positive. ■

INFRASTRUCTURE

WHAT THE NEW RAILWAY PROJECT MEANS

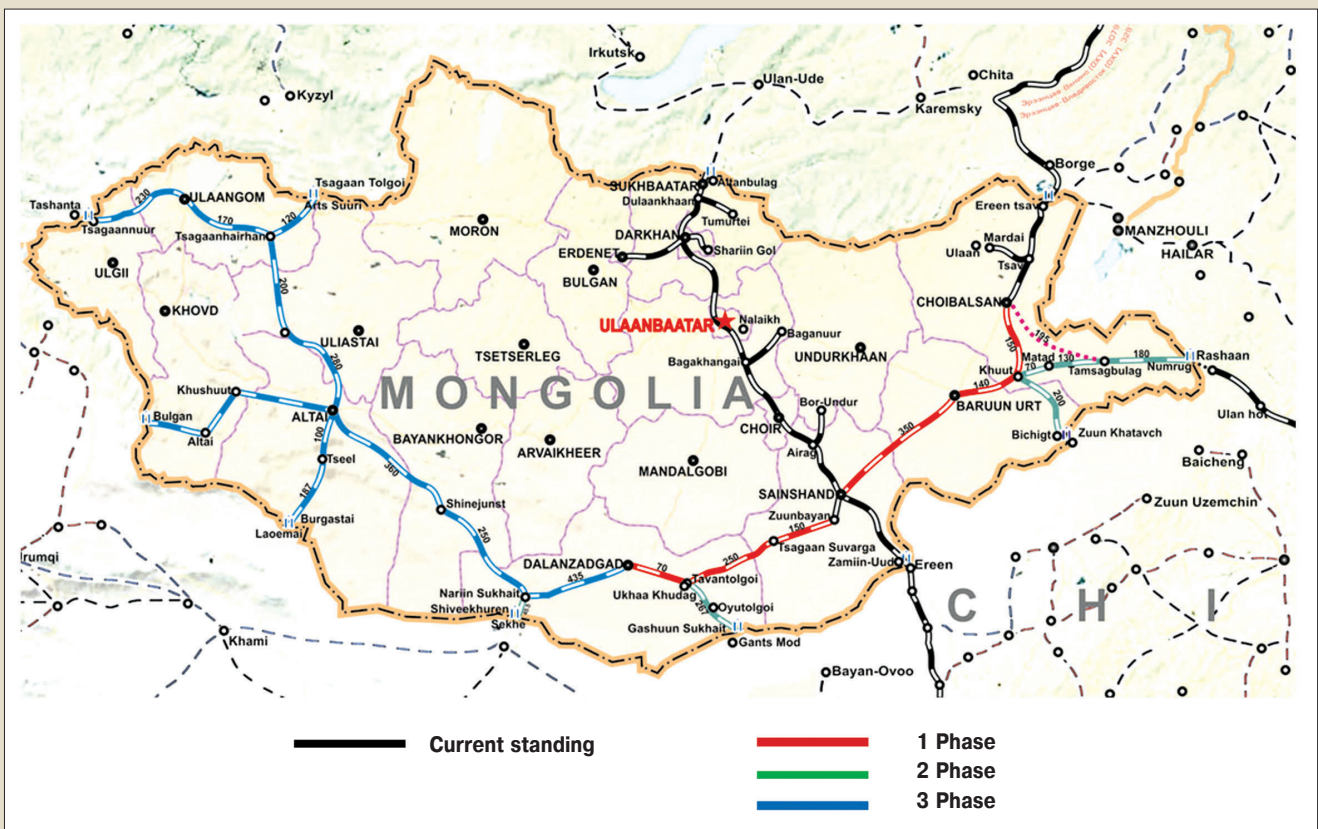
BY KH. KHULAN

Mongolia was listed as 140th out of the 150 countries ranked in the Logistics Performance Index by the World Bank. What does this ranking tell us? Clearly, it shows that Mongolia needs to improve its infrastructure quality and to strengthen its logistics.

