

Recent Trends in Mongolian Foreign Trade with Northeast Asian Countries

Enkhbayar Shagdar, Associate Senior Researcher,
Research Division and External Relations Division, ERINA

I. Introduction

Foreign trade plays a crucial role in the Mongolian economy with the value of foreign trade turnover almost equaling to the country's GDP. Mongolia is a landlocked country located in Northeast Asia covering an area of 1.5641 million square kilometer, the 17th largest country in the world by its territory. Population size is relatively small and young. It accounted for 2.74 million in 2009, whereas almost two-thirds of total were under age of 35. More than 60% of total population lives in urban area and 40% of total registered as living in the capital city, Ulaanbaatar.

After 70 years of power being concentrated in the hands of one political party, Mongolia embarked upon an irreversible path towards a market economy in 1990. Its first free elections were held in 1990 and the first democratic constitution was approved in 1992. The Constitution declared the people's ultimate goal to be the building of civil democratic society with a free market economy. These democratic changes in the political environment were crucial turning points in Mongolia's recent history. Mongolia became a member of the IMF, the World Bank and the ADB in 1991, and joined the World Trade Organization (WTO) in 1997.

At the beginning of the economic reforms, the country's immediate priority was to establish the basis of a market economy and the government adopted a policy of neo-liberal 'shock therapy' that quickly removed many regulations and controls while trying to hand as many activities over to the private sector as possible. The initial transformation contained a number of policy sets to be implemented simultaneously, including privatization, financial liberalization and the liberalization of trade aimed at integration with international trade.

Mongolia has bilateral trade, economic cooperation and investment promotion agreements with more than 30 countries, including Russia, China, ROK and Japan. In addition, Mongolia is included in the GSP (Generalized System of Preferences) schemes of Japan, the USA and Canada, under which duty-free entry is provided goods and products originated from a developing country, with the aim of assisting its economic development, based on an agreement reached at UNCTAD. Also, Mongolia is a beneficiary country EU's scheme of generalized tariff preferences under the category of the special arrangement for sustainable development and good governance, which suspends the Common Customs Tariff ad valorem duties on all products listed in its Annex II (EU, 2005).

The Northeast Asian (NEA) countries have large presence in Mongolia's foreign trade activities. This paper investigates developments in Mongolia's foreign trade with these countries in terms of its overall trends, structure, and main export and import commodities. It should be noted that the term 'foreign trade' as used in this paper refers to merchandise trade if not indicated in other way. Therefore, trade in services was not included in the analysis due to lack of data. The periods examined vary by sections depending on data availability.

II. Trade Liberalization and Foreign Trade Regulations

Liberalization of trade aimed at integration with international trade was an important part of the Mongolia's government initial economic transformation policy. Mongolia's economy attained relatively high growths before the transition. The annual average growth rate accounted for 8.1% during the period 1980-1989 and the country's real GDP expanded by 73.2% in 1989 from its 1980 level. However, during the initial years of economic transition, i.e. 1990-1993, Mongolia's economy contracted by 22.3% (MNU, 2007). At that time, many enterprises had to halt production due to such difficulties as power cuts and shortages of spare parts, raw materials and fuel. Under these conditions, it was necessary to undertake trade reforms aimed at integration with international trade.

Therefore, along with eliminating the state monopoly, the government has abolished all quantitative restrictions on exports and imports since the early 1990s, along with the state order system for exports and imports. At the same time, all forms of economic entity were permitted, including sole proprietorships, with individuals being allowed to engage freely in independent foreign trade activities in accordance with the Law of Mongolia on Economic Entities, which was passed in May 1991. Furthermore, all former state-owned trading firms were privatized in the early 1990s; and nowadays, virtually all foreign trade activities in Mongolia are handled by private companies and individuals. As a result, Mongolia's trade has diversified in terms of both the destinations of its exports and the sources of its imports and Mongolia currently trades with almost 120 countries throughout the world.

Mongolia's foreign trade prior to 1990 was characterized by a state monopoly on trade, a centrally planned pricing system, and limited export markets in the form of CMEA countries, in which the Former Soviet Union (FSU) occupied the dominant share. During that time, only 7 state-run foreign trade corporations were allowed to engage in foreign trade transactions under the state order system. Each of these corporations specialized in a particular form of foreign trade transaction and type of products¹. However, the country lost its traditional trading partners with the collapse of the CMEA along with the discontinuation of the flow of finance from the Soviet Union due to its internal difficulties and its subsequent collapse in 1990. The financial flow from the Soviet Union was equal to 35% of the country's GDP (Amarjargal, 2002). Moreover, trade transactions began to be made in hard currency, thus ending the transactions in transferable rubles that had been used between CMEA countries.

Another step towards its goal of integrating with international trade was Mongolia's accession to the World Trade Organization (WTO) on 29 January 1997. Then, on May 1, 1997, the government unilaterally abolished the uniform customs duty of 15% and excise taxes on all imported goods, apart from those levied on a few items, such as alcohol, tobacco, petroleum products and motor vehicles.

However, due to a growing need to increase budget revenues, the government increased value-added tax (VAT) from 10% to 13% in September 1998. At that time, prices of copper concentrate, the country's major export commodity and the biggest contributor to the state budget revenues, were falling since 1995 and continued to be low until 2003 (see Figure 3.5). The following year, in 1999, a 5% uniform import tariff was reintroduced, and an excise tax

¹ Namely, Mongolexport (all exports); Technikimport (machinery and equipment imports); Materialimpex (trade in construction materials); Avtoneftimport (all imports of vehicles and petroleum products); Raznoimport (consumer goods imports); Compleximport (imports and exports of goods associated with turn-key projects from the FSU); Mongolimpex (all trade transactions made in convertible currencies).

on beer followed soon after. From November 2000, the customs tariff underwent a further hike from 5% to 7%, with VAT rising to 15%. Then, in January 2003, the customs duty reduced back to 5% and VAT to 10% with a few exceptions; and it continued stable up to date.

Pedigree animals (cattle, horse, pig, sheep and goat), computers and their parts, medical and veterinary equipment have zero rate customs duties, whereas imported wheat flour and some domestically produced vegetables, such as potato, onions, cabbage, carrot and turnip, have seasonal tariff rates of 15%. Also, on the following imported items are imposed excise tax in addition to import duty and VAT:

- Alcoholic beverages (ranging from \$0.20 per liter on beer; \$5 per liter on vodka with alcoholic content below 40% and \$6 for those of above 40%; \$1.5 for wine with alcoholic content below 35% and \$6 for those of above 35%);
- Cigarettes and tobacco (\$1.20 per 100 pieces of cigarettes and \$0.90 per 1 kg of tobacco);
- Petroleum, diesel fuel and petroleum products (tax rates vary by level of octane content and port of entry);
- Automobiles, depending on cylinder capacity of engine and years in service;

All merchandise exports are exempted from both customs and VAT duties, except a few items such as unprocessed camel wool, timber, wooden planks and blocks.

There were some concerns that lower import tariffs and an excessive openness would harm domestic industries; however, some studies (e.g. Nemekhbayar, S., 2003) suggest that the lowered import tariffs had positive impacts on Mongolia's export growth. Also, accession of Mongolia's main trading partners, China² and Russia, to the WTO would bring welfare gains to Mongolia (Banse, M., 2002a, 2002b).

A further step taken by the Mongolian government, with the aim of enhancing international trade and attracting foreign direct investment into the country was the enacting of the Mongolian Law on Free Zones in June 2002. Currently, three locations in the north, south and western border areas – Altanbulag, Zamyn-Uud³ and Tsagaan Nuur, respectively – have been designated as free trade zones (FTZ); however, preparations for their becoming operational are still underway.

Furthermore, aimed at supporting small and medium sized enterprises, machinery, equipment and their spare parts classified in most of the Chapter 84 and some of Chapter 90 of the Harmonized Commodity Description and Coding System (HS) of tariff nomenclature were exempted from customs duty and VAT starting from 10 August 2009. Mongolia began to use HS as a basis for customs tariffs since the country joined WTO.

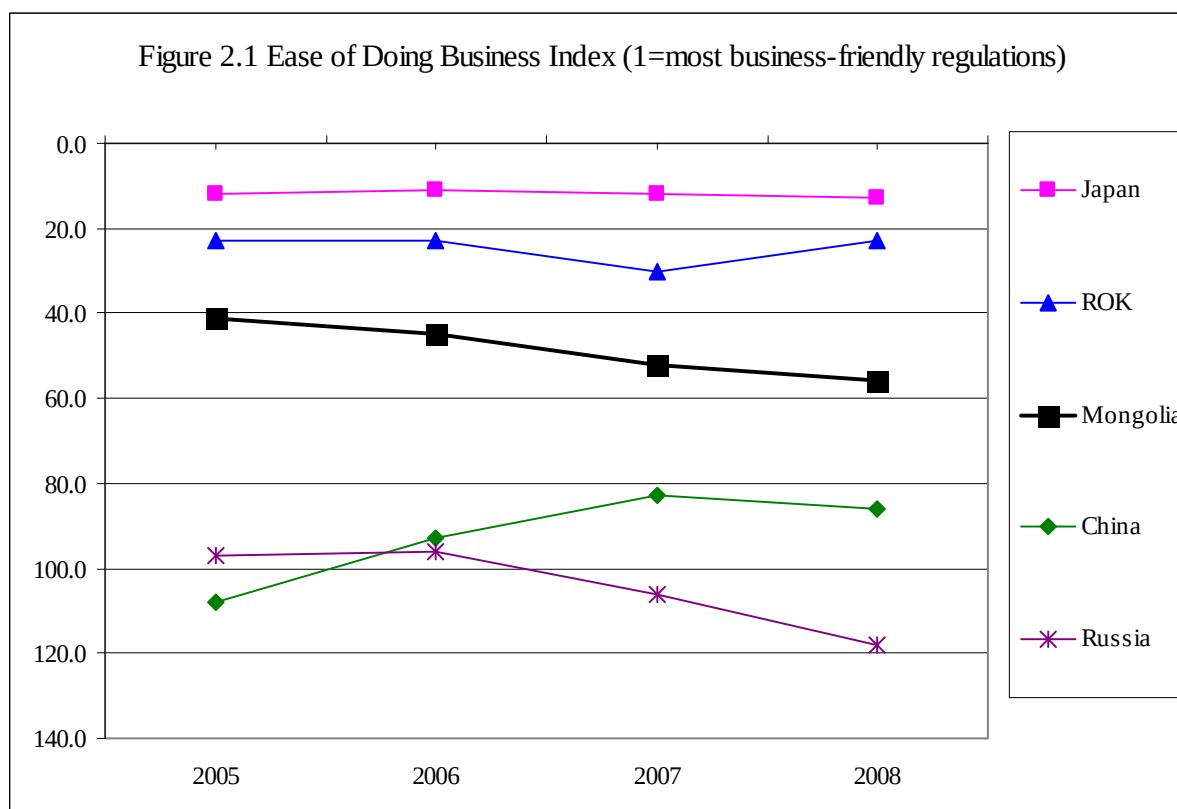
Procedures for customs control and examinations of goods, customs clearance procedures and enforcement of the customs legislation in Mongolia is regulated by Customs Law of Mongolia, and matters related to customs tariff system, principles for adopting customs duty rates, valuations, assessments and collection of customs duties area regulated by the Customs Tariff Law of Mongolia. The both laws were entered into force in 1996. Matters related to imposition of VAT, its payment to the state budget, and its refund from the state budget is regulated by Value-Added Tax Law of Mongolia.

Generally, Mongolia's regulations are considered more business-friendly than those of China and Russia, but still rank well below those of Japan and ROK. According to the World

² China became a member of WTO on 11 December 2001.

³ The designated location in Zamyn-Uud has FEZ (Free Economic Zone) status.

Bank (2009), “Mongolia has one of the least restrictive trade regimes in Asia, and a relatively liberal foreign investment regime”. However, in view of Mongolian business executives, inefficient government bureaucracy and inadequate supply of infrastructure were the top two most problematic factors for doing business in Mongolia (Open Society Forum, 2007; Figure 2.1).



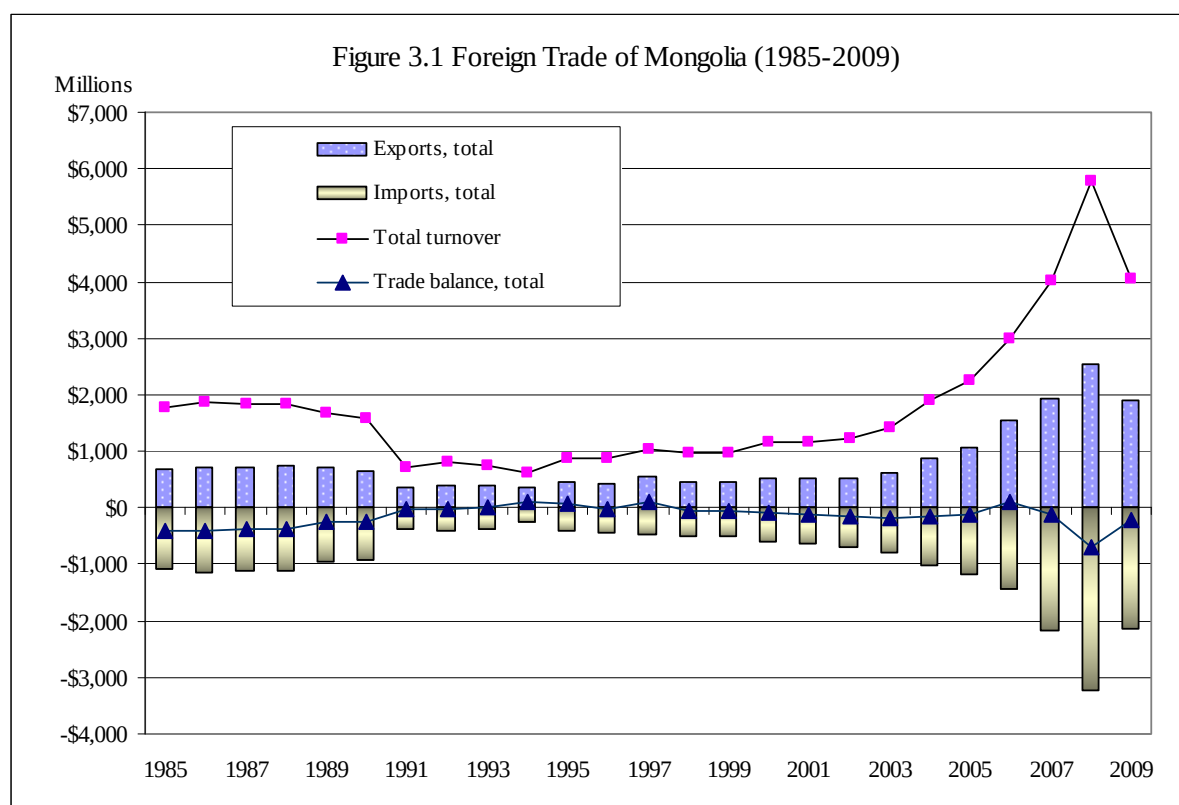
Source: WDI, 2008, 2009.

III Overall Trends in Mongolia’s Foreign Trade

Foreign trade has a large presence in Mongolia’s economy, especially after the country’s transition towards a market economy and opening up to world markets. Mongolia’s foreign trade turnover was stable during the late 1980s, but it deteriorated sharply during the initial years of the economic transition. Although it began to recover steadily after 1995, its pace was slow and it took more than a decade for its full recovery. At the same time, the country’s foreign trade has been suffering from chronic deficits since the pre-transitional period; the balance of trade remained negative throughout the period 1985-2009, apart from a few years. Therefore, Mongolia has always had to rely on financial inflows from abroad to finance her imports. Mongolia’s foreign trade balance witnessed the worst historic deficit of \$710 million in 2008 that accounted for 14% of the country’s GDP. It was associated with massive falls in the international market price of the country’s major export commodities, such as copper and zinc, resulting from the global financial and economic crises (Figure 3.1).

