

Mongolian-Chinese Economic Cooperation as an Important Factor in Northeast Asian Economic Regionalism

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Economic and trade relations between Mongolia and China have expanded dramatically over the last fifteen years, evolving from a complete freeze during the Sino-Soviet cold war to the comprehensive partnership seen today. A number of factors have contributed to this extraordinary development, which has taken place even though the two nations are still struggling to overcome the psychological burden of almost thirty years of enmity between the two peoples during Sino-Soviet confrontation. The opening-up of the economies of both countries toward the end of the 1980s did alleviate the hostile environment between two countries. The collapse of the USSR and the achievement of true independence by Mongolia were embraced by the Chinese leadership when Ulaanbaatar chose a market economy as its main blueprint for reform.

Mongolia and China successfully normalized relations within a few years of the removal of a major obstacle: the stationing of Soviet troops on Mongolian soil. Political and economic relations between the two countries underwent a three-phase process. The first phase, between 1987-1991, was characterized by the full normalization of bilateral relations. The second phase, between 1991-1994, established a new legal basis for bilateral relations. The third phase, between 1994-2005, was characterized by the exchange of top-level visits that promised a long-term, stable relationship in the new century.

1. High-level Political Dialogue

President N. Bagabandi visited China on December 10-15, 1998. He met China's former top leaders Jiang Zemin and Zhu Rongzhi. Bagabandi stated that, "Mongolia is attaching the highest priority to its relations with the PRC in Mongolia's overall foreign policy, characterized by an independent, open, multi-pillar approach, and the political and legal environment for bilateral relations is continuing to improve." Mongolian newspapers also reported that Jiang Zemin mentioned that the two countries have no political, legal or historical problems and no conflict of interests, creating excellent conditions for the active development of friendly bilateral relations and cooperation.¹

The highlight of this visit was the joint statement describing the fundamental principles of bilateral relations towards the 21st century. The statement stipulated a long-term, stable, healthy and mutually trusting relationship as being fundamental for bilateral relations in the next century. It basically confirmed what was codified in the new bilateral treaty of 1994. However, the statement

promised that Ulaanbaatar would be more conscientious in respecting China's demands regarding Taiwan, Tibet and other matters.²

Jiang Zemin, former Chinese President, visited Mongolia in July 1999, marking the highest level at which the Chinese leadership had confirmed that Beijing acknowledges the independence and sovereignty of Mongolia and was determined to maintain good-neighborly relations based on the principles of peaceful co-existence. Jiang Zemin's frequent visits to Moscow and declared "strategic partnership" between Russia and China in the second half of the 1990s undoubtedly influenced Beijing's attitude towards Mongolia. On the other hand, Beijing was eager to exploit the existing stagnation in Mongolian-Russian relations and sent Jiang Zemin to visit Ulaanbaatar ahead of any Russian presidential visits.

During Jiang Zemin's visit, the Chinese and Mongolian governments signed three documents and exchanged one note. The documents were inter-governmental agreements on economic and technical cooperation, on the joint prevention of forest and grassland fires in border areas and an exchange of letters on the use of free assistance provided by the Chinese government to the Mongolian government in 1998. The note exchanged dealt with the revision of certain articles for an inter-governmental agreement on health cooperation.³

During the negotiations between the two Presidents, a number of important bilateral issues were discussed, including a request by Mongolia for the transit through its territory of a proposed gas pipeline and energy transmission lines between Russia and China, a request for the lowering Chinese tariffs on the transit transportation of Mongolian goods on China's railways, and a request to establish highway transport between Ulaanbaatar and Tianjin. The Chinese side praised Mongolia's foreign policy strategy of placing a high priority on the two neighbors, calling it a "wise policy", and requested that the Mongolian government improve the legislative and other environments for foreign investment and protect the interests of private Chinese investors.⁴

Nambariin Enkhbayar, Prime Minister of the Mongolian government during the period 2000-2004, paid a visit to China in January 2002. The Enkhbayar government was anxious to reassure Beijing of the high priority it attached to China in Mongolia's overall foreign policy and sought to secure a Chinese pledge of economic assistance in some economic projects initiated by the Mongolian

¹ Zasgiin Gazriin Medee, December 15, 1998.

² Zasgiin Gazriin Medee, December 15, 1998.

³ Xinhua News Agency, July 16, 1999.

⁴ "Gadaad Hariltsaa", biweekly bulletin of the Mongolian Ministry of Foreign Affairs, No 17 (67), August 9, 1999, pp. 3, 10

People's Revolutionary Party (MPRP).