Mongolia is one of the world's 43 land-locked countries. Thus, it is not a stretch to argue that the country would economically benefit from the

expansion and development of Mongolia's railway network.

In November 2012, the government of Mongolia granted a special licence to state-owned Mongolian Railway for the construction of new rails. Mongolia will need the most efficient logistics to supply foreign markets with the natural resources extracted from the Oyu Tolgoi and Tavan Tolgoi deposits. ▶



Source: Ministry of Road and Transportation



► The first and the second phases of the new railway are to construct 1,800 kilometres of railway between Tavan Tolgoi, Sainshand, Baruun Urt, Khoot, and Choibalsan by 2016. Another line will run from Khoot to Numrug, and a third will run between Tavan Tolgoi and Gashuun Sukhait. B. Artur, head of the Policy Implementation and Coordination Department of Mongolian Railway said that the initial stage of the construction of 267 kilometres of tracks between Ukhaa Khudag to Gashuun Sukhait is to start in April of this year.

Government has calculated that it will need USD 5.2 billion for the construction of the 1,800-kilometre New Railway project. The government plans to provide 51 percent investment with the remaining 49 percent to come from strategic investors. The investment includes USD 400 million to come from the Chinggis bond for licensing, concession rights, and other immaterial matters. The government has initiated bidding in the *Financial Times* and other daily newspapers to attract international and national investors who are interested in investing in the construction of the backbone of the nation's infrastructure. In response, the government has received more than 20 proposals.

Mongolian Railway has not yet announced officially the list of selected companies as this bidding has not finished yet. Mackinsey & Company has developed a

feasibility study for the new railway project that proposes it could recuperate its cost within 10 years.

The decision whether to construct the new railway with a broad or narrow-gauge rail has been controversial from the very start, though it has been finally resolved. Government has settled on the 1,520 millimetre gauge that is standard in Russia. According to the official state document on Mongolia's railway policy, the decision reflects the need for "providing the security to the national economy and development of enterprises and the population."

The expansion of the new railway network of Mongolia will contribute to sustainable development and ecology by transporting the natural wealth by the railroad instead of by car. It would also enable the market with the countries.

While Mongolia debates the details concerning the development of new rail infrastructure, the rest of the world is changing rapidly. Kazakhstan, for instance, is executing its Electric Train project through a public-private partnership. The project was discussed during the "A New Silk Road: A Bridge to Connect Asia and Europe" round-table talk held in September 2012.

There have been numerous discussions about the new railway project swirling all around us. The time taken will be worth it if it results in a strong rail network for the country. ■

WAY OUT

DUTCH MIRACLE

BY B. ENKHTSETSEG

Willem Kok has been in leading government positions in the Netherlands for almost 13 years; first as minister of Finance and later as prime minister for two consecutive terms. He was invited this year to share his story of success and advice to Mongolia at the 2013 Mongolian Economic Forum as Mongolia experiences the resources curse for itself. Kok is well known as the first to initiate the “Polder Model”, which was designed to curb the threat of the resource curse and “Dutch disease”.

What was the main cause of “Dutch disease” in the Netherlands?

The main cause of Dutch disease was the extra revenues we got from gas deposits and exploration were not sufficiently used for productive investments, including knowledge and education, and were for some period of time used just for the current budget. That was already a time the Netherlands, Europe and the world was suffering from economic crisis four decades ago.

That was why we entered into a period of prices spiraling, high inflation, and high public deficit. Unorthodox answers were absolutely necessary to find solutions to overcome the disease, and finally turn the disease into a success story because in the end we recovered from the disease and we continue now to be one of the stronger European economies. It illustrates that getting the disease is a serious thing to talk about, but you can recover from »



Photo by E. Zorigt

► it. It's better of course to prevent it and use the mining revenues for productive reasons—infrastructure, knowledge, and investment. Investment can be financed by the extra revenues you get from mining activities.

