

# Common Obstacles in Conducting Foreign Trade in Mongolia: Suggestions and Solutions

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## Abstract

*In order to form an attractive business environment, it is crucial to take courses of action immediately after carefully observing the business environment and conducting a solid analysis. The main purpose of this research study is to indicate the key obstacles and their causes in conducting foreign trade in Mongolia, as well as to determine the courses of action in order to develop the sector. Within the framework of the goal of this research, the survey results have been grouped and analyzed in three groups: 1) within the territory of Mongolia; 2) within the territory of trade partner countries; and 3) difficulties that occur in the operation of international trading companies.*

Key words: foreign trade, customs duties, export/import documents, border wait-time, transportation

JEL classification code: F10, F13, F14

## 1. Background

### Research background

Although foreign trade has taken up an important position in the social and economic development of Mongolia, on the other hand the dependency solely on exports of mining products is greatly increasing the level of risk. Therefore, the Government of Mongolia has paid special attention to supporting the export of non-mining products, such as varying the economic structure by promoting non-mining sectors, establishing partnerships in foreign markets, as well as creating a flow of exports.

However, there is still an urgency for supporting business owners through developing and implementing a proper set of policies which are based on solid research by the government in order to form an attractive environment for conducting business. This research study is aimed at determining the common obstacles for international trade for companies in the non-mining sector, evaluating the implementation of the legal and policy documents of the government, and identifying the courses of action to be taken in the future.

### Research methodology and data processing

A questionnaire method was applied in conducting a survey throughout the nation, including the 21 provinces (*aimags*) of Mongolia and the 9 districts (*duuregs*) of the city of Ulaanbaatar. Survey sampling consisted of 2,100 entities in total, of which there were 75 entities each from the 5 provinces in the Western region, 70 entities each from the 9 provinces in the Eastern and Khangai regions, and 65 entities each from the 9 districts in the city of Ulaanbaatar. Data collected from 1,573 entities which met the requirements were processed through Stata.

1,349 entities responded on investment type, of which 96.4% were domestically invested entities.

70% of entities were established prior to the year 2010, with the other 30% after that year; 80% of entities were small and medium-sized enterprises (SMEs). As for annual sales revenue, 43% of the participants had lower than 100 million togrogs, 34% had 101–400 million togrogs, 16% had 401 million to 1 billion togrogs, and the remaining 7% of the participants had more than 1 billion togrogs.

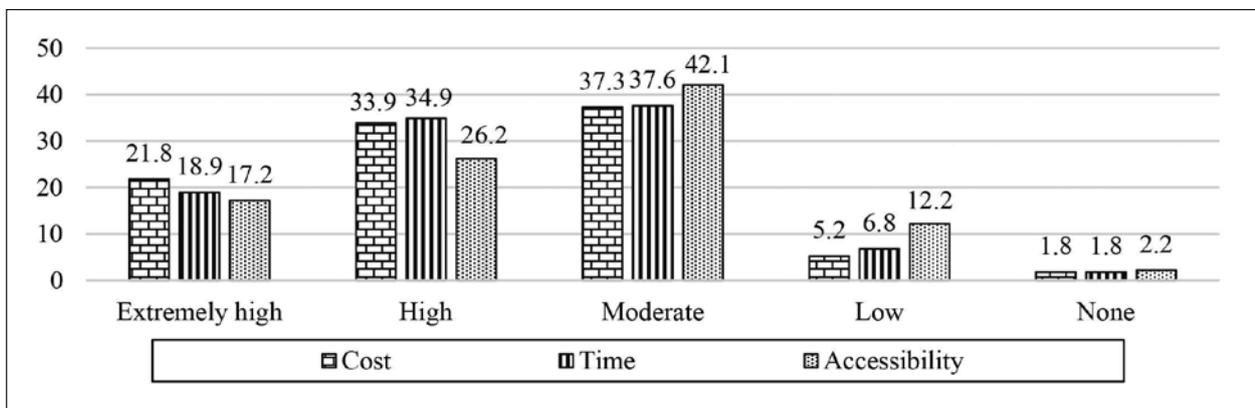
## 2. Common Obstacles in Conducting Foreign Trade within Mongolia

When participants were asked about the common obstacles for conducting foreign trade within Mongolia, they named domestic transportation, customs duties, time and fees spent collecting export/import documents, and additional costs originating from waiting at the border and customs (border wait-time). Therefore, we have looked into these difficulties by comparing the city of Ulaanbaatar and the four regions of Mongolia with the median for the country.

### 2.1 Domestic transportation

Around 2% of the survey participants responded that they face no problems related to domestic transportation, whereas the remaining 98% had difficulties related to transportation costs and time in domestic transportation.

**Figure 1: Obstacles in Domestic Transportation (%)**



Source: Author's calculations using the results of the study

As having the most negative influence on conducting foreign trade, 55.8% of the survey participants gave a response of transportation expenses, 53.8% transportation time, and 43.5% the inclusiveness of transportation means. Hence, cultivating logistics for domestic transportation can be seen as an essential matter.

