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MONGOLIAN ECONOMY



An Open Door to a Closed
Country

Rio Tinto Pioneers
Mongolian Joint Ventures

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MONGOLIAN ECONOMY

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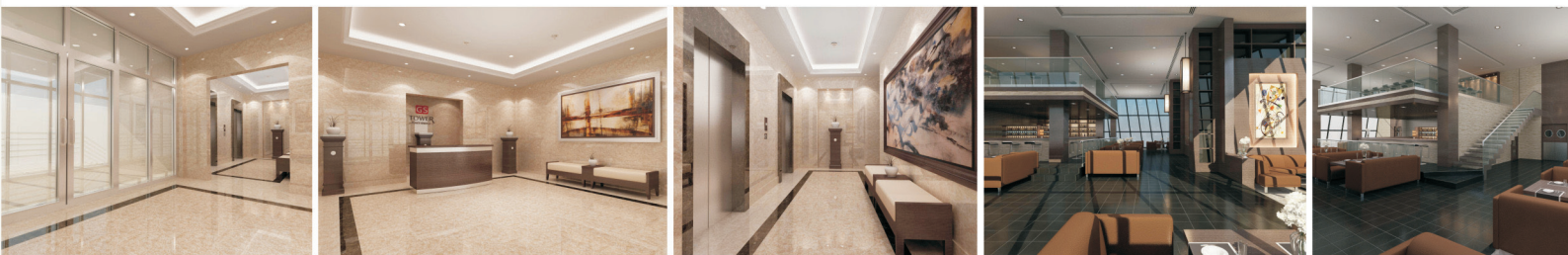
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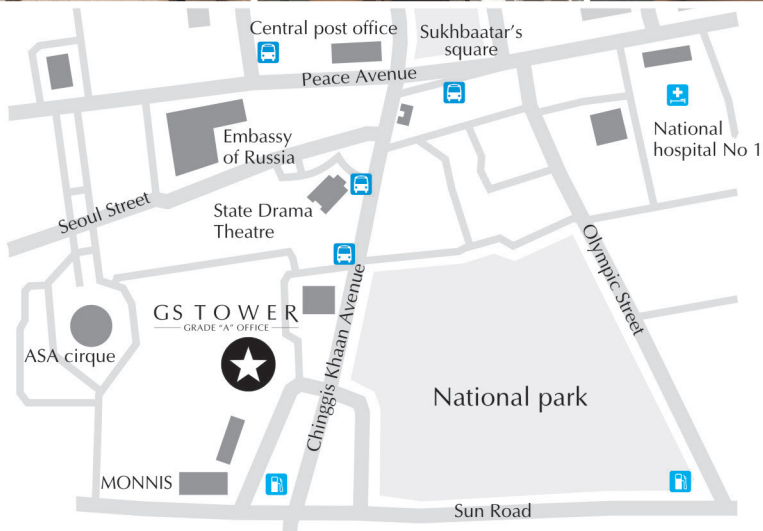


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MONGOLIA:

TAXES

Some 17 amendments are planned for Mongolia's tax laws, in addition to some new taxes. For example, one new proposed tax would tax residents and companies based in Ulaanbaatar. Another is a service tax that would be paid by companies as well as anyone receiving services from stores or restaurants.

ECONOMIC GROWTH

The Asian Development Bank has projected Mongolia's economy to grow 13 percent next year. The pro-



jection is based on expectations for a slight improvement for global economic growth and production from Oyu Tolgoi. Mid-and long-term growth in Mongolia, however, are directly related to the economic outlook for China. Some economists have advised that these factors should be taken into mind for the new monetary policy.



LAW

The State Great Khural introduced a new bill that would bring greater transparency to the gold trade in Mongolia, during

its extraordinary session in September. Mongolian law currently calls for the collection of both royalties and incremental royalties for a possible total 5 percent of sales to the Bank of Mongolia or any commercial banks in Mongolia. The bill would reduce royalty payments to 2.5 percent and zero incremental royalties. The aim is to keep gold in the country to increase the country's reserves.

INFLATION

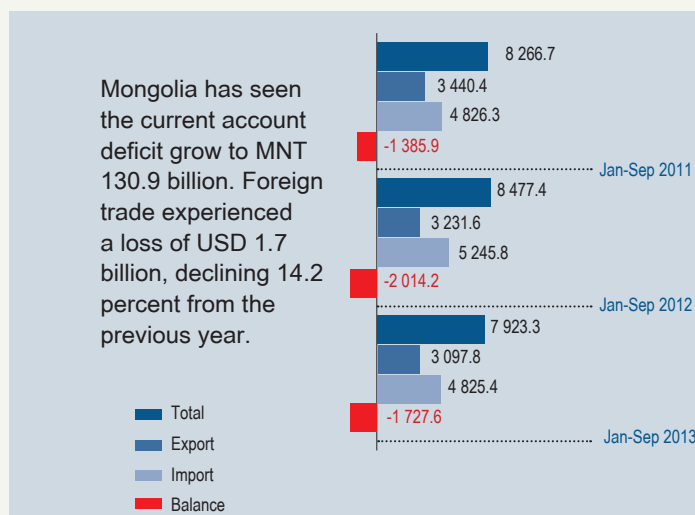
Current annual inflation is at 9.9 percent. Some 40 percent growth in inflation is mainly due to the increasing prices for goods, reported the National Statistics Office. Food stuffs saw price changes of 60 percent. Typically the prices for consumer goods grow at the end of every year, leading to the

expectation that inflation will reach the double digits again by the end of this year.

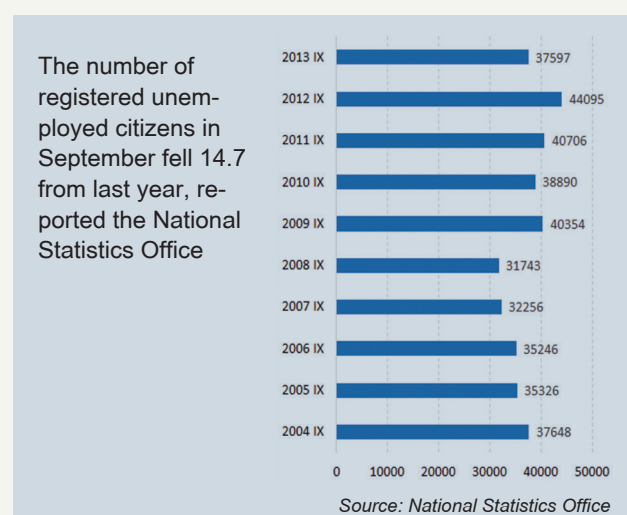
OCCUPATIONAL HEALTH AND SAFETY

A German-Mongolian conference on occupational health and safety will take place at Blue Sky Tower and Hotel on October 23 and 24. Organising the event are the Ministry of Environment and Green Development, the Financial Regulatory Commission and GIZ's Integrated Mineral Resources Initiatives (IMRI), under the two themes "Corporate Social Responsibility" and "Occupational Health and Safety in the Mining Industry". German and Mongolian experts will be delivering speeches throughout the conference.

Annual turnover of goods in foreign trade as of September 2013 (Million/s of USD)



Number of registered unemployed citizens (September 2013)



WORLD:

UNITED STATES



Frantic U.S. political attempts to avert a federal debt default have pivoted back to the Senate after plans in the House of Representatives collapsed. Upper chamber leaders were said to be working through the night on a deal to raise the U.S. borrowing limit and end a partial government shutdown. Amid the congressional disarray, a top ratings agency warned of a possible downgrade in U.S. creditworthiness. The U.S. must raise its USD 16.7 trillion debt limit by Thursday or risk default.

EURO ZONE



Industrial output in the euro zone grew at the strongest pace for more than two years in August, figures have shown. Factories in the 17-country bloc saw output rise by 1 percent in the month, which was better than analysts' forecasts. Europe's economic powerhouse, Germany, saw output rise 1.8 percent, while French output increased by 0.2 percent following three consecutive months of decline. However, output in Italy fell by 0.3 percent. This was the second decline in a row, as Italy's economy continued to falter.

CHINA

China's stocks fell the most in three weeks after JPMorgan Chase & Co.

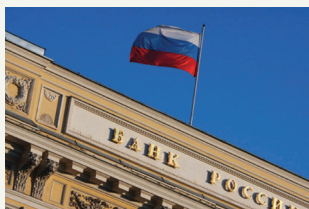


advised reducing holdings and companies linked to Shanghai's free-trade zone tumbled on concern that valuations are excessive. JPMorgan cut equities to underweight, citing a cyclical slowdown and potential policy disappointment from a Communist Party meeting in November. Consumer prices quickened last month, while exports unexpectedly fell, reports this week showed.

RUSSIA

Russia's central bank

left the one-week auction rate, its benchmark introduced last month, at 5.5 percent, leaving policy rates unchanged for the 13th month in a row Monday, Reuters reported. The bank is determined to lower inflation expectations among households and businesses despite weak economic growth. The bank said headline consumer price inflation had fallen to 6 percent as of October 7,



the top of its 5 to 6 percent target range for 2013. It expected inflation to fall in 2014, with its year-end target at 5 percent, but the bank stated that inflation expectations also need to fall further.

JAPAN

Japanese Prime Minister Shinzo Abe opened its parliament with a speech pledg-



ing more reforms and economic measures to pull the country out of its long period of deflation. He is expected to push further deregulation, reforms and other steps to encourage household spending and investment, including some aimed at offsetting the impact of the consumption tax increase in April to 8 percent from the current 5 percent. In his policy speech, he also proposed controversial plans to boost national security and participation in peacekeeping efforts around the world. ■

A. AMARSAIKHAN IS COLUMN



MONETARY POLICY

MONETARY POLICY – A PRIORITY

B. ALTAI

The State Great Khural is now discussing a bill for its 2014 monetary policy. The draft is supposed to focus on mid- and long-term economic de-

velopment. After so recently brushing up against the edges of economic crisis, one might wonder how the government plans to avoid future flirtations with disaster. One central bank official is promising more of the same.

“The monetary policy for 2013 is to be continued next year”, said S. Bold, an advisor to the central bank governor. “Some measures will be taken to help strengthen the financial and economic stability, and to maintain the ▶



Photo by B. Byamba-Ochir

The Governor at the Bank of Mongolia introduces the State Great Khural the Monetary Policy Guidance for 2014

▶ real economy via the monetary policy. Through the policy, the economic immunisation will be improved and macroeconomic stability will be strengthened”.

The monetary policy for 2014 aims to maintain the current inflation rate of 8 percent. In addition to fewer external influences on the domestic economy, less independence of the mining industry, improved long-term economic competitiveness, and strengthened economic defences. The Bank of Mongolia intends to facilitate the stability of short-term economic growth and to improve the circulation of foreign currencies to maintain long-term economic growth stability on the basis of national manufacturing and bank deposits.