The Netherlands had a strong industrial sector even before the discovery of gas deposits. How was the industrial sector performing before the onset of Dutch disease and after recovery?

Well the industrial sector has always been strong. Why? Because apart from the natural gas, we don't have any other natural resources. We are very dependent on international trade and export and import. Exports are about 50 percent of our GDP.

So, we have to be competitive and have a strong industrial base. But at the time we suffered from the Dutch disease our economic activity went down, especially in the manufacturing sector. Certain companies and even industries such as the textile industry and ship-building industry had to be closed, and many people lost their jobs. It took a long time before we recovered from that. Now, again, the industrial sector is flourishing; although we are facing a problem of an aging population and growing competition from elsewhere in the world. It's not easy but the industrial activity is at a very high level.

You have to have, of course, high quality products, services, and an excellent labour force. You need excellent education so people have the skills they need to be internationally competitive.

How well is the Netherlands recovering from the euro zone crisis?

Well, we are all hurt by the euro-zone crisis. We are still not yet out of the woods in Europe. The whole climate in the euro zone is significantly better than let's say half a year ago or a year ago. Then, everyone was extremely pessimistic. Now, this growing confidence will allow us to survive this crisis.

This is also true for the Netherlands. The Netherlands is together with the Scandinavian countries and Germany. We're still one of the few countries with 'AAA' qualifications with rating agencies. Our reputation is very high in terms of stability and financial health. That's good news.

Our so-called "Polder Model" helps us to do so because we have social partners, employers, unions, and NGOs, who are really prepared to listen to each other and set a common target for the country. That's important for the Netherlands, and I would say also important for Mongolia. It would be extremely important if the government, private sector, labours unions, NGOs, and civil society organisations had some kind of common platform where

they sometimes meet. They don't always have to agree—sometimes you disagree—but listening to each other, convincing each other, and identifying common priorities are extremely important for every country. I would advise you to draw that lesson also from what we have experienced elsewhere in the world.

Is the Polder Model still relevant strategy or is it becoming outdated?

Of course the Polder Model is not an export article, so you can't bring it to Korea or Mongolia. It has to be developed in a society. I disagree that it's something of the past, and not something for the current situation and future.

I think a social dialogue and a kind of common orientation for the future of a country is important everywhere. Everyone can do it his or her way. But I think it's worthwhile to see.

Let's take an example. You have your revenues from mining. We talk about diversifying the economy and how to develop an industrial policy where you set priorities. Where do we want to be stronger five years from now? What are the means in order to make that work?

It's extremely important in a society to make use of everyone's input, not only something for the government or private sector. No, it's the government, private sector, and, also, social organisations. Everyone has their input and defines their common goals. That helps because then you have a kind of framework where everyone looks into the same direction. That helps very much.

Some have looked at Mongolia's macro economy and have concluded that it is already infected by Dutch disease. What should be the country's next step and how can we diversify our economy?

First of all, use the extra money from the mining activities for productive investments. You have a lot of laws and budgetary rules that have already been introduced in the past. Stick to them and think about what are your priorities because not every project is of the same importance. So you have to set your priorities, and I would say knowledge, innovation, and research are extremely important. Don't forget it. Don't just think about building roads and railways, also think about how to innovate and qualify your people because only with a very qualified labour force will a country like Mongolia be able to compete internationally for the longer term.

Don't forget about investment climate and predictability for foreign investors, so that those who come into the country know what kind of fiscal cli- ►

- ▶ mate it is and aren't going to be surprised by changes all of a sudden.

Clarity is very important, and promote entrepreneurship. Promote risk-taking activities from smaller and medium enterprises. Then organise a financial system that makes it possible for these companies, economic activities, and starting small companies to have loans and financial support from financial institutions because it all fits together. There's not one single element. You have to set a whole set of ideas and use them all to make the economy stronger.

As for diversification, you have to make use of your strengths and what your country has already. I'm not an expert on Mongolian economy but I could imagine clustering a number of activities and export promotion would help. It takes some time; it doesn't work automatically. Also in the Netherlands, we worked for a long time to make our flowers well known all over the world. To some extent the same may be true for certain sectors in Mongolia.

