Assessing Mongolia’s Mining Investment Environment

National University of Mongolia  Bolor Naranhuu*

Introduction

Mongolia, a resource-based developing economy, is making challenging steps toward becoming a mining hotspot in the region. From the early 2000 it has attracted a noticeable share of the world mineral exploration investments thanks to its liberal minerals law, and favorable world commodity market conditions. As a result, Mongolia’s mining sector has steadily grown by 8-12 percent annually over the last few years, and the sector plays an increasingly important role in the economy. The mining industry’s contribution to country’s total GDP tripled from less than 10 percent to 31 percent between 2002 and 2007, while the share in the total export revenues increased by 20 percentage points, exceeding 80 percent for the same time period.

According to the reports of Metals Economics Group, in years 2004 and 2006 the exploration expenditures in Mongolia accounted for 4% of the global exploration expenditures, making Mongolia one of the world’s top ten destinations for the mineral exploration. Exploration expenditures, especially by foreign capital rose dramatically during the last 6 years. It more than doubled between 2005 and 2006, reaching over 200 billion togrog (180 million US dollars).

However, due to the significant changes in the minerals sector legislations made in 2006, more specifically, the first-ever introduction of concepts of “deposits of strategic importance” and state equity participation in “the strategic deposits” in the newly adopted Minerals Law and an introduction of huge confiscatory taxes (called “Windfall profits tax”) on gold and copper concentrate, investments in the mining sector showed a massive slowdown in 2007. Unprecedented increases in commodity prices lasted until recently awakened nationalistic sentiment of the knowledge- and information-lacking public, and political gaming with resource nationalism. Consequently, policy makers started discussing to change again the Minerals Law, which surely contributed significantly to the increased uncertainty among the mineral investors and to the drop in the exploration expenditure to its 2005 level.

Mongolia’s mining and minerals sector still faces great challenges not only on improving its unstable and unsound mineral legislation, but also on enhancing

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*Associate professor of School of Economic Studies, National University of Mongolia
the quality of other factors such as mineral taxation, governance quality and effectiveness, infrastructure and skills development, which all determine mining investment environment.

Assessing mining investment environment has been considered one of the vital tasks for mineral policy makers to improve the investment climate as well as for potential investors to decide where to invest. The first ever assessment of the mining investment environment was conducted in 2008 among the mining and mining-related business operators and investors in Mongolia.

Methodology

There are various studies on determining the criteria to evaluate mineral sector investment climate. Based on the investors’ criteria, which are used to decide where to invest, developed by Otto (2007), Fraser Institute (2008), and The Behre Dolbear Group (2008), we developed a set of criteria (15 criteria indicators) and carried out an assessment of the Mongolian mining sector investment environment.

In October 2009, we conducted the second annual survey for assessing the investment climate of the Mongolian mining and minerals sector by using the developed criteria. A survey questionnaire was developed and designed to get assessment of the mining investment climate from the mining and mining-related business investors in Mongolia. The following 15 criteria were used to assess the mining investment environment in Mongolia:

1. overall macroeconomic environment
2. political environment
3. stability and soundness of mineral legislation
4. mineral tax competitiveness
5. labor skills development
6. infrastructure development: Road
7. infrastructure development: Electricity
8. infrastructure development: Communication
9. quality of geological database
10. governance quality and effectiveness
11. government intervention in the economy
12. rule of law
13. environmental regulations
14. security
15. local community resistance.

Each of the above 15 criteria was assessed, and a composite index for the mining investment climate (MIC) for Mongolia has been estimated.

In total, 88 companies and organizations operating directly and indirectly in the mining sector participated in the survey for this year, out of which 55% runs exploration and/or mining business (core business), 34% are companies that provide various services to the core businesses, the rest of them represented governmental and non-governmental organizations and academia. The sample size increased by more than 70 percent in 2009 from 2008 (only 52 companies and organizations were covered in the assessment survey in 2008).

The results

The MIC composite index, for which the maximum score is supposed to be 1.0, for Mongolian mining and minerals sector is estimated to be 0.41, which is bit higher than the last year’s index (0.35). Looking at the ranking of 15 sub-indices that construct the composite index, government interference in the economy, labor/skills and infrastructure development (except communication), rule of law have been considered foremost important areas where huge improvements are needed. The estimated scores for those indicators are the lowest, ranging from 0.27 to 0.33. Constraints of local community and soundness and stability of the mineral legislation were another challenge for improving the mineral sector investment environment.

As can be seen from the MIC Indices (see Table 1
in the Appendix), it increased by 0.06 points (17.1%) between 2008 and 2009. More than three quarters of this increase were generated by growths in scores for only four indicators, namely, (1) soundness and stability of mineral legislation, (2) governance quality and effectiveness, (3) rule of law, and (4) overall political environment. Comparing with 2008, the mineral laws and regulations were relatively stable, and even they improved to some extent. For example, the Mongolian Parliament made a resolution on repealing the law (2) on windfall profits tax starting from January 2011. As a result, relatively less number of investors complained about the stability and soundness of the Mongolian mineral legislation this year than in last year.

Although there have not been a significant measurable improvement in the governance quality and effectiveness in Mongolia, the estimated score for this indicator showed an impressive increase, rising from 0.219 to 0.422. In 2008, almost 90 percent of the survey respondents answered that the poor institutions and ineffective governance slightly or significantly discouraged the private investments into the Mongolian mining sector, while, in 2009, two thirds of them gave the same answer. Moreover, last year only 6 percent of the survey participants replied that the current governance quality encouraged the investments in the sector, whereas the same share increased to almost 25 percent this year, which partly contributed to higher score for the investment criteria-indicator.

