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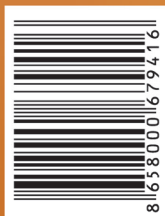
ANOTHER MEGA PROJECT

ARSHAD SAYED: A DEEPLY DISAPPOINTING DECISION
FOR PEABODY

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Closing the gap on Tavan Tolgoi

How a 30 metre error
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THE ECONOMISTS COLUMN


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Masa Igata
Mongolia’s Achilles Heel



Even though the data from the National Statistics Office shows that the trade deficit in the first quarter has improved quite significantly, we maintain our cautious stance on the outlook of the Mongolian Economy - **en/b/5684**

D. Jargalsaikhan
Frantic Taxers



Why must there be taxes? It’s because it was decided that citizens were all to contribute to financing the government, whose primary role is to organize security to protect the three basic rights of people: life, liberty, and property - **en/b/6962**

L. Byambaa
Mongolia's economic outlook for 2015



The global economy sputtered to 2014’s end with slightly less economic growth than predicted at the year’s outset. Though the US economy has revived and continues its trending rise, developing countries, Russia, China, and Europe. - **en/p/7240**

Oyu Tolgoi update

Unresolved issues linger between Rio Tinto and the Mongolian government over the fate of the Oyu Tolgoi megaproject; however, one matter has been cleared up. Rio Tinto conceded a payment of a two percent royalty, amounting to USD 1.6 billion to Mongolia over the course of 41 years of the mine's planned operation. According to an IMF assessment of a new agreement currently under negotiation between the government and Rio Tinto, Mongolia should receive 55 to 71 percent of profits before tax. For Phase Two underground expansion of the mine, the Oyu Tolgoi project still needs another USD 4.9 billion in investment, in addition to the USD 500 million already invested in the project.

Industrial policy

The government has begun a new three-phase industrial policy to be followed until 2030. Entitled 'The plan and general outline of Mongolian industry', the policy characterises the development of industrial zones in relation to the ecosystem, population, urbanisation, reserves of raw materials and infrastructure policy. The plan outlines the streamlined implementation of national production, a technology park, and a logistics network for transportation, to create a pleasant environment for trade and the diversification of exports. Mongolia has taken two previous stabs at a general industrial policy, both of which met minimal success.

Renewable energy

During the 6th Annual National Renewable Energy Forum in mid-January,

sector experts pointed out the possibility for Mongolia to produce 20 percent of its energy needs from renewable sources by 2020. A surge in renewable energy would reduce air pollution, fossil fuels' adverse effects on the environment, and current energy costs to both citizens and the government. As of today, renewable energy accounts for only 8 percent of Mongolia's total energy production. For future development, state policies must lower taxes on renewable energy technology and reduce the tax on profit for the sale of renewable energy tools.

Real estate

Last year on the directive of the mayor of the capital, the government awarded 13,523 citizens plots of land through the country. A second round of registration for land grants has begun for 2015. Citizens have until 9 February to register for a total of 13,819 plots in four separate districts: Baganuur, Songinkhairkhan, Bagakhangai, and Bayanzurkh. To register online, go to the website of the Capital Property Office: www.umch.ub.gov.mn.

Social security online

Mongolians can now check their social security statement online. Mongolians have a Social Security booklet in which all social security and health insurance payments to the state are recorded. The Social Security booklet is often used as proof of income to receive banking services or apply for a visa abroad. By adding an online resource, Mongolians now have a second option that provides social security information. For more information, go to

www.ndaatgol.mn. Today, the number of insured through work is upwards of 850,000, while nearly 160,000 are insured as opt-in additions; the majority of those insured are young.

World News

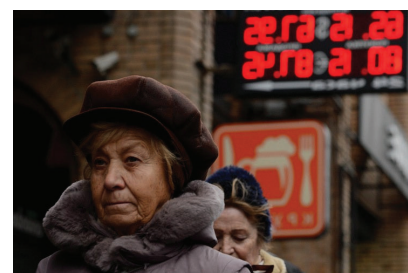
Greek elections



The radical leftwing party Syriza won elections in Greece in late January, as voters rejected economic austerity measures by the eurozone and the International Monetary Fund imposed as part of conditions to the USD 270 billion in bailouts that began in 2010 to avoid a Greek default crisis. The winning party has said it is unrealistic for Greece to pay back the huge debt in full, according to the BBC. Total debt stands near USD 370 billion, with billions already scheduled for payment in March to the IMF. Tough budget cuts throughout Greece have generated resentment amongst the people. The economy has shrunk dramatically since the 2008 global financial crisis, as unemployment rates increasing to 26 percent have thrown many Greeks into poverty. While Greece looks to renegotiate with the eurozone, the anti-austerity talks can go one of two ways—debt-relief and an increase in anti-austerity sentiment throughout Europe, or Greek default and a sure-to-be catastrophic exit from

the eurozone.

Russia's junk rating



Russia's fractured economy suffered another potential blow Monday after credit-rating firm Standard & Poor's cut the country's credit rating to junk, sending it below investment grade for the first time in more than a decade, according to the Wall Street Journal. In cutting Russia's rating to "BB+", S&P cited Russia's limited flexibility to use monetary policy to help spur growth. A dramatic 51 percent slide in the ruble in the past seven months has fueled inflation and forced the Russian central bank to drive up interest rates, a curb on economic growth. Russia's reliance on tax revenue tied to the oil industry has also left it exposed as oil prices tumble. Heavily dependent on oil exports, Russia faces mounting sanctions from US and European officials over the unrest in eastern Ukraine and its annexation of the Crimea region. The US and European leaders ramped up sanctions against Moscow in late January.

Singapore housingmarket woes

The Singapore housing boom is over, as 2014 saw home prices fall 4 percent, the first year-on-year decline since 2008, according to Bloomberg. Housing prices peaked in 2013, when demand from foreign buyers was high and interest rates

were low. To keep prices down, the government made it harder for Singaporeans to refinance loans, and added taxes on home purchases by foreigners. Far fewer foreigners are coming to work in Singapore, as hiring of expatriates has slowed, compared to its rapid increase over the past three



years. Vacancies are up, as housing supply continues to increase; many new, high-priced developments are having trouble finding buyers, while more new properties are to arrive on the market this year. Vacancy rates during the last quarter of 2014 were the highest since 2005. The low demand and rising supply means home prices will continue to fall for the foreseeable future.

Closer US-India ties

US President Barack Obama made a January visit to Indian Prime Minister Narendra Modi in New Delhi,

to strengthen relations that may prove to counter-balance China's weight in the region. The two leaders discussed strategic and economic issues, as both are wary of an expanding China's military ascent and regional activism, especially in the controversial South China Sea. India, although not a permanent ally of any country, is becoming a top player under Modi in cultivating relations with the region and the US. The two leaders look to strengthen Asia-Pacific democracies to undercut China's power into the foreseeable future. Obama pledged to support India's membership in the 48-nation Nuclear Suppliers Group—membership which China is against. China is more worried, however,



about the likelihood of US advanced military technology sales to India, according to the New York Times. The US is home to 3 million people of Indian origin, an influential diaspora in calling for closer ties. ■



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Cover Mongolia @CoverMongolia Jan 20
#Mongolia's Trade Review 2014: Trade Surplus \$537.9M, Export +35.3%, Import -17.6% | Jan 19

www.mongolbank.mn/documents/statistic/externalsector/tradebalancereview/2014/201412e.pdf

The Central Bank's year-end foreign trade review shows that the cumulative trade balance has improved 126 percent from the previous year, with export growth up and import growth down. Mineral exports represent 89 percent of total exports. Copper concentrate exports are up 171 percent, while coking coal and iron ore exports have decreased. Imports are down due to a sizable decrease in capital goods imports such as machinery and equipment, and in consumer goods such as passenger cars. Fuel imports show a decrease, while construction imports remain at the same level as 2013. The trade surplus should help stabilise the MNT.

Thomas Eriksson @ThomasE_UNDP Jan 19
@RobertAlanWard#Mongolia scores 6.62 rank 61 w political culture and participation low. Categorized as "flawed democracy" by #eiudemocracy

The Economist's Economics Intelligence Unit has surveyed Mongolia and found its democracy wanting. As per the report: "The Democracy Index is based on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture." Asia was the best performing region, although generally registered only very modest improvement. The index rated Mongolia's electoral process and pluralism score and civil liberties score relatively high, while the functioning of government, political participation and political culture scored low. Mongolia remains one of 10 'flawed democracies' in the region, and is 61 out of a total 165 countries worldwide.

Halifax @HFForum Jan 19
In search of capital, nearly one fifth of #Mongolia has been opened up for mining |

<http://www.reuters.com/article/2015/01/16/mongolia-mining-idUSL3N0UV2AH20150116>

As of January 26th, Mongolia is once again taking applications for exploration licenses. The government has made available for mining exploration a previously off-limits 10.1 million hectares—making a total of 30.8 million hectares now open to mining, or nearly one fifth of the entire country.



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Mongolia and Japan: equal partners?

By B. Enkhsetseg

Mongolians today drive hundreds of thousands of Japanese cars over bridges and roads built by Japanese expertise. Meanwhile, thousands of children attend elementary schools built with Japanese grants and to Japanese standards. These are only a few examples, visible to Mongolians every day, of a number of Japanese assistance projects undertaken both through donations and soft loans. It seems whenever Mongolia has a problem with energy, transportation or education, Japan is there to fix a power plant, donate hundreds of buses, or build dozens of schools. Today, Japan

wants to work with Mongolia on a more mature economic level, as equal partners.

New trade agreement

Evidence of new footing in the relationship is an economic partnership agreement between the two countries currently on the table. After three years of negotiations, the agreement is to be finalised by both parties before the Lunar New Year holiday in mid-February.

Comparing the two, Mongolia's economy is less than one percent of Japan's USD 4.2 trillion GDP. Building a free trade agreement with a small

market like Mongolia won't create much benefit for Japan's 130 million people. The economic partnership agreement would be Japan's fifteenth, whereas it is Mongolia's very first.

Looking at other countries that have free trade agreements with Japan, most are economically powerful and advantageous enough to act as a major partner with Japan. Brunei has the most ostensible similarities to Mongolia, with a tiny population and economy nominally larger than Mongolia's.

Economic Advisor to the Prime Minister O. Chuluunbatsaid: "As Mongolia

does not have a capable market that can compete with Japan's, no Japanese manufacturer will be afraid of us. On the flip side, Mongolians don't have any reason to be afraid and defend themselves. Thus, there should be no economic animosity between us."