What are the main priorities for fiscal policy to a resource-rich country such as Mongolia?

I would say fiscal conservatism. That means you don't spend what you don't have. With what you have in addition to your normal pattern of income, you should be very precise in terms of what you want to do with it. Don't just throw it away. Don't choose projects without a clear definition of why you need it and what do you want to get out of it.

How can a country such as Mongolia avoid Dutch disease at the stage where it currently stands?

I think Mongolia is on the right track. You have a number of institutions and a number of legislative vehicles already in place. I think Mongolia is in a phase where you develop from a very-low-income country into a higher-income country with still a lot of poverty. A lot must be done to guarantee that growth is inclusive and as many people as possible can profit from the benefits.

The country should be aware—and I think it is aware—so that the risk of very high inflation. Your governor of the central bank told us this morning that inflation levels are coming down

somewhat. It's still at a high level, but they are somewhat coming down. That is of course a potential downside. The best thing to continue on the right track is investing in real priority issues that are for the longer term beneficial to the economy and large parts of the population.

Mongolia's welfare system is growing larger year-by-year. What would you recommend for Mongolia's expansionary policy for the welfare system?

Here, again, it all depends on the wishes of the population. In Asian countries you see nowadays that there's also a stronger wish than in the past to combine prosperity with welfare systems. You see that with Korea and the whole discussion in China. You see it with whatever form elements of social safety nets come up.

Also you must always keep in mind you cannot have that for free. You cannot have a welfare system for free. Someone has to pay for it. That would be from the total gross domestic product.

If workers, for example, find it important that some kind of unemployment benefit for those who lose their jobs then you have to put some money aside because it has to be paid through taxes or social premiums. It is not a gift from heaven.

Welfare schemes, yes, I am very much in favor of. I am very proud of it in Europe that we have developed them; also in Holland. But you should always keep in mind that it somehow must be paid—not artificially but really paid—because what you reserve is for cases where you need the money. You cannot spend the money for wage increases.

Where do you think a huge welfare system like that would lead Mongolia?

I don't have the impression that there's a booming welfare state here now. You made very moderate steps into the direction of some welfare schemes and you seem to be very much aware that this is not some gift from heaven, but something you have to pay for. I think the way in which it is developing here is not very risky.

What would you recommend for Mongolia in establishing a national brand that brings in similar revenue as the mining sector does? »



► I think looking from the outside, I would say if you get extra mineral resources instead of just exporting them you can look into manufacturing them. In agriculture, for example, you can try to combine agriculture with agro-food activities. We in the Netherlands for example have very sophisticated companies who are excellent in not only increasing the output of agriculture but also having high-end economic activities translating these activities into agricultural product.

I heard also this morning in a speech by the president that he very much emphasises the importance of reforming the attitude and behavior of civil servants of the government. Don't be happy with only rules and their application—I think that's a very important message, too.

Mongolia has the prospect of developing a

green economy on its mind now. How beneficial to the economy would this be in the long run?

I think in the long run we have to put much more emphasis on environmental sustainability. I think private multi-national companies here active in the mining industry are also very much aware of that because at the end of the day it will be their licenses to operate. If you continue damaging the quality of life and air, that will not be profitable for companies. Private companies and governments have to work together to make mining, for example, environmentally more sustainable.

Setting standards based on international agreements is very important. Mining revenue will be of importance, but better to do it in the future in a more environmentally sustainable way. That in the end of the day will be more beneficial for all of us. ■



Party Leader of the Labour Party
 Willem "Wim" Kok
 4 April 1987 (Age 49)

Mongolia's Challenge

The following is a transcription of former Netherlands Prime Minister Willem Kok's address at the Mongolian Economic Forum.

Mongolia is currently at the threshold of a new and breathtaking economic transformation wave, with double-digit annual growth rate in the next five years strongly driven by the expectation of mineral resources. The share of mining and GDP will grow to 20 percent, twice the ratio of about a decade ago. This offers, without any doubt, higher prospective about employment levels and for raising living standards for large parts of the population in the near future.

