



**EUROCHAMBER MONGOLIA**

ЕВРОП МОНГОЛЫН ХАМТАРСАН ХУДАЛДАА АЖ ҮЙЛДВЭРИЙН ТАНХИМ

# **FOREIGN INVESTMENT CLIMATE IN MONGOLIA IMPEDIMENTS AND THE WAY FORWARD**

## **POSITION PAPER**

**SEPTEMBER 2021**



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The European Mongolian Chamber of Commerce and Industry (EuroChamber) is committed to contributing to stable and positive business and investment climate in Mongolia through its work as a united voice of European business community in policy dialogue with and advocate towards the Government, Parliament and other public service institutions of Mongolia.

Positive investment climate and its perception (by all stakeholders, foreign and domestic), are key success factors in the development of an emerging economy and society. The key barrier to creating a stable environment for FDI in Mongolia has been frequent government changes that lead to significant shifts in government policy. Underpinning this volatility is ambivalent public sentiment towards FDI.

Currently Mongolia has a chance to significantly improve the stability and openness of its investment climate given current unity of the three branches of government. Moreover, these changes will be quickly recognized internationally given that commodities prices of Mongolia's main exports are at or near record highs and there has been a clear trend of rising resource nationalism in many resource dependent economies in 2020 and 2021.

This position paper refers to foreign investment generally, across all sectors. However, some references are made to the resources sector given it is the largest recipient of FDI and predominant export contributor.

#### **Our key findings and recommendation focus on:**

1. Need for long term stability and predictability of the FDI investment climate
2. Need of change of attitude into "competing for FDI as a country"
3. Improving bureaucracy bottlenecks, esp. within the judiciary system, and rule of law
4. Improving public perception of FDI as positive contributor to socio-economic progress
5. Focus on connectivity and logistics infrastructure as a basis for sustainable econ. growth
6. Fostering private sector's role as the engine of economic growth, with Government acting as regulator and a catalyst of prosperity and increased business & investment confidence

Below is an outline of key areas identified by EuroChamber, our Board and member companies, which need attention and/or improvement.

#### **Principal Themes**

1. It is a **globally competitive environment** for investment and Mongolia needs to show why it is an attractive destination for investment.
  - FDI policies need to be clear, simple and transparent and while they may need to be reviewed from time to time, they should be consistent over time.
  - Enforceability and practical enforcement. Although there are few legal differences between foreign and domestic investors, there is ample experience and a common perception that agreements and rule of law can be easily abused and difficult to enforce. In this regard it is perceived that foreign investors are usually at a disadvantage to domestic investors. The playing field needs to be equal both in the law and in practice.
2. **Outward Marketing.** There is no message from Mongolia to the world to say that it is welcoming FDI, is open for business or is a better destination than alternatives. That message should be defined now, and pushed relentlessly in 2022. EuroChamber is happy



to help construct this message, and support its dissemination among existing and especially prospective investors.

**3. Stability and predictability.** A decade of adverse and sudden policy or regulatory changes in Mongolia without consultations with the private sector and arbitrary government conduct has severely eroded investor confidence. Investors need the ability to make long-term investment plans and forecasts. Stability and risk reduction are generally more important for investors than the opportunity for high short-term returns.

