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Investment Treaties Between Mongolia and EU states: Implications for Mongolia's Development Prospects.

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Abstract

This paper considers the politics of Mongolia's neoliberal transition from socialism and role of international investment and trade treaties in shaping today's Mongolia. It is not intended to provide a full account of domestic reforms in Mongolia – but instead is conceived as providing an understanding of the domestic context of how extractive sector came to be perceived as the lone driver of country's development, as well as international forces (investment and trade treaties) that helped shape country's mining and investment policy frameworks. Under this context this paper will examine the economic treaties related to trade, investment and taxation concluded between EU member states with Mongolia as well as investment trends of European development banks like the EBRD.

Keywords: Mongolia, BITs, ISDS, Shock Therapy, Investment Law

1. TRANSITION TO MARKET ECONOMY

At first glance, Mongolia's recent economic boom[1] contrasts abruptly with the country's thorny transition in the early 1990s. Mongolia has been often described as a success story of democratization – a bastion of democracy amidst authoritarian regimes. Right wing think tanks continue to label its political and economic system as 'free'.[2] However, these ratings and pronouncements hide fundamental issues of a country with weak institutions, economically dependent on export of natural resources. Because of its low state capacity and economic underdevelopment, Mongolia is subject to full force of globalization – both cultural and economic.

After 70 years of communist party rule Mongolia along with many post socialist countries embarked on a journey to democratize its rigid, centralized political system. Democracy was mainly seen as a free access to western consumer goods and cultural artifacts with a multiparty election in between. However, what was to follow was a completely opposite story – a tale of negligence and destruction. Mongolian government was in a grim situation after

[1] https://www.washingtonpost.com/news/worldviews/wp/2014/01/09/these-10-countries-are-set-to-be-the-fastest-growing-economies-in-2014/

[2] https://freedomhouse.org/report/freedom-world/2015/mongolia

the withdrawal of aid from Moscow and the decrease in trade with the COMECON[3] countries. It needed economic and political support from international donors. Organizations such as the Asian Development Bank (ADB) and the International Monetary Fund (IMF) guided Mongolia's transition by implementing structural adjustment programs (SAP's) within a framework of free trade and free capital movement, lifting of price controls, macroeconomic stabilization, and privatization of state companies and other public property. They saw functions of a welfare state such as health, education, and a social safety net as secondary to the creation of a market economy and the promotion of economic growth. Social equity, distribution of income appeared to be a less of their concern (Rossabi, 26)

These policies proved to be fundamentally destructive both in terms of human costs as well as destruction of domestic nascent industries built up during the Communist Era. Unemployment, poverty, corruption, and the attendant social problems afflicted Mongolia throughout the 1990s and into the next decade.[4] Mongolia became a member of the IMF, ADB, and the World Bank (WB) in 1991 and joined the World Trade Organization (WTO) six years later.

International Republican Institute (IRI), a U.S. state department connected organization, also played a role in domestic politics in Mongolia, after first initiating contacts through Secretary of State James Baker in early 1991. Like the Adenauer Foundation in the early 1990s, the IRI assisted newly formed neoliberal political parties hell bent on implementing structural adjustment programs. They spent $450,000 (a considerable sum at that time) in founding a political party, developing a message, grassroots organization, campaign management, and communications which turn out to win elections in 1996. (Rossabi, 36) NED did also participate in manipulating elections in Mongolia in 1996[5] by spending close to 1$ million in support of the opposition to the Mongolian People's Revolutionary Party.[6]

The Asia Foundation, an American NGO also had a prominent role in promoting the development of civil society through technical and material support for judicial and legal changes, including assistance in the drafting of a new constitution in 1992. Like the IRI it also backed new neoliberal parties and "staff members would eventually point out, with great pride, that 22 percent of those elected to the Khural in 1996 (or about 40 percent of the non-MPRP members elected) had received Asia Foundation grants, as would three of the five chairs of the standing committees in the Khural." (Rossabi, 63)

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[3] The Council for Mutual Economic Assistance was an economic organization from 1949 to 1991 under the leadership of the Soviet Union that comprised the countries of the Eastern Bloc along with a number of communist states elsewhere in the world.

[4] https://www.foreignaffairs.com/articles/mongolia/2013-01-29/meteoric-mongolia

[5] http://williamblum.org/chapters/rogue-state/trojan-horse-the-national-endowment-for-democracy

[6] NED and Project Democracy, William Blum 2000, 145, 157, 168-78

Was the Mongolian economy in such a dire state before democratic transition to be in need of so many international organizatons? History shows us a different picture. Between 1980 and 1989 average rate of growth was around 6.1 percent, rate of industrial output growth was hovering around 8.7%, agricultural output growth averaged 4.25%, and workers productivity was growing 4% a year. (T.Namjim, N.Itgel, 76) These numbers indicate a country with a healthy industry and economy.

Economic 'Shock Therapy' was administered around there main objectives.

1. Price liberalization

Table 1: Annual Consumer Price Index Changes for Selected Groups of Commodities 1991-1993 (%)

Group	Overall index	Foodstuffs	Clothing, footwear	Housing heating and electricity	Household goods	Medical care and services	Transport and communication	Other goods and services
1991	52.7	31.0	92.4	15.5	109.6	0.0	37.3	52.5
1992	325.5	476.6	253.0	112.8	279.7	96.7	289.9	182.5
1993	183.0	197.5	92.1	334.6	162.3	883.2	212.6	244.9

Source: Mongolia Statistical Yearbook

Price liberalization policy along with trade liberalization and privatization was the first and the most drastic step taken by the policymakers during 1990-1992. This move was to prove hyperinflationary and contributed to the weakening of the tugrik during the early stages of transition. Inflation reached 330 percent in 1993, peaking at an annual rate of 420 per cent in January 1993.[7]

Citing previous year's inflationary tendencies Mongol Central Bank was severely tightening its monetary policy by 1997, by charging annual rates of 48 to 66 percent to other banks, and the banks themselves charged customers interest of 5 to 10 percent a month.(Rossabi, 97) The same organization [the IMF] which advocated price liberalization a couple years ago was now pressuring the Mongol Central Back to tighten its credits and limit liquidity. Due to this

[7] World Bank. 1994. Mongolia Country Economic Memorandum: Priorities in Macroeconomic Management. Report no. 13612-MOG, Washington, D.C.

kind of policy, most small and medium-sized enterprises could not afford to borrow money thus becoming more and more insolvent.(Rossabi, 98)

2. Trade liberalization

Trade liberalization was done in such an irresponsible and hastily way that Mongolian industry would decline at an extremely high rate. In one instance, the IMF threatened to withdraw its aid if the government forced an export tax on raw cashmere in order to help local cashmere processors.(Rossabi, 100) Because of these harsh restrictions repeated pleas by cashmere processors for protection fell on deaf ear. Cashmere processors demands for low-interest loans were also denied by IMF as an attempt at subsidy. Light industrial enterprises that processed animal products like leather and cashmere where left in the cold as they couldn't obtain enough raw material because itinerant Chinese or Mongolians from Inner Mongolia could outbid them.(Rossabi, 100) As a result of these reforms in four year span (from 1989 to 1993) Mongolian GDP decreased by 23%, industrial output by 42%, agricultural output by 20%, and all transportation and cargo respectably by 21% (T.Namjim, N.Itgel, 81)

3. Privatization

The IMF and the ADB sent research groups to Mongolia to produce two reports *The Mongolian People's Republic: Toward a Market Economy* (1990) and *Mongolia: A Centrally Planned Economy in Transition* (1991) respectively. Both the IMF and ADB groups religiously believed in a limited government. According to their beliefs only an unfettered market would deliver prosperity as well as freedom. The best way of reducing the scope and size of government was to privatize state owned enterprises and to restrict the revenues at its command. However, the quick and unplanned transition meant that there was a considerable reduction in taxation and sharp cutbacks in the size of its bureaucracy, resulting in widespread unemployment and hunger.