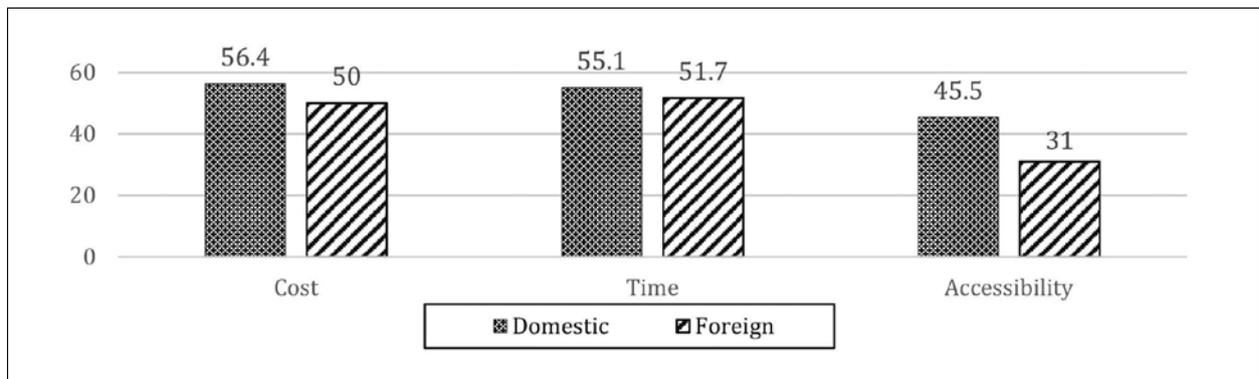
The following results were generated when comparing the difficulties in carrying out domestic transportation for the country's median, the four regions of Mongolia, and the city of Ulaanbaatar.

**Table 1: Obstacles to Domestic Transportation (by region, %)**

Difficulty	Country Median	Western Region	Khangai Region	Central Region	Eastern Region	Ulaanbaatar
Cost	55.8	64.2	62.7	49.3	47.1	51.8
Time	53.8	60.8	58.1	45.2	38.8	54.8
Accessibility	43.5	50.6	46.3	35.2	19.7	47.1

Source: Author's calculations using the results of the study

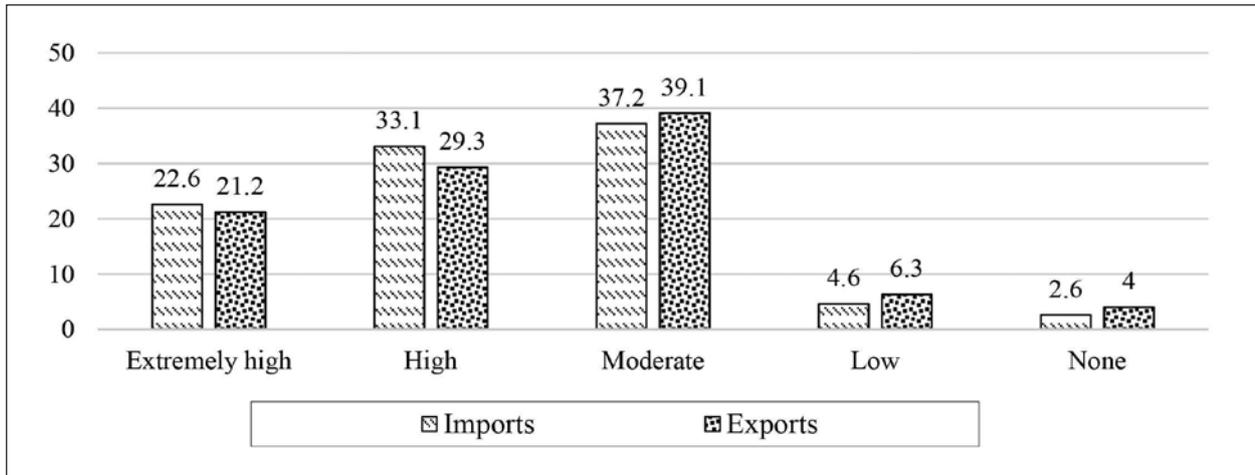
Looking at the content of Table 1, transportation costs cause the highest level of difficulty to international trade companies, and for isolated areas, the Western Region has the worst situation, followed by the Khangai [mountain] Region. Therefore, transportation infrastructure in these isolated areas needs to be cultivated with urgency. As for foreign and domestically invested entities, these obstacles may be displayed in the following way.

**Figure 2: Obstacles in Domestic Transportation (by investment type of entity, %)**

Source: Author's calculations using the results of the study

## 2.2 Customs duties

One of the biggest challenges for foreign traders are customs duties, for which it was found in the survey that 7.2% of the participants had responded that import duties don't affect them in any way, whereas 37% of the participants responded medium effects, and 55.7% of the participants responded that import duties greatly affect their business.

**Figure 3: Difficulty Level Caused by Customs Duties (%)**

Source: Author's calculations using the results of the study

Although Mongolia has some of the lowest import duties in Asia, that they still trouble business owners may suggest that the role of regulations in customs tariffs requires improvement. Therefore, we have investigated deeply the Government of Mongolia's policy toward the role of regulations on customs tariffs.

