

CURRENT SITUATION AND FUTURE TRENDS OF REPUBLIC OF KOREA'S INVESTMENT IN MONGOLIA

D. Tungalag*

This article comprises of the following 5 parts:

- Current Foreign Investment Situation in Mongolia
- Current Situation and Perspectives of ROK's Investment in Mongolia
- Legal environment for Foreign Investment in Mongolia
- Investment Opportunities In Mongolia
- Conclusion

1. Current Foreign Investment Situation in Mongolia

As of today, since 1990, in Mongolia, there are over 2400 joint ventures and wholly owned foreign invested companies from over 70 countries around the world with the total direct investment of about \$660 million. Among them, 70% are joint ventures and 30% are wholly owned foreign invested companies.

As for sector breakdown of foreign direct investment, mining sector accounts for 26%, light industry (almost textile and garment production) 12%, processing of animal origin materials 7%, construction 7%, trade and catering 5%, banking and finance 4%, and other sectors account for 39% (including 2% tourism).

Though, by the number of registered companies the public catering and trade sector (1489) is leading. After this sector construction, production of construction materials (270), mining (202), food (159) and light industry (146), processing animal origin raw materials (142) sectors are following.

** Prof., Ph.D, Chair of Academic and Curriculum Affairs of the School of Foreign Service, National University of Mongolia*

So far, foreign invested companies have created more than 67000 new jobs for domestic workforce and 2500 foreigners are working in companies' management and highly specialized operational fields.

I would like to point out that several multinational corporations such as Caterpillar, BHP, Samsung, Sumitomo, Coca-Cola, Itochu, Hyundai, Procter & Gamble, Ford and Mercedes Benz are already active in Mongolia, and are contributing to economic growth.

As of the end of 2002, there are 387 companies newly registered with the total investment of \$172.0 million. Compared to the previous year both two indicators increased by 9.6% and 37.7% respectively. Compared to 2001 where FDI per company was \$355.000, in 2002 it rose to \$446.000. This shows that the FDI environment development efforts have been improved and as a result more investors are becoming interested to invest in Mongolia and investment is becoming more solid.

Over the past years most of the registered foreign invested companies have been from China, Republic of Korea, Russia and Japan. These countries are in leading positions by both amount of investment and number of companies.

In 2002, 76.6% of the total FDI is registered in the capital Ulaanbaatar, compared to the 92% in 2001, showing that foreign investment is moving from the capital to the countryside.

The following conclusions can be drawn on current status of foreign investment:

- Foreign investment was channeled mainly into mining, textile and agro-processing industry base on raw materials of animal origin. The rise in these sectors indicates that investment will still be popular in the named sectors in the future.
- Liberalization of infrastructure, privatization of large enterprises and other programs and projects implemented by the Government lead to the trend of increased foreign investment in energy, road construction, banking and finance, and tourism sectors. Investment in mining has also a tendency for radical growth.
- In the government policy on the regional development investment is aimed more to the countryside. It can be said that FDI's role is increasing in the countryside development.
- The number of countries where investors are from is expected to rise in the future.

- The FDI of Mongolia has been rising constantly in the past years, and in order to maintain this trend in the future it is more important to intensify the promotion of country abroad as a place for foreign investment.

2. Current situation and perspectives of ROK's Investment in Mongolia

Bilateral agreement on mutual protection and encouragement of investment has been concluded between Government of Mongolia and ROK in Seoul in 1991.

ROK takes 2nd position among the foreign investors after China with its share 15.7% by number of existing companies and 10.9% by investment volume.

ROK's investors engaged in Mongolian market are increasing their investment in manufacturing and service sectors in particular communication, light industry, transport, geology, mining, trade, catering. The share of these sectors composes now about 60 percent in total number of ROK's investors.

As for sector breakdown of ROK's direct investment for mining sector accounts 18.0%, trade and catering 12.2%, light industry (almost textile and garment production) 9.4%, transport 7.8%, communication 7.4%, construction and production of construction materials 5.4%.

As of today, since 1994, in Mongolia, there are 378 joint ventures and wholly owned ROK's invested companies with the total direct investment of \$71.5 million have been registered.

As for the mining sector, 9 wholly owned ROK's invested companies or joint ventures with the direct investment of \$12.9 million have been registered, which is about 20 percent (1/5) of all ROK's investment in Mongolia. For instance, JHM company with the direct investment of \$4.1 million, Tas Filco development company with the direct investment of \$2.9 million and etc.