Mongolia’s merchandise trade value almost equals to the country’s GDP with the values of merchandise exports and merchandize imports exceeding respectively 40% and 50% of

GDP. Also, trade in services began to grow steadily since the beginning of the 1990s and accounted for 46.4% of GDP in 2004 that was almost on a par with the value of merchandise exports. Owing to Mongolia's convenient geographical location that connects Asia and Europe, transport (transit by rail route and air navigation) and travel service exports grew rapidly as the country opened up to the world. For example, tourism sector income accounted for about 12% of the country's GDP and 24% of exports during the period 1998-2004 (Enkhbayar, Sh., 2006; Figure 3.2).

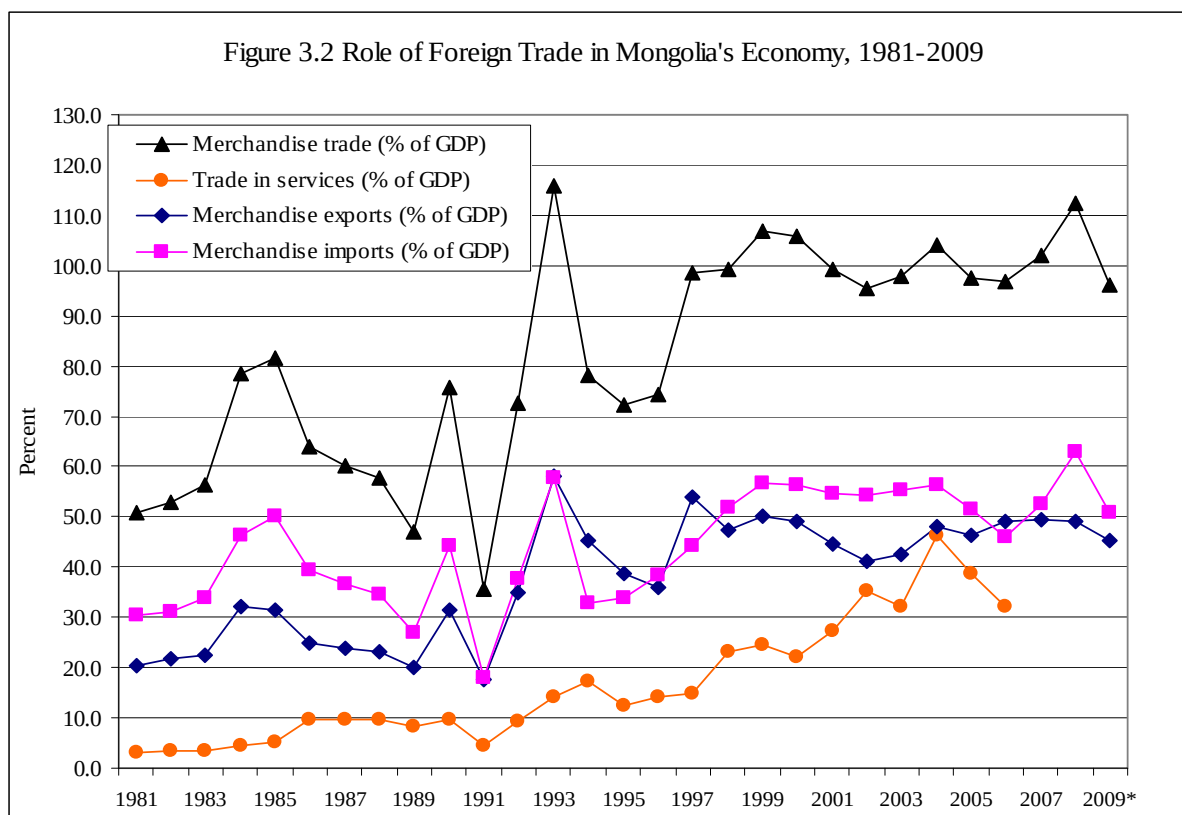


Note: Imports are illustrated in negative values.

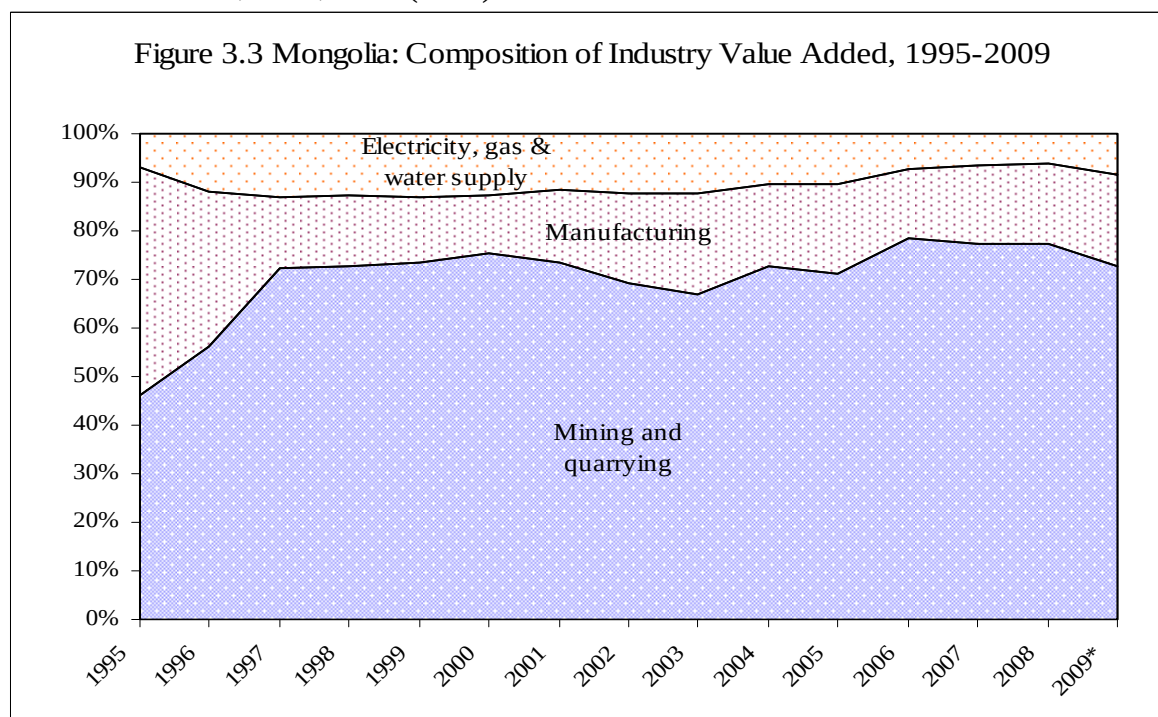
Source: Mongolian Statistical Yearbook, various issues.

Mongolia is one of the mineral resource rich countries and mining industry account for more than 70% of the country's total industry value-added, whereas industry value added accounts for more than 30% of the country's GDP. Owing to its geographic closeness to the biggest market of China for mineral resources, exports of ores and metals account for the largest share of Mongolia's merchandise exports and it accounted for 61.2% of total merchandise exports in 2007. Copper concentrate is a major commodity of Mongolia's exports and its value accounted for 68% of total ores and metals exports in 2007. The dynamics of Mongolia's copper concentrate exports during the period 1989-2009 show that supply of this item was relatively inelastic to price changes. Mongolia began to exploit crude oil since 1998 and crude oil extraction has been increasing progressively since 2002 accounting for 1.9 million barrels in 2009. Due to lack of domestic oil refinery, Mongolia exports all of its crude oil (i.e. fuel) and it accounted for 9% of the total merchandise exports in 2007. Hence, Mongolia's consumption of fuel (gasoline, diesel fuel etc.) entirely relies on fuel imports and they account for the largest share of the total merchandise imports. For

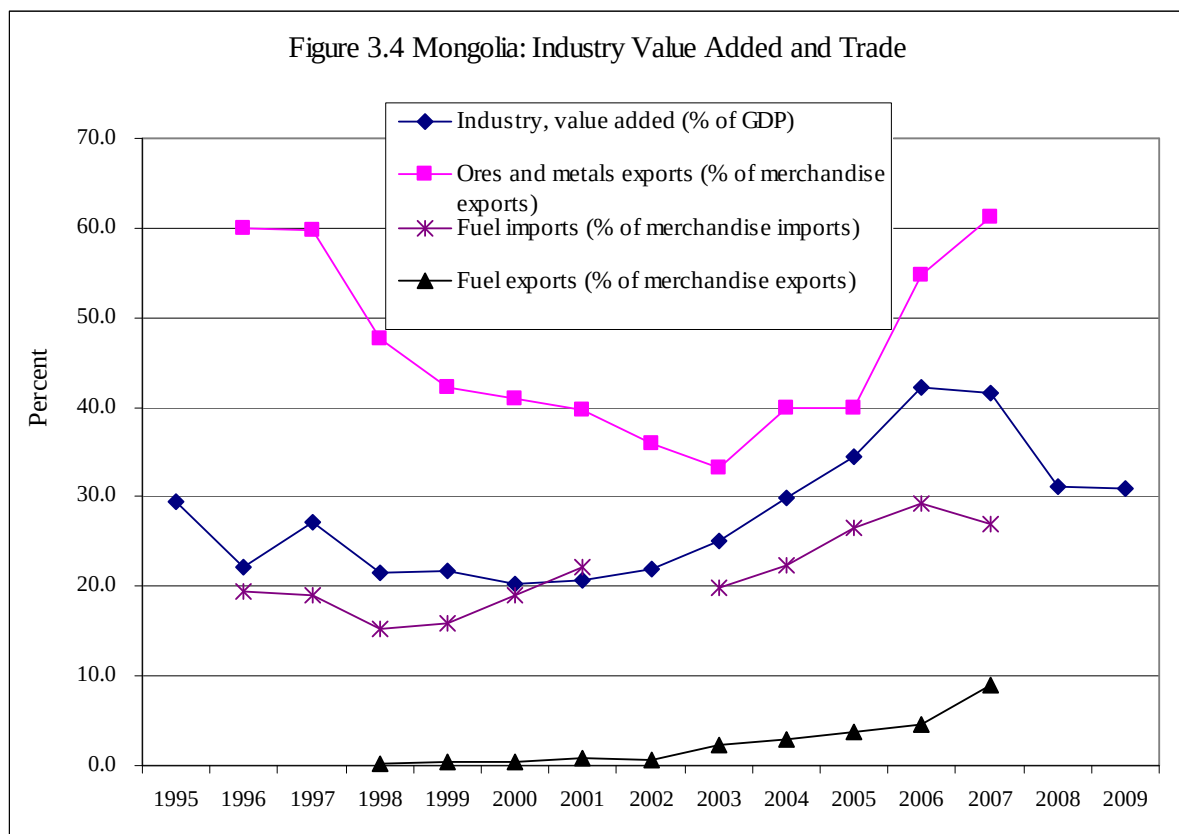
example, fuel imports accounted for 29.3% of merchandise imports in 2006 and for 26.9% in 2007 (Figures 3.3, 3.4, 3.5).



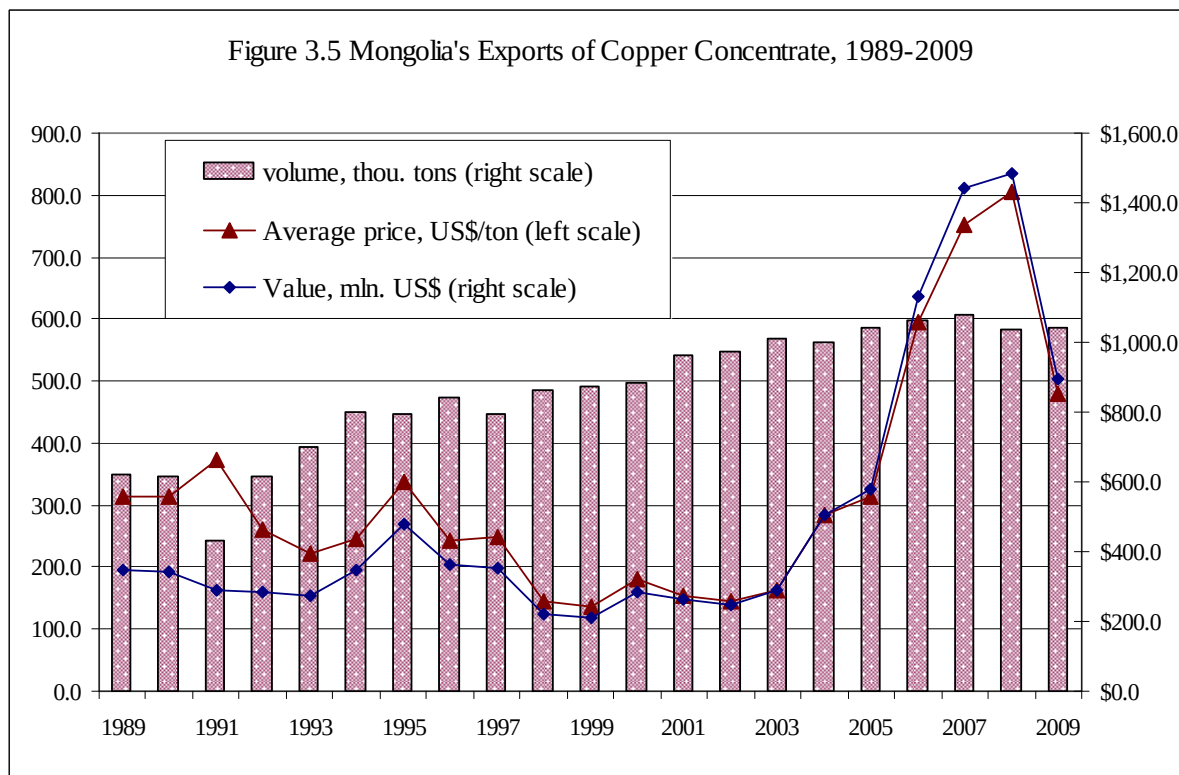
Sources: WDI, 2009; NSO (2010).



Source: Mongolian Statistical Yearbook, various issues.



Source: WDI, 2009.



Source: Mongolian Statistical Yearbook, various issues.

Mongolia's manufacturing industry was at the hardest hit during the process of transition. Manufacturing value added dropped to 5.4% of GDP in 1996 from 35.6% in 1990 and continues to be sluggish. Accordingly, manufacturing exports account for smaller shares of merchandise exports. Values of manufactures exports as percentage of merchandise exports witnessed growths until 2001 accounting for more than one-third of total, but continued to decline thereafter. It was associated with flow of textile exports⁴. On the other hand, manufacturing imports account for more than 60% of Mongolia's total merchandise imports. At the same time, food imports ranged between 12% and 18% of total merchandise imports, while those of food exports accounted for less than 6% of total (Figure 3.6).

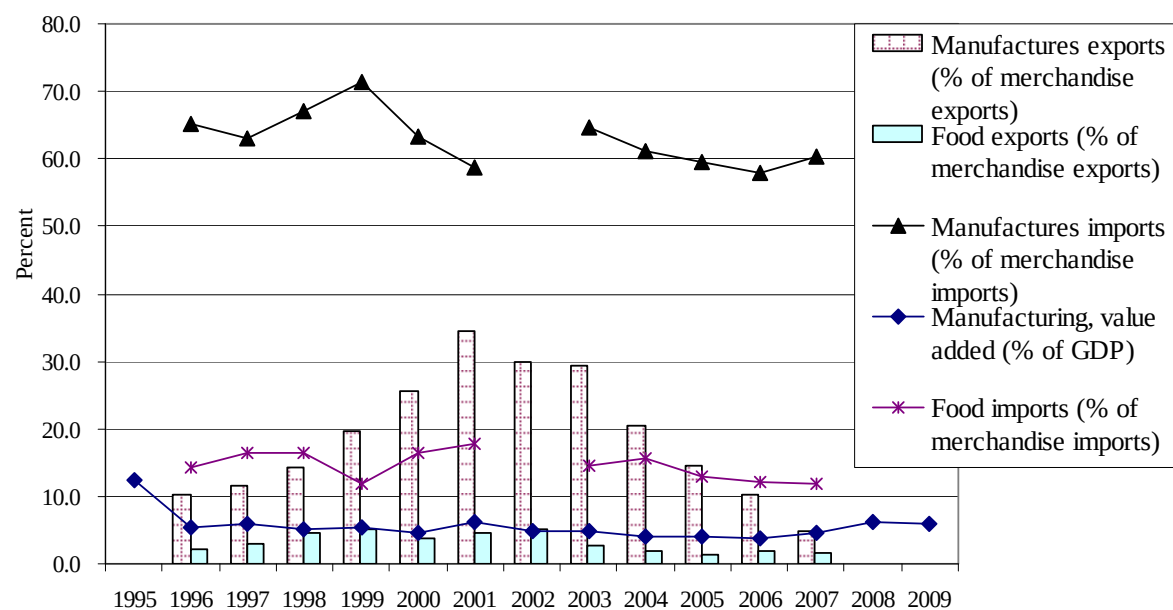
Agriculture sector, which is dominated by animal husbandry, is one of the important sectors of Mongolia's economy, whereas livelihood of more than half of the country's population depends on incomes originated in this sector. However, agriculture value added as percentage of GDP has witnessed continuous drops since the mid 1990s due to increasing shares of mining sector. Accordingly, share of agricultural raw materials exports in the merchandise exports is decreasing due to their low values compared to the mineral products (Figure 3.7).

