

## **ESTABLISHING NEW TRADE AND ECONOMIC PATTERNS IN DEMOCRATIC ERA: THE IMPLICATIONS FOR MONGOLIA<sup>1</sup>**

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When Mongolia entered its democratic transition in 1990, after 70 years of isolation from the economic development of most of its Asian neighbors, Mongolian policymakers expected that their nation, after making the necessary free market reforms, would be able to benefit from successful integration into the booming regional market and the rest of the developed world. More than twenty years later, Mongolia has extensively reorganized its economy along free market lines, joined the WTO in 1997, and opened its own economy to extensive foreign direct investment (FDI). While to be sure this has resulted in very concrete and substantial gains for the nation in GDP growth and in increased prosperity for some segments of the population, it has brought even more challenges for government leaders to wrestle with, including rising income disparities and poverty in society, unemployment, growing corruption, and environmental damage.

However, what may prove to be the most significant negative result, which was clearly anticipated but not avoided, has been the growing potential danger to the nation's sovereignty and national identity by the monopolization of its economy by its Chinese southern neighbor. China's potential and historical desire to monopolize Mongolia's economy was well understood by Mongolian policymakers, and not just an exaggeration foisted upon them by the Soviets. I believe that this point of view was not seriously taken into consideration by the Western donors and multilateral organizations that were working with the Mongols to establish the mechanisms of a new free market economy, and ultimately they promoted policies and regulations which overwhelmed Mongolian concerns about the role of China and are greatly responsible for the present-day Chinese monopolization of Mongolian trade and FDI.

Let us remember that PRC China had just experienced the trauma of Tien An Men with subsequent worldwide trade sanctions, so it was not perceived as a strong economic actor in the region. The political establishment in the Mongolian People's Revolutionary Party (MPRP) in the early 1990s, as well as the democratic opposition, quickly understood that the U.S. and its western partners in the EU, Japan, and South Korea had the potential to displace the disintegrating Soviet Union as Mongolia's

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economic partners. Mongolia saw that newly independent Central Asia nations to the west were in flux and faced with many of the same problems of political instability and lack of modern infrastructure and technological base. Thus it was natural that after some internal debate the majority of Mongolian government officials, political scientists, and economists supported Mongolian integration with the successful Asian-Pacific economies of the Northeast Asia region as the best chance for the country to develop and prosper. This viewpoint also was embraced by the U.S., which felt comfortable with Japan ostensibly leading the donor assistance planning for Mongolia and assuming the role of number one provider of massive donor aid in the range of \$100 million a year.

However, in the mid-1990s the emergence of the Asian economic crisis dashed all hopes of a special economic role for Japan or South Korea. In Europe Germany was absorbed in its own reunification efforts, while the whole of Western Europe was preoccupied with European integration. However, the PRC, seeking a new way to expand its economy quickly as a way to mitigate western influence over its domestic economic and political policies which seemed to include vocal complaints and interference in China's domestic policies, designed a new economic strategy which promoted expansion of its Asian economic and political ties. Mongolia during this same uncertain period believed its political security was paramount and so it recognized it should abandon its reliance on only one nation to protect it and developed a new foreign policy concept centered around multi-pillared diversification or 'Searching for a Third Neighbor.' This concept was first proposed for Mongolia in 1990 by then U.S. Secretary of State James Baker as a way for Mongolia to balance the tendency by its neighbors, China and Russia, to establish control over Mongolia's domestic politics and economic relations.

Mongolia pragmatically outlined its main international foreign policy, including economic goals in two documents adopted by the Mongolian Parliament in 1994—the Concept of National Security and the Concept of Foreign Policy. The overall strategic concept encompassed political, military, cultural, and economic components with emphasis on balanced, but not necessarily equal relations with Mongolia's two giant neighbors and a concerted effort to develop close ties to another western-oriented large power or regional group. The concept meant strengthening trust, developing good neighborly relations and mutually beneficial cooperation, and was put into action by Mongolia concluding a treaty of friendly relations and cooperation with Russia in 1993 and with China in 1994.

