U.S. EMBASSY IN ULAANBAATAR MONGOLIA

2012 MONGOLIA INVESTMENT CLIMATE STATEMENT

ECONOMIC AND COMMERCIAL SECTION OF THE U.S. EMBASSY
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A.1 OPENNESS OF GOVERNMENT TO FOREIGN INVESTMENT

In its specific policies, laws, and general attitude, the Government of Mongolia (GOM) has tended to support foreign direct investment (FDI) in all sectors and businesses. In general, Mongolian law has not traditionally discriminated against foreign investors. However, reflecting on 2011 and developments in the first half of 2012, observers tell us that Mongolia presents investors with a very mixed business climate. Negative trends involving intrusive and seemingly arbitrary government involvement. Despite statements to the contrary, Government of Mongolia (GOM) commitment to the transparent rule of law seems has weakened. Regulatory and legislative trends initiated in 2009 in the areas of environmental law, taxation, and mineral rights—widely perceived as narrowing Mongolia's openness to FDI—continued through 2011 into 2012.

Of particular concern, the recently passed *2012 Strategic Entities Foreign Investment Law of Mongolia* (SEFIL) potentially limits foreign ownership of assets and access to use rights in three key sectors, among them natural resource extraction. Although the exact implications of SEFIL remain unclear, investors express concern that the law may bar them from participating in key sectors of the Mongolian economy or force divestment of Mongolian assets and equities in the affected sectors. Consequently, both foreign and domestic investors tell us they see Mongolia as a demonstratively riskier place in which to invest and operate, notwithstanding optimism surrounding Mongolia's long awaited resource boom.

More positively, the key Oyu Tolgoi copper-gold project (OT) moves forward, having brought over US $2 billion into Mongolia through technology, jobs, and other revenues in 2011. Although some clouds loom over the OT horizon, this marquee project continues to justify Mongolia's investment potential for most investors.

However, doubts persist over both the GOM's commitment to honoring the OT Investment Agreement and its ability to manage public expectations over mining revenues and related development. In addition, delays in striking deals on important coal projects at the world class Tavan Tolgoi coking coal deposit (TT) along with delays in reforming Mongolia's security laws and equity markets have spurred concern that the GOM lacks the capacity to execute multiple reforms and projects. Investors worry that Mongolia, overwhelmed by these demands, will simply cease to complete vital reforms, impose new burdens on investors, and delay or effectively cancel projects.

Recent Legislative and Governmental Trends affecting FDI in Mongolia

Foreign and domestic investors have noted that Mongolia's processes for crafting both laws and regulations have negatively impacted investment into Mongolia. A key concern is that the mere proposal of amendments to a given law seems to freeze, or at least significantly slow, the Mongolian regulatory process. This process results in actions that threaten access to rights granted under current and still valid Mongolian laws. For example, the ongoing amendment process to the 2006 Minerals Law of Mongolia has adversely affected the regime for issuing exploration and mining licenses.

In 2010, the President of Mongolia announced his concerns about the existing licensing regime, which set into motion an amendment process for the entire law. This process, well into its second year, has produced numerous draft amendments by the GOM and Parliament. Although the 2006 Minerals Law remains in force, officials at all levels now delay, or openly refuse, to process normal requests for extending or issuing exploration and mining licenses. They state that the amendment process renders the current law effectively invalid, because any actions taken under current law might be subject to *post facto* changes imposed under a new statute; and officials, therefore, are reluctant to issue licenses and permits that might eventually become invalid or require alteration. In certain cases, we have received reliable reports that officials have threatened to revoke currently valid licenses under the pretext that current rights would be "illegal" under the pending legislation.

The effect has been to generate long and costly bureaucratic delays in many economic and commercial sectors, raising investment risk.

Legislating the Resource Pie

Observers have noted that the President of Mongolia, the GOM, and Parliament seek to amend the array of laws related to resource extraction, ostensibly with an eye to insuring that Mongolia gets its *fair share* from such activities and that investors and operators respect their environmental obligations and corporate social responsibilities to the national and local communities in which they work.

Public misperception and impatience fuel this trend. First, the Mongolian public believes that current statutes and regulations grant foreign and domestic investors all the benefits of extracting resources, while leaving communities with all the costs. Second, the Mongolian public is increasingly impatient over delays in receiving long-promised benefits from major mining projects. Revenue from these projects also is needed to finance Mongolia's significant infrastructure and human development needs, and the public increasingly feels it is not seeing results in this area as well.

Faced with a restive public, officials and politicians amend both statute and regulation with an eye to gaining more revenues while quelling public unease. So far the process has been extremely chaotic, characterized by non-transparent attempts to amend laws. These efforts impose higher licensing and permit fees, greater obligations on the part of investors to pay for local and regional development, higher royalties and taxes, and larger equity stake in resource extraction companies for either Mongolian public or private entities.

Investors can and should expect that investments, particularly in the resource sector, will be subject to extremely volatile legal and regulatory regimes as the Office of the President of Mongolia, the GOM, and Parliament reconcile fiscal demands and public expectations.

Passage of the Strategic Entities Foreign Investment Law (SEFIL)

In May 2012, Parliament passed the *Strategic Entities Foreign Investment Law (SEFIL),* just before parliamentary elections. Investors widely interpreted the move as a direct response to voter concerns that Mongolia's sovereignty was being threatened by the acquisition of mineral resource rights by foreign state-owned and private firms. As has become typical, there was little public transparency during parliament's short deliberative phase, and affected parties were provided with too short a window to review and comment on the draft law. General consensus among the investor community is that SEFIL is poorly drafted and will most likely be difficult to implement. Consequently, uncertainty now surrounds foreign direct investment in Mongolia. Views and commentary on the law within the business community reflect that uncertainty.

The law defines sectors of strategic importance to include (i) terrestrial resources, (ii) banking and finance, and (iii) media and communications; and imposes the following restrictions and obligations on foreign state-owned and private investors active in Mongolia:

- Private foreign direct investors (inclusive of affiliates and third parties) must obtain Cabinet and/or parliamentary approval to operate in the specified sectors of strategic importance or to conclude certain transactions with business entities operating in sectors of strategic importance (BESI) in many cases. The language "to operate" has not been defined in the SEFIL or clarified through regulations.

- Specific to shareholding, private foreign direct investors (inclusive of affiliates and third parties) must obtain approval from the Cabinet of Ministers for transactions to acquire one-third or more of the shares of a BESI. If the shareholding by a private foreign direct investor in a BESI exceeds 49 percent and the investment at the time is greater than 100 billion Mongolian National Tugriks (about $75 million USD as of this report), then parliamentary approval is required.
- Foreign state-owned legal entities, entities with state ownership and international organizations (inclusive of affiliates and third parties) must obtain Cabinet and/or parliamentary approval to operate in Mongolia or to invest in any company (inclusive of affiliated entities or third parties) in all sectors; meaning they are also regulated in sectors outside of sectors of strategic importance.
- Specific to shareholding, it so far is being widely interpreted that foreign state-owned legal entities, entities with state ownership and international organizations (inclusive of affiliates and third parties) must obtain Cabinet approval to acquire any amount of shares in any company in Mongolia. The language of the SEFIL does not clearly state whether Parliamentary approval is required if the shareholding by foreign state-owned legal entities, entities with state ownership and international organizations (inclusive of their affiliates and third parties) in a BESI or other company is greater than 49 percent and the investment at the time is greater than 100 billion Mongolian National Togrogs.
- Investors may also be required to seek approval for stock transactions for companies listed on both the Mongolian Stock Exchange and foreign exchanges.
- Stock and other equity transactions on both foreign and domestic exchanges on assets and companies in the specified strategic sectors may be subject to Mongolian taxation.
- All entities subject to the law may also be required to submit to GOM involvement in management, procurement, hiring, and other normal business operations and decisions.
- Current investments may not be subject to the law's provisions; however, if the foreign entity changes its status (i.e. tax or corporate restructuring with the same beneficial ownership), it may become subject to the law's provisions.

- International treaties, such as the U.S.-Mongolia Bilateral Investment Treaty, which allows U.S. investors to be treated as a Mongolian legal entity for investment purposes, appear to take precedence over SEFIL.

The Foreign Investment and Foreign Trade Agency (FIFTA) will serve as the secretariat and first reviewer of requests for FDI approval, making recommendations to the Cabinet of Ministers and ultimately Parliament as required.

Some elements within the GOM are concerned that the law imposes too many responsibilities on the government. Specifically, they wonder how the GOM will deal with the innumerable stock purchases and financial transactions, management decisions, and the other aspects affecting investments; and they wonder where they, the Cabinet of Ministers, and Parliament will find the time and resources to review the scores, if not hundreds, of investment requests envisioned under SEFIL.

Investors and lenders are decidedly ambivalent about SEFIL. They tell us they recognize that Mongolia, like all nations, has the sovereign right and responsibility to subject FDI to national security review. In that respect, SEFIL is consistent with international practices. Regardless, investors tell us that they are extremely concerned about the potential level of GOM and parliamentary involvement with FDI in the targeted sectors. The broad remit that the law seems to grant to the GOM to interfere in day-to-day management decisions, over and above crucial decisions on investment, capital spending, and share acquisition, makes it difficult to plan a given investment and raises risks to potentially unacceptable levels.

Investors are particularly concerned over whether the GOM will retroactively apply SEFIL to foreign investments made before the law entered into force, and if the government will force companies to divest assets to come into compliance. Although the government has stated that it will not implement the law retroactively, the law itself contains no such language, raising fears that the government might force divestiture or expropriation.

Uses of National Security Council Powers in Commercial Matters

In 2010, the President of Mongolia used his authority as head of the National Security Council of Mongolia (NSCM) to suspend the issuance and processing of both mining and exploration licenses. Publicly decrying the very disorganized and corrupt situation at the Mineral Resources Authority of Mongolia (MRAM), the President argued that MRAM situation constituted national security threat that justified his suspending the license issue process and related statutes and regulations.

2011 saw additional uses of NSCM powers in the commercial realm that have generated concerns. In 2011 NSCM powers were also used to assure that the Mongolian state would honor the OT investment agreement and to reject a proposed consortium agreement for the Tavan Tolgoi coking coal project. Observers also noted that the NSCM had informally involved itself in specific mining projects centering on coal-to-fuel/liquid (CTL) projects, urging that licenses and user rights either be revoked or granted for national security reasons. In all cases, NSCM involvement was justified on the grounds that neither parliament nor the GOM would be able to render appropriate, timely decisions on the projects in question, necessitating definitive action by the NCSM in order to address perceived threats to national security.

No previous NSCM, to our knowledge, has ever used its power so broadly and publicly to halt bureaucratic activity not normally associated with traditional national security matters. GOM officials explained that the powers granted to the NSCM are quite broad—without any apparent institutional limit in emergency situations. However, these same officials admit that neither OT and TT mining licenses, nor specific commercial or state-owned projects rise to the level of national security threat as defined by statute. Consequently, it appears that the NSCM has no statutory or constitutional authority that sanctions its actions.

Investors have expressed ambivalence over NSCM intrusions into commercial realm. On the one hand, given the political and bureaucratic gridlock, they are relieved that at least one Mongolian government institution has stepped up to the plate to provide a greater sense of stability and certainty to investors. On the other hand, they question the wisdom and practicality of using a small (unelected) body to enact decisions, which appears to be a highly politicized approach.

Limitations on Participation in Real Estate, Petroleum Extraction, and Strategic Minerals Deposits, and Law Practice

Only individual Mongolian citizens can own real estate. Ownership rights are currently limited to urban areas in the capital city of Ulaanbaatar, the provincial capitals, and the county seats (called *soums*). No corporate entity of any type, foreign or domestic, may own real estate. However, foreigners and Mongolian and foreign firms may own structures outright and can lease property and obtain use rights for terms ranging from one (1) to ninety (90) years. Mongolian law and regulation generally cedes control of the land, usually through lease, to the owner of the structure built upon a given piece of property.

Mongolian law also requires oil extraction firms to enter into production sharing contracts with the government as a precondition for both petroleum exploration and extraction.

Passed in 2006, Mongolia's current Minerals Law enacted the concept of the ***strategically important deposit,*** which empowers the GOM the right to obtain up to a 50% share of any mine on, or abutting, such a deposit. The prior 1997 law had no concept of "strategic deposits" allowing the state to take equity in mines.

The current law defines "a mineral deposit of strategic importance" as *"a mineral concentration where it is possible to maintain production that has a potential impact on national security, economic and social development of the country at national and regional levels or deposits which are producing or have potential of producing above 5% of total GDP per year."* Ultimately, the power to determine what is or is not a strategic deposit is vested in the State Great Hural (Parliament). To date, the GOM has only identified world class copper and coal reserves, some iron ore deposits, and all deposits of rare earths and uranium as reaching this threshold.

If a mineral deposit is labeled strategic and if the state has contributed to the exploration of the deposit at some point, the GOM may claim up to 50% ownership of the operating entity that may ultimately mine the resource. If the deposit is explored with private funds and the state has not contributed to the exploration of the deposit, the GOM may acquire up to 34% of that entity.

State participation (or share) is determined by an agreement on exploitation of the deposit considering the amount of investment made the state; or, in the case of a privately-explored strategic deposit, by agreement between the state and the firm on the amount invested by the state. Parliament may determine the state share using a proposal made by the government or on its own initiative using official figures on minerals reserves in the integrated state registry.

Importantly, the state equity provision is not expropriatory on its face, because the GOM has committed itself to compensating firms for the share it takes at fair market value. So far, the GOM has honored this commitment, as experience with the 2009 agreement with foreign firms for the Oyu Tolgoi copper-gold mine project confirms.

In addition, the current Minerals Law restricts the access of petroleum and mineral licenses to entities registered in Mongolia under the terms of the relevant company and investment laws. A foreign entity, in its own right, cannot hold any sort of mining or petroleum license. Should a foreign entity acquire a given license as either collateral or for the purpose of actual exploration or mining, and fail to create the appropriate Mongolian corporate or financial entity to hold a given license, that failure has served, and continues to serve,   as grounds for the GOM to invalidate the license. In essence, the foreign entity may lose its security or its mining rights. We advise investors with specific questions to seek professional advice on the status of their licenses.

Recent Amendments to the Practice of Law in Mongolia

In early 2012, Parliament amended the Law on Lawyers. These amendments impose new restrictions on foreign-owned and operated law offices. Previously, law offices could be owned and operated by foreign lawyers and parties. The amendments require foreigners to pass the Mongolian bar examine as a condition of owning or operating law firms in Mongolia.

Completing Reform of the Securities Law of Mongolia

Essential reforms to the *Securities Law of Mongolia* remain incomplete. The current law, insufficient and obsolete, was crafted to meet the needs of individual Mongolian citizens rather than those of institutional or foreign investors. The consensus is that an up-to-date law would:

- Formally distinguish between beneficial owners and registered owners.
- Allow for Custodians (financial institutions with legal responsibility for investors' securities).
- Institute new rules that would allow companies *listed* on the Mongolian Stock Exchange (MSE) to list their shares on other exchanges.

An amended securities law, consistent with practices, regulation, and statue used in other exchanges, will allow Mongolia to list and raise capital for important projects, such as Oyu Tolgoi and Tavan Tolgoi. Without such a law, Tavan Tolgoi and other public and private investments will face severe impediments to raising capital and valuing assets.

Oyu Tolgoi on Scheduled to Commence Operations in Late 2012

In October 2009, the GOM, Ivanhoe Mines of Canada, and Rio Tinto jointly negotiated investment and share-holders agreements respectively for the Oyu Tolgoi (OT) copper- gold deposit located in Mongolia's South Gobi desert. The OT agreements vest the government of Mongolia with 34% ownership of the project and provide guarantees for local employment and procurement. With estimated development costs in excess of US $7 billion and a 40-year plus mine-life, OT is conservatively expected to double Mongolia's annual GDP by the time it reaches full production around 2017. Initial production of copper concentrate is on schedule to commence in the third quarter of 2012.

With construction nearing completion, most observers of Mongolia's investment climate still consider this agreement the landmark foreign and domestic investment in Mongolia. The consensus is that the OT agreement:

- Shows Mongolia can say "Yes" to key projects undertaken with foreign involvement and investment;

- Confirms the GOM's commitment to compensating private rights holders of most deposits considered strategic under the current minerals;

- Demonstrates the GOM's and Parliament's willingness to amend laws and regulations to enhance and ensure the commercial viability of mining projects.

The positive impact and message of the OT deal for investors should not be underestimated. Its passage is largely considered responsible for spurring progress on other mining projects and for the successful listing of these projects on foreign stock exchanges.

However, as reported in the *2011 Investment Climate Statement*, some within the GOM and Parliament sought to re-open the investment agreement that sets the project's legal, tax, and regulatory environment for the next few decades. The issue came to a head in September 2011 when 20 members of Parliament and a broad array of public and private entities demanded that the GOM annul the agreement, claim a larger ownership share of the project, and impose a higher royalties. Faced with the ensuing controversy, both the GOM and Parliament remained silent on the issue, neither defending the agreement they had negotiated and passed nor refuting the calls for change. Rather, both bodies left the decision to the National Security Council of Mongolia (NSCM).

Chaired by the President of Mongolia, the NSCM also includes the Prime Minister and the Speaker of Parliament. These three members have statutory responsibility to provide comment and guidance for the national security aspects of government policy, law, and regulation, where and when such issues are determined to be involved. In the case of OT, the NSCM unanimously declared that the GOM and Parliament would honor the existing OT agreement without exception. This statement quelled investor fears that the Mongolian government would not keep its commitments and so far has seemed to calm—but not dispel—the Mongolian internal political pressures that led to the call to renegotiate deal in the first place.

While many investors expressed extreme relief that the NSCM averted catastrophe, the very fact that the dispute occurred at all has raised concerns that it will be revived during the 2012-2013 election cycle and beyond. The issue remains a threat because the NSCM lacks constitutional or statutory power to bind Parliament to any particular course of action on OT (or on any other issue for that matter); and secondly, because of ongoing public perception that deals such as OT prevent Mongolia from getting its fair share, do not put Mongolian interests first; and so, affront Mongolia’s sovereign rights.

Absent a clear, public GOM and parliamentary commitment to honor the OT agreement, the business community may well question the durability of agreements in Mongolia in general, casting a cloud on the country's investment climate. Left unaddressed, uncertainty over OT's future will impair investor perceptions and inhibit FDI into Mongolia; and, consequently, domestic development and employment linked to the resource sector.

Even as the OT investment agreement dramatically raised Mongolia’s business profile in 2011, it could just as dramatically darken it in 2012 and beyond.

Uranium and Environmental Laws Negatively Affect Investor Rights

Although OT remains a positive story for foreign investors in 2012, its impact on the investment climate is moderated by the ongoing implementation of three key laws that many foreign and domestic investors think detracts from Mongolia’s claims to being a competitive, safe, and predictable destination for investment.

The 2009 Uranium Law of Mongolia

In 2009 the Parliament imposed significant new controls on mining and processing uranium (and some rare earths) in Mongolia. The law created a new regulatory agency, the Nuclear Regulatory Energy Agency of Mongolia (NEA), and a state-owned holding company, MonAtom, to hold assets that the government will acquire from current rights holders. The law imposed several conditions:

- Immediately revoked all current uranium exploration and mining licenses and then required all holders to register these licenses with the NEA, for a fee;

- Required investors to accept that the Mongolian state has an absolute right to take -- without compensation -- at least 51% of the company that will develop the mine -- as opposed to just the deposit -- as a condition of being allowed to develop any uranium property;

- Created a uranium-specific licensing, regulatory regime independent of the existing regulatory and legal framework for developing mineral and metal resources. Prior to the Nuclear Energy Law, exploration licenses gave their respective holders the rights to discover and develop any and all mineral and metal resources discovered within that license area (this did not include petroleum resources, which are governed separately). According to GOM officials, this law means that the state can issue a distinct license for uranium exploration on a property otherwise dedicated to other mineral and metals exploration.

The Law on the Prohibition of Minerals Exploration in Water Basins and Forested Areas of 2009

In 2009, the Parliament passed *The Law on Prohibition of Minerals Exploration in Water Basins and Forested Areas*, or more colloquially, *The Law with the Long Name.* The stated intent was to limit environmental damage caused primarily by placer gold mining in and around forests and watersheds, and imposes the following restrictions on exploration and mining rights:

- Revokes or modifies licenses to explore for or mine any and all mineral resources within an area no less than 200 meters from water and forest resource.