“A monetary policy is a strong macroeconomic instrument which is flexible. The policy demonstrates the opportunity to make specific short-term changes to the economy”, said B. Altantsetseg, a PhD and senior lecturer at the School of Economic Studies at the National University of Mongolia.

The implementation of the state-backed mortgage programme can continue into 2014 with support from the Bank of Mongolia. That would provide an opportunity to develop the stock market so that it would be guaranteed by real estate and bring capital to the Social Insurance Fund. According to central bank officials, this would bring greater transparency to the labour market and taxation.

“By creating a mortgage fund, citizens can benefit by using their income for saving rather than consumption”, said Bold.

The monetary policy for 2014 comes amid tough economic circumstances, when there is 47 percent decline in foreign investment, or USD 1.6 billion less investment during the first six months of the year compared to 2012, a slowdown in China that dragged down the Mongolian economy, some 50 percent decline in mining product prices, and an expected USD 1.4 billion deficit in the current account

balance. Although Mongolia’s economy is still fragile, it has shown signs of improving.

To achieve its objectives, the Bank of Mongolia will combine conventional and unconventional monetary tactics that would ultimately stabilise the prices of goods and protect the income of citizens.

The unconventional tactics would be extending the Price Stabilisation Programme into 2014. The programme is meant to be financially independent of the central bank once it launches its self-financing principles.

Mongolia has covered its foreign trade deficit using foreign investment. However, next year, warned Asian Development Bank Senior Country Economist Jan Hansen, Mongolia will need to temporarily avoid expansionary policies. Both the Asian Development Bank and World Bank have said Mongolia has already supplied enough money for the market this year.

“Under the Price Stabilisation Programme the volume of loans issued by the Bank of Mongolia for the government of Mongolia has sharply risen”, said B. Tuvshintugs, director at the Economic Research Institute. “It means that the huge supply of money to the market has affected the exchange rate of the Mongolian tugrug against the U.S. dollar. When the amount of money in the market increases the tugrug is being gradually undervalued”.

Some people would agree that the Bank of Mongolia has successfully sidestepped crisis. Central bank Governor Naidansurengyn Zoljargal said that if it had not supplied MNT 2.8 trillion to the market and employed the Price Stabilisation Programme the economy could have collapsed. Effects might include a 50 percent increase in the price for petroleum. The money injected by the central bank represents some 13 percent of GDP, raising economic growth to 11 percent. Observers should remember at what cost economic growth came to the government when GDP is tallied

for the end of the year.

According to the proposed monetary policy, the target for inflation is no more than 7 percent for 2015 and 2016. Whether personal savings will grow will depend on inflation. The exchange rate for the tugrug will likely depend on market regulations.

For the government’s part, said Zoljargal, it should encourage foreign investment once again and increase its gold reserves. A more resilient monetary policy is a pre-condition to macroeconomic stability.

“Stable inflation is creating positive conditions for making contributions to domestic manufacturing to replace imported goods, encourage exports, reduced the foreign trade deficit and current account deficit, and improve economic defences and competitiveness”, reads the monetary policy.

Year One for Manufacturing

“The main purpose of a monetary policy in any independent central banking system is to manage inflation and maintain the inflation rate at a low level”, said economic researcher B. Oyunbilegt.

Thus strengthening the stability of the macro economy and the financial sector through stable inflation is a main priority of the proposed 2014 policy. The proposed monetary policy has calculated GDP growth for next year to be 14.4 percent.

“The result of a multi-lateral policy implemented by the Bank of Mongolia is thought to be risky. The bank actually needs to focus on stabilising inflation and the financial system”, said Altantsetseg from the National University of Mongolia.

The good news is 2014 could be the beginning of years of contributions to domestic manufacturing. Although nobody knows what the direct impacts of the policy will be, the hope is to freeze inflation, contribute to exports, expand the mortgage programme and, finally, to expand Mongolia’s middle class. ■

EXPERT COLUMN

INVESTMENT FUNDS IN MONGOLIA



Losolsurengiin Byambaa is head of investor relations at Mandal Asset Management.

Investment Fund Law

Mongolia approved the Investment Fund Law (IFL) in the beginning of October this year. This is of huge importance to the future of Mongolia's banking and finance sectors because the development of Mongolia's economy and private sector has grown stagnant, and the development of the financial sector and capital market is falling behind. The IFL establishes a fundamental basis to direct the infrastructure of the financial market into

the right direction.

The purpose of the IFL is to regulate the basic relations between the establishment of an investment fund, issue special permissions for the fund, regulate fund management, and protect the rights and interests of investors.

The law will create an additional long-term source of capital for the financial market while providing an opportunity for citizens to benefit from the economic growth currently seen in Mongolia.

Types of investment fund

Type of fund	Source	Intended use	Term
Investment fund	Revenue from citizens and companies	Securities and portfolio	Short- and mid-term
Private pension fund	Tax from employers and employees	Pension deposits	Long-term
Private equity fund	Professional investors, the budget and the SME development fund	Expansion of SME and companies	Mid-term
Venture capital fund	Professional investors	Start-up companies	Mid-term
Hedge fund	Revenue from minerals	High risk and risk allocation	Short- and mid-term

Expected Changes in the Financial Sector and Capital Market

Markets are based on the supply and demand of securities and there should be rules for participating in the market. The new Securities Law passed last spring regulates the supply, or security issuances, while trade is managed by the IFL. Both laws will take effect from January 1, 2014.

Further development of the capital market will mean creating an optimal, long-term financial source to contribute to economic growth. Start-up companies that are unable to attain bank loans can take advantage of investment funds.

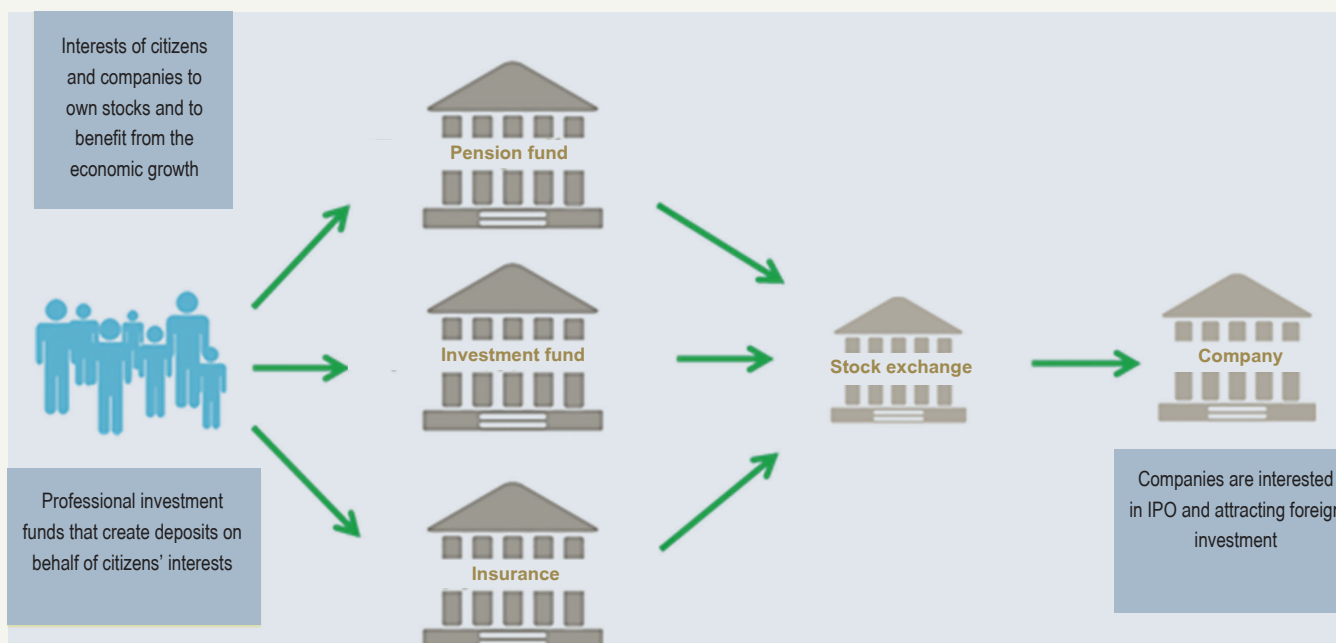
As funds become more professionalised they can become strong players in the market. Funds protect the rights of their investors and investors' interests. Those who invest in funds can also benefit from the corporate governance employed by fund management.

Funds create channels for profit distribution. This conduit has the potential to bring economic growth and the more equitable distribution of wealth that may contribute to the growth of the middle class in society.

All this will gradually reduce the dominance of banks in the financial sector, reduce market risks, and create a more sustainable environment.

Investment Fund Rules

Many people are afraid that investment funds might fail just as non-banking financial institutions have in the past. People do not see funds the possibilities for returns after handing over their savings to funds. Learning from past mistake, rules have been developed to supervise conduct for the protection of investors' interests and reduce risks. Investors are expected to play a role in maintaining the obligations of stakeholders as well as the Financial Regulatory Committee and savings institutions. »



▶ Fund managers will be licenced and the fund capital will be allocated to special accounts and stored at custodian banks.

Importance to Citizens and Investors

An investment fund creates new investment options. It opens the gate to joint investments and can help generate returns.

Making investment through funds, on the one hand, allows citizens to invest without having to watch the market or make analysis.

On the other hand, investors receive professional investment services that reduce risk.

For instance, savings deposits are vulnerable to inflation or exchange rate fluctuations. Investing through a fund provides professional consulting for risk reduction. ■

INTERVIEW

AN OPEN DOOR TO A CLOSED COUNTRY

BY E. ZORIGT

Mongolian Economy interviewed D. Jargalsaikhan, chief executive at MIH Group, about his recent visit to North Korea. He speaks on life in the reclusive nation, its economy, and businesses opportunities

What brought you to North Korea?

Last year Mongolian delegates went to the Democratic People's Republic of Korea (DPRK or North Korea) at the invitation of the DPRK Chamber of Commerce and Industry. The purpose of the visit was to discuss and agree on the opportu-

nities of cooperation between the business communities of North Korea and Mongolia.

We met the representatives of North Korea's ministries and entrepreneurs. According to them, we found that they have much interest in cooperation with Mongolia. Upon our return from North Korea, the del- ▶

regates established the Mongolian and East Asian Cooperation Council (MEACC). North Korea's geographic location demonstrates an opportunity for developing a regional cooperation between the two countries. Mongolia being a land-locked country, this would be a big chance for its geopolitics.

On the other hand, it seemed that North Korea has sought opportunities for opening relations with countries in the world through cooperation with Mongolia. Under this cooperation, some four North Korean companies were invited to visit Mongolia to discuss a variety of business opportunities.