Although the Mongolian government has consistently promoted an export-led growth policy for more than a decade of transition, the dominance of raw and low value-added products in its exports means that the country was unable to escape from the prolonged foreign trade deficit that undermines the potential of foreign trade to be the country's growth engine. The overall structure of Mongolia's foreign trade did not change much over the period 1990-2009. Exports continue to be dominated by low value-added mineral products and products of livestock origin, whereas imports comprise of a wide range of higher value-added manufacturing, food and industrial products. According to the competitive industrial performance (CIP)⁵ index of UNIDO (2009), Mongolia was positioned the 108th in 2005 among the 122 countries ranked, slightly advancing from the 115th position in 2000. This suggests that Mongolia needs to improve its export performance by seeking opportunities for exports of higher value-added products.

⁴Mongolia enjoyed quota-free treatment for textiles at the US and European markets and a number of textile and clothing factories established in Mongolia since the beginning of the 1990s attracting investors from Asian countries. Accordingly, textile exports had been growing progressively until 2001. However, due to termination of the WTO Agreement on Textiles and Clothing by the end of December 2004, Mongolia began to lose its advantage in manufacturing of textile products as all textiles and clothing products had fully integrated into WTO rules, and bilateral quotas were removed. As a result, Mongolia became unable to enjoy preferential treatment in trade of textile and clothing products; thus, their production and exports began to decline considerably.

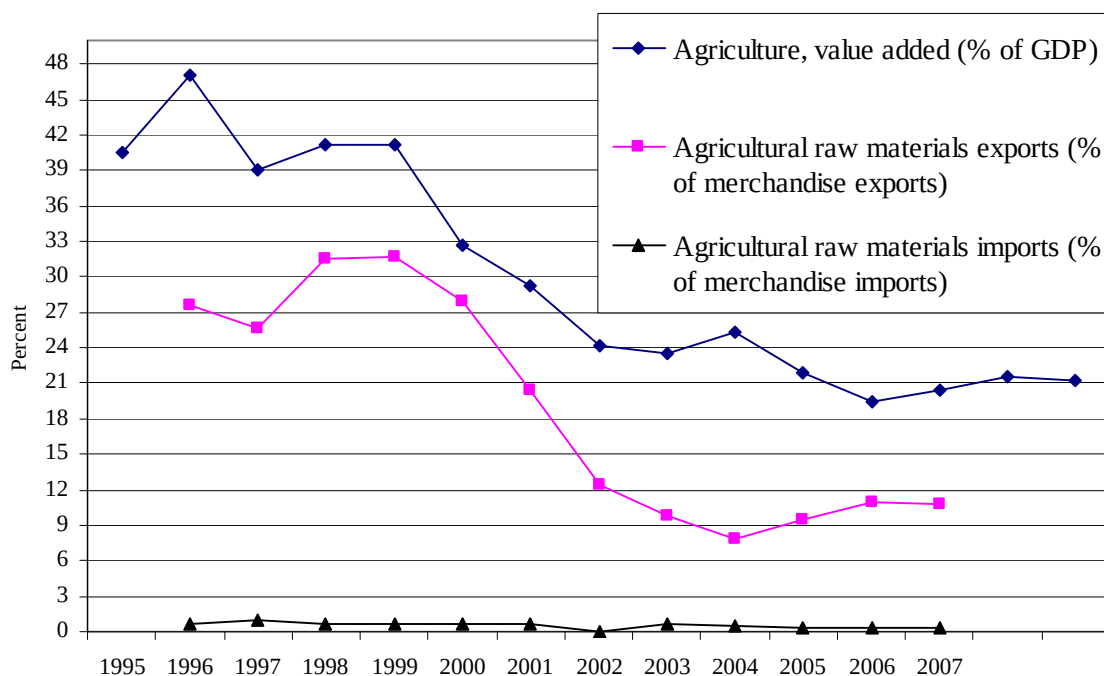
⁵ The CIP index combines four major dimensions of industrial competitiveness: industrial capacity, manufactured export capacity, industrialization intensity and export quality using six quantitative indicators: manufacturing value-added (MVA) per capita, manufactured exports per capita, and simple averages of (i) share of manufacturing in GDP, and the share of medium-and high-technology activities in MVA, and (ii) share of manufactured exports in total exports, and the share of medium-and high-technology products in total exports (UNIDO, 2009, p.117).

Figure 3.6 Mongolia: Manufacturing Value Added and Trade



Source: WDI, 2009.

Figure 3.7 Mongolia: Agriculture Value Added and Trade

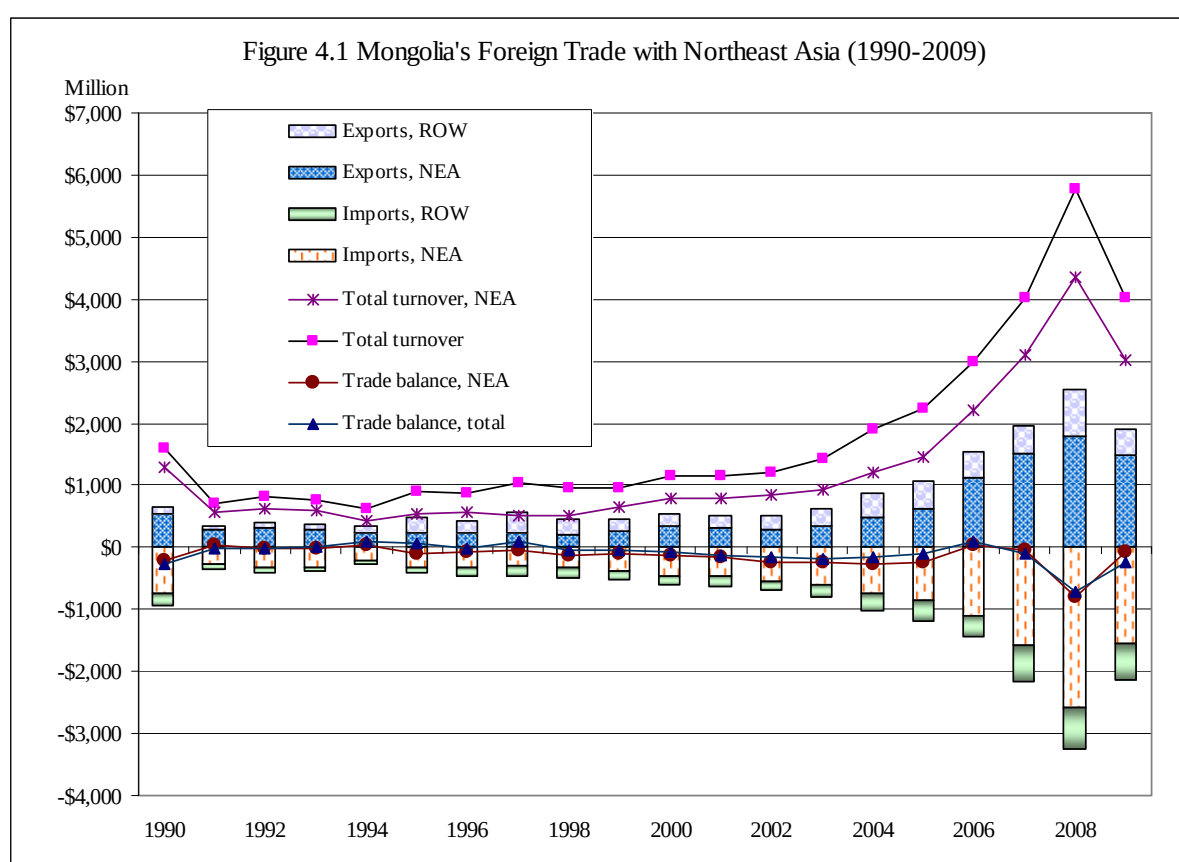


Source: WDI, 2009.

IV. Mongolia's Trade with Northeast Asia

4.1 Overall Trade Flows

Mongolia's trade with Northeast Asia (NEA)⁶ plays an important role in the country's foreign trade activities with the trade turnover values accounting for more than two-third of total. In 2009, Mongolia's trade turnover with NEA countries accounted for 75.1% of total, whereas exports and imports respectively accounted for 77.5% and 72.9% of the country's total exports and imports. These figures did not change much over the period 1990-2009, except the second half of the 1990s. It was associated with substantial downsizing of trade with Russia. However, trade dominance has shifted from Russia to China from the mid 1990s. At the same time, Mongolia's trade with NEA had continuous deficits during the period except a few years. Trade surpluses of \$30-\$35 million were observed only in 1991, 1994 and 2006 (Figures 4.1).



Note: Imports are illustrated in negative values.

Source: Estimated from Mongolian Statistical Yearbook, NSO, various issues.

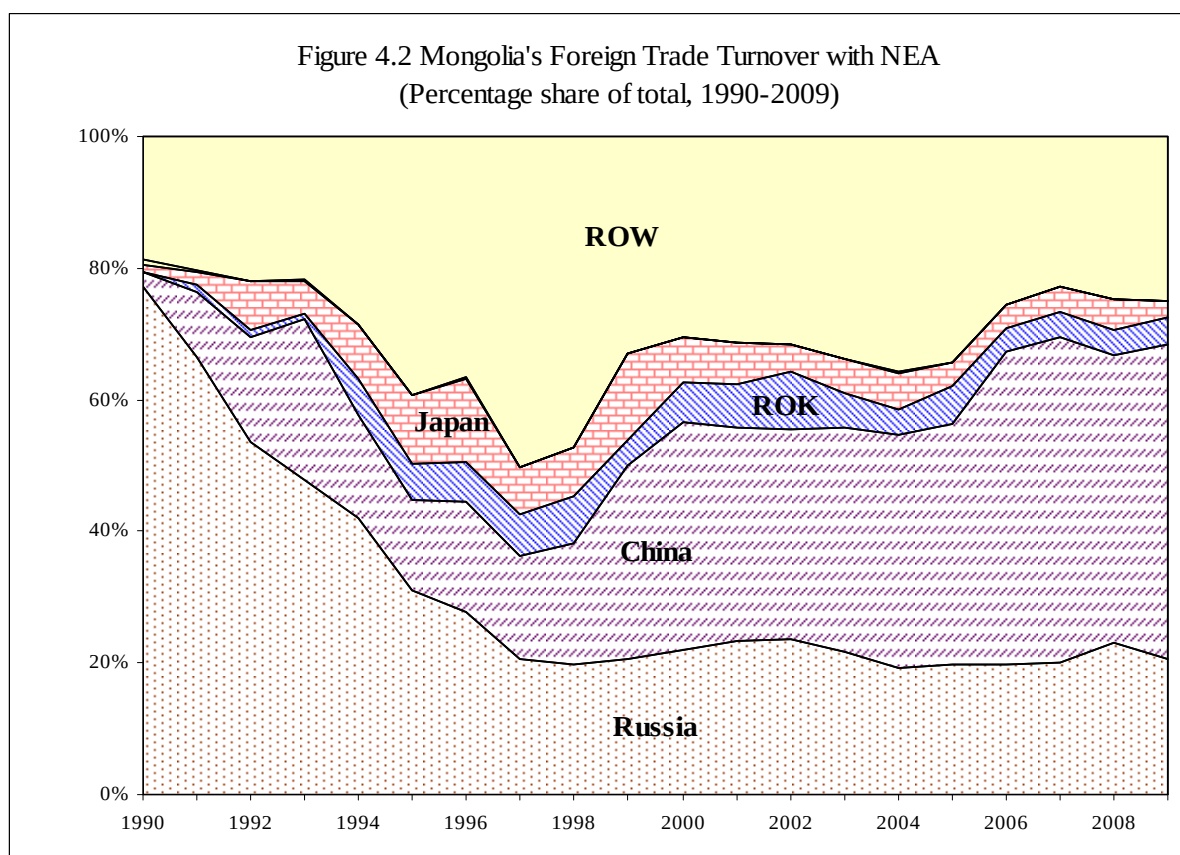
Mongolia is a landlocked country and has limited international transportation network, therefore, Mongolia's only two neighbors – China and Russia – have the largest presences in

⁶ According to ERINA, the region consists of the People's Republic of China (China), the Democratic People's Republic of Korea (DPRK), Japan, Mongolia, the Republic of Korea (ROK) and the Russian Federation (Russia).

Mongolia's foreign trade activities. In 2009, Mongolia's trade turnover with China and Russia accounted for 47.75% and 20.7% of total respectively.

As mentioned earlier, Mongolia's trade with Russia was dominant before the transition and Mongolia's trade turnover with Russia accounted for 77.9% of total, whereas those with China accounted for 2.1%. Studies suggest that about 70% of Mongolia's trade with China account for trade with Inner Mongolia, the neighboring region in China; and also about 70% of Mongolia's trade with Russia account for trades with the neighboring regions in Russia, such as, Irkutsk, Chita, Kemerovo, Buryat Republic and Tuva Republic (Baatar, 2007).

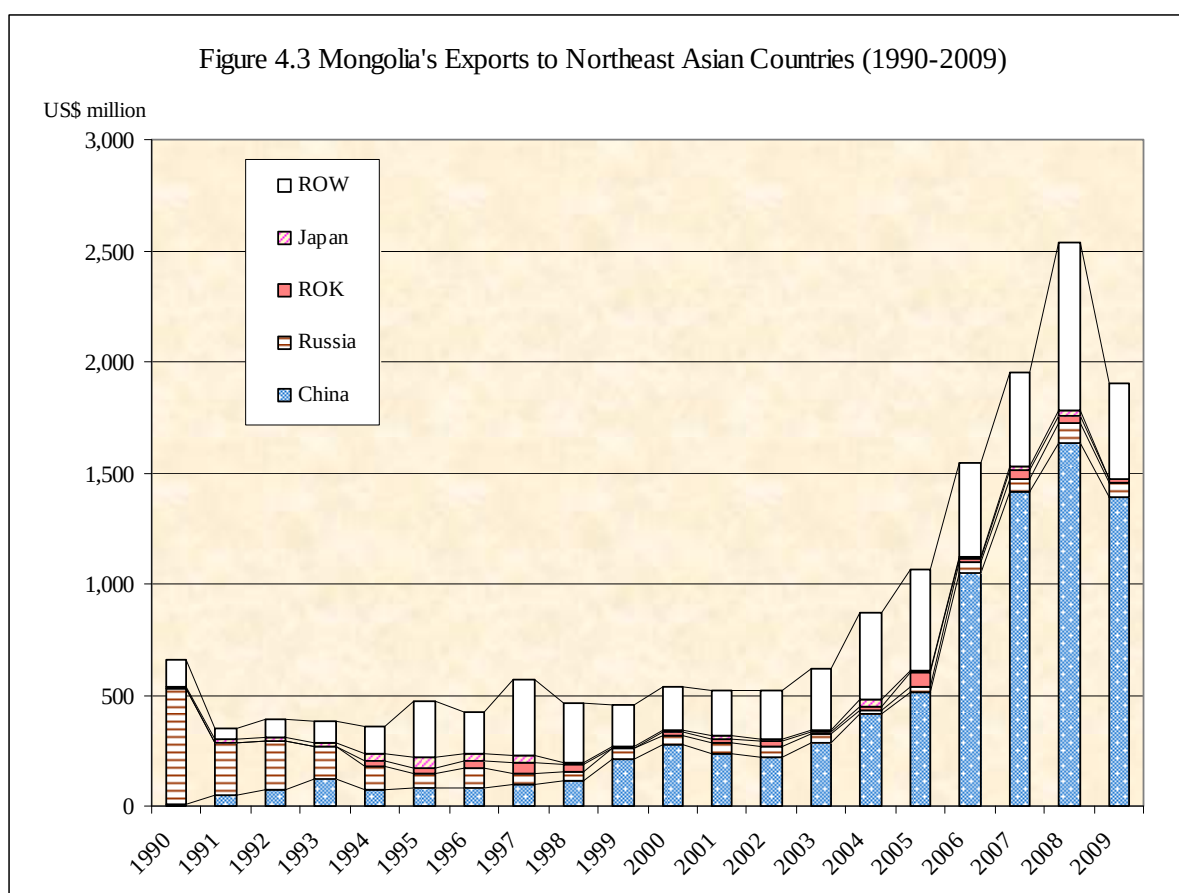
Although ROK and Japan have emerged as new trading partners of Mongolia since 1990, trade volumes remain rather limited. Trade turnover with these countries increased to 4.2% and 2.5% respectively in 2009 from 0.1% and 1.1% in 1990 respectively (Figure 4.2).



