The Two Political Economies of Mongolia: Political Factors Shaping the Liberalization and Restriction of Mongolian FDI Policy (1990-2012)

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Abstract:

The present study analyses the political factors behind the volatile changes in Mongolian FDI policy over the past two decades, which led to a period of dramatic economic and political liberalization in the 1990s and a partial reversal of this stance during the 2000s. The study finds that the changes in Mongolian FDI policies are strongly tied to the evolution of international commodity prices, which affect the incentives of Mongolian policymakers and interest groups through three channels: incentives of cooperation among societal interest groups, the strategies of politicians and high-ranking officials to achieve re-election and personal rents, and the leverage of international financial institutions over domestic policymakers. The interaction of these three distinct political dimensions lead to an equilibrium of economic liberalization during periods of low international mineral prices and to an equilibrium of economic restriction during periods of high international mineral prices.
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ABBREVIATIONS

ADB  Asian Development Bank
BIT  Bilateral Investment Treaty
COMECON Council of Mutual Economic Assistance
DC  Democratic Coalition, renamed Democratic Party (DP) in the year 2000
DP  Democratic Party, formerly Democratic Coalition
DPC Development Policy Credit (World Bank loan)
DTT Double Taxation Treaty
FDI  Foreign Direct Investments
FIFTA Foreign Investment and Trade Agency of the Government of Mongolia
FILM Foreign Investment Law of Mongolia
FT  Financial Times (daily newspaper)
IHT  International Herald Tribune (daily newspaper)
IFIs  International Financial Institutions
IMF International Monetary Fund
ME  Mongolian Economy (bi-monthly magazine)
MMJ Mongolian Mining Journal (monthly magazine)
MNC Multinational Corporation
MP  Member of Parliament
MPP Mongolian People's Party, formerly MPRP
MPRP Mongolian People's Revolutionary Party, renamed MPP in 2011
OBG Oxford Business Group
PM  Prime Minister
TI  Transparency International
UNCTAD United Nations Conference on Trade and Development
USSR Union of Soviet Socialist Republics
WB  World Bank
WPT Windfall Profit Tax
WTO World Trade Organization
Introduction

“Mongolia used to be an ugly bride, but now that she is highly educated and beautiful, foreigners are flocking to woo her.”

- Tsakhia Elbegdorj, President of Mongolia (Mongolian Mining Journal, June 2012: 101)

A widely cited finding from UNCTAD’s Investment Policy Monitor database, which tracks regulatory changes in national FDI policies, indicates a substantive change in policymakers’ attitude towards foreign direct investments over the last two decades: while nearly all recorded FDI policy changes during the 1990s were in favour of more liberalization and the proportion of restrictive changes as a share of the total number of changes was as low as 2 per cent in the year 2000, the ratio had increased to 32 per cent by 2010 (UNCTAD 2011:94). An industry-specific analysis for the year 2010 revealed that extractive industries were the sector hardest hit by restrictive regulatory changes: 93 per cent of the changes of FDI policy with regards to extractive industries in 2010 were restrictive in nature and only 7 per cent were liberalizing (UNCTAD 2011:95).

The aim of the following study is to uncover the causal mechanism leading to liberalizing and restrictive FDI policy changes in natural resources-rich developing economies. To this end, the present study uses the method of process-tracing (Bennett and George 2005: 205-232) to carefully analyze the political factors shaping the instances of liberalization and restriction of FDI policy in a single within-case study (Gerring 2004: 348) focusing on Mongolia. Based on an extensive review of secondary sources, the analysis of quantitative data and thirteen interviews with policymakers and business representatives,
the analysis finds that the liberalizing and restrictive FDI policy changes in Mongolia were a consequence of price movements in global commodity markets. The ups and downs of international mineral prices shifted the incentives of societal groups, politicians and international donors in Mongolia: during times of low international mineral prices, societal interest groups had few incentives to oppose the regulatory attraction of FDI; politicians and government cadres benefited more from liberalization than they would have from restrictions; and policymakers urgently needed the budgetary support from Western donors who proactively supported the opening of the economy to foreign investors. In contrast, when international mineral prices spiked in the early 2000s, the political economic equilibrium of liberalization was unsettled in all these three dimensions: societal interest groups, especially nomadic herders and manufacturing labour, began to demand protectionist measures; politicians, benefitting from the strengthened bargaining power against mining MNCs, were now able to reap direct and indirect benefits from higher taxation levels and other restrictive measures; at the same time, domestic policymakers could ignore the advise and demands from international donors as mining taxation revenues substituted the loans and grants formerly received from bilateral donors and IFIs. The study also finds that other prominent explanations of changes in a country’s FDI policy, in particular a change in norms among policymakers and diffusion through competition, emulation and learning, have played no major role in the case of Mongolia.

The remainder proceeds in the following way: the first part describes the dependent variable, that is, the liberalization of the FDI policy in Mongolia in the
1990s, the turn to more restrictions in the mid 2000s, and the renewed effort of liberalization in 2008-09, which was followed by an even stronger regulatory stance thereafter. The second part assesses the explanatory power of different variables to explain the variation in Mongolian FDI policy: the first section shows the high correlation over the last two decades between low or falling mineral prices and a liberalizing stance on FDI policy, and high mineral prices and a restrictive regulatory stance. The second section describes the incentives of the main economic sectors, politicians and high-ranking government officials and the leverage of international donors under conditions of low or falling international mineral prices (1990-2001 and 2008-2009). The third section shows the substantive differences in all these three dimensions under conditions of high mineral prices (2002-2007 and from 2009 onwards). The fourth section shows evidence that the hypotheses of a change in norms and of diffusion through competition, learning or emulation, are of little use to explain the changes in FDI policy in the Mongolian case. Based on this analysis, the conclusion predicts that further restrictions on foreign investments in extractive industries are the most likely scenario for Mongolia and similar resource-rich economies with relatively weak political institutions, unless there is an unanticipated dramatic fall in global mineral prices.
PART I. The Ulaanbaatar rollercoaster: A history of FDI and its regulation in Mongolia