As a result, we have been invited again by the DPRK Chamber of Commerce and Industry this year. And MEACC's members had a second visit to the DPRK. When we got there they were celebrating the 60th anniversary of victory, which is the largest celebration. The DPRK gives high priority to this celebration. We found that North Korean citizens have the greatest respect for celebrating this anniversary, and we were informed that representatives from more than 70 countries were invited to attend the event. During our visit, there were surprisingly 100 Mongolian tourists travelling in North Korea.

The global perception of the DPRK is of a poor country with strict economic controls. Many believe the state has distorted the views of its people as well. What is the truth versus the reality?

I had my own expectations before I got there. In general, our imagination comes from what we see on the [television] screen. I had imagined the same as you, but we were welcomed into a much different environment than we expected.

Its streets were clean and there were many buildings with modern designs. I saw many modern cars on the road. It seemed to me that this



Photo by E. Zorigt

D. Jargalsaikhan, chief executive at MIH Group

country is developing the same way as other developing nations. The lives of its citizens were not much worse than we expected. The prices for food was a little bit cheaper than the prices in Ulaanbaatar. Their clothes were clean and nice. There was supply of foreign currencies, including the U.S. dollar and Chinese yuan, and trade was free. However, the government set the official exchange rate. Things in North Korea were different from how we imagined.

We were brought to the Kumsusan Palace of the Sun, which is a Mausoleum dedicated to Kim-Il-sung. When we got inside, it displayed a number of awards. I was so excited to see Sukhbaatar's medal, a souvenir presented by the Mongolian Peace Commission that mostly belonged to the Communist era, and some photos were taken during the meeting held between the North Korean representatives and Jambyn Batmunkh, the general secretary of the Central Committee of the Mon- ▶

▶ golian People's Revolutionary Party.

What industries are North Korea's business people interested in working with Mongolia?

North Korean business people expressed their interests in some industries including mining, trade, infrastructure and even in the petroleum industry. North Korea has succeeded in high-tech development for itself. They were interested in introducing technology to Mongolia. They were also interested in importing mine and food products from Mongolia. Although this would bring several challenges, there could be some room for mutual benefits.

The first challenge is transport and logistics. The next one is trade and service infrastructure as well as bank transfers. If a Mongolian businessman, for instance, wants to consign freight to North Korea, he might face difficulty processing the transaction. Because the DPRK holds nuclear weapons it is subject to international trade sanctions. This in some part hinders the development of mutually beneficial cooperation.

Yet, there is an advantage between the two countries. In the beginning of the 1990s, in order to attract foreign investment, Mongolia took lots of measures, such as the improvement of its legal environment and international advertising for the country. The same thing is now happening in North Korea to attract foreign investment and to protect foreign investors. This could be a chance for Mongolia. But more importantly is the intention of the North Korean state and entrepreneurs to cooperate with Mongolia. There could be some solutions. However, there are large risks with cooperation.

You said that North Korea is interested in attracting investment from Mongolia. What do they gain from Mongolia and how did they decide on us?

North Korea is thought to be separate from the European and US markets. The West is closed to North Korea. Its 24 million population is very small compared with China. I think North Korea is wary of too much dependence on China, just like Mongolia is always wary of dependence on one country. At this crucial time, when the DPRK is looking for a third neighbour for a safe partner, Mongolia might be the most suitable choice, I think. Mongolia's economy is developing very fast while it has the chance to benefit more in businesses from its geographic location.

Also there are historic and traditional relations between the two countries, and the current diplomatic relations are excellent. There are many advantages.

Most importantly to North Korea, Mongolia could be the most likely with which it could establish an equal partnership. If North Korea chose to pursue this with China, it might face a number of issues, some political. Thus, they need a partner that they can cooperate mutually and beneficially, on equal terms.

It's easy to see one obvious thing from North Korea's policy on international relations: When any large events take place they always invite to North Korea ambassadors from the embassies of China, Russia, Vietnam and Mongolia—nobody else.

How can Mongolia and North Korea expand their relations?

I have seen what is called the Rason port on the northeast tip of North Korea. The port is always open throughout the year. This port could create a number of advantages for both nations, I think. One goal for Mongolia is to export its mining products to third neighbours for high-priced sale. Mongolia is interested in exporting coal to Japan and South Korea, but lacks the infrastructure. Thus, there is potential to transport coal to Japan and South

Korea through this port.

On the other hand, North Korea has demand for the import for mining products from Mongolia. There are a number of countries where mining products are needed, and Mongolia is interested in exporting its coal to foreign countries. This is not possible because of a lack of infrastructure. But meeting North Korean demand gives Mongolia the opportunity to exports its mining products abroad.

You mentioned earlier of North Korea's technological development. What technology from North Korea should Mongolia adopt?

North Korea has highly developed nanotechnology. Also its agricultural development for crops and poultry is incomparable to that of Mongolia. Rather than discuss North Korea's developed industries, it would be better to research this further.

Although much is known about the politics in North Korea, the economic system is still a mystery to the world. What sector contributes most to the North Korean economy thus far?

There is the Juche Idea, a political thesis formed by Kim Il-Sung. Its main concept is that the North Korean masses are the masters of the country's development and they can do everything themselves. Under the Idea, national manufacturing is seemingly managed to supply domestic demand. Also it is much richer in mineral resources than South Korea. I think, therefore, the mining industry would be the main driver of North Korea's economy in the near future. Additionally, there is also a developed industry for sea products.

The 24 million population is a much bigger market than Mongolia's. If North Korea could make its economic policy more open, there are large markets and demand surrounding it. ■

CHINA

CHINA'S NEW ECONOMIC MODEL

BY B. TOGTOKH

China has recently found a problem with its long-used economic model based on the employment of a cheap labour force for export production. Instead, China has introduced a new economic model that focuses on transitioning from the role as a global manufacturer to a global consumer. It is also attempting to improve its position in science and technology for the development of better education and improved living standards.

Former Chinese leader Deng Xiaoping's economic reforms that aimed to provide opportunities for wealth creation has become a part of history. Now that the programme that former Chinese President Hu Jintao and Premier Wen Jiabao's rolled out in 2006 for wealth creation has concluded, the new economic policy focuses on advancing technology and export. This new approach puts quality above quantity.

Foreign trade comprises 25 percent of China's GDP while its manufacturing index figures fall. A decline in foreign investment and the real estate bubble have hampered manufacturing. Still, the World Bank has projected growth of 7.5 percent for China.

Precursors

"As China focuses on the transition from an export-driven economy to a domestic-demand-based economy, it leads to a slowdown in the economic growth of developing East Asian

countries", reads the World Bank's East Asia Pacific Economic Update. Regional growth, it says, has suffered from less investment, the decline in

commodity prices, and lower-than-expected volumes of export.

"The East Asia and Pacific region comprises 40 percent of global GDP »



▶ and is still the driver of the global economy. That 40 percent is the highest indicator, which is true nowhere else”, said Axel Van Trotsenburg, vice president of the East Asia and Pacific region at the World Bank.

He said he supports the recent structural changes made in China, explaining that the global economic growth has accelerated and that the time had come for changes to economic policy in advanced economies to foster growth, reduce poverty, and improve the lives of the poor and vulnerable.

The International Monetary Fund (IMF) and World Bank have warned of a further weakening to the economies dependent on China. But the impact of decline is expected to be short-lived, with China predicting for growth in manufacturing output this year.

Despite the impressive growth projections for China, it falls well below past years. Many observers expect a backlash for countries whose economies are based on providing raw materials to China.

China’s growth is likely to fall short 0.8 percent from its target. According to the World Bank, China’s mid-term growth is expected to range from 7.5 percent to 7.7 percent because the Chinese government has made making demand conducive to growth a priority. That means greater focus on productivity, innovation, and consumption rather than investment. To maintain this priority, China sharply increased its own internal investment, resulting in 10.4 percent growth in 2010. A decline in real estate prices in 2011 cut that growth, however. Furthermore, China has cut its dependence on U.S. and European markets with a new policy focusing on building up domestic consumption.

Chinese household savings now play an important role in the Chinese economy. Total deposits in 2010 grew to 53.9 percent of GDP. When Deng first introduced his economic reforms to attract investment some 30 years ago, domestic consumption was between 50 and 52 percent of GDP in

China. However domestic consumption was flat during the boom years of the last two decades. This resulted in a sharp reduction in the volume of consumption since 1990, which then comprised 43 to 48 percent of GDP. The gap between GDP growth and the consumption growth has expanded enormously since 2000, with domestic consumption falling to a mere 34.1 percent of GDP in 2009.

An Old Regime Falls Behind the Times

Although economic reform is underway in China, political change is far and away. There has been no substantial progress in improving the living standards for Chinese people. Wage and social disparities have made cause for growing concern among China’s leadership, too.

“It is necessary to reform China’s economic structure, to re-determine the roles of the government, to make structural changes among the state-owned enterprises and banking sector, and to develop entrepreneurship”, said the 2030 China report by the World Bank.

Manufacturing from Chinese state-owned enterprises and companies currently represents 40 percent of China’s GDP, said the report. It noted that state-owned assets represented some 50 percent of GDP and had advantages over private competitors.

“These are causing inequality in fair competition”, reads a report titled “China Succeeded from Hu Jintao and Wen Jiabao” by the Institute for Strategic Studies at the National Security Council of Mongolia. That will have to be a point of focus for the new regime in China as it pursues its economic goals. ■

MICRO FINANCE

BRING IN THE START UPS

E. ZORIGT

Small businesses have never been old-fashioned nor in vogue in Mongolia. Small-and medium-size enterprises (SMEs), however, are still important to the economy.

Assisting SMEs has been challenging to past governments in Mongolia, which spent billions of tugrugs in soft loans to contribute to SME development. Despite these efforts, small business owners still complain that

not enough has been done.

“It is not true that milk and dairy manufacturers are funded by the Chinggis bond”, said an audience member at a discussion on SMEs at the CEO Summit held in September. “We heard that only some large companies received funds, but so far SMEs have not received any of it”.

There are some funds that exist for attaining soft loans. Two of them are the Employment Support Fund and the Soum Development Fund, but ▶

▶ they do not seem to be reaching their targets.

“Soft loans that are supposed to go to SMEs are usually stuck with the middle man, the bank”, said E. Ariuntugs, chief executive at the Mongolian Financial Non-Banking Institution’s Association. “You may wonder why. SMEs complain that commercial banks have long criteria when they apply for loans, including bank deposits sums and years of employment. For business start ups, they often do not meet the criteria required by banks. Those who meet the criteria are large companies that are in businesses with billions of tugrugs”.

There are also many who say that soft loans do not go to SMEs at all, but instead go to large companies. So, how does one tackle this issue? The answer is easy: Introduce a mechanism that issues soft loans through non-banking financial institutions (NBFIs) instead of banks. Unfortunately, NBFIs in Mongolian have a tarnished reputation due to their association with failed cooperatives.

