Research Paper

Mongolia in Regional Economic Integration: Challenges and Opportunities

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Table of Contents

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1. Introduction

Once a communist country preaching Marxist-Leninist ideologies, Mongolia certainly has achieved socioeconomic development following its double transition to multiparty democracy and market-based economy in 1991. As a satellite state of the Soviet Union, Mongolia experienced sharp economic contraction after the Union's collapse like many other then-communist states. Despite its difficulties, between the year 1990 and 2016, Mongolia's gross domestic product (GDP) reached US$11.1 billion from US$2.6 billion, GDP per capita to US$3,694 from US$1,172, and life expectancy increased to 69.3 years in 2016 from 60.3 years in 1990[1]. Endowed with vast mineral resources, Mongolia is home to one of the largest copper and gold as well as coking coal deposits in the world. Explorations of only fractions of such resources resulted as 17.3 percent annual GDP growth in 2011, highest in the world.

But such achievements are one side of the story. Following the collapse of the Soviet Union, Mongolia's trade and economic dependency shifted from Russia to China, between its only two neighbors. Having become a country that's heavily dependent on its mineral exports to China, Mongolia is now extremely susceptible to external shocks such as commodity price and Chinese economic wellbeing. Additionally, being sandwiched between two of the least democratic countries in the world also highlights the importance of having robust political and economic ties with countries beyond China and Russia.

Diversifying its external relationships has always been a priority for Mongolia since the early 1990s. Despite its effort and acknowledgment, Mongolia still remains relatively isolated from the international community to this day. Although a member of the World Trade Organization (WTO), Mongolia is yet to take part in regional free trade blocs and initiatives and was the last country in the WTO to conclude a bilateral Free Trade Agreement (FTA). Such isolation can be partly attributable to Mongolia's geographical location as a landlocked country. Compared to countries that have direct access to sea port, landlocked countries face additional difficulties such as higher transportation cost, burdensome customs procedures, and lack of adequate infrastructure connectivity that's vital in integrating into regional production networks, which essentially lead to higher economic development.

[1] https://data.worldbank.org/

The fact that Mongolia is a former communist country that's also landlocked between two of the largest countries in the world pose to be a challenging situation. Interestingly, and maybe not so coincidentally, many of the former communist countries are also landlocked. Basing on such common past and geographical characteristics, this paper will examine Mongolia's current degree of economic integration with the rest of the region in comparison with select post-communist landlocked countries located in Central Asia and Eastern Europe, as well as one existing communist country. Has Mongolia economically well integrated with the rest of the region in comparison with other post-communist countries? If yes, what are the factors that enabled more integration? If not, what are the key bottlenecks that are preventing Mongolia to further integrate? Answering these questions, it will then explore various trade arrangement options that could further integrate Mongolia with the rest of the world. The hypothesis goes as, when compared to other post-communist landlocked countries, Mongolia's lack of institutional integration played a large role in its current state of low degree of regional economic integration.

Here, the institutional integration is defined as "the policy decisions taken by two or more governments of countries belonging to the same geographic area in order to promote economic cooperation in terms of deepening and/or widening the spheres of coordination under the terms of an agreed pact (Mongelli, et al., 2005)."

2. Mongolia country context

Mongolia as a planned economy and years as Soviet Union's satellite state. Economic structure during that time.

Mongolia, formerly the "People's Republic of Mongolia" was the first country to become a Soviet satellite in 1921 (Radchenko, 2015). During the 1930s, there were very few major economic projects in Mongolia, such as establishing wool-washing factory in the northwest of the country, a narrow-gauge railway line between the capital Ulaanbaatar and nearby Nalaikh coal mine, and complex of factories in Ulaanbaatar that processed agricultural produce and made building materials[2]. Mongolia started attending the Council for Mutual Economic Assistance (CMEA or Comecon) meetings from 1958 and subsequently joined the organization in 1962[3]. The Soviet Union and Mongolia agreed to build a copper-mining and ore-concentrating joint venture in 1973, which became operational in 1978. Erdenet, now Mongolia's third largest city, was formed surrounding the site. This laid the foundation for Mongolia to pursue prosperity utilizing its large

[2] https://www.britannica.com/place/Mongolia/Independence-and-revolution

[3] https://www.britannica.com/place/Mongolia/Independence-and-revolution

mineral deposits[4]. By the end of 1980s, 95% of Mongolia's trade was with the Soviet Union and the remaining with its CMEA allies (Ginsburg, 1995).

Despite pursuing Soviet inspired *glasnost* (openness) and *perestroika* (restructuring) economic reform policies, the economy stagnated from mid-1980s. Coupled with increasing public dissatisfaction with the communist regime, pro-democratic movements gained popularity from late 1980s. Such movements and the collapse of the Soviet Union led to Mongolia's double transition into multiparty democracy and market economy from 1990.

Table 1. Mongolia economic indicators (1965-1990)

	A. Shares of Gross Domestic Product (from current price data)						B. Growth Rates (% per annum) (from constant price data)				
	1965	1973	1980	1988	1989	1990	1965-73	1973-80	1980-90	1989	1990
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	-	-	5.6	4.2	(0.3)
Net Indirect Taxes	-	-	-	15.8	16.4	14.4	-	-	-	-	-
Agriculture	-	-	-	16.3	17.1	17.3	-	-	-	-	-
Industry	-	-	-	33.8	34.3	33.8	-	-	-	-	-
(of which Manufacturing)	-	-	-	-	-	-	-	-	-	-	-
Services	-	-	-	49.9	48.6	48.9	-	-	-	-	-
Resource Balance	-	-	(19.6)	(28.0)	(33.1)	(26.8)	-	-	-	-	-
Exports of GNFS	-	-	19.0	25.9	23.3	22.9	-	-	2.4	(5.8)	(9.8)
Imports of GNFS	-	-	38.6	53.9	56.4	49.7	-	-	(0.2)	(14.3)	(5.9)

Source: (IDA, 1991)

Transition period after the collapse of the Soviet Union. Economic difficulties during the 1990s.

Following the democratic revolution, authorities pursued wide range of socioeconomic reform. Ensuing transition period after the early 1990s was described as an "interesting case" by Tom Ginsburg (1995) as Mongolia's socialist transformation combined both the Chinese model, where "economic liberalization is adopted without political competition" and the East European model, where political change and economic reform proceeded hand in hand.

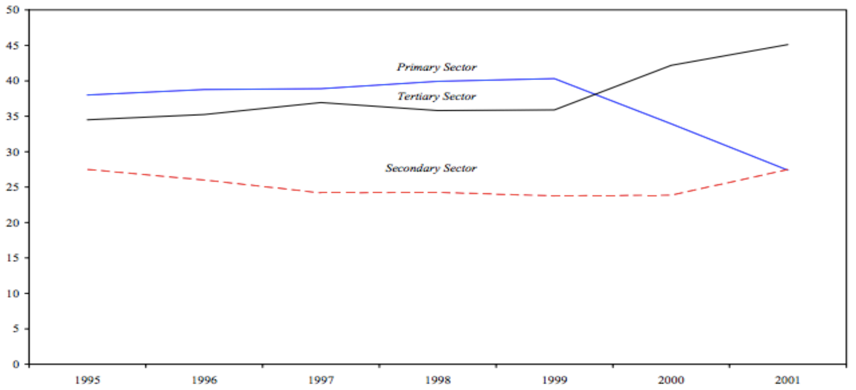
According to the International Development Association (IDA, 1991) Mongolia's per capita income was estimated at US$500 in 1990. After the collapse of the Soviet Union, per capita income fell by 20 percent, unemployment rate projected to reach 25 percent in the capital Ulaanbaatar by the end of the same year (IDA, 1991), and inflation peaked at more than 250 percent in 1993 (Cheng, 2003). Within a relatively short period, Mongolia experienced "the most serious peacetime

[4] https://www.britannica.com/place/Mongolia/Reform-and-the-birth-of-democracy

economic collapse any nation has faced" during 20th century (Ginsburg, 1995). As Mongolia heavily depended on Soviet Union's aid and subsidy before its collapse, international financial institutions and bilateral donors stepped in to assist the country in distress, holding the first Mongolia Assistance Group meeting in Tokyo (IDA, 1991).

Mongolia traditionally depended heavily on the primary sector, mainly consisting of livestock husbandry and crop production. During the 1990s, both primary and tertiary sector (wholesale and retail trade, transport and communication) was the primary source of growth (Cheng, 2003). But from early 2000s, importance of the secondary sector (mining, manufacturing, and construction) steadily increased (Figure 1).