Mongolia developed the Comprehensive National Development Strategy document (CNDS: 2008–2021) in 2008, based on the Millennium Development Goals, which indicated: “Supporting small and medium manufacturing enterprises with an export orientation through policy on customs tariffs”; “Supporting some import substitution manufactures through policy on customs tariffs”; and “Supporting import of advanced-technology precision tools and equipment through policy on customs tariffs”. Hence the document played an essential role in the regulation of customs tariffs.

Based on this comprehensive strategy, the Government of Mongolia adopted a program called “Mongolian Industrialization 2009–2016” in 2009. The program indicated issues including: developing a legal basis to levy customs duties after a certain amount of time (once the operation of manufacturing becomes consistent) for final products and goods that are manufactured by using raw materials that can't be substituted, or a substitute raw material itself; and exempting the customs tariffs on the equipment required for core technology. However, dozens of business owners believed that the implementation of this program was insufficient.

The National Security Concept of Mongolia was ratified by the State Great Khural in July 2010, and states that: “Losses on foreign trade will be reduced, and tariff and non-tariff barriers will be utilized in a proper way in order to promote domestic industry”.

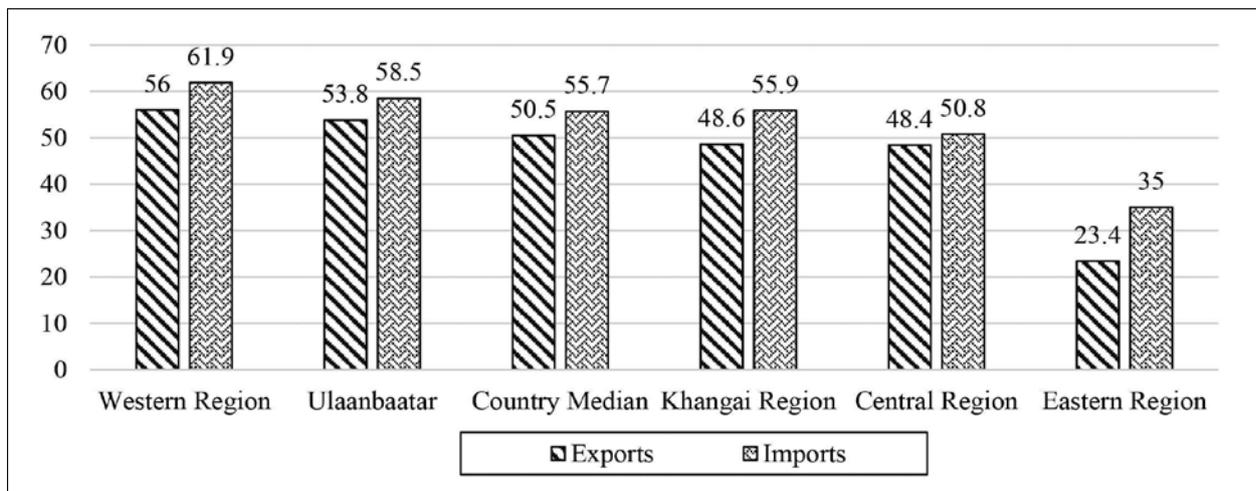
Within the implementation of the concept mentioned above, the Law on Customs Tariffs and Duties was revised and passed in 2008, and amendments were also made on more than ten occasions between 2012 and 2017. It is safe to say that these amendments were aimed toward improving the role for regulating customs tariffs to support domestic industry and investment.

The Law on Supporting Manufacturing was adopted in 2015, with certain amendments to related laws. For instance, an amendment of the Law on Customs Tariffs and Duties was made in December 2015, which included the tax exemption of equipment for research and the renewable energy industry, including spare parts, and accessories.

Even though some hefty policy documents were developed, with a purpose of improving the role of regulating customs tariffs, several amendments have been applied to the Law on Customs Tariffs and Duties in recent years, as this research shows, and those policy alterations and improvements do not have any positive impact on business owners.

In order to determine which region is most troubled by customs duties, survey responses of the most numerous difficulties were collected and analyzed by comparing the country median to the four regions of Mongolia and the city of Ulaanbaatar, which is shown in Figure 4.

**Figure 4: Difficulties Derived from Customs Duties (by region, %)**



Source: Author's calculations using the results of the study

Figure 4 shows that more than 50% in every region, excluding the Eastern Region, identify import duties as the more troublesome.

Several amendments, as follows, have been made since 2015 to the Annex to the State Great Khural's Resolution No. 27 of 1999,<sup>1</sup> which stipulated increased customs tariffs for products capable of being manufactured domestically. Therefore, the standard rate of 5% import duty for some products was pushed up to the WTO bound-tariff level,<sup>2</sup> in accordance with the World Trade Organization rules, which may have impacted importers.

- Customs tariff rates on meat products, a variety of meats, honey, canned products, cement, and trolleybuses were increased in August 2015.<sup>3</sup>
- Beginning on 1 March 2016, customs tariff rates on imported vodka and wine were raised to 40% and 20%, respectively.<sup>4</sup> On top of this, in order to fulfill the obligations Mongolia proposed to the WTO, and to implement the Economic Partnership Agreement between Mongolia and Japan, an amendment to the Excise Tax Law was made which equalized the duty for imported and domestic alcoholic beverages.<sup>5</sup>
- Beginning on 1 May 2016, the customs tariff rates were increased for over 100 products which have the potential for domestic manufacture.<sup>6</sup>

Changes to customs tariffs have both positive and negative impacts on society and the economy. The results of this study show that when carrying out alterations to customs tariffs, it

is crucial to implement them after accounting for the impact on domestic industry, consumption, and state revenue.

