The AMERICAN CHAMBER of Commerce in Mongolia

MONGOLIA'S TRADE & INVESTMENT POLICY

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American Chamber of Commerce in Mongolia's Trade and Investment Committee

Executive Summary

AmCham Mongolia's position paper "Mongolia's Trade & Investment Policy" covers the government's previous policy framework to attract and retain foreign direct investment (FDI) including Vision 2050 and the latest New Recovery Policy by focusing on Mongolia's need to increase FDI from its third neighbors.

It also highlights the factors that influence trade and investment and contains AmCham Mongolia's following recommendations including three pillars of policy reform and policy incentives to increase trade and investment from Mongolia's neighboring countries to support private sector-led economic growth:

1. Realign toward a free-market economy driven by private-sector entrepreneurs and enterprises;
2. Reforming the business and investment environment;
3. Prioritizing greater commerce and trade integration with the U.S. and third neighbors.

Background

Mongolia, situated between two superpowers, provides a unique geopolitical location for investors. It has access to the world's largest international market–China, and is located next to another superpower under economic sanctions from the international business community, which brings uncertainty.

The situation in Mongolia's two neighboring countries is extremely challenging. Closed borders due to the continued COVID-19 pandemic severely affect Mongolia's trade turnover, and a neighbor that is hostile and conducts military actions against its neighbors is also a challenge.

It is essential for Mongolia to vigorously pursue its "third neighbor" policy to attract and retain investments from other countries. The Government of Mongolia should have a policy statement that explicitly advocates for promoting investment and facilitating trade with third neighbors while pursuing balanced relations with its two immediate neighbors.

The American Chamber of Commerce in Mongolia (AmCham Mongolia) believes that a solution to ending this heavy dependence on its neighboring countries is increasing FDI from third neighbors and developed nations.

1. Context

1.1 Mongolia's Third Neighbor Policy Framework

In 2010, the Mongolian parliament approved the National Security Concept, which states, "Mongolia will implement prudent policies aimed at a multi-pillared economic policy and balanced investment policies, ensuring security in the financial, energy, mining, and foreign trade sectors." Furthermore, Mongolia aims to keep the amount of FDI from one particular country at no more than one-third of all FDI inflow to Mongolia, limit investments from foreign SOEs, and maintain a balance between investments in strategic sectors from neighboring countries and highly developed nations.

On February 10, 2011, Parliament revised its foreign policy concept by adopting Resolution No. 10, officially stating, "within its third neighbor policy, Mongolia will develop mutual and multi-sided friendly relations and partnerships with highly developed democratic countries in the political, economic, cultural, and humanitarian fields."

1.2 Vision 2050

Vision 2050, Mongolia's long-term development document, refers to several policy statements concerning investment promotion:

- 4.1.6. Attract foreign investment based on transparency and cooperation and develop collaboration and communication between external and local investors;

- 4.1.30. Create primary conditions for attracting and supporting foreign direct investment and develop and implement supply management policies and programs;
- 4.1.31. Renew investment policies to attract foreign investment by identifying demands for foreign investment, specifically by sectors and location;

- 4.1.32. Improve the environment for organizing training, re-training, and collaboration to establish accessible linkages for foreign investment with local business entities;
- 4.1.33. Develop and implement a law on supporting private investment initiatives;
- 4.1.34. Renew and implement the public-private partnership policy following international standards.[1]

1.3 Government of Mongolia's action plan for 2020-2024

The Government of Mongolia has the following objectives in its action plan for 2020-2024 concerning creating a favorable business environment and attracting FDI:

- 4.4.6. Improve the protection of private property, investment, and intellectual property rights; create a favorable environment for doing business; improve the legal environment for digital contracts and transactions; consider contracts and transactions in the digital environment as evidence in court and digitalize some court activities; and improve the legal environment to support wealth creators and the private sector.
- 4.5.3. Consistently protect the interests of foreign investors; attract foreign investment in leading economic sectors and mega projects, such as infrastructure, mining, energy, food, agriculture, and tourism; and obtain soft loans and grants.[2]

