

Foreign Direct Investment in Mongolia

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1. Introduction

Since the economy was opened up in the early 1990s, foreign investment in Mongolia has been increasing steadily, assisted by the amendments to and enforcement of the Foreign Investment Law of Mongolia and various measures taken by the Mongolian government to create a favorable legal environment for foreign direct investment (FDI). There has been worldwide interest in a variety of Mongolia's industrial sectors. The agro-processing, trade and service sectors were the first recipients of modest inflows of FDI. It has been noted that the liberalization of the investment regime, while making foreign investment procedures simpler, has also given rise to increasing capital flows.

The purpose of this paper is to review FDI inflows into Mongolia, detailing the sectors benefiting from this investment and the countries whence it originates, based on information gathered in the period to 2003 (cumulative data) by the Foreign Investment and Foreign Trade Agency of Mongolia (FIFTA).

2. FDI Inflows into Mongolia up to 2003

Despite the worldwide decrease in FDI, interest in Mongolia on the part of foreign investors, especially those from East Asia and North America, has grown over the last few years, mainly in the mining, textile, trade and service sectors.

The Mongolian government has recently been paying significant attention to FDI. As a result, a more favorable external and internal legal environment was established, in order to provide a free and open regime for business (incentives such as tax exemptions, deductions and policies aimed at encouraging exports have been put in place under the Foreign Investment Law and other related laws); this has had an important impact, leading to an increase in the total amount of FDI as well as in the breadth of the sectors.

From 1990 to the end of 2003, 3,042 foreign investment companies from 73 countries were registered with the government, implementing total direct investment of about US\$1 billion.

2. 1. FDI Inflow by Sector

Geological prospecting², mining and oil exploration

The 2003 FDI data for the oil exploration field in has been amalgamated with the figures for FDI in the geological prospecting and mining sector, and this composite sector now accounts for 46% of total FDI. FDI in oil exploration is also reflected in the list of FDI by source country. 235 foreign incorporated companies from 31 countries are registered in this sector, with investment by each company averaging around US\$2 million. The leading investing countries are Canada (US\$132 million), China (US\$130 million), the USA (US\$115 million) and Bulgaria (US\$26.9 million). It is interesting to note that investment in this sector originating from Canada, Bulgaria and the Bahamas comprises 95–99% of total investment in Mongolia by these countries.

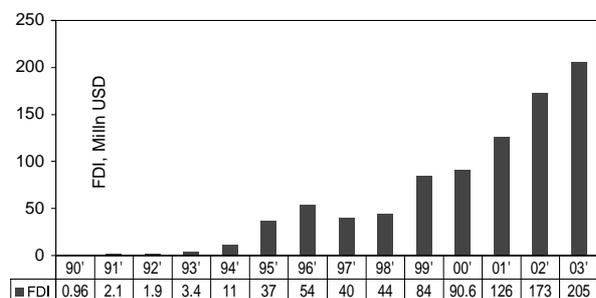
Trade and catering services

This category includes wholesale business, retail trade, restaurants and cafés. The main investors in this sector are China, the ROK, Singapore, the UK, Japan, Italy and Russia. The average value of investment per company is around US\$180,000, the lowest figure of all the sectors in receipt of FDI. All foreign investment companies establishing a presence in Mongolia are initially designated as having the right to conduct "foreign and domestic trade" in addition to their main activities; after obtaining special permission to conduct specific economic activities, they can be categorized into different sectors. If the latter activity is not specified as being the company's main orientation, then the company remains in its previous category.

Light industry

This sector mainly comprises companies active in the garment manufacturing and textile industry, which have been established by investors from Japan (US\$28.1 million), China (US\$19 million), Hong Kong (US\$8.1 million), Taiwan (US\$6.8 million), the ROK (US\$6.7 million) and the USA (US\$3.7 million). The average investment per company is around US\$524,000. Sewn underwear, apparel, coats, jackets, knitted or crocheted underwear, and sweaters are the main products of this

Figure 1. FDI Inflows by Year



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² According to the Minerals Law of Mongolia, "prospecting" means investigation in order to identify mineral concentration without disturbing the subsoil through physical observation, rock sampling, airborne surveys and reviewing related geological and mineral information (www.mram.mn).