First stage of privatization started in May 1991, when every citizen got a green/red voucher worth 10,000MNT which resulted in privatization of more than 4500 state entities. Second stage began with the establishment of Stock Exchange was in 1995 paving way for privatization of state owned enterprises and state shares in companies through public auctions, tenders, and management contracts. (Shagdar, 6)

Table 2: Private Sector Share by Industry (selected) 1999 and 2004, at current prices (%)

Sectors	1999	2004
Agriculture, hunting and forestry	96.4	95.9

Mining and quarrying	56.0	69.0
Manufacturing	75.0	86.4
Construction	89.1	94.0
Transport, storage, and communications	41.1	62.9
Education	12.9	14.5
Total private sector share of GDP	70.3	76.0

Source: NSO, 2003a; NSO 2005.

However, the success of the whole privatization process was judged, as seen in the table above, purely on the basis of how many public assets were transferred to the private sector. Nothing was known about the performance of newly privatised enterprises, the distributional consequences of privatisation, the impact on employment and possible macroeconomic implications.(Nixson, Walters, 57) Many Mongolians argue to this day that the main impetus behind privatisation was political rather than economic, and the only ones who were able to benefit from it were people with connections. Unchecked privatization meant that the newly privatized entities were mostly abandoned, its machines and equipments sent to metal scarps in China. The whole process was eerily similar to its Russian equivalent. Joseph Stiglitz evaluated that Russian privatization "set the preconditions for decline. Not only was investment halted, but capital was used up – savings vaporized by inflation, the proceeds of privatization… misappropriated. Privatization led not to wealth creation but to asset stripping."(Stiglitz, 142) This excerpt can also be used word for word to describe the Mongolian transition.

James Wolfensohn, president of the World Bank in 1999, summarized international organizations work in the following statement. "[T]oo often we have focused too much on the economics, without a sufficient understanding of the social, the political, the environmental and cultural aspects of society," In his address he acknowledged that the World Bank, IMF, and other agencies had emphasised financial stability, privatization, and reductions of state subsidies at the possible expense of programs aimed at ordinary citizen. He further contends that "the World Bank needed to provide safety nets and to emphasize greater equity and social justice, not merely economic growth." Wolfensohn ended with a critique of the trickle-down theory, noting that "the poor cannot wait on our deliberations. The poor cannot wait until we debate a new architecture." [8]

[8] James Wolfensohn, "Opening Address by the President of the World Bank Group" (World Bank Annual Meeting, Washington, D.C., October 6, 1998), 25–32.

2. MINING AS DEVELOPMENT PRIORITY: THE ROLE OF THE WORLD BANK

Full scale application of structural adjustment programs in Mongolia resulted in a country with no industrial backbone and with revolving door of governments with very little organizational and professional capacity. Liberalization of trade and capital flows did not result in a significant increase in foreign investment and transfer of know-how or new technology, except in mining companies. Many prominent critics also questioned the priorities of foreign aid which were targeted for focused on energy and mining. For example, of the money pledged by international donors in 1998, 30 percent was for mining, 27 percent for energy, 19 percent for transport, 8 percent for telecommunications, and only 3 percent for social services. (Rossabi, 59)

Mongolian industrial production was thoroughly influenced by international organizations towards exploitation of natural resources. The World Bank partially funded the first foreign investors' conference in 1997, which focused on mining.(Rossabi, 86) The World Bank has had a central role on energy policy in developing countries by investing billions of dollars in fossil fuels and large dams. The World Bank proclaims itself as a development bank and that their energy funding helps the poorest in developing countries, its investments have increased energy access for only large companies.[9] The Bank has made climate change a key priority[10] for its operations but still continue to invest dirty energy projects.

WB has been a key player in setting up Mongolia's governance framework and mining regime (starting from 1991) in line with their activities in other developing countries. Main products of their work – "mining and foreign investment laws of 1997 were regarded at the time as the most attractive [neoliberal] laws to foreign investors" (Connors, 2011) Below table lists the World Bank Groups biggest investments in mining related projects in Mongolia.

Table 1: World Bank Group extractive industry related projects in Mongolia (over US$1 million)

Project title	Amount	Approval date	Status
World Bank Projects			
Mining infrastructure Investment Support Project – Additional Financing	4.2	2014	Active
Strengthening governance	1.2	2012	Active
Mining infrastructure Investment Support Project	25	2011	Active

[9] http://www.brettonwoodsproject.org/2015/08/issue-overview-world-bank-and-energy/
[10] http://www.worldbank.org/en/news/feature/2015/12/07/cities-get-star-treatment-at-global-climate-conference-in-paris

Development Policy Credit 2	29.7	2010	Closed
Development Policy Credit	40	2009	Closed
Mining Sector Technical Assistance Project	9.3	2008	Closed
Netherlands-Mongolia Trust Fund for Environmental Reform	2.4	2007	Closed
Coal Project	35	1996	Closed
Economic Transition Support Project	20	1993	Closed
Economic Rehabilitation Project	30	1991	Closed
IFC Project			
Oyu Tolgoi LLC	1,22 billion	2015	Pending Disbursement
MIGA Project			
Oyu Tolgoi LLC	Up to 1 billion	2015	Proposed

Compiled by author from World Bank Group reports

3. SETTING UP THE INVESTMENT FRAMEWORK: FOREIGN INVESTMENT LAW AND THE MINING LAW

It was previously explained that most of the funds by international institutions been aimed at structural adjustments - in other words, promotion of a market economy. These funds were designed to foster privatization, liberalization, and foreign investment, a vital part of the international donor agencies' agenda. (Rossabi, 78)

The Foreign Investment Law of Mongolia was adopted in 1990. Amendments to the law were made in July 1993. Further amendments were also made in 1998, 2002, and 2013. Neoliberal nature of this law is outlined in Purpose of the law which stipulates "*to encourage foreign investment, to protect the rights and property of foreign investors in Mongolia, and to regulate matters relating to the operations of business entities foreign investment."*[11] Intention of this law is not to use foreign direct investment for developing the country's economy but only to serve interests of international capital. What further undermines the position of the host state is the definition of "Foreign Investment". According to Article 3 "Foreign investment" means "every kind of tangible and intangible property which is invested in Mongolia by a foreign investor for the purpose of establishing a business entity with foreign investment within the territory of Mongolia or for the purpose of jointly operating with an existing business entity of Mongolia." First, the definition neglects a normative definition of

[11] Article 1. Foreign Investment Law. 2013

FDI. There is no distinction between FDI as a development assistance tool and FDI as a market liberalisation mechanism.