Figure 1. Mongolia: Composition of Real GDP (in percent of real GDP)



Source: (Cheng, 2003)

Mongolia becoming "Minegolia" during the 2000s.

The 2000s can be summarized as a period where Mongolia became "Minegolia", a term popularized by foreign investors. One of the world's largest known copper and gold deposits were discovered in 2001 in the southern region of the country, which is now operational under the name Oyu Tolgoi project[5]. Its Project Financing agreement of US$4.4 billion involved 20 international banks and financial institutions. As such, surge in foreign direct investment (FDI) in the mining industry helped the country record 17.3 percent growth in 2011, the fastest in the world. Soon enough, Mongolia became an upper middle-income country in 2015 only to lose the status in one short year[6].

[5] http://www.riotinto.com/copperanddiamonds/oyu-tolgoi-4025.aspx

[6] http://blogs.worldbank.org/eastasiapacific/what-s-category

Figure 2. Annual GDP growth

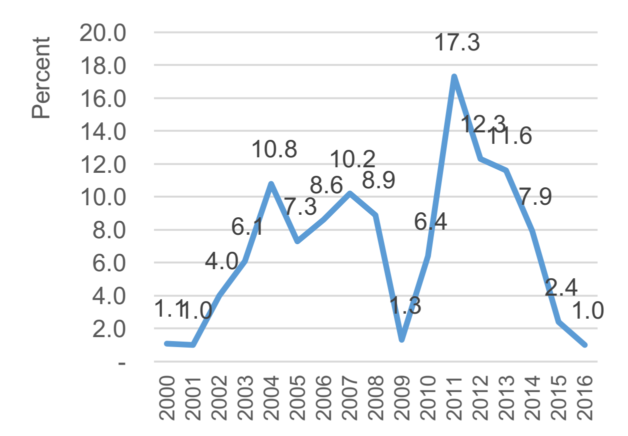
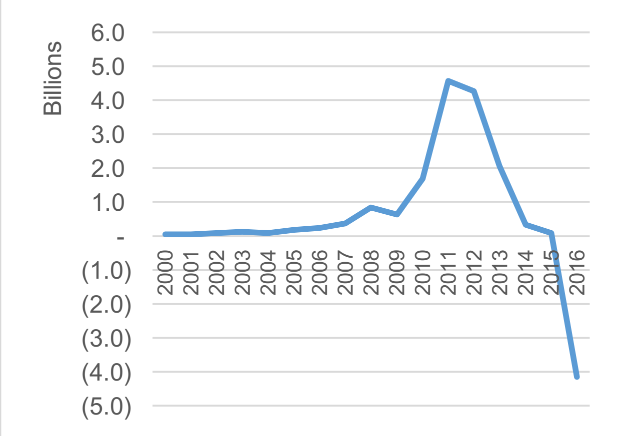


Figure 3. FDI, net inflows (BoP, current US$)



Source: Figure 2. National Statistics Office, Mongolia. Figure 3. World Bank Open Data

The bust cycle ensuing the boom period inevitably occurred and Mongolia's annual GDP growth dropped to 1.0 percent in 2016. This was a result of series of "unfortunate events" both external and internal in nature, such as stagnating Chinese economy – Mongolian minerals main export destination; drop in global commodities price; introduction of series of new regulations on foreign investment in key sectors; and poor public finance management. Mongolia is now under the International Monetary Fund's (IMF) three-year extended arrangement under the Extended Fund Facility (EFF) starting from 2017. The country also received financing package of about US$5.5 billion from the Asian Development Bank (ADB), the World Bank, Japan, Korea, and China to pursue economic reform.

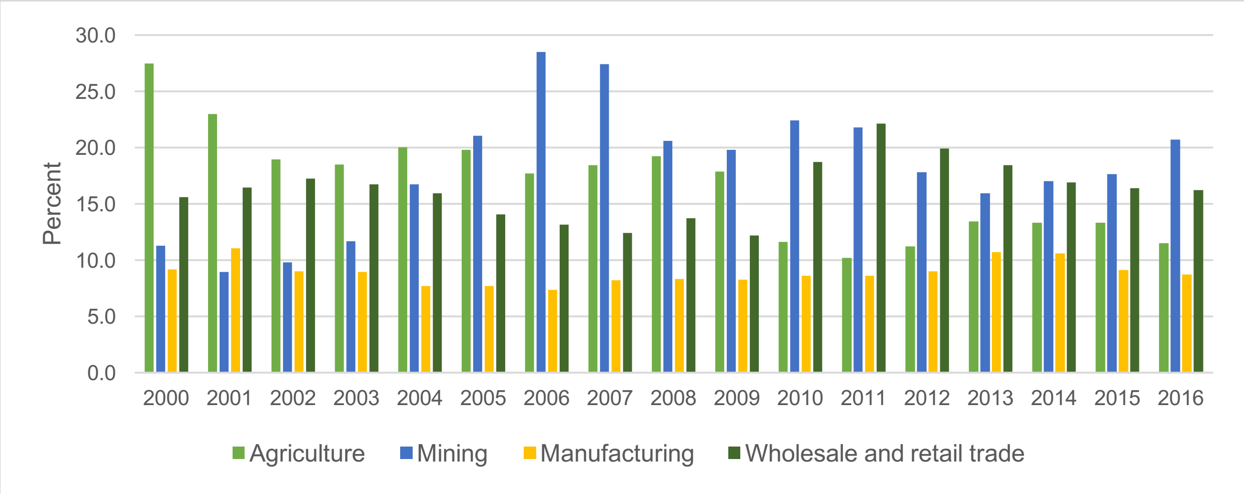
Mineral resources of Mongolia.

Mongolia possesses major reserves of 80 different minerals including copper, gold, coking coal, iron ore, fluorspar, molybdenum, and crude oil (UNIDO, 2011). Its huge mineral resource is estimated at US$1-3 trillion, according to Gupta, *et al.,* (2015) and hosts 10 percent of the world's known coal reserves. In addition to Oyu Tolgoi, the copper and gold mine, the Tavan Tolgoi coal mine is "one of the largest untapped coking and thermal coal deposits" (Gupta, et al., 2015). If the government can efficiently manage the mineral revenues, the vast mineral resources of Mongolia can be the source of economic diversification rather than current scenario of over dependency on mining sector.

Other sectors of the economy. Role of agriculture, animal husbandry and light industry in the economy and its prospects in the long run.

Agriculture traditionally played a large role in the economy but its contribution to the GDP has been steadily decreasing over the years, from 27.4 percent in 2000 to 11.5 percent in 2016 (NSO, 2017). Regardless, livestock still is an integral part of Mongolia both in economic and cultural means. At the end of 2017, the country of three million recorded 66.2 million livestock, of which 57.3 million were sheep and goat. This is a twofold increase from a total of 32.7 million in 2010 (NSO, 2017). Experts believe there is great potential for exports of high-value added industrial products from cashmere, yak hair, sheep's wool, camel hair and red meat (UNIDO, 2011).

Figure 4. Select industries' share in total GDP



Source: National Statistics Office, Mongolia

Table 2. Output of select agricultural products, thousand tonnes

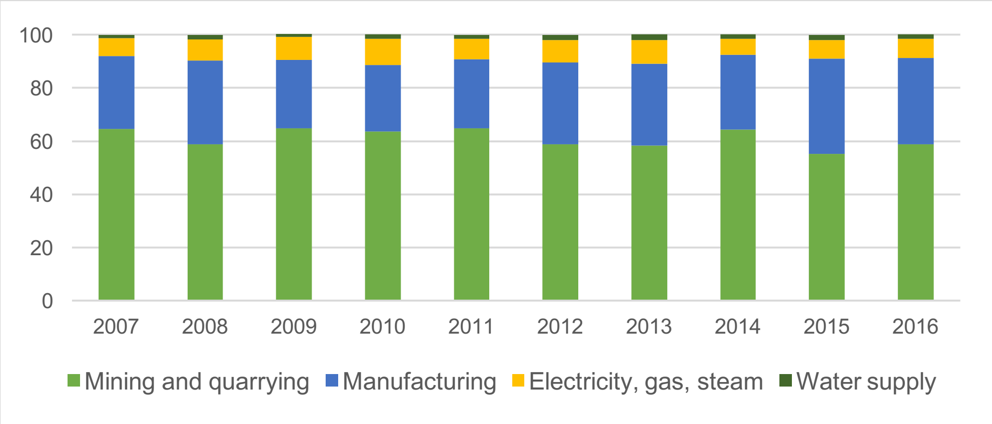
Commodities	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Meat	241.1	251.4	263.4	299.3	291.7	448.0	400.0
Beef	45.2	54.8	59.7	57.7	54.9	93.2	92.4
Mutton and goat	127.0	123.1	123.6	155.0	151.8	220.9	193.1
Hide and skin	9.5	8.7	8.6	11.0	10.2	15.2	14.0
Sheep wool	17.2	16.2	17.5	20.2	22.3	25.8	27.4
Cashmere	6.5	5.5	6.3	7.0	7.7	8.9	9.4
Milk	365.8	529.9	588.0	667.0	765.4	874.4	891.5

Source: National Statistics Office, Mongolia

Current industrial development policy and efforts towards economic diversification.