Table 1. Summary of FDI Inflows into Mongolia by Sector up to 2003
(cumulative value)

Sector	US\$1 million
	Investment
Geological prospecting, mining and oil exploration	462.076
Trade and catering services	128.466
Light industry	83.338
Processing raw materials of animal origin	50.267
Engineering construction and production of building materials	49.502
Banking and financial services	31.467
Transportation	20.957
Telecommunications	20.924
Culture, education, science and publishing	17.540
Production of food and beverages	14.387
Tourism	11.424
Agriculture	9.510
Energy	5.269
Furniture production	5.146
Health and beauty services	4.825
Public services	2.208
Electric appliance manufacturing	1.600
Jewelry and gifts	1.364
Production of housewares	1.325
Other	78.790
Total	1,000.385

sector and comprise around a quarter of the country's total exports.

Processing raw materials of animal origin

FDI in industries dealing with the processing of such raw materials as cashmere, camel wool, animal hides and skins, intestines and bones is mainly conducted by investors from China, the USA, Italy, the UK and Japan. The average investment per company is around US\$342,000. This sector also includes meat-processing companies established by investors from Russia, Kazakhstan, Poland, Germany and Switzerland. Leather, cashmere and wool goods, processed intestines and bones are the main items produced by companies in this sector.

Engineering construction and production of building materials

The construction sector is growing as well, due primarily to the promulgation of the Land Ownership Law for Mongolian citizens, which allows for the private ownership of land.

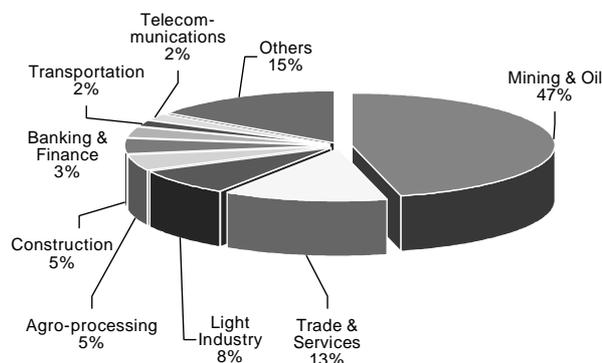
Banking and financial services

The banking sector has recently become a recipient of FDI due to the privatization of the Trade and Development Bank and the Agricultural Bank of Mongolia, as well as further liberalization in the banking system.

Telecommunications

Japan is the leading investor in the telecommunications sector, although last year investors from the ROK began to compete with Japanese investors in the provision of mobile phone services, bringing service charges down and improving quality

Figure 2. Cumulative Sectoral Distribution of FDI Inflows up to 2003



2. 2. FDI Inflows by Country

The country has been the focus of broad-ranging interest from investors in a variety of sectors across the globe, especially those in East Asia and North America. China leads the list, accounting for about 37.9% of total investment, followed by Canada (13.2%), the USA (11.4%), the ROK (8.1%), Japan (6.0%) and Russia (3.3%), with other countries accounting for the remaining 20.1%.

China is currently the leading investor both in terms of the value of investment and the number of companies. Chinese FDI flows are growing in such sectors as geology and mining (US\$153.8 million), trade and catering services (US\$92.5 million), engineering construction and construction materials (US\$30 million), and light industry (US\$22.9 million).

Canadian investors are very active in the geological surveying and mining sectors; 17 of a total of 23 Canadian investors in Mongolia are engaged in this sector and FDI

increased from US\$6 million in 2002 to US\$120 million in 2003, pushing it up from 15th place to 2nd in the list of top investing countries.