- Requires the government to compensate rights holders for exploration expenses already incurred or revenue lost from actual mining operations.

- Empowers local officials to determine the actual areas which can be mined. In effect, the local official can extend the 200 meter minimum at his discretion.

Both foreign and domestic investors have unambiguously criticized the nuclear energy and water/forest laws and their respective implementations as both non-transparent and expropriatory. They continue to argue that these laws radically change the rules for investing in Mongolia's vital minerals sector quite late in the game, raising the question of Mongolia's reliability as an investment destination.

GOM claims to the contrary, observers consider these laws expropriatory. In regards to the Nuclear Energy Law, the legislation explicitly rejects any obligation to compensate investors for loss of economic rights and property, hence generating credible investor fears of government of expropriation. In 2010, these fears became real when the GOM acted against a foreign (non-US) company in what many observers defined as a stripping of the firm's rights to develop a uranium deposit without any apparent due process or compensation. Those rights were then vested in a Russian-Mongolian state-owned company. The foreign firm has since moved to settle its claims through international arbitration.

In the case of the Water and Forest Law, the GOM peremptorily announced without any notification that it would immediately suspend and cancel the exploration and mining licenses of over 240 mines and would later move to revoke the rights of other 1,600 or so licensees. Although the Water Law requires compensation, the GOM has not devised detailed plans for indemnifying holders.

Investors note that both laws passed without sufficient public review and comment and that the subsequent regulatory drafting processes continued with little participation of the affected parties. The resulting regulatory regimes do not generally specify how and on what basis licenses will be revoked; nor explain how investors might appeal administrative revocations. The open-ended powers seemingly granted Mongolian officials seem to give central, regional, and local officials broad discretionary powers to curtail rights without apparent limit.

Revisions of the Mongolian Tax Code

The 2006 code taxes all salary and wage income at 10% while allowing interest income from securities and capital gains to be tax free until 2013. As of January 2013, all types of income will be taxed at a rate of 10%.

Businesses are taxed at 10 % for profits less than 3 billion Tugriks (US$ 2.2 million) and at 25% for any profit 3 billion or above. The Value Added Tax (VAT) is currently 10%. Mongolia also imposes a variety of excise taxes and licensing fees upon a variety of activities and imports.

The OT project has had a salutary effect on key tax provisions long-desired by foreign and domestic investors alike. Before OT, firms could only carry-forward losses for two (2) years after incurring the loss. While most businesses approved of this provision, many, especially that requiring large and long-term infrastructure development, noted that the two year carry-forward limit was insufficient for projects with long development lead times, as is typical of most large-scale mining developments. As a condition precedent of passing the OT Agreement, Parliament extended loss-carry forward to eight (8) years.

On the down side, Mongolia's Parliament has revoked and refuses to reinstate an exemption available on value-added taxes (VAT) of 10% on equipment used to bring a given mine into production, except on equipment to be used in the production of highly processed mining products.

Most jurisdictions, recognizing that most mines have long development lead times before production begins, either waive or do not tax such imports at all. Parliament, with no consultation with investors, international experts, or its own tax officials, chose to impose the VAT, which immediately makes Mongolian mining costs 10% higher than they would otherwise be, impairing competitiveness and dramatically varying from global practice.

Whether any mining output qualifies for this exemption seems completely at the discretion of the GOM, which has not set out in regulation or statute a process by which it will regularly adjudicate such VAT exemption requests.

Unfinished Business with Administering Taxation (and other functions)

Despite overall solid, positive changes, international financial institutions and foreign and domestic investors continue to note that recent tax reforms and subsequent actions remain insufficient. They report that to improve Mongolia's business environment reform efforts need to go beyond changes to the tax code to restructure the operations of the key agencies—the tax department, the customs administration and the inspections agency–that interact with firms and individuals.

Public Private Partnership/Concession Law

In 2010, Parliament passed legislation that allows the state to tender concessions for certain functions and to enter into public-private partnerships (PPPs) in a variety of areas. Currently over 170 separate projects—ranging from a major rail expansion to the north eastern border with Russia to education centers—are listed as available for private entities to engage with the GOM.

The GOM aims to enlist private industry to support social and economic development by ostensibly providing commercial incentives for participation. However, while approving the concept in principle, foreign and domestic investors criticize the operative legislation. Chiefly, potential investors tell us that they see few incentives in the design of the PPPs. As currently envisioned, most Mongolian PPPs seem to allow for recovery of construction costs and a very limited horizon for operation (and profit generation) before the asset must be returned to the GOM.   In essence, investors argue that the GOM wants them to act like fee-for-service contractors but declines to compensate as they would such a contractor.

Until these unattractive features are amended, most investors will likely pass on Mongolia’s PPP opportunities.

The Mongolian Judiciary and the Sanctity of Contracts

Generally, we find no concerted, systematic, institutional abuse specifically targeted at foreign investment. Issues of corruption and judicial partiality aside, most problems seem to arise from ignorance of commercial principles rather than antipathy to foreign investment as such. (See A. 13 for a detailed discussion of corruption in Mongolia.) In principle, both the law and the judiciary recognize the concept of sanctity of contracts. However, the practical application of this concept lags, with both foreign and domestic investors reporting inconsistent enforcement of contracts by the judiciary. This inconsistency comes from the slow transition from Marxist-based jurisprudence to more market oriented laws and judicial practices. Recent decisions in banking and land use cases in which contract provisions were upheld reflect a growing commercial sophistication among

Mongolia's judges. As more judges receive commercial training and as Soviet era (1921-1990) jurists retire, we expect to see the gradual improvement of the entire judicial system. (See Chapter A.4 for a discussion of the role of the judiciary in dispute settlement.). However, hoped for improvements aside, many investors have told us that they perceive that Mongolian courts will side with local businesses in strictly commercial cases involving business to business disputes, regardless of relevant laws, regulations, and contractual obligations.

Concerns over Exit Visas

Initially reported in 2010, Mongolian public and private entities continue to abuse the exit visa system to exert pressure on foreign investors to settle civil and commercial disputes. The required valid exit visas are normally issued at the port of departure (e.g. the international airport), but may be denied for a variety of reasons including civil disputes, pending criminal investigation, or for immigration violations. If denied for a civil dispute, the visa may not be issued until either the dispute is resolved administratively or a court has rendered a decision. Neither current law nor regulation establishes a clear process or time-table for settlement of the issue. Nor does the law allow authorities to distinguish a criminal and civil case when detaining a person. In fact, the Mongolian government maintains the right to detain foreign citizens indefinitely without appeal until the situation has been resolved.

Research reveals that abuse of the exit-visa system also affects investors from countries other than the U.S. All cases have a similar profile. A foreign investor has a commercial dispute with a Mongolian entity, often involving assets, management practices, or contract compliance. The Mongolian entity responds by filing either civil or criminal charges with local police or prosecutorial authorities. It is important to note that at this point there need be no actual arrest warrant or any sort of official determination that charges are warranted: mere complaint by an aggrieved party is sufficient to deny exit.

An investor in this situation is effectively detained in Mongolia indefinitely. Some foreign investors have resolved these impasses by settling, allowing them to depart Mongolia. If unwilling to settle, the foreign investor will have to undergo the full investigatory process, which may lead to a court action. Investigations commonly take up to six months, and in one case an American citizen was not able to depart Mongolia for over two years while under criminal investigation for a failed business deal. In addition, even if a dispute seems settled, it can be filed in the same venue again—if the local police and prosecutors are willing—or in a different venue.

Mongolian citizens are not subject to similar detention when involved in commercial disputes. Mongolian citizens require no exit visas to depart Mongolia and can only be denied exit if an actual arrest warrant has been issued.

Privatization Policies and Resistance of Mongolian firms to Foreign Investment

Privatization policies have favored foreign investment in some key industries, including banking and cashmere production. The bidding processes for privatizations and other tenders have generally been transparent. Although the GOM routinely announces plans, we have seen little real movement to privatize state holdings in the aviation, telecommunications, power, and mining sectors. Recent GOM acquisitions of mining assets– especially in uranium, rare earth oxides, and coal – suggest to some that the GOM has no plans to relinquish state ownership but rather intends to expand the state's role in some areas.

That said, the GOM continues to promote plans for initial public offerings (IPO) for certain state-owned power, infrastructure, and mining holdings. It has stated that funds from such offerings would be used to underwrite these projects and to pay for needed infrastructure improvements. To date, the IPO discussion has moved beyond the conceptual level, with the government seeking the assistance of international investment advisors to move ahead. The GOM has told the Mongolian public and investors that it would like to hold an international IPO for at least one mining asset, specifically the world-class Tavan Tolgoi (TT) coking project as early as fall 2012. While most observers believe that such an IPO is viable in the long run, they argue that the GOM's 2012 time table is too ambitious given that TT remains an undeveloped, remote Gobi site with little viable infrastructure owned by a government that has no track record in bringing such projects into operation.

Mongolian businesses vs. Foreign Direct Investors

Other than the limitations imposed by the *Strategic Entities Foreign Investment Law of 2012 (SEFIL)*, foreign companies and investors are subject to the same legal regime imposed on Mongolian domestic firms regarding incorporation and corporate activities. For example, casinos are illegal under Mongolian law; and so, neither Mongolians nor foreigners may own or operate them (except in one specifically designated free trade zone, although no casino has been established there).

Generally, Mongolian private businesses seek foreign participation and equity in all sectors of the economy. That said, some Mongolian businesses use Mongolian institutions to stop competitors, if they can. These actions represent no animus against foreign investment as such; rather, they reflect individual businesses desire to keep competitors, Mongolian or foreign, at bay.

Key Investment Laws

Foreign Investment Law of Mongolia

The Foreign Investment Law of Mongolia (FILM) transformed the anti-business environment of the socialist era into today's generally investor-friendly regime. Under the old system, everything not provided for in law was illegal. Because such economic activities as franchising, leasing, joint venture companies were not specifically mentioned in earlier Mongolian statutes, they were technically illegal. In 1993, the GOM enacted FILM to legalize all manner of foreign investment in Mongolia (amended in 2002 to allow for representative offices and franchises). This law and its subsequent amendments define broad ranges of activity that would otherwise have limited validity under Mongolian law. It also defines the meaning of foreign investment under the civil code without limiting activities that foreign investors can conduct. FILM also establishes registration procedures for foreign companies. Specifically, the law requires that any investment with 25% or more of FDI must register as a foreign-invested firm with the government. The law creates a supervisory agency, the Foreign Investment and Foreign Trade Agency (FIFTA), that runs the registration process, liaises among businesses and the Mongolian government, and promotes in- and out-bound investments.

In 2008, the Parliament of Mongolia amended the FILM. The stated intent of the revision was to improve FIFTA's ability to track foreign investment and to enhance the services provided by FIFTA to foreign investors. The 2008 FILM requires foreign investors to invest a minimum of US$100,000 and imposes a series of requirements on foreign investors seeking registration. Registered foreign companies must have FIFTA certify that their by-laws, environmental practices, their technologies, etc., comply with standards determined by FIFTA.
Foreign investors have expressed concern over what they perceive as FIFTA's broad and seemingly un-transparent regulatory authority. FIFTA officials report that procedures are still under development; and that because they lack specific

expertise in most of these areas, they will have to consult with the relevant ministries and agencies as they assesses each firm's request for investment registration. FIFTA also lacks transparent, predictable processes to evaluate investments. Investors still tell us that they do not know the exact standards FIFTA will apply for any given investment; how it will determine those standards; and how an investor might seek redress if FIFTA denies a registration request.

Ministerial Structure Related to Foreign Investment

As a result of the parliamentary elections of 2012, the current structure of government will change. We have reliably heard that number of ministerial appointments will nearly double to twenty-two (22). These changes will require Parliament to pass implementing legislation to allow for the expansion of the GOM. As of this report, these legislative changes are in process; and so, we have no clear sense how ministerial portfolios will change; nor how these changes might affect foreign direct investment in Mongolia. The *2013 Investment Climate Statement* will report on the new state structure and its impacts.

Mongolia's Ranking as a Place to Do Business

Measure	**Year**	**Index/Ranking**
TI Corruption Index (http://cpi.transparency.org/cpi2011/results/)	2011	*Corruption Perceptions: 2.7*
Heritage Economic Freedom (http://www.heritage.org/index/country/mongolia)	2012	*World Ranking*:**81/179** *Freedom Score*: 61.5
World Bank Doing Business (http://www.doingbusiness.org/data/exploreeconomies/mongolia)	2011 2012	Doing Business: 89 Doing Business: 86
MCC Government Effectiveness (http://www.mcc.gov/documents/scorecards/score-fy12-new-mongolia.pdf)	FY 2012	0.25 (75%)
MCC Rule of Law	FY 2012	0.50 (85%)
MCC Control of Corruption	FY 2012	0.07 (59%)
MCC Fiscal Policy	FY 2012	-2.8 (47%)
MCC Trade Policy	FY 2012	79.8 (89%)
MCC Regulatory Quality	FY 2012	0.45 (85%)
MCC Business Start Up	FY 2012	0.989 (96%)
MCC Land Rights Access	FY 2012	0.711 (74%)
MCC Natural Resource Management	FY 2012	80.7 (54%)

A.2 CONVERSION AND TRANSFER POLICIES

The Mongolian government employs a limited regulatory regime for controlling foreign exchange for investment remittances and maintains exceptionally liberal policies for these transactions. Foreign and domestic businesses report no problems converting or transferring investment funds, profits and revenues, loan repayments, or lease payments into whatever currency they wish to wherever they wish. There is no difficulty in obtaining foreign exchange, whether the investor wants Yuan, Euros, Yen, English Pounds, Rubles, or U.S. Dollars.

In regards to domestic transactions, current law requires all domestic transactions be conducted in Mongolia's national currency, the Tugrik, excepting those entities allowed specific waivers as determined by the Mongolian central bank, the Bank of Mongolia (BOM).

Businesses report no delays in remitting investment returns or receiving in-bound funds. Most transfers occur within 1-2 business days or, at most, a single business week.

Ease of transfer aside, foreign investors criticize Mongolia's lack of sophisticated mechanisms for converting currencies and parking money. Letters of credit are difficult to obtain, and legal parallel markets do not yet exist in the form of government dollar- or tugrik-denominated bonds or other instruments for parking funds in lieu of payment. Many Mongolian financial institutions lack experience with these arrangements. Moreover, Mongolian banking law currently provides incomplete statutory grounds and regulatory support for the activity to take place. The immediate impact has been to limit access to certain types of foreign capital, as international companies resist parking cash in Mongolian banks or in local debt instruments. That said, the government of Mongolia, the BOM, and several donor agencies are continuing efforts to develop and employ such instruments by 2012.

A.3 EXPROPRIATION AND COMPENSATION

Mongolia respects property rights as they apply to most asset types. In 2011, we detected no wide-scale changes in policies, statutes, or regulations related to the use and ownership of private property. However, the first half of 2012 has seen legislation—the *2012 Strategic Entities Foreign Investment Law of Mongolia* (SEFIL)—pass that potentially limits foreign ownership of assets and to use rights in three key sectors, among them natural resource extraction. Although the exact implications of SEFIL remain unclear, the law may require Foreign investors to seek local partners and source goods and services locally, This legislation is consistent with, and represents a continuation of, actions that represent both "creeping expropriation" and explicitly expropriatory acts sanctioned through force of law, especially but not exclusively in the resource extraction sector.

Security of Ownership

Mongolia and the United States signed and ratified a Bilateral Investment Treaty (BIT) which entered in force in 1997, and which specifically enjoins both signatories from expropriatory acts against private property and investments (for a copy of this BIT go to http://www.state.gov/e/eeb/ifd/43303.htm). In addition, both Mongolian law and the national constitution recognize private property rights and the rights associated with its use and specifically bar the government from expropriating such assets. To date, the government of Mongolia (GOM) has not expropriated any American property or assets. However, recent actions by the GOM against a foreign (non-US) mining company in the uranium exploration sector provide an example for investors of how the Mongolian government is willing to respond to seizure of, and compensation for, private property.

Like most governments, the Mongolian government can claim land or restrict use rights in the national interest. Currently, this means little, as most land outside Mongolia's few urban centers remains government property, as provided in Mongolia's constitution. The government has no plans to privatize these vast countryside holdings, but it leases parcels for such economic activities as mining, pasturage, cropping, timbering, etc. This practice remains in flux because the government must still determine how to let these rights and what fees to charge. Because the GOM has provided a clearer legal and regulatory path to investors in the minerals sector than in others, mining has traditionally attracted more foreign investment. However, recent government policies to promote agricultural activities have led to foreign direct investment in both livestock and cropping.

Since May 2003, land in the urban areas has been privatized to citizens of Mongolia or leased to both citizens and foreigners for periods ranging from 3-90 years. The legislation and implementing regulations are evolving, but so far investors believe that the GOM generally respects property rights and leases.

Expropriatory Aspect of the Strategic Entities Foreign Investment Law (SEFIL)

In May, 2012 Parliament passed *SEFIL*, just before parliamentary elections. As passed, some of SEFIL's provisions seem potentially expropriatory. Of particular concern, investors worry that the GOM will retroactively apply SEFIL to foreign investments made before the law entered into force and will force companies to divest assets to come into compliance. Although the government has stated that it will not implement the law retroactively, the law itself contains no such language, raising fears that the government might force divestiture or expropriation. For a fuller description of SEFIL's provisions see Chapter A.1.

I: Implications of the Current Minerals Laws

<u>*Minerals Law of 2006*</u>

We closely watch the key mining sector, Mongolia's major foreign exchange earner and chief engine for economic and commercial development. The current Minerals Law has several provisions that raise red flags for investors and observers alike. The law does not allow the GOM to usurp rights to explore and exploit natural mineral, metal, and hydrocarbons resources per se. Instead, the law imposes procedural requirements and grants powers to central, provincial, and local officials - powers that, if abused, might prevent mineral license holders from exercising their exploration or mining rights. The current law has the potential to deny the rights holder access to his rights without formally revoking use rights.

An example is the tender process for apportioning some exploration rights. The old law awarded exploration rights on a "first come, first served" basis, a process that gave little discretion to government officials to intervene. The current law establishes a different procedure for obtaining exploration rights on land explored with state funds or lands where the current holder has forfeited exploration rights. The Mineral Resources Authority of Mongolia (MRAM) will tender such exploration rights only to firms technically qualified to conduct minerals work. The new tender procedure neither requires nor allows for a cash bid. Only the technical merits of exploration proposals will determine who gains exploration rights. MRAM staff has the authority and responsibility to assess the merits of proposals to determine who wins the tenders.

Both MRAM and its supervising authority, the Ministry of Mineral Resources and Energy, have broad discretionary authority to select who will get tenements. Under the current system, it is possible for a company to prospect virgin territory and scope out a potential exploration site, only to risk losing the site should MRAM decide to grant the rights to another exploration company. This authority disturbs miners, who fear this power as a potential source of corruption and arbitrary decisions by MRAM.

Investors and observers are also concerned about authority granted to the MRAM Chairman to approve transfers of existing and new licenses. The law grants final approval authority to the MRAM, without specifying any check or balance on this official's authority. This power does not include revocation but if abused would certainly prevent exercise of economic rights.

Complicating matters is that in 2008 MRAM had been moved under the direct authority of the Ministry of Mineral Resources and Energy in a sweeping re-organization of the government. Prior to this restructuring, MRAM had been a quasi-independent agency, the acts of which did not require ministerial approval. In the new structure, the ministry can intervene in the registration and transfer of exploration and mining licenses. Initially, the ministry only intervened in cases where the license involved a "strategic" deposit. (See A.1 for explanation of strategic deposits.)

However, the ministry seems to have intervened in cases involving non-strategic deposits, claiming that these deposits had somehow become strategic. In this specific category, ministerial officials have ordered MRAM to freeze all transfers and transactions involving properties near or in strategic deposits, which includes uranium deposits of any size, rare earths, oil shale and shale gas, and oil deposits, small to medium size coal deposits throughout Mongolia, and massive coal and copper deposits near the Chinese border. Further, these same officials have indicated that the government may then revoke the rights of those holding exploration rights or mining licenses in or near strategic deposits. Although the law seems to allow for compensation, the ministry has not presented formal compensation packages or even issued compensation guidelines to those potentially affected by its actions.

