

MONGOLIA

Moving Mountains

Not many nations have celebrated their 800th anniversary. Mongolia not only looks back this year at the legacy created by its founding figure, Chinggis Khan, but is equally reviving his vision and values as the country becomes a modern market economy. A change of government in January 2006 ushered in a renewed drive to harness the Central Asian state's natural resources, geo-political location, tourism, and agriculture as catalysts for prosperity. Closer ties with Russia, China, and third neighbors Europe and America, are priorities for enhancing Mongolia's role in global trade; an essential element for securing national development.

The Making of a Modern Mongolia



President Nambaryn Enkhbayar

President Nambaryn Enkhbayar has, in a relatively short time, become an experienced and respected politician by serving in various high-ranking functions within the Mongolian government. His 2000-2004 term as prime minister paved the way for Mongolia to reach its highest growth rate of 10.6 percent through effective economic reforms, settle its debt to the Former Soviet Union, and effect the first privatization of land to Mongolian citizens. After a year as parliament speaker, he won the December 2005 Presidential election, inheriting a country with great prospects on one hand, yet challenges of poverty and corruption on the other. One of the government's priorities for the 2005-2008 period focuses on regional development. "One third of the population lives in Ulaanbaatar, and the capital city has potential," says President Enkhbayar, "but we believe that in order to develop Mongolia in a balanced way, we also have to modernize the regions. At present unemployment and poverty particularly affect the provinces and rural areas."

These criteria are critical to qualifying for the Millennium Challenge Account (MCA), a program initiated by the US government to strategically support developing nations in overcoming contemporary hardships. "Our main target is to use the assistance of the MCA for improving Mongolians' lives and boosting economic development. They concern elimination of poverty and unemployment, the fight against corruption, and the promotion of regional development." President Enkhbayar hopes the agreement will be signed this coming autumn. The MCA will no doubt influence FDI inflows, especially American investment. To this end, the Free Trade Agreement currently being finalized between the two nations will increase exports to the United States.

Having been voted the fourth most favorable mining destination worldwide, Mongolia's copper industry is highly valued and shows great potential. Visiting delega-

tions, from President George W. Bush in November 2005, the first acting US Head of State to visit Mongolia, to former US State Secretary James Baker, have stressed the importance of promoting bilateral programs with regard to trade and investment opportunities, as well as the fight against terrorism. But creating a favorable environment for foreign investors has been the cause of some political unrest of late. The 1997 mining law is under review for being overly accommodating towards external investors, with fears that there is not enough return for the national economy. However, some feel that drastic amendments will ward off FDI.

President Enkhbayar is tempering these political developments, maintaining that the government will render comprehensive support to foreign investors. "We will try to create a secure and attractive environment so that companies establishing themselves here consider Mongolia as the closest and most efficient gateway to large markets like China and Russia." The President stresses that Mongolia is developing its railway and aviation infrastructures to take full advantage of its geo-strategic location providing immediate access to the rapidly increasing Chinese market. These infrastructures will simultaneously increase the potential of other divisions beneficial to Mongolian citizens, like tourism. "We want to develop tourism by targeting Japanese, Chinese, Korean, Russian, American, and European tourists," says President Enkhbayar. "Finally, agriculture is another key sector, as we have plenty of land and lots of livestock which are essential elements of cashmere trade."

As the nation joins the progressive age of global cooperation, the President reminds us that the founder of his state was an advocate of free trade, a promoter of tolerance towards other religions and nations, and the creator of a managerial mechanism still used in business today. "Mongolia's 800th anniversary is a good opportunity to promote the image of our country to the international community. Rediscovering our past, we have tried to build a modern image of Mongolia as a democratic and effective country. We need to celebrate this event as a learning process; it is about becoming efficient in a system based on values of tolerance and communication."

Furthering Foreign Relations

There was a time, not so long ago, when Mongolia's greatest challenge was to raise foreign awareness of the country's location on the world map. In steps and strides, efforts were aimed at building international ties in the wake of its transition into democracy and a free market economy following independence from the former Soviet Union in 1990. Being landlocked by two massive nations, Russia and China, used to mean limited access to the world. However, now that all eyes are focused on China's economic emergence, Mongolia is experiencing a halo effect from all the interest in its neighbor, and is keen to attract attention to its own potentials in trade relations, industry, and services related to China. Russia is also discovering the benefits of the country's resources and railway system, which constitutes the shortest route between China and Europe. Even though Mongolia lost a large source of income in the 90's due to its shift in politics - up to 30 percent of GDP was Soviet related - it has managed to build up a progressive economy as well as ameliorating bilateral ties.