During his negotiations with Prime Minister Zhu Rongzhi, Enkhbayar requested Chinese economic assistance in the construction of the so-called "Millennium highway" in Mongolia, further bilateral cooperation in developing mining projects in the country, the establishment of a railway link between Mongolia's Dornod province and China's northeastern provinces via Choibalsan-Arxa. The prime ministers also discussed the issue of increasing the supply of Chinese oil products to Mongolia. Letters were exchanged regarding the Mongolian request to import Chinese oil products to the value of the amount of Chinese grant aid pledged in 2001 (about RMB 38 million).⁵

President Bagabandi made his second official visit to China on July 1-6, 2004. During that visit, the two heads of state agreed to further cooperation in the fields of finance, infrastructure and sandstorm prevention. President Hu Jintao put forward a four-point proposal for promoting Sino-Mongolian relations, encompassing such aspects as implementing reciprocal economic and trade cooperation. According to the People's Daily, Hu Jintao told the Mongolian President, "Resource exploration and cooperation in infrastructure should be at the top of the agenda, and the projects agreed by the two sides should be initiated at an early date." President Hu Jintao paid his first state visit to Mongolia in June 2003, when the two countries agreed to promote bilateral relations between their countries in the form of a "good-neighborly partnership based on mutual trust".⁶

2. Trade and Economic Relations

If we look at the past five decades in terms of Sino-Mongolian trade, the first decade, in the 1950s, was a period of stable growth, a decline took place in the second decade, the next two decades saw a stagnation in bilateral trade, and the last decade, in the 1990s, brought unprecedented growth in bilateral trade. The currencies used for payments also differed in these decades. The main currency used in 1951-69 was the Soviet ruble, the national currencies were used in 1970-76 and Swiss francs were used in 1976-90,

with US dollars becoming the main payment method in 1990.

China became Mongolia's largest trade partner in 1999. China's share in Mongolia's exports and imports is increasing steadily, with its share of exports more than doubling from 24.7% in 1993 to 58.9% in 2000 and its share of imports rising from 17.6% in 1993 to 20.5% in 2000. By 2000, China had become the largest importer of Mongolian minerals and other goods (58.9% of Mongolian exports), ahead of the US (19.9%), Russia (9.7%), and other countries (11.5%). Similarly, by 2000, China had become the second largest exporter to Mongolia (20.5% of Mongolian imports), second only to Russia (33.6%) and ahead of Japan (12.0%) and the ROK (9.0%).⁷

Mongolian exports to China have traditionally consisted mostly of raw materials of livestock origin, which account for about 80-90% of Mongolia's total exports to China. For example, in 1995, Mongolia's exports to China consisted of animal skins and hides (30% of exports to China), raw cashmere and wool (38%), and copper concentrate (17%). In 1999, China became Mongolia's main buyer of copper and copper concentrate for the first time. At present, 94% of Mongolia's copper concentrate, 100% of its molybdenum concentrate, most of its raw cashmere, skin and hides, and 49.5% of its processed cashmere are exported to China.⁸ This factor contributed to the dramatic growth of Mongolia's exports to China in 2004, when an increase of almost 40% on the previous year was seen (see the table above). Imports from China consist mostly of food, consumer products and construction materials.

Mining products such as copper, fluorspar and molybdenum concentrates accounted for 40.6% of the total value of Mongolian exports in 2004. Raw and processed hides, skins and other products of animal origin made up a further 2.7%. Textiles and textile articles accounted for 22.8%, accounting for the largest share after mineral products. With regard to the import structure, the major import items by value in 2004 were machinery and vehicles (30.2%), vegetable products and prepared foodstuffs

Table 1 Sino-Mongolian Trade (\$1 million)

Year	1995	1999	2000	2001	2002	2003	2004
Bilateral trade turnover	147.0	285.7	400.2	351.7	356.8	448.2	661.3
Exports	80.9	208.2	274.4	231.9	217.3	276.7	407.8
Imports	66.0	77.6	125.8	120.2	139.5	171.5	253.5
Balance	14.9	130.6	148.6	111.7	77.8	105.2	154.3
Share of China in total trade turnover (%)	15.7	29.5	34.8	30.3	29.4	31.6	35.5
Share of China in Mongolia's exports (%)	15.5	45.8	51.2	44.5	41.5	46.1	47.8
Share of China in Mongolia's imports (%)	15.9	15.1	20.5	18.8	20.2	21.8	25.1

Source: Ministry of Trade and Industry, Government of Mongolia

⁵ Unen, January 15, 2002

⁶ "Chinese, Mongolian Presidents hold talks", *People's Daily Online*, http://english.peopledaily.com.cn/200407/06/print20040706_148567.html, accessed July 7, 2004.