Even though Mongolia implemented an ultraliberal Foreign Investment Law it didn't increase FDI inflows to the country. From 1990 to 1999, foreign investment amounted to $284 million, meager for a developing economy. By 1999, foreign investment amounted to less than 4 percent of GDP, whereas the average for developing countries was 11 percent. (Rossabi, 116) Although foreign investment had created some employment, it had been limited and relatively unregulated and had not substantially increased manufacturing or contributed to eradicating poverty. (Rossabi, 172)

According to the latest revision of this Law [2013] an investor who intends to invest more than MNT 500 billion may apply to the State Central Agency in charge of investment, known as the 'Invest Mongolia Agency' (the Agency), for an investment agreement.[12]

In a November 2013 interview, Sereeter Javkhlanbaatar, Director General of the IMA, explained:

[T]he new law introduces a more liberal business environment. Previously there were many approval systems in place for companies willing to enter Mongolia's market, a lot of bureaucracy. The new law eliminates entry barriers... In addition, the new law lifts any foreign investment limitation for key sectors such as mining, telecommunications, banking and finance and introduces equal treatment for foreign and domestic investors. It also includes international standardized protection clauses such as no expropriation and free repatriation of profits.[13]

The new law transforms the already ultraliberal investment law into even more investor friendly piece of legislation. This is encapsulated by several new tax incentives afforded to investors:

a) exemption from taxes;

b) provision of tax rebates;

c) estimation of depreciation costs that could then be excluded from taxable income;

d) having losses excluded from taxable income; and

e) exclusion of employee training costs from taxable income.[14]

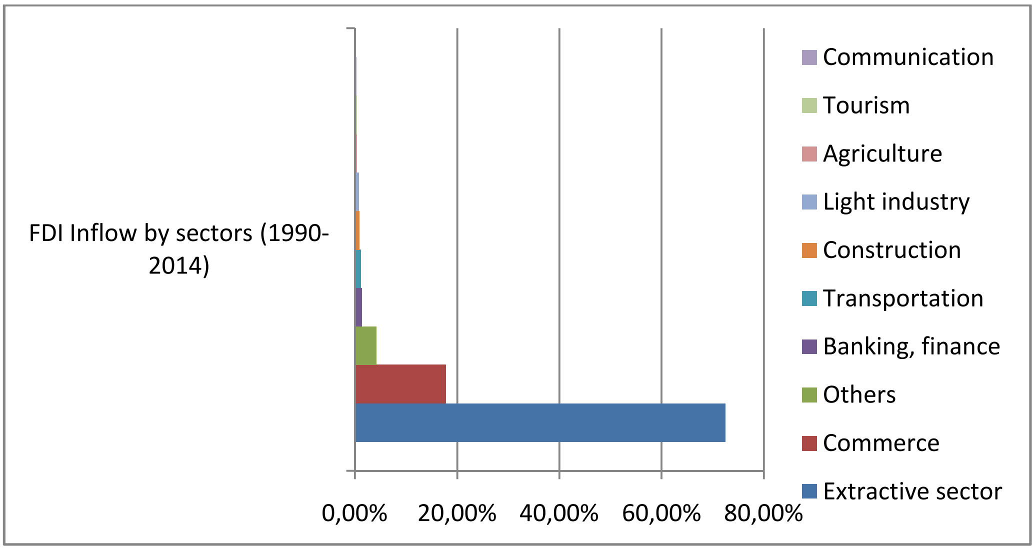
Other important concessions include the ability to conclude tax stabilisation agreements where investors may obtain tax stabilisation for a given period of time. The following taxes

[12] The Foreign Investment Law. 2013 Amendment.

[13] Jacopo Dettoni & Sereeter Javkhlanbaatar, The Diplomat, 27 November 2013, http://thediplomat.com/2013/11/sereeter-javkhlanbaatar/.

[14] Investment Law, Articles 11.1.1-11.1.5 (2013) (Mong.)

may be covered by a stabilisation certificate: corporate income tax; customs duties; value added tax; and mineral royalties.[15] There are several different criteria for investors to qualify for the use of stabilisation certificates. First, investors must meet 10 billion [approx. $5 million] MNT and over, depending on the sector in which investment is occurring. This basic numerical criteria fails to classify investments based on their contributions to national development goals. Second, the investment project must show that an environmental impact assessment has been conducted, if required.[16] If required is a very lax criteria in a country with very weak institutional capacity and rampant corruption. In addition Mongolia lacks a comprehensive evaluation mechanism for assessing social/environmental impact evaluations as evidenced by such high profile cases like Ouy Tolgoi.[17] Third, investors must demonstrate that they are employing advanced technology[18] and that a 'sustainable work place' has been created.[19] These clauses lack substantive details and rigor according to which Investment Authority can assess any investments usefulness. At fourth, the duration of stabilisation certificates will be determined by the total amount invested and the location in which an investment project will be undertaken. For example, in the 'mining, heavy industry and infrastructure sectors', an investment of greater than 500 billion togrogs in the Ulaanbaatar area will allow for a stabilisation certificate for up to 15 years. In below graph we can see that the result of successful investment laws in attracting FDI.



Source: Foreign Investment Office

[15] Id. at Articles 14.1.1-14.1.4.
[16] Id. at Article 16.1.2.
[17] 'A Useless Sham': A Review of OT Copper/Gold Mine Environmental and Social Impact Assessment. A Joint report by international and local NGO's.
[18] Id. at Article 16.1.4.
[19] Id. at Article 16.1.3.

Mining Law of Mongolia

Before 1990 Mongolian economy was diversifying rapidly and thus becoming more independent from extraction of natural resources. According to statistical reports (T.Namjim, N.Itgel, 76) mining related products were amounting 901.5 million MNT while processed products from 3 light industry sectors averaged 1.99 billion MNT. World Bank study suggests that value added products composed 33-35% of GDP in 1989.[20]

Table 3: Percentage Sectoral Share of GDP, 1970-1993

Agricultural			Industry			Services		
1970	1980	1993	1970	1980	1993	1970	1980	1993
33.1	17.4	17.8	26.3	33.3	33.0*	40.6	49.3	49.2

*Mining accounts for around 95% of industry

Source: ADB, 1994, Table A6, p.236[21]

According to the survey of International Monetary Fund in 2015, Mongolia has an estimated US$1 to US$3 trillion in mineral deposits, with coal, copper, molybdenum, fluorspar, and gold being the main reserves.[22] More than 89 per cent of Mongolia's exports are minerals, and this proportion is expected to rise to 95 per cent in 2015. This makes the economy highly dependent on commodity price cycles such as we are experiencing today.

