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MONGOLIA'S STATE POLICY ON THE MINERALS SECTOR AND ITS APPLICATION IN THE PROMOTION OF SUSTAINABLE DEVELOPMENT

OVERVIEW

Recent advances in policy-making in the minerals sector in Mongolia are ensuring the government's policy orientation better serves sustainable investment through balancing the need to remain attractive to private investment in the short to medium term with the desire to ensure medium- to longer-term sustainability in economic growth and prosperity for all citizens. This article takes a look at the government initiatives and their impact, as well as identifying some lingering challenges.

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THE NEW STATE POLICY ON THE MINERALS SECTOR

In 2014, the Mongolian parliament adopted a new State Policy on the Minerals Sector (the “Minerals Policy” or “the Policy”). The Policy is intended to serve as a framework for further amendments to the existing Mining Law and other laws relating to natural resources. The stated aims of the Minerals Policy are to:

- strengthen private sector development
- establish a stable investment environment
- improve innovation in mineral exploration, mining and processing
- encourage the use of modern, environmentally friendly technologies
- strengthen the international competitiveness of Mongolia’s mining industry.

The Policy acknowledges that the minerals sector should be the main driver of Mongolia’s broader economic development. Accordingly, the Policy outlines general principles aimed at encouraging the long-term sustainable development of the country’s mining industry, and provides for equal treatment of domestic and foreign investors under the law. In addition, it seeks to foster greater openness and transparency among government agencies and state-owned enterprises (SOEs). The Policy also calls for the gradual privatisation of minerals-sector SOEs.

The Minerals Policy also seeks to improve existing laws and regulations regarding occupational safety; artisanal mining; the issuance and transfer of mining and exploration licences; mineral deposit evaluation; gold mining; and dispute resolution through the implementation of international standards in these areas.

The government of Mongolia (GoM) also intends to enact separate legislation with regard to the exploration and mining of deposits of industrial and common minerals (for example, sand). Were such legislation to be ratified, local governments would be allowed to issue mining licences for industrial and common minerals. This would help support infrastructure construction in rural areas, and reduce the need for local companies to make the long journey to Ulaanbaatar simply to navigate state bureaucracy.

ROLE OF THE MINERALS SECTOR AND CHALLENGES TO INCLUSIVE GROWTH

Mongolia’s minerals sector has been the main driver of the country’s rapid economic growth: it currently accounts for 18.6 per cent of GDP and approximately 80 per cent of exports. In recent years, the sector has been responsible for over 70 per cent of new foreign direct investment (FDI) into Mongolia. It is also increasingly important to the state budget, accounting for approximately 30 per cent of government revenues.

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KEY POINTS OF THE STATE POLICY ON THE MINERALS SECTOR

Respect and protect stakeholders’ rights (security of tenure)
Support modern techniques, technology and innovations
Open, transparent and responsible government and private entrepreneurs
Support and encourage corporate governance
Non-discrimination on type of ownership (state versus private and domestic versus foreign)
Geological and industry related database should be open to the public to enable easier access to information
Adopt the best international practices and standards on occupational safety and health