After two centuries under the domination of the Manchu Qing Empire, Mongolia was liberated gradually from Chinese control between 1911 and 1921, in the last stage with the military support of Russian White Guard troops under the warlord Baron von Ungern-Sternberg. Later in the same year, the Russian White Guard troops were ousted by an alliance of the Soviet Red Army with the revolutionary Mongolian People's Party, inaugurating a long period of strong Soviet influence in Mongolia (Baabar 1999: 188-225). On 26 November 1924 the revolutionaries formally declared the Mongolian People's Republic, establishing the world's second centrally planned economy after Soviet Russia (Jeffries 2007:6). It is estimated that about five hundred Chinese and a dozen British and American firms operated in Mongolia at the time of independence (Batbayar and Soni 2007:35). While remaining formally independent, the political elite of Mongolia remained closely aligned with the Soviet leaders and established political and economic structures that were based on the model of the USSR: the nomadic herders were organized in collectives and the government pursued a strategy of industrialization under the lead of USSR-Mongolian state-owned joint-stock enterprises. The USSR provided Mongolia with protection from the ever-present threat of a Chinese military invasion (Bradsher 1972: 546) and massive budgetary support, approximating one full third of Mongolian GDP each year, in addition to technical assistance of a permanent staff of over 50,000 technicians.
and experts (Jeffries 2007: 66). The education and health systems were improved significantly throughout the country with Soviet assistance. However, the alignment with the USSR also meant political and cultural repressions: Mongolians had to deny their historical memories of the largest empire in world history that had been built by their ancestors under the leadership of Chinggis Khan and his successors between the 12th and 14th centuries, which had led to unprecedented prosperity and cultural exchange by securing trade routes from Central Europe to Northern Vietnam (Weatherford 2005, Findlay and O’Rourke 2009: 87-142). Much of the heritage of the Mongolian Empire was destroyed during the communist regime. Buddhist religion was also repressed and monks – as well as secular political opponents and ethnic minorities (in particular the Buryats) - were purged. It is estimated (Kaplonski 2002: 160) that over 22’000 people have been killed under Mongolian and Soviet government command between 1921 and 1990. Economically, Mongolia was highly dependent on the USSR and the COMECON, which it had joined in 1962: Mongolia was integrated into the COMECON as an exporter of commodities, principally minerals and livestock, and depended on the imports of petroleum, industrial equipment and consumer goods (Batbayar and Soni 2007: 86). The domestic process of industrialization through Soviet credits and joint ventures with state-owned companies mostly from the Soviet Union, but also from Czechoslovakia (leather and shoe-making), East Germany (carpets and meat processing), Hungary (chemical industries), Bulgaria (agricultural industries), Poland (cement and wood) and Romania (furniture), increased from the late 1960s onwards (Batbayar and Soni 2007: 87). By far the largest project was the building of the Erdenet copper mine from 1973 to 1981 as a Mongolian-Soviet joint venture,
which was initiated by the Soviet leadership to secure its copper supply after the overthrow of Allende’s socialist regime in Chile (Batbayar and Soni 2007: 83-84). The mine, jointly owned by the Mongolian and Russian governments, is in operation until today.

In sum: precise figures on the activities of foreign companies in Mongolia before 1990 are not available, but it remains clear that Mongolia as a commodity-exporter was highly dependent on imports and budgetary support from the Soviet Union for a great part of the twentieth century. This budgetary support was to dry up suddenly in 1990, putting a massive strain on the Mongolian economy.

1.2. Two steps forward: Transition to democracy and rapid liberalization (1990-2005)

The economic reformism in the USSR under the leadership of Mikhail Gorbachev rapidly spread to Mongolia. In 1985, the Mongolian communist ruling party MPRP adopted a plan of economic restructuring, which initiated marginal gradual reforms towards private ownership (Batbayar and Soni, 2007: 106). Sharav Gungaadorj, Minister of Agriculture from 1986-1990 and Prime Minister during the crucial year of transition in 1990, recalled in a personal interview that the political elite in Mongolia had become aware in the mid 1980s that the communist economic system was not going to be sustainable. The ruling party first attempted to pursue economic reforms while maintaining the communist political system. However, confronted with the dramatic events in the Soviet
Union and the rise of mass protests and hunger strikes by a strong group of democratic reformers in Ulaanbaatar from December 1989, the ruling elite in Mongolia quickly realized that more dramatic steps would have to be taken (Interview 5). On 12 March 1990, the Mongolian Politburo stepped down and announced democratic elections. At an impressive pace, the MPRP pursued a dramatic internal transformation from a communist governance system to a democratic reformist party (Rossabi 2009). This ‘new’ MPRP won landslide victories in both General Elections of July 1990 and June 1992 and held a comfortable majority in the Great Hural, the national parliament, until 1996. During their time in office, the leaders of the former communist party initiated a program of radical economic reform, which largely followed the advise of the international advocates of ‘shock therapy’¹ (Rossabi 2005: 49-55, Jeffries 2007: 2, Interview 5). In the 1996 parliamentary election, the Democratic Coalition, an alliance of reformist opposition groups, won a surprise victory. In office, they further accelerated the political and economic reforms. By the end of 1997, the Mongolian government had privatized most of the formerly state-owned companies through a voucher system, complete private ownership of housing, livestock and land had been introduced, prices were liberalized, the exchange rate was freely floating, the capital account was fully liberalized (Rossabi 2005: 43-79) and Mongolia had joined the WTO, adopting “one of the most liberal trade regimes in the world” (Jeffries 07: 66).

¹ In a regional perspective, Mongolia, Georgia and Kyrgyzstan adopted the most radical and wide-ranging programs of liberalization after the breakdown of the USSR, which contrast with a more gradual approach taken in other Central Asian economies, such as Kazakhstan, Turkmenistan, Uzbekistan and Azerbaijan (Pomfret 2005), or China and Vietnam in East Asia (Jeffries 2007: 5).
Throughout this period of intense reform, Mongolian policymakers attempted to create a favourable regime for foreign investors. The first Foreign Investment Law of Mongolia (FILM) was adopted in 1990 to allow joint ventures with foreign firms with a maximum share of foreign ownership of 49 per cent (ADB 1992: 75). Only three years later, on 1 July 1993, the law was replaced by a more liberal version, which put no limitation on foreign ownership and on the right to repatriate profits, guaranteed equal treatment for foreign and domestic investors in relation to their rights to own, utilise and exploit assets and capital and granted generous tax incentives, such as tax holidays that varied between three and ten years according to the sector in which the investment was made (OECD 2000: 21-31). In addition, the Mongolian government signed several bilateral investment and double taxation treaties (UNCTAD IIA Database 2012). Yet, despite these regulatory efforts, FDI inflows remained at low levels and were concentrated in trading and catering industries, mostly in the form of travel agencies, restaurants and bars (Interview 9). As illustrated in Figure 1 below, FDI inflows never exceeded five per cent of GDP until the year 2000.

According to several interviewees, Mongolian policymakers were well aware of the vast mineral reserves in their country during that time (Interview 1, Interview 5, Interview 12). The first small-scale artisanal mining projects dated back to the 1910s (Batbayar and Soni 2007: 14, Interview 6). Moreover, according a renowned Mongolian biochemist, many geological studies had been performed during the Soviet period, which identified forty-two very promising mining sites (Interview 12). However, mineral exploration and extraction remained at a relatively small scale in the 1990s because of a combination of four
factors (Interview 12): first, most of the geological information was held by the Russian government who lacked the necessary capital to invest. Second, China was largely self-sufficient in coal, keeping global demand low. Third, Mongolia lacked the basic infrastructure such as railways and electricity lines that are necessary for mineral extraction. Fourth, foreign investors were wary of political stability in Mongolia. Only in 1995, the Mongolian government adopted the first Minerals Law. However, it was rudimentary and insufficient in many regards to regulate large-scale mining activity (Interview 8). Two years later, it was replaced by a new law that was regarded as “the most liberal in Asia” (Connors 2011), or, in the World Bank’s (2010: 10) view, simply “among the best around the world”. The law allowed complete foreign ownership with no restrictions on the repatriation of dividends and profits, established internationally competitive taxation levels, guaranteed the conversion of exploration into mining licenses and granted generous time limits on licenses (7 years for mining, 100 years for exploration) (Connors 2011). The law was effective in generating a boom in mineral exploration and the Mineral Resources Authority readily issued thousands of exploration licenses, a majority going to Chinese junior companies (Interview 3). Further investor-friendly amendments to the Foreign Investment Law were introduced in 2002, allowing franchising and opening up the possibility for large investors (i.e. investments exceeding USD50 millions) to negotiate special ‘Stability Agreements’ with guaranteed tax levels in the medium term. In 2003, Ivanhoe Mines, a Canadian company led by Mr Robert Friedland², discovered one of the world’s largest untapped copper reserves in

² Also known under the nickname “Toxic Bob” because of an environmental disaster his gold mining company caused in Colorado in the 1990s (Rossabi 2005: 103).
Oyu Tolgoi (“Turquoise Hill”) in Southern Gobi, close to the Chinese border (Pomfret 2010: 13). The discovery captured the attention of international mining investors and further stimulated exploration activities. Only one year later, the IHT described Mongolia as “one of the world’s hottest spots for mining exploration” (IHT, 15/10/2004). Accordingly, Figure 1 shows strong increases in FDI inflows between 2000 and 2005, even though the numbers are dwarfed by later developments.