As explained previously the role of World Bank Group in setting up Mongolia's mining policy framework was extensive, to say the least and the Mining Law of 1997 was the culmination of their work. This law with extremely lax regulations on obtaining exploration licenses opened most of the country to mineral development. More than 6,000 licenses were approved, including those for the big copper and coal mines in Omnogovi province.

[20] World Bank.(1989) World Bank Data Archive.

[21] Asian Development Bank. 1994. Asian Development Outlook 1994. Oxford University Press for ADB, Oxford and Hong Kong.

[22] UK Trade and Investment, Guidance Doing Business in Mongolia: Mongolia's trade and export guide, update 11May 2015, https://www.gov.uk/government/publications/exporting-to-mongolia/exporting-to-mongolia.

4. SETTING UP THE INVESTMENT FRAMEWORK CONTINUED: BILATERAL AND MULTILATERAL INVESTMENT TREATIES

After the dissolution of the Soviet Union more than 3,200 investment agreements (IA) has been signed in the world. These IAs are mostly Bilateral Investment Treaties (BITs). BITs grant international capital in form of investor's extensive rights and privileges, limiting sovereign states control over transnational capital. The most controversial mechanism of these agreements - investor-state dispute settlement (ISDS) - allows corporations to sue governments in private international arbitration tribunals without much transparency.[23] Investors' claims through this mechanism have skyrocketed by more than 400% since the early 1990s.[24] Mongolia along with many developing countries signed into international treaties related to ISDS. Below table illustrates key treaties.

International treaties of Mongolia related to investment dispute settlement

Treaty	Date of signature
Convention on the Recognition and Enforcement of Foreign Arbitral Awards	1994.10.24

[23] Challenging corporate investor rule. Institute for Policy Studies. 2007

[24] CEO and TNI. 'A transatlantic corporate bill of rights', Corporate Europe Observatory and Transnational Institute, 19 June 2013. At: https://www.opendemocracy.net/ournhs/corporate-europe-observatory-transnationalinstitute/transatlantic-corporate-bill-of-rights(accessed 20 December 2015).

Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington	1996.05.28
Convention on civil procedure	1999.07.21

Following table lists Mongolia investments agreements. Energy Charter Treaty which Mongolia became a signatory in 1998 also contains the ISDS mechanism.

Investment agreements (IIAs)

Agreement	**Date of signature**	**Parties**	**Date of entry into force**
EEC-Mongolia Trade Cooperation Agreement[25]	16/06/1992	EU	01/03/1993
The Energy Charter Treaty*	17/12/1994	54 countries and EU	16/04/1998
Mongolia-US TIFA	15/07/2004	USA	15/07/2004
Japan-Mongolia EPA	10/02/2015	Japan	-

Mongolia has so far concluded 18 BITs with member countries of EU.

BIT's with EU countries (18 out of 43)			
Country	**Date of entry into force**	**Country**	**Date of entry into force**
Austria	**01/05/2002**	**Hungary**	**06/03/1996**

[25] The Energy Charter Treaty was/is aimed to bring western European capital to resource rich Post-Soviet frontiers through the inclusion of an IIA. Mongolia along Netherlands signed to the ECT in 1990's.)

BLEU (Belgium-Luxembourg Economic Union)	**15/04/2000**	**Italy**	**01/09/1995**
Bulgaria	**Signed (not in force)**	**Lithuania**	**03/05/2004**
Croatia	**Signed (not in force)**	**Netherlands**	**01/06/1996**
Czech Republic	**07/05/1999**	**Poland**	**26/03/1996**
Denmark	**02/04/1996**	**Romania**	**15/08/1996**
Finland	**19/06/2008**	**Sweden**	**01/06/2004**
France	**22/12/1993**	**Turkey**	**22/05/2000**
Germany	**23/06/1996**	**United Kingdom**	**04/10/1991**

Source[26]

These types of IIAs present a challenge for developing countries like Mongolia. Given their limited budgetary resources, low institutional capacity, high pay-outs to investors hit developing countries disproportionately hard.[27] Usually, these countries' policy frameworks need more public policy making space and capacity than the governments of developed countries in order to perform its duties of development. However, practically all IIAs restrict state capacity for public policy making, and thus magnify existing problems even more.

Common problems with IIAs

- These 14 BITs have no mechanism for host states policy objectives and regulations against affected investor rights in terms of the development objectives of the host state or the performance quality of the investor.

- ISDS clauses in these BIT's and international arbitration courts are not equipped to evaluate complex cases where host states long term policy priorities are weighed up

[26] http://investmentpolicyhub.unctad.org/IIA/CountryBits/139
[27] How Dutch investment treaties harm the public interest. Report by SOMO

against fairly simple contractual or treaty-based expectations and rights of an investor.

- The interpretation of certain principles like expropriation contained in these agreements has been defined too broadly and may be used to punish host states' legitimate policies like environmental regulation.

- Issues concerning the role of international commercial arbitration: a) the expertise of arbitrators in relation to non-commercial public policy issues; b) problems of potentially unregulated conflicts of interest where arbitrators whose commercial practice is built on advising investors are called upon to adjudicate in disputes involving host states; c) lack of transparency in the resolution of most investment disputes. [28]

According to International Institute for Environment and Development's report: *An international investment agreement for sustainable development would necessarily need to leave considerable sustainable development policy space to host states. But its rules would need to be capable of intervening to prevent rent-seeking resource nationalism against investors that could be seen to be making a genuine contribution to sustainable development at national and local levels.*[29]

FDI inflows into Mongolia

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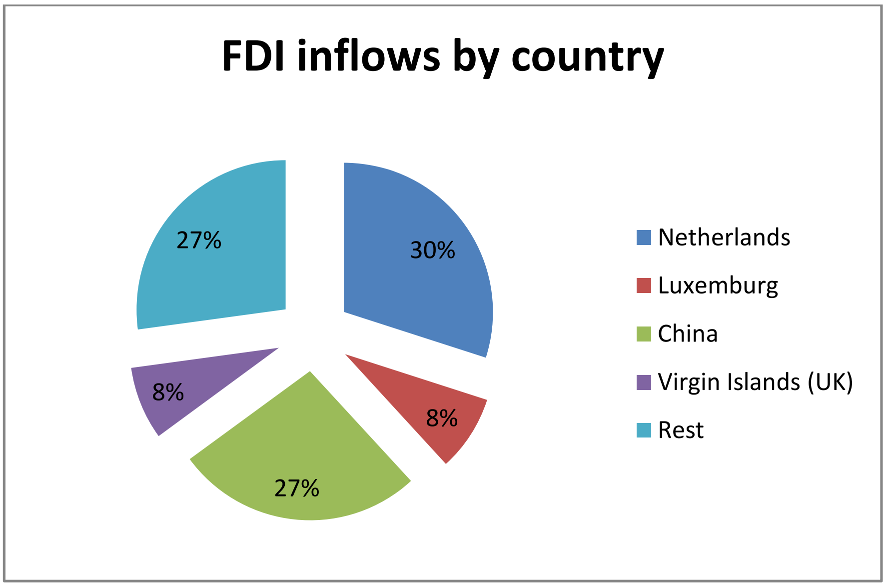
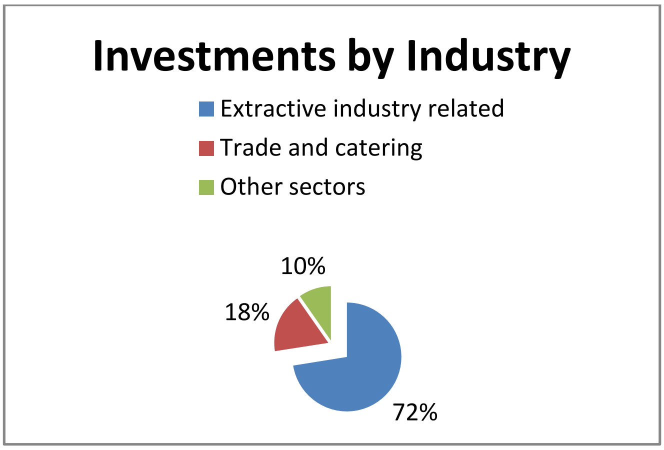