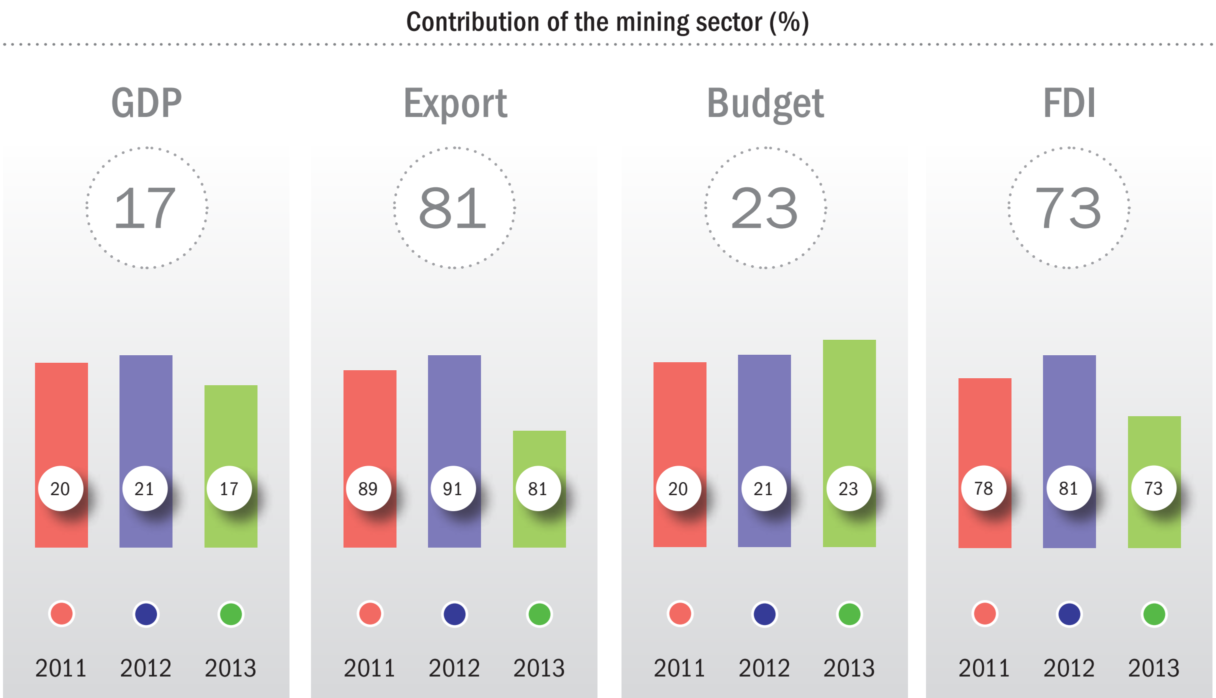
Economically, Mongolia has become a mining nation, with significant ramifications for the country's socio-cultural fabric. And while the country ranks among the top 10 countries in various mineral resources, policy-makers have yet to determine how best to leverage this wealth to advance national prosperity in a balanced and ultimately sustainable way. Although there are many solutions and diverse suggestions drawn from international experience and covering a range of outstanding issues, from institutional capacity to the management of resource rents, there is strength in the argument that Mongolia needs a more tailored approach which takes sufficient account of its unique location and developmental trajectory.

An approach that is tailored to Mongolia's unique situation may be in order: since 2009, the Mongolian economy has tripled in size, largely due to tremendous investment in its copper and coal industries. Unfortunately, there is scant evidence to show that this staggering economic growth has been accompanied by the institutional reform that is essential to underpin the sustainability of that growth. Key indices, among them economic competitiveness rankings, governance indices and studies of corruption during a similar period have not improved to the extent that was hoped for.

In fact, the boom-and-bust nature of mining, coupled with Mongolia's vibrant democracy, has created a number of new challenges for the country. Mongolia's parliamentary elections of 2008 and 2012 were accompanied by protectionist undertones, as well as promises of cash handouts designed to win over voters who felt they had not sufficiently benefited from mining-led economic growth. This behaviour served to exacerbate state budget deficits and further damage the country's balance of payments. This in turn fuelled inflation and put increased pressure on the national currency, the togrog. Ultimately, this worsened macroeconomic imbalances and served to hinder genuine efforts to diversify Mongolia's economy and build inclusive growth.