"It is very natural for our country to have good relations with our two neighbors, we simply cannot move away from here," Foreign Affairs Minister Enkhbold affirms. "That is why the priority in our foreign policy is to have balanced and friendly relations with them. At the same time, we have to foster good relations with other nations. Due to our geo-strategic position and the necessity to cooperate with diverse nations in the world, we operate with the concept of third neighbors, calling for economic and political cooperation with the United States, the European Union, Canada, and Asian countries such as South Korea and Japan." Minister Enkhbold says the main aim of creating a balanced rapport of political and economic interests with a variety of nations is an instinctive technique introduced to diversify the country's options. "We want to avoid the dominance of one, two or three countries in Mongolia, especially in terms of the economy."

Since 1990, companies from 74 countries worldwide have invested in Mongolia. In 2004, foreign investment totaled \$228 million from 767 newly registered companies. Last year FDI increased by 4.7 percent.

Transitioning from 'Aid' to 'Trade'

During the 15 years of transition from a centrally planned economy to that of a free market, Mongolia was heavily dependent on aid from mainly US institutions. The United States' government was a driving force behind Mongolia's development. "The US supported our cause alongside international organizations such as the IMF and the World Bank," asserts Minister Enkhbold. "This was very important, because the US had an ambassadorial position with regards to promoting Mongolia to the rest of the world. We have been cooperating with the IMF quite successfully and the aid we received through its activities was very helpful in overcoming the transition period." However, popular consent now agrees that the country should relinquish its dependence on such support and make the move from aid to trade, as Minister Enkhbold points out. "As

the economy of Mongolia grows, many foreign countries and other international institutions are becoming interested in supporting us. Therefore, I believe that the time has come to sit down together and reassess the terms of our future cooperation."

Although China currently accounts for the largest amount of FDI in Mongolia at 34 percent, capturing the attention of the United States, which currently represents only 3 percent of total FDI, has become a primary target since it is one of the largest economies in the world. Mongolia managed to do so gracefully in 2005, evident from a word of gratitude extended by President George W. Bush to the Asian state, when he visited Mongolia. "Earlier this year, when a terrible hurricane struck my nation's Gulf Coast, your government pledged aid, and a group of business leaders in Mongolia raised additional money. These funds are helping to rebuild shattered lives in my country and we thank you for your support and friendship." This poignant example only goes to show how global changes can facilitate a developing country to give back aid to one of its great benefactors.

"As the economy of Mongolia grows, many foreign countries and other international institutions are becoming interested in supporting us."

Foreign Affairs Minister N. Enkhbold

Foreign Affairs Minister Enkhbold believes that there are many more possibilities and opportunities awaiting his nation. "Aside from the political support, we feel that there are plenty more prospects for multifaceted cooperation between our countries." The government is now geared towards harnessing its economic growth along all lines of policy, ready to compete in a global market on its own strength. "We do not want to attract just donors' attention," states the adamant Foreign Minister. "We want to be an equal and responsible partner in co-operation with other countries and significant foreign investors. From now on, we will be asking for direct foreign investment rather than for grants."

Mongolia At a Glance

President.....	Nambaryn Enkhbayar
Prime Minister.....	Miegombo Enkhbold
Area.....	603,908 sq miles
Population.....	2,832,224 (2006)
Capital.....	Ulaanbaatar
Religion.....	Buddhist Lamaist 90%Shamanist and Christian 6%, Muslim 4%
Life expectancy.....	men 62 yrs., women 67 yrs.
GDP per capita.....	\$2,200
Climate.....	harsh winter, warm summer
Languages.....	Mongolian, Turkic, Russian
Currency.....	tugrik (MNT)
Exchange rates.....	100 tugrik = 0.084 US dollars

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The Copper Prospects of Mining

Mongolia is rapidly becoming a mineral powerhouse. The country's record 10 percent growth index in 2004 was largely attributed to a major boost in mining operations, with solid prospects projected for the copper mining industry. The significant price rise of copper on the world market alone is an indication of a bright future for Mongolia's economy, but, to sustain a high level of development, the Central Asian country needs to attract major foreign investment. To this end, a revision of the 1997 mining law aims to balance investor interests with those of the country. To harness this potential, existing companies are diversifying production. New projects, if executed efficiently, could boost the GDP by up to 70 percent.