Source: Foreign Investment Office

[28] Challenging corporate investor rule. Institute for Policy Studies. 2007
[29] Resource nationalism and sustainable development. IIED report. 2009

According to Invest Mongolia Agency as of 31 December 2014 there were 12,000 foreign-invested companies representing 112 countries registered in Mongolia. Total foreign direct investment of these entities in Mongolia was US$17 billion.[30] FDI by country included nations such as the Netherlands, China, Luxembourg, the British Virgin Islands. (see above graph) The largest investor by country listed was the Netherlands, which constituted 29.96 per cent of all FDI by country. This is likely due to the corporate structure of Oyu Tolgoi LLC. The case of Oyu Tolgoi will be dissected in later section.

With regard to investment by industry, geological prospecting and mining dominated Mongolia's foreign direct investment with 72.5 per cent of all total investment. Other notable industries included trade and catering services at 17.8 per cent.[31]



Netherlands – Mongolia BIT[32]

This treaty contains basic protection such as national treatment, freedom from unreasonable or discriminatory measures, fair and equitable treatment of investment, and ISDS clause.

Article 3.1

"Each Contracting Party shall ensure fair and equitable treatment of the investments of nationals of the other Contracting party, which shall not be less favorable than that accorded either to investments of its own nationals or to investments of nationals of any third State, and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals."

Investment state arbitration system under the BIT does involve lots of high fees, administrative costs, as well as huge compensations which undermine public funds and thus

[30] Invest Mongolia Agency, Invest in Mongolia, p. 67(2015).
[31] Invest Mongolia Agency, Invest in Mongolia, p. 67(2015).
[32] Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and Mongolia

sustainable development. Moreover, history of decisions has been extremely inconsistent due to secretive nature of these processes where some tribunals have decided differently on identical cases.[33] Average claim for damages averages in excess of 100 million along with extra costs.

Article 8

"Each Contracting Party hereby consents to submit any legal dispute arising between that Contracting Party and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting party to the International Centre for Settlement of Investment Disputes…"

ISDS enables transnational corporations to bring a case directly against a country and challenge a wide range of government regulation and public interest measures. Direct access to investment arbitration allows foreign investors to bypass the domestic legal system and effectively grants them more rights than domestic investors, effectively and unfairly undermining their competitiveness. The ISDS system not only lacks independence, accountability, transparency and coherence in law.[34]

Article 4

"The Contracting Parties shall guarantee that payments relating to an investment may be transferred. The transfers shall be made in a freely convertible currency, without restriction or delay."

BIT's allow for capital to leave countries without any restrictions. In times of economic or political distress or commodity price plunges investors can take their money without any monetary ramifications. This trend was especially evident during the Asian economic crisis of the 90s. Only Malaysia was able flow relatively unscathed by restricting the outflow of capital.

Tax treaties with 30 countries

Mongolia levies a 20% withholding tax on dividends paid by mine companies. The dual taxation agreement, however, allows firms registered in those countries to channel income from dividends, royalties and interest earned in Mongolia through their offshore company without having to pay any withholding tax. Mongolia was able to rescind double taxation agreements with Kuwait and UAE (applicable from January 1st 2015) and with Netherlands

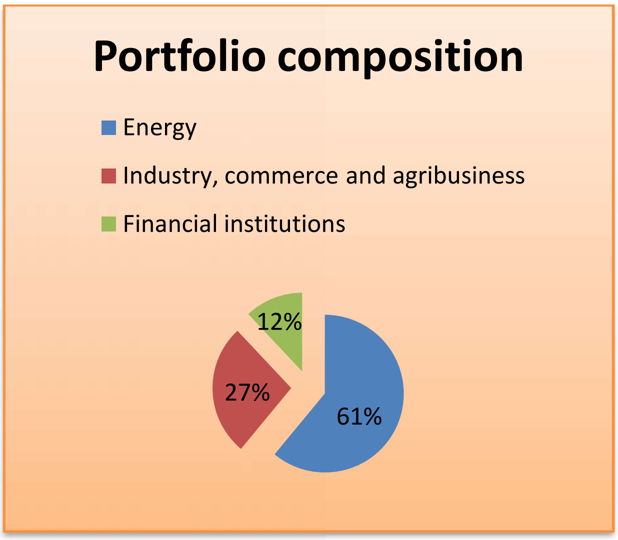
[33] Case of Mr. Lauder - U.S./Chech Republic BIT
[34] How Dutch investment treaties harm the public interest. SOMO Report.

and Luxembourg (applicable from January 1st 2014). One economist estimates that Mongolia was due to lose $1 to $2 billion worth of tax money if these four agreements stayed intact.[35] He further explains that up to 50 prominent companies, which were seen as domestic entities were incorporated in these four countries through their subsidiaries. He sarcastically remarks that "these companies would most likely immigrate to other countries in no time."

5. CASE OF EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

The European Union member states own approximately 60 per cent of the shares of the EBRD. Moreover, the European Union and the European Investment Bank have shares in the EBRD and are represented in the highest decision-making bodies of the EBRD.[36] As a public bank EBRD should be upheld in terms of EU treaties. Protection of the environment of non Member States, and their sustainable development, became an official objective of the EU only in December 2009. According to Treaty of Lisbon the EU is required to not only protect its own environment, but also the environment of non Member States. Article 3(5) TEU calls upon the EU, to contribute to the sustainable development of developing countries. In this respect, article 21(2)(e) TEU instructs that the EU 'shall define and pursue common policies and actions, and shall work for a high degree of cooperation in all fields of international relations in order to (…) foster the sustainable economic, social and environmental development of developing countries, with the primary aim of eradicating poverty'.[37] Furthermore, the environmental mandate in the Bank's Articles of Agreement commits it to promoting three broad goals: environmentally sound and sustainable development; democracy; and market economies.[38] However the EBRD's track record has been anything but sustainable. EBRD's investments have been primarily funneled into projects involving extraction of natural resources. (see below graphic)

[35] http://www.mongolianminingjournal.com/content/36611.shtml
[36] http://www.ebrd.com/shareholders-and-board-of-governors.html
[37] The Treaty of Lisbon
[38] Agreement Establishing the European Bank for Reconstruction and Development – 'Article 2'



EBRD's sustainable development commitments pale in comparison with their financing of fossil fuel projects.