An agreement would mean much more to Mongolia than it would for Japan. The agreement covers broad areas such as free trade, direct investment, and intellectual property. Currently, Mongolia imposes a five percent customs tax on all imported products. Japan similarly applies a 38.5 percent tax on meat purchases from Mongolia.

Japanese Embassy officials in Mongolia say that it is hard to express what effect free trade will have on both economies until the agreement is put into practice. They added: "Japanese exports with no customs tax currently make up less than one percent of total Japanese imports into Mongolia. Following the confirmation of the agreement, the percentage of customs-free imports could be increased up to 50 percent, and to 96 percent within the next 10 years."

As of 2013, bilateral trade was only USD 454 million, mostly imports into Mongolia, with USD 10 million exported from Mongolia to Japan. The majority of imports from Japan are used cars.

"The agreement will be mutually beneficial. The amount of trade between Japan and Mongolia is very small. The aggregate figures of imports and exports are still far less than other countries, with total Japanese imports ranking about fifth for Mongolia, after China, Russia, Korea and the US."

The agreement will cut 100 percent of customs taxes on most products over the next 10 years. During that time, the agreement calls for a gradual reduction and elimination of taxes from most mining and industrial products, as the agreement unfolds into action. Eased

taxes will likewise be granted on agriculture products such as pet food, milk products, processed beef and meat products, as the Mongolian side has requested.

O.Chuluunbat mentioned that other countries that attained a trade agreement with Japan doubled bilateral investment and increased trade five to ten times in subsequent years. Masa Igata pointed out that Mongolia will benefit from increased cashmere exports, while Japan will export more automobiles.

Meeting high Japanese standards

Although it's a win for Mongolian producers to gain full access to Japan's giant market with no added customs tax, the Mongolian production sector is still currently incapable of meeting Japanese standards, some of the highest in the world to achieve. Satisfying Japanese standards, however, will benefit every industry and sector that later seeks further export opportunities in other countries.

The agreement stipulates that a Japanese team will come to Mongolia

to provide technical assistance, along with on-site study to examine which economic sectors and products are competitive enough to invest in, and to seek possibilities to link those with the broader Japanese industrial supply chain. Both parties think that investment flow will lead to high standard production in Mongolia.

"There are four business arenas which are attractive to Japanese companies in Mongolia. The foremost area is agriculture. The second most attractive is construction, followed by the auto trading business, and finally the interest of Japanese companies in improving air pollution," said Naoki Hisada, chief representative in Ulaanbaatar for the Bank of Tokyo-Mitsubishi UFJ. He added that some infrastructure development initiatives cannot be sourced locally, hence the reliance on Japanese technical capacity and investment.

Once the agreement is signed, successful trade will depend upon a much steadier investment environment than the one currently found in Mongolia.

The Embassy of Japan in Mongolia said: "Japanese investors hope to see a stable investment environment as well as improved capital protection for investors."

"If Mongolians could learn to work much harder than now, there is the chance to export some products to Japan within the next five years," O.Chuluunbat explained. Furthermore, if Japan accepts Mongolian products, other developed countries will too.

An economic partnership agreement does not mean that there will be a limitless investment river flowing from Japan, and that Mongolians will be exporting whatever products in whatever manner they like. In order for Mongolia to get what it wants, there are yet number of hills to climb. Success will take change and growth, but this opportunity with Japan means that the time has arrived for Mongolia to grow up. ■





Mega Projects

Tavan Tolgoi: Mongolia's USD 94 billion economic contributor

By B. Bayaraa

The chosen investor for the Tavan Tolgoi coal mine, China Shenhua Energy Company, obtained an agreement last year to buy coal from the mine. During a visit to China in October 2013, former Prime Minister N. Altankhuyag agreed to deliver 1 billion tonnes of the mine's 6.4 billion tonnes coal reserves to Shenhua over a period of 20 years. According to the agreement, Shenhua Energy has been supplied since mid-2014 with coal by Erdenes Tavan Tolgoi, Mongolia's state-owned company officially licensed to own the coal deposit in perpetuity.

Mongolia sells a tonne of good quality coking coal to Shenhua Energy at USD 48.5. They use income to repay Mongolia's USD 143 million remaining debt to China's Chalco. Energy Resources, Tavan Tolgoi and Erdenes Tavan Tolgoi have been official suppliers to Shenhua Energy. Although, coal prices have hit rock bottom, Shenhua is ready to invest in Mongolia. Shenhua Energy has partnered with Japan's Sumitomo Corporation and Mongolia's Energy Resources to implement the Tavan

Tolgoi megaproject. Mongolia's coal is collateral for the partnership. Shenhua is state-owned by China.

Negotiations on Tavan Tolgoi investment are currently ongoing. If settled, coal from Tavan Tolgoi should be competitive enough to compete with coal megaprojects in Russia and Mozambique. But both sides in the negotiation agree time is urgent. The Tavan Tolgoi mine is an open pit mine that holds many direct and indirect benefits for Mongolia's present and future. However, weak infrastructure and the need for huge financial support have been the project's main obstacles to progress.

If Tavan Tolgoi negotiations proceed as planned, Mongolia's domestic coal market would experience a revival, profits from the mine would increase and railroad construction to link the deposit to China would go forward. An agreement would allow broader development opportunities in infrastructure, logistics and market opportunities over the next 20 years, says new Prime Minister Ch. Saikhanbileg.

Part of the reality facing investment for Tavan Tolgoi is that megaprojects cannot be financed by a single company or country, because they require a huge amount of investment and impose big risks. The Tavan Tolgoi project would see 30 percent of total investment financed by the Consortium, with the remaining 70 percent allocated by funds and loans from international banking and financial organisations. These banking and financial organisations must attain special licenses from the Mongolian government to finance such projects. Attaining such a license could present a major roadblock to Tavan Tolgoi in the future, as the permitting authority rests with Mongolia's off-erratic parliament. Without parliament's support, the current Tavan Tolgoi agreement could come to a dead end.

This would prove disastrous, as a fully functional Tavan Tolgoi could inject at least USD 94 billion into Mongolia's economy over the next 30 years, through direct investment and indirect expenditures on goods and services surrounding the project. ■

Burning question

Another MEGA project

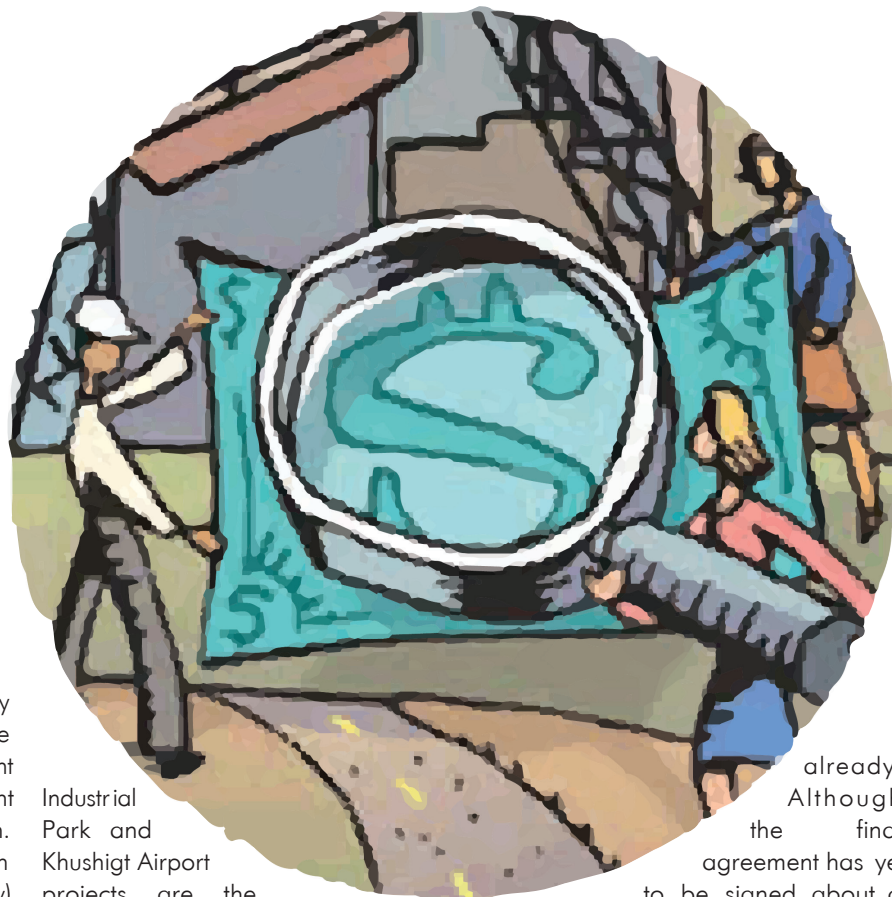
By B.Bayaraa

Tavan Tolgoi-Gashuun Sukhait railway construction is about to face the embarrassing reality that its current height and the height of its connecting point at the Chinese border do not match. The ongoing rail construction projects in China (conducted by Shenhua Energy), and in Mongolia are supposed to meet at the same elevation—not the current difference of nearly 30 metres. To make up the difference, Mongolia must now adjust its rail height to match that of China's.

The rail project received USD 280 million as financial support from the USD 1.5 billion Chinggis bond. In order to remove the height gap, the project must construct an inclined plane over a distance of 5.6 km to serve as a railway ramp.

Building such an incline is a megaproject in itself. Mongolia, to minimise the possible risks, could choose to blame China for this error, obliging Shenhua Energy to lower the height of its railway. In such a case, the last bit of Chinese rail would only need a decline extending a 3 km distance. If Shenhua does not agree to lower their height, however, Mongolia would need up to USD 300 million for incline construction. However the matter proceeds, construction to join the two countries' rail lines will remain a megaproject in itself.

Oyu Tolgoi, Tavan Tolgoi, the Railway project, Power Plant No.5, Sainshand



Industrial Park and Khushigt Airport projects are the six megaprojects currently underway in Mongolia. Unfortunately, due to faulty technical and economic analysis, Mongolia is on the verge of a seventh, and huge financial loss if it must reengineer its railway link to China. Although the government approved the narrow rail gauge in 2014 after nearly a decade of debate, the incline affair is an unforgivable technical error that could have been avoided.