"During the last two years we have seen a significant increase in geological exploration," says Luvsanvandan Bold, Chairman of the Mineral Resources and Petroleum Authority of Mongolia (MRPAM). Mongolia's resources count various assets besides copper, including coal, oil, phosphates, and gold. "In 2005, we invested around \$130 million in explorations." These investments are enabled by profits made on resource production. "From the petroleum exploitation projects we expect more than \$100 million. This equals our profits from all the previous years of petroleum exploitation." The international community has persuaded Mongolia to make more of its natural resources to sustain economic growth, a fact wholeheartedly acknowledged by Foreign Affairs Minister Enkhbold. "We agree that we should delve into the huge possibilities of using our natural mineral wealth. At the same time, it is true that we do not have the money to explore this untapped mineral potential ourselves."

■ Milling over the Mining Law

The need to attract FDI to Mongolia's mining sector was recognized relatively early on. A mineral law was adopted in the nineties to create an attractive and stable environment for foreign investors. This law has recently come under review amidst growing concerns that it might be disadvantageous to local investors and national interests. President Enkhbayar outlines the function of the new draft. "The existing mining law, passed in 1997, created a favorable environment for foreign investors. At present, we are trying to equilibrate these favorable conditions with the need of bringing benefits to the local community. Our aim is to generate such conditions for both parts, for all those who are interested in developing the mining sector and other sectors of our economy. The main political parties, the parliament, and the government all understand that this is a priority for the future wellbeing of Mongolia."

The largest company active in Mongolia's mining industry is the Erdenet Mining Corporation (EMC), owned jointly by Mongolia and Russia. Whilst priva-

tization of the copper giant is not yet on the government's table, a future sale is planned. Mr. Narankhuu, EMC's General Director, says the outcome of the hotly debated law concerns all people involved in Mongolian mining. "Small domestic capital requires equal treatment to foreign capital. As regards the mining law, there is too much populism. Economic issues are being politicized, yet no party will benefit from such disagreements. I believe we have to pass through a period of dialogue. We need to ask those inconvenient questions and answer them, to confront and to question each other and then, eventually, things will become clearer. All decisions would be incomplete if this process is not completed."

However, the MRPAM's Chairman is confident that the changes will not dissuade investors from entering the Mongolian market. "An investor-friendly environment will be kept despite any amendments to the mining law," assures Mr. Bold. "Tax laws are going to be changed, but they will lower the tax rates on corporations. After these changes, the conditions for investors will be even friendlier. Nevertheless, we have to correct some shortcomings in the legislation concerning environmental issues linked to illegal mining operations, issues related to provisions, and companies that acquire mining licenses, but don't comply with their responsibilities."

Erdenet's General Director points out that regulations should be shaped to create an environment of competition, so that industry players will be stimulated to diversify their products. "Every industry has the potential to make a small or large impact on the economy overall," asserts Mr. Narankhuu. "It depends on what priorities the government has and what policies it creates related to certain issues. For example, the government could establish some taxes on copper concentrate. As a result, mining companies would have to go for value-added products, increasing competitiveness within the market."

■ Supplying the world's largest markets

With demand for copper products skyrocketing and a

growing need for fuel in China's expanding industries, Mongolia has a unique opportunity to capitalize on its geo-strategic location. It is also the only country to have immediate entry to the world's two largest markets. Russia now also constitutes a major consumer as well as a provider of fuel to China, for which Mongolia is the fastest connection via its railway system. Ongoing regional programs in infrastructure development include direct links between Erdenet's copper mines and the neighboring nations. "China's weakest point at this moment is raw materials," EMC's Narankhuu says. "Mongolia is poised to take advantage of this fact. "It is significant that copper becomes a strategic source, a commodity for Mongolia, as with oil or gold."