Source: Mongolian Statistical Yearbook, various issues.

Mongolia exports currently to about 70 countries. Exports to Russia were dominant in Mongolia's exports until the early 1990s, but began to diminish thereafter. It accounted for 78.3% of total exports in 1990, but reduced to 3.4% in 2009. At the same time, China emerged as a new major destination of Mongolia's exports with its share of exports increasing to 73.1% in 2009 from 1.7% in 1990. ROK and Japan emerged as new export destinations since the early 1990s; however, their values remain limited despite having bilateral trade agreements between the countries since the beginning of the 1990s, and Japan grants Mongolia preferential tariff treatment under its GSP scheme. In 2009, exports to these countries accounted for 0.8% and 0.2% of total exports respectively (Figure 4.3).

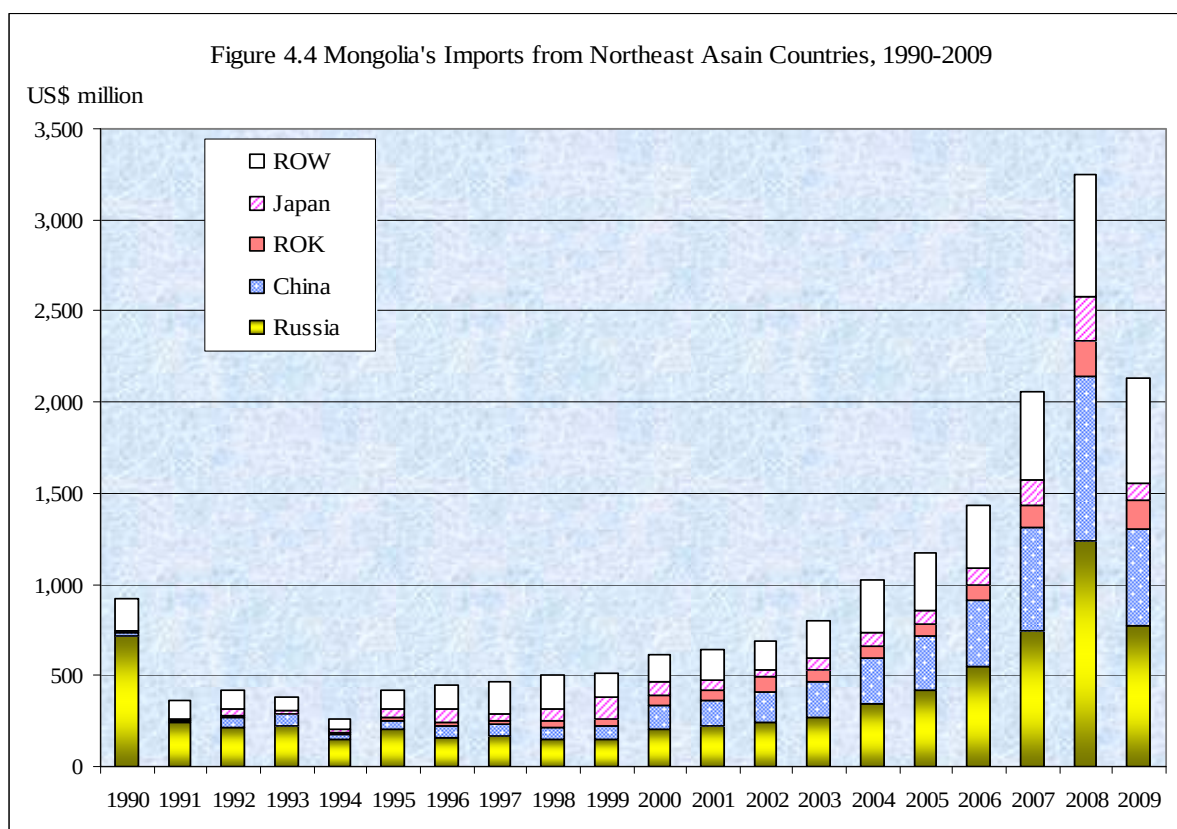
Mongolia imports from more than 100 countries. Similar to exports, Russia was the major origin of Mongolia's imports until the early 1990s. Although its share of total imports decreased since the mid 1990s, imports from Russia still account for the largest share of Mongolia's total imports. Imports from Russia accounted for 77.5% of total in 1990 and for 36.1% of total in 2009. Imports from China began to rise since the early 1990s and its share of total imports increased to 25% in 2009 from 2.4% in 1990; thus becoming the second largest origin of Mongolia's imports. Imports from ROK and Japan also began to emerge since the early 1990s, and their shares increased respectively to 7.3% and 4.6% of total imports from 0.1% and 1.1% in 1990. Imports from DPRK accounted for 0.6% of total in 1990, but reduced to 0.2% in 1993 and became almost negligent thereafter (Figure 4.4).



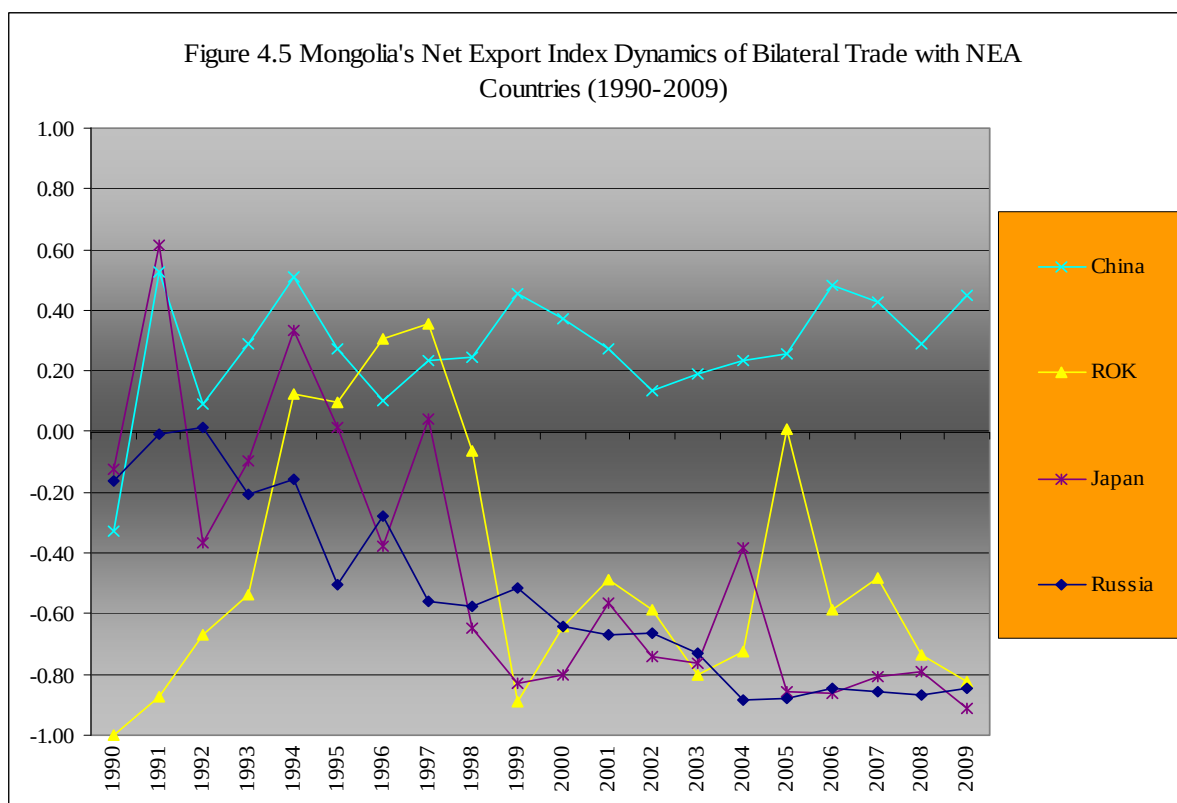
Source: Mongolian Statistical Yearbook, NSO, various issues.

Despite increasing imports from China, Mongolia's trade with China had surpluses over the entire period, except in 1990, owing to exports of mineral products and livestock-originated raw materials, which are the country's major export commodities. However, Mongolia's trade with all other NEA countries had continuous deficits over the entire period. According to an index⁷ calculated as the share of net exports to total bilateral trade between the countries, Mongolia's trade deficits with Russia, Japan and Korea had been increasing over the period. Therefore, Mongolia needs to look for opportunities to increase exports to these markets (Figure 4.5).

⁷ Calculated by formula: $I = (X - M) / (X + M)$, where X – exports, M-imports;



Source: Mongolian Statistical Yearbook, NSO, various issues.



4.2 Trade Structure

Analysis of Mongolia's trade structure with NEA is based on database developed by the Ministry of Trade and Industry of Mongolia (former name). According to Mongolia's HS classification, the traded commodities are classified into 21 groups of the Harmonized Commodity Description and Coding System (HS) of tariff nomenclature. Data was available for the period of 1995-2005 (Table 4.1).

Table 4.1 Mongolia's HS Groups Classification

Group	HS Chapter	HS 4-digit	Description	Main export commodities	Main import commodities
1	01-05	0101-0511	Animal & Animal Products	Fresh and frozen meat (beef, horse, mutton) and edible offal, intestines, horse mane and tail;	Dry milk and milk products, butter, eggs;
2	06-14	0601-1404	Vegetable Products	<i>None.</i>	Vegetable, fruits, rice, pressed green tea, packaged tea;
3	15	1501-1522	Animal or Vegetable Fats, Oils & Waxes	<i>None.</i>	Vegetable oil margarine;
4	16-24	1601-2403	Foodstuffs	Dog or cat food;	Sugar, candy, biscuits and bakers, canned vegetable products, soft drink, beer, cigarettes, tobacco;
5	25-27	2501-2716, 2841.69.00	Mineral Products	Copper concentrate, molybdenum concentrate, fluorspar concentrate, zinc concentrate, coal, crude oil;	Petroleum, diesel fuel, electricity, salt, natural gas;
6	28-38	2801-3825	Chemicals & Allied Industries	<i>None.</i>	Organic and inorganic bases chemical compounds, pharmaceutical products, fertilizers, dyes, pigments, and other coloring matters, soaps, washing preparations, candles and others;
7	39-40	3901-4017	Plastics / Rubbers	<i>None.</i>	Plastic products, tires;
8	41-43	4101-4304	Raw Hides, Skins, Leather, & Furs	Raw and processed cattle and horse hides, sheep and goat skins, furs;	Leather garments and leather goods, artificial leather;

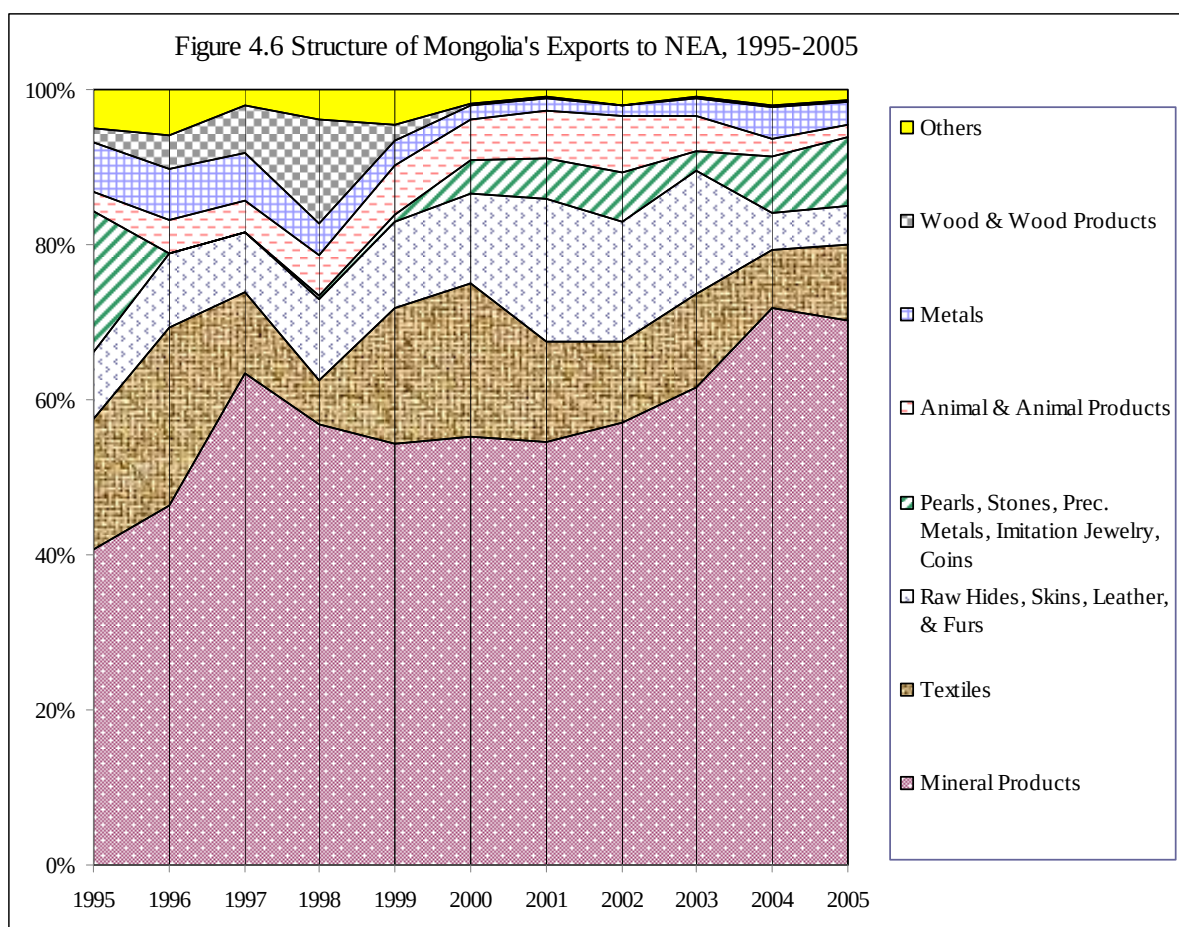
Table 4.1 Mongolia's HS Classification (continued)

9	44-46	4401-4602	Wood & Wood Products	Timber, sawn wood;	Particle board, oriented strand board (OSB), builder' joinery and carpentry of wood (windows, doors etc);
10	47-49	4701-4911	Pulp of Wood, Paper, Paperboard, Printed Books	<i>None.</i>	Wallpapers, papers, cardboards, books etc.
11	50-63	5001-6310	Textiles	Sheep and camel wool, de-haired cashmere, cashmere yarn, cashmere garments, camel woolen blankets;	Cotton and synthetic fabrics, sewing threads, knitted and sewn clothing, articles of apparel and clothing accessories;
12	64-67	6401-6704	Footwear/ Headgear	<i>None.</i>	Footwear, hats, etc.
13	68-70	6801-7020	Stone/Glass	<i>None.</i>	Building blocks, bricks, ceramic and porcelain products, mineral wools, household glassware, window glass etc.
14	71	7101-7118	Pearls, Stones, Precious Metals, Imitation Jewelry, Coins	Non-monetary gold;	Pearls, stones, jewelry, coins;
15	72-83	7201-8311	Metals	Scrap metals, steel billets, bars, copper cathode;	iron and steel articles, pipes and structures;
16	84-85	8401-8548	Machinery/ Electrical	<i>None.</i>	Central heating boilers, steam turbines, pumps, electricity generators, refrigerating and freezing equipment, lifting, loading and unloading machinery, machinery for textile industry, agricultural machinery, information processing equipment and home electrical appliances;
17	86-89	8601-8908	Transportation	Automobiles, trucks (imported);	Automobiles, trucks, public transport, tractors;