Expropriatory Aspects of the 2009 Law on Nuclear Energy as it applies to exploring and extracting uranium

In 2009 the Parliament passed a new law imposing significant new controls on mining and processing uranium in Mongolia. The law created a new regulatory agency, the Nuclear Energy Agency of Mongolia (NEA), and a state-owned holding company, MonAtom, to hold assets that the government will acquire from current rights holders. The law:

- Immediately revoked all current uranium exploration and mining licenses and then required all holders to register these licenses with the NEA, for a fee.

- Required investors to accept that the Mongolian state has an absolute right to take -- without compensation -- at least 51% of the company (as opposed to the deposit) that will develop the mine as a condition of being allowed to develop any uranium property.

- Created a uranium-specific licensing and regulatory regime independent of the existing regulatory and legal framework for mineral and metal resources. Prior to the Uranium Law, exploration licenses gave their respective holders the rights to discover and develop any and all mineral and metal resources discovered within that license area (this did not include petroleum resources, which are governed separately). According to GOM officials, this new law means that the state can issue a distinct license for uranium exploration on a property otherwise dedicated to other mineral and metals exploration.

To many foreign and domestic investors, this law is outright, statutorily sanctioned expropriation, which heretofore had not been present in Mongolia. Although the Minerals Law of Mongolia and other pieces of legislation officially state that the GOM must compensate rights holders for any taking, the Nuclear Energy Law gives the GOM the right to take uranium holdings from whomever it will with no obligation to compensate rights holders. Complicating the issue is that the law seems to conflate the deposit and the company mining it, allowing the GOM to claim an uncompensated share in any such entity. In effect, the GOM is demanding a free-carried, non-compensated interest of no less than 51% of any uranium mine. The GOM has indicated to us that this licensing regime also applies to any radioactive rare earth deposit.

GOM claims to the contrary, observers argue that implementation of the Nuclear Energy Law has validated their concerns about expropriation. In 2010, the GOM acted against a Canadian company in what observers defined as a stripping of the company's rights to develop a uranium deposit without any apparent due process or compensation. Those rights were then vested in a Russian-Mongolian state-owned company. The Canadian firm has since moved to settle its claims through international arbitration and expects a decision in 2012 or 2013.

Acts of Provincial Administrations:

With regard to the issuance of both exploration permits and mining licenses, observers routinely report that provincial officials use their authority arbitrarily to block access to mining rights legally granted under the current law. For example, reports regularly circulate that some provincial government officials use their authority to designate land as "special use zones" to usurp mining exploration tenements. In a common technique, provincial governors often reclassify property that has never felt the touch of the plow or felt the tread of a tourist for agricultural use or cultural tourism respectively, although the central government has legally granted exploration rights to miners.

Other miners harshly criticize the misuse of the local officials' rights to comment on permits for water use and mining licenses. Comments are advisory, and have limited legal force to disallow activity, but the central government routinely hesitates to reject a governor's negative comment no matter the motives behind it. The effect has been to stop progress for months, limiting access to the resource and costing rights holders time and money. Whatever the motive, these actions are seen as a creeping bureaucratic expropriation through denial of access and use rights.

The 2006 Minerals Law provides no clear limit on provincial control of permits and special use rights or guidance on how to apply these powers beyond codifying that the provincial and local authorities have some authority over activities occurring in their provinces and soums (counties). Faced with these unclear boundaries of authority, the central government often interprets the rules and regulations differently from the provincial authorities, creating administrative conflicts among the various stakeholders. The central government acknowledges the problematic ambiguity but has yet to definitively clarify the situation in law or practice. Mongolian and foreign permit holders have advised the government that letting this problem fester raises perceptions among investors that they may risk losing their economic rights, which can scare away inbound investors.

Expansion of License Revocation Powers to the Soum Level

The *Law on the Prohibition of Minerals Exploration in Water Basins and Forested Areas of 2009*—or *The Law with the Long Name*, as it is colloquially known—represents a considerable extension of unregulated authority to Mongolia's 320 *soum* (county) administrations in regards to mining activities within their respective jurisdictions.

In 2009, Parliament prohibited mining in Mongolia's water basins and forested areas. The law's stated and laudatory intent was to limit environmental damage caused primarily by placer gold mining in and around forests and watersheds. The law imposes the following restrictions on exploration and mining rights:

- Required the government of Mongolia to revoke or modify licenses to explore for any and all mineral resources within an area no less than 200 meters from a water or forest resource.

- Required the government to compensate rights holders for exploration expenses already incurred or revenue lost from actual mining operations.

- Empowered local officials, the *soum* or county governors, to determine the actual areas which can be mined. In effect, the local official can extend the 200 meter minimum at his discretion.

Current rights holders are concerned that the power of local governors to curtail mining in their respective jurisdictions seems unlimited and unregulated. Although the governor cannot allow mining within the 200 meter limit, the law sets no upper distance limit on mining near water courses and forests. Mining companies have to work out the issue with the local governor; and should any company disagree with a, the law makes no provision for administrative appeal. A company would then have to pursue redress in Mongolia's courts, which could be lengthy. In either case, the rights holder would lose access to their economic rights for a protracted period or permanently.

Adding to these concerns, in fall 2010 the central government, citing the Water and Forest Law as justification, peremptorily announced without any notification that it would immediately suspend and cancel the exploration and mining licenses of over 240 mines and would later move to revoke the rights of 1,600 or so licensees. Although the Water and Forest Law requires compensation, the government of Mongolia has not devised detailed plans for indemnifying rights holders under immediate threat of revocation of rights.

This failure to clarify the situation continued through 2011 and seems set to continue through 2012. The lack of clarity has reportedly prevented many miners from obtaining financing for ongoing operations. Banks and other lenders hesitate to lend money secured by pledged licenses that may be revocable under the provisions of the *Law with the Long Name*.

National Security Concerns May Lead to Loss of Rights:

In 2010, the President of Mongolia used his authority as head of the National Security Council of Mongolia (NSCM) to suspend the issuance and processing of both mining and exploration licenses. 2011 saw additional uses of NSCM powers in the commercial realm that have generated concerns among observers.

In taking this action, , the president publicly decried the very disorganized and corrupt situation at the Mineral Resources Authority of Mongolia, which he argued justified suspending license issuances as national security concerns and policies supersede legislation and regulation.

In 2011 NSCM powers were formally used to assure that the Mongolian state would honor the OT investment agreement and reject a proposed consortium agreement for the Tavan Tolgoi coking coal project. Observers also noted that the NSCM had informally involved itself in specific mining projects centering on coal conversions, urging that licenses and use rights be revoked or granted for national security reasons. In all cases, NSCM involvement was justified by claiming that neither parliament nor the GOM would be able to render appropriate, timely decisions on the projects in question, necessitating definitive action by the NCSM on the grounds that lack of action constituted some sort of national security threat.

No NSCM, to our knowledge, has ever used its power so broadly and publicly to intervene in activities not normally associated with national security. GOM officials have explained that the powers granted to the NSCM are quite broad and without any apparent institutional limit in emergency situations. However, these same officials claim that neither the OT agreement, nor TT, nor mining licenses, nor specific commercial or state-owned projects rise to the level of national security threat as defined by statute. Consequently, it seems the NSCM has no statutory or constitutional authority to act in areas clearly the responsibility of either the GOM or Parliament. That neither the Government nor Parliament appear unable to fulfill their mandated responsibilities to honor agreements, sustain regulatory regimes, and approve projects provides no legal or constitutional basis for NSCM action.

Investors have expressed ambivalence over NSCM intrusions into the commercial realm. On the one hand, they are relieved that at least one Mongolian institution, faced with the failure of others, has stepped up to the plate to stabilize important national projects (OT and TT) and associated rights. On the other hand, they question the practicality of subjecting regional and local projects or such day to day activities as issuing permits and licenses to a highly-politicized, non-transparent set of security criteria more appropriate to mega, projects.

How the Amendment Process Seems to Curtail Access to Extraction Rights

In 2011 investors brought to our attention concerns over the amendment process of legislation in Parliament: Merely proposing amending a given law seems to freeze, or at least significantly slow, the Mongolian regulatory process; which consequently threatens exercise of rights granted under current law. For example, the ongoing amendment process to the 2006 Minerals Law of Mongolia has affected the regime for issuing exploration and mining licensing.

In 2010, the President of Mongolia announced his concerns about the existing licensing regime, which set into motion an amendment process for the entire law. This process, well into its second year, has produced numerous draft amendments between the GOM and the Mongolian Parliament. Although the 2006 Minerals Law remains in force, officials at all levels now delay, or openly refuse to process, normal requests for extending or issuing exploration and mining licenses. They justify delay and refusal by stating that the amendment process renders the current law effectively invalid because any act under the current law might be subject to *post facto* changes imposed under a new statute; and so why issue licenses and permits that will be invalid or require eventual alteration. In certain cases, we have reliable reports of officials threatening to revoke currently valid licenses under the pretext that such would be “illegal” under incoming legislation—that is, un-ratified amendments.

Overall, the GOM and Parliament, through the amendment process for mining and other laws, have generated lengthy and costly bureaucratic log jams in many economic and commercial sectors and raised the perceived risk that officials will reject permits and licenses executed in good faith under valid laws under the pretext that the law will change in the future.

A.4 DISPUTE SETTLEMENT

The GOM inconsistently supports transparent, equitable dispute settlements. These inconsistencies largely stem from both a lack of experience with standard commercial practices and the opportunistic, non-systematic intent of some public or private entities to target foreign investors. The framework of laws and procedures is functional, but many judges and officials remain ignorant of commercial principles as well as partial to Mongolian plaintiffs and defendants in disputes with foreign investors.

Problems with Dispute Settlement in Mongolia's Courts

Court structure is straightforward and can support dispute settlement. Disputants know the procedures and the venues. Mongolia does not use juries in court proceedings; rather, plaintiffs bring cases at the district court level before a single district judge or panel of judges, depending on the complexity and importance of the case. The district court renders its verdict. Either party can appeal this decision to the Ulaanbaatar City Court, which rules on matters of fact as well as matters of law. It may uphold the verdict, send it back for reconsideration or nullify the judgment. Disputants may then take the case to the Mongolian Supreme Court for a final review. Matters regarding the constitutionality of laws and regulations may be taken directly before the Constitutional Court of Mongolia (the "Tsetz") by Mongolian Citizens, Foreign Citizens, or Stateless Persons residing legally in Mongolia.

Problems arise for several reasons. First, commercial law and broad understanding of it remain in flux in Mongolia. It has become necessary to pass new laws and regulations on contracts, investment, corporate structures, leasing, banking, etc. because generally Mongolian civil law does not work on precedents but from application of the statute as written. If a law is vague or does not cover a particular commercial activity, the judge's remit to adjudicate can be severely limited or non-existent. For example, until recently leasing did not exist in the Mongolian civil law code as such, but seemed to be covered under various aspects of Mongolian civil law regarding contracts and other agreements. But judgments on leasing made under these laws might not have applied to an arrangement not otherwise specifically recognized under its own exclusive law. Further, because precedents are not legally relevant or binding on other judges and Mongolian courts, decisions reached in one case have no legal force in other suits, even when the circumstances are similar or even before the same court and judges.

Trained in the socialist era, many judges lack training in or remain ignorant of commercial principles, in some cases willfully. They dismiss such concepts as the sanctity of the contract. Most observers argue that this view is not a problem of the law but of faulty interpretation. In several cases courts have misinterpreted provisions regarding leases and loan contracts, allegedly intentionally in some cases. Judges regularly ignore terms of a contract in their decisions. If someone defaults on a loan, the courts often order assets returned without requiring the debtor to compensate the creditor for any loss of value. Judges routinely assert that the creditor has recovered the asset, such as it is, and that is enough. Bad faith and loss of value simply have no formal standing in judicial calculations of equity.

Replacing old-school judges is not an option. It is politically impossible—if not functionally impractical—for the Mongolians to dismiss its cadre of socialist-era judges. There is a realistic hope that young justices, trained in modern commercial principles by international experts, will gradually improve judicial protections for commercial activities in Mongolia. Lately, firms report to us better decisions in several cases involving Americans seeking to recover on debts and contractual fees and to hold Mongolian government entities to the terms of their respective contracts and regulations, but these results tend to be limited to courts where modern-educated judges preside.

At the same time, a problem may be developing for foreign investors with regard to blatant preference of judges to support local firms. Investors have begun to inform us of numerous and consistent accounts of judicial (and of local arbitral panel) decisions in which they claim that the ruling clearly ignored the terms of the contract. Further, the judges adjudicating the case have stated directly to the investors or to third party intermediaries that such decisions are justified based on the foreign identity of the plaintiff or defendant. Examples of arguments include: the foreign investor can afford the loss, the foreigner must be stealing from Mongolia in some way and so deserves to lose, or that Mongolian judges must support Mongolians or risk being accused of being unpatriotic. While the validity and accuracy of these claims is difficult to assess, the number and consistency of the complaints suggest that that Mongolia’s judiciary is not treating foreign investors fairly and equitably

Bankruptcy and Debt Collection

Mongolia’s bankruptcy provisions and procedures for securing the rights of creditors need comprehensive reform. Mongolian law allows for mortgages and other debt instruments backed with securitized collateral. However, rudimentary systems for determining title and liens and for collecting on debts make lending on local security risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to creditors.

Although a system exists to register immovable property—structures and real estate—for the purpose of confirming ownership, the current system does not record existing liens against immovable property. Although legislation is working its way through the relevant ministries, no system currently exists to register ownership of, and liens on, movable property. Consequently, Mongolian lenders face the added risk of lending on collateral that the debtor may not actually own or which may have already been pledged as security for another debt. It is hoped that a project sponsored by the Millennium Challenge Corporation to create a more modern and efficient property registration system will help improve the ability of creditors and debtors to prove ownership. For program details go tohttp://www.mca.mn/?q=eng/Project/PropertyRights.

Overall, the legal system does recognize the concept of collateralized assets provided as security for loans, investment capital, or other debt-based financial mechanisms. The legal system also provides for foreclosure, but this process is exceptionally onerous and time consuming. Waits of up to 24 months for final liquidations and settlement of security are not uncommon.

Once a judgment is rendered, the disputant faces a relatively hostile environment to execute the court's decision. For example, a bank collecting on a debt in Mongolia must allow debtors to put forward assets for auction and set the minimum bid price for those assets. If assets do not sell, a second round of auctions occurs in which a reduced minimum bid is put forward. The State Collection Office (SCO) supervises this process but does not set the price. However, the SCO receives 10% from the sales price or from the second auction minimum price even if there is no sale. The SCO does not allow collateralized assets to be valued by neutral 3rd parties. Because it derives income from the forced sale of assets, the SCO has a conflict of interest; and, anecdotally, seems to have failed as an impartial arbiter between debtors and creditors.

Bankruptcy is an option on paper, but we can offer no example of a successful bankruptcy process. Indeed, local law firms suggest that the process is so apparently vague and onerous that the option is more a theoretical concept than practical step to wind down a business.

Purchase financing remains tricky. Numerous cases have come to our attention in which domestic and foreign distributors finance sales, complete with a local bank guarantee. Buyers subsequently default on loans, banks refuse to honor their guarantees, and the dealers take the respective buyer to court. Under current Mongolian law, interest payments are suspended for the duration of such a case, from first filing to final appeal before the Supreme Court of Mongolia. Possibly months of interest-free time can pass while the now impounded asset wears away. In such cases, the dealers simply reclaim the asset and drop the lawsuit, swallowing the lost interest payments and loss of value. Domestic and foreign businesses often respond by requiring customers to pay in cash, limiting sales and the expansion of the economy.

Binding Arbitration: International and Domestic

The Mongolian government generally supports and has submitted to both binding arbitration and international settlement procedures.   However, glitches remain in local execution. Mongolia ratified the Washington Convention and joined the International Centre for Settlement of Investment Disputes in 1991. It also signed and ratified the New York Convention in 1994.

To our knowledge, the government of Mongolia has accepted international arbitration in several disputes where claimants have asserted the government reneged on a sovereign guarantee to indemnify them or in which the government engaged in an improper taking of property or rights. In all cases the government has consistently declared that it would honor the arbitrators' judgments.

More widely, Mongolian businesses partnered with foreign investors will accept international arbitration, as do government agencies that contract business with foreign investors, rather than avail themselves of the Arbitration Bureau operated by the Mongolian National Chamber of Commerce and Industry.

Regarding the domestic Arbitration Bureau, foreign investors tell us they resist local arbitration, preferring to seek redress abroad because they perceive that domestic arbitrators are too politicized, unfamiliar with commercial practices, and too self-interested to render fair decisions.

Although arbitration is widely accepted among business people and elements of the government, support for binding international arbitration has not penetrated local Mongolian agencies responsible for executing judgments. In two cases, the Mongolian-state-owned copper mine lost two international arbitral cases. The awards were certified and recognized as valid and enforceable by Mongolian courts. But the local bailiff's office has consistently failed to execute the collection orders. Local business people routinely cite the failure of SCO and the bailiffs to enforce court-ordered foreclosures and judgments as the most common problem threatening resolution of debt-driven disputes.

The *U.S.-Mongolia Bilateral Investment Treaty (BIT)* entitles both U.S. and Mongolian investors to seek third country arbitration in the case of business disputes.

A.5 PERFORMANCE REQUIREMENTS AND INCENTIVES

Mongolia has traditionally imposed few performance requirements on, and has offered few incentives to, investors. For the most part, the few requirements imposed have neither been onerous nor too limiting on foreign participation in any sector of the economy. However, spring of 2012 saw legislation—*The Strategic Entities Foreign Investment Law of Mongolia* (SEFIL)—passed that seems to impose some fairly strict performance requirements on foreign investors in key strategic sectors.

Under the current Tax Law of Mongolia, the government of Mongolia (GOM) attempts to limit both exemptions and incentives and to make sure that tax preferences offered are available to both foreign and domestic investors. Exemptions are occasionally granted for imports of such staples as flour and rice or for imports in certain sectors targeted for growth, such as the agriculture sector. Such exemptions can apply to both import duties and Mongolia's value-added tax (VAT). In addition, the GOM will extend a 10% tax credit on a case by case basis to investments in such key sectors as mining, agriculture, and infrastructure.

Foreign investors have accepted phasing out of tax incentives because the amendments have brought some needed best practices to the tax code. These include provision for 8-year loss-carry-forwards, five-year accelerated depreciation, and more deductions for legitimate business expenses including but not limited to marketing and training expenses.

Revocation of the VAT Exemption

Investors view Mongolia's treatment of exemptions as something of a mixed bag. On the down side, Mongolia does not exempt equipment used to bring a given mine into production from the 10% value-added tax (VAT) unless the equipment will be to produce highly-processed mining products in Mongolia. For example, if the Oyu Tolgoi (OT) copper-gold project were to smelt copper, imported equipment supporting production of metallic copper might qualify for an exemption from the VAT. However, to promote value-added production in Mongolia, the GOM defines the production of copper concentrate as non-value-added output; and so, equipment imported to develop and operate this sort of operation would not qualify for the 10% VAT exemption.

Most jurisdictions, recognizing that most mines have long development lead times before production begins, either waive or do not tax such imports at all.

Parliament has chosen to impose the VAT, making Mongolian mining costs 10% higher than they would otherwise be, thus impairing competitiveness and dramatically varying from global practice.

New Royalty Regime

On January 1, 2011, the Windfall Profits Tax (WPT) was formally cancelled as a condition for the GOM entering the OT agreement. OT's private investors successfully argued that they would not be able to operate OT commercially if burdened with the WPT. Consequently, Parliament amended the WPT Law: (See Chapter A.1 for more details on the WPT.)

However, the end of the WPT represents a significant loss of revenue to the GOM; and so, parliament responded by imposing a revised royalty scheme. The new regime imposes a sliding scale on a variety of mineral and metal products which depends on the market price of the commodity on certain world exchanges and the amount of processing the mineral or metal receives in Mongolia. The more value added done in Mongolia, the lower the increase in royalty.

More Generous Loss Carry-forward provisions

Parliament also agreed to extend the loss carry-forward period from two (2) to eight (8) years as part of the package of tax reforms made to conclude the OT Agreement. Most investors find eight years sufficient for many Mongolian investments that require long, expensive development horizons before producing any sort of profit.

Increasing Restrictions on Foreign Investment

Restrictive Aspects of the 2012 Strategic Entities Foreign Investment Law (SEFIL)

In May, 2012 parliament passed SEFIL, just before parliamentary elections. As passed, some of SEFIL's provisions seem potentially restrictive on foreign investment. The new law specifically limits the amount of FDI in the resource, media, and financial sectors respectively; and subjects these investments to government and parliamentary scrutiny, which may lead to forced divesture of a given investment. For a fuller discussion of the SEFIL see Chapter A.1.