**Figure 1. FDI inflows in Mongolia, by sector and as a share of GDP**

DATA SOURCES: UNCTAD Stat (2012) and FIFTA (2011)
1.3. One step back: From foreign investment attraction to foreign investment regulation (2006-2012)

With the beginning of the mining boom, the enthusiasm of Mongolian policymakers for liberal investment laws and for more foreign-investor protection disappeared. The frequency of signing new BITs and DTTs, an easily measurable indication of government efforts to attract foreign investors, declined sharply after 2005 (UNCTAD IIA Database 2012). Finally, two important legislative acts that were adopted in the year 2006 uttered a clear signal of a new stance of Mongolian policymakers towards FDI inflows: On 12 May 2006, the government introduced a very hefty Windfall Profit Tax of 68 per cent, which was to be applied if copper prices exceeded USD2,600 per tonne and gold prices were above USD500 per ounce. Both copper and gold prices exceeded these thresholds by large margins at that time, and the Windfall Profit Tax caused outrage in the mining community. On 8 July 2006, parliament adopted a new Minerals Law that superseded the 1997 legislation and which was significantly more restrictive in scope. Under the new law, only legal persons established under Mongolian Law can own mining licenses, royalty rates on exported minerals were increased, and, most importantly, the notion of ‘strategic deposit’ was introduced: any company holding an exploration or mining license for such a ‘strategic deposit’ was obliged to list at least 10 per cent of its shares on the Mongolian Stock Exchange and the Government of Mongolia had the right

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3 At the time of writing, Mongolia had ratified 39 BITs and 31 DTTs (UNCTAD IIA Database 2012). Mongolia signed only 3 BITs and 1 DTT over the last seven years (2006-2012). In contrast, over the seven-year period from 1999 to 2005 the frequency had been 18 for BITs and 12 for DTT and 16 and 17, respectively, for the seven-year period from 1992 to 1998.
to acquire 34 per cent of the shares of the investment (50 per cent in case that public funds had contributed to the exploration of the deposit). The public acquisition did not require an immediate compensation and could be financed out of future dividends (Connors 2011). The law did not specify a clear definition of ‘strategic deposits’, leaving the classification open to parliament⁴. Not surprisingly, Mongolia’s position in a global ranking of mining policy regimes deteriorated sharply in 2006: Mongolia’s Fraser Index⁵ fell from 53.8 (2005) to 11.5 (2006) points, and its position fell from 33rd to 62nd out of 64 countries surveyed.

The year 2009 brought more positive, although mixed, signals to the foreign investor community: After six years of lengthy negotiations, the Oyu Tolgoi Investment Agreement between the Mongolian Government, Ivanhoe Mines and Rio Tinto was concluded, unleashing the largest mining project in the country’s history. Government ownership of the project was set at 34 per cent. As part of the deal, the Government promised to abolish the Windfall Profit Tax by 1 January 2011 (World Bank 2010:13). However, these concessions were accompanied by stronger regulations in other laws: the 10 per cent VAT exemption on the imports of mining supplies was abolished and a new Nuclear Energy Law and the Mining Prohibition in Specified Areas Law were adopted by parliament. The first classified all radioactive mineral deposits as strategically important and gave an automatic 34 per cent (51 per cent if public funds contributed to exploration) equity ownership to the newly formed state-owned

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⁴ By August 2012, the parliament had determined 39 such ‘strategic’ sites (MMJ, July 2012b: 68-73).

⁵ The index is calculated based on an annual survey among mining executives, published by the liberal Canadian think-tank Fraser Institute since 2001. 100 is the highest score, 0 the lowest.
company Monatom LLC without any compensation; the latter prohibited mining or exploration activity in areas adjacent to rivers, lakes and forests (Connors 2011). As a whole, the developments were judged positively by the mining industry: Mongolia's Fraser Index increased to 35.7 points (2010) and it climbed the country ranking to 54th out of 79 nations surveyed.

Figure 1 above illustrates the sharp increases of mining FDI inflows into Mongolia from 2005 to 2010. The figures published by the Mongolian government agency FIFTA (2011) show that close to eighty per cent of registered FDI inflows in recent years are targeted at the mining sector (green blocks in Figure 1). Confronted with these developments, Mongolian policymakers adopted further restrictions on FDI inflows. On 20 April 2010, Mongolian President Elbegdorj released a presidential decree, which put a moratorium on the issuing of new exploration and mining licenses with immediate effect to combat corruption at the license-issuing Minerals Resources Authority (Economist 2012). On 17 May 2012, the Great Hural adopted the new Law on Foreign Investments to Strategically Important Enterprises. The Law states that foreign state owned companies are not allowed to acquire more than 49 per cent ownership of any Mongolian company or mineral reserves without the explicit approval of the national parliament in three strategic sectors: mining, banking and finance, telecommunications and media. Private foreign companies also need to seek parliamentary approval if the investment exceeds US$75 million (Interview 9). Although drafts of the law had been discussed as early as 2010 (Interview 8), the surprise adoption by parliament was widely interpreted as a specific measure to avoid the planned takeover of Ivanhoe Mines-held
SouthGobi Resources’ coal deposits by the Chinese state-owned company Chalco without violating international obligations (Interview 7, Interview 8, Interview 13, FT 2012).

Overall, the regulation of FDI in Mongolia has been subject to volatile changes over the last decades: Mongolia jumped from a closed communist economic system to a very liberal regime open to FDI in the 1990s. In the mid-2000s policymakers adopted major restrictions to FDI inflows in the mining sector. These restrictions were partly reversed in 2009, just to be reinvigorated by new restrictive measures in the most recent years.
PART II. Explaining the variation in the openness of FDI policy in Mongolia

The second part will now turn to explain the political origins of the observed regulatory volatility. It is argued that the adoption of liberalizing and restrictive FDI policy changes is driven by two different combinations of three distinct political forces: societal interests, the political strategy of politicians and the leverage of IFIs. In an economy that is highly reliant on the export of minerals such as Mongolia, all three of these forces are affected strongly by the evolution of international mineral prices (Section 1): when mineral prices are low, the combination of the three forces leads to a political economic equilibrium of liberalization of FDI policy (Section 2). Yet, when mineral prices are high, the incentives of interest groups and politicians change substantially and the influence of IFIs decreases strongly, giving rise to an equilibrium of restrictions to FDI policy (Section 3).