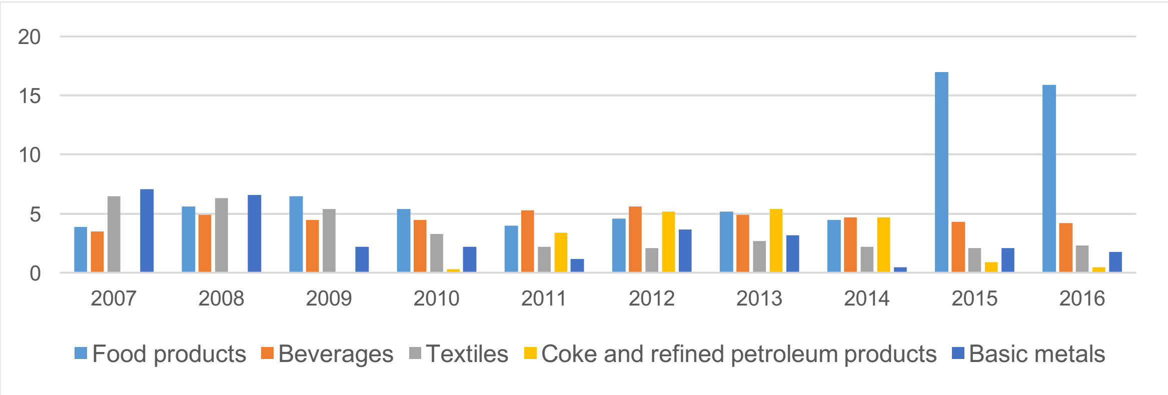
Manufacturing sector declined rapidly in the 1990s as the centrally planned economic system collapsed. It was also partly due to rapid opening of the domestic market following Mongolia's accession to the World Trade Organization (WTO) in 1997 in which all tariffs were eliminated for two-year period (UNIDO, 2011). Mongolia's manufacturing industry face both geographical and economic difficulties such as high transportation cost due to underdeveloped infrastructure and the landlocked location of the country, lack of access to long-term financing, high level of bureaucracy and corruption, shortage of skilled labor force etc.

Figure 5. Composition of Gross Industrial Output, share to total



Source: National Statistics Office, Mongolia

Figure 6. Share of key products in manufacturing industry



Source: National Statistics Office, Mongolia

Mongolia's past international trade patterns. Main products imported and exported.

For People's Republic of Mongolia, Soviet Union was its major trading partner. According to Ginsburg (1995), 95 percent of Mongolia's trade was with the Soviet Union by the end of 1980s. However in 2016, 79.4 percent of export and 31.6 percent of import was with China, which is almost 60 percent of Mongolia's total trade turnover (NSO, 2017).

Table 3. Top 10 trading partners of Mongolia in 2016, million US$

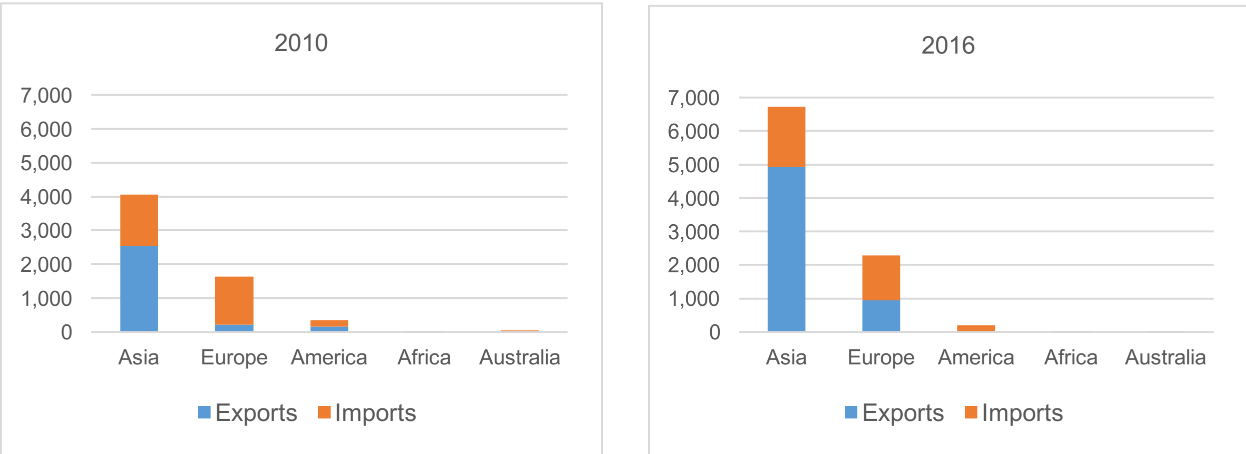
Top 10 Export destinations			Top 10 Import destinations		
1	China	3,901.6	1	China	1,061.2
2	United Kingdom	557.2	2	Russian Federation	880.4
3	Switzerland	230.7	3	Japan	330.6
4	Russian Federation	55.8	4	Republic of Korea	197.9
5	Germany	43.4	5	USA	139.2
6	Italy	33.6	6	Germany	120.3
7	Singapore	16.9	7	Malaysia	41.1

8	Japan	14.0	8	Poland	41.0
9	USA	10.5	9	Vietnam	40.1
10	Belgium	8.5	10	Ukraine	35.1

Source: National Statistics Office, Mongolia

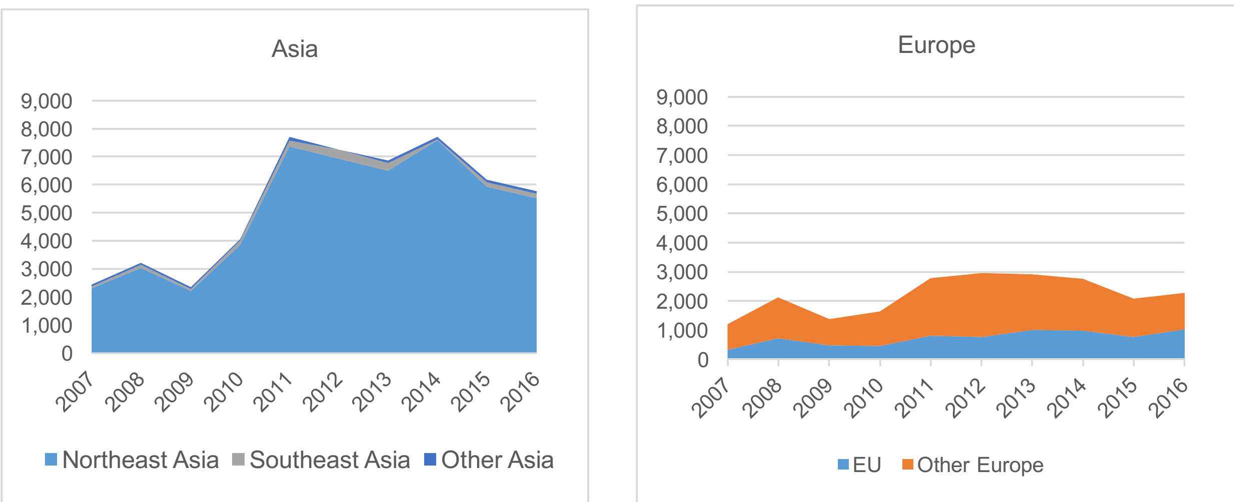
Total trade turnover was US$8.2 billion in 2016, of which 70 percent was conducted with Asia. Northeast Asia continues to be Mongolia's main trading region for the past ten years where trade with China, Japan, Republic of Korea, and Russia was US$6.4 billion in 2016 (NSO, 2017). At the height of the mining boom in 2011, 89.2 percent of the export was mineral products, followed by textile products export of mere 5 percent (NSO, 2017). The situation hadn't change much in 2016 as well, with mining products comprising 70.9 percent of export and textile products at 6.1 percent (NSO, 2017).