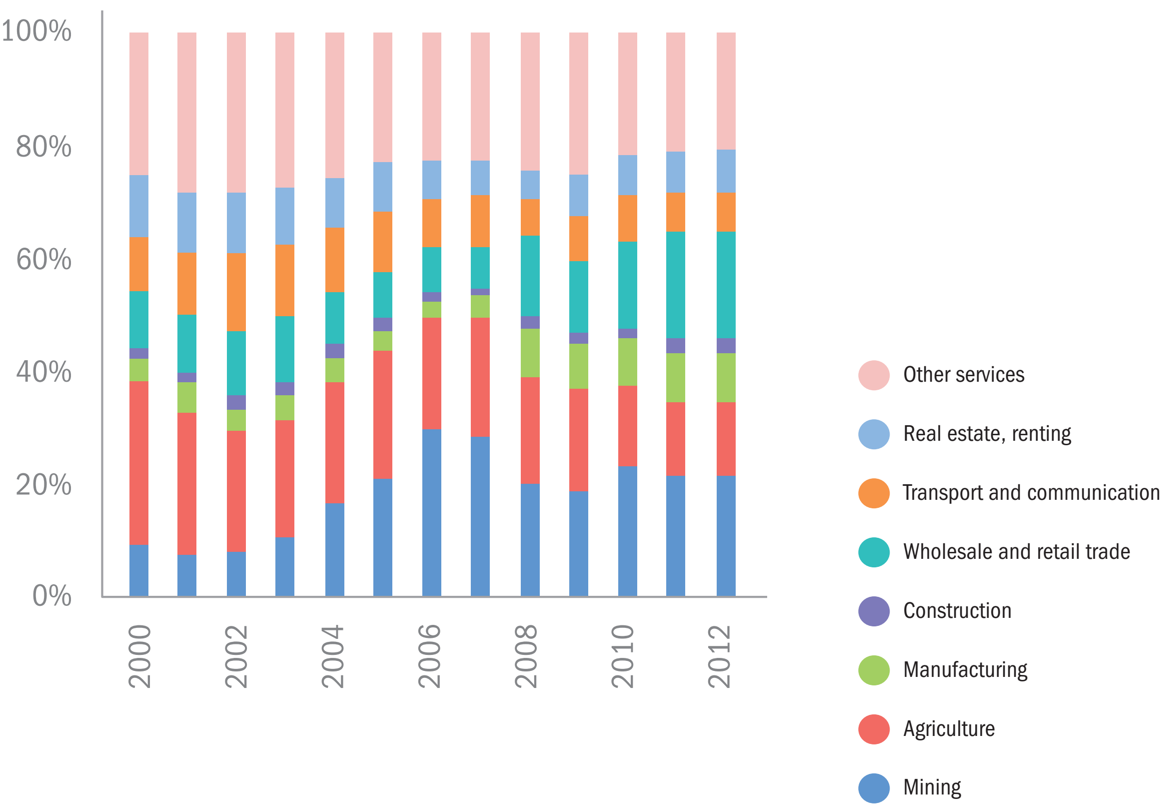
For the Mongolian minerals sector to function efficiently and promote sustainable development, reforms should be founded on three pillars: (i) enhancing institutional capacity; (ii) building public support; and (iii) improving government support for investment. What follows is a discussion of each of these pillars individually.