EMC's strategy is to set its copper processing facilities into operation. "This year we are planning to start the construction of the copper rod plant in Erdenet. It will take 2.5 to 3 years to start production. Next year we will start a copper leach plant that will utilize different types of minerals. End users are definitely in China, since China imports more than 2 million tons of copper annually." Metals have surged the past two years because of a building boom in China, as well as the use of copper in electronics. London Metal Exchange copper prices reached \$8,000 per ton in May 2006, and EMC's revenue for 2005 totaled \$383 million.

■ Ten-year development plan

A key initiative to promote Mongolia's mining sector is the three-day industry exhibition MiningWorld, the second edition of which took place in Ulaanbaatar this year from June 14-16. The exhibition is part of a tour that also takes place in Kazakhstan and Uzbekistan later in the year. The mining sector has the capability of being the biggest engine of Mongolia's economy, but it needs to be a well-oiled motor of the highest standards in order to thrive, another issue addressed by the exhibition. "At present," says Mr. Narankhuu, "one should find the right technology and adequate equipment for every sort of mineral or deposit in our mining industry. If we just excavate the raw material and ship it to China or Russia, we are not developing. It would be exactly like the mining industry 160 years ago."

"We need western management and western funds. Large private investments will definitely accelerate the whole process."

Mr. Narankhuu, General Director of Erdenet Mining Corporation

For this reason EMC has initiated a development plan which foresees a more progressive role for the company in the next ten years, and also that of the mining industry as a whole. "Today's mineral industry is about mining, extracting and creating products such as concentrate. It is about coming up with metals; copper, cathode or zinc. If you develop your production until that point, you will develop research, cooperate with foreign counterparts, and ultimately you will have to integrate as part of a big international mining community, thereby

definitely gaining more value. That is why we are trying to come up with copper cathode or at least copper rods. With the adoption of the Ten-Year Development Plan, we confirmed that EMC has all the necessary pre-conditions for signing an agreement to start production of copper rods in 2006." Another axis of the policy is to encourage internal development. "We used to purchase coal from Russia, but for the last five years we have preferred to rely on our national sources." The same was decided for gypsum, which now has a dozen local suppliers, benefiting EMC, Mongolia, and its economy.

■ The Great Potential

To look forward, one often needs to glance back. In addressing the future of Mongolia's mining industry, references to its recent past are brought up to indicate just how far the country has come, from almost near-isolation to a respected international partner. "Mongolia used to be part of the Soviet system," MPRAM's Mr. Bold reminds us. "Mongolia is now a part of the world and the global economy, as well as the regional Asian-Pacific economy. Now that we are a market economy and a democratic society, we are trying to enter Mongolia into all regional institutions, so that we can participate at all levels." Mr. Narankhuu agrees, but points out that there are still many challenges ahead. "After 15 years of transition, we learned that there are many things which need to be done by the government. Without coming back to a planned economy, there is still a need for regulatory authorities. In the West, it took several hundred years to learn, to have skilful entrepreneurs and owners. The same goes for Mongolia: it is not just about selling property, it is about dealing with people, it is about nurturing entrepreneurs and new business ideas."

MPRAM's Mr. Bold has earmarked some significant developments as holding the key to Mongolia's mining emergence. "If copper projects like the one ongoing at Oyu Tolgoi take off, they will make a significant difference to the Mongolian economy. For example, the Tavan Tolgoi project, an investment of more than \$2 billion, could boost the GDP up to 70 percent. The Oyu Tolgoi project could constitute 40 to 50 percent." Ivanhoe Mines, a Canadian company that has been prospecting the copper and gold deposits in Mongolia's southern Gobi desert since 2003, has presented its mine development plans, according to which it will have started its operations by 2008. Until that time there will be significant construction and exploration activity. It is expected to become the largest mine in modern Mongolia, showcasing Mongolia's capability of hosting first class international business.

"We need western management and western funds," admits EMC's General Director. "Large private investments will definitely accelerate the whole process." But Narankhuu says that one large competitor alone is not enough to drive the sector's advancement. "I dream of having several competitors. It will establish even higher standards of management in Mongolia, and give rise to a new generation of entrepreneurs and managers. Only then will it have a real impact on our whole economy."

Quality Cashmere Industry is Poised to Prosper

The smooth softness of cashmere has become a consumer favorite around the world, and most notably in the United Kingdom and USA. The 2005 holiday season saw cashmere clothing turn into must-have items, and made popular gifts for loved ones. More and more celebrities can be seen sporting the unique cloth. Such appearances have a knock-on effect with many followers of fashion, not only raising the status of cashmere but also, and more importantly, increasing the demand.