As the first decade of its democracy progressed, Mongolian policymakers came to the conclusion that the only realistic choice for a "third neighbor" was the United States. As former Mongolian Minister of Foreign Affairs, L. Erdenechuluun wrote: "To many Mongolian politicians and government officials, the U.S. would appear as the savior of new Mongolia and "major pillar" of its national security." [1] This particularly was the view of the democratic coalition government that was in power from 1996 to 2000. However, American officials did not fully embrace that concept until September 11, 2001 when the issue of international terrorism caused the U.S. to completely recalculate its strategic interests in Northeast Asia and embraced the Third Neighbor role with Mongolia, at least politically.

In the second half of the 1990s U.S. investment and economic ties did measurably increase because of the activities of several large US companies invested in Mongolia's cashmere and camel wool industry and the oil sector. At this same time U.S. economic advisers were in the Mongolian Prime Minister's Office in the Government House with unparalleled access to the Mongolian policymaking apparatus. Together with young Mongolian counterparts they privatized the banking structure and revised old protectionist and anti-investment legislation primarily aimed at China from the previous MPRP-controlled period, especially pushing greater transparency in privatizing remaining Government assets, for example in mining exploratory licenses, in a more transparent way, open to all bidders

according to the mantra of establishing a "level playing field." American assistance itself was focused on technical assistance to the financial and energy sectors, completing privatization of Mongolia's state enterprises, and carrying out agriculture and trade policy modernization.

These advisers evidenced a naivete or lack of understanding about the challenge of China and not only did not predict the problems but actually put in place regulations and policies to promote Chinese penetration of Mongolia's economy. This was done because these advisers, full of enthusiasm for the concept of globalization, lacked experience in the realities of what we call mercantile imperialism, did not understand the new economic strategy of a rising PRC, and did not see Chinese economic growth as a possible national security challenge for the whole Asian region. These are the economic experts who ushered Mongolia into the WTO in 1997 and suggested the policy changes necessary for Mongolia to acquire U.S. free trade status in 1999. We should note that this was all done for good intentions in expectation that this development plan would help alleviate herder poverty by giving fair prices for animal hair products and reduce urban unemployment with the creation of textile processing factories.

In those days Mongol Amicale of New York City, a US investment that had begun in the socialist era in the cashmere and camel wool sector, was the major player. Although Mongolia's apparel and textile related exports to the U.S. did increase significantly after 1999, so that by 2002 they accounted for 45% of Mongolia's total exports, yet during that same period Mongolian wool and animal hair products actually lost 8% of the world market share as these unprocessed materials moved illegally more and more to China. Mongol Amicale for ten years complained about the problem of hair supply being bought up by the Chinese and finally, after years of conflicts with the Mongolian government over taxes and duties and less than vigorous support from the US Government, this major investor and most of the other western companies in this field, just gave up and retreated completely in favor of operations in China. This is why since 2005 the animal hair processing industry has collapsed in Mongolia and the western economists now say there is no way the Mongols can compete against cheap Chinese labor even though they are the world's second largest supplier of cashmere hair. Thus the projection of a better financial return for their product for the rural herders and a new light industry employer for unemployed city dwellers has been unrealized.

Then there is the famous case of the Houston oil company, SOCO Tamsag. In the 1990s the Mongolian Government deliberately had blocked out the Chinese and favored the Americans in a bidding process to develop an old Russian oil field. SOCO was granted a 100% investment and at the end of the decade actually was Mongolia's largest FDI investor. The Mongols did not understand or write the contract to protect themselves in this strategic sector from the company deciding for purely economic reasons to sell out to another company, which is a standard practice in the capitalist world. The SOCO oil assets were sold one night to the Chinese State Petroleum Company in 2004, with no warning to the Mongolian Government, and so the Mongolian calculated intention to trust the Americans with the exploitation of its oil resources and not let them fall into the hands of either of its neighbor was totally destroyed.

The big beneficiary of the new open market policies developed and pressed upon Mongolia in the 1990s was the PRC. China rapidly poured into the Mongolian market both to replace the hole left by the collapsed of the Soviet-dominated command economy system and to take advantage of the open economic system established by the Mongols. In 1989 trade with China had been only about 3%. Ten years later, China already was been the largest trading partner for Mongolia. Soon it would be become the largest investor, initially spurred by its investments in the textile industry. China's

economic rise in Mongolia is clearly the result of China's pursuit of diversified Asian markets close by China, Chinese willingness to conduct illegal and poorly regulated cross border trade and other anti-transparent economic practices, and more recently, China's strong need for the raw materials from wool to meat to minerals that Mongolia can offer to feed China's rapidly growing economy. In 2011 Mongolian trade with China represents over 70% of overall trade. China is by far the largest foreign investor, and with the potential in this decade to extract large amounts of minerals from Mongolian deposits and most easily sell them to China, this further monopolization of Mongolia's economy is a reality that is full of national security concerns.