Figure 3. Distribution of FDI Inflows by Region

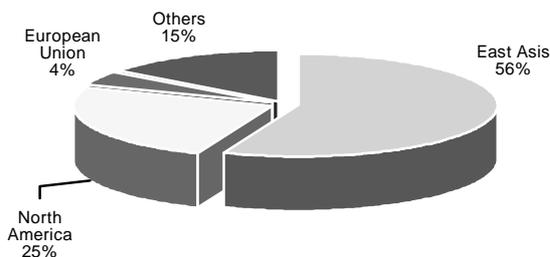
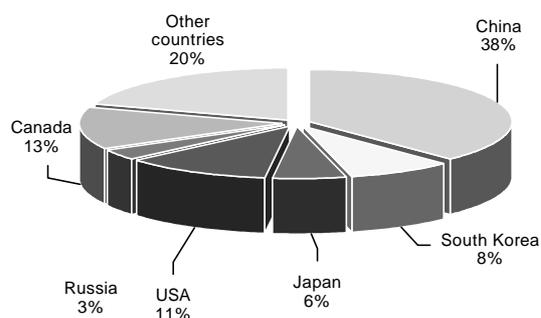


Table 2. Top Fifteen Countries Implementing FDI in 2003 (cumulative value, US\$1 million)

	Country	Investment
1.	China	379.010
2.	Canada	132.518
3.	USA	114.895
4.	ROK	80.856
5.	Japan	60.429
6.	Russia	33.718
7.	Bulgaria	27.215
8.	Hong Kong (China)	21.646
9.	UK	21.309
10.	British Virgin Islands	17.953
11.	Bahamas	14.814
12.	Taiwan (China)	10.957
13.	Italy	10.734
14.	Singapore	9.151
15.	Other countries	65.180
	Total	1,000.385

Figure 4. Distribution of FDI Inflows by Source Country



American investors were more attentive to the following sectors: geology, mining and oil (US\$94.3 million), processing raw materials of animal origin (US\$6.9 million), light industry (US\$4.0 million) and construction & construction materials (US\$2.6 million).

FDI from the ROK is increasing, taking place in such industrial and service sectors as geology & mining (US\$12.8 million), light industry (US\$6.7 million), transportation (US\$5.6 million) and telecommunications

(US\$5.3 million).

Japanese investors have preferred to invest in such sectors as light industry (US\$28.1 million), telecommunications (US\$8 million), trade and catering services (US\$3.1 million) and processing raw materials of animal origin (US\$1.8 million).

Investment on the part of Japan outstrips that of other countries in the telecommunications sector, as well as in the field of cashmere processing. Mongolian cashmere goods have been introduced to the international market for the first time with the assistance of Japan. A bilateral agreement between Mongolia and Japan on the encouragement and mutual protection of investment was signed in February 2001 and is expected to facilitate Japanese FDI in Mongolia. The presence in Mongolia of branches of such Japanese companies as Itochu, Sumitomo, Nissho Iwai, Osaka Cashmere and Mitsubishi may have influenced this growth.

As of the end of 2003, the government of Mongolia had concluded bilateral investment treaties with 37 countries and double taxation exemption treaties with 31 countries. Additional factors attracting FDI to Mongolia include the country's Most Favored Nation status under trade agreements with countries such as Austria, Canada, Japan and the USA, its Textile Trade Agreement with the European Union and its incorporation into the General System of Preferences of many countries.

It seems that interest in Mongolia on the part of Japanese investors is growing and covering new business areas too. In 2003, FIFTA registered 29 joint ventures in which Japanese personnel or legal entities were involved financially, with a total value of US\$6.8 million. Examples include Suruga Corporation, which has engaged in re-investment in golf-related business, while Dynem Investment Co. is involved in freight forwarding and Autobacs Seven Co. has an interest in car repair services and sales. Monenzim International, a newly established joint venture in the field of science and technology, has already started to produce cosmetics for the Japanese market. The tourism, trade and mining sectors are also favored by Japanese investors. Increasing investment from Japanese investors is expected, based on the growing competitiveness of Mongolian products and services, using hi-tech, environmentally friendly technologies.