Figure 7. Exports and imports by continent, million US$



Source: National Statistics Office, Mongolia

Figure 8. Trade turnover by region, million US$



Source: National Statistics Office, Mongolia

3. Path towards regional economic integration for post-communist landlocked countries

The divergence of development paths that former communist countries took following the Soviet Union's collapse is astounding. Of the 38 former communist countries, 15 are landlocked countries, of which majority are located in Central Asia, Eastern and Central European region. Three of such countries (Czech Republic, Slovakia, Hungary) are now part of the European Union (EU), nine (Belarus, Moldova, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan) are member to the Russian-initiated Commonwealth of Independent States (CIS). Along with Mongolia, which isn't member to any trade bloc, these countries were all part of the Council for Mutual Economic Assistance (CMEA) until 1991. In addition to these, Lao People's Democratic Republic is a landlocked communist country that is becoming increasingly regionally integrated as member of the Association of Southeast Asian Nations (ASEAN).

3.1. Institutional integration

Integration of Hungary, Czech and Slovak republics to the European Union

Following the collapse of the communist regimes, the former countries of the CMEA had the option to remain as a trading bloc and maintain their trading and production patterns to a certain degree, all the while leading a gradual reorientation to world markets. However, Lane (2007) argues that for Central and East European countries (CEECs) such as Hungary, Czech and Slovak republics, they opted for integration with the European Union for following reasons: to distance itself away from "Russian-dominated Soviet past" as far as possible by returning to their "European home" – a home that is much more economically rich, democratic, and with abundance of international networks and security the CEECs needed. Not to mention the economic gains from integrating into the EU market and trade liberalization. Accession to the EU also meant that economic and political compatibility with the Western Europe will be ensured and would ultimately work as a catalyst to reform for the CEECs. After years of economic and political restructuring and meeting the EU's conditionality on its aids and assistance, Czech Republic, Hungary, Slovakia and five other countries joined the EU in 2004.

Table 4. List of former and current communist states that are landlocked

No.	Formerly known as	Current	Location	Pre-1991	Post-1991
Post-Soviet states					
1	Byelorussian SSR	Belarus	Eastern Europe	CMEA	CIS
2	Moldovan SSR	Moldova	Eastern Europe	CMEA	CIS
3	Armenian SSR	Armenia	South Caucasus	CMEA	CIS
4	Azerbaijan SSR	Azerbaijan	South Caucasus	CMEA	CIS
5	Kazakh SSR	Kazakhstan	Central Asia	CMEA	CIS
6	Kyrgyzstan	Kyrgyzstan	Central Asia	CMEA	CIS
7	Tajik SSR	Tajikistan	Central Asia	CMEA	CIS
8	Turkmen SSR	Turkmenistan	Central Asia	CMEA	CIS
9	Uzbek SSR	Uzbekistan	Central Asia	CMEA	CIS
Post-Communist states					
10	Czechoslovak Socialist Republic	Czech	Central Europe	CMEA	EU
11		Slovak	Central Europe	CMEA	EU
12	Hungarian People's Republic	Hungary	Central Europe	CMEA	EU
13	Mongolian People's Republic	Mongolia	Northeast Asia	CMEA	-
Current Communist state					
14	Lao People's Democratic Republic		Southeast Asia	Observer	ASEAN

Source: Author's compilation

Formation of the Commonwealth of Independent States

The Commonwealth of Independent States (CIS) was formed in December 1991 on the ground of interacting as equal sovereign states. All except three (Estonia, Latvia, Lithuania) former Soviet Socialist Republics joined the CIS. In 1993 the CIS Economic Union was created that would promote free movement of goods, services, labor force, and capital between the member states. The Eurasian Economic Community (EAEC) was established in 2000 with Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan as founding members. The EAEC was later transformed into the Eurasian Economic Union (EAEU) in 2015 with Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia as members and negotiations still taking place for Tajikistan's accession.

Table 5. CIS and its structures' membership status

Structure	CIS	Economic Union	CIS Free-Trade Zone	CIS Customs Union	Eurasian Economic Community	Eurasian Economic Union
Founding year	1992	1993	1994	1996	2000	2015
Armenia	✓	✓	✓			✓
Belarus	✓	✓	✓	✓	✓	✓
Kazakhstan	✓	✓	✓	✓	✓	✓

Structure	CIS	Economic Union	CIS Free-Trade Zone	CIS Customs Union	Eurasian Economic Community	Eurasian Economic Union
Kyrgyzstan	✓	✓	✓	✓	✓	✓
Russia	✓	✓	✓	✓	✓	✓
Tajikistan	✓	✓	✓	✓	✓	Negotiating
Ukraine	✓	✓	✓			
Uzbekistan	✓	✓	✓			

Source: Author's compilation

Lao People's Democratic Republic's integration to the Association of Southeast Asian Nations

Lao PDR became an ASEAN Observer in 1992 and became a member in 1997, thirty years after the Association's establishment. One of ASEAN's membership criteria was that the prospective member must be able to participate in the ASEAN Free Trade Agreement (AFTA) and all other economic cooperation arrangements[7]. Lao PDR joined AFTA in 1998 with the schedule to reduce tariffs to 0-5% by 2008. Becoming an ASEAN member not only brings the possibilities to integrate into the supply chain in the region but also gain access to major markets as part of the ASEAN. For developing countries like Lao PDR, ASEAN+1 FTAs with China, Korea, Japan, Australia and New Zealand, and India are advantageous as it gives the landlocked communist country more bargaining power, expertise and reduces costs associated with trade agreements.

Mongolia in institutional integrations

Unlike other post-communist landlocked countries, Mongolia is not a member to any regional institutions that are similar to EU, CIS, or ASEAN. As of 2018, Mongolia participates in the ASEAN Regional Forum and sought to become a Dialogue Partner, but a moratorium has been imposed since 1999. Mongolia cannot join the Association as the ASEAN Charter states "location in the recognized geographical region of Southeast Asia" as one of the primary criteria of membership (ASEAN, 2015). Mongolia also expressed its interest to join the Asia-Pacific Economic Cooperation (APEC) in 1993 and voluntarily issued the Individual Action Plan for Trade and Investment Liberalization in 2000. As of 2016, almost 83 percent of total trade turnover was with APEC member countries.

3.2. Trade agreements

The EU currently has 3 Free Trade Agreements (FTAs) or Economic Partnership Agreements (EPAs) with following counterparts in effect[8]: Southern African Development Community, South

[7] http://www.burmalibrary.org/reg.burma/archives/199612/msg00022.html

[8] http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/#_in-place

Africa, and South Korea. FTAs/EPAs with countries such as Japan, Singapore, Vietnam are pending to be signed or enter into force. Conclusion of the EU-Japan FTA has become the world's largest FTA[9]. Additionally, FTAs are being negotiated with India, Indonesia, and the Philippines etc. Comprehensive Economic and Trade Agreement (CETA) with Canada is partially in place.

As for the recently established EAEU, the union has proposed FTAs with ASEAN, China, South Korea, Cambodia, Indonesia, Singapore, Thailand, Egypt, India, Pakistan, and Israel. The non-EAEU post-soviet countries such as Azerbaijan, Tajikistan, Turkmenistan and Uzbekistan have FTAs with CIS member countries[10].

Lao PDR has Preferential Trading Arrangement with its neighbor Thailand. Also as part of the ASEAN, it has trade agreements with Australia and New Zealand, India, Japan, China, South Korea and the Asia-Pacific Trade Agreement. FTAs with Canada, EAEU, Pakistan has been proposed along with the East Asia FTA and Comprehensive Economic Partnership for East Asia. The RCEP is under negotiation and FTA with Hong Kong, China is pending its entry into force[11]. Lastly, Mongolia has Economic Partnership Agreement (EPA) with Japan and FTAs with China and South Korea have been proposed.

3.3. Market integration

Trade/GDP ratio is commonly used to measure globalization (Capannelli, et al., 2009). Comparing the trade/GDP ratio of the post-communist landlocked countries since the collapse of communist regimes in 1990, we can see which countries were able to integrate more to the international market since they each pursued market economy.