⁷ Mongolian Statistical Yearbook 2000, Ulaanbaatar, National Statistical Office of Mongolia, 2001, pp. 177-179.

⁸ Galsandorj D, Bud H, "A Brief History of Mongolia's Foreign Economic Relations (1921-2000)", Ulaanbaatar, 2001, p. 184.

(15.6%), and mineral products (22.9 %).⁹

Looking at Mongolian exports to China, copper ore and copper concentrates constitute the single largest item. In 2004 alone, 556.2 tons of copper ore and concentrates worth \$280.6 million (almost 70% of the total volume of exports to China) were exported to China. Foodstuffs and consumer goods accounted for the majority of imports from China.¹⁰

Border trade. The first border trade agreement was signed in November 1985 in Ulaanbaatar. There was dramatic growth during the period 1986-1991, from just 630,000 Swiss francs in 1986 to about 30 million Swiss francs five years later.

The two governments exchanged further letters on border trade during the third meeting of the inter-governmental commission on economic, trade, scientific and technological cooperation held in April 1994 in Ulaanbaatar. Based on these letters and other agreements, border trade was conducted through ten border points, including one permanent point at Zamyn Uud-Erlan and nine seasonal ports.

On the Chinese side, until 1994 Mongolia's main trading partners were local traders from Chinese Inner Mongolia. Then traders from the coastal and southern regions of China, such as Shandong, Guangdong and Fujian, began to participate in border trade with Mongolia. This factor has brought about an increase in the import price of animal products from Mongolia to China. For instance, sheepskin cost \$6.25, horsehide \$15, cowhide \$16.6, and one kg of cashmere \$27.5 on the Ulaanbaatar market in January 2005.¹¹

Although border trade was regulated by inter-governmental agreements in 1994, there are still a lot of deficiencies and problems. Traders and economic entities from both sides frequently use fake trade documents, delay payment to each other, ship poor quality goods, smuggle goods and are guilty of other trade malpractices. Because of the poor facilities on the Mongolian side, border trade operations are mostly conducted on Chinese territory. The Chinese customs authorities also levy unfairly high taxes and other duties on Mongolian traders and their vehicles. This factor has led to some complaints from Mongolian traders regarding the one-sided nature of border trade that favors Chinese traders.

Loans and grant aid. During the 1950s, the Chinese government provided Mongolia with both grant aid and concessional loans. Grant aid of 36.0 million rubles provided in two installments in 1956 and 1960 was used for 18 construction projects including a textile factory, Nalaikh glass factory, Suhebaatar power plant and road building.

Of the loans of 67.5 million rubles provided in two installments in 1958 and 1960, 46.1 million rubles were

actually used for the construction of a number of projects including, most notably, a 50,000 square km apartment complex in Ulaanbaatar, the Tolgoit power plant, a stadium and another sports facility in Ulaanbaatar, and numerous bridges in aimags.¹² During the period 1955-64, a total of more than 18,300 Chinese laborers worked on numerous economic construction projects in Mongolia.

Since the August 1991 visit of Yang Shankun, Chairman of the PRC, the Chinese government has provided several tranches of grant aid, which have mostly used by the Mongolian government to purchase food products from China. Between 1991-98, a total of RMB 42.6 million of grant aid was provided by China.

In the 1990s, the Chinese government provided an interest-free loan in three installments: RMB 50 million in 1991, RMB 30 million in 1992, and RMB 50 million in 1994. In August 1995, the two sides selected 15 projects to be financed from these Chinese loans. It was agreed to use the remainder for a "super market" project and for the purchase of construction materials from China.

During the visit of President Natsagiin Bagabandi to China in December 1998, the Chinese government pledged to provide grant aid of RMB 30 million and additional concessional loans worth RMB 100 million. The two sides agreed to use these additional loans for the construction of an apartment complex in Ulaanbaatar.

During his visit to Mongolia in June 2003, President Hu Jintao pledged to provide Mongolia with \$300 million in loans. The Chinese government designated the Export-Import Bank of China as the bank representing Chinese interests stipulated that the loans should be utilized for high efficiency projects in the areas of mining and infrastructure development. Six rounds of negotiations were held between two parties in July 2003 and July 2004. A general agreement has yet to be reached, but the two parties have agreed that loans will be provided for 20 years at an annual interest rate of 2%.

Investment from China. The Mongolian Law on Foreign Investment was adopted in 1990 and was revised in 1993. Due to its natural disadvantages, including being landlocked and the high transportation costs it incurs, Mongolia was not able to generate much foreign investment. Changes in mining legislation in 1996 did generate some interest from foreign investors in mining, especially gold mining.