1. International commodity prices and Mongolia’s economic fundamentals

One may expect that rational governments will liberalize their mining policy in periods of high prices in order to derive the maximum benefit from the price surges (e.g., O’Callaghan and Vivoda 2010, Pomfret 2010: 14). However, in contrast to this reasoning, several studies found that a majority of nationalizations in the oil industry occurred during periods of high oil prices (Tugwell 1975, Wälde 2008, Vivoda 2009, Guriev et al 2011). The pattern of FDI
policy reforms in Mongolia suggests a similar dynamic: Figure 2 shows the coincidence of liberalizing changes (green color) with periods of low or falling mineral prices and restrictive changes (red color) with periods of increasing mineral prices.

All major liberalizing reforms in FDI policy were undertaken in periods of relatively low or falling commodity prices: The Foreign Investment Law of 1993 and the very liberal Minerals Law of 1997 were adopted during the period of relatively low mineral prices during the 1990s. The conclusion of the Oyu Tolgoi Investment Agreement and the promise to abolish the Windfall Profit Tax were adopted shortly after the abrupt fall of copper and coal prices in the wake of the global financial crisis in 2009. Instead, the most stringent restrictions on foreign investments in the Mongolian mining sector, the more restrictive Minerals Law
of 2006, the Windfall Profit Tax and the Strategic Investment Law of 2012, were all introduced after the strong increases in mineral prices from 2002 to 2006, or after the recovery of the commodity boom in 2010.

To a certain extent, this apparent regularity seems to conform with the political economy theories of crisis-induced liberalization, which suggest that countries are more likely to adopt liberal reforms in times of economic crises\(^6\) when they are more desperate to attract foreign capital (Haggard and Maxfield 1996) and their bargaining power against MNCs is low (Lukauskas and Minushkin 2000). However, so far, political economy theories of crisis-induced liberalization have failed to clearly identify the causal mechanism, which links a good economic situation with restrictive policy changes and a bad economic situation with liberalizing policy changes\(^7\).

The case of Mongolia, in which years of bad economic fundamentals coincide with periods of low mineral prices and years of good economic fundamentals coincide with high mineral prices, suggests that it is the peculiar interaction of the incentives of politicians and economic sectors, and the leverage of IFIs in ‘good’ and ‘bad’ years, which causes liberalizing and restrictive changes to a country’s FDI policy. Section 2 will explain the political economy in Mongolia during ‘bad’ years when mineral prices are low. Section 3 will explain the political economy during ‘good’ years when mineral prices are high.

\(^6\) Indeed, Mongolia’s economic indicators are strongly tied to the developments of international mineral prices: generally, years of low international mineral prices are also years of economic difficulties for Mongolia, while the performance of the Mongolian economy regularly improved during years of high mineral prices.

\(^7\) Haggard and Maxfield (1996: 37) hypothesize a rather obscure ‘shift in political power towards internationalist sectors’ and Lukauskas and Minushkin (2000: 696) mention a ‘change in external bargaining power’ as the possible causes. Yet, the evidence they present is rather thin.
2. The Mongolian political economy during periods of low or falling commodity prices

2.1. Societal interests

The liberalization of FDI policy benefits some sectors of the economy and harms others. Political science extensions of the Heckscher-Ohlin and Stolper-Samuelson theorems of trade hypothesize that - assuming that factors are nonspecific - it is the abundant factors in an economy that benefit from liberalization, while the scarce factors are harmed (Rogowski 1989). Yet, if the specificity of factors is high, a more complex sector-based analysis is logically more appealing (Frieden 1991). In general terms, abundant factors or sectors are the social groups that are close to a country’s economic comparative advantage, and scarce factors or sectors are those far from a country’s comparative advantage (Frieden and Rogowski 1996: 37). Pinto (2003) and Hiscox (2008: 103-106) propose applications of these trade theories to FDI: in developing economies, they suggest, domestic capital owners (the scarce factor that benefits from excessive interest rates) are generally harmed by the liberalization of FDI inflows while nonspecific labour is the main beneficiary.8

Given the vast territory and the small population of Mongolia, the abundant factors in Mongolia are the land, which is mostly a public good that is used by nomadic herders, and the mineral reserves in the subsoil, particularly copper, coal and gold. The scarce factors are capital and labour. The most competitive

8 However, in practice, the analysis of the distributional effects of FDI inflows is more complex, because different types of FDI inflows can have different effects (Walter and Sen 2008: 189).
sectors in the Mongolian economy in the 1990s were the production of cashmere wool and meat, and the extraction of copper (Interview 3). Instead, light manufacturing such as textiles, leather goods and carpets, were not internationally competitive and many of these industries collapsed during the liberalization period of the 1990s when governmental protection and subsidies were removed (Pomfret 2000: 153, Reinert 2004, Rossabi 2005: 80-113). Table 1 shows that the agricultural sector performed relatively well during the 1990s: the gross agricultural output, size of livestock and meat exports increased throughout the period. Instead, the gross manufacturing output declined. Copper exports increased slightly while the level of coal exports remained low during the 1990s. Based on this economic structure, we would expect that nomadic herders would support the liberalization of Mongolia’s FDI policy, while capital owners and manufacturing industries should resist it. In reality, we have seen very little political resistance to the liberalization of FDI policy from capital owners and manufacturing labour during the 1990s. The lack of resistance from capital owners, however, is not very surprising, because the implications of FDI inflows for capital owners are ambiguous: while official interest rates may fall due to increasing capital inflows, lending to FDI-induced projects can also be a source of high returns. Therefore, the resistance of capital owners to a liberalization of FDI policy should be weak at best. Instead, the absence of strong protests from manufacturing labour is rather unexpected. Yet, it can be explained by a particularity of the Mongolian economy: as a majority of the persons employed in the manufacturing sector had grown up in the countryside, many of them chose the ‘exit’ over the ‘voice’ option (Hirschman 1970) and returned to traditional self-sufficient nomadic life (Pomfret 2000, Reinert 2004).
In sum, while not explaining the turn to a liberal FDI policy stance during the 1990s, the analysis of societal interests is nevertheless useful to understand the absence of strong opposition to the economic liberalization program in Mongolia in the 1990s.

Table 1. The evolution of the export industry, industrial and agricultural output in Mongolia, 1990-2000

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<td><strong>Gross manufacturing</strong></td>
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<td>output (bln tugrug, constant 1995)</td>
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<tr>
<td><strong>Livestock</strong></td>
<td>25.8</td>
<td>...</td>
<td>28.6</td>
<td>29.3</td>
<td>31.3</td>
<td>32.9</td>
<td>33.6</td>
<td>30.2</td>
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<tr>
<td>(million of heads)</td>
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</table>


2.2. State interests

FDI inflows also affect the interests and strategies of politicians and high-level government officials, who can derive direct and indirect benefits from both open and closed FDI policies (Walter and Sen 2008: 191). Economic approaches to political behaviour in democracies make the plausible assumption that the ultimate goals of politicians and high-level public officials are twofold: they want to stay in office and satisfy their own personal material interests (Downs 1957, Niskanen 1971, Geddes 1993). To be re-elected, political leaders have to satisfy the electorate with a good economic performance that benefits the voters. To
maximize their own personal benefits, politicians will try to hold control over rent creation and distribution. As I will show, the liberalization of FDI policy helped Mongolian politicians to achieve both of these goals during the 1990s when mineral prices were low.