CHART 1 MINING SECTOR IS THE ENGINE OF MONGOLIA'S ECONOMIC GROWTH



Note: GDP = Gross domestic product. FDI = Foreign direct investment

CHART 2 COMPOSITION OF MONGOLIA'S GROSS DOMESTIC PRODUCT BY SECTORS



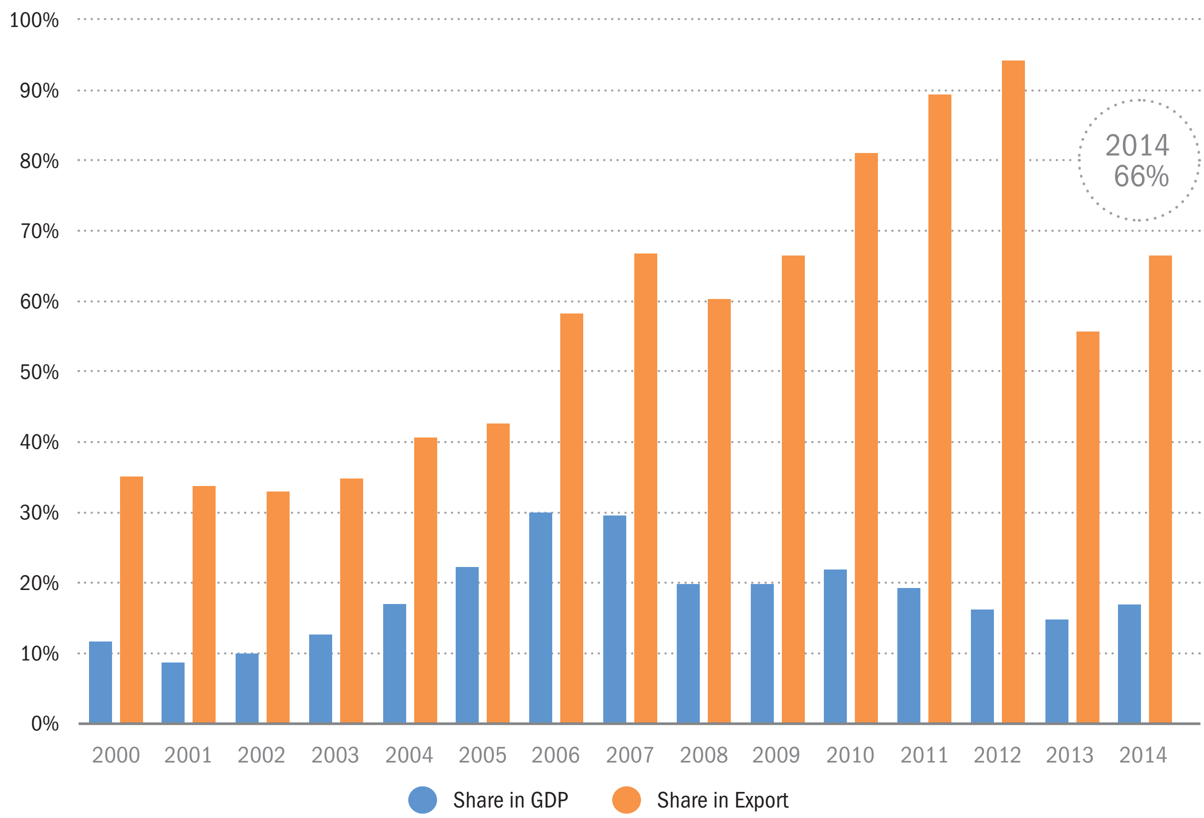
ENHANCING INSTITUTIONAL CAPACITY

After nearly seven decades of one-party socialist rule, Mongolia peacefully transitioned to a semi-presidential parliamentary democracy in 1990. At present, the parliament is the main policy-making body for the minerals sector and therefore exerts the greatest influence over its direction. It is not the only decision-making body, however: the government is able to enact regulations and also exercises control over the determination of areas which are open for exploration. The Ministry of Mining, meanwhile, is in charge of drafting policy and managing its two regulatory agencies: the Mineral Resource Authority of Mongolia (MRAM) and the Petroleum Agency of Mongolia (PAM). In addition to their respective regulatory duties, MRAM is responsible for the issuance of exploration and mining licences, and PAM is responsible for the issuance of oil and gas exploration licences and the execution of production-sharing agreements.

In 2014, the government initiated the amendment of several existing laws with the aim of liberalising the minerals sector and reducing bureaucracy related to permitting and contract negotiation. While both domestic and foreign investors have welcomed these improvements, low international price levels for Mongolia's major commodities have meant that the country will have to wait for capital investment to return.

Among the goals of the latest Minerals Policy is an increase in the volume and quality of information in the state geological database, which the government plans to accomplish through the implementation of standard international surveying methods and mineral classifications. In late 2014, Mongolia joined the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and, as a result, adopted the Australasian Joint Ore Reserves Committee (JORC) Code. The JORC Code governs the classification of exploration results, mineral resources and ore reserves. (Mongolia had previously used an old classification system developed by Soviet-era geologists.) Experts hope that bringing

CHART 3 MONGOLIA'S DEPENDENCE ON MINERAL RESOURCES



the country's geological database in line with international standards and updating it annually will encourage increased exploration by private companies.