The Tavan Tolgoi-Ganshuun Sukhait railway will be financed and built by Energy Resources, Sumitomo Corp. and Shenhua Energy, as per the agreement with the government currently under negotiation. The Consortium must hand over the railway to the government of Mongolia 30 years after the official commissioning, as stated in the tender requirements. It will be the responsibility of the Consortium to construct the 267 km railway from Tavan Tolgoi to Gashuun Sukhait. Since construction work has already been financed by the Chinggis bond, the Consortium would pay back the government's already invested USD 280 million. In turn, the Mongolian government must hand over what has been done

already. Although the final agreement has yet to be signed, about a quarter of total upfront investment is to finance railway construction. An estimated USD 1.1 billion is expected for completion of rail construction. Without rail, the billions of dollars of Tavan Tolgoi coal cannot reach the global market.

The railway will cost most of the Consortium's investment in Tavan Tolgoi. Although the mine is a hot topic today, railway construction is an even bigger goal to achieve. The height difference that has occurred is a burden on Mongolia's shoulders. The Tavan Tolgoi-Gashuun Sukhait railway is supposed to connect Mongolia with China's railway network, thus enabling Mongolia's coal to enter China's industrial zones. It could even extend the reach Mongolia's coal to seaports and the world beyond, to be more competitive in third markets. Erdenes Tavan Tolgoi exported 5.7 millions tonnes of coal last year, an amount expected to double in 2015. A railway to transport 11 million tonnes would decrease expenses and enhance export competitiveness. Only then can Mongolian coal serve a full meal, and not just an appetiser. ■

Arshad Sayed: A deeply disappointing decision for Peabody

By D.Bekhbayar



Mongolian Economy magazine interviewed President of Peabody Energy, India & Mongolia, Mr. Arshad Sayed. This is his first interview with the press since Peabody Energy lost the Mongolian government's tender for the Tavan Tolgoi coal deposit to a group consisting of Energy Resources LLC, Shenhua Energy, and Sumitomo Corp.

-In December 2014, Peabody Energy lost its bid for the Tavan Tolgoi coal deposit. There had been an expectation in the community that Peabody's bid would be selected in the tender, as Peabody has many years of experience operating in Mongolia. As a representative of Peabody in Mongolia, what is your opinion of the selection process?

-I think the decision was deeply disappointing for Peabody, because Peabody has been in Mongolia for seven years pursuing to cooperate in Tavan Tolgoi project. I think it is also going to be disappointing for any western investors who are considering to invest in Mongolia in the field of new technology, new processes, new knowledge, and to

bring in world class standards in safety and environment.

-According to Tavan Tolgoi's government working group, Peabody's proposal was submitted alone, without any international or domestic partners. This was seen as a downside in the selection process, as a consortium of three companies ultimately won the tender. Why did Peabody make this decision to not have any joint partnerships in this tender?

-I think it's not appropriate to respond in the press about what was a confidential tender proposal. I'm surprised that the government is choosing to say this publically and do these things. I don't think it's good to do that for Peabody, but I can share something that's open and known for everybody. Since 2010, Peabody has done its best to participate, to come prepared and respond to the government of Mongolia's every desire, rule, and changes that they've had. You've had three different governments since 2010, and in each one of them Peabody has responded the best that we could. Clearly Peabody had met the requirements of the government

in 2010, that's why it was selected to participate as one of the six [bidders, in an earlier, later scrapped tender for Tavan Tolgoi. Ed.]; from the six it was narrowed down to three; and then Peabody was asked to participate with the Russian and Chinese companies. But the result was withdrawn by the National Security Council. And that was in 2011. Then in late 2013, we were asked to have discussions with ETT [Erdenes Tavan Tolgoi] and with Shenhua for cooperating in TT project; and we did that in the first half of 2014, where we spent six months having negotiations with the parties. Even though the process was running effectively where the parties were about to sign a partnership framework principles memorandum, suddenly it is halted by the government. Then again we had a change in the latter part of the year, with the government changing. Again the new terms and conditions were given with the Government resolution #268 of August 20th 2014, where the national company would hold 51 percent of the project company, and we were given one month to prepare for that, which was then extended for one

month. And only one national company met that criteria for forming a consortium. Like I said in the beginning, it's not good to negotiate in public, I thought the government will invite us and we'll talk about it with the other partners, and then there would be a way to form a consortium at the right time. So I don't think it's good to have that discussion in the public, in the media, about the tender process. What I would like to suggest is that Peabody's proposal was mainly about how to create a maximum value for the Mongolian people, and for the Mongolian side. And how that can be done best, whether it's through a private company or public company through the government of Mongolia; Peabody has always been open to these ideas. But, given the time, given how this process was laid out, there was no room to try and put together anything as quickly in the one or two months' time as was given.

-In this tender, was Peabody unable to reach a working agreement with another private company, despite that being a request of the government of Mongolia?

-In 2011, we were asked to work with Shenhua and Russian Railways. We spent time on that. In 2014 we were asked to spend time with Shenhua and Erdenes TT. We spent time on that. Then we were asked to work with Shenhua and Energy Resources in this round of bidding. And in each of these we have always put forward a proposal where we think we will maximize the value of TT. We do not change our proposals for shortcuts, to try and do things differently. We have always tried to make sure that whatever proposal we are putting forward, it is all about maximizing value. In this round, the way the construct is and the framework is, it is still not clear that this will give the maximum value. We wanted to make sure that the proposal that we had and were discussing with ER and with Shenhua—we did not think we had reached a point where we all agreed on what is the common value, and how do we increase the value for the Mongolian side. That's why we did not reach an agreement and there was no time to reach an agreement.

-Experts say that Peabody made a good proposal that had several advantages. These included raising

Tavan Tolgoi's value up from USD 5 billion to 8 billion, a USD 500 million prepayment and off-take agreement, and the incorporation of environmentally friendly and highly technological mining practices into the project. What are the main differences between your proposal and the Consortium's proposal?

-First, I want to be clear—because we signed a confidentiality agreement with the government, we should not be talking about our proposal or their proposal. It is not a good practice to do that. But what I will say is that our proposal has not been different from our proposal back in 2011. It only reflects some changes because of changing market conditions. But the main thrust of our proposal, is really about having a long-term view on how to create value in TT, over the long-term, and make this project a success and make it sustainable. That's the goal of our proposal. And that's what we have been trying to push forward. And I'm assuming the other proposals have the same conditions—and if they have them, then they're good. But if they don't, then I would question that. I think at the end of the day, we don't want to talk about whether this proposal is good or that is bad, because I don't know their full proposal. What is really important is I think the people of Mongolia need to understand these proposals for themselves, to see what is best in their long-term interest, for the people here in Mongolia. I think that's the main test of the proposals; to see whether this will create value, will it be sustainable, whether it will use the best international practices, will it help diversify your ability to enter different markets, will it create jobs, will it create training opportunities for children and youth in Mongolia, will it give businesses—the small and medium enterprises—a chance to participate, will there be transparency, will there be openness in procurement, will it create a better environment for corporate governance, and will it, at the end of the day, help make sure that Mongolia develops a very strong coal industry.

-As there was an expectation in the public that Peabody would be awarded development rights in the final tender, the surprise that followed when Peabody lost has led many to wonder what it was that

the government found was lacking in Peabody's proposal. We are aware of the confidentiality agreement you signed with the government, but could you shed any light whatsoever on the matter?

-First, I just want to be clear that Peabody's proposal, when it's assessed independently, will show that we have answered every question that the government asked, and we've answered these in a way that I think meets or exceeds what the government required. The second is, Peabody's proposal is meant to do two things: to ensure the commercial success of the enterprise, and the development of Mongolia. This means the proposal had to be medium- and long-term orientated. So we think not just two years or three years ahead, but five years, ten years, twenty years, thirty years—that's how long we have to think about this project. And so have not tried to do things that are only good in the short-term, or only meant to help one thing or solve only one problem; but rather which look over all these aspects of commercial success and development. To do this we have chosen to adopt the best practices to what we do globally—in financing, in developing, in assessing, in evaluating feasibility and then in ensuring the implementation; all is done to world class standards. As far as the specifics are concerned, absolutely I would be happy to discuss that, negotiate with the government or whoever else, explain to any party there what the details are specifically.

-Insiders say that at the start of 2014 there were negotiations amongst three companies to sign an agreement; however the process stalled, due to the rumor that while Energy Resources was willing to sell its power plant to Peabody, Peabody was unwilling to buy it. Was that the main reason these negotiations stopped?

-I don't think that's true. That's all I will say.

-Since Peabody has worked on long-term sustainable development ideas for the Tavan Tolgoi project, how would you advise this project to proceed?

-We have to start by first understanding that Mongolia has a very different geology; it has a very fragile environment, so you have to be mindful of the environment,



and you also have to understand the fact that this is a resource that is precious to the people of Mongolia, so how do you optimize it, how do you maximize the value. Those are the principles first that I would start with. And then I would say, do you use those principles and ensure that you come up with a world-class coal industry, so Mongolia becomes a hub that creates value for Mongolia coal, which is processed on the Mongolian side and then different forms of that are exported, whether it's energy, whether it's coal to liquid, whether it's chemicals? I think that has to be the vision and the starting point. The pieces that will help realize that vision are first, you must have an integrated infrastructure, an integrated deposit, which is what the government is trying to do, so that's good. By having all the deposits as one, which have a common infrastructure—especially for the use of water, which is very precious in the South Gobi, we are to be very careful about that, how we use it, what is the way in which we can save water, how we make sure to minimize environmental issues there, like dust, and making sure things like that don't happen. Having an integrated infrastructure plan, and developing in an integrated way, I would say, is one of the first things to realize that vision. Coming to the project itself, I think there are key elements one has to think through on the Mongolian side. The first is: how do you make sure that you know the full value of this deposit, and you can capture that value in the best possible way? Which means, you have to have some form of feasibility; you have to have some form of studies done so you understand the real value of this deposit. And then, how do you make sure that value is captured over time in the best possible way? Then on the production side, I think you have to make sure that you are optimizing the production based on quality and based on market, so that you are capturing high amounts when the market price is high, and you

may have to lower production when the market is low, so that you capture most of the value and you're not simply pushing tonnes out. And which quality to blend from where, which products, how do you brand it as a TT product—these are also very important. Then you have to think about financing. What is the right mix of equity, debt, and other instruments over time, so that you are making sure of a couple of things? One: that you're attracting more investors, foreign investors, because that's what you want. More sources of financing. And two: you're making sure that financing is there for the long-term. Right now what we have is companies are struggling because they did not think in the downturn what will happen; and so they got a lot of debt and they don't know what to do. So, it has to be financed in a way that is thinking long-term, not just taking from one source or the other source, or one kind to the other kind. You also have to think about what other industries can come out from this. How to support the small industries, the medium enterprises, what'll be the linkages, and making sure that procurement is transparent, so that people in Mongolia and small businesses can compete and get this kind of contract, so that it's not just for a few people. I think it's very important that you think about that, as well as you think about what are the other industries, coal to liquid, coal to gas, etc. As the project becomes successful, in what areas can you diversify that will build on this, coal to chemicals, things like that? I think those have to be thought through over time; but start with the first piece, which supports small and medium enterprises and procurement and transparency. The last piece, of course, is you must never forget the people. Meaning, how do you create jobs for the next generation? How do you provide skills and training so that they become managers and people who are at a high level and position? We have to think about what kind of labor force do you want, what kind of technology do you want to use, how do you want to have them trained, where do you want to have them trained? Those are the very important decisions that I think have to be thought through. As far as our proposal is concerned, I don't

think we have the answers to everything. But I think working with the Mongolian people we can come up with good solutions to all of these things. Some of them we have done in other countries; we have worked in Australia, in the US, in different areas. We think we can bring those practices. And that's part of our proposal.