The withdrawal of Soviet economic assistance and military protection in 1990 posed two severe policy challenges to Mongolia’s political leaders during the transition period (Interview 5): To avoid economic collapse and to prevent a military invasion by Chinese troops. The liberalization of FDI policy was part of a broader political strategy to prevent both of these two scenarios. On the one hand, Mongolian policymakers hoped that a liberal FDI policy would attract external funds desperately needed to repel economic collapse (Interview 9). On the other hand, it was also seen as a way to strengthen the economic ties with the West and Japan who were to guarantee Mongolia’s military and economic survival and who provided essential budgetary support (see also Section 2.3.).

But at the same time, a liberal FDI policy was also in the personal interest of politicians and high-ranking officials. Against the claim of neoclassical economics that economic closure creates rents and economic opening dissipates them, the case of Mongolia clearly illustrates that both economic opening and closure give rise to different types of rent capturing opportunities. The two single most important sources of rents for the Mongolian political elite in the 1990s were the privatization process and the issuance of exploration and mining licenses: the liberal mining policy anchored in the 1997 Law facilitated the private acquisition of mining licenses and allowed the amassing of as many as forty to fifty such licenses by well-connected individuals (Interview 6). The reliable geological
surveys that had been conducted by Soviet and Eastern European engineers in the 1980s further reduced the risks of such acquisitions for investors with good political connections (Interview 6). At the same time, the voucher-based privatization program led to a concentration of ownership over the few profitable formerly state-owned companies in the hands of a small number of politically powerful families (Fritz 2008). In this context, the opening up of the FDI policy and the adoption of a liberal mining policy was strongly in the interest of politicians and high-level officials because it increased the demand (and hence the value) of the mining licenses and shares in Mongolian companies that they were holding.

Hence, while societal resistance to an opening up of the FDI policy was low, Mongolian politicians and high-ranking officials actively benefited from a liberal FDI policy: it was a tool to avoid economic collapse, which at the same time increased the personal wealth of the political elite. To complete the puzzle, liberalizing changes were also strongly supported by international donors, who enjoyed significant leverage in the period of low mineral prices, as discussed in the next section.

2.3. International donors

Donors from the West and Japan were the partners of choice of Mongolian politicians to avoid economic collapse. Without any doubt, IFIs played a prominent role in Mongolian politics in the 1990s. Yet, the specific influence of IFIs on the liberalization of FDI policy is debated in the political economy
literature: an econometric cross-country study of the determinants of FDI policy by Stephen Kobrin (2005) finds no statistically significant support for the hypothesis that an increasing amount of World Bank and IMF loans in a country increases its likelihood to liberalize the investment regime. Instead, qualitative case studies of mining reform in Africa compiled in Campbell (2004) claim that IFIs exerted a very strong influence on African governments to adopt liberal mining codes both through soft means, such as well-meaning consultants, as well as more coercive tools, such as conditional loans.

The degree of engagement of IFIs in post-Soviet Mongolia has been strong in international comparison. The sudden stop of Soviet aid money that had amounted to up to one third of GDP during most of the second half of the twentieth century (Bradsher 1972), put Mongolia on the brink of economic collapse. In the short term, the Mongolian economy could only be sustained thanks to a substitution of Soviet aid through loans of Western donors and Japan. Due to its geostrategic position and the democratic commitment of the political leadership, Mongolia became some sort of an ‘aid darling’ (Laird and Guariglia 2000: 82) and the annual ratios of aid inflows as a share of GDP were some of the highest in the world (see Figure 3). Obviously, this provided international donors with a potentially strong leverage over policy decisions in Mongolia. And all of the interviewees and most secondary sources (e.g., Rossabi 2005, Jeffries 2007, Reinert 2004) agree that the IMF, the World Bank and the ADB did not hesitate to make use of their financial leverage and that their influence on policy decisions in Mongolia was significant during the 1990s. With regards to FDI policy, the World Bank played an important role in the drafting of both of the
two crucial legislations adopted in the 1990s: the Foreign Investment Law of 1993 (Interview 4), and the Minerals Law of 1997 (Interview 8). One interviewee, a staff member of the Minerals Division at the Office of the President, argued that the 1997 Minerals Law was essentially written by World Bank consultants according to their view of ‘international best practice’. Apparently, *ex post*, the law is well known among government officials working for the Minerals Resources Authority as ‘The World Bank Law’ (Interview 8). The fact that the liberal mining policy was reversed soon after the leverage of IFIs decreased (see section 3.3.), is a relatively strong indication that the 1997 Law was against the government’s favoured policy choice. Nevertheless, this study does not support the extreme view that the liberalization of Mongolian FDI policy was dictated by IFIs. As shown in the previous section, the main reason for the liberalization of FDI policy was that it served the interests of domestic policymakers. The role of IFIs in the liberalization process of FDI policy in Mongolia is best described as supporting: IFIs had an important impact on the content of FDI legislation in Mongolia, but only because Mongolian politicians chose them as their strategic partner. In this sense, it was not a case of pure coercion. In turn, the relationship of Mongolian policymakers with IFIs is best described as pragmatic: they granted political influence to IFIs because their budgetary support was essential to prevent economic collapse. But as soon as the need for budgetary support faded as international mineral prices increased, Mongolian policymakers turned away from their advice (see section 3.3.).
Figure 3. ODA outflows to Mongolia as a share of GDP, 1990-2000

Viewed as a whole, the liberalization of FDI policy in Mongolia in the 1990s is not a surprise: it was in the interest of Mongolian politicians and supported by international donors, while domestic interest groups had little reason to resist it. The adoption of a liberal FDI regime was a way to secure essential funds to avoid economic collapse, which at the same time allowed politicians and high-ranking officials to derive personal material benefits. All this was to change with the spike of mineral prices in the beginning of the 2000s.
3. The Mongolian political economy during periods of high commodity prices

3.1. Societal interests

The spike in mineral prices in the early 2000s shifted the incentives of sectoral interest groups substantially, resulting in a realignment of preferences among economic sectors. The commodity price increases were so extreme that they caused a veritable explosion of coal extraction (see Table 2) and capital inflows into the Mongolian mining sector (see Figure 1). Some sectors, in particular domestic banks, consumer goods importers, construction and real estate companies reaped the benefits from the increases in purchasing power of mining executives and the political elite (OGB 2012: 29-37). But other sectors suffered from strong adverse effects of the massive inflows of external funds (cf. Frieden and Rogowski 1996: 41-42): The massive inflows of cash into the small Mongolian economy led to a spike in inflation and interest rates, a very strong appreciation of the exchange rate, as well as environmental degradation (Bolor 2011). These developments fuelled resistance to the liberal FDI policy adopted in the 1990s, mounting pressure for more restrictions on FDI inflows targeted at the mining sector.