In the past ten years the Mongolian Government, mainly in the hands of the MPRP now called MPP party, has been struggling to find a way to participate more fully in the globalized economy while balancing the overwhelming Chinese presence in its economy by attracting more diversified trade partners. These years can be seen as fitful attempts to develop a more protectionist mechanism for managing foreign investment in its mineral resource sector, when the expected sizable American and other western investment in mining did not proceed. There are many reasons for the lost years of argument about the contents of mining law revisions in Mongolia's legal regime, and taxation and customs disputes with the IMF. But what cannot be disputed is that in the fluid situation of the first half of the 2000s, more and more western capital of all sorts flowed out of Mongolia. For example, today U.S. investment in Mongolia has slipped from first to 6th place. The major growing western investors in 2011 are Canada and Australia, while Japan and South Korea have only managed to maintain much more modest levels. In 2004 the U.S. exported to Mongolia only \$28.1 million worth of products while importing \$239.2 million mostly textile products. By 2010 imports had fallen to a meager \$11.6 million—a level comparable to the very early 1990s. However, U.S. exports (mainly machinery, foodstuffs, and vehicles), have risen dramatically to nearly \$115 million.

Thus, the Third Neighbor concept, at least economically, has been a failure in the past decade from Mongolia's point of view. It did not prevent the economy monopoly of the Mongolian economy or result in sizable western investment. Another very serious consequence has been how Chinese economic penetration has created real domestic unrest in Mongolia as the average citizen and the government worry about what is the Chinese agenda for Mongolia. This is a real factor that Mongolian officials must monitor and should not be ignored by Mongolia's friends. There is a well documented rise in overt anti-Chinese feelings among the Mongolian population, which is concerned about being ethnically and economically colonized by their southern neighbor. It must be acknowledged that the history of Sino-Mongolian relations over the past eight centuries has been hostile and antagonistic. Now in post-socialist Mongolia the concept of the Chinese threat has intensified, and Mongols look at their southern neighbor with fear and suspicion. Mongolian politicians of all parties in the democratic period have promoted a Mongolian nationalism which at times is tinged with strong anti-Chinese views. Although in the last 20 years there have been no outstanding border disputes between the two nations and increasingly frequent high level political exchanges, the legacy of history and the increasing Chinese presence in Mongolia's economy from foodstuff supplier to mineral developer has perpetuated a widespread fear that Mongolia will become "sinified" and lose its language and identity as has happened in Inner Mongolia (South Mongolia). Today there may be 15,000 to 40,000 Chinese legal and illegal workers, and these numbers will only increase with Mongolian mineral exploitation. Perhaps what is most worrisome about the phenomenon of extreme anti-Chinese attitudes is the lack of firm public response by the Mongolian authorities. At the same time, it must be said that Mongolia has real justification to worry about what the future holds for the people and the nation, whose great riches may be the source of great danger as well as great potential wealth.

## THE WAY FORWARD

So what is the way forward for Mongolia? A decade of discussions, parliamentary debate, new laws, rescinded laws and more debate has concluded with the emergence of a new Mongolian strategy toward economic development, the China question, and strengthening of national security. This is embodied in a new National Security Concept which emerged in 2010. This is a remarkable document that came out of many months of largely private discussions among 70 or so Mongolian policymakers, researchers, and politicians. It begins by boldly stating the key fundamental that "The ideological basis of the policy ensuring national security is national patriotism." Furthermore, it proclaims that Mongolia has learned from the mistakes of the past 20 years when it warns about (VIII #2): Over estimation and blind imitation of civilizations of other nations or failure to safeguard against the negative side-effects of a market economy and modern science and technology." It lists many factors affecting national security divided into internal and external ones, over a time spectrum:

"6. Factors affecting the national security are divided into internal and external by their origins and into immediate, temporary, long-term and permanent by their duration. The vital national interests of Mongolia are interests of a permanent nature."

