Sino – Mongolian economic interconnectivity: Big talks, little progress

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Sino–Mongolian political relations have not gone idle in these pandemic times. The Chinese foreign minister and the defence minister have made stopovers in Ulaanbaatar.[1] The Mongolian president and foreign minister have visited China.[2] Mongolian diplomats and businesses have been working hard to mitigate the challenges of the COVID-19 impacts on the country's commodity exports to China and imports from and through Chinese major ports. If the COVID-19 factor is set aside, China and Mongolia appear to have all the favourable conditions for fruitful economic interconnectivity.

Mongolia shares the largest land border with China, stretching from Manchuria to Xinjiang, with no disputes or unresolved issues and with bilateral relations reaching the highest level for establishing a comprehensive strategic partnership.[3] Both nations are enjoying a peaceful setting that is free from a militarized stand-off or cross-border terrorist activities.

Mongolia also has abundant natural resources, an enormous landscape for tourism and the potential to serve as a trade inroad to the Russian Federation. China, with the world's second-largest economy, is ready to offer its markets, technology and infrastructure connectivity that would bring many opportunities to Mongolia. Mongols and Kazakhs, who are cross-border co-ethnic groups, share common traditions, lifestyles and language and are bridging communities for economic cooperation between China and Mongolia.

But something is idling in this relationship. Mongolia still transports its coal and copper concentrates by thousands of trucks rather than a railway, relies on cheap, low-quality products from Chinese border regions, refuses to conclude major investment agreements and is fearful of tapping into Chinese tourism to Mongolia. This policy paper examines the slow progress of Sino–Mongolian economic interconnectivity from the differing perspectives of the two sides.

More political concerns than economic interests

Following the Sino–Soviet rapprochement from the late 1980s, China and Mongolia resumed bilateral economic ties, which led the Soviet Union (Russian Federation) to close its markets to Mongolia. As a result, Mongolia leaned heavily on Chinese goods, markets, infrastructure (ports and rails), and labour. However, without an adequate cooperation plan in place for the two countries, Mongolia, which was struggling to overcome challenges of the economic transition and was largely dependent on Western donor aid, felt especially pinched. During this period, Beijing's concern with Mongolia was mostly geostrategic rather than economic cooperation—military neutrality as well as political neutrality and wanting respect for its core security concerns, ranging from Inner Mongolia and Taiwan to Tibet.[4]

As the commodity boom began in Mongolia, China pursued regionalization efforts with its neighbouring regions, including Central Asia, which led to talks about big plans. During Chinese President Hu Jintao's visit to Mongolia in 2003, the two sides identified the mining sector and infrastructure as priority areas of cooperation.[5] Prior to the visit, Chinese investment was small, mostly in trade, catering and construction. After the visit, investment started shifting to the mining sector, and a decade later, more than 70 per cent of Chinese investment in Mongolia was in the mining sector. During President Xi

Jinping's visit to Mongolia in 2014, the Chinese proposed expanding the cooperation in mining and infrastructure and added the financial sector.[6] Subsequently, China agreed in 2015 to cooperate in five areas – the policy coordination, infrastructure connectivity, unimpeded trade, financial integration, and people-to-people connection - under the Belt and Road Initiative.[7]

In the same year, Mongolia and China ratified the five-year Medium-Term Trade and Economic Cooperation Programme. Its implementation is discussed at the biennial meeting of the Mongolia–China Intergovernmental Commission. Mechanisms have been established to address issues between ministries, departments and agencies in charge of infrastructure, mining, energy, customs and inspections. At the implementation level, however, things are not so smooth for Chinese state-owned corporations. For instance, Shenhua Group, a state-owned mining and energy company, was rejected three times (2010, 2014, 2016) from participating in the development of the largest coal deposit in Mongolia, at Tavan Tolgoi. Another Chinese state-owned company, Aluminum Corporation of China, has experienced numerous challenges. In April 2012, the Mongolian Parliament cancelled the company's purchase of a controlling stake in Canadian South-Gobi Resources Ltd and then annulled a contract worth US$250 million. China and Mongolia initially agreed to build the Shivee energy coal power plant in Gobi Sumber Province in Mongolia to supply energy to China's northern provinces. The plan has been stalled, although it was agreed upon at the top political level. For Mongolia, this would have been a massive undertaking, equivalent to the Oyu Tolgoi copper project.

Chinese banks have faced similar challenges. The People's Bank of China established a currency exchange mechanism with Mongolia's central bank in 2011. The Bank of China opened a representative office in 2012, followed by the Industrial and Commercial Bank of China and the Export-Import Bank of China in 2017. All three banks had hoped to invest in major infrastructure and mining development projects, finance small and medium-sized enterprises and provide loans and mortgages. Due to strong opposition from certain politicians, the Chinese banks were not provided local banks, financial institutions or commercial banking licenses.

China's Belt and Road Initiative has yet to produce any tangible infrastructure development to improve the economic interconnectivity through the envisioned China–Mongolia–Russian Federation Economic Corridor, which would be one of six Belt and Road Initiative economic corridors. For this purpose, the Heads of State of China, Mongolia and the Russian Federation signed a programme agreement in 2016 (see the following table) and established 10 tripartite intergovernmental mechanisms to implement 32 projects.