“People are afraid of NBFIs; that they will go into bankruptcy just like what happened to SCCs [savings and credit cooperatives] in the past. But total statutory funds of NBFIs that operate in Mongolia amount to MNT 150 billion”, said B. Bat-Amgalan, director at the SME department at the Ministry of Labour. “At present, none have gone into bankruptcy. Now it

is time for NBFIs to conduct public awareness among the general public on how they are reliable and financially sound”.

Sorting out the differences

There are three entities that provide loan services in Mongolia: banks, SCCs, and NBFIs. Each has different rules and features.

SCCs collect money from member participants. That money is then credited to other members. But an NBFI is different. It operates within numerous financial activities, where 70 percent of total assets are held by investors. Conversely, in the banking sector a mere 10 percent is investor-owned, with the remaining 90 percent financed through deposits.

These differences are the main determinants of their risk-taking abilities in the financial market. While SCC provides financial services among its members, NBFIs cover a much wider scale, including micro-financiers, store owners, service providers, craftsmen and SMEs.

Most SMEs who fail to meet the threshold put up by banks are left with no choice but to knock on the doors of NBFIs. SME start ups are typically classified as high risk by banks. Companies with many years of experience and have already carved out their places in the market are more likely to repay their loans. This allows those companies to attain lower interest as well.

“Banks cannot take risks because 90 percent of its total assets are clients’ deposits”, said D. Bat-Ochir, chief executive at Khas Bank, explaining the need for caution by

banks.

But an NBFI is different from the bank. They provide services for about 60 percent of SMEs, with some 390,000 clients typical among them. In total MNT 320 billion is circulated among NBFIs in Mongolia, of which about 70 percent is investors-owned equity. This gives more leeway to take risks and provide fewer obstacles for small business owners to attain credit.

“The total assets of NBFIs in Mongolia comprise a mere 2 percent of the total assets of banks,” said A. Altansukh, director general at Bid NGFI. “However, in terms of owned equity, NBFIs comprise about 20 percent, and in terms of statutory funds, they comprise 45 percent among the financial market.”

Altansukh said that was enough for NBFIs to take more risks than banks. Thus, banks can continue loaning to large, low-risk companies while NBFIs attend to small-business start ups. This sort of model is common throughout the world.

More advantages

Mongolian banks comprised 93 percent of the financial market in 1993 compared with 96 percent today. The growth in banking is pushing other financial institutions out of the market, but it does not necessarily mean that competing institutions are weak. Their strength comes from state policy as the implementation of projects and programmes employed by the government are most often funded by banks. The disadvantage is that the economy depends solely on the banking sector, giving banks hold of a dangerous monopoly. The lack of competition may also be disincentivising banks from lowering the interest rates on loans.

A larger number of micro finance institutions have the power to make financial services more available to people, reduce interest on loans and increase the size of loans, said N. Oyunchimeg, director of the micro-finance department at the Financial Regulatory Commission. It has been ▶



Mongolia's non-banking financial institutions have MNT 150 billion statutory fund

▶ already 20 years since Mongolians wanted to bring the annual loan interest to the single digits. SMEs usually lag behind in opportunities for getting low-interest loans because they do not meet the criteria of banks. Those who cannot attain soft loans may ask banks for loans with higher interest, but the strain can be difficult to manage.

“If the current situation further remains the same, the banks will comprise 99 percent of Mongolia’s financial market and other financial institutes will be removed from the market”, said Bid’s Altansukh.

He added that large manufacturers and companies will have all the advantages, while smaller businesses fall to

the wayside.

Approval of the Investment Law by the State Great Khural is a large step forward in the right direction for Mongolia’s financial sector. However, this too is likely to be of most benefit for the country’s largest companies. Only NBFIs have the power to directly address the situation. ■

SPEECH

PUTTING THE CRISIS BEHIND US



The following is a speech delivered by Naidansuregyn Zoljargal, governor at the Bank of Mongolia, during the CEO Summit held at the Government Palace in Ulaanbaatar on September 25.

In 2012, two things were very clear. The first thing is a substantial shrinkage of loans and the second thing is a sharp reduction in the volume of foreign currencies’ inflow to Mongolia. However, the inflation rate was seemingly stabilised. What would have happened if this circumstance had remained longer? Indeed, it was not necessarily to continue like this. The Bank of Mongolia, therefore, has taken some measures. And I would like to give you some information on what measures were taken.

In the beginning of this year the Price Stabilisation Programme was announced. This was the first time that we put money in our economy to fight against inflation. And it has been so since February. We saw good results on the price of petroleum. If no

measure was taken last December, the price of petroleum could have increased up to 50 percent in connection with fluctuations in the exchange rate. This is just a simple example in which the bank’s policy has protected the country’s economy. Also since loans have shrunk, the bank has created a loan source for commercial banks. As a result, the economy has been relatively stabilised. It was apparent that if the bank did not take any measures the economy could have collapsed. An allocation of a total MNT 2.8 trillion in the market has resulted in declined inflation of 9 percent.

In contrast, there has been no improvement for the external circumstances, including a deterioration in the investment environment and a decline in the inflow of foreign currencies. Nei-

ther the price nor volume of exported products has increased. But there has been a 10 percent decline in the volume of imported products in the first half of this year.

While the economic situation was so bad, how did the economic indicators manage to grow and the inflation rate fall to the single digits? This is because of the supply of money allocated by the Bank of Mongolia, aimed to prevent job losses and protect real economic growth. We did not allocate the money through the state budget, but through the commercial banks. It provides loans that were cheaper than on the market.

Some of you may wonder why we have provided a source of loans through the private sector. As the bank’s first half year’s financial statement has been released, I guess that there is no need for repetition. But I want to give you only one example. When money supply was rising 13 percent, GDP was growing 11 percent. Mongolia once experienced growth from 7 percent to 14 percent. The important issue here is the result. This is because of our policy to invest through the private sector, espe- ▶

►cially during this time when a crisis is possible.

Mongolia's construction industry has seen 125 percent growth compared with the previous year. There are 240 companies which manufacture building materials, of which a majority have already begun to manufacture some products that can replace imported materials. What we learned from this is it would be appropriate to supply the sources for capital through the private sector if we really want to contribute to the economy. The source of loans will be available for domestic construction companies for three years. It is related to our policy to prevent job losses and benefit manufacturers at a time when the economy might be in crisis.

According to the Bank of Mongolia, the hardest time is falling behind us. Many people explain global recession in many ways. But we would like to announce that the Bank of Mongolia has managed to maintain the economy without any weakening in the past 20 months while the country has experienced foreign trade deficit, huge expansion of the state budget from government to government, and the budget deficit. As we know well, this year Mongolia has a trade deficit of USD 1 billion to USD 2 billion compared with the previous year because of a number of laws which caused a substantial reduction in foreign direct investment. Also we could see a basic change of USD 2 billion to USD 3 billion that is already circulating in the economy. This is an ordinary example of weakening.

In these difficult circumstances, it is believed that the economic stabilisation is coming from those construction companies, their employees and the wealth which has been created by them. Another important thing to Mongolia's economy has been a new mortgage system, which depends on those jobs. The challenge here is whether this will last. This would be a policy that must be enforced, I think.

Two things are still missing in the economy. One of the two is domestic manufacturing. This is very important, from every aspect, including the fight against inflation, overcoming the current account deficit and generation of the budget revenue.

In Japan, a 10 percent change in the exchange rate has an impact of 0.25 percent on its inflation rate. But in Mongolia, the exchange rate is about 4 percent. This is an example of how it [inflation] depends on the exchange rate and foreign trade. The situation is likely to be exacerbated if domestic manufacturing is not developed. It seems that there is quite often debate in the media on whether or not the economy is going to develop under the current structure.

How much further can Mongolia make its own path with such a huge dependence on imports? If the exchange rate further strengthens, what would be happen to Mongolia?

Mongolia's National Manufacturing Competitiveness on the exchange rate ranges from MNT 1,150 to MNT 1,200 against the U.S. dollar. If the rate of the US dollar goes below that, there would be no need for manufacturing in Mongolia. Then, imports from the Chinese border town Erenhot would be much cheaper than the cost for manufacturing. According to a macroeconomic level study, the National Manufacturing Competitiveness could be improved when the exchange rate strengthens more than the current rate. But Mongolia has already grown accustomed to consumption of imported goods and they have learned to create wealth by using imported goods. But we have the potential to manufacture our own products to replace such imported goods. This would be a "mission possible" if we could provide the required sources for manufacturers. Thus, the Bank of Mongolia is heading in this direction.

This year the bank is more focused on improving national manufacturing.

What we want is to create a system that encourages any manufacturer who manufactures products and has the potential to export. This will improve Mongolia's competitiveness. This would also have a gradually positive impact on inflation. For instance, our actions on the price of petroleum have succeeded, but there has been a MNT 50 impact on the price. Petroleum, itself, is a very strong influencing factor that affects all industries. Thus, the bank has focused on it and even our policy is a result of this.

From tomorrow onward, we could probably transition to a scenario in which fines are imposed on those who received loan in the local currency and benefits for those who received loans in US dollars. We have been through both circumstances in which local currency loans were more beneficial than the US dollar or vice versa. What we learned from this is an excessive change or fluctuation would not be beneficial to anybody. Therefore, what we need is to have the potential which would be predictable and relatively stable. The Bank of Mongolia is planning to create a mechanism to regulate when companies that generate their revenues in the local currency receive loans in US dollars. There might be some companies which receive loans in US dollar and have experienced losses, and now they are transitioning to the local currency. But this transition could lead them to a much worse situation in the future. In general, everything has two sides. There are risks for both. For Mongolia, foreign currency revenue needs to grow. If the current situation continues for much longer, our competitiveness ►►



Construction industry has 125 percent growth compared to the previous year

▶ and defences will be exacerbated.

Next year we aim to contribute to exports and to end the dependence on the mining industry. It is necessary to reduce the dependency within three years. It would be quite difficult to overcome today's economic instability. The current account deficit and the budget deficit are connected with the mining industry. We have been experiencing losses throughout all this. We at least need to raise the volume of non-mining products up to 20 to 30 percent of total exported products. Otherwise, it would be difficult to bring the country's economy to long-term stability.

From the aspect of socio-economic efficiency, there is an obvious need to contribute to sectors other than mining in Mongolia. That is why the Bank of Mongolia this year has begun to support the construction industry. Now we need a legal environment to assist the other industries, which would hopefully result in the reduction of interest rates on loans.

In this regard, loan repayment is another important thing. We plan to have the State Great Khural discuss a legal mechanism for this issue. As a result, we anticipate with hope a decline in the interest rate on loans of 3 to 4 percent a year.