- Mongolia over the years has continually shown itself to have an unstable investor environment on multiple levels. Perception of this and reality of the situation should change to make the country attractive for investment.
- Specifically, given the imperative of the post-pandemic recovery situation, we suggest to consider agreeing an "Investment Stability Pact" among all leading political parties, signaling an in-principle policy agreement beyond the 4-year election cycle. An Investment Stability Pact could, for example, agree that:
  - i) key laws and initiatives related to attracting investment and improving the economy would not be significantly changed for a period of time such as (for example) 6 years;
  - ii) after the current Oyu Tolgoi discussions are completed, foreign investments in Mongolia, including in strategic assets, would be "ring-fenced" and would not be subject to renegotiation of contracts or substantial agreement changes after the money is invested, and would not be publicly targeted for political capital.
- Such a commitment or "Pact" would give a clear signal to investors that there is broad-based support to increase stability, to not make significant changes which can negatively impact investors or be used for political purposes, and to not renegotiate terms of investment after having invested. The importance of the current post-pandemic recovery provides an unprecedented opportunity to make such an Investment Stability Pact in a way not seen before, which would appeal to investors and show Mongolia is serious about creating stability.
- **Type of investors / attracting and keeping the global players.** The multi-nationals in particular are more sensitive to long term stability than smaller investors, and without a stable environment they will not come, or leave if they are already here. There are several examples of mining multi-nationals that had offices in UB until 2013-14, and have left. A recent example in the renewable power sector, was Engie, a global company in the sector. Engie had an office in Mongolia and planned to invest in multiple projects. However due to difficulties on their first project, related mainly to regulatory and policy pressures, they closed their office.

**4. Public perception of foreign investment is negative.**

- Most countries seek FDI as it grows the economy, brings latest technology and know-how, and leads to increased prosperity. These benefits are well recognized by the public in most countries.
- However, a large section of the Mongolian population is confused about whether foreign investment is a benefit to Mongolia, or a disadvantage. The main reasons for this confusion are the repeated populist / resource-nationalistic rhetoric (usually part of past election campaigns), as well the highly public nature of the ongoing dispute with Rio Tinto over Oyu Tolgoi.
- Information about the indirect benefits of investment (whether foreign or domestic) needs to be made known to the public, because there is currently an attitude that unless there is an immediately visible direct benefit, for example in the form of a job, or supply contract, then there is no benefit. Indirect benefits are not well understood, or understood at all by a large section of the population.
- An information campaign may be considered to help the public understand the indirect benefits such as employment generally, skills upgrading and technology transfers etc.



Additionally, the public needs to understand the multiplier effect, impacts on overall personal wealth and GDP growth of the country. Examples may be given of how economies in many other countries have boomed due to such investment.

- Without a positive public perception of FDI, foreign investment will continue to be a target during elections. This practice often leads to the newly elected government making wholesale changes, reversals of prior policy and a continuation in the instability of the investment environment.

## 5. The Mining Industry.

- **Boom in global mining investment.** In recent years Mongolia FDI mining inflows have been disappointing in an environment where record high commodities prices have fueled a global boom in mining investment. For example, the largest stock market for mining investment is the Canadian TSX and TSXV. In 2020 \$7.5 bn was raised by mining companies on these markets. In just the first 6 months of 2021, most of the 2020 amount (\$6 bn) has already been raised. On the Australian stock exchange, the amount of money raised for mining IPOs between 2017 – 2020 was 8.3x higher than the amount raised in the four preceding years, from 2012 – 2016. Mongolia risks to miss out on this mining investment boom.
- **A complete mining ecosystem** is necessary for development of projects during their lifecycle. Without interest from mining “majors”, the mining ecosystem will be incomplete. Explorers with large projects will have limited / no possibility of having their projects developed if large mining companies are not willing to invest in Mongolia. This will result in reduced investment in exploration and reduced mine development.
- **Few new foreign invested projects / no new large projects.** Since 2017 (when mining investment started to recover globally), there have been very few new foreign invested mining projects in Mongolia and no new large foreign invested mining projects. The only large foreign invested project continues to be Oyu Tolgoi.
- Further to the incomplete ecosystem, the mining projects that tend to attract FDI in Mongolia are usually small, for example small gold mines that can be developed by junior exploration companies that evolve into mining companies. However, many mining projects, for example porphyry copper projects, require large investment, typically several hundred million, or in excess of one billion, US dollars. Projects such as these are beyond the scope of junior companies, and they require a mining “major” to develop this type a mine.