In trade and catering, 99 wholly owned ROK's invested companies or joint ventures with the direct investment of \$8.7 million have been registered. For instance, Retona Ink Mongolia company with the direct investment of \$6.7 million, Sky Trading company with the direct investment of \$3.6 million, Rainbow club company with the direct investment of \$2.0 million, Seoul group company with the direct investment of \$1.1 million, etc. It is the first large sector by number of registered companies and second large by FDI. This sector is less investment-required sector among the other prioritized sectors, eventually more entities are involved in there.

There are 25 wholly owned ROK's invested companies or joint ventures with the direct investment of \$6.7 million have been registered in light industry (almost textile and garment production). For instance, Cosmotamkhi company, Mongolsamik company and etc.

For the transport sector, there are 28 wholly owned ROK's invested companies or joint ventures with the direct investment of \$5.6 million have been registered. For instance, City taxi company with the direct investment of \$2.0 million.

In communication sector, 7 wholly owned ROK's invested companies or joint ventures with the direct investment of \$5.3 million have been registered. These are Skytel company with the direct investment of \$3.0 million, Moncom company with the direct investment of \$2.1 million and etc. This sector is attracting more investment in recent years.

As for the construction, production of construction materials sector, nearly 20 wholly owned ROK's invested companies or joint ventures with the direct investment of \$3.9 million have been registered. For example, MKI company with the direct investment of \$1.7 million. ROK's investors are involving more towards production of modern designed building materials and building construction.

3. Legal environment for Foreign Investment in Mongolia

Foreign investors nowadays target their vision not only towards places with potential opportunities to reap benefits and profits, but also places with a secure and safe environment for investment.

Since the start of political and economic reform process in 1990 Mongolia has proclaimed an "open door" policy towards the outside world and since then has been implementing continuously policies to promote Foreign Direct Investment /FDI/. The Government of Mongolia passed Law on Foreign Investment in 1991 and subsequently revised the Law in 1993, 1998 and in 2002. The changes have been made with the purpose to create a more favorable investment climate and to improve the legal conditions for potential long-term investors. These are:

- Maintaining the current incentives granted to foreign investors such as exemptions on customs duty, income tax and Value Added Tax /VAT/;
- Expanding the types of investment, additional paragraphs on the registration of the "Investment agreement", "Foreign company branch" are now included in the law as well;
- New forms of investments such as "financial leasing" and "franchising" are reflected in the law.

- It's been reflected that the Government of Mongolia shall conclude so called "Stability agreement" with the foreign investors who invested over \$2 million in order to maintain stable taxation environment during certain period of doing business in Mongolia.

The Constitution of Mongolia protects FDI and the Foreign Investment Law complemented by relevant legislation and regulations, as well as international treaties and agreements to which Mongolia is bound.

Mongolia signed the "Agreement on Avoidance of Double Taxation" with 28 countries and the "Agreement on Mutual Protection and Encouragement of Investment" with 34 countries. Mongolia acceded to the "Washington Convention on Investment Dispute Settlement of 1965" in 1996, joined World Trade Organization in 1997, and joined the "Seoul Convention on Investment Insurance of 1985" in 1999.

I would also like to mention here that Mongolia is a full member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group and investors will thus be eligible for risk insurance through MIGA.

The Government has been providing tax holidays and incentives to foreign investors. These are:

- Full income tax exemption for 10 years and subsequent 5 years of partial exemption (50 percent) for foreign investors engaged in the construction or operation of thermal power plants, power transmission and heating distribution lines and systems, as well as railways, roads, air transportation, telecommunication and civil engineering facilities.
- Full income tax exemption for 5 years and subsequent 5 years of partial exemption (50 percent) for foreign investors engaged in mining, oil, metallurgy, petrochemicals, automotive and electronics industries, excluding precious metals processing.
- Full income tax exemption for 3 years and subsequent 3 years of partial exemption (50 percent) for foreign economic entities or entities with foreign participation, which export 50 percent of the output to outside markets.
- Tax incentives can be offered to foreign investors operating in other fields. Such incentives are subject to submission by the Government to the Parliament for a final ratification on case-by-case basis.

- On 27 June 2001, the Government in its Resolution No.140 has approved a list of sectors. In accordance with the list, the technological equipment and machinery brought into Mongolia by foreign investors as a part of share capital of foreign-invested companies are granted customs duty and VAT exemptions. These companies have to be engaged in cultivation of grain and plants for livestock feed, coal mining, oil and gas processing, mining of uranium, iron ore and other minerals, manufacturing of food, textiles, fur, leather and wooden products, manufacturing of chemicals, processing of secondary raw materials and to some extent in infrastructure.
- Recent changes in the VAT law canceling the 10% gold export tax created lots of confidence in gold mining companies about investing in this sector.