-In 2011 and 2012, the coal market was very good. But now the coal market is in a downturn, and coal prices are low and going lower. In light of these circumstances, do you think now is the right time for Mongolia to develop the Tavan Tolgoi coal mine?

-Very good question. I think this is the right time to start doing the basic groundwork for increasing the value of this deposit. This is the right time to start. How do you do that? One: you start building the supporting infrastructure for this deposit and for this project. You start doing the feasibility and other studies that are needed to ascertain the value of this project. So you understand the coal qualities, the extent of the coal, the seams, so that you know what products will be made, the blending; and continue to do what you are doing right now, which is to do the work that is ongoing. Get the financing in place for developing this deposit in the medium- and long-term. And then as the markets come back, you can choose the time when you think you are right to capture that value, monetize it, and then give it back to the Mongolian people.

-Do you think the consortium will develop Tavan Tolgoi in the manner in which you explained?

-I would worry about it. I hope that they will take what we are saying and what we have said and implement that. It's hard to say without knowing exactly their plans, what they plan to do. But I can say with some certainty that the level of experience, the depth of experience, is not there in that consortium, because you have a local and a regional company that has operated either in Mongolia or in China, mainly; you don't have a company which has operated across the world. So I think it's a different set of choices and a different set of operations that you will see. They are good companies in their own areas, I'm not denying that. All

I'm saying is that if you want a global footprint and a global operator, that's different.

-As Shenhua is a Chinese state-owned enterprise, there's a view that Chinese government policies will be incorporated into the project development process. If Peabody rather had been awarded development, might that have led to clearer business accountability and profitability for the project? How do you see the situation going forward?

-First let me say that I think Shenhua is a very good company; it's a very strong company, it's a well-known company; we should not try and minimize that. Having said that though, Peabody has 130 years of experience in coal mining in the United States, in Australia, which makes it very different. And the good thing about being a private company is that we don't have any other objective except to maximize profit for the company. In that way, Peabody is different. We bring different kinds of capabilities. Shenhua's strength is in the Chinese market, in marketing, logistics and rail. They are very strong. Also Energy Resources is indeed a largest national coal company. Peabody has 130 years of operational experience; very strong global experience in safety, in the environment, in land reclamation which you have seen in Bulganaimag. So I think we bring a very different set of skills and capabilities which is not the same.

-How do you think a Mongolian company and a Chinese state-owned enterprise will work together throughout this project?

-We would've liked to have been a part of it, so that what we would bring is very strong operational experience—not just contractors, but our own personal experience developing deposits all over the world. By bringing our marketing experience, analytics, all of that, we would be able to share that and make sure we get the best price for TT coal. The same thing for safety and environmental practices, we would have brought the global best practices. So now without us, I don't know how that will work. I honestly don't know where they will get it from; maybe they can hire people. We would have been a good complement and a good balance to the other strengths that

are there in the consortium.

-What will Peabody do now in Mongolia?

-I think we are definitely reviewing our Mongolian strategy. We are also considering how we will look at Mongolia, in terms of opportunities. Based on this we will shortly decide on whether we will continue in Mongolia or do something else. Because after seven years being here in Mongolia, I think finally Peabody is feeling like we are a foreigner now. We have always thought we were a part of Mongolia, we became Mongolian, but last month we were reminded that we are a foreign company, and that we should always look at ourselves as a foreigner. To me, that's the biggest disappointment.

-If Peabody is to pursue any other megaprojects in Mongolia, does it have any confidence in the government of Mongolia to do so? And as for other megaprojects in Mongolia, not just in the coal sector, how do foreign companies view those projects now? How would you advise them?

-I think if a company like Peabody, which has been here seven years in Mongolia, is told one day "Thank you very much, you can leave now. You have no role", I think it's a very harsh decision, it's a very difficult situation. Other investors, particularly western investors, are going to be very cautious, based on Peabody's experience. But we, personally, will always wish well for the government here, and for the people of Mongolia. We will continue to support whatever we can. But I don't think we will necessarily participate anytime soon on any other project.

-As the former leading World Bank official in Mongolia for four years, how do you view Mongolia's current actions to help today's poor economic situation?

-I was very pleased to hear the Prime Minister's speech in parliament that he gave recently. I think he has correctly diagnosed the situation. And I think part of solving the problem is to first recognize the problem and then accept the problem, and I think he has done that. I recognize that because this is a coalition government, it is not often easy to get consensus. But I think it is important to sometimes push forward policies that may not be liked by everybody but that have

to be undertaken; and that is the next step. Because what you have right now is a very sharp slowdown of economic activity in Mongolia and the region, which requires very strong policy actions; and if you don't do those, the situation can become much worse.

-Nowadays the government is trying to implement fiscal contraction policies, in a situation where the debt level is very high. How do you view these actions?

-I think I said this before when I was at the World Bank: the number one challenge for Mongolia is cyclical—ups and downs—and how you come up with a policy that helps deal with this cyclical. And the answer is always very simple, as it has been before. For any family, you should save when you have more, and spend when you have less. But we often do the opposite, in the family as well as in the government. So when you get more money you want to spend more, and when things come down you want to save more. So I think this has to stop. We have to recognize and learn from that lesson; and say for our fiscal rules, monetary policy and fiscal policy, we must make sure that going forward that we have fiscal space—so you spend when there is a problem, a downturn, and then you save and you put money into your stabilization fund when there is more money in the economy. That's at the policy level. At the structural level, one of the key pillars of Mongolia's growth has always been foreign direct investment. And that investment has come down drastically. So you must find ways to make sure that you will continue to attract foreign direct investment, technology, knowledge, that will help grow Mongolia's economy and increase productivity and keep Mongolia then growing for a long time.

-The Tavan Tolgoi project moves on while Oyu Tolgoi project expansion remains stalled. What do you see happening in the near future for Oyu Tolgoi?

-There is very little I know about the Oyu Tolgoi project. I think that it is a very important project for the economy, and I sincerely hope that we are able to find a solution to move this forward, because it is such an important project for the country. ■

Stocks

How Tavan Tolgoi benefits shareholding citizens

By G. Munkh-Erdene *Investment Analyst, Gauli Investment Securities*

What is TavanTolgoi?

Tavan Tolgoi is a coal deposit and mine under development, located near Mongolia’s southern border with China. It is 98 km from Dalanzadgad, the capital of Umnugovi province, 15 km from Tsogttsetsii soum centre, 540km from Ulaanbaatar, and 270 km from the Chinese border. In 1934, local herders discovered the site and began using Tavan Tolgoi coal. On 18 April 1966, under decision number 124 of the Committee of Ministers of the People’s Republic of Mongolia, the deposit became a state mine and extraction officially began.

How much coal is in TavanTolgoi?

According to a partial technological and economical evaluation of the deposit conducted by the USSR State Mine

Design Institute Giproshakhtin in 1989 and 1990, the site contains 6.4 billion tonnes of coal reserves.

What is Erdenes Tavan Tolgoi?

Erdenes Mongol, formerly Erdenes MGL, is a state-owned company that owns all of Tavan Tolgoi. Erdenes Tavan Tolgoi is a joint-stock company (JSC) subsidiary that manages part of the site and is listed on the stock exchange. Following the decision of the Government of Mongolia and the State Property Committee, Erdenes Mongol was founded on 22 February 2007; in 2010 it was reorganized under the law of the Human Development Foundation.

Do Mongolian citizens have shares of Erdenes Tavan Tolgoi?

The government has allocated shares

of Erdenes Tavan Tolgoi to every Mongolian citizen.

Given decision number 98 of 31 March 2011, all citizens of Mongolia born on that date or earlier have the right to own 536 shares.

Given decision number 116 of 11 April 2012, all citizens born on that date or earlier have the right to own an additional 536 shares. Citizens who removed their Mongolian nationality or who have died between 1 April 2011 and 11 April 2012 may not possess the additional 536 shares, and may only take possession of the first 536 shares.

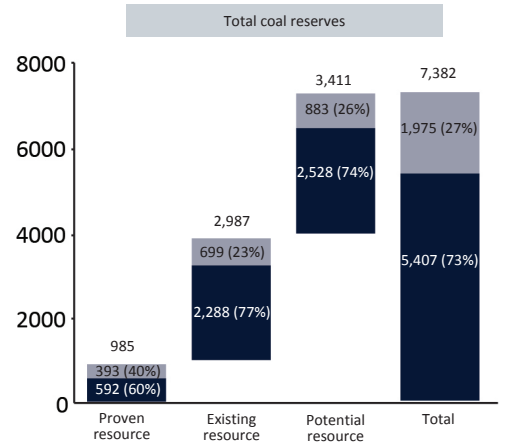
For citizens entitled to all 1,072 shares, the value of the total is equal to MNT 1 million, with unit share priced at MNT 933.

What has been the process so far of bringing the Tavan Tolgoi mine into the economic system?