Competition in the cashmere industry is reaching feverish heights, as four key countries vie for a cut of the market. Sheering for a share are Mongolia, China, Iran, and Afghanistan. China is dominant and covers 70 percent of the world market followed by Mongolia's 20 percent. Iran and Afghanistan both share 10 percent. Nevertheless, it's the quality of Mongolian cashmere and not the quantity that has made it so wanted. Not only does its warmth engage the senses, but especially the much sought-after softness of quality cashmere. On these grounds there is only one undisputed leader, Mongolia, which produces the finest, thinnest, and purest cashmere. The country's industry has geared up to take center-stage at international trade fairs and textile markets, experiencing buyers' preferences first-hand.

"High quality criteria set our products in a better position than those of China, therefore the Europeans tend to prefer Mongolian cashmere," comments Mr. Sedvanchig, CEO of Gobi Corporation, Mongolia's leading manufacturer of cashmere. The company exports more than 65 percent of the total national wool and cashmere processing sector's capacity, and has experienced a direct increase in exports as a result of the Mongolian government signing the Generalized System of Preferences (GSP+) 2006-2008 with the European Union. "Signing this agreement is a big step towards the development of our factory, but also the Mongolian cashmere industry as a whole," says Gobi's CEO.

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Mr. Sedvanchig, CEO of Gobi Cashmere Corporation

Having advanced in the industry for 25 years, Gobi Corporation has built up a strong network of partners worldwide, with Europe, Japan, and the United States as its main markets. Mongolia has also benefited from a Trade and Investment Framework Agreement with the United States, which makes Gobi a prime contender for investors, enabling it to upgrade its production technologies and expand its activities to capitalize on global opportunities. "We have become a country with a favorable environment for trade with America," confirms Mr. Sedvanchig.

Privatization has been on the cards for some years

and 2006 might well see the breakthrough. The government has taken measures to ensure tax-free imports of technological equipment and raw materials for the development of factories and other incentives such as covering up to 50 percent of employee's social insurance. These measures, together with the current demand in quality cashmere, make the Mongolian market very attractive. "According to the information we have, we foresee that Gobi will be privatized in the near future," reveals Mr. Sedvanchig, adding that since the last international tender in 2004, Gobi's situation has improved in terms of economic and financial statistics. "Currently, 75 percent of our company's shares are state-owned and 25 percent of shares are floated on the stock market."

Mongolia produces over 3,500 tons of cashmere per year, equivalent to 20 percent of the world's entire supply. The focus should not be on the export of raw wool, but the production of cashmere clothing within Mongolia.

Mongolia produces over 3,500 tons of cashmere per year, equivalent to 20 percent of the world's entire supply. The focus, however, should not be on the export of raw cashmere wool, but the production of cashmere clothing within Mongolia, in order to capture the market that China is dominating. The Chairman of the Mongolian Cashmere and Wool Association, G. Yondonsambuu, says that 70 percent of raw Mongolian cashmere finds its way abroad, mainly to China, and believes government policies should promote the manufacturing aspect in Mongolia through incentives. "The price of raw cashmere on the world market is not stable, whereas that of manufactured cashmere products is. China's policy prohibits exporting raw cashmere and as a result, production has increased dramatically." However, with market indicators showing a shift towards refined materials and quality cloth, Mongolia still represents the most promising partner for prosperous designs.

Cashmere is one of Mongolia's best products. "Gobi Corporation is one of the five biggest companies in the world in terms of cashmere production. We have a professional team, with skilled workers, and competent specialists," says Sedvanchig. Furthermore, Gobi shares have recently witnessed a significant increase in value.

At the Frontiers of Expansion

From freight to fiber optics, Mongolia is becoming a network force.

Mongolia's expansive territory covers a geographically strategic area in Asia between the Russian Federation and China. Its reach, however, extends far beyond these primary partners, as third neighbors like Japan, the United States and most importantly Europe come to recognize the lifeline Mongolia is providing in the transit of freight. With China's rapidly increasing industrial demands on energy, Russia's supply of oil is essential to their market. Vice versa, Chinese products rely on an equally dependable link for their exports to Europe. Opportunities are being created region-wide with the necessity of swift and stable delivery. This bridge is made possible by the Mongolian Railways, with its efficient and timesaving network. As Mongolia's road infrastructure is not as developed as that of its railroads, transportation depends heavily on its system.