Nomadic herders were hit by the appreciation of the tugrug, the Mongolian currency, as it undermined the price competitiveness of Mongolian cashmere wool and meat and Mongolia’s comparative advantage in the agricultural sector more generally. Table 2 shows that while gross agricultural output increased, meat exports declined rather dramatically after reaching a peak in 2002. Mining
exploration and extraction projects were also destroying ever more pastureland, affecting the nomads’ traditional way of life. In addition, to benefit from the high gold prices, up to 100’000 nomadic herders turned to artisanal small-scale mining - pejoratively dubbed as ‘ninja mining’ -, entering into competition over territory with large-scale miners (Interview 10). Hence, given this new situation, nomadic herders overall had good economic reasons to oppose the liberal mining policy. At the same time, the mining boom further deteriorated the situation of the stagnating domestic manufacturing industry: domestic companies suffered under the increase of the interest rate and the growing competition for the scarce high-skilled labour force, which was driving up wage levels (Bolor 2011). Domestic mining companies, in addition to their obvious interest in increasing domestic participation requirements in mineral extraction, also resented the regulatory advantages, such as tax incentives, granted to foreign mining companies, calling for a ‘level playing field’ (Interview 11, Interview 13). In sum, while the mining boom pushed profits in the banking, real estate and imports industry, the politically influential agricultural sector received incentives to turn against the liberal mining policy, together with the stagnating manufacturing sectors. Thus large social groups had good economic reasons to “change their mood” (Interview 12) against foreign mining companies in the early 2000s and to be receptive to so-called ‘resource nationalism’.
Table 2. The evolution of the export industry, industrial and agricultural output in Mongolia, 2001-2008

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
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<th>2007</th>
<th>2008</th>
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<tr>
<td><strong>Meat exports</strong></td>
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<td></td>
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<tr>
<td>(thousands tonnes)</td>
<td>19.8</td>
<td>23.3</td>
<td>15.1</td>
<td>8.4</td>
<td>7.8</td>
<td>11.7</td>
<td>10.9</td>
<td>10.3</td>
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<tr>
<td><strong>Coal exports</strong></td>
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<tr>
<td>(thousands tonnes)</td>
<td>1.9</td>
<td>10.9</td>
<td>435.4</td>
<td>1’635.1</td>
<td>2’217.8</td>
<td>2’380.1</td>
<td>3’269.0</td>
<td>4’169.3</td>
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<tr>
<td><strong>Copper exports</strong></td>
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<tr>
<td>(thousands tonnes)</td>
<td>540.9</td>
<td>548.6</td>
<td>568.9</td>
<td>562.6</td>
<td>587.1</td>
<td>599.5</td>
<td>607.8</td>
<td>582.9</td>
</tr>
<tr>
<td><strong>Gross manufacturing output</strong></td>
<td>...</td>
<td>321.5</td>
<td>370.3</td>
<td>341.6</td>
<td>253.5</td>
<td>...</td>
<td>...</td>
<td>...</td>
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<tr>
<td>(bln tugrug) constant 2000/constant 2005</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>310.3</td>
<td>387.2</td>
<td>540.8</td>
<td>575.0</td>
</tr>
<tr>
<td><strong>Gross agricultural output</strong></td>
<td>...</td>
<td>317.6</td>
<td>338.7</td>
<td>413.1</td>
<td>446.6</td>
<td>...</td>
<td>...</td>
<td>...</td>
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<tr>
<td>(bln tugrug, constant 2005)</td>
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<tr>
<td><strong>Livestock</strong></td>
<td>26.1</td>
<td>23.9</td>
<td>25.4</td>
<td>28.0</td>
<td>30.4</td>
<td>34.8</td>
<td>40.3</td>
<td>43.3</td>
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<td>(million of heads)</td>
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### 3.2. State interests

The spike in international commodity prices also fundamentally changed the strategy of Mongolian politicians and high-level officials: as the opportunity costs of mining MNCs to stay out of Mongolia increased proportionally to the mineral prices, the need of the government to actively attract foreign investors decreased. In consequence, the priority of policymakers changed from maximizing FDI inflows to maximizing taxation on foreign investments. In turn, the spike of mining taxation revenues allowed politicians to pursue populist policies to assure their re-election. As a whole, the easy access to taxation revenues and the strengthening of the external bargaining power against MNCs
made room for a more comfortable (and significantly less FDI-friendly) political strategy towards re-election and personal rent-seeking: economic populism.

One indication of the fundamental change in political strategy in Mongolia between the 1990s and 2000s, is the lack of a partisan difference regarding FDI policy⁹: during the period of low mineral prices in the 1990s both major parties, the MPRP and the DC, had supported a reform program of drastic economic liberalization, which included the removal of obstacles to foreign investors and the granting of generous tax incentives. In contrast, in the first decade of the twentieth century, both parties – which governed the country as a grand coalition from 2004 until 2012 - unanimously supported more regulation of foreign investments in the mining sector. Accordingly, it is difficult to find any major differences in the party manifestos for the 2012 elections, with both parties strongly advocating more stringent regulations of foreign investment in the mining sector (MMJ 2012a: 82-84). The reason for this consensual shift in FDI policy is a change in the broader political strategy of both parties from economic survival during the 1990s to economic populism during the 2000s. As the government gained easy access to revenues, policymakers’ priority shifted from attracting FDI and ensuring the budgetary support of international donors to repel economic collapse, to maximizing the revenues and to redistribute them in order to please voters. The Windfall Profit Tax of 2006 is an exemplary illustration of this new strategy. Populist policies, such as gifts to newly wed couples and new born babies, the distribution of shares in state-owned mining companies before elections or just straightforward cash handouts to every

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⁹ This observation also contradicts Pinto (2003) who argued that left governments are more supportive of FDI inflows than right governments.
citizen, have increased dramatically over the last few years (Interview 3). One Mongolian economist has calculated that such forms of populist policies amounted to up to ten per cent of Mongolian GDP in 2011 (ME 2012).

At the same time, powerful politicians and government cadres have attempted to enlarge their personal shares of the dramatically increasing government revenues. There are strong indications that political corruption, which was nearly inexistent during the socialist regime (Galbaatar 2012), has become a serious issue and many analysts have shown concerns about an 'oligarchization' of Mongolian society (Rossabi 2009, Interview 7, Interview 10). Accordingly, the position of Mongolia in Transparency International's annual Corruption Perception Index has deteriorated continuously: from 85th out of 158 countries in 2005, to 102nd out of 180 countries in 2008, and to 120th out of 182 countries in 2011 (TI 2012).