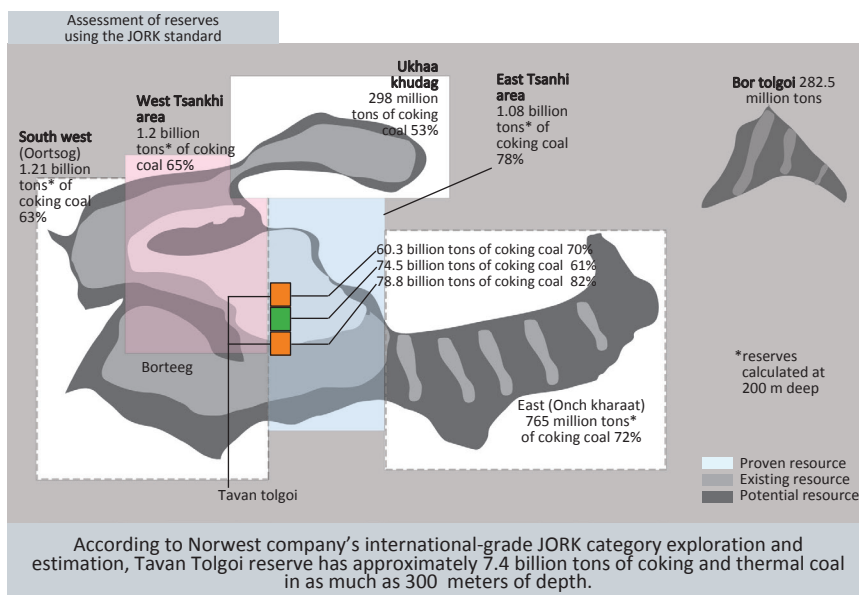
Following decision number 39 of Parliament, the President of Mongolia called for the selection of an investor to begin extraction, to bring Tavan Tolgoi into the economic system.

In 2010, the government gave the State Property Committee and Erdenes Mongol the order to organize a tender.

In total, 15 participants submitted applications; six were shortlisted and negotiations began. Negotiations dragged on for several years until they were rejected by the National Security Council of Mongolia. The idled negotiations resumed active government discussion during August 2014 cabinet meetings.



Source: Norwest



Source: Audit report of Erdenes Tavantolgoi

The duties of potential investors, as per government decision No. 268, August 2014:

Operation with special permission of the mine Tavan Tolgoi under the direction of state-owned Erdenes Tavan Tolgoi; no ownership transfer to the investor; establishment of a contract called 'Investment and cooperation';

The investor must exploit the West and East trenches on the land included in the special permit, and conduct research to increase the reserve;

In the first 2.5 years, the investor must create a coal breaker system with a minimum capacity of 30 million tonnes; and must supply coal to at least two foreign markets;

The investor must pay Erdenes Tavan Tolgoi's debt held by Chinese corporation Chalco, and complete any obligation of that business;

The investor must be in charge of taxes, levies and payments for the exploitation of natural resources, and be aware of payments; if necessary, the investor must pay a supplement and make an advance on part of forthcoming sales revenue as per the investment and collaboration agreement;

The investor must fund railway construction and management for the Tavan Tolgoi-Gashuun Sukhait line, with the main condition to transfer 51 percent gratis to the ownership of the state after 30 years of operation. After establishing railway management for Tavan Tolgoi-Gashuun Sukhait, the investor must construct the railway for Tavan Tolgoi-Sainshand, dependent upon the situation of the coking coal market.

New investors and ongoing negotiations

The Mongolian government selected a consortium of three companies to operate the Tavan Tolgoi deposit; Energy Resources, Shenhua Energy, and Sumitomo Corp. are in

Output of one share in one year		
Variables	Explanation	Total value
Coal sales value per tonne	Supply value on the Chinese sea market	USD 100.00
Amount of coal for sale	Accordinging government's 268 th decision	30,000,000 tonnes
Total Sales Revenue	Coal sales for Erdenes Tavan Tolgoi	USD 3,000,000,000
Royalties from sales-income	Minimum 5 percent	USD 150,000,000
	Maximum 10 percent	USD 300,000,000
In the account of Erdenes Tavan Tolgoi (from 5 and 10 percent)	If 40 percent of the royalties is transferred to Erdenes Tavan Tolgoi's account	USD 60,000,000
		USD 120,000,000
Number of shares attained by citizens-maximum	(Please read bellow)	3,000,000,000
Unit profitability of shares (USD)	If royalties are by 5 percent	USD 0.02
	If royalties are by 10 percent	USD 0.04
Exchange rate	USD 1 equivalent	MNT 1940
Unit profitability of shares (MNT)	If royalties are by 5 percent	MNT 38.80
	If royalties are by 10 percent	MNT 77.60

Short-term	4 billion USD investment, Jobs created and supplier businesses stimulated
Medium and Long-term	Export revenue 30 million tons of coal x 80 USD= 2.4 billion USD
	Cost savings Current cost of coals can be cut substantially. This will improve profit.
	Stock value Erdenes Tavan Tolgoi is discussing scenario of transferring 40% of coal sale tax and distributing dividends to citizens

Source: Research estimate

final negotiations. The government workgroup dealing with the three companies is divided into two groups: Railway and Mine Operations. Minister of Mongolia M.Enkhsaikhan plans to close the negotiations before the nationwide Lunar New Year holiday break begins on 19 February 2015.

Positive impact of the project

It is quite possible that the US dollar will depreciate following the contract's signing and the investment of USD 4 billion that will follow. As the Tavan Tolgoi deposit goes online, a steady income in the medium- and long-term will have a positive effect on the flow of liquidity. The cost of coal production will decrease considerably, allowing the operation to tap more profit. In addition, any increase in coal prices on the market would increase profitability.

Value of shares for Mongolian citizens

Today's contract under negotiation between the government and the Consortium contains stipulations on the value of shares issued to Mongolian citizens. Current negotiations involve the dividends to be distributed to citizens; a 40 percent tax on the exploitation of coal reserves and royalties, through payment to Erdenes Tavan Tolgoi, is being discussed. If the contract is established according to this condition, then the value of each share would be as follows:

Proviso:

Initially, 3 billion shares were distributed to citizens; however, many chose to instead receive the cash value of their shares. Note that the individual unit value of 3 billion shares will increase if the government provides for the payment of liquidity to those who requested it in place of shares.

Warning:

This assessment is forecasted on the originally proposed contract according to the above conditions. The final agreed upon contract may reflect small or large differences. There may be a difference in valuation between the actual and expected output of shares. ■

Current affairs



M.Enkhsaikhan: Peabody did not meet investment requirements

By B.Erdene

Minister of Mongolia M.Enkhsaikhan heads the government working group behind negotiations for the Tavan Tolgoi mine investor tender. Here are a few of his replies concerning the project from his most recent press conference.

The Tavan Tolgoi tender requirements were strict. The government working group set new conditions for the companies that had been expressing their investment interest since 2010. The renewed tender announcement was delivered to companies such as China's Shenhua Energy, Japanese Sumitomo Corp., Russia's RJD, and Peabody from the US. Applications were submitted by December 1st, 2014. In short, two parties sent proposals. One was the Consortium group of Shenhua Energy, Sumitomo and Energy Resources; the other was Peabody. Other companies expressed their gratitude for the invitations and added that they declined to take part in the tender. After receiving the proposals from the participating companies, the working group made its final decision that the Consortium would invest in Tavan Tolgoi.

Peabody approached the tender from a different angle. It did not fulfill the government's requirements directly. We do acknowledge their idea of bringing

out the real value and price of Tavan Tolgoi. However, Peabody did not go along with the government's requirement for investment.

Two parties sent their investment proposals, with a general idea of investment estimates. But the government of Mongolia clearly indicated that railway construction had to continue. However, some companies did not offer clear investment solutions. For that reason, the Consortium took the tender.

We agree that Peabody's philosophy in the Tavan Tolgoi project should be included in the project at a certain level. Unfortunately, Peabody did not meet another requirement that stated the company must cooperate with a national company. In an attempt to support national companies and improve their competitiveness, the government stood strictly by that requirement. However, Peabody came in with no specific solution to this. If Peabody wants to do any kind of collaboration with the Consortium, it is up to them. It is not the job of the working group.

Erdenes Tavan Tolgoi does not only have debt to Chalco. There are other debts. But we are not here to discuss the debt amount of the company. If there are issues, related to the mine operations or expenditures, which the investors need

to approve, we are open to having discussions and finding solutions as they arise. Those kinds of problems will be discussed at the negotiating table.

According to the 268th Resolution of the government, investors are to operate in East and West Tsankhi. Negotiations with such investors need to be done first. If we come to an agreement, the result will be introduced to the government and parliament. The final decision will be made there.

Issues related to citizens' 1,072 shares are all in the hands of the Mongolian government. This is because the mine is state-owned. And from it, Mongolian citizens are granted with the right to own shares. Distributing the shares will certainly happen. However, when and how are the remaining questions. Issues related to cost and amount will be discussed at the negotiating table.

Tavan Tolgoi will remain owned by the State. Erdenes Tavan Tolgoi's workforce, trained in Mongolia's coal sector, will be participating in the project. Since Erdenes Tavan Tolgoi is state-owned, the Consortium will have to make payments to the Mongolian State. The Consortium is to pay a 40 percent royalty. That idea might seem new to Mongolia. The numbers will be discussed at the negotiating table. ■



Investment

Developing Asia remains top global investment destination

By B.Unubold

Spurred by the continued rise of developing economies, foreign direct investment (FDI) is up around the world, with the biggest slice of pie going to Asia. “Cautious optimism returns to global foreign direct investment”—that’s the trend, according to the World Investment Report 2014, released by the United Nations Conference on Trade and Development (UNCTAD). After a slumping 2012, 2013 began the trend, as FDI increased by 9 percent to USD 1.45 trillion; the rise continued in 2014 with a total worldwide inflow of USD 1.6 trillion.

Developing economies maintained their lead in both FDI inflow and—uniquely—outflow in 2013. FDI to

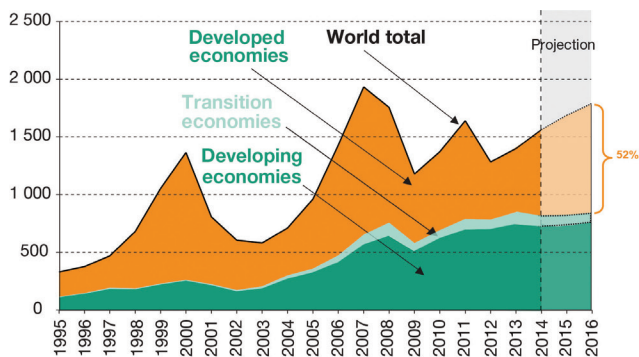
developed countries increased by 9 percent to USD 566 billion, or 39 percent of the total global share, while developing economies reached a new high of USD 778 billion, or 54 percent of total share. The balance of USD 108 billion went to transition economies. Developing and transition economies now constitute half of the top 20 nations ranked by FDI inflow.