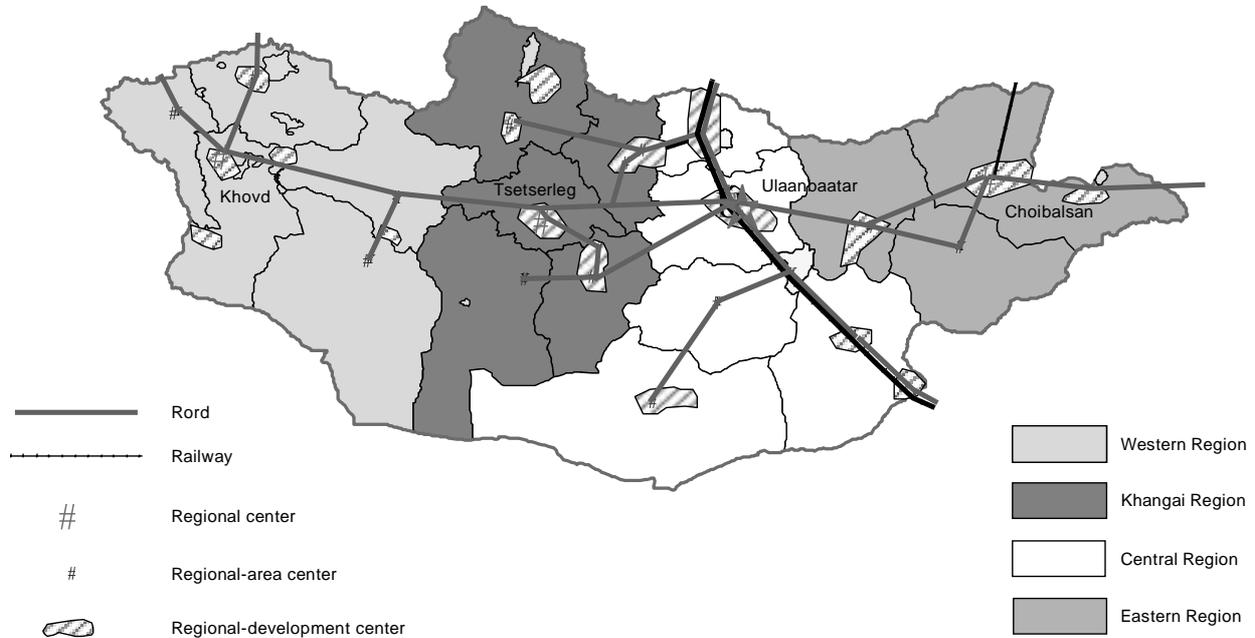
FDI flows from Russia tend to be concentrated in such sectors as geology & mining (US\$7.8 million), construction & construction materials (US\$5.2 million), banking and financial services (US\$4.1 million) and the food industry (US\$3.1 million) sectors. It should be noted at this point that this review does not cover data on investment predating the 1990s.

2. 3. Ownership and Average Value of Investment

Of the 3,042 foreign incorporated companies that have been registered in Mongolia, 60.4% are joint ventures and 39.6% are wholly owned foreign-invested companies.

The average value of FDI per company is about US\$330,000, but varies greatly depending on the sector, ranging from around US\$2 million in the geology, mining and oil sector to US\$180,000 in the trade and catering sector.

Mongolia's Economic Development Regions



2. 4. FDI by Location

Looking at investment by location, 95.6% of total registered investment is concentrated in the capital city of Ulaanbaatar, with the remaining 4.4% (i.e. about US\$43.7 million) being distributed among the provinces. 11% of investment in the provinces is registered in the Western region, 29.4% in Khangai region, 33.1% in the Central region and 27.5% in the Eastern region. In other words, FDI is basically concentrated in the cities and provinces, where infrastructure is better developed.

Western Region (Zavhan, Uvs, Khovd, Bayan-Olgii and Gobi-Altai provinces)

Since 1993, 61 foreign-invested companies registered with FIFTA have directly invested a total of US\$4.4 million in this region. These companies are mainly active in the geology & mining, food processing, light industry and service sectors.

Khangai Region (Khovsgol, Bulgan, Orkhon, Arkhangai, Ovorkhangai and Bayankhongor provinces)

Since 1992, 41 foreign-invested companies registered with FIFTA have directly invested a total of US\$13.4 million in this region. These companies are mainly active in the wool, leather and wood processing industries and the mining, construction, tourism, agriculture and service sectors.

Central Region (Selenge, Darkhan Uul, Tov, Dundgovi, Dornogovi, Gobisumber and Omnogovi provinces)

Since 1992, 88 foreign-invested companies registered with FIFTA have directly invested a total of US\$14.5 million in this region. These companies are mainly active in the geology & mining, light industry, building materials manufacture and service sectors.