For both the post-soviet landlocked EAEU and non-EAEU member countries, integration to the international market seem to be lagging except for Kyrgyz Republic and Belarus (see Figures 9 and 10). Although there are year-to-year fluctuations in trade/GDP ratio for these countries, a downward trend in market integration can be observed for most. This may imply the ineffectiveness of the CIS although it's aim is to create free flow of goods and services within the region. Having said that, for the recently signed EAEU countries the trade integration seems to be picking up slightly since the 2015. But existence of such trend is too early to conclude.

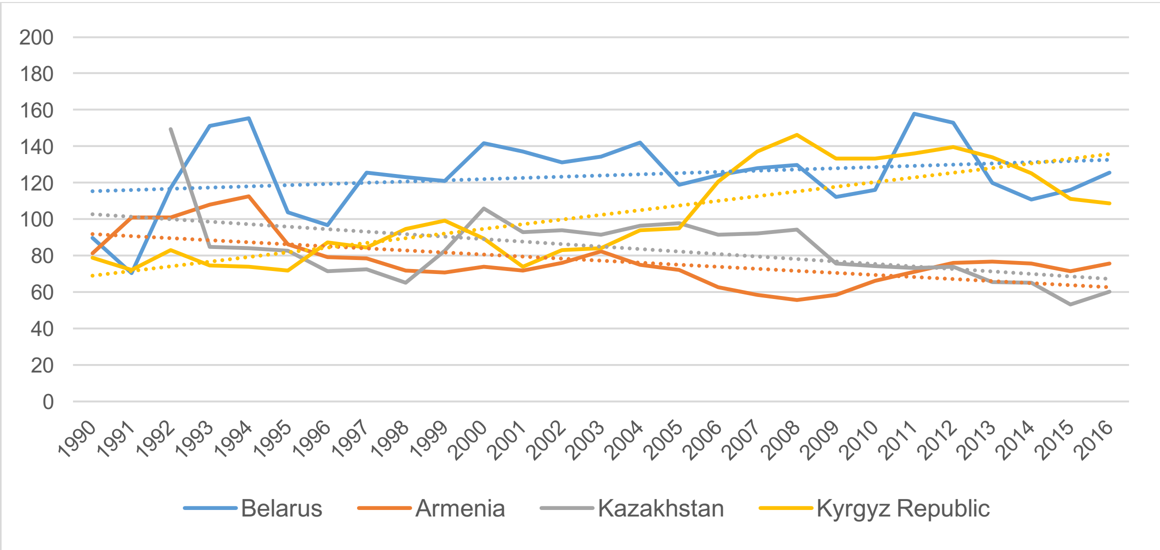
[9] https://www.reuters.com/article/us-japan-eu-trade/eu-japan-conclude-worlds-largest-free-trade-agreement-idUSKBN1E21BT

[10] https://aric.adb.org/database/fta

[11] https://aric.adb.org/database/fta

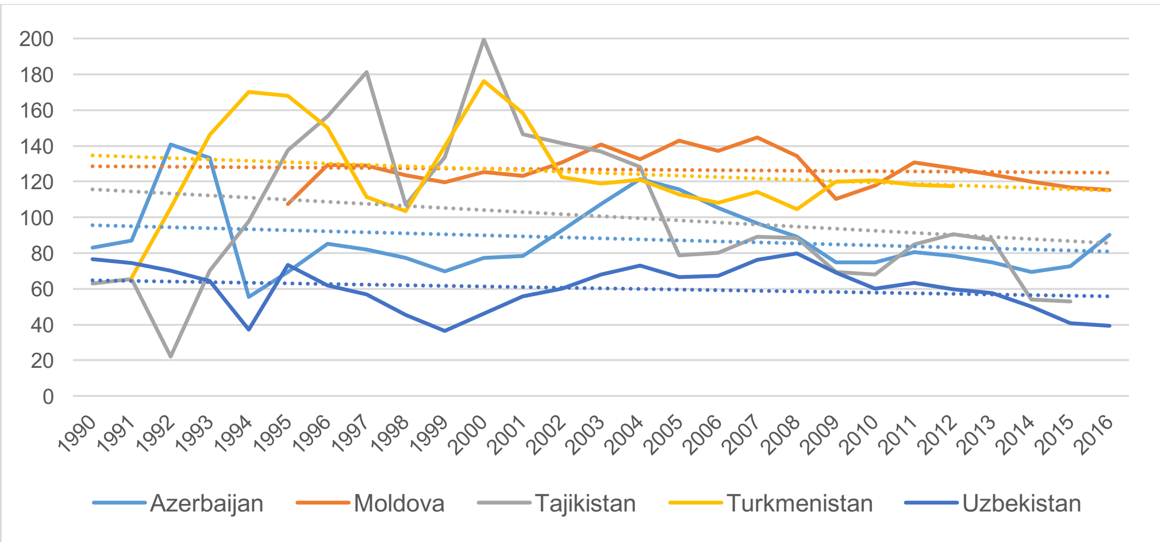
On the contrary, a clear increasing trend in market integration for post-communist landlocked EU members (Hungary, Czech Republic, Slovak) is observed since the 1990 (see Figure 11). The same also applies to Lao PDR's level of integration but much subtler for Mongolia. Such trends may also imply that CEECs' accession to the EU and Lao PDR's membership to the ASEAN have catalyzed their integration to the international market, even though the starting point for these countries were same as Mongolia in 1990.