FDI outflow from developing countries also reached record levels. Transnational corporations (TNCs) from developing economies are increasingly acquiring foreign affiliates from developed countries located in their regions. Developing and transition economies

together invested USD 553 billion, or 39 percent of global FDI outflow, compared to only 12 percent at the beginning of the millennium.

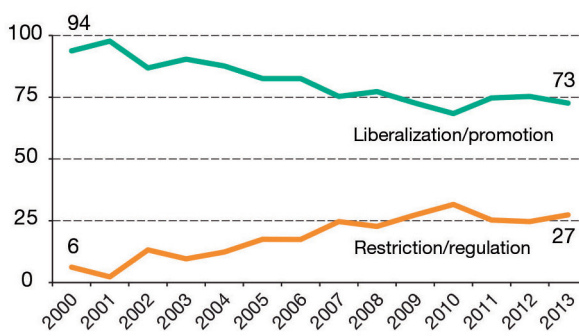
That the poorest countries are less and less dependent upon extractive industry investment is an auspicious trend noted by the report. Over the past decade, the share of the extractive industry in the value of greenfield projects was 26 percent in Africa and 36 percent in less-developed countries overall. These shares are rapidly decreasing; manufacturing and services now make up about 90 percent of the value of announced projects both in Africa and in LDCs.

Figure 1. FDI inflow, global economies and groups



Source: “UNCTAD” Investment Policy Monitor

Figure 2. Changes in national investment policies 2000-2013 (percent)



Investment policy trends and key issues

Most investment policy measures remain geared towards investment promotion and liberalisation. At the same time, the share of regulatory or restrictive investment policies has increased, reaching 27 percent in 2013. Some host countries have sought to prevent investments by established foreign investors. Other

home countries promote re-shoring of their TNCs' overseas investments.

In 2013, according to UNCTAD's count, 59 countries and economies adopted 87 policy measures affecting foreign investment. Of these measures, 61 related to liberalisation, promotion and facilitation of investment, while 23 introduced new restrictions or regulations

on investment. The share of new regulations and restrictions increased slightly, from 25 percent in 2012 to 27 percent in 2013 (Figure 2). Almost half of the policy measures applied across the board. Most of the industry-specific measures addressed the services sector.

FDI in Mongolia, and diversifying investment

To accomplish a new bill on investments in 2013, the Mongolian government obtained an Investment Policy Review (IPR) from UNCTAD. Mongolia requested a parallel review of their foreign commercial policy by the International Chamber of Commerce. Mongolia's way forward is twofold, the reports concluded. The country must capitalise on development opportunities presented by foreign investment in mining, while simultaneously pursuing a strategy to diversify FDI inflow into the country.

The UNCTAD report shows that there are many opportunities to diversify inflow beyond mining, into sectors such as tourism, financial and business services, niche product manufacturing, livestock, and infrastructure development.

Since the Mongolian government first began this twofold policy in 2014,

several changes have occurred in foreign investment flow.

An updated 2014 investment law suppressed the distinction between local and foreign investors. In order to improve investment quality, the government instituted a minimum limit of USD 100,000 capital investment for foreign investors.

The new investment law is likely to be stable for quite some time, as two thirds of parliament must come to an agreement to make any valid changes to the law. To further support the change, the government created a specialised agency called Invest Mongolia, to promote Mongolia around the world. Besides the promotional role of the agency, it also acts as a protector of foreign investors' rights.

The agency's main agenda is to diversify investment. Through

the agency's efforts, Mongolia has attracted about USD 800 million from more than 300 companies for FDI outside the mining sector.

D. Irmuun, director of promotion and consulting at Invest Mongolia, says: "Despite the difficult outlook of the economy, 2014 was a very good year for our investment environment. We established a healthy and secured investment environment during the year."

The government remains fairly positive about 2015's FDI inflow, as diversification policies begin to bear fruit. Continued diversification throughout the year will lessen the risk related to mining megaprojects such as Oyu Tolgoi or Tavan Tolgoi. The main issue in today's economy is the fact that it relies entirely on the mining sector—and Mongolia should never put all of its eggs in one basket. ■

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Interview

Jackson Cox: “I hope that 2015 will be a year of solving problems”

By B. Narantsogt



What was the process of founding AmCham Mongolia?

AmCham Mongolia was officially established in 2011. I registered the organization and then reached out to a few key American companies that are in Mongolia such as Peabody, GE, and Wagner Asia, and also to Mongolian companies that work closely with American companies, such as Magnai Trade. We have grown quickly since we started. AmCham currently has about 40 corporate members. Most significantly AmCham is working hard—each and every day—to be a meaningful partner for its members and to promote greater commerce between the United States and Mongolia.

How do you see the business climate of Mongolia unfolding in 2015?

To appreciate the business climate in 2015, you have to first appreciate 2014 and 2013, which were very tough years for the Mongolian economy. What we are seeing right now is the result of what's left of the business community after two years of decline and capital flight. To appreciate the challenges of the current business climate, I think it's important to understand that we are at this point of crisis today due to decisions that were made by policy makers. I don't like to dwell on the past and I'm generally an optimistic person, so I hope that this will be a year of solving problems, and the result of the solutions will allow for a more stable investment environment, a more predictable policy and regulatory environment—one that brings confidence back to the economy. Hopefully, those decisions will be made, and we'll start seeing the positive results from that. I think it's important when we talk like this to be realistic about expectations.

One of AmCham's most successful contributions was advocating for the

U.S.-Mongolia Transparency Agreement that was recently ratified by Parliament. What's the importance of the Agreement, and how can it help the economy of Mongolia?

Well, to be fair, AmCham joined the cause very late in the game. Most of the critical work was done by the governments of Mongolia and the United States over many years, and they are to be congratulated for this important milestone. This is a great agreement and I'll tell you why—because everyone benefits. Everyone benefits from a parliament that does not take impulsive decisions affecting commerce and trade. What the Transparency Agreement says, among other things, is that any law dealing with trade and commerce and investment, needs to be first published in Mongolian and English, and announced publicly, and have a 60 day period for comment by the private sector, by citizens, to voice opinions about the draft legislation. Also, if you look at what's happening in the Asia region right now, it's amazing how much is happening. Australia just signed free trade agreements with Japan and Korea. Korea, Japan and China are negotiating between themselves; China is negotiating with ASEAN; the United States is negotiating with 12 Asia-Pacific economies on the largest free trade agreement in history called the Trans-Pacific Partnership. What these agreements have in common is that not only do they allow the free trade of goods and services between these economies, but these agreements also set forth very high standard policy agreements—high standards for the protection of intellectual property, environmental protection, labor, and transparency. So the Transparency Agreement between Mongolia and the United States sends a message, loud and clear to the region, that Mongolia is ready

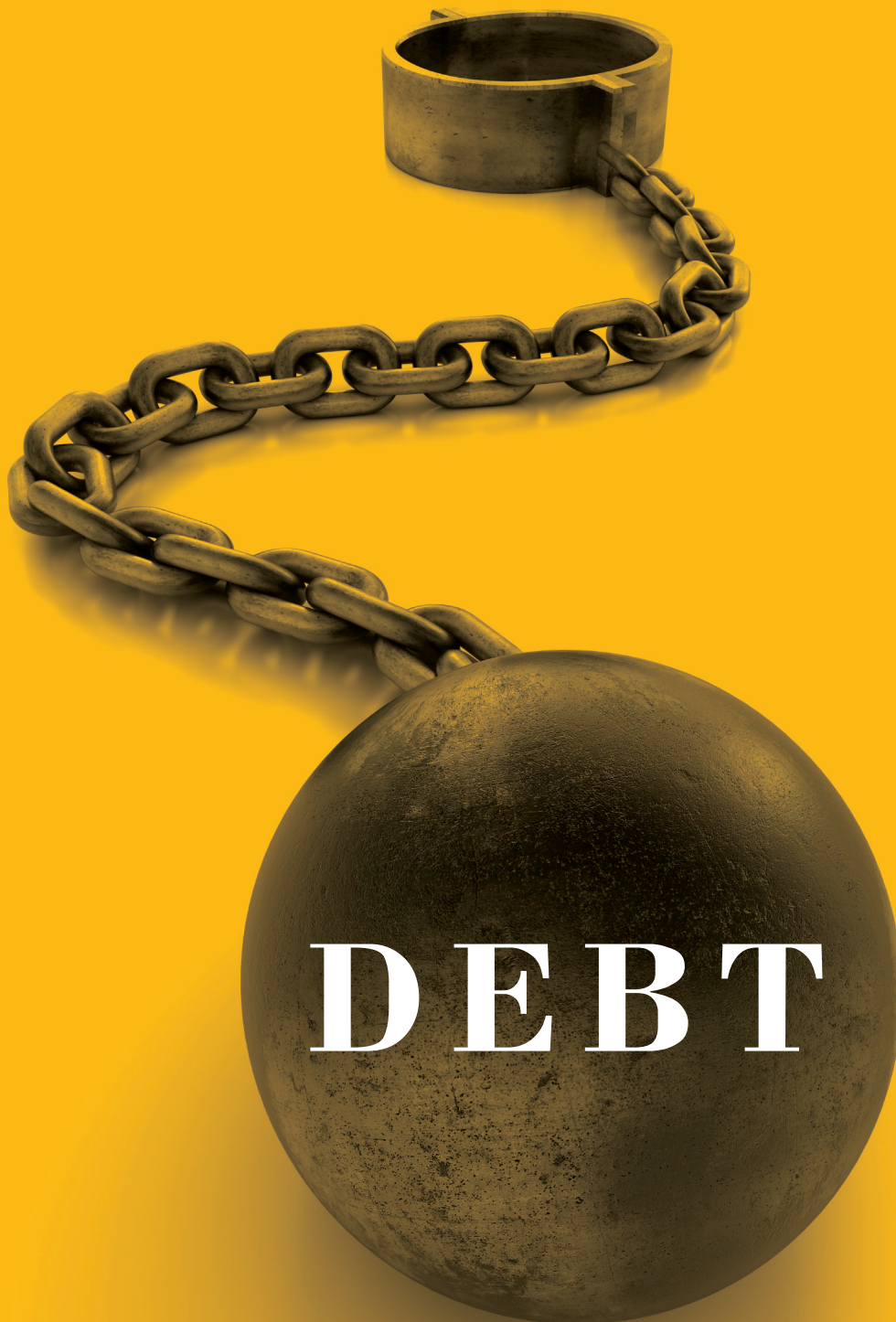
to play by the same high standards that all these other countries do.