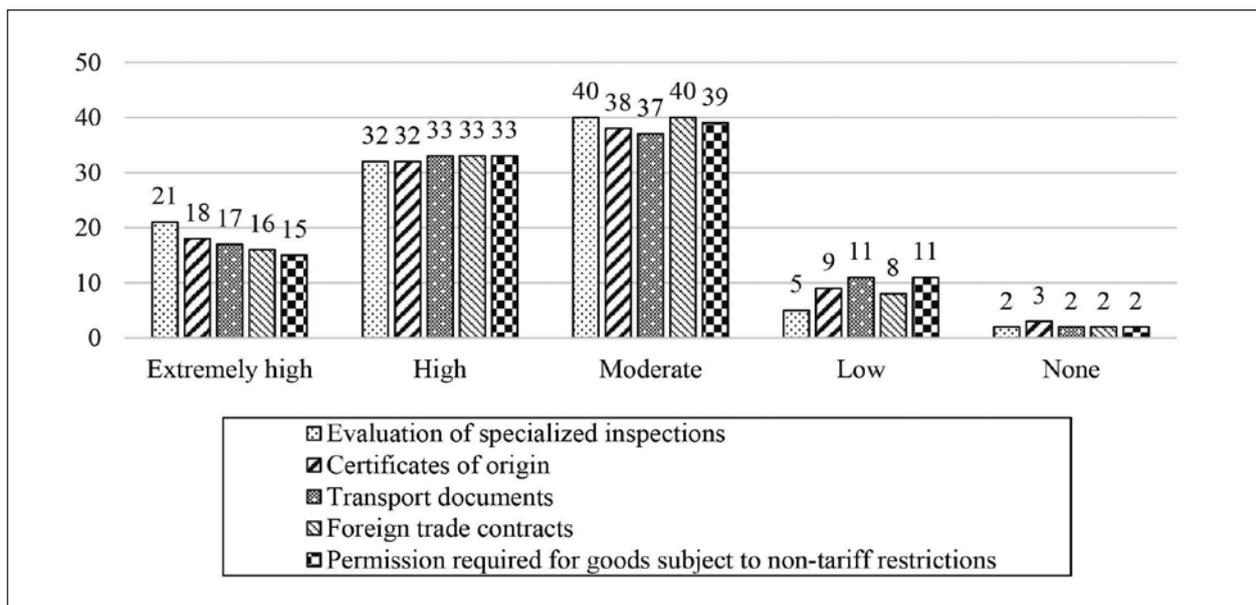
As for export duties, those that are imposed on lumber, timber and logs according to the law concerning customs duties on some export commodities cause business owners the same difficulties as import duties. In particular, more than 50% of foreign traders in the Western Region and Ulaanbaatar have responded that export duties are one of their biggest obstacles.

### 2.3 Difficulties in obtaining export/import documents

Prior to 2013, conducting international trade used to require more than ten documents, and take around a month. In order to reduce this problem, as well as to soften international trading procedures, an amendment to the customs law was applied in 2012, which changed the required documents to four, including foreign trade contracts or invoices, transport documents, permissions, licenses required for the goods subject to non-tariff restrictions, and evaluation for certain goods specified by the law issued by the agency for specialized inspections (Inspection Certificate, Health Certificate, Phytosanitary Certificate, and Product Testing Certificate). Foreign trade contracts or invoices, and transport documents are the mandatory documents. In addition, in accordance with the Economic Partnership Agreement with Japan, an amendment to the customs law was made in 2015, which states that “According to Mongolian law, it is necessary to apply for a certificate of origin if it is required by a legal entity”.

According to survey participants when they were asked whether they face any obstacles related to obtaining documents, 53% of the participants responded with the evaluation of specialized inspections, while 50% of the participants responded with certificates of origin and transport documents, 49% responded with foreign trade contracts, and 48% responded that licenses required for goods subject to non-tariff restriction were considered as highly difficult issues. (Figure 5).

**Figure 5: Obstacles in Obtaining Export/Import Documents (%)**



Source: Author's calculations using the results of the study

Table 2 shows the summary for responses of “extremely high” and “high” in a questionnaire on which region has the most problems with obtaining export/import documents, comparing the country median and regions.