Other Restrictions on Investors

The government applies the same geographical restrictions to both foreign and domestic investors. Existing restrictions involve border security, environmental concerns, or local use rights. There are no onerous or discriminatory visas, residence, or work permits requirements imposed on American investors. Generally, foreign investors need not use local goods, services, or equity, or engage in substitution of imports. Neither foreign nor domestic businesses need purchase from local sources or export a certain percentage of output, or have access to foreign exchange in relation to their exports.

Although there remains no formal law requiring the use of local goods and services, the GOM encourages firms to do value-added production in Mongolia, especially for firms engaged in natural resource extraction. All Mongolian senior officials and politicians make in-country processing a consistent feature of their public and private policy statements regarding the development of mining. For example, the new royalty scheme offers reduced royalty rates for companies that do more value-added processing in Mongolia. Government talks on coal production constantly feature discussions of power generation and coals-to- liquid processing in Mongolia. Government plans also call for increased investment in businesses and activities that keep the “value” of a resource in Mongolia. Consequently, firms should continue to expect the GOM to press aggressively for value-added production in Mongolia.

Generally, foreign investors set their own export and production targets without concern for government imposed targets or requirements.   There is no requirement to transfer technology. As a matter of law, the government generally imposes no offset requirements for major procurements. Certain tenders and projects on strategic mineral deposits (See Chapter A.1 for a discussion of the concept of a *strategic mineral deposit*.) may require agreeing to specific levels of local employment, procurement, or to fund certain facilities as a condition of the tender or project, but as matter of course such conditions are not the normal approach of the government in its tendering and procurement policies.

Investors, not the Mongolian government, make arrangements regarding technology, intellectual property, and similar resources and may generally finance as they see fit. Foreign investors generally need sell no shares to Mongolian nationals. Equity stakes are generally at the complete discretion of investors, Mongolian or foreign -- with one key exception for *strategic* mining assets, discussed below.

Although Mongolia imposes no official statutory or regulatory requirement, the GOM, as a matter of foreign policy, sometimes negotiates restrictions on what sort of financing foreign investors may obtain and with whom those investors might partner or to whom they might sell shares or equity stakes. These restrictive covenants will most likely be imposed in certain sectors where the investment is determined to have national impact or national security concerns, especially in the key mining sector.

Regarding employment, investors can locate and hire workers without using hiring agencies—as long as hiring practices are consistent with Mongolian labor law. However, Mongolian law requires companies to employ Mongolian workers in certain labor categories whenever a Mongolian can perform the task as well as a foreigner. This law generally applies to unskilled labor categories and not areas where a high degree of technical expertise not existing in Mongolia is required. The law does provide an escape hatch for all employers. Should an employer seek to hire a non-Mongolian laborer and cannot obtain a waiver from the Ministry of Labor for that employee, the employer can pay a monthly waiver fee per employee per month. Depending on the importance of a project, the Ministry of Labor may grant an employer a 50% exemption of the waiver fees as an incentive.

Increasing Performance Requirements

Performance Requirements Imposed by the Strategic Entities Foreign Investment Law (SEFIL)

SEFIL requires foreign investment in the targeted sectors submit to GOM involvement in management, procurement, hiring, and other related processes and decisions. In particular, SEFIL appears to require foreign-invested entities to use Mongolian suppliers and labor. Whether this constitutes a formal requirement to use Mongolian labor and suppliers under all circumstances or whenever possible remains unclear. As many skill sets, goods, and services are not available in Mongolia, investors tell us an iron local-sourcing requirement may cripple their ability to execute investment in Mongolia. For a fuller discussion of SEFIL see Chapter A.1.

Requirements in the Petroleum and Mining Sectors

Performance requirements are sparingly imposed on investors in Mongolia with the exception of petroleum and mining exploration firms. The Petroleum Authority of Mongolia (PAM) issues petroleum exploration blocks to firms, which then agree to conduct exploration activities. The size and scope of these activities are agreed upon between PAM and are binding. If the firm fails to fulfill exploration commitments, it must pay a penalty to PAM based on the amount of hectares in the exploration block, or return the block to PAM. These procedures apply to all investors in the petroleum exploration sector.

Under the Minerals Law of Mongolia, receiving and keeping exploration licenses depends on conducting actual exploration work. Each year exploration firms must submit a work plan and report on the execution of the previous year's performance commitments, all of which are subject to annual verification by the Minerals Authority of Mongolia (MRAM). Failure to comply with work requirements may result in fines, suspension, or even revocation of exploration rights. Exploration work commitments expressed in terms of US dollar expenses per hectare per year:

- 2nd and 3rd years miners must spend no less than US $.50 per hectare.
- 4th to 6th years miners must spend no less than US $1.00 per hectare.
- 7th to 9th years miners must spend no less than US $1.50 per hectare.

Moreover, in the case of *strategic deposits,* the GOM can acquire a sliding percentage of the mines operating entity ranging from 34% to 50%. It also requires the holder of the *strategic* asset to sell no less than 10 percent of the enterprise to Mongolian citizens on the existing Mongolian Stock Exchange. (See Chapters A.9 and A.10 for details on the Mongolian Stock Exchange.) Mining companies that operate or seek to develop non-strategic deposits have reported that GOM has also vigorously pressed them to list on the MSE although not required by law or regulation. While foreign and domestic investors and mining companies have supported the GOM's call to list in principle, they argue that neither the statute nor the GOM provide clear, transparent guidance on how listing is to be accomplished.

In 2009 Parliament passed a new law imposing significant new controls on mining and processing uranium in Mongolia. The Nuclear Energy Law created a new regulatory agency, the Nuclear Energy Agency (NEA) and a state-owned holding company, MonAtom, to hold assets that the government will acquire from current rights holders. The law imposed several conditions:

- Immediately revoked all current uranium exploration and mining licenses and then required all holders to register these licenses with the NEA, for a fee.

- Required investors to accept that the Mongolian state has an absolute right to take -- without compensation -- at least 50% of the company (as opposed to the deposit) that will develop the mine as a condition of being allowed to develop any uranium property.

- Created a uranium-specific licensing, regulatory regime independent of the existing regulatory and legal framework existing for mineral and metal resources. Prior to the Nuclear Energy Law, exploration licenses gave their respective holders the rights to discover and develop any and all mineral and metal resources discovered within that license area (this did not include petroleum resources, which are governed separately). According to GOM officials, this law means that the state can issue a distinct license for uranium exploration on a property otherwise dedicated to other mineral and metals exploration

Requirements Imposed on Foreign Investors Only

All foreign investors must register with the Foreign Investment and Foreign Trade Agency (FIFTA). The Foreign Investment Law of Mongolia requires all foreign investors to show a minimum of US$100,000 in assets (cash, working stock, property, etc.) registered in Mongolia as a precondition for registration. In addition to this particular requirement, all foreign investors must pay an initial processing fee of some 12, 000 Mongolian Tugrik or about US$8.00. Foreign Investors must then pay a yearly prolongation fee of 6,000 Mongolian tugrik or about US$4.00.

In addition to these fees, foreign investors must annually report on their activities for the coming year to the government through FIFTA. Businesses need not fulfill plans set out in this report, but failure to report may result in non-issuance of licenses and registrations and suspension of activities. This requirement differs from that imposed on domestic investors and businesses. Domestic investors have no yearly reporting requirement. Mongolians pay lower registration fees, which vary too much to say with any precision what the fees actually are.

FIFTA explains that the higher registration costs for foreign investors arise from the need to compensate for the services it provides to foreign investors, including assistance with registrations, liaison services, trouble-shooting, etc. The different reporting requirements provide the government with a clearer picture of foreign investment in Mongolia. Foreign investors are generally aware of FIFTA’s arguments and largely accept them, but they question the need for annual registrations. Investors recommend that FIFTA simply charge an annual fee rather than require businesses to submit a new application each year.

Regarding reports, foreign businesses are concerned about the security of their proprietary information. Several foreign investors routinely claim that agents of FIFTA use or sell information on business plans and financial data. We have yet to verify these claims, but FIFTA acknowledges that data security largely depends on the honesty of its staff, as there are few internal controls over access to the annual reports.

In 2011, in-bound investors complained about FIFTA's attempts to impose arbitrary requirements on foreign-invested business not otherwise specified in law. For example, FIFTA refused to issue required documents unless investors agreed to a set of FIFTA-imposed company charters, even though nothing in either the Foreign Investment Law or the Company Law of Mongolia required a particular format be adopted.

Tariffs

Mongolia has one of Asia's least restrictive tariff regimes. Its export and import policies do not harm or inhibit foreign investment. Low by world standards, tariffs of 5% on most products are applied across the board to all firms, albeit with some concerns about consistency of application and valuation. However, some non-tariff barriers, such as phyto-sanitary regulations, exist that limit both foreign and domestic competition in the fields of pharmaceutical imports and food imports and exports. The testing requirements for imported drugs, food products, chemicals, construction materials, etc., are extremely nontransparent, inconsistent, and onerous. When companies attempt to clarify what the rules for importing such products into the country are, they routinely receive contradictory information from multiple agencies.

WTO TRIMS Requirements

Mongolia employs no measures inconsistent with World Trade Organization Trade Related Investment Measures (TRIMS) requirements, nor has anyone alleged that any such violation has occurred.

A.6 RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Mongolia seems to have retreated from what was once one of Asia's most liberal ownership and establishment regimes. Generally, unless otherwise forbidden by law, foreign and domestic businesses may establish and engage in any form of remunerative activity. All businesses can start up, buy, sell, merge; in short, do whatever they wish with their assets and firms, with exceptions in the minerals and hydrocarbon, banking and finance, media and telecommunications, and real estate sectors.

Strategic Entities Foreign Investment Law of 2012 (SEFIL)

In May, 2012 Parliament passed SEFIL, just before parliamentary elections. As passed, some of SEFIL's provisions seem to limit the right of private ownership and establishment that investors had come to expect from Mongolia's investment regime. The new law specifically limits the amount of FDI in the resource, media, and financial sectors respectively, and seems also to limit how investors can buy, sell, merge, or develop assets in the affected sectors. In this respect, SEFIL appears to be a sea change in what heretofore has been a fairly liberal investment regime. For a fuller discussion of the SEFIL see Chapter A.1.

Competition from the State-Owned Sector

Mongolia passed and implemented a competition law applying to foreign, domestic, and state-owned entities active in Mongolia. As a practical matter, competition between state-owned and private businesses has been declining for the simple reason that many parastatals have been privatized. Exceptions include the state-owned power and telecom industries, a state-owned airline, the state-owned rail system (half-owned by Russia), several coal mines, and a large copper mining and concentration facility (also half-owned by Russia).

Currently, firms from Mongolia, China, Japan, Europe, Canada, and the U.S. are actively seeking opportunities for renewable and traditional power generation in Mongolia. However, few want to invest in the power generation field until the regulatory and statutory framework for private power generation firms up and tariffs are set at rates allowing profits.

Regarding its railway sector, Mongolia has no plans to privatize its existing railroad jointly held with the government of Russia, but current law does allow private firms to build, operate, and transfer new railroads to the state. Under this law several private mining companies have proposed rail links, and obtained licenses to construct these new lines from their respective coal mines to the Chinese border or to the currently operating spur of the Trans-Siberian Railroad.

These proposals have not progressed, and are not likely to given Parliament's current national rail expansion plan. Under the plan, the GOM and Parliament require that railroads linking key coal deposits in the southern Gobi desert region must first begin linking those deposits to Russia's Pacific ports before they develop suitable links with Chinese markets. Further, these projects may use international gauge used in China only after the links with Russia are completed, using Russian gauge. The GOM argues that it needs these policies to keep Mongolia from being dependent on one market to buy its coal products, namely China. (Note: The parliamentary resolution specifies that once the Russia lines are under construction, the Chinese lines can commence. As construction on the Russian lines has officially, if slowly, commenced the Mongolian Mining Corporation mine at Ukhaa Huydag in the Tavan Tolgoi Basin has begun construction on its south-running line to China.)

Some observers question the rationale and sequencing of government plans. In their collective opinion, the Chinese market, the largest and most lucrative, should be developed first, followed by (or parallel with) diversification strategies. They also fail to see a clear justification of the commercial and economic benefits behind GOM plans, in particular the contribution of northern rail lines to Russia on the commercial operations of Gobi coal mines close to the Chinese border. As a result, they argue that investment incentives are needed to convince potential partners to follow this scheme. .

Government re-enters the mining business

Although the trend had been for the GOM to extract itself from ownership of firms and other commercial assets, the 2006 Minerals Law of Mongolia and the newer 2009 Nuclear Energy Law keep the state in the mining business. (See Chapter A.1 for fuller discussions of both laws.) Under both laws, the GOM granted itself the right to acquire equity stakes ranging from 34% up to 100% of certain deposits deemed strategic for the nation. Once acquired, these assets are to be placed with one of two state-owned management companies: *Erdenes MGL*, for non-uranium assets; or MonAtom for uranium resources. These companies are then mandated to use the proceeds from their activities for the benefit of the Mongolian people.

The role of the state as an equity owner, in terms of management of revenues and operation of the mining asset, remains unclear at this point. There are some concerns over the capacity of the GOM to deal with conflicts of interest arising from its position as both regulator and owner of these strategic assets. Specifically, firms are worried that the GOM's desire to maximize local procurement, employment, and revenues may comprise the long term commercial viability of any mining project.

Investors have also expressed concerns about the GOM's capacity to accept the fiduciary responsibilities that come from operating mining operations. In the case of its Erdenes MGL Tavan Tolgoi mining operation (EMTT), the GOM received a prepayment of US $250 million prepayment for coal from a Chinese state-owned entity. Rather than allowing EMTT to retain these funds to cover substantial start up costs, the GOM claimed the balance of the payment, US$200 million, for its Human Development Fund, which redistributes primarily mining revenues to the Mongolian public in the form of monthly cash payments. This GOM action left EMTT with insufficient funds to cover ongoing startup and daily operational costs.

Pondering this, investors are concerned that the GOM will divert future revenues gained from mining activities—for example capital raised through initial public offerings from strategic mines—for unrelated expenses. Going forward, the GOM will likely have to provide binding assurances that it act as responsible steward of company interests rather than seeing state-owned companies as nothing more than transfer mechanism for payments to the Mongolian public.

There is also a concern that the GOM will waive legal and regulatory requirements for its state-owned mining companies that it imposes on all others. These claims seem borne out by the GOM's treatment of its Erdenes MGL Tavan Tolgoi mining operation. Generally, private mining firms take at least two years to submit and receive approval for relevant environmental and operating permits for coal mines in Mongolia. However, there is no indication that GOM has required its operation at Tavan Tolgoi to follow the statutory or regulatory requirements imposed on other operations; in fact, a review of the timeline suggests that the normally lengthy approval process cannot have been followed. This preferential treatment runs counter to extremely vocal GOM demands that companies show respect for Mongolia's rules and laws and comply with all applicable mining statutes. Of course, waiving such requirements would give the GOM's own companies substantial cost advantages over those forced to follow the law.

A.7 PROTECTION OF PROPERTY RIGHTS

Both Mongolia's constitution and statutes recognize the right to own private property, movable and immovable. Regardless of nationality (except for land, which only Mongolian nationals can own), owners can generally do as they wish with their property. One can collateralize real and movable property. If debtors default on such secured loans, creditors do have recourse under Mongolian law to recover debts by seizing and disposing of property offered as security. The only exceptions to this liberal environment may be found under current mining laws and the newly passed Strategic Entities Foreign Investment Law (SEFIL), both of which impose restrictions on how foreign investors may own and deploy property and property rights in the minerals and hydrocarbon, banking and finance, media and telecommunications, and real estate sectors.

Strategic Entities Foreign Investment Law (SEFIL)

In May, 2012 Parliament passed the SEFIL, just before parliamentary elections. As passed, some of SEFIL's provisions potentially compromise investors' property rights. Investors tell us they believe that the level of GOM and parliamentary involvement with FDI in the targeted sectors constitutes a threat to their property rights under both existing law and the Constitution of Mongolia. SEFIL seems to grant a broad remit to the government to interfere in day-to-day management decisions, let alone crucial decisions on investment, capital spending, and other key practices limits the ability of investors to use rights, capital, and other material involved in the investment as they see fit, which on its face represents new and explicit diminishing of property rights protections. For a fuller discussion of the SEFIL see Chapter A.1.

Mongolia's Current Regime to Protect Creditors

The current protection regime for creditors functions but needs reform. The legal system presents the greatest pitfalls. Although the courts recognize property rights in concept, in practice they have a checkered record of protecting them. Part of the problem is ignorance of, and inexperience with, standard best international practices regarding land, leases, buildings, and mortgages. As noted in Chapter *A.4 Dispute Settlement*, some judges, whether out of ignorance or apparent partiality for Mongolian disputants over foreigners have failed to follow such practices. Some newly trained judges are making a good faith effort to uphold property rights, but need time to learn how to adjudicate such cases.

Mongolia's bankruptcy provisions and procedures for securing the rights of creditors need reform. Mongolian law allows for mortgages and other loan instruments backed with securitized collateral. However, rudimentary systems for determining title and liens and for collecting on debts make lending on local security risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to creditors.

Although a system exists to register immovable property—structures and real estate—for the purpose of confirming ownership, it does not record existing liens. Nor does the system record ownership and liens on movable property. Consequently, Mongolian lenders risk lending on collateral that the debtor may not actually own or which may have already been offered as security for another debt. The Millennium Challenge Corporation is sponsoring a project to create a more modern and efficient property registration system that should improve the ability of creditors and debtors to prove ownership. For program details go to http://www.mca.mn/?q=eng/Project/PropertyRights.

Overall, the legal system recognizes the concept of collaterized assets as security for loans, investment capital, or other debt-based financial mechanisms. The legal system also provides for foreclosure, but this process remains exceptionally burdensome and time consuming. Current law bars creditors from non-judicial foreclosure, requiring them to submit all contested foreclosure actions for judicial review through Mongolia's court system. This approach slows debt collection substantially: Waits of up to 24 months for final liquidations and settlement are not uncommon.

Debt Collection Procedures

Even with the delays, getting a ruling is relatively easy compared to executing the court's decision. The problem is not the law but the enforcement. A judge orders the *State Collection Office* (SCO) to move on the assets of the debtor. The SCO orders district bailiffs to seize and turn those assets over to the state, which then distributes them to creditors. However, foreign and domestic investors claim that the state collection office and the district bailiffs frequently fail in their responsibilities to both courts and creditors.

In some cases, bailiffs refuse to enforce the court orders. The perception is that they do so because they have been bribed or otherwise suborned. Bailiffs are often local agents who fear community retribution if they make collection. In some cases, bailiffs will not collect unless the creditor provides bodyguards during seizure of assets. Creditors also have reason to believe that the state collection office accepts payments from debtors to delay seizure of assets.

Protection of Intellectual Property Rights

Mongolia supports intellectual property rights (IPR) in general and has protected American rights in particular. A member of the World Intellectual Property Organization (WIPO), Mongolia has signed and ratified most treaties and conventions, including the World Trade Organization Agreement on Trade Related Aspects of Intellectual Property Rights (WTO TRIPS). WIPO Internet treaties have been signed but remain un-ratified by Mongolia's Parliament. Despite this, the Mongolian government and its intellectual property rights enforcer, the *Intellectual Property Office of Mongolia* (IPOM), make a good faith effort to honor these agreements.

Under TRIPS and Mongolian law, the Mongolian Customs Authority (MCA) and the Economic Crimes Unit of the National Police (ECU) also have an obligation to protect IPR. MCA can seize shipments at the border. The ECU has the exclusive power to conduct criminal investigations and bring criminal charges against IPR pirates. The IPOM has the administrative authority to investigate and seize fakes without court order. Of these three, the IPOM makes the most consistent good faith effort to fulfill its mandates.

Problems stem from ignorance of the importance of intellectual property to Mongolia and of the obligations imposed by TRIPS on member states. Customs still hesitates to seize shipments, saying that their statutory mandate does not allow seizure of such goods, but Mongolian statutory and constitutional laws clearly recognize that international treaty obligations in this area take precedence over local statutes and regulations. A clear legal basis exists for Customs to act, which has been recognized by elements of the Mongolian Judiciary, the Parliament, and the IPOM. Customs officers may occasionally seize fake products, but it seems that Mongolian customs law will have to be brought into formal compliance with TRIPS before Customs will fulfill its obligations. The ECU has also been lax. The ECU hesitates to investigate and prosecute IPR cases, deferring to the IPOM. Anecdotal evidence suggests that ECU officials fear political repercussions from going after IPR pirates, many of whom wield political influence.