How does AmCham promote Mongolia to US companies?

AmCham does a trade mission every June to the United States—we'll be doing one this June. Most of the participants in the trade mission are Mongolian companies who are looking to partner with American companies. We also do it in the region. You don't have to go all the way to the United States to access American companies, because they are working all over the region. AmCham Mongolia is part of an organization called APCAC, the Asia Pacific Council of American Chambers of Commerce. That's the collection of all the AmChams in the Asia-Pacific region. That group meets regularly, and we'll be going in March to the APCAC annual business summit in Singapore, and we'll be taking people from Mongolia there, too.

How would you advise Mongolian entrepreneurs who have an idea to develop a service or technology and want to connect successfully with an American or foreign company through an organisation like AmCham?

I would encourage them to do their homework, and find ideas that are marketable. And then really prepare. I think homework and preparation is the advice that I would give. What is an idea that can be successful on the ground in Mongolia, for this economy, for this market? And after that, what would be the best American partner? What American partners have this technology, or have that infrastructure or engineering. I would encourage them to look around the region, and see what is already being done, and being done well and being done successfully. And give us a call. We want to help you. ■

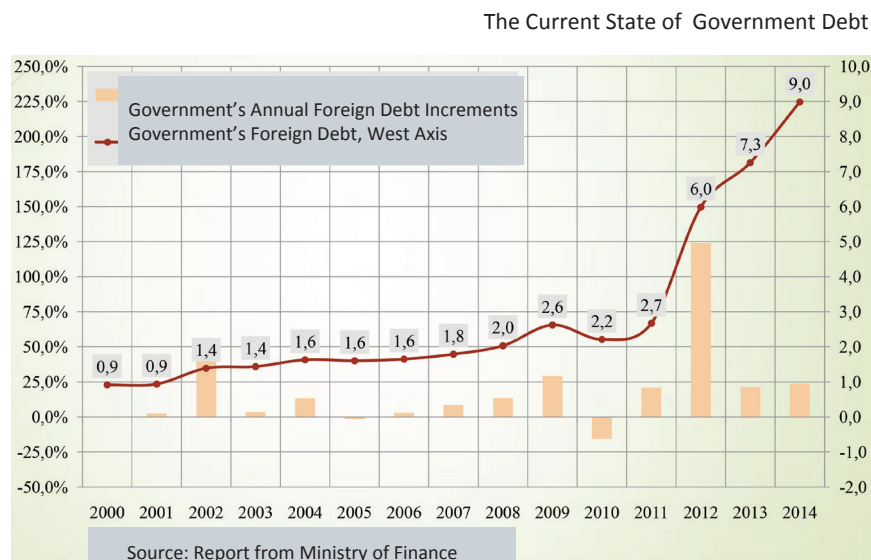


Foreign debt risks and recommendations

Mongolia's foreign debt has reached 58.3 percent of the country's GDP, 18.3 percent more than the legally mandated limit. Recently, the Great Khural discussed the Budget Stability Law and decided to include additional changes to the debt limit amount. The new law states Mongolia's debt ceiling shall be no more than 58.3 percent of GDP. Although an increase in the debt ceiling seems inevitable to avoid drastic cuts in expenditures, it could pose several risks. A study conducted by researcher L.Gangerel on behalf of the Open Society Forum, entitled 'Government's foreign debt', examined these risks.

Mongolia's capital market transition in the post-socialism 1990s enabled the Mongolian government to lend or issue bonds from both national and international sources. According to World Bank and Asian Development Bank classifications, Mongolia was regarded as a poor country until 2009. In this sense, the country could take donations and loans from international donor organisations or from developed countries. However, once upgraded from poor to low-income country in 2009, the country became able to issue bonds on international stock exchanges. In 2012, Mongolia, through its Development Bank, issued its first bonds, worth USD 600 million. Later in the same year it issued the USD 1.5 billion Chinggis bond. However, compared to previous loans and credits, the conditions of these bonds were stricter to a degree that could lead to debt burden in the future. Some economists and private citizens have criticised the bonds' short-term consumption targets, due to the fact that, instead of investing directly in profit-turning projects, the money went into indirectly beneficial projects such as road construction and infrastructure projects.

In 2002, Mongolia's foreign debt was MNT 1 trillion. By 2014, that amount had



increased to nine times as much. Foreign debt had increased steadily until 2011. But in 2012, the bonds' issue at foreign market, as well as government guarantees for the traded bonds, resulted in a 250 percent surge in debt. Organisations such as the Asian Development Bank and the World Bank granted most of the lending in 2013, while Japan and China have lent Mongolia the most financial support.

L.Gangerel's research report into foreign debt has laid out the following recommendations for politicians and decision makers:

The government Mongolia should clarify the definition of foreign debt; according to the calculation methods of foreign debt of the International Monetary Fund, the Bank of Mongolia's foreign debt should be included in government debts.

The government of Mongolia should urgently develop and implement detailed repayment scheduling, since the country will have to start repayment of the Chinggis bond and the Development Bank bond starting in 2017.

The government of Mongolia should conduct detailed research on who will be responsible in case Mongolia should be unable to repay its debt and declare default. The research should include possible solutions and should be introduced to the Great Khural.

The Debt Management Law bill should be discussed and approved by the Great Khural as soon as possible. Additional changes to this law should not be ratified unless at least two thirds of parliament approve.

The government of Mongolia should present specific planning of projects; Great Khural should give its approval *before* releasing bonds in the name of the government or through its Development Bank, to better attract huge amount of capital from international markets.

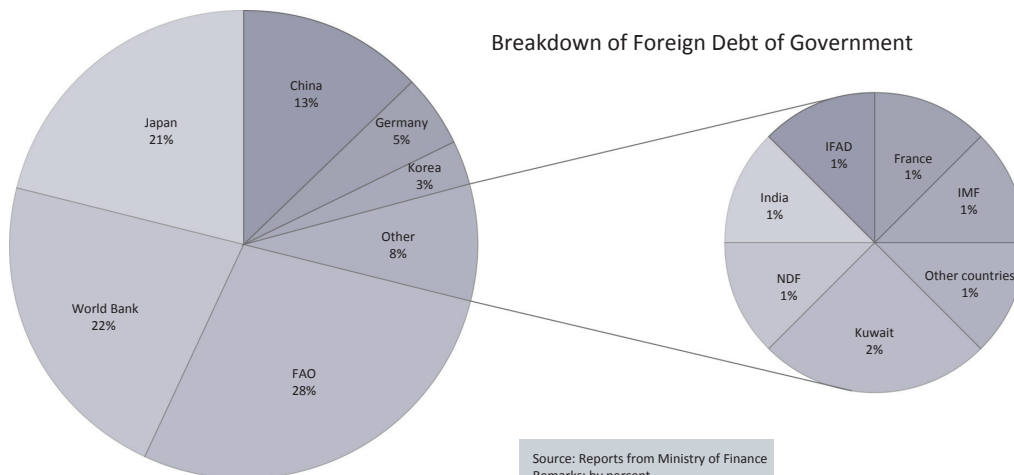
Mongolia should urgently introduce and implement international standards that register private sector foreign debt in the country's foreign debt registration.

In cooperation with its Ministry of Finance, the Bank of Mongolia should create and implement a legal environment mechanism that regulates and limits the private sector's foreign debt.

When choosing foreign investors for strategic deposits, Mongolia, as one of the requirements, should try to find a long-term, cheap financial source in order to repay its foreign debts that are expensive short-term debts.

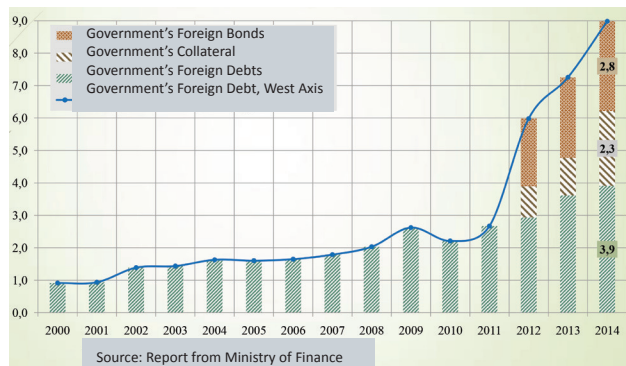
In order to decrease outflow of its foreign reserves, Mongolia should pursue possibilities to barter oil imports with meat exports to Russia, and establish a ruble swap negotiation with the Russian Central Bank. ■

Breakdown of Foreign Debt of Government



Source: Reports from Ministry of Finance
Remarks: by percent

The Current State of Government Debt



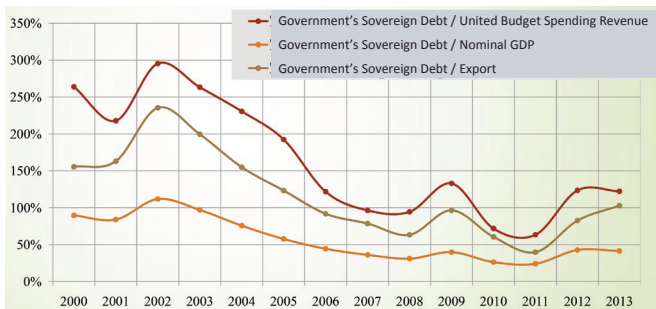
Source: Report from Ministry of Finance
Remarks: by trillions

Attributes of Government loans: relatively low interest, longer maturity rate and variety of stipulations

Loan Category	Years of waiver from payback schedule	Payback years	Interest Type	Interest Level
Soft Multi-lateral Loans	10	40 years	Regular	0.75%
Soft Bi-lateral Loans	7	20 years	Regular	2.00%
Commercial Multi-lateral Loans	5	20 years	LIBOR+1.25	2.89%
Commercial Bank Loans	4	9 years	CIRR+1.5	3.14%

Source: Report from Ministry of Finance

Stability of Foreign Debt of Government



Source: Researcher's estimation

Government Guarantee

	Date	Amount Borrowed	Amount Spent (2014-09-30)
Development Bank (foreign securities)	2012	580 million USD	580 million USD
MIAT State-Owned Company (EXIM Bank Loan)	2013	121.4 million USD	121.4 million USD
Development Bank (Samurai Bond)	2014	30 billion JPY	30 billion JPY
Development Bank (Credit Suisse loan)	2014	300 million USD	180 USD
Development Bank (People's Republic of China loan)	2014	162 million USD	112 million USD

Source: Report from Ministry of Finance

Projection of Foreign Debt of Government

Indicators	Performance of 2014-09-30	2015	2016	2017
Government's External Debt from Loans	3,911.50	4,089.20	4,299.10	4,169.30
Government's External Debt from Securities	2,760.80	2,625.00	2,550.00	2,490.00
Government's Liability	2,305.50	2,515.80	2,439.20	1,312.50
Total Government's External Debt	8,977.80	9,230.00	9,288.30	7,971.80

Source: Report from Ministry of Finance

Government Definition of External Debt

Debt types	Explanation
Foreign loans	Loans from international organizations and donor countries
Bonds or securities issued in international market	Bonds or securities issued by the government
Outstanding Liabilities	Collateral guarantee that the government is giving for securities that companies issued internationally
Foreign State Savings	Foreign savings placed in Central Bank



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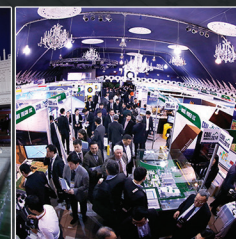


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Patrons of Mongolia: Copper, Coal, Oil



By B. Dulguun *Economist*

It is difficult to explain the importance of copper, coal and oil for Mongolia without listing the external trade figures.