I think at the same time it is fair to say that such rapid economic expansion, especially if this is going to be driven by the exportation of vast mineral resources, brings serious risks or downsides as well that should better not be ignored. The serious challenge Mongolia is facing, like other re-

source-rich economies all over the world, is the following: The inflow of foreign direct investment and currency into the country will have inevitably an upward effect on both exchange rate and the price of non-fallible goods and services, including wages and salaries. And thereof, of course, higher inflation on the one hand, worsening exporting and importing firms by weakening their competitiveness and on the other hand increasing the cost of living for large parts of the population. Experiences from elsewhere across the world tells us that even if resource-rich economies like Mongolia have good institutions in place in a time when resources are discovered and explored, they still have to face the challenge of managing risks like the disease also known as the "Dutch disease."

And this is a very good occasion for me to share some of my personal experiences with you on what happened to the Netherlands after we discovered large natural gas deposits in the early 1960s. »

▶ When the oil prices shocks of 1973 and 1979 occurred, rising wages and on top of that rising indirect wage costs caused by higher contributions from the Dutch welfare schemes started weakening the competitiveness of traditional export sector enterprises, squeezing their profitability. The income share of capital fell from 17 percent in 1970 to less than 6 percent 10 years later. Average annual growth in manufacturing fell from 4.2 percent in the first half to 0.7 percent in the second half of the 1970s.

Please don't get me wrong, all this was not caused by our gas discoveries and exploration only. The world economy went through a very difficult time, and by the end of the 1970s we were all suffering from a severe global economic depression. But increases in public spending continued as well as social transfers. As the revenue from resources exports grew and were expected to grow further, it proved to be extremely difficult for the Dutch government to resist the temptation to spend more than they actually could afford.

Public expenditure rose from 45 percent of GDP in 1970 to 66 percent in 1982, and as a consequence public budget deficits rose sharply. In short, the combination of high-cost inflation and the upward wage price spiral deteriorating competitiveness of our industries and increasing public deficits as the government continued spending by making use of current and future gas revenues would become known as Dutch disease.

Large parts of our manufacturing industries had to reduce or bring their economic activities to an end. Unemployment reached dramatically high levels—especially youth unemployment. This simply could not go on. Only unorthodox initiatives could bring this downward trend to a halt. And let me briefly tell you my personal story here.

At that time in the early 80s, I was chairman of the largest trade union confederation in the Netherlands. In that capacity I had to defend the interests of our members, of course, the workers and their families. But many of them were losing or had already lost their jobs, and, moreover, the sustainability of our welfare schemes was in danger. I was and am still proud of

the welfare system and high levels of social protection we have been able to create in my country over decades. The system is more or less compatible with those of countries like Sweden, Norway, Denmark, Finland, or Germany. In these days of crisis it became crystal clear however that the stagnating or even declining economy puts the sustainability of such advanced social systems at serious risk. In order to turn the tides, the government imposed wage restriction by law. Strikes and heavy protests against these legal measures were organized by the labour unions, but all of these remained without any results. As a consequence the social climate became even more grim and unpleasant. A solution seemed to be far away. At the time in the end of 1982, when the government announced a new round of legal measures in order to continue freezing nominal wages, salaries and social transfers, I decided as president of the trade union confederation to initiate direct negotiations with the confederation of employers, coordinate bilateral agreements based on a longer-term tradeoff between, on the one hand, continued wage moderation on a voluntary basis and, to the other hand, employment including work sharing by reduction of hours and job and trading opportunities for young, unemployed people .

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After a number of years, it became clear to many that our agreement had gradually started paying off. Workers were enjoying job growth and rising real income again combined with preserving their protective but costly social system. Meanwhile companies enjoyed the benefit from recovering profitability and competitiveness as well as social peace and a motivated work force. And last but not least, our economy as a whole was finally cured from the Dutch disease, although it lasted until the mid-90s before this recovery process was completed and instead became better known as a European success story called the Polder model. This model was based on a political culture of fiscal conservatism, coordinate currency and wage restraints, and a high level of social protection for those who need it, combined with labour market reforms.