According to Lincoln Kaye of the *Far Eastern Economic Review*, "China enjoys advantages in Mongolia that no other potential supplier or investor can match":

- *Proximity.* Shipping costs to and from China's heartland are a fraction of any other partner's. Even for overseas trade, rail links from China's Tianjin port are five times shorter than from the Russian Far Eastern ports on which Mongolia used to rely.
- *Complementarity.* China needs Mongolia's resources

⁹ Foreign Trade Statistics, December 2004, published monthly by the Mongolian General Customs Administration, pp. 26-27.

¹⁰ *Ibid.*, p.89.

¹¹ *Business Times*, January 2005, No 3 (407)

¹² The two governments met in 1986 and agreed that the Mongolian side would pay 49.2 million rubles to repay that debt with interest. 20.9 million rubles were paid off between 1986-1990, with the remainder being deferred at the request of the Mongolian government.

of timber, minerals and animal products. At the same time it offers farm produce, light manufactures and capital goods that fit Mongolia's level of development and spending power.

- *Familiarity.* For better or worse, China and Mongolia have long experience of each other. And Chinese-controlled Inner Mongolia provides Beijing with a ready supply of Mongolian-speaking market agents.¹³

Indeed, China was well positioned to exploit the opportunities created by new liberal legislation designed to create an extremely favorable environment for foreign investors. Mongolia has signed several agreements with China on the avoidance of double taxation, as well as treaties on mutual protection and the encouragement of investment. Between 1990 and 2004, 1601 Chinese companies registered with the Mongolian Foreign Investment Board, investing a total of \$457.6 million. In 2004 alone, Chinese investors invested \$125.9 million, 2.7 times the amount of investment in the previous year. According to statistics released by the Foreign Investment Board, 68.5% of Chinese investment was directed to the mining sector, 24.1% to retail sales and restaurants, 1.1% to construction, 0.6% to light industry, and 4.2% to other industries.¹⁴

Understandably, Chinese joint ventures were mostly established in construction, restaurants and fast food, and retail sales businesses. Lately, Chinese investment has been moving towards mining and agriculture. Although China retains the number one position among foreign investors in terms of total investment committed so far, Chinese investment has a number of weak points. Firstly, most Chinese small investors use their registration to obtain a long-term residence permit rather than actually for the purpose of investing and doing business. Secondly, the low initial capital requirement for registration (\$10,000) makes it easy for Chinese people to register a joint venture but engage in other activities. Most of the Chinese businesses established in Mongolia are small-scale, technologically poor, and primarily engaged in buying raw materials from Mongolia and transporting them to China to add value to them there.

Tourism. Tourism is another branch of the economy with good prospects for Mongolian-Chinese cooperation. There are two ways in which collaboration in this field could be implemented: firstly, travel between the two countries should be encouraged; secondly, mutual investment in the tourism industry should be promoted, with a view to operating transnational tourism that includes tourist destinations in Mongolia, Russia and China. According to Chinese statistics, 399,100 people from Mongolia visited China in 2000. Average expenditure per visitor from Mongolia was estimated at \$377 per day.¹⁵ According to

that estimate, Mongolian visitors contributed \$151 million to China in 2000 alone.

In 2000, 158,000 foreign passengers crossed the border into Mongolia, 58,300 of whom were from China. There is great potential for developing cooperation between China and Mongolia in the international tourism industry and China's accession to the WTO will undoubtedly have a positive influence. Negotiations are underway with the aim of concluding a framework agreement to include Mongolia in the number of most favored tourist destination countries, which Chinese tourists can visit in groups.

Prospects for cooperation in mining. China is expected to experience a large deficit of raw materials in the coming two decades. China's crude oil consumption was expected to reach 270 million tons in 2004, including more than 100 million tons of exports.¹⁶ Some of the demand can be met by imports from Russia and also Mongolia, as the latter has discovered a large deposit of oil in the border province of Dornod, in the Tamsag valley.

China accounts for about 20% of global copper consumption, double the level of a decade ago, and the country's appetite shows no signs of abating. Copper prices have almost doubled in the past two years as demand surges in China, the USA and Japan.¹⁷ Exports of copper accounted for more than 70% of Chilean exports to China in 2003 and it is becoming necessary for China to purchase mines abroad and establish joint ventures to ensure further supply. At the same time, copper is one of Mongolia's major export products. In addition to Erdenet mining, the discovery of several new mining deposits in Mongolia has been reported, along with the need to attract foreign direct investment. The Tsagaan-Suurga copper deposit, located 164 km southwest of the Zuun-Bayan railway station, is located in an under-populated, water-scarce semi-desert region of Southeast Mongolia. Commercial ore reserves at the deposit have been estimated at 220-240 million tons. The gold and copper reserves of the Oyu-Tolgoi deposit, which is situated in Khanbogd soum, Umnugobi aimag, are estimated at 448.7 tons and 3.2 million tons respectively.