Figure 9. Trade integration of landlocked EAEU countries, trade in GDP %



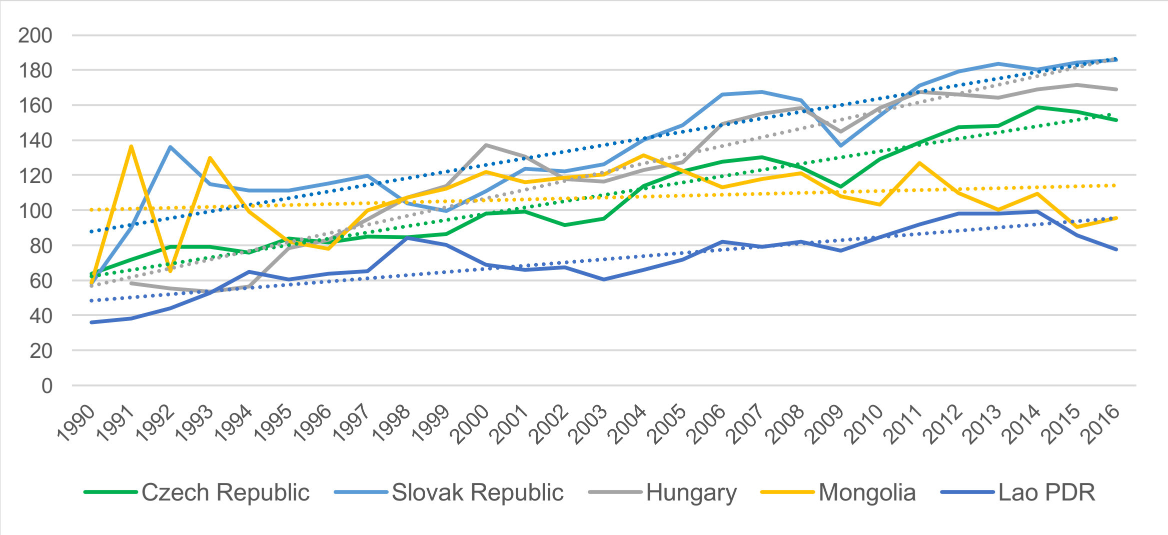
Source: Data from data.worldbank.org

Figure 10. Trade integration of landlocked non-EAEU countries, trade in GDP %



Source: Data from data.worldbank.org

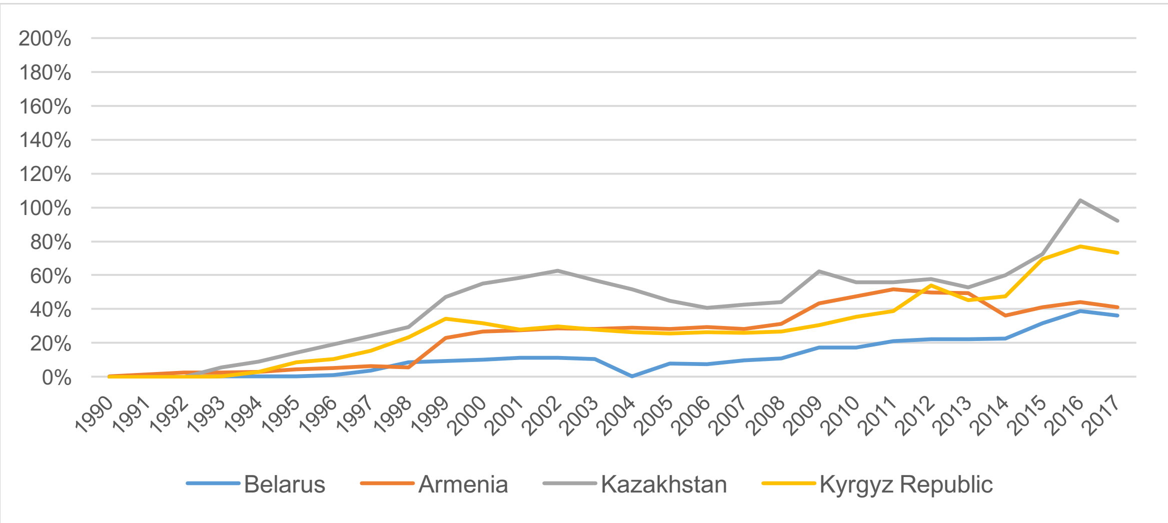
Figure 11. Trade integration of post-communist landlocked EU countries, Mongolia, Lao PDR, trade in GDP %



Source: Data from data.worldbank.org

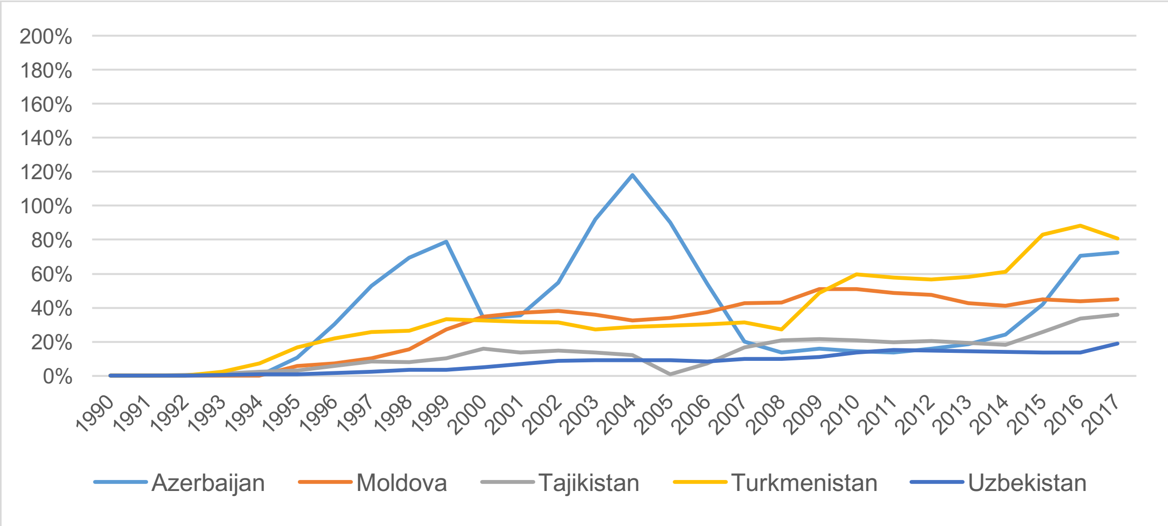
As for the share of inward FDI stock in GDP (see Figures 12 to 14), all sample countries experienced increasing trend to varying degree. The increase in share of inward FDI stock in GDP is inconsistent for both EAEU and non-EAEU landlocked countries, whereas for landlocked EU members the trend is somewhat synchronized. Among all 14 countries, Mongolia seem to be the outlier, with drastic increase in inward FDI stock from 2009. This is consistent with the exploration of the largest copper and gold mine in the country, the Oyu Tolgoi.

Figure 12. Inward FDI stock of landlocked EAEU countries, share in GDP



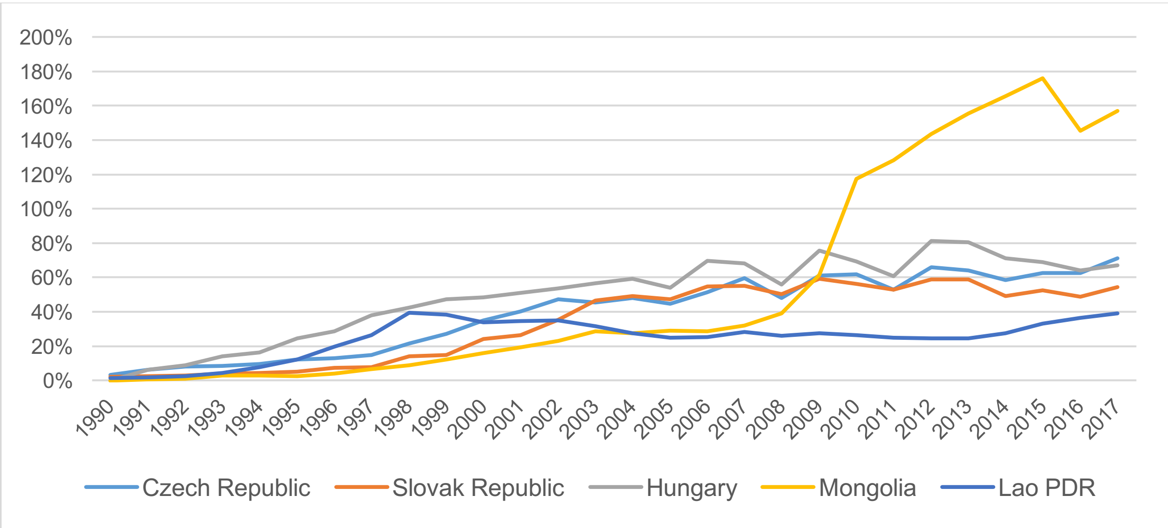
Source: Data from data.worldbank.org and unctad.org

Figure 13. Inward FDI stock of landlocked non-EAEU countries, share in GDP



Source: Data from data.worldbank.org and unctad.org

Figure 14. Inward FDI stock of post-communist landlocked EU countries, Mongolia, Laos, share in GDP



Source: Data from data.worldbank.org and unctad.org

3.4. Infrastructure connectivity

The disadvantages of being landlocked are summarized as international trade dependency on transit neighbors; high transport and trade cost due to long distance; cumbersome transit procedures; and inadequate infrastructure, which all negatively affect the country's economic development and poverty reduction efforts (WBG, 2014). This is especially true for developing countries with poorer infrastructure development as building adequate infrastructure requires large amount of investment. Lack of good quality physical infrastructure also becomes a bottleneck for supply chain connectivity.

For many of the landlocked countries, centers of production and consumption are more than 800 km away from the closest seaport (see Table 7). As for railway connectivity, the post-soviet countries have relatively well maintained, extensive rail network left from the Soviet Union (WBG, 2014). As the transporting distances are high for most of these countries, transportation through railway remains more competitive than road transportation. Air connectivity also plays an important role in improving connectivity of landlocked countries in transporting time sensitive produces as well as highly affecting the tourism industry.

Table 7: Distance to ports from select post-communist landlocked countries

Country	Ports	Range (km)	Mode
Armenia	2	800-2,400	Rail, road
Azerbaijan	2	800	Rail, road
Kyrgyz Republic	4	4,500-5,200	Rail, road
Lao PDR	3	600-750	Rail, road
Mongolia	4	1,700-6,000	Rail, road
Moldova	2	800	Rail, road
Uzbekistan	3	2,700	Rail, road
Tajikistan	3	1,500-2,500	Rail, road
Turkmenistan	3	4,500	Rail, road

Source: (WBG, 2014)

According to the Logistics Performance Index (LPI) developed by the World Bank, landlocked CIS countries except Kazakhstan and Moldova scored near the bottom out of 160 countries surveyed (see Table 8). Mongolia ranked at 108 and Lao PDR at 153, whereas all three post-communist EU members were one of the top performers. Although the LPI is developed based on both quantitative and qualitative performances such as survey results and may not capture the level of logistics development completely, it's a useful benchmark tool to compare the relative quality of logistics services that would ultimately affect the country's connectivity to global value chains. We can see from the results that physical infrastructure connectivity is a major factor in determining landlocked countries' integration to the international market.