Generally, loans depend on deposits. They depend directly on the total deposits and how long they are maintained in Mongolia. Our economy lacks investment funds and long-term sources. The pension fund, which should be the largest [fund], has had nothing. By introducing a mortgage programme, the fund has seen some good results and it will be further improved. There are enough jobs in Mongolia. Those who are employed will have their money saved for their future pensions. This is a source for long-term loans. Thus, we need to raise this fund. Without the fund, it would be impossible to reduce the interest on loans. It would also lead to a greater current account deficit and weakness in the exchange rate.

Another big issue is gold. Once gold was given to the Bank of Mongolia and the bank issued local currency, the tugrug. But currently, the situation has reversed. There are several ways to accumulate wealth and currency reserves

in the world. And there are four methods to earn the four foreign currencies in Mongolia. In some countries, there are three to four.

Mongolia's advantage is gold, which is a chance that is not often found in other countries. But gold companies do not sell their gold to the Bank of Mongolia. Instead, they prefer other [countries'] central banks. Perhaps, the Mongolian state's interest could be a five percent tax that is levied when gold is sold to the other central banks, but the interests of the Bank of Mongolia and mid- and long-term interests of the Mongolian economy are a bit different. Gold that is mined in Mongolia could be sold to the Bank of Mongolia instead of being sold to the Chinese central bank, which will enable those companies 5 percent tax rebates. The main point here is an economic interest to maintain 97.5 percent of the total gold that is mined in Mongolia.

In contrast, all gold is sold to foreign central banks and the Mongolian state imposes, a just 5 percent tax on it. As I have previously mentioned, gold represents a long-term money source for the economy. If a law that mandated sale to the Bank of Mongolia gold with a 2.5 percent tax rebate was approved it would benefit everybody. On the other hand, if gold was stored at the Bank of Mongolia, it could be a pure reserve which would positively affect the economy. When the long-term source is absent, it would not be that much easier to supply money for the market, to contribute to the national manufacturing and to fight against inflation.

We need to support the inflow of foreign currencies towards Mongolia. There are some opportunities in which foreign currencies could come, including foreign direct investment, gold and loans or bonds. Gold might be the most dangerous among those.

The monetary policy for 2014 will focus on contributions to exports. In doing so, we would need a long-term source for capital. Thus, we will have to take into account these factors that create long-term sources. If we could do that, we would have the potential to become independent of the mining industry. Although the Bank of Mongolia has reduced its interest rate, it could have been lower. This is be-

cause of lower currency inflows to Mongolia. If the inflow was stronger, it could create jobs while reducing the interest rate. If the interest rate is 7.5 percent on average, then the economic stimulus would grow as much as 10 times larger.

In conclusion, 2013 is the year to reduce the economic slowdown. It could have been more severe than this. If the market was not supplied with MNT 2.8 trillion, money supply could have declined 23 percent. If the money supply was reduced, no loan would have been repaid, which could have brought crisis to the country's economy.

We do not know when the crisis will come. There are no warnings. When the crisis is known about, an exit is already present. When it begins, we are already tightening our belts and controlling our revenues and expenses.

We look forward to substantial growth next year because this year we have managed to take important measures against any possible crisis. In particular, it was an enormous challenge for us to deal with this issue just as the country's economic situation began deteriorating.

Today's economic growth is 11 percent and the inflation rate is 9 percent in Mongolia. There have not been serious job losses this year. We have been through fluctuations in the exchange rate, which was not good. We did not want this, but it was an inevitable factor.

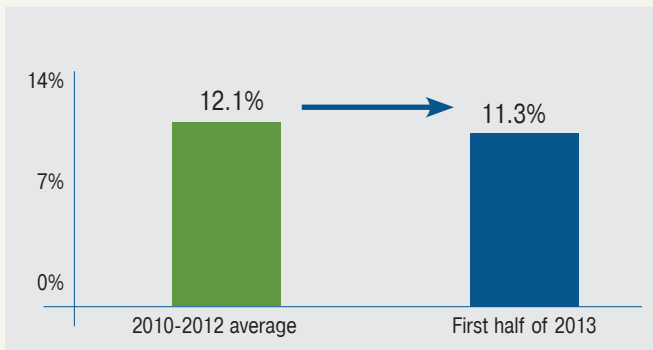
The Bank of Mongolia has some reserves that are needed for combating against the decline in the exchange rate. There is currently USD 2.7 billion in the bank in total. We also have Chinese yuan reserves. But these reserves should not be exhausted. If tomorrow is going to be much harder than today, what shall we do? We really need to be prepared for that. Currently, the exchange rate is in decline. The wish is that it will stabilise in the future. By the end of this year, the volume of imports for consumption is likely to grow, but most of the imported goods that we buy from stores are indeed tolerable ones.

The Mongolian state is doing a lot to improve the inflow of foreign currencies to Mongolia. I look forward with hope for the approval of laws to contribute to the inflow of currencies. We have managed to save 170,000 jobs this year and we might see the results of this in 2014. ■

IN FIGURES

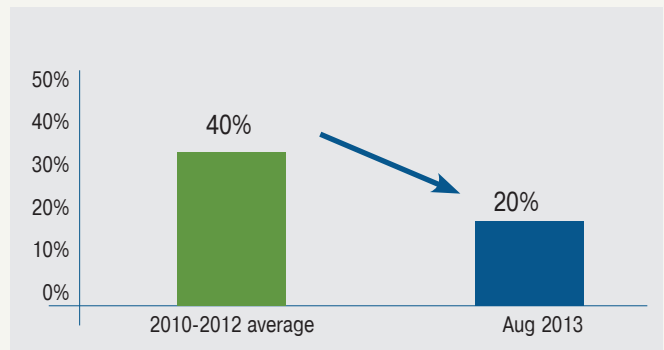
Some view the current economic conditions in Mongolia as a sign of an impending crisis while others think the economy has avoided possible crisis. The following charts demonstrate economic activity over the past three years.

Real Economic Growth



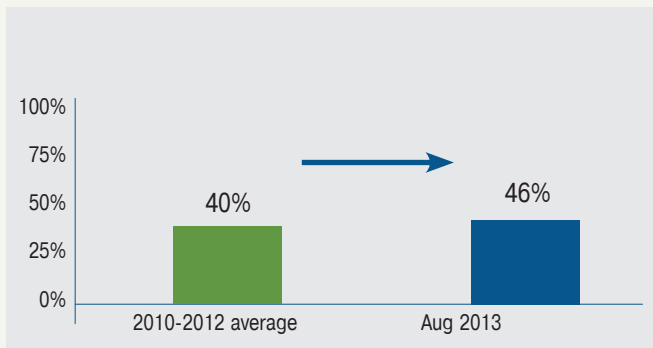
Source: the National Statistics Office

M2: Money Supply Growth



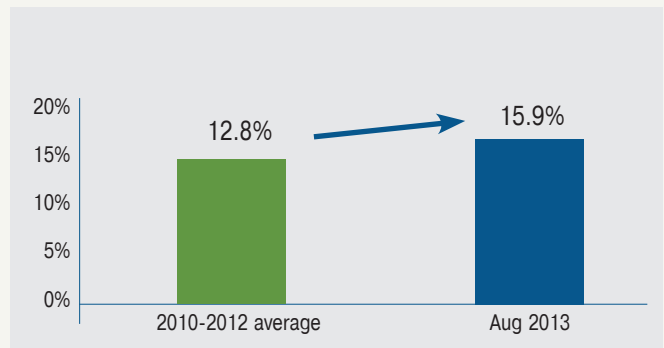
Source: the Bank of Mongolia

Annual Growth in Bank Lending



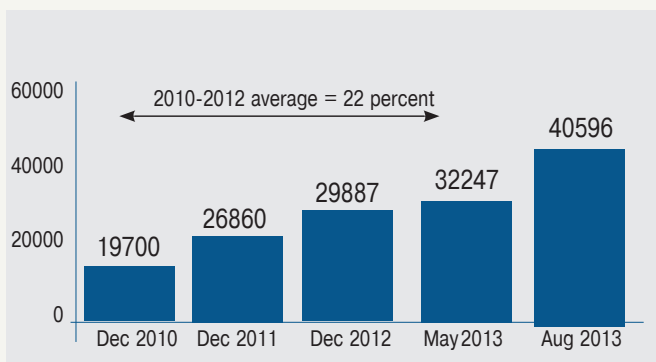
Source: the Bank of Mongolia

Bank Solvency



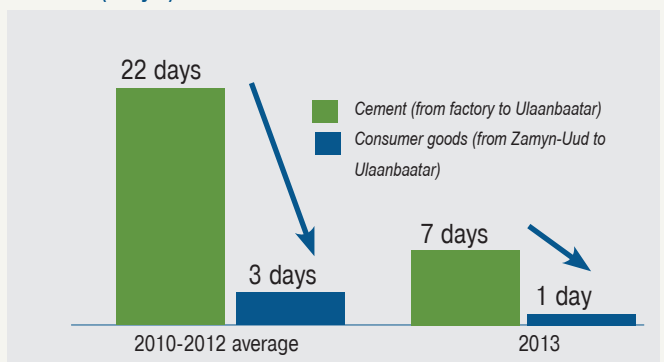
Source: the Bank of Mongolia

Number of Mortgage Loan Recipients



Source: the National Statistics Office

Length of time for the Transport of Consumer Goods (days)



Source: the Ministry of Road and Transport

GUEST

RIO TINTO PIONEERS MONGOLIAN JOINT VENTURES



BY D. BEKHBAYAR

Jean-Sébastien Jacques was appointed chief executive of Rio Tinto's copper group in February 2013. He joined Rio Tinto in October 2011 as president of international operations for copper, where he led a senior team and oversaw Rio Tinto's interests in the Palabora Mining Company in South Africa, the North Parkes Mines in Australia, Kennecott Eagle Minerals, the Pebble Mine in the United States and Sulawesi in Indonesia.

Prior to joining Rio Tinto, Sébastien spent more than 15 years working across Europe, Southeast Asia, India and the United States in operations and strategy for aluminium, bauxite and steel mining operation. He served as group director of strategy and was on the executive committee at the Tata Steel Group from 2007 to 2011.

What are your thoughts on Mongolia after having visited more than once?

Last time I was there was a week ago for the ceremony of the first shipment and it was emotional for all parties. The reason why I'm saying this is because some of our colleagues have been working on the project for 15 years and some of them have been working for 20 years. When the first truck of concentrate left the mine, for those individuals you could see some tears in their eyes. It was a nice thing to watch.

The other piece was that the government was there. I think it was important for them as well. I believe it ▶

► was emotional for the team as well because it was twelve years of hard work and USD 7 billion of investment. It has been a bumpy ride. There were some downs, but people were very proud of what they achieved. I think that there were a lot of emotions.

Given the current situation, how confident are you about the Mongolian economy for the long-run?

I think it should be a great story because there are lots of minerals there. You build a mine with lots of development.