3. Some Implications for Japanese Trade and Investment in Mongolia

Although Japan has been the largest provider of Official Development Assistance (ODA) to Mongolia since 1991, Japanese trade with and investment in Mongolia remains insignificant. The annual volume of Mongolian-Japanese trade has exceeded the \$100 million mark only three times: in 1996, 1999 and 2004. According to the Ministry of Trade and Industry, bilateral trade grew in 2004 to \$107.9 million, with Mongolian imports totaling \$74.5 million and Mongolian exports totaling \$33.5 million. Mongolian exports to Japan consisted of two main categories of items: unprocessed or semi-processed gold

¹³ Lincoln Kaye, "Two Mongolias: Faltering Steppes", *Far Eastern Economic Review*, April 9, 1992, p. 16.

¹⁴ Foreign Investment Board, Ministry of Trade and Industry

¹⁵ <http://www.cnta.gov.cn>

¹⁶ http://www.chinadaily.com.cn/english/doc/2004-04/09/content_321994.htm

¹⁷ "Copper soars on China, sagging dollar", *USA Today.com*, <http://usatoday.com++Copper+soars+on+C...> accessed on April 5, 2005.

(almost 80% of exports), and animal wool or hair (15% of exports). Mongolia's main imports from Japan were mining equipment, cars and other vehicles, and electronics.

Japan is the fourth largest investor in Mongolia. During the period 1990-2003, a total of \$60.4 million was invested by Japanese private investors. Most Japanese FDI (44.2 %) was directed towards cashmere processing or the manufacture of cashmere goods, 12.7% to telecommunications, another 12.7% to the education sector, and the remainder to transportation and services. Mobicom, a Mongolian-Japanese joint venture in the cell phone service sector, and Buyan Holding, a joint company involved in the manufacture of cashmere goods, are registered as the two most valued foreign investors in Mongolia. Companies like "Hasebe International" and "Dai Sogen" have invested in tourism, tourist hotels and restaurant services.

Japanese ODA has played a crucial role in sustaining the Mongolian economy in the transition years since 1990. It still plays a key role in the rehabilitation of infrastructure, including energy, transportation and communications, and in the revitalization of agriculture and the livestock industry. However, Japan's ODA contributions to Mongolia have been falling in recent years. China has assumed a greater role in the Mongolian economy and has gradually replaced Japan as the biggest donor to Mongolia. A Chinese offer of \$300 million in concessional loans to Mongolia in June 2003 is further evidence of China's growing confidence and active engagement in Mongolia.

4. Conclusion

China has emerged as Mongolia's largest trade partner and the biggest private investor in Mongolia in less than a decade. While Russia and others still enjoy some political and economic influence in Mongolia, it is China that is emerging as its main partner. For landlocked Mongolia, the vital roads to the south and east run through China. In its August 2004 issue, the Chinese weekly "Liaowang Dongfang" published a feature entitled "China is coming back to Mongolia".¹⁸

Notwithstanding routine high-level visits and pledges of economic cooperation, some serious risk factors remain in Mongolian-Chinese relations. China offers increased trade and investment in return for Mongolia's commitment to the "one China" principle and its acceptance of the Chinese veto on visits to Mongolia by the Dalai Lama. Beijing has also called for a shared view with Ulaanbaatar on global and regional issues in order to limit growing US involvement and presence in Central Asia and Mongolia.

Proximity and economic complementarity make the two countries natural partners for increased economic interaction and trade. A recent article in the *Far Eastern Economic Review* stated that, "The result of this growing economic engagement is an expansion of China's soft power – a nation's ability to get what it wants by attracting and persuading others to adopt its goals, instead of through blunt economic and military suasion."¹⁹ As Chinese energy demand rises, a stable and neutral Mongolia is important for China as a minerals exporter and a transportation corridor between resource-rich Siberia and Far Eastern Russia and resource-deprived coastal and central China.

¹⁸ "Liaowang Dongfang Zhoukang" (Oriental Outlook Weekly), 2004.08.26. pp. 32-45.

¹⁹ David Murphy "Softening at the edges", *Far Eastern Economic Review*, November 4, 2004, pp. 32-33.