Eastern Region (Khentii, Dornod and Sukhbaatar provinces)

Since 1992, 22 foreign-invested companies registered with FIFTA have directly invested a total of US\$11.4 million in this region. These companies are mainly active in the geology & mining and agriculture sectors.

2. 5. Free Economic Zones

The Mongolian parliament has recently passed a number of laws concerning the development of free economic zones (the Free Zone Law, the Altanbulag Free Trade Zone Law, the Zamyn-Uud Free Economic Zone Law and the Tsagaan Nuur Free Trade Zone Law) in 2002 and 2003.

Trade in the Altanbulag Free Trade Zone, located along the northern border with Russia, is expected to expand rapidly due to the favorable economic incentives as well as its excellent infrastructure, including both road and rail links. A masterplan for this free trade zone has been formulated and will soon be published with the aim of attracting further investors.

Located on the southern border with China, the Zamyn-Uud Free Economic Zone will be very important for the economic development of the country due to its close proximity to a large trading partner and the increasing volume of trade being seen in that area.

Located on the western border with Russia, along the Millennium Road, Tsagaan Nuur Free Trade Zone was recently established by means of an act of parliament.

2. 6. FDI: Economic Aspects

FDI has increased as a result of measures taken by the Mongolian government, bringing new investment from an increasingly diverse group of international investors into numerous sectors, helping to broaden the country's economic base while providing greater opportunities to the

workforce.

So far, foreign incorporated companies (including joint ventures established before the 1990s) in Mongolia have created around 70,000 jobs (cumulative data). They also account for about half of the country's total exports and pay about 40 billion togrog in tax revenue each year. According to the General Taxation Authority, in 2002 foreign invested companies paid a total of 37.3 billion togrog, accounting for 10.5 % of total tax revenue.

In addition to creating new job opportunities and contributing tax revenue to the state budget, foreign-invested companies indirectly promote other industrial and service sectors (including electricity, heating, telecommunications and transportation).

653 companies were registered in 2003, with total investment worth US\$205.2 million, equivalent to 17.5% of GDP, a 10% increase on the previous year.

2. 7. FDI in 2003

653 companies were registered in 2003, with total investment worth US\$205.2 million. Compared with the previous year, these indicators increased by 67% and 11.7% respectively. It is interesting to note that existing foreign investors in Mongolia are now re-investing, making significant contributions to overall total FDI for the year. This trend is a very positive one and FDI is expected to pick up further in the future. For instance, between 2000 and 2003, 105–140 existing foreign incorporated companies invested a total of US\$29.5–141.1 million, accounting for between 28.3% and 69.2% of FDI for the relevant year.

Sectors such as geological prospecting, oil exploration & mining, trade and catering services, construction and manufacture of construction materials, banking, the food industry and the textile industry are the leading recipients of foreign direct investment.

Table 3. FDI Inflows in Major Sectors in 2002 and 2003

Sectors	Investment (US\$1 million)	
	in 2002	in 2003
Trade and catering services	89.543	8.315
Geological prospecting and mining	36.176	157.225
Engineering construction and production of building materials	5.985	2.390
Banking and financial services	4.002	0.125
Culture, education, science and publishing	3.430	2.391
Production of food and beverages	2.996	0.736
Light industry	2.885	4.708
Transportation	1.154	2.284
Tourism	0.719	0.826
Processing raw materials of animal origin	0.296	0.125
Others	25.334	25.806
Total	172.520	205.214

Table 4. Top Foreign Investors in Mongolia for 2002

Recipient Company	Origin of Investment	Main Sphere of Activity
SOCO Tamsag	USA	Oil exploration
Ivanhoe Mines	Canada	Mining
Mobicom	Japan	Telecommunications networks
Boroo Gold	Canada	Mining
Buyan Holding	Japan	Cashmere processing
Chinggis Khaan Bank	British Virgin Islands	Banking
Mongol-Amicale	USA	Cashmere & camel wool processing
Tumurtei Huder	China	Mining
Zolotoi Vostok	Russia	Mining
Mongol Hung Hua	Hong Kong	Textiles
GL-Monpolimet	USA	Mining
Gobital	Italy	Cashmere processing
Zuilun	China	Construction
Huanchan	China	Construction
Menatep - Sankt Peterburg	Russia	Banking
Temujin Mench	UK	Textiles
Rock Oil	USA, China	Oil exploration
Trade & Development Bank	Luxembourg	Banking
4x4 Parts Mongolia	Australia	Trade and services