"This year, we doubled our carrying capacity and succeeded in improving our time efficiency due to the modernization of our fleet. A trip that in the past would have taken 6.5 days has now been reduced by 2.5"

V. Magdey, Chairman of Mongolian Railways

Mongolian Railways, a joint venture between Mongolia and Russia, manages the country's 690-mile line between Russia and China. It is part of the Euro-Asian route that runs 3712 miles between Yekaterinburg via Ulaanbaatar to Beijing and Tianjin. There are two alternative routes on the Trans-Asian railway network, over Russia and Kazakhstan, but Mongolia's route undercuts these by 464 and 318 miles respectively. To increase its competitiveness, Mongolian Railways has implemented strategic investments on its infrastructure and services. "In 2005, Mongolian Railways improved the quality of its network as a result of technological and managerial upgrading," explains Mr. V. Magdey, the company's Chairman. "Our strategy of growth focuses on three main objectives: developing branch lines, automating the controlling of trains, and considering electrification as part of updating our fleet. This year, we doubled our carrying capacity and succeeded in improving our time efficiency due to the modernization of our fleet. A trip that in the past would have taken 6.5 days has now been reduced by 2.5."

The advantages of such a time-efficient management are evident from the vast volume of freight being handled by the railways. Total freight for 2005 was 15,572,510 tons, a turnover increase of 12.11 percent on the previous year. Of this amount, 8 million tons was transit freight, a number that according to Ulaanbaatar's Chairman is set to rise to 10 million tons by the end of 2006. "Transit traffic between China and Russia through the Mongolian territory is increasing dramatically. We foresee that in 2021 our transit freight could reach 38.8 million tons per year and the total freight should be 61.9 million tons." With a second railway line planned and wagons supporting weights up to 6000 tons, the route is becoming the most attractive by far. Another competitive

edge of Mongolia is that transit tariffs are lower than its main competitors, namely Kazakhstan and Trans Siberian lines. There are discounts available of up to 60 percent between China and Russia for containers, chemicals, home appliances, metals, oil, and timber. The increased traffic is also due to the developments in Mongolia's mining sector, to which the railway infrastructure plays a pivotal role.

Apart from its massive freight capacity, the national operator is also becoming an expert in fiber-optic networks, having joined in collaboration with China Unicom and Trans Telecom Russia. The project will create a direct territorial communication link between Europe and Asia, connecting Beijing, Ulaanbaatar, and Moscow. Mr. Magdey is confident that all these projects will put Mongolia and his company at the frontier of Asian enterprise. "We are developing in a dynamic way and we have the potential to transport twice as much as we do at present. Mongolian Railways is ready to transport freight at the shortest routes connecting Europe to Asia, in the shortest time and at the most competitive prices."

There is no doubt that Mongolian Railways is set to take on an extensively important role in the growth of Mongolia's economy in the coming years. With its infrastructure in place, and world trade rising to unparalleled heights, the operator has all the elements of becoming one of the region's major players. This is by no means limited to freight alone. Mongolia is also becoming a popular destination for tourists who wish to travel the great lengths of the country's steppes by rail. The views from the routes once traveled by Chinggis Khan on horseback are just as breathtaking as the railway company's future prospects.

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Offshore Ambitions of a Landlocked Nation

The transition is a reference point for most aspects of Mongolia and the financial sector is no exception. Whereas most markets were able to build up a gradual yet steady growth, Mongolia's commercial banks experienced a trilogy of harsh winters that saw five banks fold, mainly due to a high number of failed loans.

A rigorous modernization process followed and the consolidation is now beginning to harvest fruitful returns, as newly appointed Finance Minister Nadmid Bayartsaikhan explains. "Whereas the non-performing loan portfolio in 2001 ranged from 8 to 10 percent, in 2005 this figure fell to 5.6 percent. This indicates the extent to which the supervision and governance in the banking sector has been improved," says Bayartsaikhan. "The Central Bank of Mongolia increased the minimum paid-up capital to \$2 million in 2001, \$4 million in 2004 and \$8 million in 2006 respectively. The deadline to meet these criteria was March 31, and almost all banks complied with this requirement." The Central Bank's Governor, Mr. Ochirbat Chuluunbat, says imposing a minimum capitalization was the first step in improving the sector. "Through the consolidation we wanted to strengthen the banking sector, to improve competition, and improve the financial environment for strategic foreign investors."