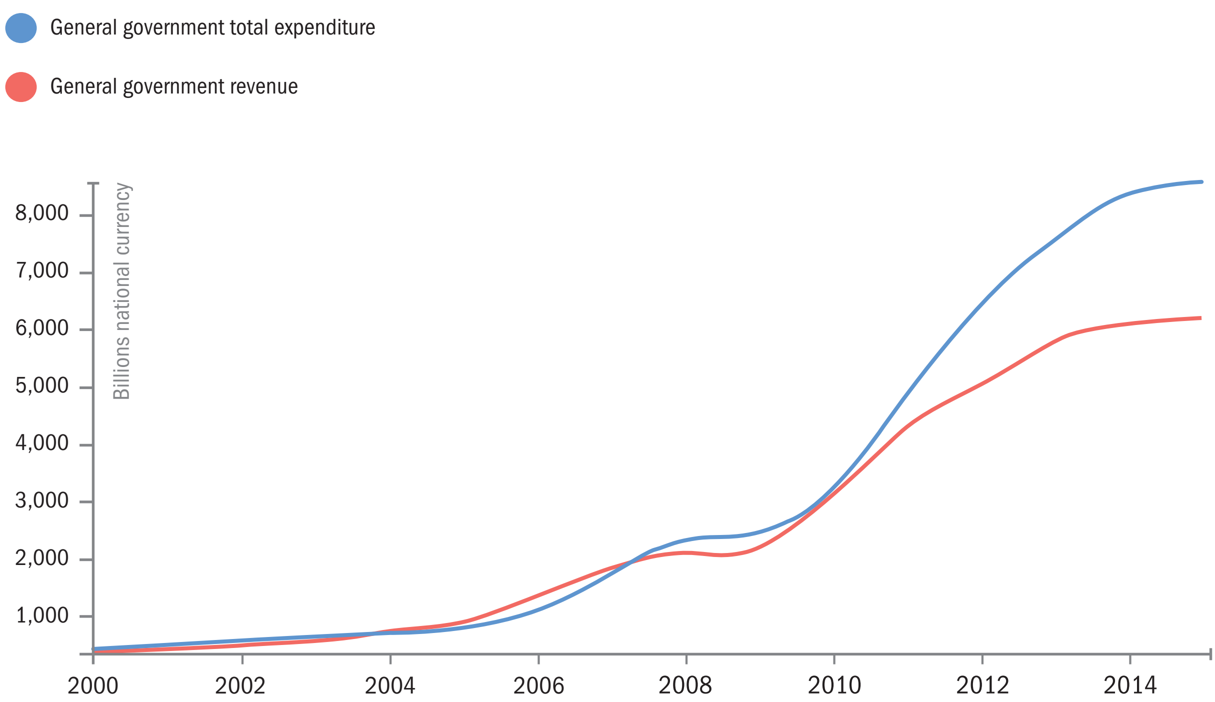
While there has not yet been any comprehensive study of the institutional capacity in Mongolia's minerals sector, sources such as the World Justice Project's Rule of Law Index; the World Bank's Worldwide Governance Indicators; the World Economic Forum (WEF) Global Competitiveness Report; and consulting firm Behre Dolbear's rankings of top countries for mining investment all suggest that Mongolian government institutions perform poorly in supporting business and enabling sustainable investment. While the government has taken steps with the Minerals Policy to improve its ability to work with the private sector, currently available data indicates that it still has a long way to go.

BUILDING PUBLIC SUPPORT

Further complicating matters is the fact that Mongolia's mining industry is facing an identity crisis. The country is home to such world-class projects as the Oyu Tolgoi (OT) and Erdenet copper mines, as well as numerous medium- and small-scale mines, including some that are illegally operated by artisanal miners. These three mine classes are currently in contention in the public imagination for the defining image of the sector.

Large mines such as OT – often termed "mega projects" – are generally foreign-invested and employ world-class safety standards and environmental practices. Their performance has a huge impact on the Mongolian economy. As a result, they are often featured in international news stories, which in turn greatly influence the outside perception of the Mongolian government and the state of the country's minerals sector as a whole.