We are committed that over 90 percent of the people working in the mines will be Mongolian nationals. We are committed to increase the Mongolian content. We wanted to have a strong, capable supplier base. What we agreed with the government is that we need to have a power station and we needed to build infrastructure around it. From our perspective, we think that OT will have a direct and indirect impact on the Mongolian economy.

Rio Tinto is a leading mining companies in the world. What makes it a world-class mining company?

The company has been here for 140 years. Some of the key aspects include the quality of exploration and the ability to find good deposit. It's not easy. We have been very strong in finding new deposits. The second aspect is the ability to operate the mine in a safe and cost-effective way. The third aspect is about the value of the group. I think that is important.

What is the main objective of your company?

Like all companies, we have an intent to create strategy for investors, which isn't different from other companies. What is different is that we want to create a first-class portfolio of low-cost, long-scale, and large-scale strategies. That is one of the key periods of our strategy.

If you look at some facts about OT, it's a bit over budget and ran over time. Why is that?

I don't think it was over time. It's an interesting question in the sense of that the team had not done a good job, then we wouldn't have been on time. We were late by nine days to do the first shipment. After twenty years of hard work and planning, we planned to send out the shipment in June but we did so on July 9. The government pulled the plug on the ceremony two weeks before so I believe we were on time.

If you guarantee that people can be late by nine days after over twelve years of hard work, then I think that's good and on time.

Safety issues are the most important thing. What are your safety procedures?

This one is simple: In Rio Tinto we have one standard and it doesn't matter if you're in the US, Australia, or in Mongolia. There is only one standard. All of the safety procedures and systems that are being implemented elsewhere are being implemented in Mongolia as we speak.

The second aspect is that we have to transfer people from all over the world in order to make sure it happens. The third aspect, I can say, is that we are constantly training Mongolian nationals—not only in Mongolia, but in London, Australia and the US in order for them to have a first-hand experience. It's training in and outside of Mongolia.

What is Rio Tinto doing to build a future workforce in Mongolia for underground mining?

As I mentioned, we have a few Mongolian nationals outside Mongolia working in existing mines. For obvious reasons, we can't transfer thousands of people outside Mongolia. It just doesn't work.

We started working underground about five years ago. We currently have two shafts. To answer your question, we have a training center in OT where there is state-of-the-art simulation. Here you can train people in a safe environment. So we've got all the techniques to train people in a safe environment before we put them

underground.

Rio Tinto has also come across some legal challenges for Oyu Tolgoi. What would you do to change the government's stance on underground mining?

It's not our job. If the government wants any input, we are more than happy to help. The responsibility of writing the laws is not with Rio Tinto, it's with the government. As we do in Australia and the US, if the government wants any input, then we will help out.

What can you do to promote human resources?

We've got these big graduate programs. We spend hundreds of millions to make it happen. The biggest challenge is human resources and development capabilities, which is why we spend so much time, effort and money. We have so many expatriates for one main reason, and that is so they can train people in order to build capability. That's the investment we are doing as we speak.

You have one experienced person working with a Mongolian and after some period of time, you remove the expatriates and the colleagues from Mongolia will be able to work on the project. That's what happens across the entire site. The quantum of training is absolutely massive.

As I said, the intent is to have over 90 percent of the workers to be Mongolian nationals on site. We need to train people and that's what we're doing as we speak.

What are your thoughts on the downward trend being seen in the global mining sector?

The mining industry is changing and it's facing a challenging time. Everybody has to prioritize their capital. It's a challenge, but it's an opportunity as well.

The important piece to understand is that it's not just about money. When you have a big project and spend billions of dollars on it, you want to make sure the A-team is working on it. So it's not only about money, it's about ►

▶ people.

When we take up a project, we don't look at just the costs. We look at the long-term aspects of it. The prices are wherever they are because I can't change the prices. What are important for me are two things. One thing is making sure that we are adding the right decisions in terms of long-term perspective. The second thing is to make sure that I create value for all stakeholders.

What are the principles of responsible mining for Rio Tinto, and what is its long-term strategy for responsible mining in Mongolia?

What you want to make sure at the end of the day is that you have a net positive impact in the region where you did operate. Responsible mining is a broad thing that includes lots of things such as water management, environment management, and the development of the local community.

When you step back, you have to make sure that you're creating a net positive impact. The way it is delivered may vary from one location to another.

What are you planning to do in terms of environmental issues?

We've got teams on the ground. If you want to go outside and see what we're doing in terms of preserving water and making sure that we don't damage the environment in which we operate, you have to check it out. I think if you go there, you'll see some pretty good stuff and you'll be impressed. I can't give you all the statistics unless you see it with your own eyes.

Rio Tinto has many different mining projects around the world. You have 140 years of history and how do you react with resource nationalism in different countries?

It's a very good question. I think that if you look at other large companies besides Rio Tinto, we have a portfolio of projects. This is not only a question for Rio Tinto. At the end of the day, we have limited capital and limited resources. It's not just about capital; it's about people as well.

The truth of the matter is, the

money and the people will go to the best project globally. I know that many people don't want to hear that, but that's the reality of life. If I have two projects and one gives me 100 and the other gives me 50, then there is no point in choosing the one that will give me 50. That's what people need to understand.

The capital and resources are done on a global scale. It is very important in two ways. We spend billions and billions of dollars so it's critical to have stability of the environment as well as consistency. We go to the project that has that entire framework. That's not only for the mining industry. It's across all industries. If you want to attract investors, stability of the framework is absolutely critical. Otherwise, the capital will go elsewhere.

It's also not just about Mongolia. It's about all economies. When you want people to invest billions of dollars and send lots of their people, you just have to make sure that you have the right environment to invest.

Mongolia recently passed a law setting the criteria for corporate governance. Rio Tinto could be a good example of corporate responsibility. What is philosophy for corporate governance in Mongolia?

Once again, all the standards that we expect people to do are being implemented in Mongolia. There is only one standard and there is no difference whether you are in the US or in Mongolia. The expectations on our behalf are exactly the same. We don't do politics and we are absolutely against nepotism and conflicts of interests. We have a clear set of rules and we implement a clear set of checks.

We need third parties to make sure that all the companies are compliant with the rules. I've said several times that there is only one standard. We implement this standard in Mongolia the same way we do it in the US or in Australia. There's no difference on this one.

What type of difficulties do you find when you work with Mongolian companies?

If you do a project in Mongolia or elsewhere, there is no difference. When you start a project anywhere you have to develop your supplier base and so forth. You're facing the same challenges. You don't always have the right set of suppliers at the start so you need to find a way to develop those suppliers so you need some time.

I don't think there is a big difference between Mongolia, the US, or Australia. With OT, there was nothing around it. There was no power or water. If you had to do OT in the middle of Chile, you would face the same issues. I don't think Mongolia is different from anywhere else.

What will be Rio Tinto's real contribution to Mongolian development?

My sense of the following is that the OT project will have a huge impact on the impact of the economy in Mongolia. Importantly, I believe that it's important for all parties to make a success out of OT. The reason being is that everyone is watching OT and it's a test case. If OT can be a success, then I think that Mongolia can attract a lot of investment.

Do you think Rio Tinto already brought good standards?

The government wants to look at what we have in terms of process and standards. If they want to use it elsewhere then so be it. They know they have access to everything and they can audit what they want. If they want to learn from it, it's not a big problem.

What are some of the advantages and disadvantages you have seen in the Mongolian business environment?

That's a very good question. What we are very pleased with is the quality of the workforce. People are very keen to learn. They are very committed and they really want to make a success out of OT. They know what they are doing and how to make a positive impact on the Mongolian economy.

We, as Rio Tinto, did agree to invest billions of dollars on the back of a ▶

► series of documents called the investment agreement [IA] that was signed by the government as a binding document. We expect the government to comply with what they signed a few years back. That's very important.

Lots of people have asked to renegotiate the IA. We are very clear that those documents are regarded as binding. You can't ask to change it. If you have a situation when the government signed an agreement and they change their mind several years later, it makes it hard for investors to buy. They want to have stability and consistency. If you change the rules every five minutes, the money will flow elsewhere.

What do you think of Baatar

Bold's appointment at Rio Tinto? Many here in Mongolia are happy to see a Mongolian president of the copper group. What's the benefit of having a Mongolian in this position?

I am very happy because I did appoint him. I promoted him and he is doing my previous job. I am very pleased.

Bold was promoted on the back of his capabilities. The second aspect is that if you want to run a global company, I think it's very important to have different nationalities at the top. If you have a lot of assets in South Africa for example, it's important to have people from this region.

The truth of the matter is you have

to fully understand the culture. The best way to understand the culture and to close any cultural gaps or challenges is to have people coming from those regions working with you. This way you can truly understand those differences.

Back to what we discussed about training, we want to understand what the culture is about and we want Mongolians to understand Rio Tinto culture as well. Once again, there is one standard. There is no difference. The rules of the game and the rules of engagement are the same. We want to have people who can understand Rio Tinto culture because there is only one culture. ■

ISSUE

EXPECTATIONS FROM OYU TOLGOI

B. TOGTOKH

The government of Mongolia this year was supposed to generate MNT 445.8 billion from the Oyu Tolgoi copper mine—that is with the amendments to the Investment Agreement it proposed in the 2013 budget. Unfortunately, the two parties could not agree on the matter and Mongolia will see a shortfall of MNT 209.9 billion in revenue from the project this year. The Human Development Fund, too, will earn less than expected, falling short MNT 154.8 billion.

The Oyu Tolgoi mining unit expected to pay MNT 161.5 billion in royalties to the government for the production of 723,000 tons of copper, 24.9 tons of gold, and 60.2 tons of silver next year

compared with 382,000 tonnes of copper and 424,000 ounces of gold and 802,000 ounces of silver for 2013. A USD 1.6 billion decline in foreign direct investment to Mongolia and falling prices for coal have made it clear necessary to amend the 2013 budget. During the first half of this year, the economy grew by 11.3 percent. Production from the Oyu Tolgoi plant is expected to have a direct impact on annual growth for 2013. Delays at Oyu Tolgoi this year, however, are expected to cut 2013 production expectations by 23 percent for 295,000 tonnes of copper concentrate. Even with the production shortfall, the Ministry of Finance has projected the mining sector to grow 20 percent this year.

The current global economic

outlook is poor for growth and is followed by sluggish growth in China's economy. The slowed growth in China and waning demand for minerals has brought down commodity prices. According to a study by the Bank of Mongolia, the first eight months of 2013 saw a 32 percent decline in the price of coking coal compared with the beginning of this year, in addition to a 14 percent decline in the price of copper and 17 percent decline in the price of iron ore. Also, Mongolia saw a 22 percent decline in foreign trade, compared with the average from the last three years and a 10 percent decline in exports.