It pragmatically indicates that the best way to ensure and strengthen national security is to identify or eliminate threats at the beginning stages:

"7. The factors that may have a negative impact on national security are divided into objective and subjective by their character, and into real and possible by the probability of danger they might cause. The policy of ensuring and strengthening the national security aims at identifying and eliminating any threats at the "probable" stage of its occurrence, as well as at reducing or preventing objective threats by the timely elimination of subjective ones."

The National Security Concept clearly indicates what it sees as external threats to Mongolia's sovereignty in its Clause 21:

"21. External factors which may adversely affect the security of the existence of Mongolia: #6. Imposition of political, military, economic and ideological control over Mongolia; #8 Destabilization of the Mongolian economy, attempts at or organizing coup de taches or using Mongolia as a bridgehead for policies and activities directed against other States; #11. Massive inflows of migrants from a neighboring State;

Clause 22 cites internal factors which may adversely affect the national security of Mongolia, such as:

"1. Breakdown of statehood, or designs and/or attempts at turning Mongolia into a satellite State;  
2. Political, economic and military acts aimed at disrupting national unity and or/ undermining the independence of Mongolia;

The 2010 revised Concept has an expanded section dealing with Economic Security (#32. "Economic security means building an economic structure which has the potential for effective economic reproduction through the use of internal resources, for meeting the basic needs of the people and strengthening the country's independence, and in cases of need to sustain the country for a definite period of time.") and new sections outlining Scientific and Technological Security as well as Security of Mongolian culture and Way of Life. Reflecting the perilous times Mongolia faces, it states that: "Economic security represents the cornerstone of the independence and sovereignty of Mongolia."

The external factors which are listed as adversely affecting the country's economic security include (#33)

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1. Restricting or impeding the development of foreign trade and economic cooperation;
2. Turning into a raw materials appendage to other countries;
3. Plummeting of prices of the country's export items of strategic importance and/or loss of markets for them;
4. Direct dependence on any one country in economic branches of strategic importance.

The list above does not mention China but it clearly refers to the present situation.

There is also a warning about internal factors which could adversely affect economic security and again there is a reflection of the present Sino-Mongolian situation. For example, "8. Sharp increase in the number of foreigners and stateless persons resident in Mongolia, and mass emigration of nationally trained personnel and skilled workers;"

The National Security concept then expansively redefines strategic importance of economic activities to include (#35) food and agriculture, mining, light industry, chemical industry and infrastructure of energy, fuel, telecommunications and information, and roads and transport. It (#7) specifically states that:

"7. when developing trade and economic relations with various countries, safeguard against situations where the country's economy, especially its branches of strategic importance, may become the object of dominance by one country, or a group countries or where the country may turn into a raw materials appendage. Impart an interest in the developed countries to freely maintain and expand relations with this country;

10. keep the amount of strategically important raw materials and equipment to be imported, as well as the number of experts and workers to be received from any one country at the level not capable of affecting national security;

It should be emphasized that this new Mongolian approach to economic security includes the recognition that China rightly should be a major economic partner of Mongolia (In Foreign Security Concept: "Accord top priority to the question of relations with the two neighboring countries and adhere to the principle of a balanced relationship with them. Maintaining a balanced relationship does not mean keeping equidistance between them or taking identical positions on all issues but this policy does mean strengthening trust and developing all-round good neighborly, relations and mutually beneficial cooperation with both of them... A policy of non-involvement and neutrality shall be pursued in relation to the disputes between the two neighbors unless the disputes affect the vital national interests of Mongolia." From the 2010 Foreign Policy Concept: "The foreign policy priority of Mongolia is to develop long-term, stable and good neighborly relations with its two neighbors, Russian Federation and the People's Republic of China. The policy core is not to adopt the line of either of these two countries but maintain a balanced relationship with both of them. The Russian Federation and People's Republic of China are our main trade partners as well as major investors.")