**Table 2: Difficulties in Obtaining Export/Import Documents (by region, %)**

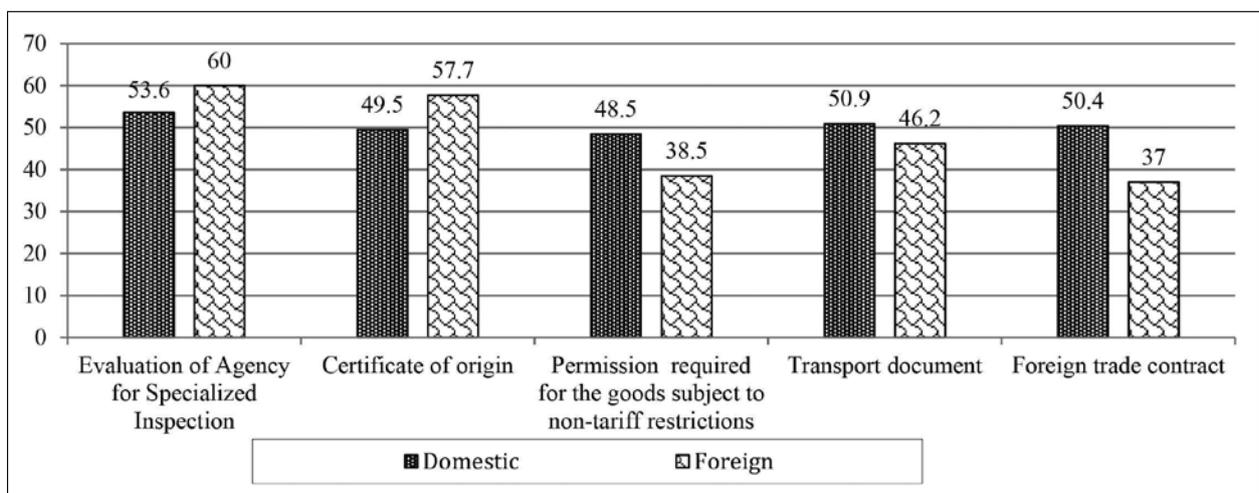
Region	Evaluation of Agency for Specialized Inspections	Certificates of origin	Permission required for goods subject to non-tariff restrictions	Transport documents	Foreign trade contracts
Western Region	<b>62</b>	<b>56</b>	52	<b>58</b>	<b>53</b>
Ulaanbaatar	57	46	46	47	48
<b>Country Median</b>	<b>53</b>	<b>50</b>	<b>48</b>	<b>50</b>	<b>49</b>
Khangai Region	44	50	46	49	50
Central Region	41	47	<b>53</b>	45	52
Eastern Region	38	52	33	56	33

Source: Author’s calculations using the results of the study

According to Table 2, international traders in the Western Region believe the excessive amount of time spent obtaining documents is one of their biggest challenges. In particular, it should be noted that 62% of the survey participants responded that the evaluation of specialized inspections causes them difficulty, and this was the worst in the nation as a whole.

When we take the investment type and characteristics into consideration regarding the time spent obtaining export/import documents, the certificates of origin and evaluation of specialized inspections are the most troublesome factors for foreign-invested entities, whereas evaluation of specialized inspections causes the most difficulty for domestically-invested entities.

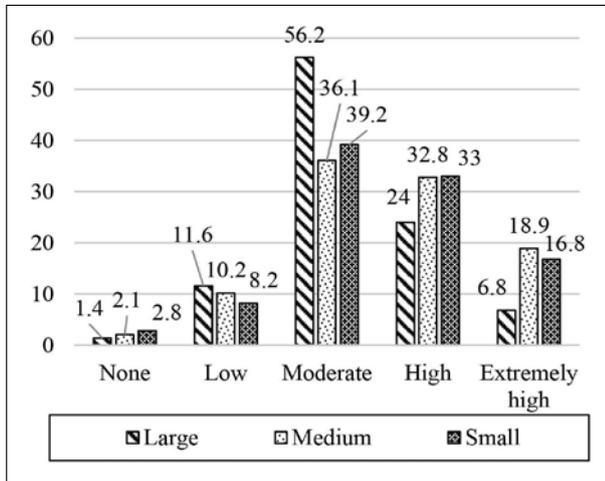
**Figure 6: Difficulties in Obtaining Export/Import Documents (by entity investment type, %)**



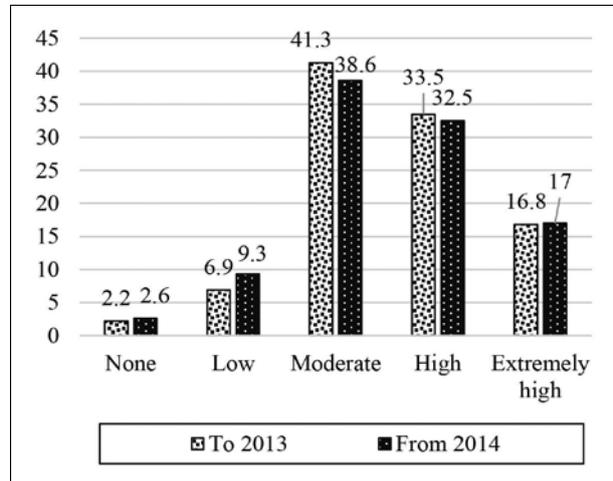
Source: Author’s calculations using the results of the study

Figures 7 and 8 show the differences among foreign traders in obtaining export/import documents regarding their company size and experience.