The IPOM generally has an excellent record of protecting American trademarks, copyrights, and patents; however, tight resources limit the IPOM's ability to act. In most cases, when the U.S. Embassy in Ulaanbaatar conveys a complaint from a rights holder to the IPOM, it quickly investigates the complaint. If it judges that an abuse occurred, it will (and has in every case, so far) seize the pirated products or remove fakes, under administrative powers granted in Mongolian law.

We note two areas where enforcement lags. Legitimate software products remain rare in Mongolia. Low per capita incomes give rise to a thriving local market for cheap, pirated software. The IPOM estimates pirated software constitutes at least 95% of the market. The Office enforces the law where it can but the scale of the problem dwarfs its capacity to deal with it. The IPOM will act if we bring cases to its attention.

Pirated optical media are also readily available and subject to spotty enforcement. Mongolians produce no significant quantities of fake CD's, videos, or DVD's, but import such products from China, Russia, and elsewhere. Products are sold through numerous local outlets and regularly broadcast on private and public local TV stations. The IPOM hesitates to move on TV broadcasters, most of which are connected to major government or political figures. Rather, the IPOM raids local ("street") DVD and CD outlets run by poor urban youth who lack the political and economic clout of the TV broadcasters. Again, when an American raises a specific complaint, IPOM acts on the complaint, but rarely initiates action.

Restrictive Aspects of Current Mining Laws

<u>*Minerals Law of 2006*</u>

The current Minerals Law of Mongolia would seem on its face to prevent transfer of exploration or mining rights to any third party lacking professional mining qualifications as determined by the Mineral Resources Authority of Mongolia (MRAM).

Under the Minerals Law, the concept of ***mining expertise*** can either qualify or disqualify any entity from acquiring, transferring, or securitizing exploration and mining rights. The law has the potential to limit the ability of rights holders to seek financing, because it forbids transfer of mining licenses and exploration rights to ***non-qualified individuals.*** Consequently, a miner might not be able to offer his licenses as secured collateral to banks or to any lender lacking the professional qualifications to receive these rights if the miner defaulted on his debt obligations.

In addition, no foreign entity, in its own right, can hold any sort of mining or petroleum license; only entities registered in Mongolia under the terms of relevant company and investment laws may hold exploration and mining licenses. Should a foreign entity acquire a license as collateral or for the purpose of actual exploration or mining, and fail to create the appropriate Mongolian corporate entity to hold a given license, that failure may serve as grounds for invalidating the license.

Foreign financial institutions should be particularly vigilant as the GOM has proven willing and able to revoke mining and exploration licenses held by foreign financial entities on the grounds that they have not been properly pledged to legitimate Mongolian financial institutions. We advise investors with specific questions regarding the current status of their respective to seek professional advice on the status of those licenses.

Nuclear Energy Law of 2009

The Nuclear Energy Law of 2009 dramatically curtails property rights protection regime protecting most exploration and mining licenses. The law imposed the following conditions upon investors in the uranium (and some rare earths) mining sector:

- Immediately revoked all current uranium exploration and mining licenses and then required all holders to register these licenses with the Nuclear Energy Agency (NEA), for a fee.

- Required investors to accept that the Mongolian state has an absolute right to take -- without compensation -- at least 51% of the company (as opposed to the deposit) that will develop the mine as a condition of being allowed to develop any uranium property.

- Created a uranium-specific licensing, regulatory regime independent of the existing regulatory and legal framework existing for mineral and metal resources. Prior to the Nuclear Energy Law, exploration licenses gave their respective holders the rights to discover and develop any and all mineral and metal resources discovered within that license area (this did not include petroleum resources, which are governed separately). According to GOM officials, this new law means that the state can issue a distinct license for uranium exploration on a property otherwise dedicated to other mineral and metals exploration

To both investors and observers, this law statutorily sanctions expropriation without compensation, a concept heretofore alien to Mongolian law. Although the

2006 Minerals Law of Mongolia and other pieces of legislation officially state that the GOM must compensate rights holders for any taking, the Nuclear Energy Law allows the GOM unfettered power to seize holdings with no obligation to compensate rights holders. Complicating the issue, the law conflates deposits with the companies developing those deposits, letting the GOM claim an uncompensated share of any entity that might mine the deposit. In effect, the GOM demands a free-carried, non-compensated interest of no less than 51% of any uranium mining firm in Mongolia.

In 2010, these fears became concrete when the GOM acted against a Canadian company in stripping the firm's rights to develop a uranium deposit without any apparent due process or compensation. Those rights were then vested in a Russian-Mongolian state-owned company. The foreign firm has since move to settle its claims through international arbitration.

Affected uranium rights holders contested the constitutionality of these provisions before Mongolia's Constitutional Court, and lost the case. The Court upheld the law, asserting that the all minerals in the ground are the property of the Mongolian state even if extracted from the ground. Legal experts with whom we consulted explained that the Court seems to make the extraordinary and unprecedented claim that Mongolia's ownership extends to products created with the ore; hence the state has a "legitimate" claim on both the ore body and any company mining the resource. This theory appears to undermine the property rights of uranium investors and chips away at property rights protections granted both under the constitution and Mongolia's Minerals, Company, and Foreign Investment Laws.

A.8 TRANSPARENCY OF THE LEGISLATIVE AND REGULATORY PROCESS

Generally, Mongolia's problem is not lack of laws and regulations—Mongolia has passed more than 1,800 laws since undertaking its transition to a democracy and a market economy 20 years ago—but rather, that legislators and government officials lack knowledge on what foreign and domestic investors need from the state when investing; and that they do not consult with those affected by their legislative and regulatory actions. Corruption aside, it is that laws and regulations change with little consultation creates a chaotic situation for all parties.

Problems with the Drafting Process for Legislation and Regulations

Normally, laws can be crafted in two ways. Once rare but now common, Members of Parliament and the President of Mongolia may draft their own proposals for direct submission to the Parliament. Such bills need not be submitted to the Cabinet of Ministers but can be delivered directly to the Speaker of Parliament for consideration by the relevant Standing Committee. The relevant Standing Committee may either reject the bill (in which case it dies in committee) or pass it on to the Parliament's plenary body, unaltered or revised, for a general vote. More typically, Parliament or the Cabinet of Ministers requests legislative action. These institutions send such requests to the relevant ministry. The respective minister then relays to his ministerial council, which in turn sends the request to the proper internal division or agency, which in turn forms a working group. The working group prepares the bill, submits it for ministerial review, makes any recommended changes, and then the bill is reviewed by the full Cabinet of Ministers. Relevant ministries are asked to comment and recommend changes in the legislation.

Prior to a final vote by the Cabinet of Ministers, the National Security Council of Mongolia (NSCM)—consisting of the President of Mongolia, the Prime Minister, and Speaker of Parliament—can review each piece of legislation for issues related to national security. Although the government has never clarified the legal and constitutional authority of the NSCM to veto or recommend changes to draft legislation, the Cabinet to our knowledge will not and has never overruled NSCM recommendations.

Once through NSCM and Cabinet reviews, the bill goes to Parliament. Parliament may follow or reject NSCM recommendations as its members see fit. In Parliament, the bill is vetted by the relevant Standing Committee, sent back for

changes or sent on to the full Parliament for a vote. The President can veto bills, but his veto can be overcome by a two-thirds (2/3) vote of Parliament.
For regulations, the process is truncated. The relevant minister tasks the working group that wrote the original law to draft regulations. This group submits their work to the minister who approves or recommends changes. In most cases, regulations require no Cabinet approval, and become official when the relevant incumbent minister approves them. When legislation crosses inter-ministerial boundaries, the Cabinet authorizes the most relevant ministry to supervise an inter-ministerial approval process for regulations.

The Ministry of Justice and Home Affairs (MOJHA) plays an important role in both laws and regulations. MOJHA vets all statutes and regulations before they are passed for final approval. In the case of legislation, MOJHA reconciles the language and provisions of the law with both existing legislation and the constitution of Mongolia, after which the law passes to the Cabinet and then Parliament. In the case of regulations, MOJHA vets the regulations to ensure consistency with current laws and provisions of the constitution. In effect, MOJHA can either modify or even veto legal or regulatory provisions that it finds inconsistent with the statutes and constitution.

System Lacks Transparency

On paper the Mongolian legislative and regulatory process appears transparent.

In 2011, Parliament passed the *Law on Information Transparency and the Right to Information (LIT).* This new legislation sets out which government, legislative, and non-governmental organization must provide information to the public—both in terms of what information should be regularly disseminated and how these respective organizations should respond to requests by citizens and legal entities residing in Mongolia. LIT requires state policies, some legislative acts, and administrative decisions be posted on the appropriate government websites in understandable language for no less than 30 days for comments and review, which may be incorporated in proposals if deemed appropriate. In addition, government entities must post public hiring processes, concessions, procurement, and budget and finance information. LIT specifically exempts armed forces, the border protection and internal troops, and intelligence organizations from its provisions. Finally, ongoing citizen complaints and petitions are not subject to LIT's provisions; nor does the law apply to intellectual property information, corporate or business information, or personal information.

In addition to LIT, the *Law on Making Laws* (LML) requires (or requests in the case of Parliament) that those who draft and submit laws to Parliament –termed *lawmakers* in the LML--must subject their legislative acts to comment and review. Specifically, the President and the ministries must submit their legislative drafts for review and comment. Parliament, however, may seek comment and review but is not required to do so as it drafts and approves statutes. In any case, the LML does not specify who is to be consulted, how they are to be consulted; when or where; and what is to be done with comments and critiques of a given piece of legislation.

In response to LIT, the Cabinet of Ministers issued a decree requiring ministries to post proposed regulatory changes on ministerial websites for comment and review at least thirty (30) days before approval. As with LML, the Cabinet decree does not specify a standard process for collecting and acting upon public comment and review.

These important gestures toward transparency notwithstanding, investors continue to find that legislative and regulatory processes continue to lack a statutory, systematic, and transparent review of legislation and regulations by stakeholders and the public. Ministerial initiatives seem to go unpublished until the draft passes out of a given ministry to the full Cabinet. Typically, the full Cabinet discusses and passes bills on to Parliament, without public input or consultations. Parliament itself neither issues a formal calendar nor routinely announces or opens its standing committees or full chamber hearings to the public. While Parliament at the beginning of each session announces a list of bills to be considered during the session, this list is very general and often amended. New legislation is commonly introduced, discussed, and passed without public announcement or consideration. Members of the public that request information on the voting record of their representative are often told that such information is not publicly available.

In late 2010, Parliament limited transparency even further by statutorily denying media access to committee meetings. Parliament justified the new law by publicly asserting that the lack of press coverage would prevent members from grandstanding and making populist gestures. However, the media are allowed to cover plenary sessions. As with many of Parliament's controversial acts, this law passed without public review and comment. The public and media responded to this closure with vocal and creative protests, and Parliament subsequently suspended enforcement to consider amending the law. In 2011, strongly encouraged to submit its deliberations to the provisions of LIT, Parliament specifically refused to impose LIT on its legislative deliberations; and so, for parliament transparency remains a matter of choice.

The U.S. Embassy in Ulaanbaatar and foreign and domestic investors repeatedly urge the Mongolian government to use the government's *Open Government* web site and other media to post draft and pending legislation for public consultation and review before it is finalized and sent to Parliament. The Business Council of Mongolia (BCM: http://www.bcmongolia.org/) also reports on laws and regulations and maintains an in-house working group that monitors and reports on legislation to the BCM's members. The BCM will also represent its members' concerns about legislative and regulatory issues to Mongolian officials and legislators directly.

Monitoring and consultation efforts remain a *project-in-process*. Mongolian regulators resist consultation when it comes to implementation. Bureaucrats are only slowly becoming comfortable with the concepts and practices of broad, public consultation and information sharing with their own citizens, let alone foreigners. Many times businesses ask unsuccessfully for a clear copy of the current regulations. The government has long acknowledged that the socialist-era State Secrets Law requires substantial amendment. Currently, most government documents—including administrative regulations affecting investments and business activities—can be technically classified as "state secrets" not to be released to the public. This gives both bureaucrats and regulators a convenient excuse to deny requests for information or, more commonly, to demand extralegal fees to provide documents. The legacy of secrecy has also resulted in cases where government officials themselves cannot get up-to-date copies of the rules. Mongolia has considered a freedom of information law for several years, but it remains in legislative limbo.

High officials acknowledge the value of, and need for, a more open, transparent system. While laws are easy to fix, the behavior of individual bureaucrats, Members of Parliament, and the judiciary will only gradually change with training and experience. Already a younger generation of professionals, many trained abroad during Mongolia's democratic era, is taking hold and moving into senior positions of authority. The successful media-led pushback of Parliament's attempt to limit access to committee and subcommittee sessions bodes well for Mongolia's continuing transition to a private sector-led, open market economy underpinned by good government and corporate governance.

Laws, Regulations, and Policies that Impede FDI

While the GOM supports FDI and domestic investment, individual agencies and elements of the judiciary reportedly use their respective powers to hinder investments into such sectors as meat production, telecommunications, aviation, or pharmaceuticals. Both domestic and foreign investors report similar abuses of inspections, permits, and licenses by Mongolian regulatory agencies. Outside of the concern of the growing perception that the judiciary is prejudiced against foreign investors, we generally note no systematic pattern of abuse consistently initiated by either government or private Mongolian entities aimed against foreign investors in general or against U.S. investment in particular. (See Chapter A. 4 for a fuller discussion of the Mongolian judicial response to foreign investor disputes.) More typically, we find opportunistic attempts by individuals to misuse contacts to harass U.S. and other foreign investors with whom the Mongolian entity is in dispute.

Alternatively, other reports suggest that Mongolians use connections to well-placed regulators at all levels to extract extralegal payments from both foreign and domestic businesses or otherwise hinder their work. In the latter case the general approach is to demand a payment in lieu of not enforcing work, environmental, tax, health and safety rules, otherwise imposing the full weight of a contradictory mix of socialist era and the current, reformed rules on the firm. Most foreign businesses refuse to pay bribes and in turn accept the punitive inspections, concede to some of the violations found, and contest the rest in the City Administrative Court. In our experience companies that show resolve against predatory abuse of statutory and regulatory power will face impediments at the start; but these usually ease over time as state agents look for easier targets.

Abuse of the Exit Visa System

Although we note no systemic or routine abuse of Mongolia's legal system to hinder FDI and investors, a worrisome trend affecting implementation of Mongolia's requirement for exit visas by both public and private Mongolian entities to exert pressure on foreign investors to settle commercial disputes.

Valid exit visas are required and normally issued *pro forma* at the port of departure (e.g., the international airport), but may be denied for a variety of reasons including civil disputes, pending criminal investigation, or for immigration violations. The law does not allow authorities to distinguish a criminal and civil case when detaining a person. If denied for a civil dispute, the exit visa may not be issued until either the dispute is resolved administratively or a court has rendered a decision. Neither current law nor regulations establish a clear process or timetable for resolution. In fact, the

Mongolian government maintains the right to detain foreign citizens indefinitely without appeal until the situation has been resolved.

Research into the issue has revealed that abuse of the exit-visa system also affects investors from countries other than the U.S. All cases have a similar profile. A foreign investor has a commercial dispute with a Mongolian entity, often involving assets, management practices, or contract compliance. The Mongolian entities respond by filing either civil or criminal charges with local police or prosecutorial authority. It is important to note that at this point there need be no actual arrest warrant or any sort of official determination that charges are warranted: Mere complaint by an aggrieved party is sufficient grounds to deny exit.

An investor in this situation is effectively detained in Mongolia indefinitely. Some foreign investors have resolved the impasse by settling, thereby allowing them to depart Mongolia. If unwilling to settle, the foreign investor will have to undergo the full investigatory process, which may lead to a court action. Investigations commonly take up to six months, and in one case an American citizen was denied an exit visa for two years. In addition, even if a dispute seems settled, it can be filed in the same venue again -- if the local police and prosecutors are willing -- or in a different venue.

We note that Mongolian investors are not subject to similar impositions of their immigration codes when involved in commercial disputes. Mongolian citizens do not require exit visas to depart Mongolia and can only be denied exit with a pending arrest warrant.

Use of NGOs as regulators may affect provision of services

Finally, some investors have expressed concern about the GOM's effort to allow certain NGOs and professional associations to conduct regulatory activities on behalf of the state. Investor responses to the concept have been mixed. On one hand, they are quite familiar with this approach as an international best practice and approve of the concept of NGOs and professional associations monitoring, supervising, certifying, and sanctioning members and their businesses in place of government agency.

On the other hand, concerns arise over the composition of the monitoring entities and how they will resolve disputes. Some domestic and foreign businesses have brought cases to our attention in which they claim the role of the GOM is so intrusive that it oversteps the bounds of inspection and interferes directly in commercial matters. For example, the GOM has used "public interest" as a justification to specify content and form for broadcasters, to set pay rates for legal services, and to enforce responsibilities for Internet Service Providers (ISP).

To cite a few examples, a Mongolian ISP might have to certify that information and comments posted on blogs are not defamatory; otherwise they may face civil or criminal penalties. Also, attorneys would not be able to charge more for their legal services than allowed by an Advocates Association. This association, largely composed of GOM-selected appointees, would also have the power to set professional standards and impose fines. The proposed plan also severely limits the role that foreign lawyers licensed in Mongolia can play in courtroom activities.

In most cases, the GOM has neither involved nor consulted with the affected parties. In fact, in all cases brought to our attention the affected industry and practitioners were invited to comment only very late in the drafting and approval process, usually at the moment that the rules were near approval.

Without speculating on the motives behind the GOM’s specific approaches to regulating certain professions, foreign and domestic practitioners who seek to practice in Mongolia may find their ability to service clients in Mongolia increasingly restricted.

A.9 EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Mongolia is developing the experience and expertise needed to sustain portfolio investments and active capital markets. It currently has a regulatory apparatus for these activities, and both the state and private entities beginning to engage in them. The government of Mongolia (GOM) imposes few restraints on the flow of capital in any of its markets. Multilateral institutions, particularly the International Monetary Fund, have typically found the regime too loose, especially in the crucial banking sector. Although the government has clear rules about capital reserve requirements, loan practices, and banking management practices, the Bank of Mongolia (BOM), Mongolia's central bank, has historically resisted restraining credit flows and interfering with operations at Mongolia's commercial banks, even when the need to intervene has been apparent. However, in the ongoing aftermath to the 2008 global financial crisis on Mongolia's banking sector, the BOM has attempted to improve its capacity to deal with improperly managed banks that have affected the health of Mongolia's financial system. To illustrate, closed and/or merged banks resulted in a net loss of three of the country's 16 banks. Additional consolidation is under consideration but the reform process has stalled. In addition to these ongoing concerns, investors and lenders have told us they are wary of the impact of the recently passed *Strategic Entities Foreign Investment Law of 2012* (SEFIL), as it can potentially disrupt collaterization of Mongolian equities upon which Mongolian-based investments have been secured.

Capital and Currency Markets

Inflation Concerns

In the past liquidity had been quite high in Mongolia while affordable capital remained scarce; however, 2011 saw liquidity in the private sector dramatically contract as the BOM, faced with inflationary impact of excessive government spending, moved to curtail excessive money supply and loan growth. These activities have driven up interest rates, which had been trending down, from around 12% for the most credit worthy to perhaps 90% per annum (or more) for the least.

These efforts notwithstanding, inflation remains an ongoing concern. In 2008, inflation peaked at around 40% in 2008 before settling at 24%. Inflation eased in 2009 and 2010 as the global economic crisis drove down global commodity prices, which, when coupled with domestic monetary tightening, helped lower Mongolia's import-driven inflation rate. The official rate has hovered at around 12%; however, the IMF and other observers believe that the 2011 and 2012 budgets, larded as they have been with massive amounts of cash transfers, salary and pension increases, and public capital projects, may cause inflation to rise as high as 18% in 2012.

Capital and Currency

Foreign investors can easily tap into domestic capital markets. However, they seldom do, because they can do better abroad or better locally by simply taking on an equity investor, Mongolian or otherwise.