However, Mongolia is still assessing how best to deal with some of the sector's essential challenges. Interest rates are still relatively high these days. Finance Minister Bayartsaikhan believes that the business environment can be further supported by providing greater access to finance sources and additional credit finances could re-energize the banking sector. "The current annual interest rate of commercial banks is 27–28 percent causing a negative effect on the industrial sector and resonating the shortage of financial resources." He adds that the government is considering various ways of fund raising, by either attracting long-term concessional loans or offering government bonds to international financial centers.

■ Seeking Assurance

Mongolia receives \$25-30 million worth of concessional loans annually from the World Bank. "Since 1991, 21 concessional loans have been disbursed for the implementation of economic, social, fiscal, and infrastructural projects," Finance Minister Bayartsaikhan points out. "At present, eleven projects have been completed and ten are ongoing." For 2006, an aid agreement was reached with the World Bank for \$26 million. Great Britain has provided Mongolia with important financial relief by paying 10 percent of that loan to the World Bank. The IMF has also been a strategic partner of Mongolia since 1991 through the Enhanced Structural Adjustment Facility, Poverty Reduction and Growth Facility projects, which have utilized \$105.1 million. "By and large," says Bayartsaikhan, "the participation of the World Bank and the IMF are in high consideration."

The organizations have urged Mongolia to concentrate on creating a regulatory and transparent system. In response, the country created the Financial Coordinating

Committee, which in only a few months started to actively supervise the financial institutions. A huge effort has also been made to improve the governance of the Central Bank and the corporate administration of the commercial banking sector. "We enacted a law that created a supervisory board in the Central Bank which will monitor its activities internally, reporting publicly and transparently," says Central Bank Governor Chuluunbat. A twice-yearly testimony is broadcast nationally on television and covered extensively in newspapers.

The Central Bank has also been questioned on its handling of the nation's gold market, but the Governor has assured critics that the situation is under control. "Mongolia is very rich in gold and we have reserves of more than several hundred tons," says Chuluunbat. "Parliament passed a bill in the nineties asking the Central Bank to play a key role in the development of the gold market. Since then, the market has increased more than 30 times and last year we sold nearly 25 tons of gold. In 2002, we liberalized the market and now most banks are active on the gold market, but they don't have enough liquidity to serve the gold mining companies, so they usually sell gold to the Central Bank." The final exporter of all gold produced in Mongolia is still the Central Bank. "But today the Central Bank's role is as manager of the gold reserves, and not the buyer of physical gold on the market."

Minister Bayartsaikhan lists some of the advantages FDI could bring to Mongolia's banking sector: "The introduction of new practices, the management skills of the financial services sector, as well as the strengthening of competitiveness in the banking sector, make financing national projects possible. FDI would also assist in creating a more favorable environment for developing the mortgage market." In this regard, a main focus of attracting US investment and expertise is to develop Mongolia's life and non-life insurance sector, which is currently underperforming at only a fraction of the GDP compared to the rest of the world. "In Mongolia, it ranges from 2 to 6 percent of GDP. There is a lack of risk management and this leads to high financial losses. People have just become accustomed to private ownership and the concept that ownership of assets means taking liability." In order to promote insurance, an injection of foreign capital is needed, which will in turn bring a value added service and increased competition, according to Bayartsaikhan. "Lack of a sound insurance system prevents retail banking from growing and halts the sector's mobility."

Nevertheless, big things are planned for Mongolia's monetary future. "One of our ambitious goals is to create a continental 'offshore' financial hub by developing a national financial sector," says Bayartsaikhan. One of Mongolia's main advantages is the fact that there are no restrictions to the flow of capital, as Central Bank Governor Chuluunbat points out. "We don't impose any control of inflows or outflows of foreign exchange and that is why banking sector deposits are growing faster than any other country in the area. Even the IMF is quite surprised that the Mongolian money supply is growing without provoking high inflation."