**Figure 7: Difficulties in Obtaining Export/Import Documents (by entity size, %)**



**Figure 8: Difficulties in Obtaining Export/Import Documents (by year established, %)**



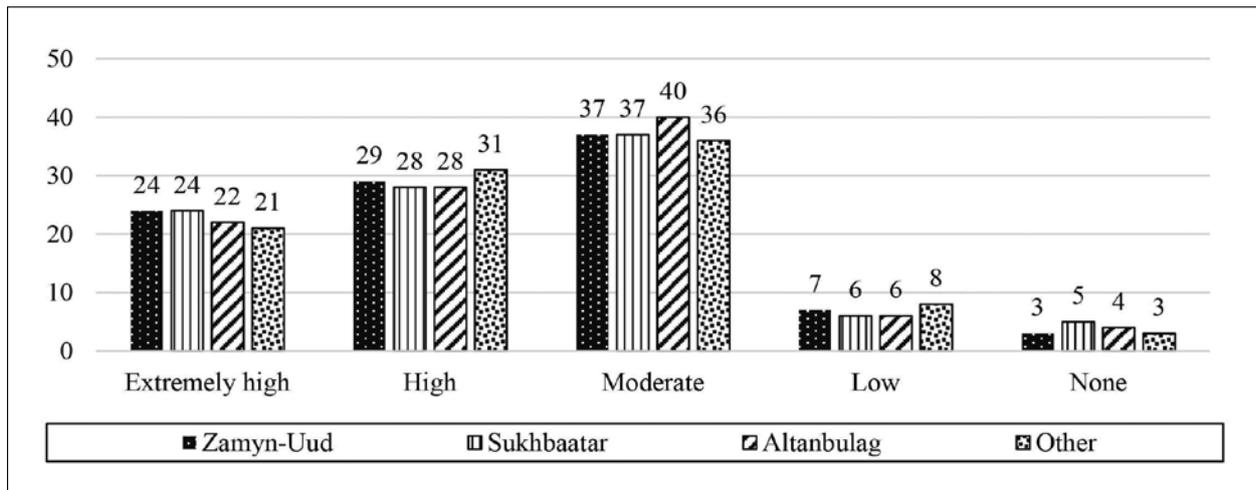
Source: Author's calculations using the results of the study

56.2% of large-sized entities responded that there is moderate difficulty in obtaining documents, whereas 49.8% of small and 51.7% of medium-sized entities responded that obtaining documents is the most problematic.

#### 2.4 Occurrence of additional costs due to extensive time spent at customs and borders

Quality, time and simplification of customs and border services (customs, border control, specialized inspections, restrictions, prohibitions, etc.) are significant indicators of the logistics performance index. Mongolia was ranked 100th at 2.39 points in 2016 according to this index, and had moved up 32 places compared to 2014 (132th place, 2.2 points).

Therefore, we investigated whether there is additional expense due to the waiting time at customs and borders when conducting foreign trade.

**Figure 9: Occurrence of additional costs due to waiting time at customs and borders (%)**

Source: Author's calculations using the results of the study

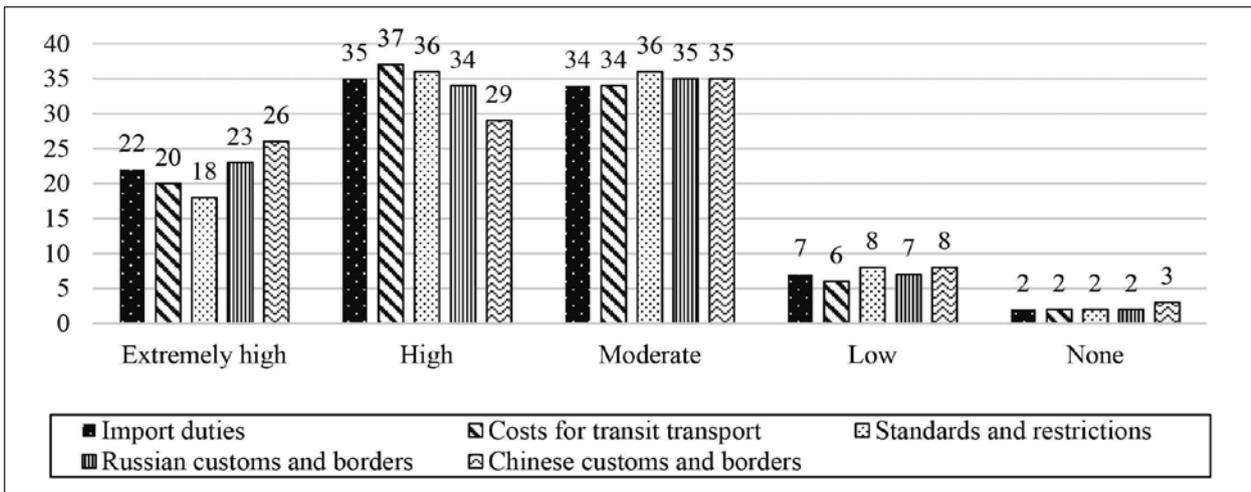
Figure 9 shows that 3–5% of international traders responded that they face no problem at customs and borders, whereas over 50% of the participants responded that they encounter difficulties due to losing time at customs and borders, and resultant additional costs. Hence, it is fair to assume that there is a lack of integrated regulation for customs and borders.

When respondents were asked whether they have difficulties related to the time spent obtaining export/import documents, they responded that the evaluation of specialized inspections takes an excessive amount of time in processing documents, and they suggested that evaluation of specialized inspections should be carried out without troubling other business owners. In addition, it should be noted that the government needs to take a set of actions in order to improve the capacity of the borders, control equipment and laboratories.