Fossil fuel financing	• 13 projects
Renewable energy financing	• 1 project

Source: EBRD website[39]

EBRD's transition indicators on the project and country level tend to regard privatization of state owned entities and liberalization of trade as ends in themselves. We can see that private sector share of cumulative investment of EBRD has achieved that goal. (*see* graphic below)

EBRD activity in Mongolia to date

Number of projects	• 74
Private sector share of cumulative investment	• 100%
Cumulative EBRD investment	• **€898.7 million**

[39] http://www.ebrd.com/cs/Satellite?c=Page&c21=on&cid=1395238314964&d=&pagename=EBRD/Page/SearchAndFilterPSD&page=1&safSortBy=Sector&safSortOrder=ascending

We can see some justification for supporting private sector activities, but the cumulative impacts of these policies are at best inconclusive. Although EBRD's Mining Policy[40] focuses on promoting responsible mining and the application of the best international standards its financing of private sector extractive projects continue to be extremely controversial as seen with cases like Altain Khuder[41] and Centerra Gold[42]. Centerra Gold's Boroo and Gatsuurt projects involve mining operations in important forest and river resources areas forcing government to amend its laws[43] to allow these damaging project to take place. Destruction of water and forest in protected natural site[44] by the Gatsuurt project, both scarce resources affecting climate change already at 2 degrees Celsius observed in Mongolia[45] is one example of non-compliance with the environmental and sustainability policies of EU as well as with EBRD's own Mining Policy. Using public money to finance controversial projects like Gatsuurt with lack of communication and allegations of corruption directed at local authorities[46] will in all likelihood continue to damage the EBRD's reputation as a development bank.

The EBRD should:

- Diversify its portfolio in Mongolia by better distributing its investments to other sectors in order to help Mongolia's equitable and sustainable development;
- Balance its past investments in fossil fuel projects in Mongolia with investments in renewable energy.
- Stop investing in mining operations within "no-go zones", including natural reserves, glaciers, and UNESCO world heritage sites.

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[40] EBRD, Mining Operations Policy, approved by the Board of Directors on 17 October 2012, http://www.ebrd.com/downloads/policies/sector/mining-operations-policy.pdf

[41] Impacts of the global iron ore sector. Case Study: Altain Khuder in Mongolia. Tim Steinweg & Anne Schuit. Amsterdam, December 2014. SOMO

[42] Mining in protected areas, an update on Kumtor and Centerra Gold, http://bankwatch.org/news-media/blog/mining-protected-areas-update-kumtor-and-centerra-gold

[43] Centerra Gold's Gatsuurt project gains 'strategic important' Mongolian status, http://www.engineeringnews.co.za/article/centerra-golds-gatsuurt-project-gains-strategic-important-mongolian-status-2015-01-23

[44] The Short History of the Law With Long Name, http://www.transrivers.org/documents/rivers-and-mining/the-short-history-of-the-law-with-long-name/

[45] Mongolia: Country of climatic extremes vulnerable to impacts of climate change, http://blogs.worldbank.org/eastasiapacific/mongolia-country-of-climatic-extremes-vulnerable-to-impacts-of-climate-change

[46] Mongolians Protest Centerra Gold Mine, http://thediplomat.com/2015/05/mongolians-protest-centerra-gold-mine/

6. CASE OF OYU TOLGOI

Corporate structure of OT

OT subsidiaries	Place of registration
Ivanhoe Mines Delaware Holdings, LLC	Delaware, USA
Ivanhoe Mines Aruba Holdings LLC	Aruba, Netherlands
Turquoise Hill Netherlands Cooperative	Netherlands
Oyu Tolgoi Netherlands B.V.	Netherlands

In early 2000s the Government of Mongolia granted exploration rights over 46,000 square miles in Umnugovi province at a site known as Oyu Tolgoi to a controversial American Robert Friedland. He is called "Toxic Bob" because of a large scale environmental disaster his gold mining company inflicted on US territory, which was cleaned up by the Environmental Protection Agency at a cost of $200 million.(Rossabi, 103) Friedland claims to have spent $60 million in his exploration of Oyu Tolgoi (Rossabi, 104) and to have discovered one of the world's largest deposits of gold and copper. It is difficult to calculate the exact amounts Freidland spent on exploring the site but his company Ivanhoe Mines [now Turquoise Hill Resources - a majority-owned subsidiary of Rio Tinto] was granted a 66% stake in Oyu Tolgoi deposit – one of the largest in the world.[47]

In 2009, Mongolian government was able to establish a joint venture with Turquoise Hill Resources (a majority-owned subsidiary of Rio Tinto) to develop the Oyu Tolgoi copper and gold deposit (OT). Prior to this event a coalition government was formed in order to push through this project as it was/is the biggest foreign-investment project ever undertaken in Mongolia. Nevertheless, there were significant problems associated with the negotiation process as well as the agreement itself. In nutshell, this project signifies everything that is

[47] Art 5.5 of the 2006 amendment to Mining Law stipulates that the State can claim up to 34% in deposits of strategic importance where non-state sources were used in determining proven reserves.

wrong with Mongolian investment regime and EBRD and Netherlands plays/can play a huge role in this fiasco.

The total project cost is estimated by OT LLC to be $13.2 billion[48], a significant portion of which will be financed by multilateral institutions such as the World Bank Group (WBG) and EBRD. The main point of contention is the financing of the project where the joint company (OT) is financed from fellow shareholders. According to Shareholders Agreement (SA) there are no cashflows paid to Erdenes Oyu Tolgoi[49] from OT until the Debt/Preferred Shares are repaid in full (referenced in Sections 10.4(a), 11.4, 12.2, 14.1(d), 14.2 of the SA). In summary, the SA of establishment of this joint venture cuts Mongolia completely out of the value chain around OT while strangling it with enormous liabilities and no legal way to protect itself or its strategic assets. It effectively delivers to Turquoise Hill Resources the entirety of OT's value, including 100% of the economic value of Mongolia's 34% equity stake, while leaving Mongolia with bankruptcy inducing indebtedness and a lack of control or oversight mechanisms.[50] The SA fails completely to protect the interests of the Government of Mongolia and leaves Mongolia with debt. Besides project financing problems, issues of cost overruns reared its ugly head after OT-1, which exploits the open pit mine of the deposit, had started commercial production in 2013. A working group established by The State Great Khural to audit OT found numerous issues of cost overruns connected with excessive management service fees.[51]