Table 4.1 Mongolia's HS Classification (continued)

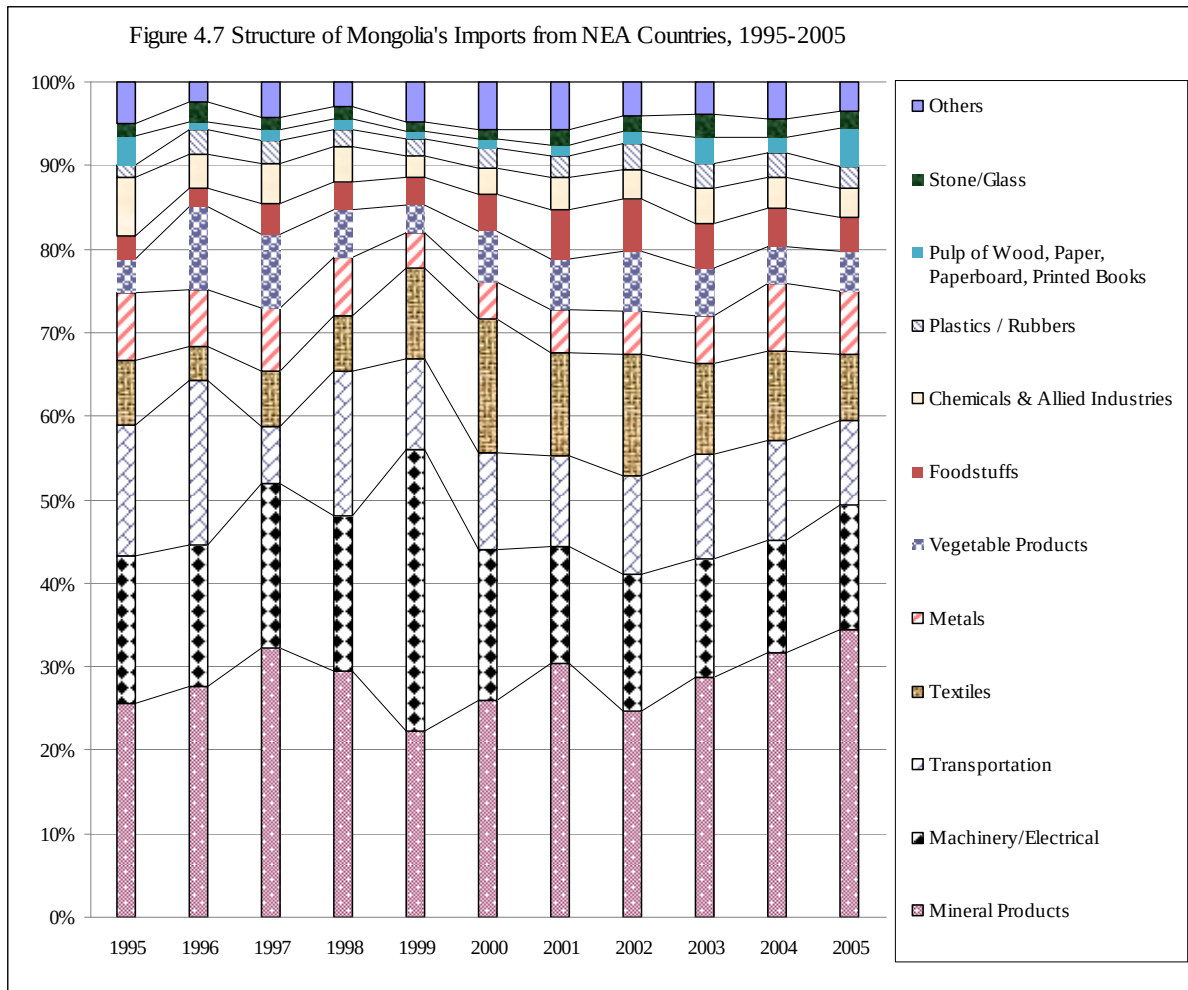
18	90-92	9001-9209	Optical, Photographic, Measuring, Checking, Medical Instruments, Clocks & Watches, Musical Instruments & Parts Thereof	<i>None.</i>	Not specified.
19	93	9301-9307	Arms & Ammunition, Parts & Accessories	<i>None.</i>	Not specified.
20	94-96	9401-9618	Miscellaneous Manufactured Articles	<i>None.</i>	Not specified.
21	97	9701-9706	Works of Art. Collectors' Pieces, Antiques	Not specified.	Not specified.

Mineral products (HS 25-27) were the major export commodity of Mongolia to NEA. Share of this item increased to about 70% of total exports to NEA in 2005 from 41% in 1995. Textiles (HS 50-63) and raw hides, skins, leather, & furs (HS 41-43) were the next main exports commodities until the early 2000s, but textile exports began to shrink after the WTO Agreement on Textiles and Clothing terminated in 2004. Exports of these items ranged between 5% and 23% per annum of total imports from NEA during the period 1995-2005. Exports of non-monetary gold (HS 71) became another main export item and accounted for 8.8% of total in 2005. Exports of animal and animal products (HS 01-05) and metals (72-83) were other large groups of exports to NEA with their shares accounting ranging from 1.5% to 7.3% of total annually. Combined exports of these 6 groups of HS commodities accounted for 95.5% of total cumulative merchandise exports to the region during the period 1995-2005 (Figure 4.6).



Source: Data from MIT, 2005.

In terms of imports, imports of mineral products (HS 25-27) had the largest share of total imports from NEA followed by machinery/electrical (HS 84-85) commodities. Imports of mineral products accounted for 22.3%-34.5% of total imports per annum during the period 1995-2005, whereas those of machinery/electrical products accounted for 13.5%-33.6%. Transportation (HS 86-89) and textile (HS 50-63) imports were the other major import items of Mongolia from NEA countries with their shares ranging from 7% to 17% of total annually during the period. Metals (HS 72-83), vegetable products (HS 06-14), foodstuffs (HS 16-24), chemicals and allied industries (HS 28-38), plastics/rubbers (HS 39-40), paper board/printed books (47-49) and stone/glass (HS 68-70) were the other groups of key import commodities from the region. Their shares ranged between 6.4% and 1.9% of total cumulative imports from NEA during the same period. Combined imports of these 11 groups of HS commodities accounted for 95.8% of total imports from the region during the period 1995-2005 (Figure 4.7).



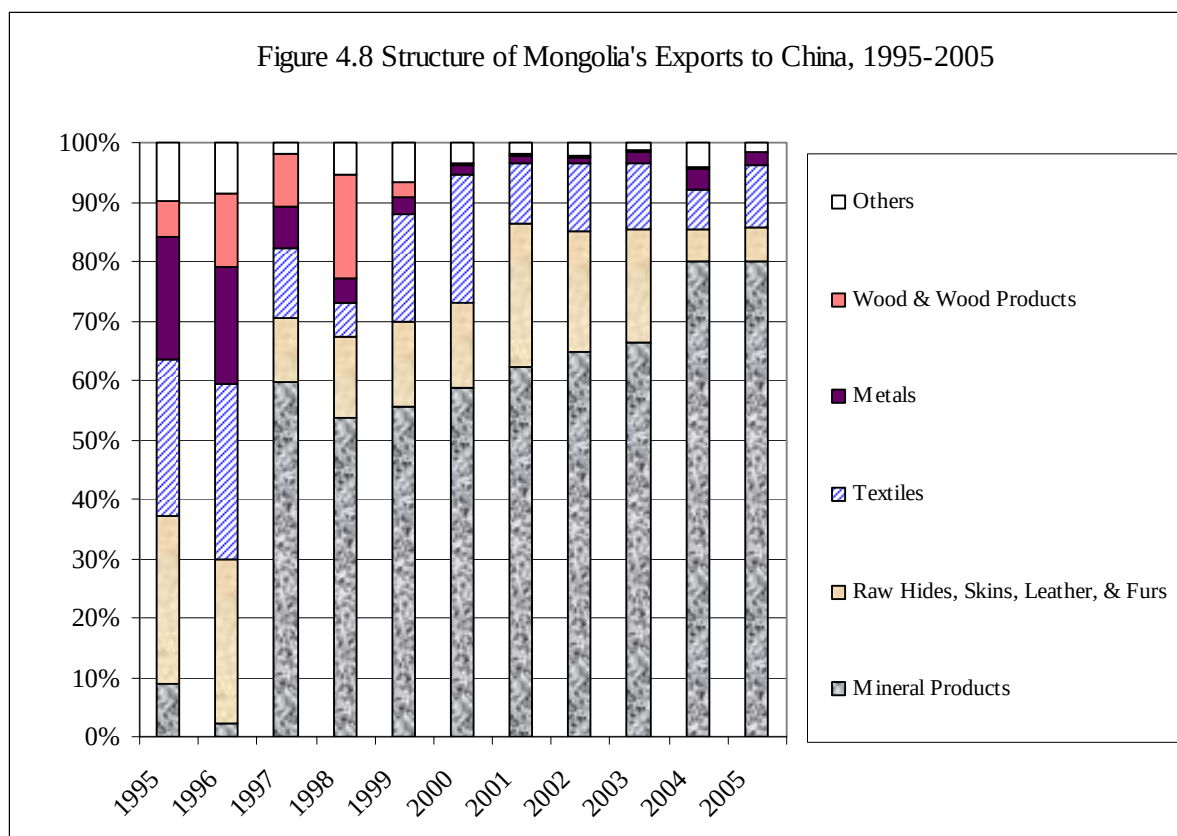
Source: Data from MIT, 2005.

4.3 Bilateral Trade Structures

a. Structure of Mongolia-China Trade

Mongolia's exports to China are dominated by mineral products (HS 25-27) exports. Cumulative exports of this item accounted for 63.8% of total exports to China during the period 1995-2005. Raw hides, skins leather & furs (HS 41-43) and textiles (HS 50-63) were the next major export commodities to China with their shares accounting for 13.7% and 12.5% of total during the period. The following large groups of export commodities to China were metals (HS 72-83) and wood & wood products (HS 44-46) that accounted for 3.7% and 2.9% of total exports to China during the period. The combined share of these 5 groups of HS commodities accounted for 96.6% of total exports to China during the same period (Figure 4.8).

Figure 4.8 Structure of Mongolia's Exports to China, 1995-2005



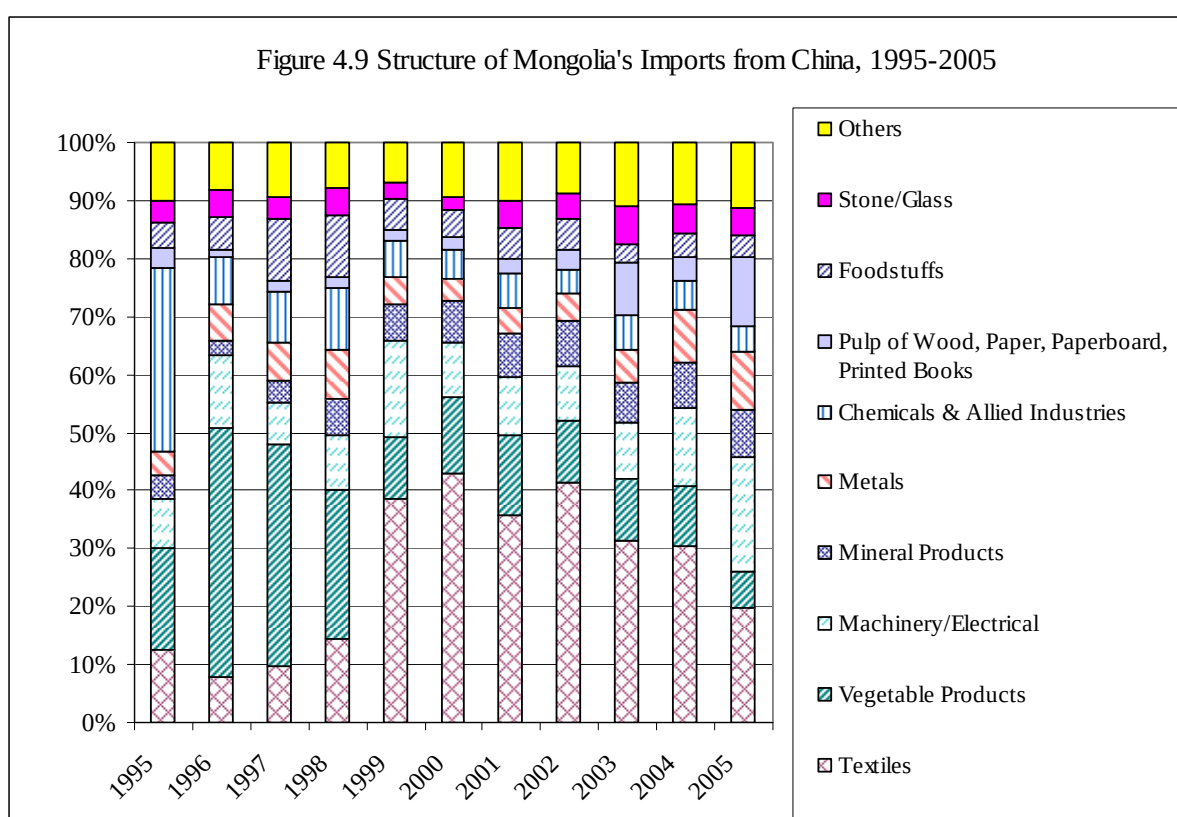
Source: Data from MIT, 2005.

Textile (HS 50-63) imports were the major commodity of Mongolia's imports from China accounting for 28.5% of total cumulative imports from China during the period 1995-2005. In particular, the shares of textile imports from China equaled to more than one-third of Mongolia imports from China per annum during the period 1999-2004. These were mainly textile fabrics and auxiliary materials supplied by the foreign customers of CMT (*cut-make-trim*) operation based clothing businesses. A number of foreign-invested factories have been established in Mongolia during this period to take advantage of Mongolia's excess quota available for textile exports to the U.S. and European markets.

Vegetable products (HS 06-14) and machinery/electrical (HS 84-85) were the next major import commodities accounting for 13.7% and 12.7% of total imports from China during the period. Mineral products (HS 25-27), metals (HS 72-83), chemicals and allied industries (HS 28-38) were the other major import items from China and each group accounted for about 7% of total imports from China during the period. Pulp of wood, paper, paper board, printed books (HS 47-49), foodstuffs (HS 16-24) and stone/glass were the other main imports commodities from China and each group accounted for about 5% of total (Figure 4.9).

Trades on commercial bases accounted for almost all of the Mongolia's exports to China, whereas those of imports accounted for less than 75% of total imports. As mentioned above, about one-third of imports from China were goods supplied by the foreign customers of CMT operation based clothing businesses. At the same time, goods imported on FDI (foreign direct investment) accounted for about 5%-10% of Mongolia's total imports from China per annum.

Figure 4.9 Structure of Mongolia's Imports from China, 1995-2005



Source: Data from MIT, 2005.