Thus, while societal pressures to reduce mining FDI have increased, it was also in the interest of politicians and high-level officials to change their stance on FDI policy. Taking advantage of their markedly stronger bargaining power, their priority became to maximize taxation rather than to attract foreign investments. The replacement of the budgetary support granted by international donors through mining taxation revenues further facilitated this strategy, as will be discussed in the next section.
3.3. International donors

Without exception, all interviewees agreed that the influence of IFIs has faded during the 2000s. One interviewee (Interview 8), who acted as a member of the Working Group that drafted the 2006 Minerals Law, said that the staff of the World Bank played at best a marginal role in their deliberations. This evolution seems also confirmed by the implementation of the Windfall Profit Tax and the new Minerals Law in 2006, both strongly against the will of IFI representatives (Interview 7). Many interviewees understood the decreasing influence of international donors in the new millennium as a disappointment with the outcomes of the liberal agenda, in particular increases in corruption and social inequality (Interview 1, Interview 3), which undermined the IFIs’ abilities of intellectual persuasion. Yet, the events in the wake of the global financial crisis suggest that persuasion never played a major role and that it was rather the decreasing leverage of IFIs through conditional loans that drove the strong reduction of IFI influence over Mongolian policy in the mid-2000s. Figure 4 shows that the levels of aid inflows as a share of GDP decreased sharply in the mid-2000s. But then, rather unexpectedly, WB officials returned to Mongolia in the autumn of 2008. The dramatic decreases of mineral prices had hit the country, whose budget was relying on mineral revenues to approximately one third (World Bank 2009: 15), completely unprepared. To avoid financial collapse, the government had to negotiate a USD229 millions standby-agreement with the IMF, a USD60 millions Development Policy Credit with the World Bank, a USD60 millions loan agreement with the ADB, and a bilateral loan from Japan for USD50 millions (World Bank 2010: 13). The DPC report, which is available
online, strongly criticizes the Windfall Profit Tax and the 2006 Minerals Law (World Bank 2009: 10) and explicitly mentions “to review and revise the minerals policy and law” (World Bank 2009: 43) as one of the key objectives of the DPC program. Effectively, later in the same year, the government promised to abolish the Windfall Profit Tax by 2011 and the Oyu Tolgoi Investment Agreement came to conclusion. How strongly these outcomes are connected to the conditional loans granted in 2009 is not clear. Nevertheless, the general sentiment of a rapidly fading influence of IFIs during the periods of economic boom before and after the crisis, and the coincidence of WB-supported reform efforts in the years of crisis are a relatively clear indication that the leverage of IFIs did play a role.

**Figure 4. ODA outflows to Mongolia as a share of GDP, 2001-2010**

*Sources: ODA flows from OECD Stat (2012), GDP from WB Databank (2012)*
In sum, it has been shown that the turn to restrictive FDI policies in the 2000s is the result of an interaction of three distinct political forces: The strengthened governmental bargaining power allowed politicians to increase taxation on FDI to finance populist policies, at the same time that interest group pressures to restrict mining FDI increased as the agricultural and manufacturing sectors felt the adverse effects of the mining boom, and the substitution of budgetary support from international donors through mining taxation revenues markedly decreased the influence of IFI representatives over FDI policy decisions.

4. Alternative explanations

4.1. ‘I’m a Believer’? Change in norms and ideology of policymakers

A growing literature in political economy has successfully argued that ideas can have an important impact on economic policymaking, independently from individuals’ material self-interests (e.g., Blyth 2002, Chwieroth 2010). Kobrin (2005: 67) considers “(local) policy makers’ beliefs that attracting more FDI is in the best interest of their countries” as the main driving force behind the liberalization of FDI policy in the 1990s. Similarly, Sumner (2008: 253) sees the rise of sceptical scholarship about the benefits of FDI and “shifts in the policy narrative” as the main reason for the spread of restrictions to FDI policy in the 2000s.

A major difficulty with such arguments is how to measure changes in ideas objectively and how to disentangle the personal beliefs of policymakers from persuasion by epistemic communities. Probably the most promising avenue to
tackle this challenge is to start by analyzing the educational background of policymakers (Chwieroth 2007a, 2007b, 2010). Table 3 provides this information for the three most powerful economic policymakers in Mongolia between 1990 and 2012. The table shows that the political leadership from 1990 to 1996, which agreed to open up Mongolia to foreign investments and to attract foreign investors with regulatory advantages through the Foreign Investment Laws of 1990 and 1993, were mostly economists educated in Moscow and Irkutsk (the closest major city to the Mongolian border), former communist party officials aged between forty and sixty. The victory of the opposition Democratic Coalition in the 1996 elections brought a change in profile, bringing in a new generation of politicians (born between 1955 and 1967), many of whom are leading the country until today. It is striking that this new generation has a much more diverse educational and professional background: among the most prominent politicians there are a former journalist (Elbegdorj), a novelist/translator (Enkhbayar), three natural scientists (Narantsatsralt, Batbayar and Altanhuyag), three lawyers (Bayar, Bayartsogt and Tsagaan), five economists (Amarjargal, Enkhbold, Ochirsukh, Ulaan, Bayartsaikhan), an entrepreneur (Batbold) and a former refrigerator technician at a Beer and Vodka factory in Ulaanbaatar with a remarkable professional career who turned President for two successive full terms from 1997-2005 (Bagabandi). A second striking feature is their increasing exposure to the West: among them are graduates of the Harvard Kennedy School, Columbia University, the London Business School, the Imperial College London, Leeds University and Bradford University. However, the effect of this increasing ‘Westernization’ on Mongolia’s FDI policy is not as expected: as we have seen, the leaders of this new generation
seemed to take a more critical stance regarding free markets and foreign investors than their USSR-educated antecedors.

In sum, the correlation between educational background and FDI policy appears rather weak. In particular, the hypothesis that more Western exposure during university education leads to more liberal policymaking is not confirmed. There are two potential mitigating factors: First, the policymakers completed studies in a great variety of fields, of which many are not associated with economic liberalism (such as biophysics or translation). Second, education in the West is probably overall more sceptical towards free markets than supposed. Also, none of the Mongolian leaders had graduated from one of the departments defined as ‘neoliberal’ by Chwieroth (2007a: 12).

Table 3. Educational and professional background of the political leaders in Mongolia from 1990 to 2012

<table>
<thead>
<tr>
<th>PRIME MINISTER</th>
<th>PRESIDENT</th>
<th>MINISTER OF FINANCE</th>
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<tbody>
<tr>
<td><strong>1990</strong></td>
<td>Gungaadorj, MPRP, *1935, PhD in agricultural science, State Agricultural University Moscow</td>
<td>Ochirbat, MPRP, *1942, engineer and mining specialist, University of St. Petersburg</td>
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<tr>
<td><strong>1991</strong></td>
<td>Byambasüren, MPRP, *1942, economist, Moscow Higher School of Economics and Statistics</td>
<td></td>
</tr>
<tr>
<td><strong>1992</strong></td>
<td>Jasrai, MPRP, *1933, agricultural economist, Moscow Higher School of Economics and Statistics</td>
<td>Ochirbat, DC (new), *1942, engineer and mining specialist, University of St. Petersburg</td>
</tr>
<tr>
<td><strong>1993</strong></td>
<td></td>
<td>Bayambajav, *1939, economist, Finance and Economics Institute of Irkutsk</td>
</tr>
<tr>
<td><strong>1994</strong></td>
<td></td>
<td>Tsagaan, *1959, lawyer, Mongolian National University MNU</td>
</tr>
<tr>
<td><strong>1995</strong></td>
<td></td>
<td>Batbayar, *1954, biochemist, Moscow State University and Imperial College London, UK</td>
</tr>
<tr>
<td><strong>1996</strong></td>
<td>Enkhsaikhan, DC, *1955, PhD in economics, Kiev State University</td>
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<tr>
<td><strong>1997</strong></td>
<td>April-July: Elbegdorj, DC, *1963, journalist and political scientist, Lviv Military Academy and Harvard Kennedy School</td>
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<td><strong>1998</strong></td>
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<td><strong>1999</strong></td>
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<td>--------------------------------------------------------------------------</td>
</tr>
<tr>
<td>2000</td>
<td>Enkhbayar, MPRP</td>
<td>economist, Mongolian National University</td>
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<td>2001</td>
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<td>2002</td>
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<td>2003</td>
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<tr>
<td>2004</td>
<td>Elbegdorj, DC</td>
<td>economist and political scientist, Lviv Military Academy and Harvard</td>
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<tr>
<td>2005</td>
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<td>School</td>
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<tr>
<td>2006</td>
<td>Enkhbold, MPRP</td>
<td>economist, Mongolian National University</td>
</tr>
<tr>
<td>2007</td>
<td>Bayar, MPRP</td>
<td>lawyer and journalist, Moscow State University</td>
</tr>
<tr>
<td>2008</td>
<td>Batbold, MPRP</td>
<td>economist and entrepreneur, MGIMO and London Business School</td>
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<td>2009</td>
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<tr>
<td>2012</td>
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</tbody>
</table>