2. 8. Top Investors in 2002 and 2003 and their Main Spheres of Activity

2. 9. Comments by Investors

“In my experience over the past three years, the Mongolian government has been implementing appropriate policies concerning the promotion of foreign investment, encouraging investors with various incentives. As the economy grows, living standards are improving, the country is being integrated into the world economy, and there is a more business-friendly environment. As for local Mongolians, they are very friendly, talented, hard-working and helpful in assisting with the growth of companies. I believe that Mongolia will develop successfully in the future,” said Mr. Wilson Wong Ho, General Manager of “United Apparel-Mongolia Limited” Co., Ltd., which is active in the textiles sector. (Source: FIFTA Brochure 2004)

“In the past few years, the Mongolian government has taken a number of steps in the right direction in terms of attracting foreign investment. The major advantage of investing in Mongolia is the fact that, compared with other Asian countries, procedures for setting up a business here are simple, such as obtaining licenses and special approval. Tax policies are being improved in comparison with other countries. Mongolia has many fields worthy of investment.” Mr. John Savageau, General Director of the Mongolian-American joint venture “Magicnet” Co., Ltd., shares his experience in the information and telecommunications sector. (Source: FIFTA Brochure 2004)

“For investors like us, a stable political, economic and legal environment, a clear tax policy and attractive incentives are the important factors when making an investment and doing business. I would particularly like to note that Mongolia has one of the best laws on minerals. In addition, the opportunity to work with the country’s skilled

and motivated young workers creates a pleasant business environment for us. I would say that Mongolia is the right option for entrepreneurs seeking to invest overseas, especially because of the excellent opportunities it offers in the mining sector.” Mr. Edward Flood, Vice-President of “Ivanhoe Mines” Co., Ltd. (Source: FIFTA Brochure 2004)

Mr. Robert J. Washon, General Manager of Soco Tamsag Inc., which is active in the field of oil exploration, said that, “We have been increasing the volume of our investment in Mongolia by US\$5-7 million annually and 2003 is no exception. We have adequate reason to increase our investment”. (Source: *Onodor* newspaper, #222, 19th September 2002, Kh. Enktuya, *Let’s Cooperate in the Development of Mongolia*, Ulaanbaatar)

3. Outlook for 2004 and Beyond

UNCTAD predicts that FDI flows will stabilize in 2003, with further increases from 2004 onwards depending on factors at the macroeconomic, microeconomic and institutional levels. The fundamental economic forces driving FDI growth remain largely unchanged and intense competition continues to force transnational corporations (TNCs) to invest in new markets and seek access to low-cost resources and factors of production. Green field investment is likely to become more important as a mode of entry, especially in developing countries and Central and Eastern Europe. Tourism and telecommunications are expected to lead the recovery.

It is expected that the upward trend will continue in a steady manner in 2004 and beyond, in line with increased interest in Mongolia as an investment destination. Investment will most likely continue in areas recently targeted by foreign investors, such as geological prospecting and mining by international companies such as Cameco Gold, Ivanhoe Mines, Placer Dome Inc. and AngloGold. Reasons for this include the following:

- Ease of access to the vast markets of China and Russia.

Table 5. Top Foreign Investors in Mongolia in 2003

Recipient Company	Origin of Investment	Main Sphere of Activity
Boroo Gold	Canada	Mining
Soco Tamsag	USA	Oil exploration
Ivanhoe Mines	Canada	Mining
Trade and Development Bank	Luxembourg	Banking and financing
Suruga Mongol	Japan	Golf
Baolinpetrochem	China	Oil exploration
Petmongolia	UK	Light industry
Erdmin	USA	Copper processing
Mobicom	Japan	Telecommunications
Bogda Holdings	China	Construction, tourism
Donshen Gazryn Tos Mongol	China	Oil
Magic Suit	USA, Canada	Light industry/textiles
Ulaanbaatar Cinema	ROK	Entertainment services
Monperlit	Ukraine	Manufacturing construction materials
Mongol Amicale	USA	Cashmere and wool processing
Etsiopharodari	Austria	Trade and services
United Apparel	Bermuda	Light industry
Temujin Mench	UK	Knitting and textiles
Monfresh Juice	China	Food production
Nasny Zam	China	Construction of roads and ferro-concrete bridges