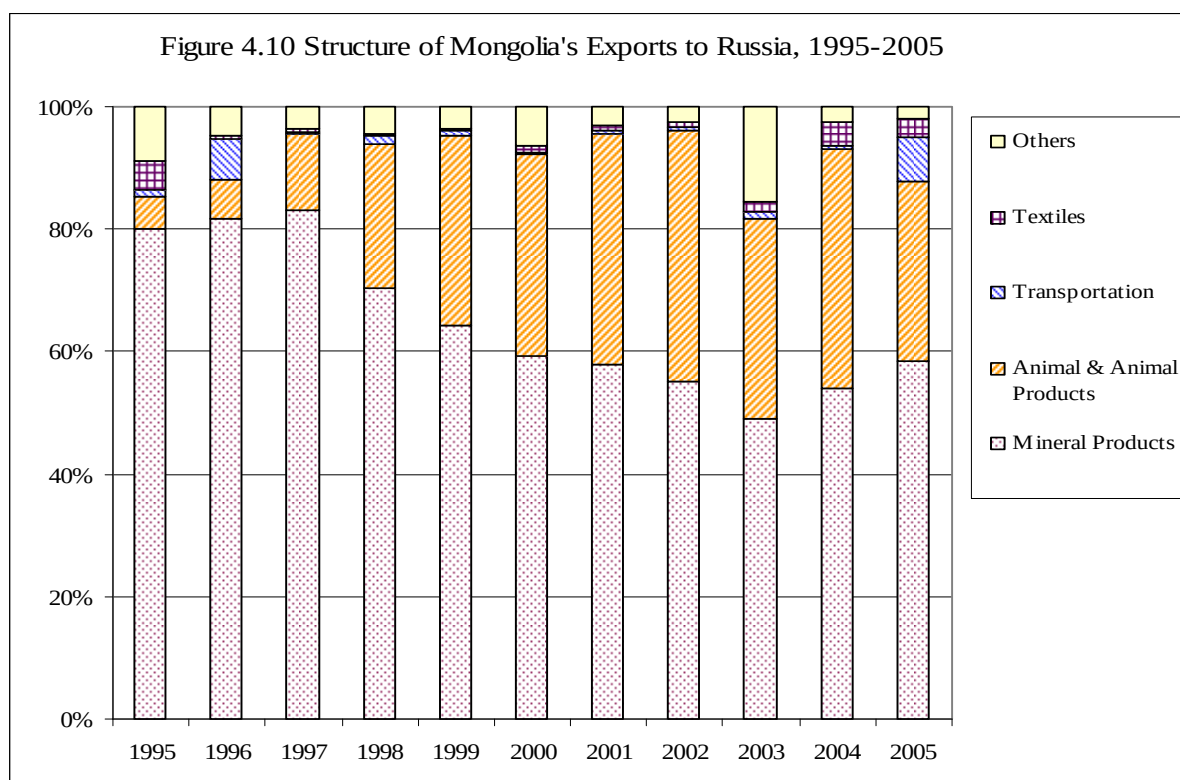
b. Structure of Mongolia-Russia Trade

Mineral products (HS 25-27) were the major commodity of Mongolia's both exports to Russia and imports from Russia, whereas exports accounted for 65.3% of total cumulative exports to Russia during the period 1995-2005, and those of imports accounted for 55%. Mongolia imports almost all of its petroleum and petroleum products from Russia that account for the largest share of Mongolia's total imports. At the same time, Mongolia's exports of mineral products to Russia were dominated by fluorspar and fluorspar concentrates (Figures 4.10, 4.11).

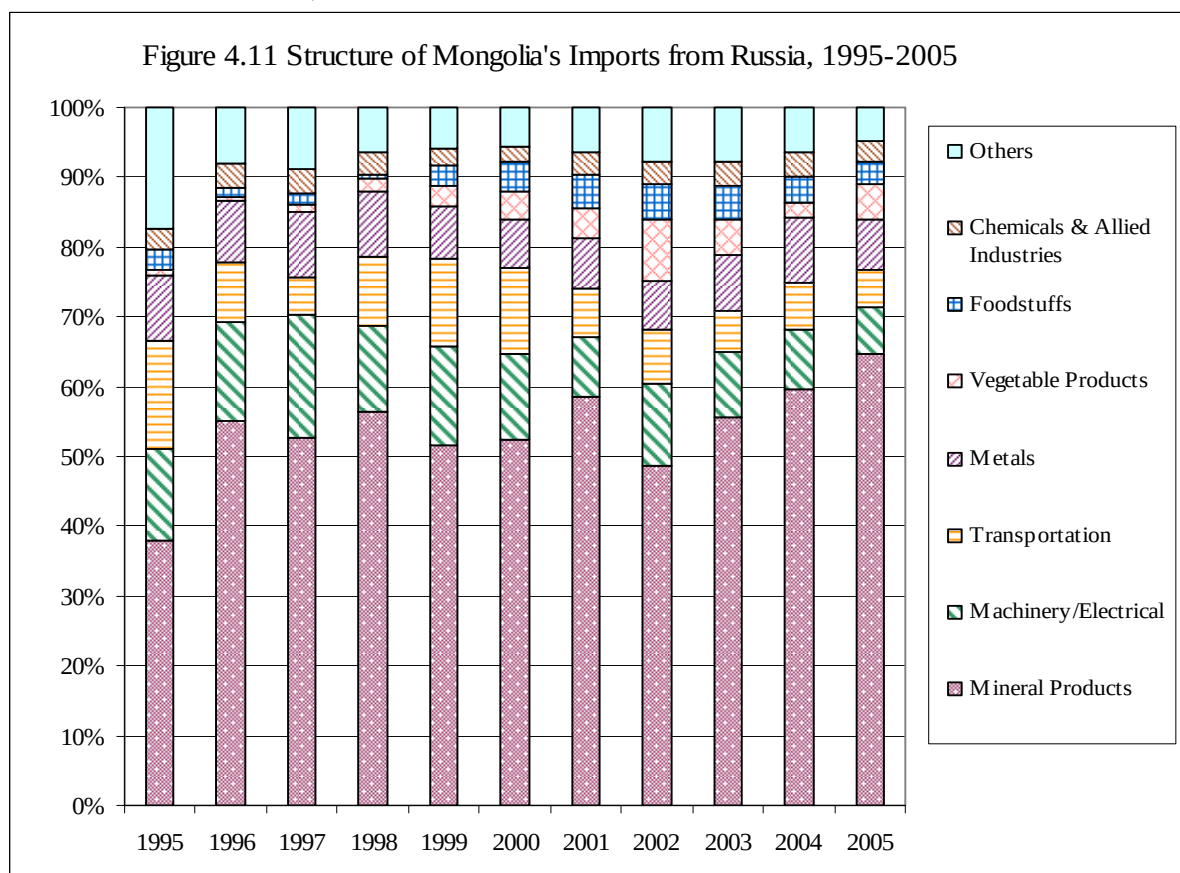
Animal and animal products (HS 01-05) was the next largest export commodity of Mongolia to Russia that accounted for 21.4% of total cumulative exports during the period. Exports of transportation (HS 86-89) and textiles (HS 50-63) commodities accounted for 1.9% and 1.4% of total exports to Russia during the same period (Figure 4.10).

Machinery/electrical (HS 84-85) commodities were other main imported items from Russia that accounted for 10.9% of total. At the same time, transportation (HS 86-89) and metals (72-83) imports accounted for about 8% of total, whereas the shares of imports of vegetable products (16-14), foodstuffs (HS 16-24), chemicals and allied industries ranged between 3.2% and 3.6% of Mongolia's total imports from Russia (Figure 4.11).

Trades on commercial bases accounted for almost all of the Mongolia's exports to Russia, whereas those of imports accounted for 70%-85% of total imports. At the same time, goods imported from Russia on FDI accounted for about 5%-15% of total annually.



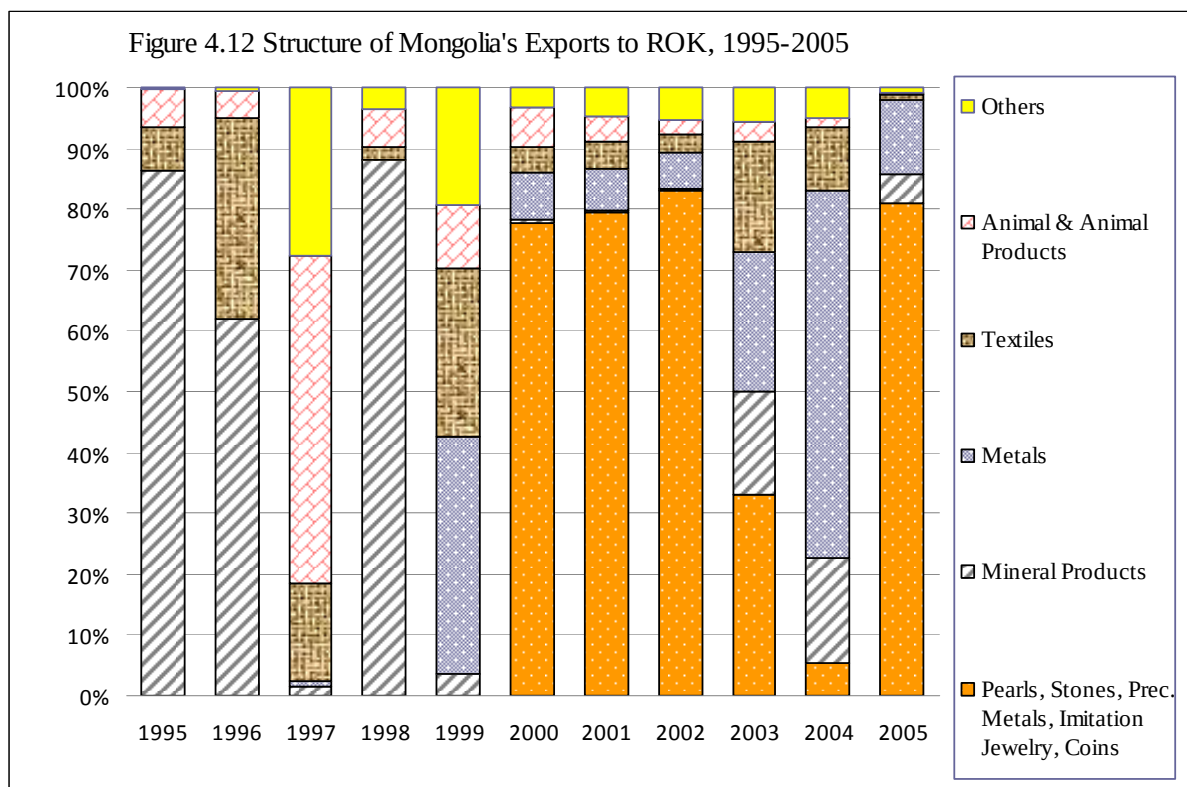
Source: Data from MIT, 2005.



Source: Data from MIT, 2005.

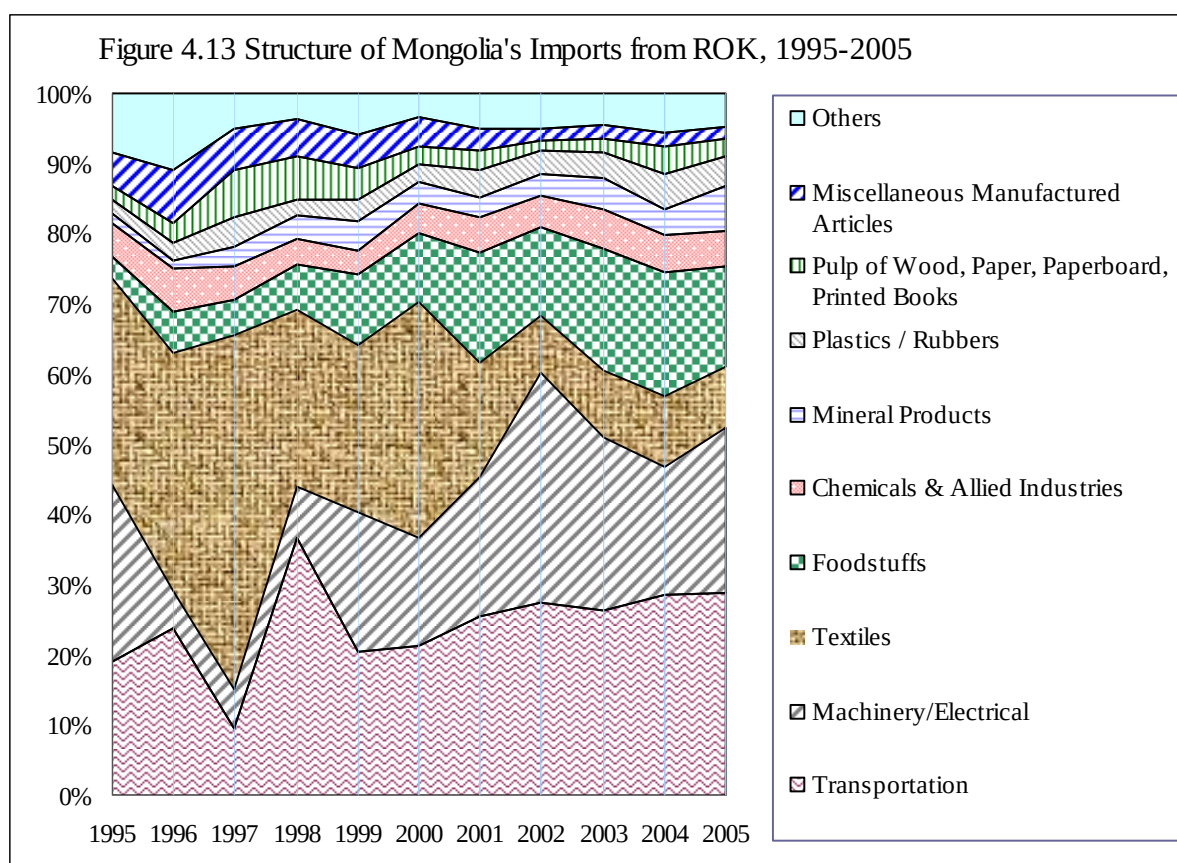
c. Structure of Mongolia-ROK Trade

Mongolia's export structure to ROK was unstable and demonstrated rather a random walk pattern over the period 1995-2005. Exports of mineral products (HS 25-27) were dominant in the beginning of the period, whereas exports of non-monetary gold (HS 71) became the dominant export commodity to ROK during the later period. Cumulative shares of these commodities accounted for 27.3% and 47.3% of total exports to ROK during the period. Metals (HS 72-83) and textiles (HS 50-63) were the other main export commodities to ROK with their shares accounting for 9.5% and 9.2% of total cumulative exports during the period. At the same time, the cumulative exports of animal and animal originated products accounted for 3.8% of total exports to ROK (Figure 4.12).



Source: Data from MIT, 2005.

However, Mongolia's import structure from ROK was relatively stable during the period 1995-2005 with majority of imports being transportation (HS 86-89) and machinery and/electrical (HS 84-85) commodities. Shares of these groups were 25.8% and 20.6% of total imports from ROK respectively during the period. Textiles (HS 50-63) and foodstuffs (HS 16-24) were the other main imported items from Korea during the period accounting for 18% and 12.5% of total respectively. In particular, more than 30% of Mongolia's imports from ROK were mainly textile fabrics and auxiliary materials supplied by the foreign customers of CMT (*cut-make-trim*) operation based clothing businesses during the period 1995-2000. At the same time, imports of chemicals and allied industries (HS 28-38), mineral products (HS 28-38), plastics/rubbers (HS 39-40), pulp of wood, paper, paperboard, printed books (HS 47-49) and miscellaneous manufactured articles (HS 94-96) accounted for about 3% to 5% of total (Figure 4.13).