### 3. Common Obstacles within the Territory of Trade Partner Countries

We have looked into the common obstacles within the territory of trade partner countries, or in other words, the common difficulties business owners face after crossing of the Mongolian border. Participants named “import duties”, “standards and restrictions”, “transit costs”, and “additional costs due to the extensive amount of time spent at customs and borders” as the most problematic issues, which are shown in Figure 10.

**Figure 10: Common Obstacles within the Territory of Foreign Partner Countries (%)**



Source: Author’s calculations using the results of the study

Around 2% of the survey participants responded that they have no issues within the territory of foreign partner countries, whereas 54–57% of the participants responded that they experience problems to some degree.

According to the policy on customs tariffs of partner countries, there is a distinct tariff depending on the product manufactured. Although the customs tariffs for Mongolia’s main export products, such as raw material and minerals, are generally zero or very low, that the customs duties for non-mining products with added value are relatively high is causing some degree of difficulty in exports. Therefore, it is important to consider the beneficial factors of a product when Mongolia signs a preferential or free trade agreement with its main trading partner countries.

Transit transport is one of the biggest challenges for conducting foreign trade, thus resulting in an increase of costs and a decrease in profit in a country like Mongolia, which is landlocked and located between two major nations. Therefore, it is critical to reach agreement with these neighboring countries on reducing the rates for transit transport, and on reducing the transportation costs via reducing the volume of goods by processing raw materials and minerals.

Wool, cashmere, rawhide, leather, and food products have the highest potential for export among the non-mining export goods of Mongolia. Concerning these products, not only customs tariffs, but also the standards, sanitary and hygiene procedures, and restriction requirements of the importing countries cause a substantial amount of difficulty. Therefore, a systematic course of action needs to be urgently taken, such as establishing an integrated system for raw material preparation, providing a solution to transportation logistics, and introducing quality control and the standards of other countries.

When the survey participants were asked about the obstacles at the customs and borders of the neighboring countries, 57% responded that they encounter a certain level of difficulty at Russian customs and borders, and 55% responded that they run into trouble at Chinese customs and borders.

Evaluation of common obstacles in the territory of trade partner countries has been made by comparison with the country median, as shown in Table 3.

**Table 3: Common Obstacles within the Territory of Trade Partner Countries (by region, %)**

Region	Import Duties	Standards and Restrictions	Transit Costs	Russian Customs and Borders	Chinese Customs and Borders
Western Region	63.8	61.1	60.6	58.4	59.3
Khangai Region	57.4	48.4	50	48.8	48.3
<b>Country Median</b>	<b>57.1</b>	<b>54.5</b>	<b>57.3</b>	<b>56.2</b>	<b>54.5</b>
Ulaanbaatar	56.6	57.8	57.3	58.7	54.7
Eastern Region	52.1	26.5	66.7	41.2	46.5
Central Region	49.5	56.6	57	63.8	57

Source: Author's calculations using the results of the study

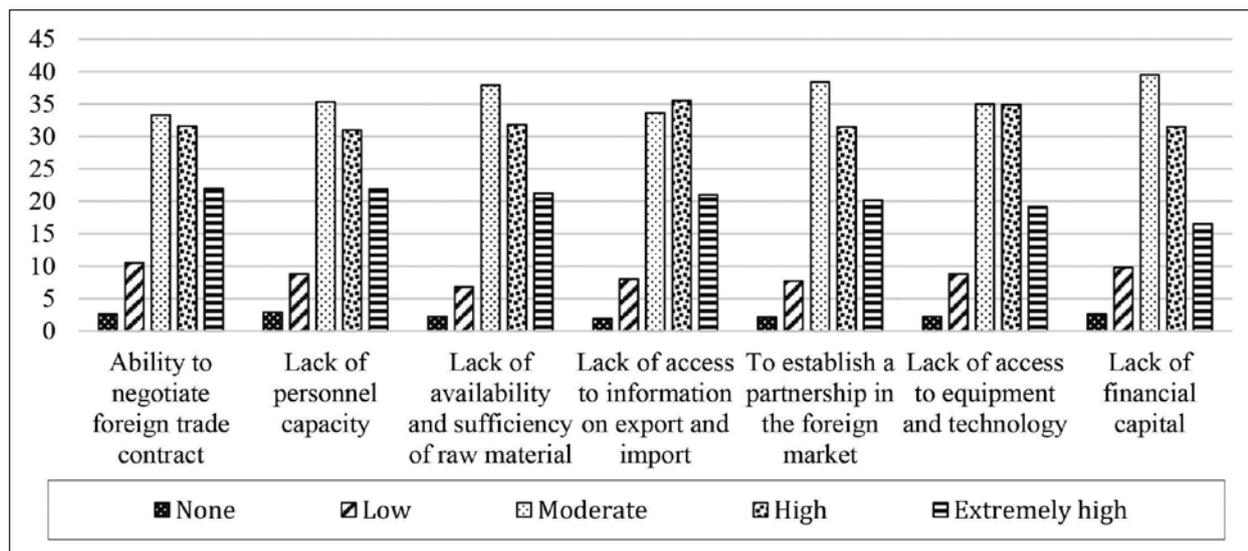
Regarding common obstacles within the territory of trade partner countries, the Western Region has difficulties with import duties, standards and restrictions, and Chinese customs and borders, whereas the Eastern Region has difficulties with the cost of transit transport, and the Central Region had trouble at Russian customs and borders. In order to overcome these obstacles, we suggest signing a memorandum or agreement of cooperation with the corresponding organizations of the neighboring countries, and to co-monitor implementation.