While Mongolia is not by any means abandoning its "third neighbor" policy (see in the foreign Policy Concept: "Within the framework of the multi-pillar foreign policy, Mongolia seeks to promote its relations with the industrially advanced nations of the west and east, including the United States, Japan, and Germany. At the same time it advocates a cooperative relationship with other countries of Asia and Europe, such as India and South Korea. The political, financial and moral support of these countries has played a paramount role in consolidating the new political, economic and social developmental strategies to speed up the transition into the market economy."), yet at the same time, this new security concept reflects Mongolia looking more towards an economically powerful Russia

in Eurasia which is interested both in some of Mongolia's mineral resources and in curbing Chinese economic and political penetration—seemingly a return to again using Mongolia as a buffer to protect, if possible, the Russian Far East. Russia is very interested in Mongolian uranium and has indicated a willingness to take over the exploitation of all of its uranium deposits. If this were to happen, even in a reduced way, these minerals definitely would not end up in Chinese hands. For Mongols, the return of an activist Russia to being a major player in their economy and politics is not unwelcome. We must remember that Mongolia holds true warm feelings and gratitude for Russia's part in protecting Mongolian independence during the treacherous times of the 20th century and from an aggressive, at times unstable, China. While certainly Mongolia does not want to lose its vigorous democracy and free market and return to its Cold War era satellite status, its policymakers increasingly are thinking that inviting much more sizable Russian FDI and even military assistance are not bad ideas at all since Western nations have so far proven slow to act and disappointing.

### CONCLUSION

Mongolia is faced with the following realities as it plans its future economic and strategic security. According to the International Energy Agency, energy demand from China is calculated to grow by over 2% annually between 2009 and 2035, despite Chinese efforts to curb their fossil fuel use. They predict that China will make up over 80% of the demand growth in coal demand between 2008 and 2035. Chinese oil imports will grow from 4.3 million barrels a day in 2009 to 12.8 million barrels a day in 2035 and China will need to increase its oil imports from 53% of domestic demand to 84% by 2035.[2] The pressure and enticements from China will only increase for Mongolia, and must be better managed. The recent rise of what is called Resource Nationalism has led to questions about the rise of new economic and military powers such as China in the Asia-Pacific. This is why the US and developed nations are concerned about how the domestic interests of China are intertwined with the question of whether or not China will play by the established market rules governing trade and investment.

There may be a real opportunity for Mongolia to benefit from such concerns as it seeks greater diversification of foreign trade and investment partners. The new best opportunity may be in rare earth minerals or elements, which are a group of 17 elements called the lanthanides and others with similar properties. These are often called the materials of the future because of their widespread application in the hi-tech and defense industries. The US used to be the dominant supplier but in 1988 China surpassed the US to become the top producer in the world, and today it continues to be the largest producer, consumer, and exporter. Rare extraction processes can cause environmental problems, which is a major reason the US closed its operations. However, politics has suddenly changed the dynamics of this industry. When in 2010 China cut its supplies of rare earths to Japan because of a military dispute at sea and then cut its total exports by more than 11%, Western nations began to see danger to their economies and national security. The unexploited rare earth element reserves in independent Mongolia thus are a potential key source for advanced nations and it is the perfect time for the Mongolian government to concentrate on developing an environmentally clean extraction industry which will involve more diversified FDI. Thus the future push to invest in and trade with Mongolia for Japan, Korea, the US, and European consumers may prove to be more for these very unique but crucial rare earth elements, rather than just as western middlemen companies sending huge coal, copper, and oil extractions to the Chinese market.

In addition, the United States and other nations should help Mongolia in promoting a set of standards for Mongolia to capture the benefits involved in extracting natural resource while reducing the negative outcomes, often called “Dutch disease.” One mechanism is the Extractive Industries Transparency Initiative that began in 2002 with the goal of increasing transparency in the collection of revenues from the resources industry. Another suggestion is for Mongolia to recognize that in the Asia-Pacific region US naval strategy to keep the sea lanes open can play a restraining role directed towards China. This is why landlocked Mongolia needs to enhance its understanding of the dynamics of the U.S. Pacific Command and Chinese Navy relationship. When other nations that supply mineral resources become involved in great power games, it not only effects the prices of minerals on the world market, but also pushes China to seek mineral sources closer to home. So the higher prices which will aid Mongolian economic development may actually be the seeds of new drives by the Chinese to penetrate Mongolia’s economy. These are the kinds of sophisticated globalized challenges that Mongolia needs to research and include in its calculations to maintain its sovereignty and independence in the 21<sup>st</sup> century.

[1] Mongolia’s strategic options,” in *Northeast Asia towards 2000: Interdependence and Conflict?*, K. Lho and K. Moller, ed. (Baden-Baden, Germany: 1999), 95.

[2] International Energy Agency, *World energy outlook* (Paris: IEA, 2010), 98-99.