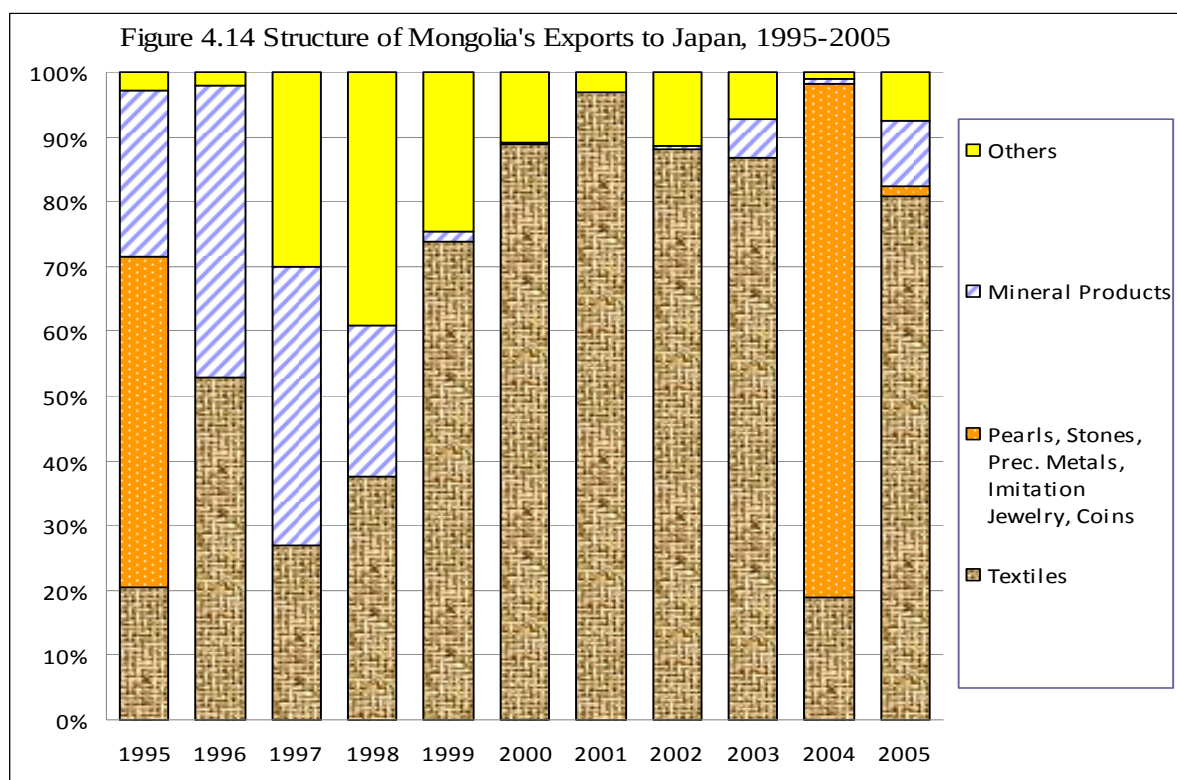


Source: Data from MIT, 2005.

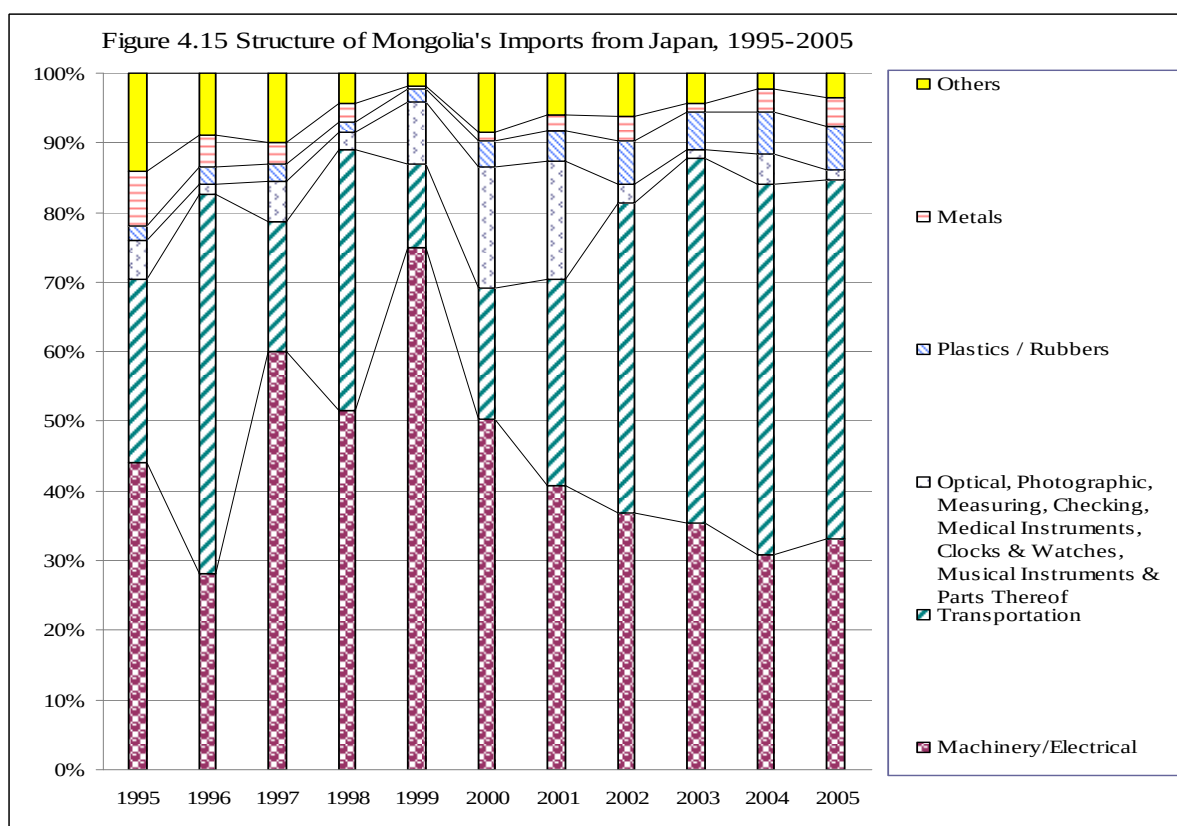
d. Structure of Mongolia-Japan Trade

Mongolia's exports to Japan were dominated with a fewer items than those to other major trading partners of Mongolia in the region, despite Japan grants Mongolia preferential tariff treatment under its GSP scheme. Mongolian exports to Japan mainly consisted of textiles (HS 50-63), in particular, semi-processed cashmere, cashmere garments and camel wool blankets. Exports of these commodities accounted for 40.5% of total cumulative exports during the period 1995-2005. Similar to exports to ROK, Mongolia's exports of non-monetary gold (HS 71) and mineral products (HS 25-27) to Japan had a random walk pattern during the period. Shares of these commodities accounted for 29.5% and 21.7% of total cumulative exports to Japan during the period (Figure 4.14).

Mongolia's import structure from Japan also had a limited number of commodity groups with dominance of machinery/electrical (HS 84-85) and transportation (HS 86-89). The shares of these items accounted for 45.5% and 35.8% of total cumulative imports from Japan respectively during the period. At the same time, imports of optical, photographic, measuring, checking, medical instruments, clocks & watches, musical instruments & parts thereof (HS 90-92) accounted for 6.4% of total imports from Japan, whereas those of plastics/rubbers (HS 39-40) and metals (HS 72-83) accounted for 3.7% and 2.8% (Figure 4. 15).



Source: Data from MIT, 2005.



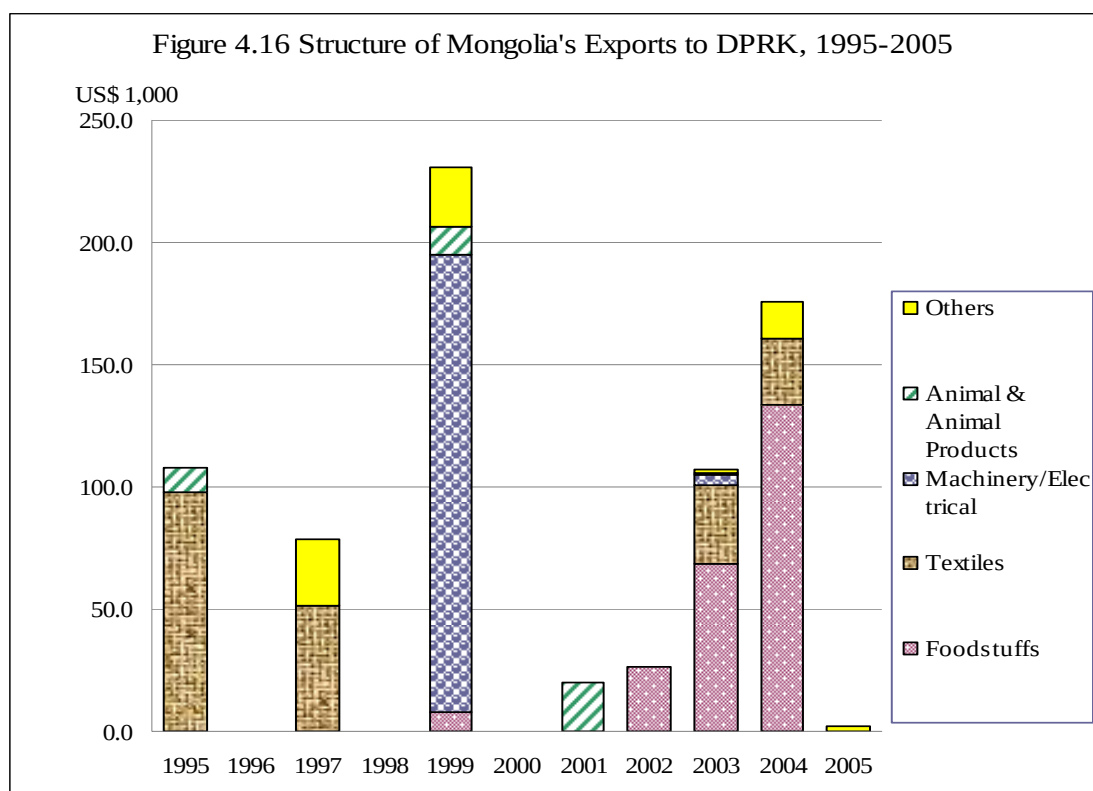
Source: Data from MIT, 2005.

However, it should be noted that Mongolia's import commodities from Japan were dominated by commodities supplied on the governmental loan and grant aid of Japan to Mongolia. The cumulative shares of commodities imported on grant aid and loan accounted respectively for 34% and 21.3% of total imports from Japan during the period 1995-2005, whereas imports on commercial bases accounted for 36.5% of total only. The shares of merchandise imports supplied on government loan and grant aid were higher until the early 2000s, but declined after 2004. For example, goods imported on government loan and grant aid accounted for 60% and 22% of total imports from Japan in 1999, whereas those of commercial imports accounted for 12.5% of total. Also, goods imported on FDI accounted for about 6% of total imports from Japan per annum during the period 1995-2005. At the same time, almost all of the Mongolia's exports to Japan were those on commercial bases, except in 1997, when goods exported as the government's loan repayment accounted for 34% of total exports to Japan.

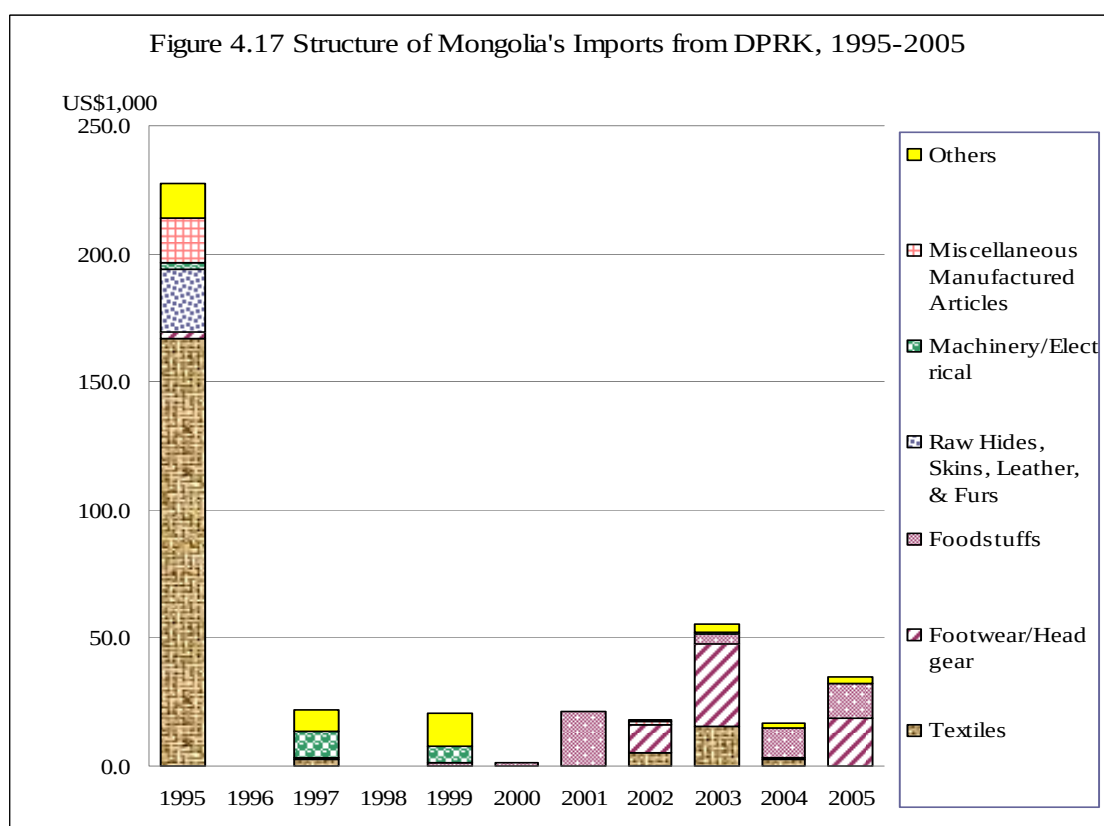
e. Structure of Mongolia-DPRK Trade

Structure of Mongolia's trade with DPRK has a random walk pattern in both exports and imports along with limited values of bilateral trade flow during the period 1995-2005. There were no trades between the two countries in 1996 and 1998. Mongolia's exports to DPRK in 1995 dominated by textile (HS 50-63), namely, sheep wool (90% of total) and sewn goods (10% of total), whereas export of machinery/electrical (HS 84-85), namely, used printing machinery (55% of total), was dominant in 1999. Foodstuffs (HS 16-24) (sausages, canned vegetables and biscuits) were the other exported items to DPRK during the period 2002-2004 (Figure 4.16).

In terms of imports, textiles (HS 57), namely, synthetic woven fabrics were the major imported commodity from DPRK in 1995. Imports during the following years were very limited and their structures are illustrated in Figure 4.17.



Source: Data from MIT, 2005.



Source: Data from MIT, 2005.

V. Intra-industry Trade

It is not surprising that Mongolia's exports are dominated by mineral products, in which Mongolia has a relatively abundant endowment; and thus a comparative advantage. Therefore, it was interesting to evaluate the extent of Mongolia's intra-industry trade, especially with NEA countries that have dominant share in the country's foreign trade. Intra-industry trade represents international trade within same industries rather than between different industries. "Intra-industry trade produces extra gains from international trade, over and above those from comparative advantage, because intra-industry trade allows countries to benefit from larger markets" (Krugman, P. & Obstfeld, M., 2000. p.139).

Due to data availability, HS commodity group data was used as a proxy to represent the industries. The dynamics of indexes⁸ of intra-industry trade with NEA for Mongolia during the period 1995-2005 indicate that very few industries had intra-industry trade. Therefore, large part of Mongolia's trade with these countries was inter-industry trade. Only two sectors, mineral products (HS 25-27) and textiles (HS 50-63), had values of intra-industry trade indexes greater than 0.5 throughout the period. The values were respectively 0.84 and 0.71 in 1995, and 0.81 and 0.94 in 2005. The indexes for metals ranged between 0.27 and 0.80 during the same period. There were also a very few industries, which had intra-industry trade indexes even above 0.3. The indexes for animal and animal products (HS 01-05) became higher than 0.3 after 2001, whereas those of wood and wood products (HS 44-46) ranged between 0.09 and 0.74 during the period (Figures 5.1a, 5.1b).

Considering the nature of the commodities traded between Mongolia and NEA countries (as described above, even within the same product group, Mongolia's exports are dominated by raw and semi-processed products, while imports are dominated by finished products, see Table 4.1), this situation implicates that Mongolia's industries have not integrated with the regional industries, where Mongolian industries could, in fact, benefit from larger markets in the region and increase their competitiveness, and at the same time, the consumers benefit from an increased range of product choices.