On 18 May 2015, Mongolia and Rio Tinto Group settled their dispute over the US$5.4 billion underground expansion of the Oyu Tolgoi copper and gold mine without renegotiating structural failures mentioned above. According to this agreement the Government of Mongolia could muster a meager concession by Rio Tinto to pay US$30 million in tax, a figure reduced from an original charge of US$127 million.[52]

In addition to problems related to project financing and cost overruns, OT and many other mining projects in Southern Gobi provinces are plagued with environmental problems. Along with the tar sands mines in Canada, Oyu Tolgoi is among the most scrutinized mining projects around. Due to its location in one of the most water-starved regions of Mongolia OT faces severe problems related to water supply and pasture degradation. The World Bank study published in 2010 said that 3.8 million head of livestock consumed nearly 32,000 cubic

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[48] Oyu Tolgoi Project IDOP Technical Report, p 450 (http://www.ivanhoemines.com/i/pdf/IDOP_2012Mar29_Tech_Rpt.pdf)
[49] State entity which owns 33% of share in OT
[50] OT agreement analysis by Dr. David E. Martin, Chairman, M•CAM Inc.
[51] Materials connected with OT cost overruns are made public. http://politics.eagle.mn/content/read/25126.htm
[52] IFM Working Paper, From Natural Resource Boom to Sustainable Economic Growth: Lessons for Mongolia, p. 5 (2015).

meters of water daily. That was less than a fifth of the almost 100,000 cubic meters of water used daily by coal mines around Tsogttsetsii, and the nearly 70,000 cubic meters that was consumed daily by Oyu Tolgoi during its construction.[53] At that rate of consumption the region's groundwater supplies would last 10 to 12 years.[54] Furthermore, unchecked mining activities financed by international public banks like EBRD are creating "new socio-ecological vulnerabilities across sub-national spaces – including areas that host no mining activities at all."[55] These include community displacements, pasture degradation, problems of dust, and many more transboundary impacts.

How are the international financial institutions involved?

The European Bank for Reconstruction and Development (EBRD), and the International Finance Corporation (IFC), the private sector lending arm of the WBG, have both proposed funding second phase of Oyu Tolgoi LLC as part of numerous financial institutions. This was confirmed on 15th of December of last year when The European Bank for Reconstruction and Development (EBRD) has arranged a syndicated loan of US$ 1.221 billion to Oyu Tolgoi LLC.[56]

The EBRD financing is part of a US$ 4.4 billion package supported by international financial institutions, export credit agencies, development banks and commercial banks. The EBRD is providing US$ 400 million on its own account (A-loan) and the remainder is provided by a syndicate of 15 commercial and development banks (B-loan). It is the largest ever syndicated loan for the EBRD.[57]

The involvement of a European public bank like EBRD in an extremely contentious project like this which undermines Mongolia's development for a foreseeable future is unfortunate, to say the least. The fact that EBRD purports to support Mongolia's "fair, efficient and transparent management of the wealth generated by natural resources and a sustainable development model" in it's to current strategy for Mongolia[58] but acts in completely different ways should alarm European countries as well as their taxpayers.

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[53] World Bank study "Southern Gobi Regional Environmental Assessment (REA)", Jan. 2010: http://siteresources.worldbank.org/INTEAPREGTOPENVIRONMENT/Resources/SouthernGobiREAtext.pdf

[54] http://www.circleofblue.org/waternews/2013/world/mongolia-copper-mine-oyu-tolgoi-tests-water-supply-young-democracy/

[55] http://www.laurenbonilla.com/research.php

[56] http://www.ebrd.com/news/2015/ebrd-arranges-us-12-billion-syndicated-loan-for-oyu-tolgoi-mine.html

[57] http://www.ebrd.com/news/2015/ebrd-arranges-us-12-billion-syndicated-loan-for-oyu-tolgoi-mine.html

[58] http://www.ebrd.com/downloads/country/strategy/mongolia.pdf

Possible role of Netherlands in future disputes

Oyu Tolgoi Netherlands BV presently has a 100 per cent voting equity ownership interest in OT joint company due to the corporate structure of Oyu Tolgoi LLC.[59] This means that any future disputes between Government of Mongolia and Rio Tinto/Turquoise Hill Resources could be settled according to investment settlement provisions inserted in Netherlands – Mongolia BIT. Furthermore, there are dangers of classifying any case of regulatory intervention by the Government of Mongolia to be identified as non material expropriation. There are numerous possible scenarios where the Netherlands – Mongolia BIT can be used to undermine Mongolian Government and its people.

7. CASE[60] OF KHAN RESOURCE

It was pointed out that transition to market economy entailed totally different challenges for Mongolia and its people. International institutions were putting numerous conditions in their loan and aid programs without considering specifics of the country. These included BIT's and multilateral treaties i.e. Energy Charter Treaty. Recent case of Khan Resources – a Canadian company – clearly illustrates contradictions of these numerous treaties.

In March 2010, Nuclear Energy Agency of Mongolia inspected Canadian registered Khan Resources' Dornod Project site. NEA found that the project failed to eliminate previously identified violations of Mongolian law and later in April 2010 invalidated Khan's mining licenses.[61] FIPA negotiation between Canada and Mongolia was in talks for years but failed to materialize so far. Due to that fact and a lack of BIT between two countries, Khan Resources couldn't use investment protection clauses typically found in aforementioned type of treaties. What is alarming is that Khan Resources had many more options to sue the Government of Mongolia. The company's statement proves that a controversial mechanism known as treaty shopping[62] was used to bring arbitration against Mongolia. In other words, each part of Khan Resource's corporate structure used different international mechanisms. Khan's offshore holding company registered in Netherlands – Khan Resources BV – was able to utilize the IIA clause in of the Energy Charter Treaty. It is clear that Khan Resources BV was registered in in the Netherlands is an investor for the purposes of the ECT as well as double taxation and BI

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59 Annual Information Form, Turquoise Hill Resources Ltd, p. 12 (12 December 2015), available at www.turquoisehill.com/i/pdf/2014-TRQ_AIF.pdf.

60 Khan Resources Inc., Khan Resources B.V. and CAUC Holding Company Ltd. v. The Government of Mongolia and MonAtom LLC, PCA Case No. 2011-09

61 http://www.news.mn/content/205701.shtml

62 Intltax.typepad.com,. "Treaty Shopping & Anti-Treaty Shopping - International Tax Blog". N.p., 2008. Web. 7 Dec. 2015.

treaties. That way companies registered in places like Netherlands can claim its protections against Mongolia.

Letterbox companies such as Khan Resources BV are notorious for their use for tax dodging[63] but Mongolia's experience shows us that ECT and Netherlands' network of BIT's allow investment protection advantages as well.