Table 8. Logistics Performance Index (LPI) 2016 ranking of post-communist landlocked countries, out of 160 countries (0-lowest, 5-highest)

Countries	LPI Rank	LPI Score	Customs	Infrastructure	Logistics Competence
Landlocked EAEU countries					
Kazakhstan	77	2.75	2.52	2.76	2.57
Belarus	120	2.4	2.06	2.1	2.32
Armenia	141	2.21	1.95	2.22	2.21

Countries	LPI Rank	LPI Score	Customs	Infrastructure	Logistics Competence
Kyrgyz Republic	146	2.16	1.80	1.96	1.96
Landlocked non-EAEU countries					
Moldova	93	2.61	2.39	0.35	2.48
Uzbekistan	118	2.40	2.32	2.45	2.39
Turkmenistan	140	2.21	2.00	2.34	2.09
Tajikistan	153	2.06	1.93	2.13	2.12
Landlocked post-communist countries					
Czech Republic	26	3.67	3.58	3.36	3.65
Hungary	31	3.43	3.02	3.48	3.35
Slovak Republic	41	3.34	3.28	3.24	3.12
Mongolia	108	2.51	2.39	2.05	2.31
Landlocked communist country					
Lao PDR	152	2.07	1.85	1.76	2.10

Source: Logistics Performance Index, World Bank

4. Way forward for Mongolia

Following the collapse of the communist regime in the early 1990s, Mongolia was the only country that did not pursue economic and political integration to the region it belongs to unlike other former communist landlocked countries. CEECs such as Hungary, Czech and Slovak republics took on reforms to join the EU, Central Asian former CMEA countries formed the CIS along with Russia. Lao PDR also became an ASEAN member country and although the country is still struggling to catch up with its fellow members, it's integrating firmly to the Southeast Asian production networks. From this, we can say that Mongolia is indeed lagging behind regional economic integration due to its isolation from institutions that seek free movement of goods and services, capital and people.

Having said that, Mongolia's trade/GDP ratio, inward FDI stock/GDP ratio as well as its extent of infrastructure connectivity shows that it's regionally better integrated than most of the landlocked CIS countries. It's true that strong regional institutions such as EU and ASEAN can catalyze pending countries' internal political and socioeconomic reforms by enforcing external pressure and various conditionality. But at the same time, having reliable physical infrastructure and well managed customs services are just as equally important in integrating the country to regional supply chains. Pursuing institutional integration solely will not necessarily result in better regional integration if insufficient investment in infrastructure exist.

4.1. Institutional integration

We've seen from Hungary, Czech Republic, Slovakia and Lao PDR's current degree of regional integration that becoming member of a customs union or regional trade arrangement with strong institutional leadership and governance greatly benefits the joining country. The benefit seems to be amplified when such countries are former communist states. For those transition economies, economic reforms to establish sound functioning market, fair competition, and protection of private properties are catalyzed and guided by the regional institution they're joining, such as EU and ASEAN. For EU, their conditionality is not only economic but also political or social, such as enforcing and promoting rule of law, good governance, democracy and civil society. The PHARE (Poland and Hungary: Assistance for Restructuring their Economies) program by the EU that started in 1989 and later extended to Czech Republic, Slovakia etc. is one such example.

On the contrary, although the CIS has been existing for almost three decades now, the difference it made for its member countries are not as remarkable as in the case of EU and ASEAN. This implies that being a strong institution that values and promotes the fundamental principles of market economy is a crucial prerequisite to positively influence and induce internal reforms within its member countries. The difference in quality of governance and democracy between CIS and post-communist EU member countries is striking (see Table 9).

Table 9. Freedom in the World Index 2018 (0-weak, 100-strong) and World Bank World Governance Indicators 2016 (-2.5 [weak], 2.5 [strong])

Countries	**Freedom House 2018**		**World Governance Indicators 2016**[12]			
	Nations in Transit[13]	Freedom in the World[14]	Gov't Effecti-veness	Regula-tory Quality	Rule of Law	Control of Corrup-tion
Landlocked EAEU countries						
Belarus	Consolidated Authoritarian Regime	21/100	-0.51	-0.94	-0.78	-0.29
Armenia	Semi-Consolidated Authoritarian Regime	44/100	-0.15	0.25	-0.11	-0.57
Kazakhstan	Consolidated Authoritarian Regime	22/100	-0.06	-0.10	-0.42	-0.80
Kyrgyz Republic	Consolidated Authoritarian Regime	37/100	-0.90	-0.35	-1.10	-1.08
Landlocked non-EAEU countries						
Azerbaijan	Consolidated Authoritarian Regime	12/100	-0.16	-0.28	-0.57	-0.87

[12] http://info.worldbank.org/governance/wgi/#home

[13] https://freedomhouse.org/report/nations-transit/nations-transit-2018#key-findings

[14] https://freedomhouse.org/report/freedom-world/freedom-world-2018

Moldova	Transitional Government	61/100	-0.62	-0.12	-0.54	-0.96
Tajikistan	Consolidated Authoritarian Regime	11/100	-1.02	-1.09	-1.18	-1.07
Turkmenistan	Consolidated Authoritarian Regime	4/100	-1.14	-2.09	-1.56	-1.46
Uzbekistan	Consolidated Authoritarian Regime	7/100	-0.60	-1.62	-1.13	-1.20
Landlocked post-communist countries						
Czech Republic	Consolidated Democracy	93/100	1.06	0.99	1.09	0.51
Slovak Republic	Consolidated Democracy	89/100	0.89	0.89	0.69	0.24
Hungary	Semi-Consolidated Democracy	72/100	0.45	0.60	0.51	0.08
Mongolia	-	85/100	-0.11	-0.08	-0.22	-0.50
Landlocked communist country						
Lao PDR	-	12/100	-0.39	-0.73	-0.77	-0.93

Source: See footnote 12-14

In order for Mongolia to further progress its socioeconomic reforms in spite of internal political instabilities and short-sighted decisions of the politicians, external pressures to enforce principles of market economy and rule of law seems essential. Although international financial institutions such as the World Bank and Asian Development Bank cast conditionality to its loans and aids, those are likely to cover few industries, tend to be project specific, and span for no longer than few years.

This creates the necessity for Mongolia to be part of a strong regional institution that is comparable to the EU or ASEAN. Mongolia is at times also considered as a Central Asian country which makes membership to the EAEU geographically possible, but given the CIS countries' track record so far and the current status of their democracy makes the institution an unattractive option. Although Mongolia does attend the ASEAN Regional Forum, a formal membership to the association is clearly frowned upon as we've seen from public reaction to Philippine President Rodrigo Duterte's comments about Mongolia's possible membership[15]. The only hope for Mongolia, it seems, is to rely on and also nurture its economic and political relationship with Northeast Asian countries, especially with Japan and South Korea, both with strong institutional capacities that enforce rule of law.

[15] https://thediplomat.com/2017/05/can-dutertes-philippines-add-turkey-and-mongolia-to-asean/

4.2. Trade agreements

When compared on the grounds of existing and proposed FTAs/EPAs with other landlocked post-communist countries, Mongolia is far behind. Having no association with regional institutions such as EU or ASEAN increases the burden that Mongolia face in negotiating trade agreements. Not only it's costly, Mongolia also faces severe shortage in capacity and expertise. But in order for Mongolia to open up new markets, to diversify its export and trading partners, it's inevitable not to negotiate trade agreements.

CJK+M FTA

The region of Northeast Asia has the "potential to create one of the largest economic blocs in the world", that can be comparable to the European Union (EU) or the North American Free Trade Agreement (NAFTA) (Jeong & Lee, 2016). Following the 2008/09 global financial crisis there seems to be increasing need to further develop economic and financial cooperation within the region. One of the framework that have been gearing towards such a goal is the China-Japan-Korea Trilateral Free Trade Agreement (CJK FTA) which the negotiations began in 2012.

CJK FTA has both economic and political significance, given the sensitivity of the political and security issues in the region. For some, it's seen as a confidence building mechanism between these three countries, as observed by Terada (2016). Economically, a computable general equilibrium (CGE) model predicted that if the CJK FTA is ratified, South Korea's GDP will increase by 0.41 percent (US$1.83 billion), China by 0.21 percent (US$1.8 billion) and Japan by 0.02 percent (US$0.43 billion) (Jeong & Lee, 2016).