In 1995, during my first term in office as prime minister, my country introduced a rather revolutionary system of so-called "flex-security" on the labour market, strik- ▶

▸ ing the right balance between flexibility and social security. That helped us enormously in helping us become one of the front runners in Europe in terms of labour market participation and employment rate. And again this was only possible with the active support of the two sides of industry: workers and employers.

According to me this short story of the Netherlands is of some relevance to Mongolia, in spite of clear differences between our two countries for two sets of reasons. Firstly, because the story illustrates how crucially important it is for a country like yours to avoid a disease like they suffered from in the Netherlands some decades ago. Your economy is highly dependent on mining revenue. My strong advice to you is not to repeat one of the mistakes we made in the Netherlands, namely spending a too-large part of these revenues for structural, nonproductive purposes.

If I'm informed correctly, your Fiscal Stability Law contains three important rules: strict limits and ceilings on the fiscal deficit, expenditure increases, and public debts. All three limit the risks of getting infected by some sort of Dutch disease. Please allow me to congratulate the key drivers behind this initiative, which was especially crafted to prevent Mongolia from getting the disease.

But more needs to be done of course to strengthen the basis for a robust, diversified and competitive economy, and to ensure that the economic transformation is inclusive and sustainable as well so that all Mongolians will have an opportunity for a better life today and tomorrow. I'll come back to that in the final part of my speech.

Secondly, my story may be of some relevance to Mongolia because of the way we in the Netherlands were finally able to get the worst of the disease behind us. It illustrates the importance of building and strengthening institutions based on mutual respects and some kind of shared responsibility. Share responsibility for the future of the country and the well-being of its population. In the Netherlands we had to rebuild our country after its destruction after the Second World War by Nazi Germany. One of the important decisions was for the creation of institutions where employers and workers met on a regular basis in order to discuss methods of common interest and-or to negotiate. These institutions have definitely contributed to our relatively

peaceful social climate. Strikes are really exceptions, and to our economic progress are high levels of employment combined with advanced welfare systems as well. Even in times of diverging opinions our social dialogue helps sometimes in realising positives and in reducing differences.

This form of cooperation creates awareness and involvement in the formulation of common goals for the country and the means for achievement. It is a modern form of politics of what I call togetherness.

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I advise you to keep in mind there is little course in making growth of GDP to be an end in itself. Macro-economic growth is no more and no less than [something that is] very welcome, but only an important means for achieving things people value and for improving living standards and happiness. And this is exactly why combining economic growth with social inclusiveness, welfare policies, and social protection is so vital.

We are entering an era worldwide where we will have to move much more from more to better. A mental shift is needed. Environmental sustainability has to be part of the solution in making the turn in new ways of producing, consuming and living. One of the lessons I learned in my life is that the most successful and harmonious societies are those where all stakeholders are prepared to think and act together at all levels for the common good. This means including social and ecological areas in this cooperation as well as enabling broad parts of society to get a fair share of the benefits. Both environmental sustainability and social inclusion are key ingredients for a better life. Governments carry the overall responsibility for finding and maintaining the right balance between economic growth, social cohesion and environmental sustainability. This has never been easy and it won't get any easier.

It's a crucial responsibility of governments to build knowledge-based economies and societies. In the triangle between education research and innovation lies the key to productivity, a diverse economy and the well-being of citizens. It is rightfully important for governments to invest in education, digital learning and training so that citizens can acquire the skills they need to compete successfully internationally. Governments can foster public-private innovation partnerships between companies, universities ▸

► and research institutes. This isn't all about money, although a good budget for the ministry of education certainly helps.