The global economic crisis savaged Mongolia's currency, capital, and equity markets. While the currency, the Tugrik, proved resilient in holding its value against most international currencies, it fell some 40 % against the U.S. dollar from late 2008 into spring 2009, as the worst of the crisis hit. In 2010 through mid-2011, the tugrik appreciated nearly 15% against the U.S. dollar; only to lose much of these gains in the latter half of 2011. This resiliency has largely been attributed to the latest commodities boom and to the influx of capital to fund the Oyu Tolgoi mining project. As elsewhere, of course, the strengthening of the currency may prove something of a mixed blessing, complicating economic policy.

Equity Markets

In 2011, investors had hoped that the GOM would deliver on long-standing promises to adopt and implement reforms that would see the Mongolian Stock Exchange (MSE) a more or less fully functioning stock exchange.

The MSE remains fully state-owned and state-managed, although it does allow private brokerage firms to conduct stock-trading operations. It is officially owned by the State Property Committee of Mongolia (SPC), a government agency that oversees all state-owned enterprises, and had been managed day-to-day by a team selected from the ranks of the leading political party (although such employees do have to give up official party membership upon accepting a position at any state-owned enterprise).

Faced with growing demands from the public and development needs, the GOM recognizes that its ambitious program to raise capital for development projects—IPO's of state-owned businesses and underwriting of state-owned mining companies—hinges on creating a best-practices exchange. Hence, the GOM accepts in principal that the MSE required wholesale changes. To support this effort, the GOM has replaced the existing management at the MSE with a qualified international operator of stock exchanges, the London Stock Exchange (LSE) .

However, observers tell us that both the GOM and Parliament are lagging on important and essential reforms of the Securities Law of Mongolia. The current law is insufficient and obsolete, having been craft to support the needs of individual Mongolian citizen investors rather than those of institutional or foreign investors. Consensus is that an up-to-date, best practice law would

- Formally distinguish between beneficial owners and registered owners.
- Allow for for Custodians (financial institutions with legal responsibility for investors' securities).
- Institute new rules that would allow companies *listed* on the Mongolian Stock Exchange (MSE) to list their shares on other exchanges.

An amended securities law, consistent with practices, regulation, and statue used in other exchanges, will allow Mongolia to list and raise capital for important projects, such as Oyu Tolgoi and Tavan Tolgoi. Without such a law, Tavan Tolgoi and other public and private investments will face severe impediments to raising capital and asset valuation.

Mining company stock issues also remain an impediment to expanding the role of the MSE. The 2006 Minerals Law of Mongolia contains a provision that requires that holders of mining licenses for projects of strategic importance—Oyu Tolgoi, for example—must sell no less than 10% of the resulting entity's shares on the Mongolian Stock Exchange. Foreign and domestic mining companies with non-strategic assets have told us that the GOM has been pressuring them to list shares on the MSE, too. To our knowledge no company has followed the law or submitted to GOM pressure to list, because no one understands, nor has the GOM explained, what this provision means in practical terms or how it is to be implemented.

The Banking Sector

Weakness in Mongolia's banking sector concerns all players, including the International Monetary Fund (IMF: http://www.imf.org). The total assets of Mongolia's remaining 13 commercial banks adds up to just around US$5 billion. The system has been through massive changes since the socialist era, during which the banking system was divided into several different units. This early system failed through mismanagement and commercial naivety in the mid-90s, but over the last decade has become more sophisticated and somewhat better managed.

Mongolia has a few large, generally well-regarded banks owned by both Mongolian and foreign interests. They follow international standards for prudent capital reserve requirements, have conservative lending policies, up-to-date banking technology, and are generally well managed. If a storm descends again on Mongolia's banking sector, these banks appear well-positioned to weather it.

However, concerns remain among bankers and the sector's observers about the effectiveness of Mongolia's legal and regulatory environment. As with many issues in Mongolia, the problem is not of lack of laws or procedures but the will and capacity of the regulator, BOM, to supervise and execute mandated functions, particularly in regard to capital reserve requirements and non-performing loans.

From 1999 through late 2008, BOM consistently refused to close any commercial bank for insolvency or malpractice. In late 2008, Mongol Bank took Mongolia's fourth largest bank into receivership. Most deposits were guaranteed and their depositors paid out at a cost of around US$150 million -- not an inconsequential sum in an economy with a US$5 billion per annum GDP. In 2009, Mongolia's fifth largest bank went into receivership, and in 2010 two other mid-sized banks were merged.

The BOM and Mongolia's financial system have endured the crisis. However, most observers note that the insolvent banks had shown signs of mismanagement, non-performing loans, and ill-liquidity for several years before the BOM moved to safeguard depositors and the financial sector. In response the BOM has attempted to introduce long-term reforms to enhance its ability to supervise the banking system; however, parliament has yet to approve a package of reforms that has been before it for over a year. Little remedial action occurred in 2011, and none is expected in 2012.

Potential Impact of the Strategic Entities Foreign Investment Law (SEFIL)

In May, 2012 Parliament passed SEFIL, just before parliamentary elections. As passed, some of the law's provisions may impact the ability of investors to finance and raise capital on projects in the affected sectors. Specifically, lenders and investors are concerned that SEFIL might delay or prevent use of Mongolian equities to secure investments and financing; and, consequently, disrupt badly needed investments into the affected sectors. Prior to SEFIL, lenders and investors could secure their financing and investments by transfers of shares or other forms of equity. Under SEFIL, the GOM has the authority to intervene or at the very least delay the transaction ensure GOM concerns under the law are satisfied. Although the review SEFIL process remains unclear, it is likely that any process will take several months if not longer. Of equal concern is the possibility of having to seek approval for share transfers that occur abroad.   This lack of clarity on financing and investment would invariably impact planning, hiring, and procurement decisions for relevant projects. For a fuller discussion of SEFIL see Chapter A.1.

A.10 Competition from State-Owned Enterprises (SOE)

Mongolia has SOEs in, among other areas, transport, power, and mining. Investors are allowed to conduct activities in these sectors, although in some cases a largely opaque regulatory framework limits both competition and investor penetration.

Corporate Governance of Mongolian SOEs

Officially, all Mongolian SOEs are under the direct control of the State Property Committee (SPC), which in turn answers to the Prime Minister of Mongolia, who in turn appoints the Chairman of the SPC for a term of six years subject to parliamentary approval. Once approved, the Chair can serve out the full term regardless of any change in government, unless parliament votes to remove the incumbent. The SPC selects a board of directors for each SOE, which includes members of the SPC. These boards then select management teams to run each state-owned entity. If an SOE's activities fall under the regulatory remit of certain line ministries, that particular ministry may have a role on the board of directors.

In the case of Mongolian mining sector SOEs, several agencies, ministries, and the SPC have various responsibilities and authorities. For example, because the Nuclear Energy Law is unclear on which government agency has primacy in managing uranium assets, it is not certain if the SPC, Nuclear Energy Agency, or the holding company, MonAtom, has paramount authority.

In any case, when investing with Mongolian SOEs, investors are strongly advised to contact all relevant government entities to learn what their respective interests are and what actual administrative and management authority they actually have.

All SOEs are technically required to submit to the same international best practices on disclosure, accounting, and reporting as imposed on private companies. When the SOEs seek international investment and financing, they tend to follow these rules. However, because international best practices are not institutionalized in, and are sometimes at odds with, Mongolian law, many SOEs tend to follow existing Mongolian rules by default. At the same time, foreign-invested firms follow the international rules, causing inconsistencies in disclosure and accounting.

Aviation SOE

The state involves itself in the domestic and international aviation sectors; however, at this time, it operates no regular domestic schedule of flights. In addition to the state-owned Mongolian Airlines (MIAT), Mongolia has four private domestic service providers: EZNIS, Aero Mongolia, Blue Sky Aviation and Mongolian Airlines. Government regulation recommends maximum ticket prices that airlines may charge for all domestic routes, but the law does not strictly forbid airlines from charging fees higher than the state carrier, which does not currently operate domestically. Private carriers have succeeded in charging rates that might yield profits and support safe and efficient flying arrangements. MIAT flies a regular and profitable schedule of international flights, serving China, Korea, Russia, and Germany. Air China, Korean Air, and Aeroflot also serve these routes. EZNIS and two other new private carriers also fly international routes to second tier Russian, Chinese, and Japanese cities, and seek additional routes throughout the Eurasian region.

As far as the provision of airport services is concerned, there is no indication that MIAT is receiving preferential pricing or services.

Rail SOE

Mongolia has no plans to privatize its existing railroad jointly held with the government of Russia since 1949. As far as the construction of additional rail lines, the state has no real plans to turn over control of any rail network to a private entity: Current law does allow private firms to build and operate but ultimately transfer new railroads to the state. Under this law several private mining companies have proposed rail links, and obtained licenses to construct these new lines from their respective coal mines to the Chinese border or to the currently operating spur of the Trans-Siberian Railroad. However, because landlocked Mongolia and its neighbors have yet to resolve transnational shipping issues, companies have not been able to use rights granted under these licenses.

In 2010, Parliament imposed further limitations on company rights to develop shipping and transport infrastructure required to move mineral and metal products to likely markets, most obviously the Chinese market. Specifically, current policy requires that rail railroads linking key coal deposits in the southern Gobi desert region must first link those deposits to Russia’s Pacific ports before they develop links with Chinese markets. Further, these projects may use the international gauge used in China only after the links with Russia are completed and using the Russian gauge. The GOM has stated that these policies are needed to keep Mongolia from dependency on one market to buy its coal products, namely China.

Mining SOEs

Mongolia maintains two basic categories of mining SOEs. The first group is composed of legacy SOEs from the socialist era. The most important of these are Mongolrostvetmet and Erdenet Mining Concerns, both jointly owned by the Mongolian and Russian governments. The second category includes new SOEs in copper and coal and uranium and rare earth held by Erdenes MGL and MonAtom respectively. Erdenes MGL holds the government's 34 % of the Oyu Tolgoi project, although it does not seem to have management responsibilities for this asset. Erdenes also holds the GOM's 100% share of the Tavan Tolgoi coal deposit. Part of this holding is structure through a subsidiary company Erdenes MGL Tavan Tolgoi (EMTT) , which owns and operates a new project on one of the Tavan Tolgoi licenses. In 2011, EMTT began to extract and ship coal from the eastern half of the Tsankhi license area of the Tavan Tolgoi deposit.

Although the trend had been for the GOM to extract itself from ownership of firms and other commercial assets, both the 2006 Minerals Law of Mongolia and the 2009 Nuclear Energy Law bring the state back into mining. (See Chapter A.1 for fuller discussions of both laws.) Under both laws, the GOM granted itself the right to acquire equity stakes ranging from 34% to perhaps 100% of certain deposits deemed strategic for the nation. These companies are then mandated to use the proceeds from their respective activities for the benefit of the Mongolian people.

Driving these recent trends is an explicit, public desire by the GOM to create national champions in the key mining sector for high profile products such as coal, uranium, copper, and rare earths. The policy posits that a national champion owned and operated by Mongolians for Mongolians would be more inclined (and more susceptible to state and public pressure) to conduct value-added operations in Mongolia than would foreign investors. Whether this policy is an effective response to Mongolia's development needs for mining, observers have told us that they perceive that the GOM may not favor foreign investment and even take steps to limit such investment in projects because it considers such investment will hobble GOM aims. Recent resolutions by parliament that specifically limit how long foreign firms can operate before they must turn over the operations to the GOM (and which vary from best practices followed in most mining regions) tend to support these perceptions.

There is also concern that the GOM will waive legal and regulatory requirements for its state-owned mining companies that it imposes on all others. These claims seem borne out by the GOM's treatment of its Erdenes MGL Tavan Tolgoi mining operation. Generally, private mining firms take at least two years to submit and receive approval for relevant environmental and operating permits for coal mines in Mongolia. EMTT was up and running within a single year; and for the GOM's EMTT mine there is no indication that it has required its operation at Tavan Tolgoi to follow the statutory or regulatory requirements imposed on other operations; in fact, a review of the timeline leading to operation suggests that the extensive statutory requirements of the current approval process that normally takes several years to complete cannot have been followed in this case. If true, this runs counter to extremely vocal GOM demands that companies show respect for Mongolia's rules and laws and comply with all applicable mining statutes.

Finally, investors have also expressed concerns about the GOM's capacity to accept the fiduciary responsibilities that come from operating mining operations. In the case of its Erdenes MGL Tavan Tolgoi mining operation (EMTT), the GOM received a prepayment of US $250 million prepayment for coal from a Chinese state-owned entity. Rather than allowing EMTT to retain these funds to cover substantial start up costs, the GOM claimed the balance of the payment, US$200 million, for its Human Development Fund, which redistributes primarily mining revenues to the Mongolian public in the form of monthly cash payments. This GOM action left EMTT with insufficient funds to cover ongoing startup and daily operational costs.

Pondering this state taking, investors are concerned that the GOM will divert future revenues gained from mining activities—for example capital raised through initial public offerings from strategic mines—for non-related expenses. Going forward, the GOM will likely have to provide binding assurances that it act as responsible steward of company interests rather than seeing state-owned companies as nothing more than transfer mechanism for payments to the Mongolian public.

Mongolia's Human Development Fund and Development Bank

In 2008, parliament approved the Law on the Human Development Fund (HDF) to establish governance of the GOM putatively-named country's first ever sovereign wealth fund, although it does not seem to function as a sovereign wealth fund precisely. The stated purpose of the law was to fulfill campaign promises to provide every citizen with cash payments in excess of U.S. 1,000 so that the public benefits directly from Mongolia's mineral wealth. The HDF has been funded from the profits, taxes, and royalties generated by the mining industry as a whole, including large, medium and small scale projects.

There seems no plan to use the HDF as a conduit for foreign direct investments. The HDF basically serves as an instrument to distribute cash to the citizens of Mongolia as a share from the mining profits. HDF funds will also used be for the following social benefits: payments for pension and health insurance premiums; housing purchases; cash benefits; and payments for health and education services. In that sense, we find no conflict between the HDF and private sector investments.

In early 2011, parliament passed the Law on the Development Bank for the explicit purpose of financing major development infrastructure projects. The Mongolian government has selected a South Korean company to manage the Development Bank, overseen by a board of directors composed of government appointees. Early plans were for the Development Bank to invest in cashmere processing, railways, power, and oil processing; however, at this point, it seems that the Development Bank has been directed to fund government housing projects through the granting of low-interest rate mortgages. Foreign and domestic builders and the private banks that provide financing for these housing projects have questioned why the GOM should compete with private companies in what are essentially commercially viable projects, rather than focuses solely on the initially proposed infrastructure projects.

In spring of 2012, the Development Bank sold its first bond issue to foreign buyers, raising some U.S. $ 600 million, with plans for several more issues in the works. Although some ambiguity remains on how these funds will be spent in Mongolia, there is general consensus that the lion’s share will go for rail projects with the rest perhaps going to underwrite mortgages and for other undefined infrastructure projects.

Mongolia passed a Fiscal Stability Law (FSL) in 2010 as part of its Stand-By Arrangement with the International Monetary Fund which ended on September 30, 2010. The FSL establishes a stabilization fund that sets aside certain mining revenues in excess of pre-set structural revenue estimates. Savings may then be used during a downturn to finance the budget. Under the FSL, a portion of the savings generated by the Fiscal Stability Fund can be used to finance domestic and foreign investments. For example, the government is allowed to use this money to purchase long term securities offered by the Development Bank to fund its activities.

How the GOM and parliament will divide mining revenues between the HDF and the FSL remains to be determined.

A.11 CORPORATE SOCIAL RESPONSIBILITY (CSR)

It is early days for corporate social responsibility (CSR) in Mongolia. Most Western companies make a good faith effort to work with the communities in which they invest. These efforts usually take the form of specific projects aimed at providing missing infrastructure or public benefit—wells, power, clinics and schools—or support for education such as books and scholarships. The larger Western firms tend to follow accepted international CSR practices and underwrite a full range of CSR activities across Mongolia; however, the smaller ones, lacking sufficient resources, often limit their CSR actions to the locales in which they work. Only the largest Mongolian firms regularly undertake CSR actions, with small- to medium –sized enterprises generally (but not always) hindered by limited resources from underwriting CSR actions.

Generally, firms that pursue CSR are perceived favorably, at least within the communities in which they act. Nationally, responses range from praise from politicians to cynical condemnation by certain civil society groups of CSR actions as nothing more than an attempt to "buy" public approval.

A.12 POLITICAL VIOLENCE

Mongolia is both peaceful and stable; political violence rare. Mongolia has held nine (out of 10) peaceful presidential and parliamentary elections in the past 17 years, though a brief but violent outbreak of civil unrest followed the disputed parliamentary elections on July 1, 2008. During that unrest, five people were killed and a political party's headquarters was burned, though the unrest was quickly contained and order restored. There has been no repeat of civil unrest since then, and indeed Mongolia held peaceful presidential elections less than a year later in May 2009, in which the incumbent president was defeated and conceded at noon the next day, and power smoothly transitioned to the winner. Most recently, Mongolia held successful and peaceful parliamentarian elections in June 2012, followed by a peaceful transition of power in August 2012 after the formation of a new government.

Mongolia has an ethnically homogenous population: 97% of the population is Khalkh Mongol. The largest minority, numbering an estimated 90,000 people, is Kazakh (Muslim), concentrated in the far western part of the country.

There have been no known incidents of anti-American sentiment or politically motivated damage to American projects or installations in at least the last decade. However, there has been a gradual and perceptible level of rising hostility to Chinese and Korean nationals in Mongolia. This hostility has led to some instances of improper seizure of Chinese and Korean property; and in more limited cases acts of physical violence against the persons and property of Chinese and Korean nationals resident in Mongolia. Other foreign nationals living in Mongolia have expressed concern that they may inadvertently become victims of this hostility. Groups of young men occasionally verbally or physically harass foreigners.

A.13 CORRUPTION

Current Views on Mongolian Corruption

In mid-2005, the USAID Mission to Mongolia, in collaboration with USAID/Washington and The Asia Foundation (TAF), funded a corruption assessment conducted by Casals & Associates, Inc. (C&A) The complete report is available at http://www.usaid.gov/mn. Follow-up surveys of the problem show that the results of this assessment remain valid in 2012. The study found that opportunities for corruption continue to increase in Mongolia at both the "petty" or administrative and "grand" or elite levels. Both types of corruption should concern Mongolians and investors, but grand corruption should be considered a more serious threat because it solidifies linkages between economic and political power that could negatively affect or ultimately derail or delay democracy and development. Several inter-related factors contribute to Mongolia's corruption problem:

- A blurring of the lines between the public and private sector brought about by systemic conflicts of interest at nearly all levels;

- A lack of transparency and access to information, stemming in part from a broad State Secrets Law that surrounds many government functions and has yielded criticism that it renders the media ineffective and hinders citizen participation in policy discussions and government oversight;

- An inadequate civil service system that gives rise to a highly politicized public administration and the existence of a "spoils system;"

- Limited political will to actually implement required reforms in accordance with the law, complicated by conflicting and overlapping laws that further inhibit effective policy implementation;

- Weak government control institutions, including the Central Bank, National Audit Office, parliamentary standing committees, Prosecutor General, Generalized State Inspection Agency, State Property Committee, and departments within the Ministry of Finance.

The aforementioned systemic shortcomings have allowed for an evolution of corruption in Mongolia that "follows the money," meaning that graft on the most significant scales generally occurs most often in the industries and sectors where there is the most potential for financial gain.

During the early 1990s, in the early transition toward democracy and market economy, two areas that offered particular opportunities for grand scale corruption at that time were foreign donor assistance and privatization of state-owned enterprises. As Mongolia later embarked on further policy changes to institutionalize capitalistic practices, corruption reared its head in the process of privatizing public land. As the economy continues to develop, emerging areas for corruption include the banking and mining sectors. There also are several areas that provide stable and consistent opportunities for corruption, both grand and administrative in nature, such as for procurement opportunities, issuance of permits and licenses, customs, inspections, the justice sector, among high-level elected and appointed officials, and in the conduct of a variety of day-to-day citizen- and business-to-government transactions, notably in education, health care, and city services.

Despite the fact that few of the conditions to prevent corruption from getting worse are in place, the situation has not reached the levels that are evident in many other countries with contexts and histories similar to that of Mongolia. Perhaps more importantly, there are a number of efforts underway to actively combat corruption, including:

- Government commitments to international anti-corruption regimes and protocols, such as the Anti-Corruption Plan of the Asian Development Bank/Organization of Economic Cooperation and Development (ADB/OECD) and the United Nations Convention Against Corruption (UNCAC);

- Development of a National Program for Combating Corruption and formation of a National Council for coordinating the Program and a Parliamentary Anti-Corruption Working Group;

- Implementation of an anti-corruption law that has included the formation of an independent anti-corruption body;

- Short- and medium-term anti-corruption advocacy and “watchdog” programs initiated by civil society organizations, often with international donor support.