1.4 Mongolia's Trade and Investment Roadmap 2019-2023

In 2019, Mongolia's Trade and Investment Roadmap (TIR) was developed by the Ministry of Foreign Affairs and the Mongolian National Chamber of Commerce and Industry (MNCCI) with support from International Trade Centre. The overall vision of the TIR is "a vibrant Mongolia leveraging its heritage and creativity to foster trade and investment-led growth, supported by the following four strategic objectives[3]:

1. Build a long-term growth path by creating an enabling business and investment environment;
2. Strengthen trade and investment support institutions to effectively respond to the needs of Mongolian firms;

[1] Vision 2050, Mongolia's long-term development document, p.30
[2] Cabinet's action plan for 2020-2024
[3] Mongolia's Trade and Investment Roadmap 2019-2023, p.2: https://mfa.gov.mn/3d-flip-book/mongolias-trade-and-investment-roadmap-2019-2023

3. Enhance firms' capacities to meet market requirements and sustain export relationships;
4. Stimulate innovation and entrepreneurship by unleashing entrepreneurial capacities, strengthening the start-up ecosystem, and venturing into knowledge-based sectors.

1.51 Cabinet's New Revival Policy

In 2022, Cabinet initiated the New Revival Policy, which is designed to strengthen Mongolia's economic independence, reduce the negative economic impact of the COVID-19 pandemic, promptly address developmental constraints, and create basic conditions for the implementation of Vision 2050.

The policy is being implemented in six main areas: ports, government productivity, green growth, energy, industry, and urban-rural development. In partnership with the private sector, the government will implement 94 projects, including improvement of the railroads, border ports, and Chinggis Khaan International Airport; power plants; an oil refinery; expansion of the Erdenet, Tavan Tolgoi, and Oyu Tolgoi mines; and the digitalization of public services to remove bottlenecks and attract more FDI in these areas.

According to the policy, the cabinet is planning to implement the following measures:

> **3.4.** Develop the agriculture sector based on the latest state-of-the-art equipment, technology, and innovation and increase new products, services, and manufacturing.
> **3.5.** Increase the export of semi-produced and value-added finished products by expanding the capacity of agricultural raw materials and products.
> **3.6.** Develop industry based on the latest trends in the digital economy and science by adopting advanced technology, blockchain, and AI.[4]

1. Analysis of the international practices and country context

1.1. WTO Policy review

According to a WTO Trade Policy Review, the current Government of Mongolia has put forward the following goals in foreign trade and external economic cooperation:

- Develop solutions for export financing and increase the volume of export products;
- Simplify customs services to serve the promotion of foreign trade to protect citizens from illegal and counterfeit products; continue customs reforms for the full collection of taxes and royalties from the exploitation of natural resources;

[4] The New Revival Policy

- Continue the step-by-step construction and development of infrastructure for free trade
zones to create an environment conducive to the development of trade, services, and light industry aimed at export and the domestic market; and to extend support to foreign and domestic investors;
- Establish economic cooperation zones at border areas in selected regions that are close to markets and natural resources and have the potential for a sufficient labor force and industrial development;
- Establish an export guarantee fund to provide specific support to entities exporting their products;
- Expand the throughput capacity of border ports and upgrade them to the standards of the ports of neighboring countries; renovate and improve the quality of border post buildings and facilities;
- Develop networks of agricultural goods production and sales to reach the full domestic supply of major food products and support import-substituting and export-oriented production;
- Complete the feasibility study for natural gas pipelines from the Russian Federation to China through Mongolia and to carry out preparations to start construction;
- Expand the road and transportation networks to ensure economic growth and increase export;
- Prioritize foreign economic relations to increase and diversify export relying on public-private partnership and continue the policy of minimizing and mitigating the difficulties faced in foreign trade;
- Consistently protect the interests of foreign investors, support the attraction of foreign Investment, and secure concessional loans and aid for priority economic sectors such as infrastructure, mining, energy, food, agriculture, tourism, and related mega projects.

1.2. Factors influencing trade and investments

According to the World Bank's report "Rebuilding Investor Confidence in Times of Uncertainty", even before the COVID-19 outbreak, global FDI was in decline due to trade policy uncertainty, rising protectionism, falling rates of return on FDI, and changing forms of international production.