If we look at Mongolia's external trade over the last six years (Figure 1), this value increases from USD 4 billion to 11.4 billion between 2009 and 2011, and then falls in 2014 to 11 billion. Since 2009, Mongolia has had an external balance loss, but in 2014 it was able to clear profits of USD 537 million. The majority of this trade was carried out with China (Figure 2). According to the data, Mongolia executes 89 to 90 percent of its exports and 25 to 30 percent of its imports with China.

The main source of foreign currency inflow to Mongolia is from exports to China, and the main exports are three natural resources: copper concentrate, coal and crude oil. These three products account for 70 to 80 percent of exports to China (Chart 3).

Before 2014, copper concentrates occupied 20 to 30 percent of exports to China. But since the beginning of major activity at Oyu Tolgoi mine, copper concentrate now occupies 51 percent of exports (Figure 4). The export of copper

concentrate, coal and oil are as important in the future as they are today, and thus earn the title 'Patrons of Mongolia'.

Copper, coal and oil's contribution to the state budget

On January 23 2015, parliament approved the amendments in the Mongolian budget law for 2015, finalising the year's budget. Budget income is calculated at MNT 6,632.6 million, or 27.6 percent of national GDP. Budget expenditures are fixed at MNT 7,837.4 million, or 32.7 percent of GDP. This represents a fixed budgetary loss of 5.1 percent of GDP.

The operating income payment of natural resources was set at MNT 426.9 billion in the budget (Figure 5). The price per tonne was approved at USD 6,354.7 for copper, and USD 30 to USD 60 for coal.

Although these commodity prices are used by the government to calculate expected budget income and expenditures, they also impact the profitability of the mining sector, and can hinder the government and mining sector alike when prices are lower than anticipated. We can see from a

2015 Ministry of Economy presentation, Oyu Tolgoi LLC and Erdenet Mining Corporation (EMC) constitute 14 percent of income taxes, or 11 percent of total income. But the planned for injection into the state budget of MNT 324.9 billion from petrol was revised downward to MNT 284.9 billion. Also, as compared to the previous budget of 2015, the level of exports and the price of coal have been revised downward 20 percent; instead of injecting MNT 217 billion, MNT 130 will inject the budget.

Thus companies in the copper, coal and oil sectors make up 20 percent of the state budget income, making Mongolia heavily dependent upon these products. Diversification and the question of an exit solution in the case of a fall in prices of these products is a necessity to be weighed by policymakers and citizens of Mongolia alike.

Low prices on the international market

In the 2015 Budget, a tonne of copper is estimated at USD 6,354.7. But as of January 26, 2015, the London markets show the metal's price has declined to USD 5,580. Despite the government's wishes, there is no guarantee of



commodity price stability. Everyone knows that the company contributing the most to the state budget is Erdenet Mining Corporation. According to the director of the company, D. Ganbaatar, an evaluation of the plan of 2015 has been made at three levels depending on the state of the international market. For example, the company will declare a loss of MNT 20 billion if the price of copper reaches USD 6,000 per tonne; more than 100 billion MNT if the price falls to USD 5,500; and a loss of MNT 183 billion if the price drops to USD 5,000. While the production cost of the company in 2014 was USD 6,100 per tonne. If EMC started working at a loss, even if the budget is devalued by more than 600 million, results at 100 percent could not be expected. Our main question remains: will the price of copper fall in 2015?

According to a projection published in Bloomberg financial news on 21 January 2015, the forecast calls for a devaluation of the average copper price to USD 5,983 during the first quarter of 2015 (Figure 6). The forecast improves in the second quarter as copper prices should reach USD 6,565.

At the moment, the price of copper is less than hoped for, but the trend is for it to rise. If copper goes down, or even remains at today's same level, the state budget will be in a difficult situation.

As for the price of oil, the planned budget income is to be quite low. Initially the government assessed the price per barrel at USD 110; yet as the price went

down in the months leading to the final budget, the clarifying price was lowered. The oil price plummeted to USD 45 at the beginning of 2015, a worrying level for anticipated budget income. (Figure 7).

The budget and our future

The price of oil has halved in less than three months. With copper's decline, EMC is working at a loss. There is likewise no evidence of increased coal prices on the market. With such a drain of low commodity prices on today's budget, there is almost no solution to stop the loss.

There has always been a hole in the state budget—ever more expenditures and ever less than planned income. 2014's loss was MNT 875 billion. But the secret of the former government—to operate as if there wasn't a hole in the budget—lies in its bonds. According to a member of the permanent committee of the budget of the national parliament, B. Chojijilsuren, at the end of 2014 the government possessed an internal debt reaching MNT 2.9 trillion. The sum of the internal debts and Chinggis and Samurai bonds represents 53 percent of GDP, which pushed the government to raise the government debt ceiling. If the budget in 2015 seems insufficient, I would like to ask the members of government, who enlarged instead of limited the state budget, how they might fill this gap. Dear Members of Parliament: how are you intending to fill the fiscal gap if the price of raw materials remains low or

even falls?

If you think it is enough to issue bonds once again to fill the void, you are mistaken. The state obligations represent very little risk, so the yield is lower. There is only one explanation to the fact that the rate of bond interest remains higher than the rate of savings in the Mongolian banks on the Mongolian stock market. The Mongolian government is in direct competition with domestic banks to attract more money. As there is no one to invest in state bonds, the government is in competition to attract savers' money. If the state budget remains broken, where will this competition lead us?

The operation, export, and price of these products on the international market nourishes the economy of Mongolia. When the price falls, our economy is directly affected. So we have to evaluate our budget without budgetary loss, and protect ourselves from the risk of variations and falls in prices. Only then can we truly protect the internal economy and boost competitiveness. But the newly approved 2015 budget is completely the opposite of what it should be. If the price of manufactured products does not rise, I fear another dangerous revision of the state budget in 2015. ■



B.Sainbayar: “Mongolia needs to change in order to proceed with Rio Tinto”

By B. Bayartogtokh

Deputy CEO of the National Council of Private Sector Support B.Sainbayar recently graduated from a business innovation course at Harvard University. Currently he heads FranklinCovey’s licensed representative office in Ulaanbaatar, Mongolia. He shared his point of view on the Tavan Tolgoi and Oyu Tolgoi projects with Mongolian Economy magazine.

Tavan Tolgoi negotiations are ongoing. What positive effects could realisation of this project have for investment flow to Mongolia and to other megaprojects?

The Consortium of three big companies really demonstrates the value of the Tavan Tolgoi mine. Competitors are collaborating—this is a promising sign for investment flow to Mongolia. The Consortium of Japanese Sumitomo, China’s Shenhua Energy and Mongolia’s Energy Resources has set a whole new standard in partnership. In my opinion, this is a balanced union. Tavan Tolgoi has proved that the investment environment is improving. It’s kind of sensational that Mongolia has a business partner other than Rio Tinto. I hope the negotiations will succeed as we hope they should. It is a historic opportunity. Tavan Tolgoi has brought Mongolia back



into the international spotlight.

The Oyu Tolgoi project has been delayed for a while now. Is there remaining uncertainty about its future?

Let’s take the Erdenet Mining Corporation factory as an example. Whether it is right or wrong, the factory is operating. The agreement is sealed and production has started. Mongolians have been benefitting from the factory until now. Oyu Tolgoi is the next version of Erdenet. The agreement is signed, the project started. Thus, instead of trying to pull it back, Mongolia has to push it forward. Doing so would fix the crumbling economy of Mongolia and enable further development. Rio Tinto is a world giant. It has its own standards and management. Such a big company will, of course, try not to make any mistakes. If they do, the world would judge Rio Tinto’s mistakes, not Mongolia. Mongolia cannot afford the repercussions of such a process. This could turn out suicidal for us. We can’t change Rio Tinto, because we can’t change the way world political, economic and social relations go. Thus, Mongolia needs to change in order to proceed with Rio Tinto. Rio Tinto will not likely change its policies just to reach an agreement with Mongolia. Disagreements in the Oyu Tolgoi project have to be approached professionally. It is important

both parties speak the same business language.

Could the newly elected Prime Minister of the Solution government make any progress on Oyu Tolgoi?

There is still hope. Expectations are there. Both sides have expressed their interest in Oyu Tolgoi proceedings. Thus, I expect the Prime Minister to take steps towards activating this economically important project. Oyu Tolgoi is Mongolia’s trademark. It is this trademark we should carry when entering the global market.

Oyu Tolgoi has been a hot topic for quite a while now. For some politicians, has the project become less a tool and more a toy to play with?

If we keep denying our past, our future will fade with the same mistakes we made in the past. We made mistakes. However, an agreement is agreement. There are two important cultures in the business world. One is to respect the already made agreement, while the other is the governance of the law. Since we don’t have that much of a choice, Oyu Tolgoi has to continue. The project will be a door to other megaprojects. The Oyu Tolgoi agreement was signed according to international standards. We must take and use what opportunities we have. ■



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