There is, in fact, time for Mongolians and the international community to nurture these efforts and take further action before corruption grows too large to rein in. In general, the main need in Mongolia is to develop effective disincentives for corrupt behavior at both the administrative and political levels. In its broadest configuration, this implies a strategy of increasing transparency and effective citizen oversight, as well as intra-governmental checks and balances. Without these major changes, administrative reforms may provide some small improvements, but they are unlikely to solve the problem. Specifically, the aforementioned USAID-sponsored report of 2005 makes several strategic recommendations, which remain relevant in 2011, including:

- Diplomatic engagement focused on keeping anti-corruption issues high on the policy agenda, promoting implementation of existing laws related to anti-corruption, and highlighting the need for further measures to promote transparency and improved donor coordination;

- General programmatic recommendations to address conflicts of interest, transparency/access to information, civil service reforms, and the independent anti-corruption body, with a definitive focus on engaging civil society and promoting public participation utilizing UNCAC as a framework; and

- Specific programmatic recommendations to address loci of corruption, such as citizen- and business-to-government transactions, procurement, privatization, customs, land use, mining, banking, the justice sector, and the political and economic elite.

In addition, the reputable international anti-corruption NGO Transparency International (TI) opened a national chapter in Mongolia in 2004 (for more information, see: www.transparency.org). U.S. technical advisors have worked with TI to train Mongolian staff to monitor corruption and to advocate on behalf of anti-corruption legislation and. TI first included Mongolia in its annual "Perceptions of Corruption" survey in September 2004. In that initial survey, Mongolia ranked 85 out of 145 countries and its score of 3 on the Corruption Perception Index was "poor." (TI's CPI Score relates to "perceptions" of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt). TI's 2005 Survey ranked Mongolia 85 out 158; and again Mongolia earned a "poor" score of 3. In 2007, Mongolia was still 99 but out of 179 nations and had achieved a score of 3.0, a slight uptick but still poor. 2009 found Mongolia dropping to 124 out of 180 nations, and declining to a poorer score of 2.7; 2010 found Mongolia 116 out of

178, with a score of 2.7; and 2011 saw no improvement, with Mongolia staying in the bottom range with a score of 2.7.

Although TI's ranking was stable from 2009 to 2010, other signs of decline persist. In 2011, MCC's Mongolia score card for controlling corruption hit a new low, falling below the median for controlling corruption based on World Bank and Brookings WGI indices. ***Failure of this one indicator signifies failing the MCC scorecard.*** In 2012, MCC reported a slight positive uptick on the corruption score MCC and Mongolia are working to reverse this trend, but no one pretends that the decline will be easily reversed. (http://www.mcc.gov/documents/scorecards/score-fy12-new-mongolia.pdf)

Current Anti-Corruption Law

In 2006, Parliament passed an Anti-Corruption Law (ACL), a significant milestone in Mongolia's efforts against corruption. The legislation had been under consideration since 1999. The ACL created an independent investigative body, the Independent Authority Against Corruption (IAAC). The IAAC has four sections. The Prevention and Education Section works to prevent corruption and educate the public on anti-corruption legal requirements. The Investigation Section receives corruption cases and executes investigations. The third section collects, checks, and analyzes the legally required property and income statements of government officials. The fourth section, the IAAC's Secretariat, handle s administrative tasks. The IAAC formally began operations in August 2007. (For a review of the IAAC's activities from its inception through the present see The Asia Foundation Mongolia: http://asiafoundation.org/publications)

Recent Conviction of Former Senior Official

On August 2, 2012, former President of Mongolia, N. Enkhbayar (and three other co-defendants) was convicted on five corruption charges brought against him by the IAAC and the Chief Prosecutor of Mongolia. No doubt President Enkhbayar will appeal the conviction. However, observers remain ambivalent on the implications of the conviction. Some groups have argued—including Enkhbayar's defense team—that case was a spurious, politically motivated attack to prevent the President from running in the 2012 parliamentary elections. Others assert that even if the charges have a political dimension to them, that the very act of going after such a senior figure sends a clear message to others that senior politicians can no longer hide behind their current and former offices.

Anti-Corruption Resources Available to U.S. Citizens

U.S. Foreign Corrupt Practices Act: In 1977, the United States enacted the Foreign Corrupt Practices Act (FCPA), which makes it unlawful for a U.S. person, and certain foreign issuers of securities, to make a corrupt payment to foreign public officials for the purpose of obtaining or retaining business for or with, or directing business to, any person. The FCPA also applies to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States. For more detailed information on the FCPA, see the FCPA Lay-Person's Guide at: http://www.justice.gov/criminal/fraud/docs/dojdocb.html.

Guidance on the U.S. FCPA: The Department of Justice's (DOJ) FCPA Opinion Procedure enables U.S. firms and individuals to request a statement of the Justice Department's present enforcement intentions under the antibribery provisions of the FCPA regarding any proposed business conduct. Opinion procedures are available on DOJ's Fraud Section Website at www.justice.gov/criminal/fraud/fcpa. Although the Department of Commerce has no enforcement role with respect to the FCPA, it supplies general guidance to U.S. exporters who have questions about the FCPA and about international developments concerning the FCPA. Also, see the Office of the Chief Counsel for International Counsel, U.S. Department of Commerce, Website, at http://www.ogc.doc.gov/trans_anti_bribery.html.

Other Assistance for U.S. Businesses: The U.S. Department of Commerce offers several services to aid U.S. businesses seeking to address business-related corruption issues. For example, the U.S. and Foreign Commercial Service can provide services that may assist U.S. companies in conducting their due diligence as part of the company's overarching compliance program when choosing business partners or agents overseas. The U.S. Foreign and Commercial Service can be reached directly through its offices in every major U.S. and foreign city, or through its Website at www.trade.gov/cs.

The Departments of Commerce and State provide worldwide support for qualified U.S. companies bidding on foreign government contracts through the Commerce Department's Advocacy Center and State's Office of Commercial and Business Affairs. Problems, including alleged corruption by foreign governments or competitors, encountered by U.S. companies in seeking such foreign business opportunities can be brought to the attention of appropriate U.S. government officials, including local embassy personnel and through the Department of Commerce Trade Compliance Center "Report A Trade Barrier" Website at tcc.export.gov/Report_a_Barrier/index.asp.

Exporters and investors should be aware that generally all countries prohibit the bribery of their public officials, and prohibit their officials from soliciting bribes under domestic laws. Most countries are required to criminalize such bribery and other acts of corruption by virtue of being parties to various international conventions discussed above.

A.14 BILATERAL INVESTMENT AGREEMENTS

Reporter	*Partner*	*Date of Signature*	*Entry in to force*
Mongolia	Austria	19-May-01	1-May-02
	Belarus	28-May-01	1-Dec-01
	Belgium/Luxembourg	3-Mar-92	15-Apr-04
	Bulgaria	6-Jun-00	------------
	China	25-Aug-91	1-Nov-93
	Croatia	8-Aug-06	------------
	Cuba	26-March-99	-----------
	Czech Republic	13-Feb-98	5-Jul-99
	Denmark	13-Mar-95	2-Apr-96
	Egypt	27-Apr-04	25-Jan-05
	Finland	15-May-07	------------
	France	8-Nov-91	22-Dec-93
	Germany	26-Jun-91	23-Jun-96
	Hungary	13-Sep-94	29-Aug-95
	India	3-Jan-01	29-Apr-02
	Indonesia	4-Mar-97	13-Apr-99
	Israel	25-Nov-03	2-Sep-04
	Italy	15-Jan-93	1-Sep-95
	Japan	15-Feb-01	24-Mar-02
	Kazakhstan	2-Dec-94	3-Mar-95
	DPR of Korea	10-Nov-03	-----------
	Republic of Korea	28-Mar-91	30-Apr-91
	Kuwait	15-Mar-98	1-May-00
	Kyrgyzstan	5-Dec-99	-----------
	Lao People's DR	3-Mar-94	29-Dec-94
	Lithuania	27-Jun-03	3-May-04
	Malaysia	27-Jul-95	14-Jan-96
	Netherlands	9-Mar-95	1-Jun-96
	Philippines	1-Sep-00	1-Nov-01
	Poland	8-Nov-95	26-Mar-96
	Qatar	29-Nov-07	------------
	Romania	6-Nov-95	15-Aug-96
	Russian Federation	29-Nov-95	------------
	Singapore	24-Jul-95	14-Jan-96
	Sweden	20-Oct-03	1-Jun-04
	Switzerland	29-Jan-97	9-Sep-99
	Tajikistan	20-Mar-09	16-Sep-09
	Turkey	16-Mar-98	22-May-00
	Ukraine	5-Nov-92	5-Nov-92
	UAE	21-Feb-01	-------------
	United Kingdom	4-Oct-91	4-Oct-91
	United States	6-Oct-94	4-Jan-97
	Vietnam	17-Apr-00	13-Dec-01

(UNCTD: http://www.unctad.org/sections/dite_pcbb/docs/bits_mongolia.pdf)

Taxation issues of Concern to U.S. Investors

Taxation remains a key concern for Americans, other foreign investors, and Mongolian domestic investors and businesses. 2011 has seen the end of the Windfall Profits Tax but generally there appear to be few changes to the tax code on the horizon for the year ahead—although parliament and the GOM are considering lowering or waiving the value-added tax rate to encourage local production of certain mineral and food products among other items.

Revisions of the Mongolian Tax Code

The 2006 code taxes all salary and wage income at 10% while allowing interest income from securities and capital gains to be tax free until 2013. As of January 2013, all types of income will be taxed at a rate of 10%.

Businesses are taxed at 10 % for profits less than 3 billion Tugriks (US$ 2.2 million) and at 25% for any profit 3 billion or above. The Value Added Tax (VAT) is currently 10%. Mongolia also imposes a variety of excise taxes and licensing fees upon a variety of activities and imports.

The OT project t has had a salutary effect on key tax provisions long-desired by foreign and domestic investors alike. Before OT, firms could only carry-forward losses for two (2) years after incurring the loss. While most businesses approved of this provision, many, especially that requiring large and long-term infrastructure development, noted that the two year carry-forward limit was insufficient for projects with long development lead times, as is typical of most large-scale mining developments. As a condition precedent of passing the OT Agreement, Parliament extended loss-carry forward to eight (8) years.

On the down side, Mongolia's Parliament has revoked and refuses to reinstate an exemption available on value-added taxes (VAT) of 10% on equipment used to bring a given mine into production, except on equipment to be used in the production of highly processed mining products. For example, if the OT project decides to smelt copper, imported equipment supporting production of metallic copper might qualify for a 10% reduction on VAT. However, in an effort to promote value-added production in Mongolia, the GOM defines the production of copper concentrate as non-value-added output; and so, equipment imported to develop and operate this sort of operation would not qualify for the 10% VAT exemption.

Most jurisdictions, recognizing that most mines have long development lead times before production begins, either waive or do not tax such imports at all. Parliament, with no consultation with investors, international experts, or its own tax officials, chose to impose the VAT, which immediately makes Mongolian mining costs 10% higher than they would otherwise be, impairing competitiveness and dramatically varying from global practice.

Whether any mining output qualifies for this exemption seems completely at the discretion of the GOM, which has not set out in regulation or statute a process by which it will regularly adjudicate such VAT exemption requests.

Unfinished Business with Administering Taxation (and other functions)

Despite overall solid, positive changes, international financial institutions and foreign and domestic investors continue to note that recent tax reforms and subsequent actions remain insufficient. They report that to improve Mongolia's business environment reform efforts need to go beyond changes to the tax code to restructure the operations of the key agencies - the tax department, the customs administration and the inspections agency – that directly interact with private firms and individuals.

A.15 OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The U.S. government's Overseas Private Investment Corporation (OPIC: (www.opic.gov) offers loans and political risk insurance to American investors involved in most sectors of the Mongolian economy.

In addition, OPIC and the GOM have signed and ratified an *Investment Incentive Agreement* that requires the GOM to extend national treatment to OPIC financed projects in Mongolia. For example, under this agreement mining licenses of firms receiving an OPIC loan may be pledged as collateral to OPIC, a right not normally bestowed on foreign financial entities.

The U.S. Export-Import Bank (EXIM: www.exim.gov) offers programs in Mongolia for short-, medium-, and long-term transactions in the public sector and for short- and medium-term transactions in the private sector.

Mongolia is a member of the Multilateral Investment Guarantee Agency (MIGA: www.miga.org).

A. 16 LABOR

The Mongolian labor pool is generally educated, young, and adaptable, but shortages exist in most professional categories requiring advanced degrees or training. Only time and investment in education and training will remedy this deficit of trained skilled labor. Unskilled labor is sufficiently available.

Shortages exist in both vocational and professional categories because Mongolians who obtain such skills frequently go abroad to find higher wages. Foreign-invested companies are dealing with this situation by providing in-country training to their staffs, raising salaries to retain employees, or hiring expatriate workers to provide skills and expertise unavailable in the local market. In addition, the USG funded Millennium Challenge Corporation (MCC) is underwriting a five-year training and vocational education program (TVET) to develop sustainable programs to help Mongolia meet its needs for skilled *blue- collar* workers (http://www.mca.mn or http://www.mcc.gov).

Mongolian labor law is not particularly restrictive. Investors can locate and hire workers without using hiring agencies—as long as hiring practices are consistent with Mongolian Labor Law. However, Mongolian law requires companies to employ Mongolian workers in all labor categories whenever a Mongolian can perform the task as well as a foreigner. This law generally applies to unskilled labor categories and not areas where a high degree of technical expertise nonexistent in Mongolia is required. The law does provide an escape hatch for employers. Should an employer seek to hire a non-Mongolian laborer and cannot obtain a waiver from the Ministry of Labor for that employee, the employer can pay a monthly waiver fee. Depending on a project's importance, the Ministry of Labor can exempt employers from 50% of the waiver fees per worker. However, trends suggest that it is becoming more difficult to obtain waivers, in part because of public concerns that foreign and domestic companies are not hiring Mongolians at an *appropriate level*.

Impact of the Strategic Entities Foreign Investment Law (SEFIL) on Labor

The recently passed *SEFIL* has raised concerns among employers as to their freedom to hire the labor they need in three affected sectors of resource extraction, banking and finance, and media and telecommunications. One of SEFIL's key provisions requires foreign investors to use Mongolian labor and apparently allows the GOM to intervene in hiring and firing and related labor policies as a condition of authorizing foreign investment into the relevant sector. How this legislative remit will be implemented through the regulations remains unclear; however, investors have conveyed that they have little appetite to cede broad control over their workforces to the GOM. For a fuller discussion of SEFIL see Chapter A.1.

Foreign and domestic investors consistently argue that they bear too much of the social security costs for each domestic and foreign hire under the amended 2008 Social Insurance Law enacted in July 2008. Foreign employees became liable for social insurance taxes if they reside within Mongolia for 181 days within a 365 day period. . Employers must pay a tax equivalent to 13% of the annual wage on both domestic and foreign workers. Given that state pensions have yet to barely broach even US$150 per month, employers argue that pensions are not commensurate with worker contributions, especially those of highly-paid ex-patriot employees. In addition, workers must pay in for twenty years in order to be vested, highly unlikely for many ex-patriot employees, who reside in Mongolia for less than three years on average. Local and foreign business associations are attempting to work with both the government and Parliament to address these perceived inequalities.

***ILO conventions* (http://www.ilo.org):**

Convention	Ratification date	Status
C29 Forced Labor Convention, 1930	15:03:2005	ratified
C59 Minimum Age (Industry) Convention (Revised), 1937	03:06:1969	denounced on 16:12:2002
C87 Freedom of Association and Protection of the Right to Organize Convention, 1948	03:06:1969	ratified
C98 Right to Organize and Collective Bargaining Convention, 1949	03:06:1969	ratified
C100 Equal Remuneration Convention, 1951	03:06:1969	ratified
C103 Maternity Protection Convention (Revised), 1952	03:06:1969	ratified
C105 Abolition of Forced Labor Convention, 1957	15:03:2005	ratified
C111 Discrimination (Employment and Occupation) Convention, 1958	03:06:1969	ratified
C122 Employment Policy Convention, 1964	24:11:1976	ratified
C123 Minimum Age (Underground Work) Convention, 1965	03:12:1981	ratified
C135 Workers' Representatives Convention, 1971	08:10:1996	ratified
C138 Minimum Age Convention, 1973	16:12:2002	ratified

C144 Tripartite Consultation (International Labor Standards) Convention, 1976	10:08:1998	ratified
C155 Occupational Safety and Health Convention, 1981	03:02:1998	ratified
C159 Vocational Rehabilitation and Employment (Disabled Persons) Convention, 1983	03:02:1998	ratified
C182 Worst Forms of Child Labor Convention, 1999	26:02:2001	Ratified

A. 17 FOREIGN TRADE ZONES/FREE PORTS

The Mongolian government launched its free trade zone (FTZ) program in 2004. Two FTZ areas are located along the Mongolia spur of the trans-Siberian highway: one in the north at the Russia-Mongolia border town of Altanbulag and the other in the south at the Chinese-Mongolia border at the town of Zamyn-Uud. Both FTZs are relatively inactive, with little development at either site. A third FTZ is located at the port of entry of Tsagaan Nuur in Bayan-Olgii province.

There are concerns about the Mongolian free trade zones in general and Zamyn-Uud in particular. In April 2004, the USAID sponsored Economic Policy Reform and Competitiveness Project (EPRC: http://www.eprc-chemonics.biz/) made the following observations of Mongolia's FTZ Program. In 2012, these issues remain concerns:

1. Benchmarking of Mongolia's FTZ Program against current successful international practices shows deficiencies in the legal and regulatory framework as well as in the process being followed to establish FTZs in the country.

2. Lack of implementing regulations and procedural definitions encapsulated in transparency and predictability quotient required to implement key international best practices.

3. A process of due diligence, including a cost-benefit analysis, has not been completed for the proposed Zamyn-Uud FTZ.

4. Identifiable funding is not in place to meet off-site infrastructure requirements for Zamyn-Uud and Altanbulag sites.

5. Deviations from international best practices in the process of launching FTZs risks repeating mistakes made in other countries and may lead to "hidden costs" or the provision of subsidies that the government of Mongolia did not foresee or which will have to granted at the expense of other high priority needs.

A. 18 FOREIGN DIRECT INVESTMENT STATISTICS

The Foreign Investment and Foreign Trade Agency (FIFTA) provides most of the data for tracking FDI in Mongolia. However, these data have limitations:

Incomplete reporting

Many foreign firms provide FIFTA with incomplete data on their annual investment amounts. FIFTA’s registration regime requires companies to document business plans and total FDI for the coming year. FIFTA uses these amounts to determine FDI for the year. However, concerns in the business community that FIFTA cannot be trusted to keep proprietary business information confidential means that many firms withhold data on their activities.

Mongolia, therefore, suffers from promised investment that does not materialize or which comes in at a lower level than originally stated. FIFTA does not update reports to account for these or other changes to investments during the year. (See Chapter A.5)

Many of Mongolia’s largest foreign-owned or foreign-invested entities are in the mining sector, which because of a quirk of the current Minerals Law of Mongolia are not necessarily defined as foreign-invested firms. The current minerals law specifies that only domestically registered mining firms can have mining licenses registered in their names, which means that foreign investments associated with mining are channeled through a locally-established entity. As a result, the entity's investment may not be recorded by FIFTA, even though the investment is demonstrably foreign. For example, the massive Oyu Tolgoi mine is managed by Oyu Tolgoi LLC, a joint venture of the government of Mongolia, Rio Tinto, and Ivanhoe. Although it has generated immense foreign investment, it is considered a domestic entity and not part of FIFTA's record.

Data not Available

To our knowledge neither FIFTA nor any other Mongolian agency tracks Mongolia’s direct investment abroad.