As noted in section on the Foreign Investment Law, Article 2 and 25 of the Law allows international treaties to prevail over domestic laws. Article 25 stipulates that "the settlement of disputes may be resolved pursuant to the provisions of international treaties to which Mongolia is a party or by any contract between the parties" and was used Khan's lawyers.[64] Even though Article 25 was removed from the new revision of the Law in 2013, Khan's Notice on arbitration shows that Article 25 was used as an "additional basis of consent" beyond the ECT. In the end Khan Resources was awarded US$100 (80 for compensation) million in arbitration proceedings. However, calculation of damage to Khan Resources and the resulting compensation was mired with controversies. The Claimant's side pushed for a discounted cash flow analysis (DCF) for the calculation of damages on the basis that it was already at the production stage. On the other hand, Respondent's side was requesting to consider Khan's sunk investment, rather than DCF. Mongolian side argued that the value of the Claimants' investment should be calculated by reference to the share price of Khan Canada as at the Valuation Date, which, according to the Respondents' expert Mr. John Lagerberg, would amount to between USD 13.4 and USD 18.6 million.[65] This method was also consistent with the Investment Law of Mongolia of that time. Article 8.4 stipulated that "unless provided otherwise in international treaties to which Mongolia is a signatory, the amount of compensation shall be determined by the value of the expropriated assets at the time of expropriation or public notice of expropriation". This is also controversial because international treaties undermine local laws.

8. IMPLICATIONS FOR MONGOLIA'S DEVELOPMENT

Along with institutions like Word Bank, IMF, and Asian Development Bank - the European Union, and other western governments and institutions have been trying to democratize the post-soviet countries. Nevertheless, their programs over the last twenty-five years have failed to establish healthy democracies. Investments by the EU and International public banks like the EBRD are mostly focused on extractive industries and large-scale infrastructure for the

[63] Hidden profits: The EU's role in supporting an unjust global tax system 2014: Briefing
[64] Notice of arbitration. http://www.khanresources.com/investors/pdf/khan-notice-of-arbitration.pdf
[65] Award on the Merits. PCA Case No. 2011-09. *Khan Resources Inc vs The Government of Mongolia.* 2015. P.

export of natural resources. These policies have had a negative impact on Mongolia's political and economic security by making its economy and political establishment totally dependent on natural resource extraction.

Domestic laws like The Foreign Investment Law of Mongolia and The Mining Law were mostly set up by institutions like The World Bank which has been a key player in setting up Mongolia's governance framework and mining regime. Analyzing treaties related to Investment dispute settlement agreements (i.e. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington), multilateral investment agreements (i.e. The Energy Charter Treaty), bilateral investment treaties (14 out of 43 BIT's are concluded with EU countries), 30 plus double taxation treaties (mostly with EU countries) we conclude that these treaties mostly help to secure the cheap supply of raw materials and energy resources to the big Chinese and European markets. Irrespective of intentions these treaties shape the direction of Mongolian economy towards dependency on mining as the prime sector which erodes the foundations of its infant democracy.

8. FRAMEWORK FOR REFORMS

This paper proposes that the prescriptions of the 1990s, which focused on creating favorable investment conditions for multinational corporations, have to give way to a more equitable and transparent model concerned with social and environmental impacts, as well as with sustainable development for the host countries. An essential element of the Mongolia' s Investment law and model investment treaties should be to attuned to the development of a viable and capable developmental state. To truly support democratization process in developing countries like Mongolia, EU countries (and their development banks) should play a significant role in transformation of international treaties and dispute settlement systems towards more sustainable, inclusive, and equitable models as well as divert their investments from export-oriented mining projects towards the support for more transparent and sustainable production systems.

Selective admission of foreign investment doesn't necessarily threaten FDI inflows which are backed up by the fact that countries like Australia and China are rated by the OECD as investment restrictive while being very successful in attracting FDI. In its Trade and Development Report 2014, UNCTAD comes to the conclusion that "BITs appear to have no effect on bilateral North-South FDI flows" and warns developing country policymakers not to assume "that signing up to BITs will boost FDI" and to remain cautious about entering into investment agreements.[66] Commodity prices appear to be the main driver of investment

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[66] 'Do Bilateral Investment Treaties attract FDI flows to developing economies?", in UNCTAD Trade and Development Report 2014, p.159. At: http://unctad.org/en/PublicationsLibrary/tdr2014_en.pdf

flows. Mongolia's experience of the past 20 years appears to prove this contention. Below graphic illustrates the FDI inflows into the country which coincides with worldwide commodity price booms.

Source: Foreign Investment Office

Other important determinants of foreign direct investment are political stability, overall levels of economic development as well as market size and potential, productive workforce, availability of natural resources and adequate infrastructure of the host country.[67] Even though 'Four 10's' tax policy made Mongolia the lowest taxed nation in the world[68] it is struggling to attract FDI into the country.

In addition Mongolia needs a highly detailed, regulated investment structure and review process which draws on concepts of 'national security' and 'national economic security'.

Economic security of Mongolia is defined as "the adoption of a sustainable development model that ensures independent economic development and a natural environment conducive to human security and peaceful living."[69] Further determinants of Economic security include "a multi-pillared economic structure, balanced investment policy, financial security as well as an efficient policy on such issues as energy, mineral resources, foreign trade and regional economic integration."

[67] UNCTAD, 'The role of International Investment Agreements in attracting Foreign Direct Investment to developing countries', 2009. At http://unctad.org/en/docs/diaeia20095_en.pdf.
[68] The Second Phase of Tax Reform, http://mongolianeconomy.mn/en/p/6106.
[69] National Security Concept Of Mongolia. 2010. http://www.legalinfo.mn/law/details/6163

An essential element of the country's own BIT model would be to safeguard the interests of the state. The government of Mongolia should not be made liable for private investor disputes. Alternative dispute resolution (ADR) mediation should be made compulsory, while foreign arbitrators should be decided in advance through consensus.

BIT's should be renegotiated to include performance based requirements such as:

- Requirement for local content like Labor, Technology, Goods and services
- Requirement for labor training and development
- Requirement for some level of in country R&D

Ownership and selection

- Possibility of establishing SOEs as sole actors (free carry obligations) as well as requirement for joint ventures
- The prohibition of undesirable FDIs
- The promotion of portfolio investment
- The imposition of exchange controls
- Textual clarification of treaties
- Increase transparency of arbitration proceedings
- Legal assistance

Developing countries like Mongolia are confused in dealing with EU countries. It is very difficult to notice if there is a synergy between EU countries individual investments policies and EU's overall policy. Developing countries should be able to know whether FDI is a development assistance tool or only a means to promote market liberalisation. Coherent policy on this issue from EU would be a first necessary step. According to Cardwell and French entry into force of the Treaty of Lisbon in December 2009 is likely to have the greatest impact upon the capacity of the EU to act proactively in this area [FDI]. (Brown, Chester, 204) More progressive ideas include a proposal to create a 'comprehensive European international investment policy'.[70] This paper proposes that any comprehensive EU international investment policy shall include provisions for BIT which takes into account sustainable development policy of both parties in all its complexity and variations.

[70] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: Towards a Comprehensive European International Investment Policy (COM (2010) 343 final, 7 July 2010) (Commission Communication).

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