**December 98-July 99:** Narantsatsralt, DC, *1957, PhD in geography, Moscow State University

**From August 99:** Amarjargal, DC, *1961, economist, Plehanov Institute of National Economy in Moscow and University of Bradford, West Yorkshire, UK

**Bagabandi, MPRP, *1950, technician and philosopher, Odessa City Institute for Refrigeration Technology and Moscow Academy of Social Sciences**

**Ochirsukh, *1967, economist, Mongolian National University and Columbia University, US**

**Ulaan, *1954, PhD in economics, University of Irkutsk**

**Altanhuyag, *1958, biophysicist, Mongolian National University**

**Bayartsaikhan, *1962, economist and political scientist, University of Irkutsk**

**Bayartsogt, *1967, lawyer and economist, Moscow State University and Academy of Foreign Trade, Baden Wurttemberg, Germany**

**SOURCES:** Rossabi (2005), Sanders (2010)

### 4.2. A falling domino? Competition with other mineral-rich economies, emulation and learning

Diffusion theorists have argued that policymaking has become increasingly interdependent, i.e. that decisions in one country are dependent upon decisions made in other countries. For instance, Kobrin (1985) argued that the successful nationalizations of oil industries in Algeria and Libya in 1971 had a demonstration effect, which subsequently led to the diffusion of nationalizations.
in oil industries around the globe. Policies can spread across countries for a variety of reasons (Simmons et al 2008: 1-63, Poulsen 2011: 47-76): competition among nation-states may lead to the adoption of similar policies among rivals; countries may learn from successful policy experiments in other countries; policymakers may copy policies from their peers not primarily because of their effectiveness, but because they are considered as symbolically ‘appropriate’, a phenomenon described as emulation (Simmons et al 2008: 31-40); or powerful actors - such as IFIs - may coerce weaker states to adopt certain policies. The coercive element has been discussed at length in the previous sections. This section will show that the other three mechanisms of diffusion, especially competition, the most plausible channel of diffusion in this case, did not have a strong influence on FDI policy in Mongolia.

Figure 5 shows the FDI policy changes in the twenty nation-states most dependent on the exports of minerals, as calculated by UNCTAD (2007:85). The data on FDI policy changes is from UNCTAD’s unpublished Investment Policy Monitor database. The original dataset distinguishes changes in eight categories (data from 1992 to 1999) and three categories (since 2000). To facilitate comparison I have removed this categorical distinctions, so that +1 means ‘at least one liberalizing change’ and -1 means ‘at least one restrictive change’ in country x in year y.

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10 I would like to thank Professor Stephen Kobrin, Dr Joachim Karl and Mr Thomas van Giffen for sharing the datasets.
Overall, Figure 5 shows a constant trend with approximately one quarter of the twenty countries (the minimum is four, the maximum eight) undertaking a more liberalizing reform to its FDI policy every year between 1992 and 2001. From 2002 to 2006, regulatory activity increased to a maximum of twelve countries undertaking reform in 2006. In this period, more restrictive changes occurred; however, two out of three changes were still in the liberalizing direction. This changed in the years 2007 and 2008 when the frequency of liberalizing reforms decreased strongly and more restrictive than liberalizing changes were observed. In 2010 and 2011 again half of the changes were restrictive. Hence, Mongolia’s main liberalizing efforts in 1993 and 1997 occurred in a period of a general international environment of steady liberalization of FDI policy among...
minerals exporters. However, it is not likely that diffusion played an important role. At that time, Mongolia’s economy was not internationally competitive to attract FDI in any sector, so there was no obvious rival whom to compete with. Learning or emulation from peers also doesn’t seem a convincing explanation, because most of the regional success stories (such as Japan, Taiwan, Korea or China) had adopted a more moderate approach to FDI attraction than Mongolia did in the 1990s (see Wade 1990, Amsden 2001). The Minerals Law of 2006 and the introduction of the Windfall Profit Tax coincide with the year of highest regulatory activity. However, only three other mineral exporters (Bolivia, Peru and Zambia) adopted a restrictive change in the same year, while nine countries adopted liberalizing reforms. Given the outrage of the international community about these restrictive changes, it is also not likely that it was a case of emulation. Instead, some form of learning may have played a role for the WPT as Mongolian policymakers did explicitly study royalty regimes in other countries, especially Australia, Chile and the US (Interview 4, Interview 8). Elements of learning were also involved in the adoption of the Strategic Investment Law of 2012 as the draft law was written by a Mongolian government delegation that had specifically completed a study trip to Australia (Interview 8). In sum, it is clear that Mongolian policymakers do consider trends and legislative activities in other mineral exporting economies. However, actions by other minerals exporters did not have a major effect on Mongolian FDI policy by itself.
Conclusion

The boom of international commodity prices has substantially altered the incentives of Mongolian policymakers and interest groups, shifting the political equilibrium of FDI policy from one of liberalization to one of restrictions. The empirical assessment of the political factors shaping Mongolian FDI policy found that the level of mineral prices has a strong impact on the opening and closure of FDI policy through three channels: incentives of cooperation among societal interest groups, the strategies of politicians and high-ranking officials to achieve re-election and personal rents, and the leverage of international financial institutions over domestic policymakers.

During the period under consideration, Mongolia was in a historically extraordinary situation of a simultaneous political and economic transition. It is likely that the exceptional vulnerability of the political institutions during that time have reinforced the external shocks from volatile commodity prices. Yet, Figure 6, which shows the evolution of the disaggregated averages of the Fraser Index for developing and developed countries, suggests that most of the fourteen mineral-rich developing economies in the sample have restricted their FDI policy during periods of commodity price booms from 2002 to 2007 and from 2009 onwards. In contrast, the policy regimes of the United States, Canada, Australia and Chile have remained remarkably robust. The investigation how stronger political institutions appear to absorb the shocks of the volatility of international commodity prices must be left to future studies.
The implications of the findings of this study for foreign investors in the Mongolian mining sector are rather pessimistic. It has been shown that the restrictions to mining FDI, which have been introduced in recent years, are deeply entrenched in the political structure of Mongolia during times of high mineral prices. Thus it seems unlikely that the current trend towards more restrictions will change unless an unexpected downturn in international mineral prices will hit the country.

Figure 6. The mining investment climate deteriorated only in developing countries

SOURCE: Calculations based on Fraser Institute (various)
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