A. TRADE TURNOVER (USD MLN.)

Year	**Total Turnover**	**Percent comp.**	**Exports**	**Percent comp.**	**Imports**	**Percentage comp.**	**Balance**
2000	**1,150**	**119%**	**536**	**118%**	**615**	**120%**	**-79**
2001	1,159	101.%	513	97%	638	104%	-116
2002	1,215	105%	524	101%	691	108%	-166
2003	1,417	117%	616	116%	801	116%	-185
2004	1,891	133%	870	141%	1,021	128%	-152
2005	2,249	119%	1,065	122%	1,184	116%	-120
2006	3,018	134%	1,529	144%	1,489	126%	39
2007	4,119	136%	1949	126%	2,170	146%	-221
2008	6,155	149%	2,539	130%	3,616	167%	-1077

Source: National Statistics commission of Mongolia, December 2009, 2010

B. TOP 10 INVESTOR COUNTRIES (THOUSAND USD)

№	**Countries**	**%**	**Total**	**1990-2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
1	China	50.99	**2,468,235**	441,786.38	227,922.28	172,014.03	339,614.67	497,800.88	613,058.80	176,038.36
2	Canada	8.26	**400,005**	174,206.58	1,542.25	72,180.37	497.15	2,739.57	1,028.00	147,811.12
3	Netherlands	6.08	**294,081**	5,265.58	221.70	475.86	58.50	4,069.20	51,028.60	232,962.18
4	South Korea	5.29	**255,813**	85,180.14	19,004.49	16,434.78	22,991.38	41,765.41	31,673.98	38,763.43
5	UK Virgin Islands	4.60	**222,438**	48,394.23	5,033.92	6,111.67	35,449.00	6,157.89	19,305.18	101,986.27
6	Japan	2.86	**138,570**	66,208.26	5,840.80	4,727.59	2,450.10	46,623.46	5,594.78	7,125.37
7	Hong Kong SAR	2.63	**127,350**	25,033.35	773.02	350.50	8,255.51	1,757.81	11,032.44	80,148.35
8	Bermuda	2.50	**121,059**	1,604.48	4,962.86	-	30.30	6.46	-	114,455.56
9	USA	2.39	**115,690**	45,725.48	5,564.06	37,165.78	4,285.67	6,466.89	2,571.52	13,911.20
10	Russia	2.24	**108,250**	37,163.16	7,450.14	11,654.52	39,774.38	3,795.42	6,139.20	2,273.18

Source: FIFTA

C. TOP 25 INVESTOR ENTITIES (FDI – 2010)

No	Entity	Equity	Foreign	Domestic	Sectors	Countries
1.	Oyutolgoi	***65,005,920***	*65,005,913*	-	Geological prospecting and exploration	Netherlands-Mongolia
2.	MD Securities	***43,603,000***	*43,500,000*	-	Trade and catering service	Virgin Islands (UK)
3.	MCS mining	***25,100,000***	*25,000,000*	-	Geological prospecting and exploration	Singapore
4.	HSBC	***10,000,000***	*9,990,000*	-	Others	South Korea
5.	Wagner Asia Leasing	***9,890,224***	*9,890,224*	-	Trade and catering service	USA
6.	Seoul Senior Tower	***7,840,000***	*7,140,000*	-	Health and beauty services	South Korea
7.	Khan Bank	***20,599,356***	*7,073,699*	*3,393,576*	Bank and financial services	USA-China /Hong Kong/-Japan-Mongolia
8.	Gyantbaylag	***7,000,000***	*7,000,000*	-	Geological prospecting and exploration	Virgin Islands (UK)
9.	Globalcom	***4,500,000***	*4,500,000*	-	Trade and catering service	Virgin Islands (UK)
10.	Louis Vuitton Mongolia LLC	***6,000,000***	*4,000,000*	-	Trade and catering service	France
11.	Credit Bank	***9,585,108***	*3,900,686*	-	Bank and financial services	Cyprus
12.	MCS Asia Pacific	***15,000,000***	*3,850,000*	*3,150,000*	Production of foods and beverages	Singapore-Mongolia
13.	Shangri-La Ulaanbaatar Hotel	***10,000,000***	*3,820,000*	-	Trade and catering service	Virgin Islands (UK)
14.	EAM Bayan-Ulgii	***3,548,107***	*3,538,107*	-	Geological prospecting and exploration	Canada
15.	Handy Soft Rich	***3,000,000***	*2,900,000*	-	Trade and catering service	South Korea
16.	Tethys Mining	***26,992,495***	*2,793,974*	-	Geological prospecting and exploration	Switzerland
17.	Big Mogul Coal and Energy	***4,627,722***	*2,776,633*	*1,851,089*	Geological prospecting and exploration	Luxemburg-Mongolia
18.	Hong Kong Sunkfa group Mongol	***1,600,000***	*1,600,000*	-	Transportation	China-China /Hong Kong/
19.	EAM Exploration	***1,511,710***	*1,501,710*	-	Geological prospecting and exploration	Canada
20.	Santanmores	***5,300,000***	*1,500,000*	-	Geological prospecting and exploration	South Korea

Source: FIFTA

FDI by COUNTRY in 1000s USD (*Source: FIFTA)*

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
1	China	50,99	**2468235,40**	441 786,38	227 922,28	172 014,03	339 614,67	497800,88	613058,80	176038,36
2	Canada	8,26	**400005,03**	174 206,58	1 542,25	72 180,37	497,15	2 739,57	1 028,00	147811,12
3	Netherlands	6,08	**294081,63**	5 265,58	221,70	475,86	58,50	4 069,20	51 028,60	232962,18
4	Korea	5,29	**255813,61**	85 180,14	19 004,49	16 434,78	22 991,38	41 765,41	31 673,98	38 763,43
5	UK Virgin Islands	4,60	**222438,15**	48 394,23	5 033,92	6 111,67	35 449,00	6 157,89	19 305,18	101986,27
6	Japan	2,86	**138570,37**	66 208,26	5 840,80	4 727,59	2 450,10	46 623,46	5 594,78	7 125,37
7	Hong Kong SAR	2,63	**127350,99**	25 033,35	773,02	350,50	8 255,51	1 757,81	11 032,44	80 148,35
8	Bermuda	2,50	**121059,66**	1 604,48	4 962,86		30,30	6,46		114455,56
9	USA	2,39	**115690,58**	45 725,48	5 564,06	37 165,78	4 285,67	6 466,89	2 571,52	13 911,20
10	Russia	2,24	**108250,01**	37 163,16	7 450,14	11 564,52	39 774,38	3 795,42	6 139,20	2 273,18
11	Singapore	1,80	**87 361,96**	8 513,28	4 645,78	728,60	700,00	32 339,86	9 359,44	31 075,00
12	Great Britain	1,06	**51 326,56**	25 813,22	6 347,90	9 013,47	2 429,000	6 057,76	972,15	693,07
13	Cayman Islands	1,00	**48 417,86**	264,02		2 400,00		35 069,33	321,45	10 363,06
14	Switzerland	0,86	**41 469,98**	5 732,89	2 563,50	6 676,45	366,52	90,00	22 190,40	3 850,22
15	Luxemburg	0,72	**34 647,84**	2 911,70	1 809,30	10,00	3 118,917	195,80	1 012,65	25 589,47
16	Bulgaria	0,64	**30 867,98**	30 778,48		17,00	15,00	7,50		50,00
17	Germany	0,57	**27 737,41**	10 369,80	370,20	1 386,27	817,49	580,01	13 281,00	932,64
18	Vietnam	0,50	**24 352,85**	505,80	231,67	20 448,54	674,73	1 270,11	442,00	780,00
19	Australia	0,47	**22 622,74**	3 730,19	12 066,75	384,40	289,20	3 361,90	516,50	2 273,80
20	France	0,41	**20 024,49**	326,99	35,00	66,30	12 550,00	170,08	2 376,34	4 499,79
21	China /Taiwan/	0,41	**19 811,31**	11 123,37	474,75	20,10	590,80	6 443,49	997,50	161,30
22	Islands of Saint Kitts & Nevis	0,41	**19 718,25**	5,00			10,00		173,70	19 529,56
23	The Bahamas	0,36	**17 627,79**	17 435,79		102,00				90,00
24	Italy	0,31	**15 212,65**	8 265,85	5 219,43	44,90	37,50	856,97	340,00	448,00
25	Malaysia	0,30	**14 411,85**	4 529,19	2 993,00	711,60	60,75	5 340,69	445,12	331,50
26	Kazakhstan	0,30	**14 288,15**	551,76	35,30	31,30	11 522,22	214,57	1 515,00	418,00
27	Portugal	0,28	**13 506,00**	13 506,00						
28	Cyprus	0,24	**11 607,65**	244,08		10,00	7 091,52	71,00	190,00	4 001,05
29	Israel	0,17	**8 356,68**	8 094,91	10,00	20,00	23,70	15,00		193,07
30	India	0,16	**7 527,69**	334,00	10,00	128,00	4 925,00	690,00	1 155,00	285,69
31	Ukraine	0,15	**7 290,54**	6 148,12	24,95	89,90	66,90	45,00	725,63	190,04
32	Czech Republic	0,14	**6 833,74**	4 145,87	24,00	52,22	80,61	2 015,04	80,00	436,00

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
33	New Zealand	0,13	**6 301,02**	2 489,20	1 139,60	60,00	225,95	1 706,28	580,00	100,00
34	Belgium	0,11	**5 272,71**	2 744,72		2 190,90	134,46	75,00	27,62	100,00
35	China /Macao/	0,09	**4 461,00**	4 461,00						
36	Turkey	0,07	**3 368,67**	1 910,27	80,00	32,00	114,30	338,60	514,50	379,00
37	Lichtenstein	0,07	**3 336,45**	3 336,45						
38	Austria	0,05	**2 335,14**	1 984,85	10,00	101,87	6,40	191,52		40,50
39	Poland	0,04	**2 036,26**	1 780,26	10,00	16,00	20,00	10,00	150,00	50,00
40	Hungary	0,04	**1 895,68**	1 162,48	12,71	54,20	18,00		240,00	408,29
41	Uzbekistan	0,04	**1 704,30**		3,20			100,00	756,10	845,00
42	DPRK /North Korea/	0,03	**1 401,86**	1 162,61	66,50	22,75	50,00			100,00
43	Panama	0,03	**1 293,65**	1 055,45	7,70				100,00	130,50
44	Slovakia	0,02	**1 192,06**	869,06		273,00	50,00			
45	Pakistan	0,02	**931,05**	698,95	15,00	6,00	21,10	80,00		110,00
46	Antigua & Barbuda	0,02	**729,86**	729,86						
47	Kyrgyzstan	0,01	**650,50**	469,50	1,00				120,00	60,00
48	Sweden	0,01	**660,10**	13,10	10,90		466,00	30,00	40,10	100,00
49	Mauritania	0,01	**510,00**					30,00	480,00	
50	Syria	0,01	**410,99**	285,89	5,10	15,00		105,00		
51	Belize	0,01	**375,88**		13,00	175,88			85,00	102,00
52	Ireland	0,01	**320,14**	46,25	9,00		9,00		76,54	179,35
53	Gibraltar	0,01	**291,00**	176,00	15,00					100,00
54	Thailand	0,01	**287,10**	76,00				3,00	108,10	100,00
55	Yugoslavia	0,01	**285,07**	280,17	4,90					
56	Armenia	0,01	**270,05**	239,60	15,30	6,60		8,55		
57	Belarus	0,01	**269,06**	27,00				56,00		186,06
58	Iran	0,01	**253,00**		18,00		2,00			233,00
59	Bangladesh	0,00	**215,00**				10,00		105,00	100,00
60	Azerbaijan	0,00	**210,00**				20,00			190,00
61	Isle of Man	0,00	**200,00**							200,00
62	Anguilla	0,00	**200,00**							200,00
63	Saudi Arabia	0,00	**198,30**	198,30						
64	Norway	0,00	**193,15**	67,15	10,00	5,00	6,00	90,00		15,00
65	Cambodia	0,00	**168,30**		153,30	15,00				
66	Croatia	0,00	**146,00**	146,00						
67	Lebanon	0,00	**142,86**	134,94		7,92				
68	Iraq	0,00	**115,00**	15,00						100,00
69	Indonesia	0,00	**104,00**			20,00			84,00	

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
70	Romania	0,00	**100,00**							100,00
71	Denmark	0,00	**90,30**	90,30						
72	Spain	0,00	**89,60**	59,60		20,00	10,00			
73	Georgia	0,00	**73,05**	18,05			5,00		50,00	
74	Seychelles Islands	0,00	**70,00**				10,00	17,00		43,00
75	Argentina	0,00	**55,00**						55,00	
76	Greece	0,00	**49,00**	49,00						
77	Finland	0,00	**41,67**	20,00	8,17	7,00		6,50		
78	Moldavia	0,00	**41,50**	39,00			2,50			
79	Qatar	0,00	**40,00**					10,00	30,00	
80	Nepal	0,00	**35,00**	5,00					30,00	
81	Turks and Caicos Islands	0,00	**31,00**		3,10					27,90
82	Turkmenistan	0,00	**30,00**							30,00
83	Barbados	0,00	**30,00**	20,00	10,00					
84	Tajikistan	0,00	**30,00**	10,00	10,00	10,00				
85	Sri Lanka	0,00	**28,00**					28,00		
86	British Indian Ocean territory	0,00	**25,00**			25,00				
87	Jordan	0,00	**24,93**	21,60		3,33				
88	Liberia	0,00	**20,50**	20,50						
89	Morocco	0,00	**20,00**					20,00		
90	Honduras	0,00	**19,50**	13,50	6,00					
91	Estonia	0,00	**17,00**	17,00						
92	Serbia Montenegro	0,00	**15,00**	8,25	6,75					
93	Cameroon	0,00	**12,00**	12,00						
94	Mauritius	0,00	**12,00**			12,00				
95	Latvia	0,00	**10,00**	10,00						
96	Marshall Islands	0,00	**10,00**	10,00						
97	Myanmar	0,00	**10,00**		10,00					
98	Minor Outlying Islands	0,00	**10,00**			10,00				
99	Saint Helena	0,00	**6,00**		6,00					
100	Dominion of Melchizedek	0,00	**5,61**	5,61						
101	Nigeria	0,00	**5,00**	5,00						
102	The Philippines	0,00	**4,90**				4,90			
103	Ethiopia	0,00	**2,50**	2,50						
104	US Virgin Islands	0,00	**2,00**		2,00					
	TOTAL	**100**	**4,840,319**	**1,120,895**	**316,839**	**366,545**	**499,962**	**708,923**	**801,158**	**1,025,996**

Foreign Invested Companies by Country

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
1	China	49,52	**5303**	1534	532	827	876	859	299	376
2	Korea	18,42	**1973**	632	203	274	332	302	113	117
3	Russia	7,18	**769**	433	54	105	72	51	37	17
4	Japan	4,21	**451**	190	29	56	60	58	35	23
5	USA	2,25	**241**	98	19	28	27	44	11	14
6	Germany	1,60	**171**	102	10	18	13	13	8	7
7	UK Virgin Islands	1,41	**151**	27	9	12	26	17	23	37
8	Vietnam	1,41	**151**	25	14	34	46	21	3	8
9	China /Hong Kong/	1,20	**129**	54	9	5	10	14	10	27
10	Singapore	1,15	**123**	52	9	5	10	21	4	22
11	Great Britain	1,13	**121**	61	14	12	10	15	4	5
12	Canada	1,01	**108**	38	8	13	10	17	9	13
13	Australia	0,67	**72**	18	5	8	12	4	4	21
14	Czech Republic	0,63	**67**	40	3	7	8	4	1	4
15	Malaysia	0,56	**60**	17	8	9	3	11	5	7
16	China /Taiwan/	0,49	**52**	33	1	3	6	7	2	
17	Ukraine	0,45	**48**	21	1	12	7	3	3	1
18	France	0,45	**48**	14	2	12	4	9	3	4
19	Turkey	0,43	**46**	18	4	3	4	8	5	4
20	Kazakhstan	0,42	**45**	16	3	4	11	5	1	5
21	Pakistan	0,41	**44**	31	1	2	4	4		2
22	Italy	0,41	**44**	15	3	2	4	13	3	4
23	Netherlands	0,39	**42**	14	3	2	6	7	6	4
24	Switzerland	0,38	**41**	25	2	3	4	3	3	1
25	India	0,28	**30**	5	1	5	11	4	1	3
26	Poland	0,23	**25**	16	1	2	2	1	2	1
27	Hungary	0,21	**23**	7	1	5	3		3	4
28	New Zealand	0,21	**22**	11	1	3	2	3	1	1
29	Austria	0,17	**18**	7	1	2	2	6		
30	Bulgaria	0,17	**18**	12		2	2	1		1
31	Israel	0,14	**15**	7	1	3	2	2		
32	Belgium	0,14	**15**	7		4	2	1		1
33	DRPK	0,13	**14**	9	1	2	1			1
34	Bermuda	0,12	**13**	8		3	2			
35	Syria	0,11	**12**	10				2		
36	Antigua & Barbuda	0,10	**11**	11						

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
37	The Bahamas	0,10	**11**	8		2				1
38	Luxemburg	0,10	**11**	2		1		2	1	5
39	Uzbekistan	0,09	**10**		1			1	2	6
40	Cyprus	0,08	**9**				5	3	1	
41	Sweden	0,07	**7**	2	1		1	2		1
42	Cayman Islands	0,07	**7**	2		3		1	1	
43	Slovakia	0,07	**7**	3		2	2			
44	Spain	0,07	**7**	6		1				
45	Belarus	0,06	**6**	2				1		3
46	Kyrgyzstan	0,06	**6**	4					1	1
47	Iran	0,05	**5**		2					3
48	Norway	0,05	**5**	2	1	1	1			
49	Thailand	0,04	**4**	2					1	1
50	Gibraltar	0,04	**4**	1	2					1
51	Panama	0,04	**4**	3					1	
52	Liberia	0,04	**4**	1		3				
53	Yugoslavia	0,04	**4**	4						
54	Saudi Arabia	0,04	**4**	4						
55	Lebanon	0,04	**4**	3		1				
56	Bangladesh	0,03	**3**				1		1	1
57	Belize	0,03	**3**		2					1
58	Mauritania	0,03	**3**					3		
59	Seychelles Islands	0,03	**3**				1	2		
60	Moldavia	0,03	**3**	2			1			
61	Barbados	0,03	**3**	2	1					
62	Jordan	0,03	**3**	3						
63	Isle of Man	0,02	**2**							2
64	Anguilla	0,02	**2**							2
65	Ireland	0,02	**2**				1			1
66	Azerbaijan	0,02	**2**				1			1
67	Iraq	0,02	**2**	1						1
68	Islands of Saint Kitts & Nevis	0,02	**2**	1						1
69	Indonesia	0,02	**2**	1					1	
70	Georgia	0,02	**2**		1				1	
71	Qatar	0,02	**2**					1	1	
72	Sri Lanka	0,02	**2**					2		
73	Armenia	0,02	**2**		1			1		
74	Tajikistan	0,02	**2**	1		1				

Source: FIFTA

№	Country	%	Total	1990-2004	2005	2006	2007	2008	2009	2010
75	Estonia	0,02	**2**	1		1				
76	Ethiopia	0,02	**2**	1		1				
77	China /Macao/	0,02	**2**	2						
78	Romania	0,01	**1**							1
79	Turkmenistan	0,01	**1**							1
80	Nepal	0,01	**1**						1	
81	Argentina	0,01	**1**						1	
82	Finland	0,01	**1**					1		
83	Morocco	0,01	**1**					1		
84	The Philippines	0,01	**1**				1			
85	Marshall Islands	0,01	**1**			1				
86	Myanmar	0,01	**1**		1					
87	Turks and Caicos Islands	0,01	**1**		1					
88	Cambodia	0,01	**1**		1					
89	Denmark	0,01	**1**		1					
90	Honduras	0,01	**1**		1					
91	Mauritius	0,01	**1**		1					
92	Portugal	0,01	**1**	1						
93	Lichtenstein	0,01	**1**	1						
94	Croatia	0,01	**1**	1						
95	Greece	0,01	**1**	1						
96	Serbia Montenegro	0,01	**1**	1						
97	Cameroon	0,01	**1**	1						
98	Latvia	0,01	**1**	1						
99	Dominion of Melchizedek	0,01	**1**	1						
100	Nigeria	0,01	**1**	1						
101	British Indian Ocean territory	0,00	**0**							
102	Minor Outlying Islands	0,00	**0**							
103	Saint Helena	0,00	**0**							
104	US Virgin Islands	0,00	**0**							
	TOTAL	**100**	**10,709**	**3,691**	**971**	**1,505**	**1,609**	**1,551**	**613**	**769**

Source: FIFTA