

Why are American investors struggling in Mongolia?

by Mendee Jargalsaikhan

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Unlike the 1990s, Mongolia is now in the radar of US investors. Then, Mongolians were desperate for US investors, but few responded because of the unattractive market environment, uncertain political and socio-economic development, and undeveloped regulatory framework for foreign investment. Today, Mongolia is described as a high-potential investment destination for US investors, although there remain some complications.

Mongolia has restructured its macroeconomy with assistance from international financial institutions (IFIs), entered into a series of agreements with the US to increase bilateral trade and investment, and even offers short-term visa exemptions for US citizens. Above all, Mongolia recognizes the US as a vital 'third neighbor' to balance the influence of its powerful neighbors, China and Russia. Mongolia sought to strengthen its relationship with the US by renewing its commitment to democracy, deploying over 2,000 military personnel to Iraq and Afghanistan, and constantly seeking opportunities to develop closer ties. In spite of cultural and geographic distance, Mongolian officials have invited US corporations to invest in large-scale mining and infrastructure projects. Moreover, Mongolia is committed to democratic principles, proximate to East Asian economies, and is not experiencing any armed conflict. Why then are major US investors struggling to close investment deals in Mongolia – especially, in areas of mining and infrastructure development?

It is neither because of changes in our foreign policy objectives nor limited knowledge about Mongolia's investment environment. The 'third neighbor' foreign policy has been re-affirmed by politicians in policy statements and in meetings with US officials. This soft-balancing strategy has never been challenged by China or Russia. They seem to respect Mongolia's strategy as long as Mongolia remains militarily neutral. Nor can ignorance be the problem: an enormous amount of knowledge has been generated by IFIs, ranging from the World Bank to the European Bank of Reconstruction and Development, embassies, trade representatives, local branches of multinational corporations, legal firms, consulting services, and media ever since Mongolia's opening in 1990 and re-opening of mineral wealth in the first decade of the millennium. Mongolia has been recognized as the new frontier for US entrepreneurs.

The main obstacle for US investors is domestic politics in Mongolia. Self-interested politicians and political-business factions increasingly dominate domestic politics and foreign policy. This results in weak government institutions, unaccountable politicians and political parties, and unclear decisionmaking processes.

The government's ability to make long-term policies has been weakened by the politicization of public service. In theory, public servants are supposed to serve as gatekeepers against parochial, short-term interests by adhering to long-term developmental policies that would benefit Mongolia as a whole. Following the first parliamentary election in 1992, there was competition in Mongolia between two major political parties as well as smaller ones to appoint party-affiliated individuals to senior, mid-level and junior positions of the government and state-owned enterprises. This encourages individuals and public servants to seek political party affiliation, and in turn, discredits merit-based professional public service. The emerging pattern now is that political parties either attempt to reduce politicization during coalition governments, as in 2004 and 2008, or take revenge and politicize positions when one party dominates both the legislature and the Cabinet as occurred in 1996, 2000, and 2012. As a result, key policymaking areas are understaffed with career technocrats while overall posts were filled with party-affiliated officials whose main aim is to benefit within the four-year election cycle.

Similarly, Parliament, a key legislative, policymaking body, lacks nonpartisan professional staff and research capacity, which are important aspects of parliamentary democracy if there is to be policy continuity. The absence of such capacity allows politicians to intrude on the lawmaking process without much analysis by politicizing any issue on populist grounds. For example, Parliament has been unable to produce substantial studies and reports on major developmental projects like strategic mines or infrastructure development for the public since its establishment in 1992. In the vacuum, influential individuals and factions spur public opinion with one-sided facts to cancel or delay other factions' projects and to advance their own interests. That means the government is operating on flash-drive memories of influential politicians and factions rather than the hard-drives of capable, professional government institutions.

Another related problem is increasing unaccountable, opportunistic behavior by government officials at the national and local levels. Particularly at the national level, members of Parliament and the Cabinet are influential political actors. They engage in competitions over governmental posts at ministries, agencies, and state-owned enterprises such as the Erdenet copper plant, airlines, and railways, as well as in newly established ones in the mining and infrastructure sectors. Since political parties are divided along factional

interests and are losing political cohesiveness to self-interested individuals and business factions, the two major political parties are unable to hold their members accountable for opportunistic behavior. Politicians and factions favor short-term construction projects in their locality for quick benefits, rather than supporting long-term major projects. In general, politicians are afraid of allowing their opponents to get credit for implementing major long-term projects – like Oyu Tolgoi and Tavan Tolgoi, two of the largest mining operations in Mongolia – and related infrastructure. This creates an environment that favors blame game tactics against opponents and encourages unaccountable, opportunistic, political behavior. As a result, members of Parliament and the Cabinet are perceived as skillful rent-seekers who make false promises to foreign and domestic investors.

The other problem is an unclear decisionmaking process. On paper, Mongolia has a clear decisionmaking process where all issues can be openly debated in public. But, over the last decade, the decisionmaking processes have been overtaken by informal politics and bargaining among politicians and political-business factions. Good intentions become hostage to self-interested politicians, factions, and political entrepreneurs who seek to disadvantage opponents to improve their own bargaining position. Therefore, politicians and business factions enter into a non-transparent decisionmaking processes. This creates opportunities for others to upset the balance of power to trigger more rounds of crises, bargaining, and compromise. As a result, no major development projects and policies to solve socio-economic challenges are fully implemented. No single study has been completed on the pros and cons of any major investment agreement or policy. The public and investors (both foreign and domestic) suffer while self-interested individuals and factions benefit.

The self-interest-dominated Mongolian politics is worsened by competition among foreign and domestic investors. Unlike US, German, and Japanese companies, the main competitors in Mongolia are not obligated under international and domestic anti-bribery and corruption acts (e.g., the Foreign Corrupt Practices Act, OECD Antibribery Convention). As a result, competition over major projects generates incentives for politicians and political factions to gain short-term benefits at the expense of national priorities. For such politicians, narratives of geopolitics and nationalism are easy ways to spur public opinion while meeting their short-term self-interest.

Mongolian politicians are aware of the importance of US investments to strengthen the ‘third neighbor’ policy. But, ‘short-termism’ in Mongolian politics is weakening the institutional capacity of the state to reach and honor investment agreements while implementing long-term policies to cope with socio-economic challenges. Unless politicians and political-business factions restrain their short-sighted interests and focus on national priorities that would strengthen state sovereignty and benefit Mongolians as a whole, the country will become an unstable, debt-ridden ‘island of the poor’ in the stormy sea of Inner Asia. Celebrations of democracy will not save the nation and keep third neighbors close by. Disciplined, professional, and apolitical state

institutions together with responsible political parties and politicians will create an ‘island of opportunities.’

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