- Worldwide availability of information about Mongolia's mineral resources (Oyu Tolgoi and other copper and gold deposits) and government decisions approving a list of priority sectors for foreign investment in 2001, and the 2002 publication of the medium-term plan for the geology and mining sector.
- Free FDI regimen (foreign investors allowed to establish wholly foreign-owned enterprises and engage in any activities not restricted by law), FDI protection, and taxation incentives and exemptions under the Foreign Investment, Taxation and Customs Laws of Mongolia. Amendments made to the Foreign Investment Law in 2002 increased the forms and types of FDI, opening up opportunities for bigger investors to do business in stable taxation conditions.
- Increased private savings (private savings increased from 86.4 billion togrog in 1998 to 207 billion togrog in 2002 and to 348.6 billion by the end of 2003) improves the competitiveness of local businesses, which may ultimately also have a positive impact in terms of attracting foreign investors.

Mr. Blair Baker, a market trade specialist with *The Wall Street Journal*, has been quoted as follows, "The sound policies of the government and the Central Bank of Mongolia have a positive impact on investors' interest in Mongolia. Today, Mongolia has created a favorable legal environment for foreign investment. However, as a matter of fact, the strengthening of the economic indicators has a far greater impact in terms of promoting Mongolia overseas than improvements to the legal system." (Source: FIFTA Brochure 2004)

Therefore, the main way in which FIFTA³ can achieve its targets might be to undertake professional advertising activities aimed at attracting foreign investment to sectors such as mining and infrastructure, as well as monitoring and providing support for the implementation of approved projects. In addition, one of FIFTA's priority activities will be to attract FDI into the Free Economic Zones and Regional Economic Development Zones, in addition to supporting and advertising relevant projects.

4. Conclusion

The Mongolian government has been successful in developing and implementing policies aimed at opening up the country, attracting FDI, and building a favorable legal environment in line with global standards. As a result, Mongolia has performed superbly in terms of attracting FDI and has great potential to do even better in the future⁴.

It is important to use this internationally recognized comparative advantage for attracting FDI into key domestic development sectors (mining, tourism and agro-processing), transferring and adapting innovative technologies in order to increase the competitiveness of local products and services, and promoting programs targeted at investors concerning the re-investment of profits, the protection of the environment and consumer rights.

Improved competitiveness is closely related to the transfer of innovative technology and efforts should be made to use FDI for this purpose.

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³ The primary goal of the Foreign Investment and Foreign Trade Agency of Mongolia (FIFTA) is to attract and promote foreign direct investment into key social and economic sectors in Mongolia. FIFTA provides investment matchmaking services to both foreign and Mongolian investors seeking cooperation in the areas of technology, management and marketing. It hosts foreign investment missions and organizes Mongolian business missions overseas, as well as holding international investment conferences and seminars. In addition, FIFTA carries out investment promotion activities in order to promote a favorable image of the Mongolian business environment.

FIFTA's One Stop Service Center is designed to coordinate assistance to investors wishing to establish business enterprises, by providing a local network facility that will enable investors to comply with all registration procedures. At this center, investors can benefit from the professional advice and support of representatives of such government authorities as tax, customs and labor authorities and other business licensing organizations. Its registration service is authorized to issue a certificate of incorporation with foreign investment or representative offices based on the investor's application; and its aftercare service concentrates on assistance to investors in facilitating further stages of the process of investing in and running a business, including supporting the import of capital and equipment, issuing official letters to the authority responsible for the investor's residency permit and multiple entry visas to Mongolia, as well as assisting with guidance concerning problems faced by investors at the relevant authority level.

FIFTA's web sites: <http://www.investmongolia.com>, <http://www.exportmongolia.com>

⁴ According to UNCTAD's Inward FDI Performance Index and Inward FDI Potential Index surveys, Mongolia moved to the front-runner high potential FDI category in 1999–2001, having been in the lowest FDI potential and performance category in 1993–1995.

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