#### 4. Difficulties in the Operational Activities of Foreign-Trading Entities

A company's capacity building plays a crucial role in conducting foreign trade, and therefore we have evaluated the common difficulties they encounter. The most troublesome factors are: establishing partnerships in foreign markets; signing foreign trade contracts; the lack of availability of skilled employees; accessible information on exports and imports; the lack of financial capital; the lack and sufficiency of raw materials; and the lack of access to equipment and technology.

According to Figure 11, 2 to 3% of the survey participants responded that they face no difficulties in conducting foreign trade, whereas 50% replied otherwise. Moreover, 57% responded that they face a lack of access to information on exports and imports. Therefore, it is essential to introduce the best practices of top-notch export/import management companies from foreign countries, such as Japan, which have expertise in certain sectors, products, and markets. It is also important to provide foreign-trading entities with technical consultancy services and substantial information.

Moreover, issues including lack of experts, and inability to establish trade partners in the foreign market and to negotiate trade contracts are crucial to every entity. Lack of personnel capacity is considered the most troublesome factor for medium-sized enterprises (60.4%) and for small entities (55.6%), whereas processing foreign trade contracts is a major issue for large entities (50%); on the average, however, establishing trade partners in foreign markets is the most difficult obstacle for all entities.

**Figure 11: Common Obstacles in the Operational Activities of Foreign-Trading Entities (%)**

Source: Author's calculations using the results of the study

A foreign trade contract is one of the main documents required at customs. The profits or losses of foreign-trading companies depend on how well the contract was negotiated. Some entities, however, attempt to fabricate a contract in order to reduce customs tariffs. Contracts have no legal power to enforce customs declarations; in other words, if the main required documents don't meet the requirements, importers will be turned down at the border, which causes a certain level of difficulty for foreign trading entities.

When respondents were asked via an open question about the initiatives and activities the government should implement in order to support business owners in accessing international markets, 27.4% of survey participants responded: support of domestic industry, including implementing special policy to support small and medium-sized manufacturers and companies in local areas, and protection from imported goods; 25.2% responded: implementing policy on tax incentives, reducing customs duties and easing inspections at border controls. 21.9% of the respondents suggested implementing strategy supporting exports, including exemption of fees for research and investigation of exported goods, reducing the number of required documents, and specifically supporting the export of agricultural products. 20% of the respondents suggested that it is crucial to develop foreign relationships, concluding trade and business contracts (with the involvement of the government and guaranteed by the state), supporting international cooperation, and reaching agreement with neighboring countries on reducing customs tariffs.

## Conclusions

- Over 50% of the survey participants responded that the expenses and time for transportation are the main problem factors, in which the Western Region had the worst result among the regions, followed by the Khangai Region. This shows that there is an urgent need for developing the logistics for domestic transportation in Mongolia.

- 56% of the survey participants responded that the import duties of Mongolia cause them trouble due to a lack of implementation of policy on customs tariffs and of its effectiveness.
- Although the Government of Mongolia has taken a certain amount of action on reducing the number of documents related to international trade, 50% of the survey participants responded that they encounter problems obtaining documents. In addition, they specified that there is a need for action to be taken, such as speeding up the process of obtaining documents, introducing a single-window system, and computerization.
- 49% of the respondents replied that foreign trade contracts are a problem. The main cause is that no contract would be carried out for a low product amount and value, and even in some cases contracts signed do not meet requirements.
- Over 50% of the survey participants responded that additional costs due to spending an excessive amount of time at customs and borders is one of their greatest obstacles. Therefore, the government needs to take courses of action to improve the capacity of customs and borders, control equipment, and laboratories.
- 54–57% of total respondents answered that the import duties of the partner country, restrictions and prohibitions, and the cost of transit transport were the most problematic when exporting goods. Hence, it is essential to agree upon a memorandum or agreement of cooperation with the corresponding organizations of the neighboring countries, and to co-monitor implementation.
- A company's capacity plays a crucial role in conducting foreign trade. 60% of the survey participants (mostly entities in the countryside) responded that they lack experts in certain sectors, products, and markets, and this leads to complications in accessing the foreign market, due to the absence of expert information, analysis, and assessment.

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- <sup>1</sup> “Adopting Customs Duty Rates on Import Commodities” on 3 June 1999.
- <sup>2</sup> Bound tariffs are specific commitments made by individual WTO member governments. The bound tariff is the maximum MFN tariff level for a given commodity line.
- <sup>3</sup> State Great Khural Resolution No. 332 of 17 August 2015.
- <sup>4</sup> State Great Khural Resolution No. 17 of 4 February 2016.
- <sup>5</sup> Excise Tax Law of Mongolia, 2006.
- <sup>6</sup> State Great Khural Resolution No. 185 of 28 March 2016.

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