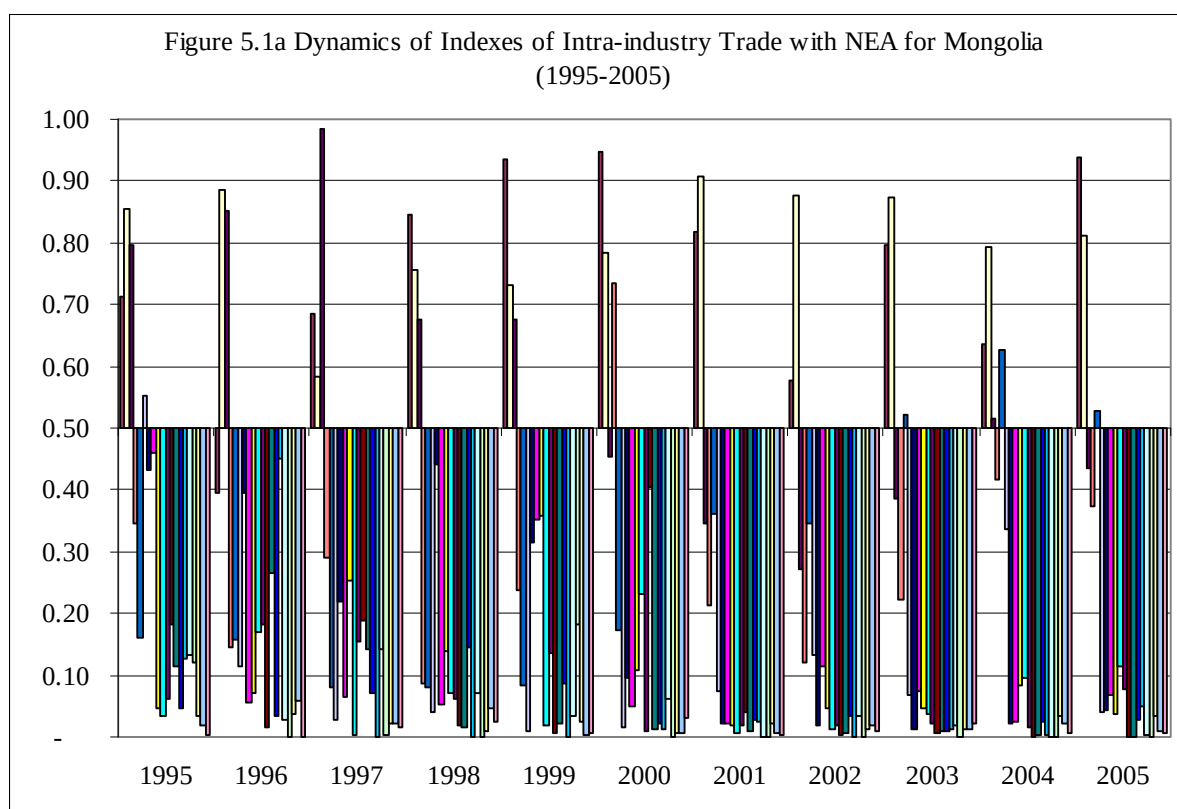
As indicated OECD (2002), "the low share of intra-industry trade reflects a tendency for a high proportion of these countries' manufactured exports to consist of relatively simple transformations of the raw materials with which the country is endowed, and such transformations are not suited to division across different countries" (p.163). Mongolia's intra-industry trade performance also supports this finding. According to Davis (2010), mining is very similar to manufacturing, because it requires the application of energy, labor, and capital in order to make concentrates from ore.

Therefore, as indicated Porter (2008), "economic coordination among neighboring countries can significantly enhance competitiveness (p.36), but cross-national collaboration is not a substitute for national microeconomic reforms" (p.37), effective policies and actions on the part of both the government and business need to be intensified (pp. 36-37). Mongolia's record in terms of educational attainments implicates that potential for a rapid build-up of industrial/technological capabilities exists in side Mongolia (Open Society forum, 2007).

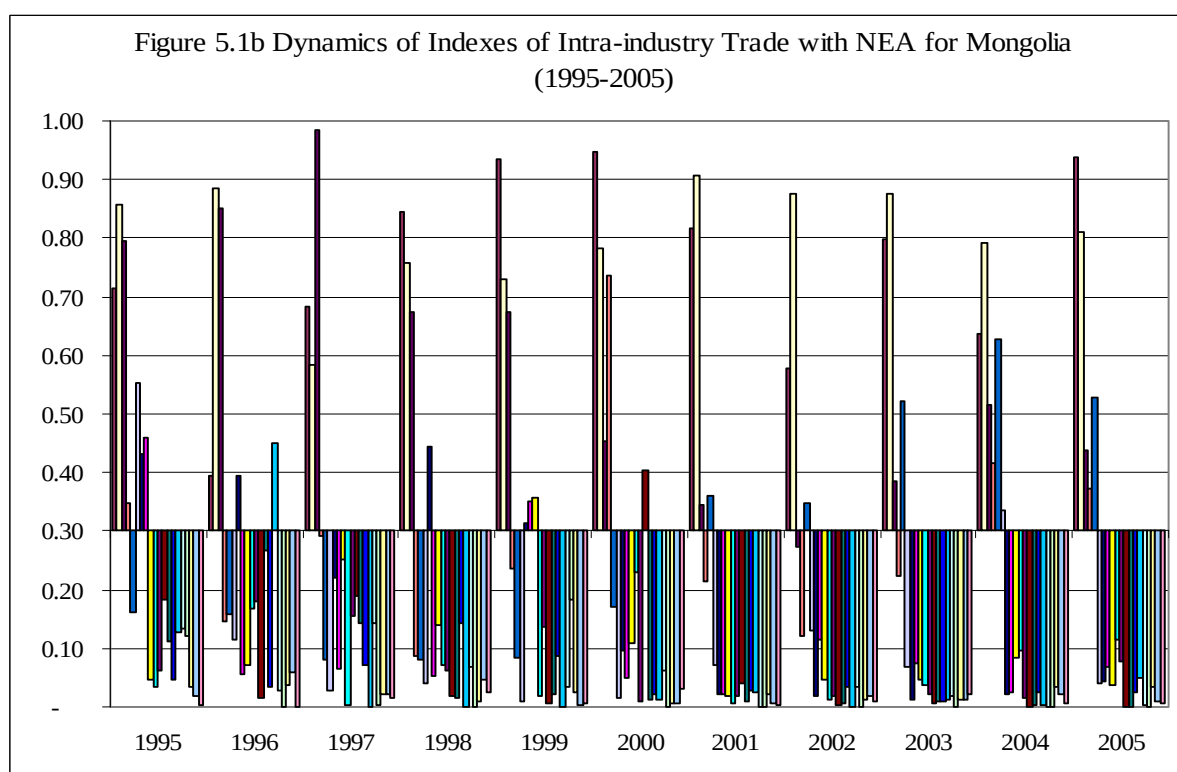
⁸ The Index is calculated using the standard formula for calculating the importance of intra-industry trade within a given industry as below:

$$I = 1 - \frac{|\text{exports} - \text{imports}|}{\text{exports} + \text{imports}}, \text{ where the expression } |\text{exports} - \text{imports}| \text{ means "absolute value of the}$$

trade balance". Index closer to one indicates intra-industry trade, and closer to zero indicates inter-industry trade (Krugman, P. & Obstfeld, M., 2000. p.138).



Source: Estimated from MIT, 2005.



Source: Estimated from MIT, 2005.

VI. Conclusion

Foreign trade plays a crucial role for the Mongolia's economy and the Northeast Asian countries have large presences in Mongolia's foreign trade activities accounting for more than $\frac{3}{4}$ of the country's total merchandise foreign trade turnover.

Because Mongolia is a landlocked country and it has limited transportation network both domestically and internationally linked ones, Mongolia's the only two neighbors – China and Russia – have the largest presences in its foreign trade activities.

China became Mongolia's largest export destination in the late 1990s. The majority of Mongolian exports to China consist of mineral products and raw materials of livestock origin. Mongolia's trade with China continued to experience surpluses over the entire period, owing to exports of mineral products and livestock-originated raw materials, the country's major export commodities.

At the same time, exports to Russia has diminished, however, Russia remained the major source of imports to Mongolia, despite having lost its leading share in total trade turnover. Therefore, Mongolia continues to have large trade deficits with Russia. In fact, Mongolia imports from Russia almost all of its petroleum and petroleum products, which account for the largest share of Mongolia's total imports.

Though, Japan and the ROK have emerged as ones of Mongolia's export destinations, their volume still remain limited. Mongolian exports to Japan mainly consisted of semi-processed and finished cashmere goods, while exports to ROK had a random structure of various mining products. Though, Japan and the ROK have emerged as ones of Mongolia's export destinations, their volumes still remain limited. However, imports from these countries tend to increase, whereas imports from ROK consist of transportation, machinery/electrical, and various manufactured and industrial goods and foodstuffs and those from Japan dominate by machinery/electrical and transportation goods.

Although the Mongolian government has persistently been promoting an export-led growth policy for more than a decade of transition, the dominance of raw and low value-added products in its exports makes the country unable to escape from the prolonged foreign trade deficit that is undermining the potential of foreign trade to be the country's growth engine. The overall structure of Mongolia's foreign trade to NEA region did not change much over the period 1995-2005. Exports were dominated by mineral products and those of livestock origin, whereas imports comprised a wide range of consumer products and industrial goods. Apart from gold and sewn goods, no major new commodity has been included in the list of exported goods during this period. Therefore, Mongolia needs to improve its export performance by diversifying its markets and seeking opportunities for exports of higher value-added products, especially to markets of ROK, Japan and Russia.

Moreover, intra-industry trade indexes implicated that Mongolia's industries have not yet integrated with the regional industries. In view of Mongolia's relatively small size of domestic market, an effective regional integration would give opportunity for Mongolian industries to benefit from the regional larger markets and increase their competitiveness, while the consumers benefit from an increased range of product choices available at the domestic market. Therefore, effective policies and actions on the part of both the government and businesses need to be strengthened.

References

- Akita, T. and Enkhbayar, Sh. (2002). Regional Income Inequality in Mongolia; 1989-1999. *The Journal of Econometric Study of Northeast Asia (JESNA)*, Vol. 3, No. 2, 2002, pp. 51-73.
- Amarjargal, R. (2002). Mongolia: The Early Stage of Transition. A background paper presented at the JIIA International Forum, November 26, 2002.
- Baatar, Ts. (2007). *Mongolia's Foreign Economic Relations in the Era of Globalization* (in Mongolian), Bembi San LLC: Ulaanbaatar.
- Banse, M. (2002a). Impact of Chinese WTO Membership on Mongolia. Shot-term study in the GTZ Project "Mongolian German Co-operation in the Field of International Trade Policy/WTO" Project No. 98.2087.9-001.00.
- Banse, M. (2002b). Russia at the gate to WTO. Impact of Russian WTO Membership on Mongolia. Shot-term study in the GTZ Project "Mongolian German Co-operation in the Field of International Trade Policy/WTO" Project No. 98.2087.9-001.00.
- Davis, G. (2010). Trade in Mineral Resources. World Trade Organization, Economic Research and Statistics Division. Staff Working Paper ERSD-2010-01.
- Enkhbayar Sh. (2007a). Neo-Liberal "Shock Therapy" Policy during the Mongolian Economic Transition. ERINA Discussion Paper No. 0703e, 16 pages. Available online: <http://www.erina.or.jp/en/Research/dp/pdf/0703e.pdf> (April 8, 2010).
- Enkhbayar, Sh. (2002). The Mongolian Livestock Sector: Vital for the Economy and the People, but Vulnerable to Natural Phenomena (English and Japanese). *ERINA Report*, Vol. 47, Aug. 2002, pp. 4-26.
- Enkhbayar, Sh. (2003a). Unemployment and Impoverishment in Mongolia: A Close Look at the Reality. *ERINA Report*, Vol. 51, pp. 41-47, Apr. 2003.
- Enkhbayar, Sh. (2003b). Proceedings and Outcomes of the Neo-liberal Policy During the Mongolian Economic Transition. *ERINA Report*, Vol. 54, pp. 35-42.
- Enkhbayar, Sh. (2005). Mongolia's Foreign Trade in 1985-2003 (Summary in Japanese). *ERINA Report*, Vol. 62, Mar. 2005, pp. 29-36.
- Enkhbayar, Sh. (2006). Mongolian Foreign Economic Relations with the Northeast Asian Countries (in Japanese). *SGRA Report*, No. 0031, pp. 51-57.
- Enkhbayar, Sh. (2007b). Explaining Mongolian Economic Performance in Transition: The Results of a Capital-Investment Analysis. *ERINA REPORT*, Vol. 76, pp. 43-53.
- Enkhbayar, Sh. (2008). Institutional Aspects of the Mongolian Economic Transition, (in Japanese, summary in English). *ERINA Report*, Vol. 80, pp. 33-39.
- EU (2005). Council Regulation (EC) No 980/2005 of 27 June 2005 applying a scheme of generalised tariff preferences. Official Journal of the European Union, L 169/1, 30.6.2005.
- http://siteresources.worldbank.org/INTMONGOLIA/Resources/Mongolia_ISN_2009_2010.pdf (April 8, 2010).
- ITC (2005). International Trade Statistics: Copper Concentrate Exports 1999-2003, Available online: <http://www.intracen.org/tradstat/sitc3-3d/ep283.htm> (January 14, 2005).
- Krugman, P. & Obstfeld, M. (2000). *International Economics: Theory and Policy*. Fifth Edition, Addison-Wesley Publishing Company: Massachusetts.
- MIT (2005). Foreign Trade Statistics Database of the Ministry of Industry and Trade, Mongolia, (personnel communications).
- MNU (2007). *Mongolia in a Market Economy* (in Mongolian). Mongolian National University (MNU), School of Economics. 2007, MNU Publishing House: Ulaanbaatar.

- Nemekhbayar, S. (2003). The Effect of the Entry into WTO on Mongolia's Economy. Available online: <http://www.trade-policy.mn>
- NSO (2004a). "Mongolia in a Market System" Statistical Yearbook, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2004b). Mongolian Statistical Yearbook 2004, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2005). Mongolian Statistical Yearbook 2005, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2006). Mongolian Statistical Yearbook 2006, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2007). Mongolian Statistical Yearbook 2007, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2008). Mongolian Statistical Yearbook 2008, Ulaanbaatar: National Statistical Office of Mongolia.
- NSO (2009). Monthly Bulletin of Statistics: December 2009, Ulaanbaatar: National Statistical Office of Mongolia.
- OECD (2002). VI. Intra-Industry and Intra-Firm trade and the Internationalization of Production, *OECD Economic Outlook 71*, pp. 159-170.
- Open Society Forum (2007). *Mongolia: Competitiveness Assessment of the Industrial Sector*. Report prepared for the Government of Mongolia, Ministry of Industry and Trade by the United Nations Industrial Development Organization, Open Society Forum, Ulaanbaatar, 2007.
- Porter, M. (2008). Competitiveness: Creating a Mongolian Economic Strategy (presentation). Available online at: www.isc.hbs.edu
- State Great Khural (1991). Law of Mongolia on Economic Entities. Law Database of the Parliament of Mongolia.
- State Great Khural (2002a). Law of Mongolia on Free Zones. Law Database of the Parliament of Mongolia.
- State Great Khural (2002b). Law of Mongolia on the Legal Status of "Altanbulag" Free Trade Zone. Law Database of the Parliament of Mongolia.
- State Great Khural (2003). Law of Mongolia on the Legal Status of "Zamyn-Uud" Free Economic Zone.
- State Great Khural (2004). Law of Mongolia on the Legal Status of "Tsagaan Nuur" Free Trade Zone.
- UNIDO (2009). Industrial Development Report 2009. United Nations Industrial Development Organization, 2009.
- Utkulu, U. & Seymen, D. (2004). Revealed Comparative Advantage and Competitiveness: Evidence for Turkey vis-à-vis the EU/15, 26 pages, Available online: <http://www.etsg.org/ETSG2004/Papers/seymen.pdf> (March 19, 2010).
- WDI (2008). World Development Indicators CD-ROM 08, The World Bank.
- WDI (2009). World Development Indicators CD-ROM 09, The World Bank.
- World Bank (2009). Draft World Bank Group Interim Strategy Note for Mongolia, CY 2009-10. 25 pages. Available online:
- WTO (2004b). The WTO Agreement on Textiles and Clothing (ATC) 1995-2004. Available online: [http://www.wto.int/english/tratop_e/texti_e/texintro_e.htm#\(ATC\)](http://www.wto.int/english/tratop_e/texti_e/texintro_e.htm#(ATC)).