CHART 4 MONGOLIA'S GROWTH IN GOVERNMENT EXPENDITURE AND REVENUE



Source: Citation Text

Medium-scale mines, meanwhile, are generally not covered in international news stories nor do they meet international standards – although they are improving in this regard. This is in contrast to illegal, small-scale mines operated by artisanal or so-called "ninja" miners. Although artisanal mining is seasonal and not closely monitored by the government, estimates place the number of workers employed by these small mines somewhere between 17,000 and 40,000. Despite government efforts, these mines are generally beyond the reach of workplace-safety and environmental regulatory authorities.

Because of the environmental damage caused by irresponsible miners – particularly artisanal miners – and because resource rents often do not trickle down to the local level, many small communities are reluctant to support mining. Public polls by the Ministry of Mining have shown that respondents generally do not believe that the minerals sector is benefiting the country.

However, surveys by the non-governmental organisation Sant Maral Foundation suggest that there has been a shift in national thinking about resource rents: an increasing number of respondents have stated they prefer long-term investment to direct transfers in allocation of resource rents. According to these surveys, the Mongolian public also largely continues to support significant state participation in the development of mineral deposits deemed strategically important by the state, as they see this as a way to ensure that the Mongolian people benefit from mining.

The opportunistic rhetoric of populist politicians, coupled with the occasional misconduct of foreign and domestic mining companies alike, has in recent years had a chilling effect on the development of Mongolia's minerals sector. Ultimately, only educated voters can assist in creating a political environment that enables the formulation of government policy geared towards effective regulation and sustainable development. To do this, policy-makers must acknowledge the degree to which the country's socialist past and semi-nomadic traditions shape policy debates, and adopt a communication strategy that allows for a constructive national discussion of the role of mining in Mongolia's new economy.

IMPROVING GOVERNMENT SUPPORT FOR INVESTMENT

At the core of the Minerals Policy's numerous objectives is the need to foster the development of a responsible, transparent mineral extraction and processing industry that is sustainable, export-oriented and compliant with modern international standards.

With regard to the development of strategically important mineral deposits, the state's current objective is to develop better cooperation with the private sector, while also improving control and oversight of these deposits. While the Minerals Policy does not state how this will be achieved, it does seek to ensure efficient monitoring of mining operations by state and local authorities. This includes monitoring the levying of appropriate fees and charges, and ensuring that charges are not duplicated by different levels of government.

The Minerals Policy additionally aims to increase Mongolia's ability to conduct secondary processing of minerals and engage in other value-added activities. The government hopes to accomplish this through the introduction of tax and other financial incentives for projects such as coal-concentrate, coking-coal and chemical plants. Coal-fired power plants and plants that extract liquid fuel or gas from brown coal and fuel from oil shale are also eligible.

The Minerals Policy also seeks to create conditions that will allow both investors and local communities to better understand the social and economic impact of a mining project through public presentations *before* the commencement of mining operations. This is in line with the current Minerals Law, which states that a transparent, inclusive local development agreement should be formed between the investor and the local community before project development.

Despite its adherence to the Extractive Industries Transparency Initiative (EITI), Mongolia continues to struggle in Transparency International's Corruption Perceptions Index, ranking 80th out of 175 countries in 2014. (However, this was an improvement from 2012, when it ranked 95th.) One of the challenges for the country in the coming years will be to create greater openness in agreements between public-sector agencies and officials and private companies.

Human capital development is also crucial to ensuring that Mongolia is an attractive jurisdiction for mining companies. Despite the country's high adult literacy rates, private companies surveyed by the World Economic Forum (WEF) frequently cite an inadequately educated workforce as the main barrier to doing business in Mongolia. Ensuring that workers are sufficiently skilled is particularly critical for the success of the minerals sector, which requires highly qualified specialists capable of carrying out exploration or production operations in the country's often-harsh climate. To this end, the Mongolian parliament recently ratified the International Labor Organization's Safety and Health in Mines Convention, as prescribed by the Minerals Policy.