But there is hope for the future. Nyamjavyn Batbayar, minister of ►►



economic development, recently introduced a very optimistic projection for next year that Mongolia's mega projects would bring an additional 30 percent growth and raise total foreign trade to USD 14 billion.

Clearing Hurdles

The first tranche of Oyu Tolgoi's shareholders' meeting took place in London from September 23 to 27, and a second was held in Ulaanbaatar on October 15. The results of the second tranche are still unknown, but it is clear that the two parties are behaving more cooperatively together. Neither is interested in wasting any more time than they already have. For Mongolia, the fall from the Oyu Tolgoi disputes over development of the underground mine has been largely seen in fleeting foreign investment.

During the London meeting, Oyu Tolgoi mining partner Rio Tinto said less intervention for the Mongolian

government, realistic expectations, and more cooperative attitudes were essential to moving forward.

There are several reasons to accelerate Oyu Tolgoi's operations. For one, the outlook for copper is a likely plunge in its price in 2018. Also there are some large copper deposits in Mozambique, Chile and Afghanistan that are being developed that Oyu Tolgoi will have to compete with. "During the shareholders' meeting held in London, some 22 issues have been raised by the Mongolian side and some eight issues have been raised by the investors' side", said Chuluuntseregiin Otgochuluu, a board member appointed by the government for Oyu Tolgoi.

Through their discussions, he said, the two parties were able to resolve 15 issues. The remaining 15 issues will likely be addressed in the forthcoming meeting. The two parties are expected to come to a common ground by the end of December so they can make a joint decision on USD 4 billion in project financing.

Misleading Information

Oyu Tolgoi's shareholders are sitting in the same boat. But the boat could hit rocks and sink if shareholders head too far off course. Otgochuluu said that providing Mongolia accurate reports on spending would be the best course for its private partners.

"The London meeting has made us feel that the misleading information coming out is compromising Oyu Tolgoi's reputation in the world", said Otgochuluu.

And sending the right message will be key for Mongolia, The grandstanding, populist statements that come out of the mouths of some Mongolian politicians have had serious impacts across the world. Mongolia sometimes gives investors in London and elsewhere cause for alarm. However, the new board members at Oyu Tolgoi to represent the government can perhaps bring a new images to the country. ■

CORPORATE SOCIAL RESPONSIBILITY

TEACHING CORPORATE SOCIAL RESPONSIBILITY

BY I. OTGONJARGAL

Celina Pagani-Tousignant is president of Normisur International. She is a well-known international expert who has trained thousands of individuals from business, government and civil society on topics of corporate social responsibility (CSR). She has worked with business executives from Asia, Europe, the Middle East, the United States, Canada and Latin America. She organised a CSR training seminar in Ulaanbaatar in June this year. The following is an interview held after the training.

This is the first time you have trained Mongolians in corporate social responsibility (CSR). What is your impression of Mongolians' understanding of CSR?

This was a very different type of course. Usually when I do training my audiences are companies. It was a mixed training where the representatives were from the government, civil society and also companies. It is very rare that you put in a room people from different sectors because they usually have different points of view.

It was a little bit risky when I think about it because it was bringing people from different sectors with different ideas. And I think it went very well. They were able to give their opinions with respect for each other. I think we created a common base of knowledge. So, the people who came to this training heard the same message,



In June 2013, Celina Pagani-Tousignant was invited to Mongolia and organised the first training on Corporate Social Responsibility

and so that is what they are going to repeat from us as they go to different sectors.

For me, I learned a lot of culture. The culture of Mongolia and how the traditions of the past were respectful of all these CSR things we are talking about right now. And there has been a tremendous change in this country in the last 23 years and tremendous growth and more wealth creation. There has been a lot of movements and some of these things have been put to the side, but I feel that there is a core value.

What it means to Mongolians is that in the next decade people are going to come back to that in a direction to create a sustainable Mongolia, basically. But this is a normal thing because Mongolia has been only 23 years of a different regime. I think a

beauty of this training was to bring different actors from different sectors. I appreciate that.

Stakeholders are important to CSR. In Mongolia, the mining industry is developing rapidly. There are some misunderstandings between civil society, government, and mining companies. How can CSR development engage the different stakeholders?

It seems to be that mining companies have been pushed to do stakeholders' engagement because of their business, and I think that there is an opportunity to do this right in the sense that companies should not be afraid of stakeholders. There is probably a sense that stakeholders are asking too many things and companies need to be confident identifying »

▶ the stakeholders who are surrounding the company, maybe impacted by the company or could impact the company, basically. Then, taking stakeholders' engagement as a strategy, not like a one time event.

But something that builds the trust with different groups is going to take some time, and it is going to take some patience. And it is going to take one step after the other.

The main thing here is building trust. And that trust is not built overnight. So they have to understand. The stakeholders should put themselves in the shoes of the other. Sometimes that is difficult. It is not only CSR professionals that do CSR stakeholders' engagement, it is a whole company. It is a huge project.

I think that in Mongolia I see them in the beginning stages. Some industries, like mining, they have to deal with them and they are dealing with them as best they can. But I think that there is opportunity to do this more strategically.

How would it be possible to deliver knowledge and understanding about CSR to small and medium-sized companies (SMEs)?

SME means small and medium enterprises. They are just small businesses. So, the concepts can be applied in a small business, but it is going to be different.

A small business is not going to give lots of money to the community because they do not have it, but small businesses can give some products to the community. They are not going to develop programmes for employees that cost a lot of money, but they can give small things. So the concepts can be applied. I think that it needs to be held at the government level.

The companies could help by applying CSR to their supply chains. That is why they have influence. Then the government may be down the line to create some funds and put them together to build the capacity of small businesses. In my experience, small businesses quickly want to be competitive. If they understand that CSR is going to help their competitiveness

they will do it. But otherwise they would think that CSR costs too much and it is not for me, and it is only for large companies. So there are some barriers.

The first thing is to understand their barriers. What do they think about this? And then try to get to them with the simple tools. It has to be simple. It has to be practical and it has to be down to earth. They would never dedicate a whole week. They cannot and they do not survive. Things have to be quick. They like the tools that they can apply rapidly.

I think that down the line I would like to see, hopefully, some help coming from the government maybe sometimes in partnership between the government and the companies. This has to be a topic separate. There has to be initiatives for SMEs. And I think that probably that is coming down the line because here in Mongolia the way I see it is that large companies are getting their houses clean and in order. That is step number one. Then SMEs will come down the line.

If it is voluntary, how can companies be encouraged to conduct CSR?

There are laws because there are companies that no matter what you say they are not going to do it. So you have to bend their arms, basically. But companies need to see value added from CSR. If they think CSR is a good investment they will do it. If they do not see it they would not. That is why when I go to companies I usually talk to the board of directors or chief executive. And I have to convince them that CSR is a good for their businesses. If they see that, there is a click, like something happens. They see it and they want to have it done.

You need to understand it is crucial how to sell this to a business person. Once they get it then it is about "Okay, well, do we have the resources to do a full-blown strategy or do we want to start with a programme in one particular area"? Also they need to depend on the resources that are available. They need to understand it. There are some business people who do it be-

cause of a moral thing, because they think CSR is the right thing to do. But in my experience, business people are the same everywhere. They want to see how it is helping my business, so, I would say that once they see that then there is pure pressure.

Companies sometimes do CSR because their competitors are doing it. It is creating that competitiveness and a little bit between one and the other, "I do not want to get behind and I will do it". Sometimes it is a mixture of incentives and a mixture of pressures coming from investors or consumers. The neighbourhood said here that citizens have not woken up here yet to say I demand this or I demand that of the company. That is going to come in the next five years, I bet you. There is going to be a whole movement about that.

So, the company will feel pressures from different points. It is understanding those pressures and then selling them the value-added and telling them, "if you do not do CSR, it is up to you. If you do not do anything this is going to happen: They will close your factory. You are going to lose market share. You are going to lose clients. You will get fined by the government". So, there is a whole bunch of soft confrontation. And then, they will wake up.

CSR is like a way of doing business. If you are a company, it is going to be important because there are consumers who care about this. They may not want to buy your products. So, down the line it will be like something that differentiates you from others. If you contaminate, maybe you are fulfilling the law because the law says that this is the limit of contamination, even if you are going below. But it is still hurting the community. The community is going to be upset at you. So, your business will be affected. And CSR can enhance your business.

And what about the government responsibilities?

It is talking about responsible practices. They do not have the driver of the money because it is the government. They have the driver of running ▶

► their operations more efficiently. In the government, the selling point is there is not so much about you, but you will be more efficient in the way you run your operation. CSR will help you to be more efficient and you will gain a reputation with the citizens because you are doing this. And also you will be respected by the companies because you came in to put losses for the company, but they are not doing anything. So, they are going to look at you with sarcastic eyes.

And then NGOs want to partner with the companies and it also wants to partner with the government, too. If I am from a company and if I am an NGO and doing this internally, I am going to

feel that they are already doing something that I am doing. And I am going to feel like I want to partner with them. So it will be easier. The partnership will be created easier. Also for an NGO, they may be able to get some funds from the companies because you know it is going to be opening for them and they will run their operations more efficiently.

Is CSR a part of corporate governance or are they separate concepts? How does one distinguish between these two?

That is a very good question. Because maybe here in Mongolia the confusion is not that CSR is philanthropy, but CSR is the corporate governance. CSR is bigger, like a big umbrella. And

CSR has several topics.

One of them is governance. The governance is one of the main CSR topics. The governance is only about how the company makes a decision. It is about if they are ethical or transparent. How do they conduct their businesses? So, that is one element.

But CSR is a lot of further elements. How do you treat your employees and are your products safe? What is your relationship with the communities? Are you contaminating the environment or not? CSR is much bigger than corporate governance. So, that is a good distinction and maybe it is important to make it because that is the confusion that you are picking up. ■

POINT OF VIEW

FRONTIER, EMERGING, DEVELOPING: WHAT'S IN A NAME?



Nigel Finch is an associate professor in accounting and researches in the areas of creative accounting, security valuation, mining, asset impairment, and financial disclosures made under the application of fair value accounting principles. He is an academic member of the University of Sydney's China Studies Centre and the Sydney Southeast Asia Centre with considerable experience in the areas of business regulation and economic development across Asian and emerging economies.

It may be the case you have heard the term “emerging market” in the business press and are curious about what this means?

An emerging market is an economic term that refers to a nation's level of business activity, in particular, a nation that is in the process of rapid growth and industrialisation.

An emerging market differs from

a “developed market” in that a developed market is much more established with respect to the nature of and level its business activity, and as such, would typically have higher levels of liquidity and lower levels of risk associated with its business investment.

By looking at the characteristics of economic and financial data related to each country it is possible to rate

a country as either “emerging” on the one hand, or “developed” on the other. In fact, is it common within financial markets to use more granular descriptions to describe a nation's level of business activity.