Taking Tourism to a Higher Level

Mongolia's natural diversity ranges from camels crossing the Gobi desert in the South to reindeer roaming the steppes of the North. The country's many splendors are attracting an increasing number of tourists, as well as being hailed as the "Best Tourist Destination" at the 18th International Tourism Fair KOTFA 2005 in Korea. Unless you live in Russia or China, however, the only way to visit Mongolia effectively is by air, and what better way to fly there than with the 'friendliest airline' of 2005, Mongolia's national carrier MIAT.

The airline has not only been lauded for being the first contact with Mongolia's famed hospitality, but has also recently earned recognition from the European Union and the Asian Safety Committee for its international service standards. The EU's 2006 certification allows MIAT to carry out heavy technical servicing, both for its own Airbus A130 and Boeing aircraft as well as offering service assistance for "any aircraft of any airline", according to the company's President, Mr. Baltav Tsogoo.

As far as tourism goes, the fact that MIAT's tickets for the 2006 summer schedule have sold out is only the tip of the iceberg. The increased interest in Mongolia as a tourist destination has enabled the company to pay off its loans and run a healthy profit.

"Mongolia has a long history, longer than the 800 years that represent the beginning of our written history. Open space dominates our nature and one can find true nomadic life and traditions in Mongolia, an experience you won't forget."

Baltav Tsogoo, President of MIAT

The logical next level is the expansion of the airline's network. Mr. Tsogoo maps out MIAT's strategy: "We have a very busy schedule, especially during the summer period. According to our latest calculations, tourism will dramatically grow within the next two years. We have already signed an agreement with an Italian company to rent two large airplanes, with 272 seats each. Between June and September, they will fly on the route Milan - Berlin - Ulaanbaatar. It is a type of lease known as 'wet' leasing, in which the Italian crew is provided, including an insurance program and technical safety maintenance." Under this arrangement, MIAT will source the passengers and supplemental cabin attendants. Its traditional routes include Beijing, Seoul, Tokyo, Osaka, Irkutsk and Moscow, but progressive plans exist to expand in China and Siberia. "We made an official visit to China to establish new destinations, focusing on the closest cities to the border with Mongolia like Harbin, Tianjin, Hohhot, Hailan, and Kunming. We meet increased demands in that area."

Realizing that collaborations with the private sector increases options, Mr. Tsogoo stresses that MIAT will not seek to monopolize on domestic or international flights.

"This will be another chance for private companies with smaller sized aircrafts to cover shorter distances. MIAT has large airplanes, suitable for longer flights. We are supporting the private sector and we are glad to open these new routes for private companies." The carrier's main objectives are to develop infrastructure, safety, and civil aviation, as a large number of international routes pass through Mongolian airspace. A contract was recently signed with Korean Air for the technical upgrading of Mongolia's air traffic control system. Korean Air said it would also support the domestic services of MIAT and extend its social contributions to the country. The partnership began after Mongolia acquired its first jet, a Boeing 727, from Korean Air in 1992. As part of the agreement, Mongolia in return allowed Korean Air flights bound for Europe to use its airspace. MIAT has planned to have daily flights during the summer to Seoul Incheon Airport.

The focus now is on what MIAT's decision will be as to which aircraft it shall purchase for its medium term expansion plan. Owning both Airbus and Boeing aircraft, the ticket could go either way. "We would prefer to collaborate with one company; to sign an exclusive agreement," says Tsogoo. "Our staff has become familiar with Boeing, as it is quite well trained by them, and we have a good Boeing network in Asia. On the other hand, we will be able to pay off our Airbus by August 2008." The question remains as to which company will be able to provide a better offer for the Mongolian national airline.

Perhaps the decision will come forth from MIAT's planned privatization, which is in the hands of a commission made up of the State Property Committee, the Civil Aviation Authority, the Ministry of Transportation and Tourism, and the Ministry of Finance. Either way, after having celebrated this year's 800th anniversary, Mongolia can look forward to many more years of increased tourism development to its land, and all that flies above it.

For information on VIP customized tours, camel trekking through the Gobi, touring with jeeps in the wilderness or living with local Nomads, please contact Tsengel Purevsuren Sharid on +976 9927 3105 or tsengel@yahoo.com

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"The sound policies of the Government and the Central Bank of Mongolia positively affect investors to be interested in Mongolia. Today, Mongolia has created a favourable legal environment for foreign investment."

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