## 6. The message in regard to Oyu Tolgoi.

EuroChamber has no opinion on the dispute between the Government of Mongolia and Rio Tinto, however this is such an important issue that it needs to be mentioned. The fact the government has a long-standing dispute with a global mining “major” has two very obvious effects:

- i) it sends a negative message to the foreign investment community on the investment environment in Mongolia,
- ii) it negatively affects the perception of foreign investment by the public generally (detailed above). As a result, a significant proportion of the public does not believe that the Oyu Tolgoi (OT) project is a benefit to Mongolia.

The Mongolian State has two roles in regard to OT, first as a government - regulator, and second as a shareholder. The government needs to explain this to the public and to explain that the State must carry out these two functions concurrently.

As a government - regulator, the government needs to explain that OT, and projects like it, bring various significant benefits to any country in the world, and Mongolia needs such projects to further its development, to improve living standards and to meet the goals of Vision 2050. To the best of our knowledge, the government has never publicly acknowledged any major benefits to Mongolia of the OT project, nor made any positive statement about the OT project to the public.



As the State shareholder, the government needs to explain the basis for the OT deal. Specifically, the government should explain the basis for negotiations, for example, the percent of benefits which accrue to Mongolia and the percent which accrue to Rio Tinto including the relative context to these benefits such as the percent invested or guaranteed by each shareholder in the project. The government should explain the debt structure, and that this is only relevant in the context of other terms that are being negotiated, and also better explain the dispute generally together with the reasons for the dispute.

#### **7. Connectivity.**

COVID-19 has caused significant international travel issues which limit fresh FDI. Post pandemic we recommend the government makes full use of the excellent new infrastructure it has already invested in, such as the new airport, and of infrastructure it continues to invest in such as the new railways and logistics infrastructure. For example, the government should encourage more airlines to fly to Mongolia, open up regular direct (non-stop) flights to at least one new European hub city per year, and significantly improve the immigration regime for business travelers and investors so they can get quicker access to Mongolia.

- 8. Blocks and bottlenecks in the bureaucracy processes.** Investors give up and pull out of Mongolia because the investment process, permissions, and bureaucracy takes too long. Investment in Mongolia requires much longer timescales than in many other developing countries, and this time requires significant high level (expensive) management time on the ground in Mongolia. If it takes too long, it is no longer attractive for investors.

### **Detailed Proposals for Legal Changes**

#### **9. Changes in law and implementation of existing laws.**

##### **Integration of existing laws with international agreements.**

- **New laws and changes in laws:** better due process is needed to avoid introduction of new laws that have negative side effects, including conflicts with existing laws. The process of drafting new laws should include consultation, obtaining input from experts (domestic and foreign), and studies of impacts of similar changes in other countries, with greater consideration of the wider and long-term impacts of changes.
- **Effective implementation:** the government should concentrate on effective implementation of current laws, meaning abandoning the practice of renegeing on agreements and revoking licenses without due cause.
- **WTO member/ other international agreements' incorporation with the local laws:** Mongolia has signed many international agreements, laws, and other bilateral agreements. Due to the limited understanding of these agreements and treaties, the incorporation with the local laws is incomplete and the advantages that could be taken from those agreements are not fully realized. Periodical review with local laws to uncover discrepancies would be ideal.

#### **10.Reduce abuse of the court system / means of redress when problems arise.**

Many foreign investors have suffered due to the unreasonable or unethical activities of their Mongolian business partners (breaching agreements, not consulting on key decisions, and similar) and these small investors have found it difficult to seek redress or find reasonable solutions. There are several reasons for this, however they usually come down to the incentives to abuse the court system for one's own advantage and the ease and minimal cost to do so. There is a deep perception among investors that foreign companies suffer unduly because they are foreign. These practices need to be curtailed, and we provide some examples below:



- **Measures to reduce abuse of court processes:** A very common practice is to drag out court cases through the four levels of court and General Executive Agency of Court Decisions (the “Enforcement Agency”) simply because defendants are incentivized to do so.
- **How difficult is it to take a case to court?** Anyone involved in a business dealing, can get the case opened in the preliminary court. Once the case is opened, both parties to the case have the right to four levels of court hearings. This creates incentives to avoid and delay justice.
  - **How long does the court process take?** Under normal circumstances, it likely takes approx. 1.5 years to go through the four levels of court if there are not significant delays. However, it is possible for cases to be dragged on for far longer due to simple procedural matters that anyone with legal representation can take advantage of. Other delays are not uncommon, for example in recent years significant delays occurred due to, firstly, changes to the judiciary in 2018/19 and secondly, due to impacts of COVID 19. Since 2018, a period of over two years has been the norm for the four levels of court.
  - **What are the incentives for a defendant to bring a case to court?** They are usually:
    - To delay payment
    - Once a judgment has been issued, no further amounts accrue, whether the case was a simple payment or a loan, therefore the defendant is incentivized to delay payment for as long as possible. In this regard the defendant can simply use (abuse) the resources of the state in order to suit their own business interests. There is no penalty for doing this.
    - To encourage the plaintiff to reduce the claim in order to avoid multiple years in court and Enforcement Agency seeking payment on an amount owed.
- **Suggested Solutions.** We recommend to take away the incentive for debtors to force creditors to use the court system to get paid and reduce the length of court processes. Further, we suggest to reform the enforcement law to facilitate the enforcement process.
- **Accrue interest on judgments.** The incentive to abuse the court system to avoid justice (payment) should be removed. We note that in many jurisdictions this practice is used, rates are usually set at fixed levels (for all judgments). Rates are often several (around 5-6) percentage points above the central bank policy rate. In Mongolia this would equate to a rate of say; 12%, being 6 (policy rate) + 6 (accrual on judgments). Examples from Australia and Hong Kong:
  - <https://www.fedcourt.gov.au/forms-and-fees/interest-rates>
  - [https://www.judiciary.hk/en/court\\_services\\_facilities/interest\\_rate.html](https://www.judiciary.hk/en/court_services_facilities/interest_rate.html)
- **Courts should refuse to open cases when it is not necessary for the case to be heard in court.** Opening a case is the start of the process to waste time and abuse the resources of the state, because once a case is open, it can be dragged out for years in court using simple procedural techniques. Examples comprise:
  - A very simple matter of a defendant defaulting on a loan, easily proven because bank transfers prove the loan was defaulted on, and there are no other extenuating circumstances in the case. Cases such as these could be dealt with without a court involvement.
  - A defendant refuses to accept the value assigned to an asset that has been pledged to a bank, when the Enforcement Agency ordered the valuation and it was performed by a qualified valuation company. Defendants should not be permitted to open these sort of cases, the defendant could simply order and pay for a second valuation themselves.
  - There are many other examples of typical cases that should not be proceeded by the court system because the cases lack sufficient merit.
- **Limit the right of appeal.**
  - For cases where there is a unanimous preliminary court and appeal court decision, the appeal court decision should be final, so the cases cannot proceed to Supreme Court (as they are clear-cut cases).



- The practice of an appeal to the General Judge against a Supreme court decision should be abolished as it further stretches out the court process and therefore it is used largely for abuse.

**11. The Enforcement Law (General Executive Agency of Court Decisions of Mongolia).** The current enforcement law was introduced in July 2017. That was a time when the Mongolian economy underwent financial distress and the new enforcement law was designed to slow / stop the seizure of collateral by creditors, in particular banks. In a new economic context after the pandemic, the law should be changed entirely so that the enforcement mechanism can return to a more functional and effective state. In this regard, EuroChamber has two recommendations, either:

- Abolish the 2017 law in its entirety and reinstate the law prior to 2017 - with the previous law, and with the solutions to court abuse as recommended above, this would provide a more effective enforcement mechanism; or
- Review the enforcement law and update the problematic sections. EuroChamber would be happy to provide details and suggestions.