The Minerals Policy also calls for the establishment of a Policy Council in which the views of the government, investors, professional associations and the public are represented. Conceivably, the Policy Council would support the implementation of the Minerals Policy and make recommendations as to how it might be refined. (This would be similar to the Policy Council created by the Ministry of Mining in 2014, which has worked to improve dialogue between the government and private sector stakeholders.) Were it to be created, the Policy Council would also be tasked with safeguarding the legal stability of the Minerals Policy during the 2016 parliamentary elections.

RECOMMENDED NEXT STEPS

Today, Mongolia's economy is heavily dependent on the extraction of minerals and their export to China. Continued volatility in the demand for (and therefore in the prices of) these minerals means that in order to build sustainable long-term growth, Mongolia must diversify its economy and move on to higher value-added industries. This will require not only the development of such activities as minerals processing, but also support for other sectors of the economy such as agriculture and textiles (for example, cashmere), as well as a diversification of export destinations away from China.

There has been considerable progress towards this goal. In 2007, Mongolia announced that it would begin adhering to EITI protocols in order to encourage FDI, which has been the leading source of capital for the mining industry over the past decade. However, disputes in recent years over investment agreements have led some investors to increasingly view Mongolia with caution. Symptomatic of this, FDI has declined from its 2011 peak of US$ 4.6 billion to just US$ 542 million in 2014. (Although, this was also due in no small part to the decline in commodity prices.)

To jump-start growth in its minerals sector, Mongolia needs policies that:

- assess and enhance the climate for foreign investment in mining, with a special focus on human capital, corporate governance, business ethics and rule of law
- adequately direct policy-makers and those charged with implementation on mineral-sector reforms that facilitate both FDI and exports – including the development of clusters between multinational enterprises, local mining companies and small and medium-sized enterprises (SMEs) to encourage knowledge transfer
- enable the minerals sector to move up the mining value chain
- identify opportunities for technology transfer in the minerals sector.

In addition, strengthening the capacity of the government to engage in dialogue with the private sector and to manage contracts would help to increase the confidence of foreign investors and help pave the way for further reform. To judge its progress with respect to economic competitiveness, transparency and stability of policy, Mongolian policy-makers should pay closer attention to benchmark surveys conducted by international organisations such as the Organisation for Economic Co-operation and Development (OECD), the World Bank and the WEF. The OECD in particular has provided a number of recommendations to the government regarding how mining SOEs might improve their management and governance.

Mongolia has made notable progress with the creation of its National Council for Vocational Education, which has encouraged public-private dialogue geared towards helping the labour market supply the sort of skilled workers demanded by the private sector. The Council can be seen as a model for the private sector's provision of guidance to the government (and the Ministry of Mining in particular) with the aim of increasing the sophistication of Mongolia's minerals sector and should be further emulated. Public-private dialogue is also vital for enhancing the country's system for dispute resolution.

As previously mentioned, reliable geological information is essential for the country's attraction of investment into the minerals sector. However, enhancing Mongolia's capacity in geology will require both investment and focus on the part of public decision-makers. Nevertheless, a national geological survey – created with the coordination of all relevant government agencies (that is, those dealing with water, industrial minerals, oil and gas and hard minerals) – should be developed under the guidance of the Ministry of Mining. The Ministry should in turn seek technical assistance from donor organisations for this project.

CONCLUSION

Mongolia has the potential to achieve national prosperity through the development of its vast natural resources. While it is too early to assess the effectiveness of this new Minerals Policy, the government should be credited for the steps it has taken in liberalising the minerals sector and encouraging the adoption of international best practices.

The impact of these reforms will only be felt in time, as the current economic slow-down in China has created unfavourable near-term conditions for Mongolia's minerals sector. However, the country's successful development of world-class megaprojects, such as the Oyu Tolgoi copper mine, suggests that Mongolia's future is bright. However, political instability and poor institutional capacity remain as obstacles to Mongolia's ability to attract foreign investment and improve its international competitiveness. It is well within the nation's power to overcome these challenges, but doing so will require a firm resolve and a willingness among all stakeholders to work together towards a shared vision of prosperity.