According to the perception of the survey participant-mining investors, the rule of law (enforcing, administering the laws and regulations) in Mongolia improved. The fact that the estimated score for the rule of law increased from 0.195 to 0.311 is partly explained by a significant decline (from 48% in 2008 to 26% in 2009) in the share of the survey respondents who answered that the rule of law seriously discouraged the investments into the mining sector. Moreover, the share of the mining investors, who supported the fact that the rule of law encouraged the mining investments in Mongolia, increased from 8% in 2008 to 16% in 2009, which contributed to the increase in the estimated score for the rule of law in Mongolia.

The estimated score for the political environment in Mongolia showed another impressive growth (from 0.335 in 2008 to 0.517 in 2009) since the share of the survey respondents who voted that the political environment got worsened declined from 40% in 2008 to 22% in 2009. On the other hand, the fact that the share of the mining investors who answered that the political environment improved between the two years increased from 6% to 25% also contributed to the estimated score to go up.

Besides the above mentioned indicators (investment criteria) that generated the majority of the growth in the mining investment climate index, the estimated scores for “labor skills development”, “government intervention in the economy”, “overall economic environment”, “communication development”, and “local community relationship” increased by 23-36 percent. However, the estimated scores for some indicators showed no change and even some declines in the two years. For example, as can be seen from the scores, the mining investors still concerned with the infrastructure, especially the road development and availability of electricity supply in Mongolia. Therefore, the corresponding scores were still low as were in 2008. There have been noticeable declines in the estimated scores for the indicators “quality and availability of geological database” and “environmental regulations” due to the fact that more mining investors (survey participants) thought that the current status of the quality and availability of the geo-database in Mongolia were not able to support and encourage investments in the mining sector.

**Conclusion**

Mongolia has become one of the global mining hotspots in terms of its acquired share in the global mining investments. As a result, the mining industry
has been playing an increasingly important role in the economy. However, there are a lot of rooms for improvement in the mining investment environment in order to sustain the private investments into the industry. One of the contributions to this challenge would definitely be an evaluation of the Mongolian mining investment climate with the private investors in the mining sector.

The first effort to assess Mongolia’s mining investment environment was made in 2008 through an assessment survey conducted among the mining business investors operating in Mongolia, and produced an index called “Mining Investment Climate (MIC) Index”. This year we did the same assessment study covered more investors. The study resulted in slightly higher MIC Index than in previous year, implying that the Mongolian mining investment environment is, at least, not getting worse. The composite index shows that even if there have been some improvements in the certain indicators (investment criteria), some indicators still need to be stressed from the policy makers point of view. More specifically, the vital criteria for making mining investment decision such as infrastructure and labor skills developments, government interference in the economy, and rule of law, have been considered as first priority targets for greater improvements. It does not necessarily mean that the rest of the criteria have been assessed as acceptable. In fact, only two or three indicators get half or more than half of the maximum score, namely, communication development, overall political environment, and overall tax level. Finally, we can conclude that Mongolia’s mineral sector investment climate is getting better than in the previous years, but there are still many rooms for improvement.

Notes

1) The law, which was enacted in 2006, was one of the serious obstacles that deteriorated the mining investment environment.

References

### Appendix.

**Table 1. Mongolia: Mining Investment Climate (MIC) Index**

<table>
<thead>
<tr>
<th>2009 Ranking</th>
<th>2008 Ranking</th>
<th>Sub-indices</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>Infrastructure development: Communication</td>
<td>0.571</td>
<td>0.706</td>
</tr>
<tr>
<td>2</td>
<td>6</td>
<td>Political environment</td>
<td>0.335</td>
<td>0.517</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Overall tax level</td>
<td>0.513</td>
<td>0.496</td>
</tr>
<tr>
<td>4</td>
<td>10</td>
<td>Overall economic environment</td>
<td>0.360</td>
<td>0.472</td>
</tr>
<tr>
<td>5</td>
<td>1</td>
<td>Quality and availability of geological database</td>
<td>0.559</td>
<td>0.467</td>
</tr>
<tr>
<td>6</td>
<td>5</td>
<td>Security</td>
<td>0.462</td>
<td>0.439</td>
</tr>
<tr>
<td>7</td>
<td>11</td>
<td>Governance quality and effectiveness</td>
<td>0.219</td>
<td>0.422</td>
</tr>
<tr>
<td>8</td>
<td>3</td>
<td>Environmental regulations</td>
<td>0.549</td>
<td>0.408</td>
</tr>
<tr>
<td>9</td>
<td>15</td>
<td>Soundness and stability of mineral legislation</td>
<td>0.191</td>
<td>0.388</td>
</tr>
<tr>
<td>10</td>
<td>9</td>
<td>Local community</td>
<td>0.277</td>
<td>0.340</td>
</tr>
<tr>
<td>11</td>
<td>7</td>
<td>Infrastructure development: Electricity</td>
<td>0.321</td>
<td>0.332</td>
</tr>
<tr>
<td>12</td>
<td>14</td>
<td>Enforcing, administering the regulations</td>
<td>0.195</td>
<td>0.311</td>
</tr>
<tr>
<td>13</td>
<td>8</td>
<td>Infrastructure development: Road</td>
<td>0.281</td>
<td>0.290</td>
</tr>
<tr>
<td>14</td>
<td>12</td>
<td>Skills / Labor availability</td>
<td>0.204</td>
<td>0.278</td>
</tr>
<tr>
<td>15</td>
<td>13</td>
<td>Government intervention in the economy</td>
<td>0.204</td>
<td>0.268</td>
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</tbody>
</table>

**MIC Composite Index**

<table>
<thead>
<tr>
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<tbody>
<tr>
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<td>0.349</td>
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