## **12. Investment law / visas / digitalisation**

- **Minimum capital to incorporate a company.** USD 100k is a significant barrier to foreign SME investment. Many businesses do not need this amount of investment to fund themselves when they are starting up. Additionally, a one-dimensional policy on investment visas is limiting. As an example, it excludes many foreigners that may be able to significantly contribute to Mongolia's development in the IT sector. Making it easier for young foreign entrepreneurs and engineers would encourage rapid development of the IT sector.
- We note that in China before 2010 the amount to register a company in Beijing or Shanghai (lower in other areas) was USD 100k, however this was reduced to approximately USD 10k after 2010.
- An example of an (ex-soviet bloc) country that has reinvented itself as a digital nation is Estonia. Information can be found at: <https://e-estonia.com/>. In regard to establishment of a business presence sufficient for a residency visa, as a sole proprietor, an investment equivalent to USD 18.7k is required to obtain a visa
- **Visas**
  - Applications are still not fully online
  - **Business visas.** There needs to be an easy way for business people considering Mongolia for potential trade and investment to obtain a visa. The current business visa is up to 12 months, multiple entry with a maximum 30 days stay.
  - We suggest to change to a maximum stay as the length of the visa. People looking for business opportunities often want to spend time in Mongolia, not to have to leave every 30 days. This is especially true of young entrepreneurs. For example, in China when the economy was developing rapidly prior to 2012 this type of visa was always available on a 6 or 12 month basis (depending on the passport of the applicant). 3 or 6 months stays would significantly facilitate investment searches.
  - Easy entry visa on arrival - there used to be a 30 days visa on arrival. It was withdrawn in 2016, we recommend it be reinstated.
  - There also used to be 30 days visa-free stay for many countries before 2016 including all of the EU countries and the UK. We recommend this visa-free entry and stay for up to 30 days be re-introduced.
- **Digitalisation**
  - For various reasons, including rapid development of e-commerce, success of the government's digitalisation program, and the extent Mongolia has fallen behind advanced countries in abolishing business related bureaucracy, Mongolia should make significant efforts to re-orient itself as a digital economy and to foster a domestic IT industry. We support the government's recent steps in this area. As



noted above, a country that has pursued this policy with success is Estonia. We note that in Estonia:

- It is possible to establish and manage an Estonian incorporated company 100% online, from anywhere in the world
- A company owner can sign and authenticate documents anywhere
- Tax entities easily declare taxes online
- **Digital signature law.** The proposed revised law is very close to the existing law of 2011, and it has not been widely adopted by business. It has principally been adopted by government agencies. Even after a vasco has been purchased by businesses, the government agencies still require documents to be submitted both online and in paper, raising the question what is the point of buying the vasco.
  - However, with a couple of changes the digital signature could be widely adopted by businesses. Specifically, the government should take responsibility to provide the approval code for the signature and it should be free to use. The approval could be provided with a random number generator, available on a mobile phone. To obtain this application, businesses could register with a registered, or validated phone number. Currently each government agency issues their own vasco devices. For consumers to obtain “toon garin useg” (digital signature) they must go to Mobicom and install a new SIM. There is an initial cost and a yearly maintenance fee. The government provided mobile application would greatly assist with widespread adoption of digital signature by biz and consumers.
- **Labour Law.** It is widely recognised that small and medium sized companies have especially suffered during the pandemic. Moreover in some countries, Australia for example, it is recognised that small and medium sized companies need more flexibility in labour relations including the recruitment and departure of employees (whether voluntarily or arising from financial distress) than large companies. Under the labour law of Mongolia it is usually difficult to terminate employees even when such employees are redundant due to a company’s worsening economic condition. It is also widely perceived that in disputes over termination the courts take the employees’ side most of the time. This can easily result in hardship for SMEs and represents a real risk to the viability of some SMEs, thus making investors more cautious in committing money and resources to a company. Greater flexibility generally leads to greater amounts of investment.