The COVID-19 crisis is presenting a new, unprecedented source of investor risk that is depressing business confidence to historic lows, resulting in a projected fall in global FDI
by more than 40 percent in 2020.

More than two-thirds of multinational investors in developing countries are reporting disruptions in supply chains, declines in revenues, and falls in production as a result of COVID-19—and the impacts are projected to worsen in the coming months—based on a new World Bank survey on the impact of the pandemic.

FDI can alleviate the impact of the COVID-19 crisis and boost countries' economic resilience by providing a critical source of external capital for financing public debt and continuing to create more and better-paid jobs, lift people out of poverty, and boost productivity.

According to the report, investors consider various factors when investing. The two most important factors are:

- Political stability and security;
- A business-friendly regulatory environment.

Regulatory predictability and efficiency are viewed as critical elements of the business environment.[5]

To attract investment, governments must lower political risk and increase protection, stability, and predictability.

Ninety percent of the investors surveyed rated various legal protections as important or critically important, such as:

- The ability to transfer currency in and out of the country;
- Legal protections against expropriation, breach of contract, non-transparent or arbitrary government conduct.

Government actions—such as reducing investor risk and increasing policy predictability can rebuild investor confidence, based on the report's new global database of regulatory risk.

Investment promotion agencies can boost their countries' investment competitiveness by better aligning their FDI attraction and retention efforts with market signals and changing investor preferences.

Governments can leverage FDI for robust economic recovery from COVID-19 by avoiding protectionist policies, seizing new opportunities from changing FDI and supply chain trends, and fostering global cooperation.[6]

5 https://www.worldbank.org/en/topic/competitiveness/publication/global-investment- competitiveness-report-2019-2020

6 https://pubdocs.worldbank.org/en/713351591134479937/211536-Main-Messages.pdf

Figure 7. Factors influencing trade costs of Asia-Pacific economies

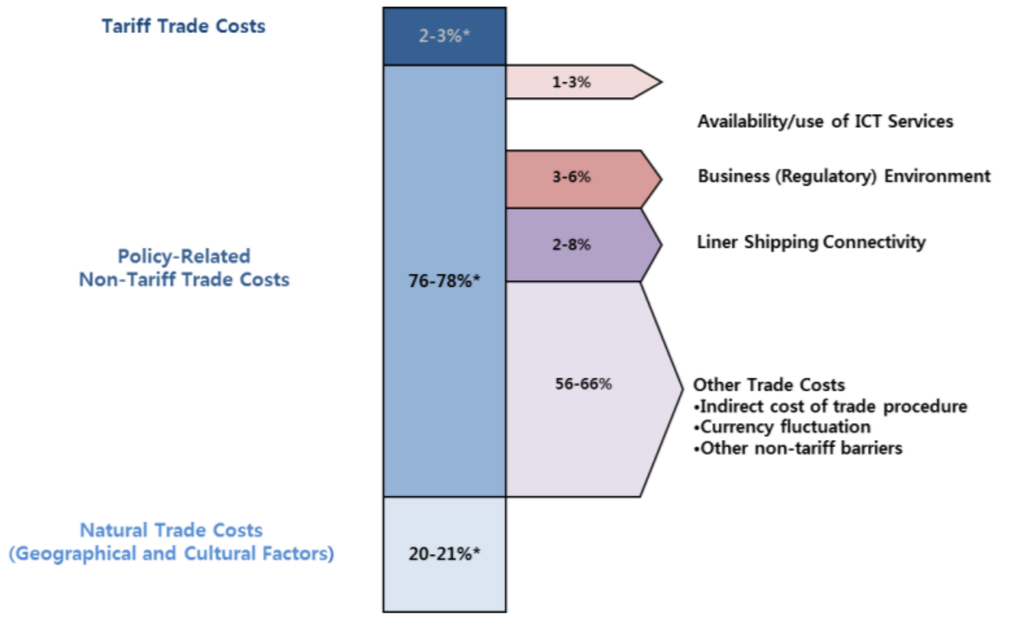

Figure 7 revealed that the quality of the regulatory environment was a key determinant to attracting FDI, and high trade costs had a negative effect on FDI.[7] In fact, a one percent reduction in comprehensive international trade costs—excluding tariffs—between the source and host countries was shown to be associated with an average 0.8 percent increase in FDI. Higher import tariffs in the host country were also shown to have a significant but negative impact on FDI flows.[8] Therefore, it is important to reduce trade costs.