For Mongolia, 66.6 percent of trade turnover, 79.8 percent of total export, and 47.4 percent of total import was with the CJK countries in 2016. Mongolia joining the CJK FTA negotiations may be the most viable option to further integrate with its three major trading partners. As Mongolia already signed an Economic Partnership Agreement with Japan, striking a similar deal with South Korea may not be as hard given the lower trade volume between the two. Additionally, both Japan and South Korea can be a "buffer" or an active supporter for Mongolia when negotiating bilaterally with China. Negotiating a trade agreement only with China is not desirable for Mongolia as the country of three million does not have sufficient bargaining power to strike a "win-win" deal. Mongolia having no territorial disputes nor long-lasting political tensions with all three countries can be an advantage that Mongolia can bring to the negotiation table.

Having said that, Jeong & Lee (2016) argued that if the gap in technology levels are high between negotiating partners, it's highly possible that certain industries of the country with the lowest technology capacity may lose the chance to transit into higher value businesses due to import competition. This is certainly the case for Mongolia given its low level of industrialization. Protecting the few agricultural industries that has potential to grow such as meat and dairy production, textile and light industry may become vital.

NEA FTA

The members of the potential Northeast Asia Preferential Free Trade Agreement (NEA FTA) are CJK members plus Mongolia and Russia. Although talks of such region-wide trade negotiation is not as frequent yet, a study found that ratification of NEA FTA will bring welfare gains to all participating economies. The predicted welfare gains were as following: Japan US$23.5 billion; South Korea US$12.4 billion; China US$5.1 billion; Russia US$1.97 billion ad Mongolia US$58 million (Shagdar & Nakajima, 2018).

Other possibilities

For a small market with population of three million, opening up potential foreign markets is important for Mongolia to ensure economic development. In this sense, negotiating trade agreements with its two main trading partners China and Russia seems inevitable, especially to address non-tariff barriers to trade. But given Mongolia's weak bargaining power and institutional capacities, Russia and China are best approached as part of either CJK+M or NEA FTA, or even CJKM+NEAE FTA. The downside to this approach is, it's only possible when CJK is successful to begin with, but such timespan may be beneficial for Mongolia to brush its negotiation capacity in the meantime. FTA with both ASEAN and EU is also possible as Mongolia saw increased trade with ASEAN members such as Thailand, Vietnam, and Malaysia as well as EU members such as Italy, Poland, Germany and Sweden in recent years.

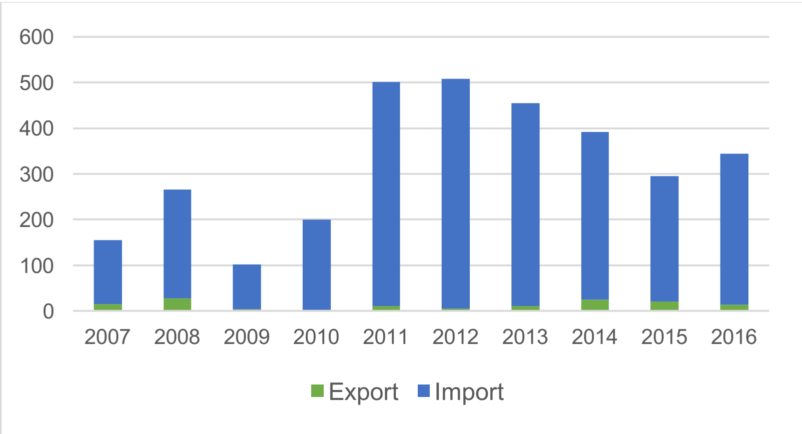
4.3. Market integration

It's important for the Government of Mongolia to keep in mind that signing either bilateral or multilateral trade agreements with its trading partners will not immediately result as more integrated market. This is evident from the unchanging level of trade turnover with Japan in spite of concluding the Japan-Mongolia EPA (JMEPA) in 2014 (see Figure 15).

The difference here is that for Mongolia, the JMEPA is its first ever FTA to sign while for Japan, JMEPA is its 14th FTA. Additionally, Japan's existing network of private sector industry associations and public trade support institutions make the usage of FTAs more likely for Japanese firms (Kawai & Wignaraja, 2011). As FTA utilization entails large fixed costs and technical knowledge about the agreement that can be burdensome for small and medium sized enterprises (SMEs), providing institutional, technical and financial support to promote the usage of trade agreement is crucial.

It is also widely acknowledged that the JMEPA has been concluded for political incentives and less so for economic gains. This may be the reason behind lack of commitment or incentives to successfully implement the agreement from the Mongolia's side. In this regard, certain pressure from Japan to further promote utilization of the scheme will not only increase the total trade turnover between the two countries, but will also benefit Mongolia by catalyzing internal reforms.

Figure 15. Trade turnover with Japan, million US$



Source: National Statistics Office, Mongolia

4.4. Infrastructure connectivity

As a landlocked developing country that inherently face disadvantages in infrastructure connectivity, Mongolia must continue to invest in its infrastructure development. As such largescale developments are often costly and require technical expertise, cooperating with international financial institutions (IFIs) is a necessity. IFIs such as Asian Development Bank (ADB) and European Bank for Reconstruction and Development (EBRD) have been active in investing in infrastructure in Mongolia, other possibilities such as the recently established Asian Infrastructure Investment Bank (AIIB) and Belt and Road Initiative should also be explored. At the same time, debt sustainability should not be sidelined[16]. For infrastructure connectivity, not only road and railway transport should be considered, but also opportunities in developing cross border electricity connectivity must be explored. As Mongolia's South Gobi region is proven to have not only vast mineral resources, but also high level of renewable energy resources such as wind and

[16] https://asia.nikkei.com/Economy/ADB-chief-warns-of-Belt-and-Road-debt-trap

solar power, Mongolia has a potential to export electricity from clean energy to North East Asian market.

5. Conclusion

In many sense Mongolia is indeed a unique country that faces equally unique challenges given its communist past, landlocked nature, and its vast mineral resources. At the same time, being both landlocked and post-communist economy itself doesn't bring Mongolia to the spotlight as there are more than handful of countries that went through, and are going through the same challenges as Mongolia did. The landlocked CEECs countries that are Hungary, Czech Republic, and Slovak have successfully re-established themselves as law abiding, democratic, market oriented economies. Of course, for these countries such achievements didn't come solely as a political commitment, but also as a result of successful intervention or support exerted by the EU. Lao PDR, another landlocked and communist country was successful in joining the ASEAN, is steadily liberalizing its market and integrating to the East Asian production network. A common characteristic from these "success stories" is that strong regional institutions play a crucial role in catalyzing internal reforms to its latecomers.

As a country that isn't part of any regional institution similar to EU or ASEAN, Mongolia faces challenges in staying on track of reforms that will firmly place Mongolia as a competitive market economy in the region. As the country lacks regional institutional integration opportunities, it's important for Mongolia to further deepen its ties with Northeast Asian economies, especially with Japan and South Korea. To promote more institutional integration in the NEA region, Mongolia should support a successful CJK FTA, which Mongolia could subsequently join. Mongolia could benefit greatly from joining a high quality CJK FTA, so that Mongolia could "import" high standard of rules and regulations from Japan and South Korea that would essentially improve Mongolia's overall business environment. FTAs with ASEAN, EU, EAEU or its individual member countries should also be pursued for the sake of opening up potential markets by lowering tariffs as well as addressing non-tariff trade barriers that tend to be high for developing countries. Here, institutional, technical and financial support for Mongolian both larger firms and SMEs to utilize existing and future FTAs must be a priority for the Government of Mongolia.

As Mongolia continues to pursue regional economic integration in trade or market means, physical infrastructure connectivity must go hand-in-hand as well. Investing in domestic infrastructure networks, transit hubs and logistics systems, as well as improving customs services, border control will further promote trade integration and supply chain development. Various financing options should be explored that will also provide technical expertise, while keeping eye on debt sustainability.

In conclusion, this paper has found that Mongolia is relatively well integrated to the rest of the region when compared to CIS countries but lagging behind of post-communist landlocked EU member countries as well as Lao PDR in terms of trade integration. Mongolia’s relatively strong democracy that’s comparable to that of Czech Republic and Slovakia may have played a large role in establishing Mongolia as a country with more stable business environment than many Central Asian countries. But Mongolia’s lack of institutional integration to strong regional scheme is preventing the country from further regional integration and necessary internal reforms that require certain external pressures. Continuous efforts must be exerted by the Government of Mongolia to further economically integrate itself to the region through institutional, trade, and infrastructure means.

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