### 13. Anti-Money Laundering (AML) and State Registration.

- Ultimate Beneficial Ownership (UBO) registration requirements under AML are burdensome and therefore creating various obstacles for other registration related activities. The process to register the UBO should be simplified with a focus on practicality.

### 14. Tax.

- Foreign investors universally perceive the attitude of the tax office as tricky and punitive, sometimes for the purpose of corruption. This is particularly evident in regard to tax audits. This stance by the tax office is seen as contrary to the spirit of openness and improvement of the environment for foreign investment.
- The tax office freezing assets and taking other measures during a tax dispute is becoming an issue. This is being perceived as heavy-handed, it should be eased.
- Valuations of land rights/ licenses remains an issue with respect to transfer of shares and/or change of UBO of a company. More specifically, if the company has only an exploration license, the valuation should not refer to a feasibility study or deposit etc., instead it should be entirely practical and consider only the price of the asset on the market. The Ministry of Finance regulation should be considered.
- No discrimination should be applied to foreigners in regard to SHI and PIT exemptions or reductions (level playing field principle).





- 15. Onerous soviet-style documentation that was abolished long ago in most countries.** Companies are obliged to comply with detailed documentation requirements, none of which are digital, and it is hard to see the meaningful purpose in a modern business context. There are many such examples, to name a few: i) on employment contracts, there is a requirement to: A. make a director order with each new hire, B. an order for the termination of each contract, C an order to change a job position. ii) The requirement to file social insurance taxes on paper and online - if it is online why does it need to be filed also on paper? iii) Onerous and seemingly unnecessary documentation required by certain government agencies, much of which can be irrelevant.

Generally, companies would welcome all processes to be online and eradication or significant reduction of old, soviet-style documentation requirements.

- 16. Audit Law Update to support investment.** The Audit Law requires rotation of auditors after 5 years, but many foreign investors are subject to audit rotation rules in their own countries e.g. in the EU there are rotation requirements. Investors in Mongolia can end up with multiple sets of auditors at the same time in order the investors can comply both with the parent company requirements and Mongolian legislation, thus adding significant burden and cost. A simple solution would be to amend the law to allow foreign invested companies to follow the audit rotation requirements of their parent company's jurisdiction.

## Conclusion

Mongolia has many advantages which typically create initial interest from foreign investors. However, the initial interest will not lead to significant investment unless there is comprehensive change in the investment environment in Mongolia.

Now is an opportune time to implement changes given the unity at Mongolia's three levels of government, the strong interest in mining investment globally and the fact that resource nationalism has been rising in other resource dependent economies (Verisk Maplecroft, a leading resource sector focused risk consultancy, stated that in 2021 resource nationalism rose in a large number (34) of countries included in the resource nationalism index). For these reasons Mongolia's openness and improvements to the investment environment are likely to get noticed by the international community.

Mongolia needs effective international Public Relations to promote its message supported by meaningful, concrete changes and observable stability as illustrated in this Position Paper. Recent statements concerning OT indicate a new constructiveness in the discussions and are encouraging. It is essential Mongolia identifies, cultivates and promotes examples of investment success stories in order to attract new investors. Other factors can also be used in the PR messages such as the popularity of the recent digital nation event, which shows the enthusiasm of a young, active population to embrace the digital economy with new technologies, and the fact that Mongolia has the best performing top group of shares on a stock market in the world in 2021 to date.

EuroChamber is a strong proponent of the private sector's role as the engine of economic growth. Government policy must consider how to act as a catalyst for this process wherever possible, creating clear signals that increase business and investor confidence.

We wish the Mongolian government great success in its endeavours to improve the investment climate and to attract substantial new investment into Mongolia, and we will be happy to assist further in this process.