For example, a taxonomy such as “frontier”, “emerging”, “developing” and “developed” may be useful to stratify each nation where “frontier” would ►

▶ signify the level of country business activity is in its infancy, while “developed” would signify the most mature market state. The economic and market data that would be most useful to inform such a classification might include: the economic size of each country, the nation’s wealth, the quality and integrity of its markets and institutions, and the depth, breadth and liquidity of its markets.

A frontier economy has the smallest market size based on market capitalisation and liquidity. The implication is that the frontier market would develop over time to become more liquid and less volatile as it transitions to an emerging market. A frontier economy is still an investable market; it just presents a different risk profile with a much lower correlation with other markets. This could be because of economic or political instability, or regulatory factors such as restrictions on the level of investment or trade. Global ratings agency Standard & Poor’s classifies 36 countries as frontier markets including Bangladesh, Kazakhstan, Pakistan and Vietnam.

An emerging economy has a larger market capitalisation and liquidity than a frontier economy yet still exhibits signs of being much less developed. An emerging economy is likely to have a high profit potential but is exposed to a variety of unique risks that are less probable in developing or developed markets. Emerging markets are likely to be experiencing transformation in their public and financial institutions, and the opening up of new markets in these countries will typically manifest in rapid growth in annual GDP as the economy starts to accommodate larger scale projects along with the funding of a greater number of investment opportunities. Standard & Poor’s classifies 20 countries as emerging markets including Brazil, Indonesia, Russia and Thailand.

A developing economy is one whose financial characteristics consistently place it at the top end of the emerging economy benchmark over an extended period. Other factors such as transparency, rule of law and political stability also build the case for

the subjective classification of a country as a developing economy. While there is no definite list of developing economies, consensus among the composition of financial market indices and rating agencies may suggest developing economies include China, India, Taiwan and South Africa.

A developed economy is the most mature along the classification spectrum with the largest and deepest markets and the lowest levels of perceived risk and volatility. Standard & Poor’s classifies 26 countries as developed markets including The United States, Australia, United Kingdom and Japan. ■



NEWSWIRE HIGHLIGHTS

NewsWire is a weekly news aggregate sponsored by the Business Council of Mongolia. Each week NewsWire delivers breaking and significant news from local and international news sources for a Mongolian and foreign audience alike. The following are news highlights from the month of October:

BUSINESS

RIO, MONGOLIA RESOLVE ISSUES IN MINE CONFLICT

The Mongolian government says half of the concerns about the development of Mongolia’s massive Oyu Tolgoi copper and gold mine have been resolved and that a meeting will be convened to whittle away the remaining issues.

Rio Tinto PLC, the project operator and major shareholder, and the Mongolian government held an Oyu Tolgoi board meeting last week in London in which they resolved 15 out of the 30 urgent issues that had led to the suspension of the USD 5.1 billion expansion project. The board agreed, among other things, that all Oyu Tolgoi licenses owned by third parties should be transferred to Oyu Tolgoi, giving the Mongolian government a 34 percent stake in the licensed deposit area. This means that two licenses part-owned by Cana-

da-listed mining company Entree Gold will be transferred to Oyu Tolgoi. As part of the transfer, the Mongolian government will receive an additional USD 1.4 billion over the duration of the project, the government said.

The Mongolian government and Rio Tinto have been at loggerheads over the investment terms of an agreement signed by both parties in 2009. The government has been pressing Rio to improve the terms of the deal, amid escalating costs. For its part, Rio wants to ensure that the government keeps to the original investment agreement.

The board will meet again on Monday to address three key outstanding issues: how to monitor and reconcile project cost overruns, submit an authorised registration of the expansion project plan, and review additional project financing.

Source: *The Australian*

ERDENET MINING MULLS COPPER CATHODE PLANT

Mongolia’s Erdenet Mining Corp. is carrying out a feasibility study for the construction of a 100,000 ton-a-year copper smelter, according to commercial department head N. Enkhbaatar.

“We have no problem with energy in Mongolia—there are a lot of coal companies and also we get out power from the ▶▶

▶ state-owned company in Ulaanbaatar”, Enkhbaatar said.

He could not give timeliness and details of the copper cathode plant. The company has an annual capacity of 530,000 tons a year of copper concentrate.

“We sell all our concentrate to Chinese smelters through agreements with traders”, Enkhbaatar said.

The company would like to sell directly to the Chinese copper smelters, he said. EMC has, in the past, signed two-year supply contracts with major trading houses, he added. The government of Mongolia has a 51 percent stake in Erdenet Mining while the Russian government holds 49 percent. Erdenet is located in northern Mongolia and lies about 241 kilometers northwest of Ulaanbaatar.

Source: Metal Bulletin

ECONOMY

FINANCE MINISTER LAYS OUT 2014 BUDGET PLANS

Finance Minister Chultem Ulaan gave a summary of the 2014 budget plans, specifying targets for loan repayment and salary increases.

Ulaan said next year's budget would have greater defense against price fluctuations in minerals, and that the budget deficit would be below 2 percent of gross domestic product. He specified that expenditures would be no greater than that of 2013. Losses in the budget would be made up with financing in the local market with shares of state-owned companies and low-interest foreign loans.

“Current foreign debt stands at 45 to 47 percent of gross domestic product, the repayment of which will be made as planned”, said Ulaan.

He said that although loans repayments would likely go on as scheduled, the government would have to seek options for the repayment of the USD 250 million loan from Oyu Tolgoi and USD 350 million from Tavan Tolgoi. He said Mongolia would have to allocate MNT 450 billion from the state budget for loan repayment.

Additionally, the budget will see MNT

200 billion allocated to salary increases, allowances and pensions, without specifying how much growth would be seen in any of these areas.

Source: Undesnii Shuudan

TAX OFFICIALS SET TO REVAMP TAX CODE

The General Department of Taxation is preparing to submit a new set of tax laws to parliament in the fall session.

The tax department says it intends to make the tax code clearer and make compliance easier, in addition to the introduction of some new taxes. Tax officials noted that the any changes to the tax code would not be due to attempts to fill the budget deficit. The tax department aims to pass two laws and amend 15. The proposed City tax would tax anyone or any company based in Ulaanbaatar or a city in Mongolia between 0.1 percent and 0.3 percent, with exemptions for apartments. The second proposed tax on inheritance and endowment would exempt businesses with a net income of less than MNT 1.5 billion for 90 percent on income.

The Ministry of Finance also plans to reform income taxes with a more progressive system, so that higher earning individuals will pay more than lower income.

Source: BDBSec JSC, News.mn

POLITICS

PARLIAMENT RECEIVES BUDGET PROPOSAL FOR 2014

Finance Minister Chultem Ulaan submitted a 2014 budget proposal to the Parliament speaker for the Social Insurance Fund and Human Development Fund (HDF) on 1 October.

The proposed budget includes an expenditure plan, revenue sources, allocations to local budgets, allocations to local development funds, usage by general managers, deficit recovery sources. Major objectives of the budget are to form a security net for those vulnerable to deep poverty, reduced unemployment and poverty rates, pensions and allowances, improved social

welfare, income equality through the taxes, the abolishment of redundant allowances, and reduced wasteful spending.

The proposed budget for the Human Development Fund would provide cash allowances to young people under the age of 18. The proposed budget for the Social Insurance Fund would create a financial source for the cabinet to implement its initiatives and allocate funds to the fund.

Source: Montsame

IMF DELEGATION COMPLETES MISSION VISIT

The head of the International Monetary Fund (IMF) mission warned against expansionary policies in Mongolia while giving a generally positive economic forecast.

“Adverse shocks to FDI inflows and exports, together with expansionary macroeconomic policies, have put pressure on the balance of payments”, said Geert Almekinders, who led the mission, as delegates concluded their mission. He added, “Mongolia's medium-term prospects remain promising given its large natural resource endowment. However, expansionary macro policies are likely to put pressure on inflation and the balance of payments in the period ahead. Also, Mongolia is facing an uncertain external environment”.

He noted that advanced economies were seeing recovery and that a re-balance in China was expected that focused more on consumption rather than investment, both of which would likely have “spillover” benefits in the region.

“Spillover risks will particularly affect the more vulnerable emerging market economies. In light of this, Mongolia needs to change course to avoid becoming highly exposed to these external shocks and risks of crisis”.

The final staff report on the Article IV consultations will be submitted to the IMF executive board in coming weeks and will be considered by the Board in November.

Source: International Monetary Fund ■

mongolia2013

INVESTMENT SUMMIT

HONG KONG

19-20 November 2013, Four Seasons Hotel, Hong Kong

Key sectors covered in 2013 include:

- Mining • Financial Services • Infrastructure • Energy • Retail • Real Estate • Construction • Agriculture •

Mongolian Government representatives, business leaders and international investors sharing their insights at the Summit include:

 <p>Mr. Tsagaan Secretary GENERAL SECRETARIAT OF MONGOLIA</p>	 <p>Ambassador Light State Secretary AMBASSADOR OF MONGOLIA TO HONG KONG</p>	 <p>Mr. Tsogzolbaatar State Secretary DEPUTY MINISTER OF FOREIGN AFFAIRS OF MONGOLIA</p>
 <p>Mr. Makharia Managing Partner M&P INVESTMENT BANK</p>	 <p>Mr. Makharia Chief Executive Officer MONGOLIA STOCK EXCHANGE</p>	 <p>Mr. Makharia Managing Director TRUSTEES INTERNATIONAL GROUP LLC</p>
 <p>Mr. Makharia Chief Executive Officer MONGOLIA TELECOM GROUP</p>	 <p>Mr. Makharia President and Chief Executive Officer MUTUALBANK LLC</p>	 <p>Mr. Makharia Chief Executive Officer MONGOLIA</p>
 <p>Mr. Makharia Executive Director MONGOLIA</p>	 <p>Mr. Makharia Senior International Manager MONGOLIA</p>	 <p>Mr. Makharia Managing Director, Metals and Mining Division MONGOLIA</p>
 <p>Mr. Makharia Executive Director MONGOLIA</p>	 <p>Mr. Makharia Executive Director MONGOLIA</p>	 <p>Mr. Makharia Executive Director MONGOLIA</p>
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 <p>Mr. Makharia Executive Director MONGOLIA</p>	 <p>Mr. Makharia Executive Director MONGOLIA</p>	 <p>Mr. Makharia Executive Director MONGOLIA</p>

What's new in 2013?

- updated session on reviewing Mongolia's legal framework for foreign direct investment
- Focus on successfully managing risk and doing business in Mongolia
- Meet more projects and concrete investment opportunities
- Hear investors sharing their tips and insights
- Meet investors and Mongolia's government officials
- Business matching tool to help you set up meetings and build your deals
- extended networking opportunities, ensuring you connect with the right people
- meeting program, featuring keynotes and panel discussions

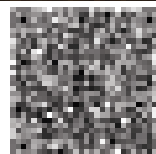
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