There's more that governments can and should do. Crucially, governments are responsible for creating a good investment climate. This means predictable and transparent fiscal systems, contract sanctity and good governance with checks and balances against corruption and abuse of power. This is also true for Mongolia. It also means in your case investing in excellent infrastructure, developing and implementing a comprehensive industrial policy, an effective financial sector, and last but not least a sound legal framework for mining—one that's fair, one that ensures that impact on environment and people are addressed in a consultative manner, and one that is transparent so the benefits from the impacts of mining are known to all Mongolians.

If governance creates the right framework there's a lot the private sector can and must do to help spur development. First companies can bring FDI and technology to the country. In my own experiences countries with an open-door policy outwardly looking at good-looking countries attract more foreign direct investment and their companies find it easier and more attractive to develop international partnerships. Where advancement takes place one sees also the emergence of global supply chains, which means more skills and capabilities, more meaningful jobs, and more innovation; so less poverty. Companies can also develop skills and train people directly for instance, again, according to my own experience, international companies are training local nationals to take leadership positions. They offer training programs that have to help young people set up their own companies.

When it comes to environmental sustainability government has an important role in giving companies the right incentives to develop and deploy clean technologies at the lowest costs. Government can help point the private sector in the right direction, for instance, by setting clear and challenging environmental efficiency standards.

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Inflationary tendencies have to be mitigated. The government of Mongolia has outlined an ambitious program focusing on creating jobs through economic diversifica-

tion, bringing greater transparency and accountability within governance, and completing some large infrastructure projects. Resource and mining revenues should be used, learning from other countries, with sovereign wealth funds mainly for investment purposes; including infrastructure and research, education, innovation, and developing a knowledge-based economy and society in order to limit the risk of being affected by the Dutch disease.

Mongolia is certainly on the right path. The president talked about it, and I can only agree. It has already adopted several good reforms that set a very good regulatory foundation including the Fiscal Stability Law, the integrated budget law, the fulfillment reform, the Social Welfare Law, and the Law on Conflict of Interests, if I am just to name a few.

The time has come now for relentless and persistent implementation. This seems to be the toughest part now. Finding the right combination of grasping opportunities and managing risk eventualities looks essential to me. Whilst your country should keep its eyes wide open for potential downsides caused by an expected slowdown of economic growth in China over the medium term, on-going uncertainties and even recessionary tendencies are imparted on the world. And for your economy, I advise you to pay specific attention to the following three policy areas. One is how to enhance Mongolia's capacity to manage the mining economy sustainably and transparently. Secondly, how to build and how to strengthen a sophisticatedly diversified basis for economic growth and employment in both urban and rural areas. Thirdly, how to realize, improve access to services and better service delivery, social safety net provisions, better access to health and education, and poverty eradication.

Progress, Mongolia, will be able in making each of these three challenges decisive for the future. The discovery of vast mineral resources and their exploration is a huge asset for this country. Learning from experiences elsewhere should be possible to limit risks and potential downsides on the one hand and spreading the benefit over large parts of the population so the economic growth will be fair, sustainable and inclusive. That is the challenge.

POLICY SURVEY

CONFIDENCE AND OPTIMISTIC EXPECTATIONS

The following are the conclusions drawn from the Consumer Confidence Index. The study was developed by a research team from the School of Economic Studies of the National University of Mongolia. The team conducting the research for the survey was headed by Ts. Davaadorj (Ph D), dean of the school. The researchers were B. Suvd, (Ph D), B. Altantsetseg (Ph D), and D. Bayarmaa (a Ph D candidate). In 2012, consumer perception of the economy had significantly improved. In addition, this study reveals positive news about the decline of poverty.

-In October 2012, the Consumer Confidence Index (CCI) had significantly increased from the 2011 level. In 2012, the CCI increased by 13.5 percentage points from the year before, reaching 133.1. Both components of the index, the current situation index and the expectation index, contributed to this increase. In particular, an increase of 23 percent in the current situation index played the most significant role. If we compare the CCI to that of April 2009 (during the economic downturn), consumer confidence has improved 3.6 times in three and half year.