The existing Foreign Investment Law guarantees some rights and privileges for foreign investors such as that it is prohibited to nationalize and illegally confiscate assets and capital of foreign investors; and foreign investors receive treatment equal to that enjoyed by domestic investors as regards rights to own, utilize and exploit assets and capital:

- To own, utilize and dispose of investment assets and to repatriate capital invested in Mongolia;
- To manage and to participate in management of economic entities with foreign investment participation;
- To assign and transfer their rights and duties to other legal bodies.
- To transfer the following revenue, income and profits out of Mongolia:
 - i. dividends and income associated with shareholders' contribution
 - ii. income associated with disposal of assets, bond sales and transfer of ownership rights and liquidation of assets.
- Foreign investors are permitted to lease land for up to 60 years and such a lease can be extended for another 40 years.
- Foreign investors have a right conclude a Stability agreement with the Government of Mongolia.
- Foreign investors have a right to implement an investment project without registering a business entity in Mongolia. Foreign investors have a right to implement an investment project under the existing company name by registering company branch offices etc.

4. Investment Opportunities in Mongolia

The Foreign Investment Law of Mongolia imposes high potential for foreign investment in all sectors of economy except production of narcotics, guns and explosives, pornography and running a casino.

The Government of Mongolia considers mining, agriculture, tourism, and infrastructure sectors as the priority sectors for attracting foreign investment into the country.

Mongolia has significant mineral resources such as gold, copper, uranium, coal, molybdenum, phosphor, oil, etc. As well, it has 1.3 million hectares of arable land, where pure natural products of high demand of the world market can be produced. As of the end of 2001, the total number of livestock in Mongolia has become 26.1 million. These livestock provide annually 2.7 thousand tones of high quality cashmere, 15.8 thousand tones of wool, 4.0 million pieces of hides and skins and 252.7 thousand tones of meat.

Mongolian sheep wool is particularly suitable for the manufacture of rugs, carpets and blankets. Mongolia is the world's second-largest producer of cashmere, with a world market share of 30 percent. Regarding livestock outputs only cashmere and cashmere products can now compete at the international market. Thus there is a need for foreign investment for improvement of processing of other products like tannery and carpet making.

With its untamed nature and well preserved nomadic culture, Mongolia is an exotic tourism destination. The year of 2003 has been announced as "VISIT MONGOLIA" year and number of activities are set to increase the foreign tourist arrivals in Mongolia.

The Government appreciates the wide possibilities of social and economic development created due to the achievements in information and communication technologies /ICT/. Mongolian consumers have been enjoying benefits of a rapid development of information and communication technologies, and the per capita ratio of computers and mobile phones is relatively high.

We think the reforms in the education sector in line with ICT development will build a potential for production of software competitive on the world market. Also achievements of information technology can be used for the purpose of better diagnosis and other medical treatment methods in the field of public health protection.

Mongolia offers the following competitive advantages and favorable environment for foreign investors:

- Stable political environment and open economy;
- Strategic and easy access to the giant markets of Russia and China;
- Extensive natural resources;
- Favorable legal environment;
- Relatively young, educated population;
- Vast territory, clean and undisturbed nature.

Despite the positive policies of the Government towards FDI, some difficulties and challenges remain. At present, there is a certain degree of inefficiency caused by the transformation from a bureaucratic command economic system to a system based on market economy and the rule of law. Old habits of unnecessary control and licensing still exist and can sometimes create difficulties for investors.

The Mongolian Government is fully committed to eliminating these problems as quickly as possible to create better climate for investment. In the new Special Licensing Law in 2001 the government of Mongolia has significantly reduced from 600 to 87 licenses and permissions that needed to be obtained for business activities. Although the number may still seem very high, the remaining licensing have to do with security, environmental and safety issues.

5. Conclusion

As for the researcher, I would like to draw following conclusions on current status of ROK's investment:

- Its appreciable that ROK's investment is placed in top positions by number of the companies engaged. Nevertheless, the volume invested can not be considered as significant as to impact on export activities and Mongolian economic structure as well.
- Likely Government of Mongolia's initiatives to identify properly risk taking for investors areas and subsequently conclusion of bilateral inter government agreements to develop a cooperation is needed to be intensified.
- Possibly, entering many ROK's companies particularlry in small and medium sector may have purpose of testing the Mongolian market with further deepening its investment in more beneficial areas.

- Potentials are seen as pointed out by Prime Minister of ROK Li Khan Dong during his official visit paid in 2001, first, contribution of ROK's investors being made so far is not at their potential level with the given favorable condition set up by Government of Mongolia. It eventually must increase. Secondly, he noted that advantages such as rich natural resource endowment of Mongolia and high technological development of ROK are potential area of further cooperation.
- Research studies and project implementation on investment issues is another potential area of cooperation development.