2. Mongolia's Investment and Trade Policy

Based on the abovementioned factors influencing trade and investment, AmCham Mongolia recommends that the Government of Mongolia implement the following trade and investment policies to increase trade and investment from Mongolia's neighboring countries to support private sector-led economic growth:

- Improve the legislative environment for trade and investment
- Remove tariff and non-tariff barriers
- Review current legislation and regulations that hinder foreign trade relations
- Diversify and promote export-oriented products
- Support the export of organic and eco-friendly products
- Support the import of the latest technology, autonomous and semi-autonomous equipment and machinery, and eco-friendly products from third neighbor countries, including the United States of America, the EU, Japan, and Korea, and provide more favorable tax policies and simplified custom clearance processes.

[7] Annex 1: Factors influencing trade costs of Asia-Pacific economies
[8] https://www.unescap.org/sites/default/files/publications/STI84_Final.pdf#page=19&zoom=100,56,209

3.1. Three pillars of policy reform

To attract new FDI and retain current foreign investors, Mongolia should implement the following three pillars of policy reform to improve the business and investment environment:

I. Realign toward a free-market economy driven by private-sector entrepreneurs and enterprises.

a. Removing the state as a market participant: state-owned enterprises, planned economic policies, and state-planned investment
b. Eliminating state interference with private enterprises (the state is only a regulator)
c. Encourage free-market, private sector-driven policies and legislation
d. Capital market development: Foreign investors would require clear exit strategies. Therefore, introducing institutional investors such as wealth funds, investment banks, investment funds and pension funds is vital for the development of local capital markets.
e. Support and develop small-medium enterprises as SMEs could be seen as the landscape that creates pre-requisites for the healthy overall investment climate in the country, for both macro and micro economics perspectives.

II. Reforming the business and investment environment

a. Reforming key areas of legislation
    i. Developing an investment policy that encourages an open market and an incentivized investment law
    ii. Replacing the Labor Law with a market-oriented, freedom to contract, modern labor law that encourages competitiveness and growth over entitlement, limits state encroachment into corporate affairs, and encourages investment and job creation
    iii. Realigning the minerals policy and Minerals Law toward economically viable, investment-oriented, private sector-driven exploration and exploitation.
    iv. Addressing disincentives in tax legislation (e.g., WHT 20 percent)
b. Reforming the judiciary and court enforcement agency to act impartially and effectively for dispute resolution
c. Reform the Tax Dispute Settlement Council for rapid and effective resolution of tax disputes
d. Replacing state autocracies (agencies and regulatory bodies) with a merit-based, professional, and capable civil service with a philosophy of service and implementing a sustainable and clear regulatory framework.

III. Prioritizing greater commerce and trade integration with the U.S. and third neighbors

Mongolia should actively participate in the U.S. government's global initiatives to benefit from mega projects and improve its regional competence:

a. Global Infrastructure Initiative
b. Indo-Pacific Economic Framework
c. Bi-lateral ties: Transparency Agreement shifting toward a Free Trade Agreement

3.2. Policy incentives

The Government of Mongolia and Parliament can also provide policy incentives and tax credits, including exemption from import duty, VAT, and excise tax, to promote and increase trade and investment with its neighboring countries.

These incentives could focus on the following policy goals of the Mongolian government:[9]

- Adopt the latest equipment, technology, and know-how from developing countries
- Increase employment and develop the capacity and competitiveness of local human resources
- Increase the government's tax revenue in the long-term
- Improve the efficiency and productivity of key sectors and industries by reducing operational costs
- Meet growing social and environmental concerns

The Government of Mongolia should consider that in addition to policy incentives, investors look into political stability and security as primary factors for investment.

[9] Annex 2: Goals of the Government of Mongolia in foreign trade and external economic cooperation