-The changes to the assessment of business conditions and household income reflect significant improvement in consumers' assessment of economic conditions in 2012. The proportion of respondents expecting an increase in household income had increased significantly from 29.8 to 37.2. However, in 2012 the proportion of respondents expecting business conditions and employment opportunities to be normal increased significantly.

-In October 2012, 27.7 percent of households found it the right time to purchase durable goods, whereas 43 percent of households found the time to be wrong. The share of respondents finding it the wrong time to purchase durable goods was decreasing until 2011, and in 2012 the share increased sharply by 6.6 percentage points.

-According to the 2012 CCI, two-thirds of households were expecting an increase in price levels within six months or a year. In 2012, more households were expecting greater inflation than in previous years. However, they were expecting significantly lower inflation than in 2011.

-Households' assessment of the appropriateness of the time for durable goods purchased lowered and expected inflation may indicate falling economic activity compared to the previous year. The economic situation is expected to be at the normal level.

-In October 2012, the proportion of »



- ▶ households expecting an increase in the exchange rate within the next six months was similar to the previous year, whereas the proportion of households expecting an annual increase in the exchange rate increased by 6.7 percentage points.

However, the number of households that responded “not sure about a change in the exchange rate of the US dollar” has increased sharply from survey to survey. This reflects uncertainty in exchange rate fluctuations.

-In October 2012, households' expectations about the interest rate and housing prices changed significantly. The share of households expecting an increase in housing prices and the interest rate significantly increased.

-Moreover, consumer confidence in the banking sectors was similar to that of the year prior. 73.7 percent of households found banks a better place to keep their money.

-In October 2012, the unemployment rate was 5.6 percent and was 3.3 percentage points lower than in October 2011. However, the unemployment rate was persistently high among poor households.

The unemployment rate of poor households was four times higher than households above the poverty line. Although unemployment among poor households was considerably less than that of during the economic crisis, as recorded in the April 2009 index (25.9 percent), it was still very high. Moreover, there are huge differences in unemployment depending on housing conditions.

-In 2012, the poverty line was set at MNT 126,500 as a minimum living standard by the National Statistical Office. That office estimated that 22.7 percent of the population fell below that threshold.

According to results from CCI, household livelihood has improved and the poverty rate has been falling as the economy recovered. The poverty level was varied depending on levels of education, housing conditions and employment status. According to dynamic data from CCI, the number of employed heads of households fell, while the poverty level among households with an unemployed head fluctuated following a gradual fall up until 2010.

This proves the importance of employment for household livelihood and poverty reduction. According to CCI there is a grow-

ing discrepancy within the the impoverished segment of the population among households with an employed head and an unemployed head since 2009.

-According to CCI, households view the independence of the central bank as insufficient in Mongolia. Moreover, they view that demand factors have played more of a role than supply factors.

-According to households' opinions, the cash handout policy and a lack of information are the key factors for falling participation in the labour sector.

Recommendations

-CCI provides valuable information about consumer confidence in the overall state of the economy, which can be used for designing macroeconomic policies. As mentioned earlier, the Mongolian economy experienced many short-term changes. Therefore, more frequent (quarterly or monthly) surveys on consumer confidence may give policy makers an opportunity for timely policy reactions by providing valuable information about consumer confidence.

-CCI provides valuable information about households' incomes and employment statuses as they change. According to the survey, the characteristics of households varied significantly across different groups. Therefore, social welfare policies need to be targeted in order to increase efficiency and reduce cost.

Data and information from CCI can be used for designing optimal social welfare policy.

-Although there is a falling trend in unemployment, the discrepancy among household heads with varying levels of education, housing conditions and gender persists. Employment policy should reflect this. In order to increase participation in labour, it is important to improve access to information about the labor market and limit cash allowances.

-Public confidence in monetary policy is an important factor for the successful reduction in inflation. The independent status of the central bank increases the confidence in monetary policy and increases its impact. Therefore, the Bank of Mongolia has to show its independence through its actions. ■