Economic corridor mechanisms of China, Mongolia and the Russian Federation

№	Mechanism	Frequency	Main objective
1.	Meeting of the Heads of State	Once a year	Achieve high-level agreements
2.	Tripartite Working Group	Once a year	Advance the implementation of the economic corridor

3.	Meeting of Deputy Foreign Ministers	Once a year	Discuss the issue of the Heads of State Meeting and the implementation of the economic corridor
4.	Expert level meeting and at the level of director of the Ministry of Foreign Affairs	Once or twice a year	Discuss implementation of projects
5.	Investment Research Center		Conduct research related to projects
6.	Meeting of the ministers of road and transportation		Discuss sector cooperation
7.	Meeting of tourism ministers	Once a year	Discuss sector cooperation
8.	Customs Cooperation Working Group	Once a year	Discuss sector cooperation
9.	Mongolia–China–Russian Federation Trilateral Economic and Trade Cooperation Forum	Once a year	Implement cooperation between enterprises, introduce projects and programmes, concludes agreements and has become a business platform
10.	Think tank association	Once a year	Conduct research and exchange research information

At the 2017 tripartite experts meeting, the parties agreed to prioritize the following three projects of the 32 projects included in the programme:

Ø Study the economic feasibility of renovating the Central Railway Corridor, construction of dual carriageways and electrification

Ø Use the AN-3 route of the Asian road network for transit transportation and study the economic feasibility of building a highway on this route

Ø Study the possibility of Chinese companies' participation in the modernization of the Mongolia–Russian Federation power grids

According to a monitoring study conducted in 2020, implementation of the economic corridor is at about 56.3 per cent, which is mostly paperwork. Projects in the transport, tourism and science sectors, which have a tripartite mechanism, are progressing while projects in the industrial, agriculture, health and quarantine sectors, which have yet to establish a tripartite meeting mechanism, are gaining ground only on a bilateral basis. Six years have passed since the launch of the projects, but there is no direct impact on the Mongolian economy.

To date, there are no projects funded by the China Silk Road Fund, the Asian Infrastructure Investment Bank or a public–private partnership model. Despite the pandemic, the Chinese-based financial mechanisms have provided significant funding for corridors and projects in other countries, excluding Mongolia. Although China and Mongolia have made commitments at the highest political level to improve economic interconnectivity, little progress has been made on the ground. The Moon Bridge in Ulaanbaatar is the only major infrastructure project constructed through the Belt and Road Initiative. Clearly, that bridge is not contributing to either bilateral or trilateral economic interconnectivity.

Mongolia from the Chinese economic perspective

Mongolia attracts two types of economic interests from major Chinese businesses. One is mineral resources, such as coal, iron ore, copper, zinc and uranium. These Mongolian mining products meet three requirements of Chinese buyers: proximity, low price and uninterruptible transport. Interestingly, major mining deposits have been discovered close to Chinese borders, but because China is the only potential market for minerals, its businesses have the upper hand and are able to exert control over the price. Unlike China's western and southern borders with high mountains and subtropical landscapes, its border with Mongolia is conveniently connected through flat terrain. This encouraged interest from big Chinese corporations, such as Chalco, CNNC, Shenhua and Sinopec, to invest in the development of large mining deposits and related infrastructure. Over the past two decades, China has developed its domestic railroad system, which could easily be extended to Mongolia's mining deposits. To no surprise, Chinese companies built the mineral processing factories just across the Sino–Mongolian border in the western and north-eastern provinces of China.

Today, Petrochina's Daqing Tamsag operates the crude oil mines. A joint Qinhua-MAK-Nariin Sukhait partnership is developing the coal deposit, while China Nonferrous Metal Industry's Foreign Engineering and Construction Company operates a zinc mine. Chalco and Shenhua have been interested in investing in the Tavan Tolgoi coking coal deposit. As noted, though, these two giants have not been successful in securing a major investment deal.

The other economic interest relates to Mongolia's potential as a transit route to the Russia Federation and Europe. This potential is among the reasons why the Chinese government designated Mongolia as one of the six Belt and Road Initiative economic corridors.

The China–Mongolia–Russian Federation Economic Corridor aims to improve the infrastructure connectivity between China's northeastern provinces, the Russian Federation and Europe through Mongolia.[8] In comparison with the Russian Federation's Far Eastern Railway, the Trans-Mongolian railway is shorter, but it is older and slower than the newly built railway connection through Kazakhstan. The railway was built in the 1950s and requires gauge change at the Sino–Mongolian border, where both land ports are underdeveloped. Given the long-term benefits, Chinese companies are interested in investing and constructing new rail infrastructure, which would also enable a Chinese stake in operating the infrastructure. The main hurdle is coming from the Russian Federation. Along with Mongolia's political and business factions, the Russian Federation was able to influence the country's domestic politics to maintain its railway standards[9] (1,520 mm, locomotives, trains) as a part of its geopolitical strategy, which is in effect in the former Soviet republics and even in Eastern Europe.[10]

Beyond these interests, Chinese businesses have not shown any explicit interest in Mongolia. For large Chinese corporations, Mongolia is a small market—with a population of 3.6 million, it is the size of a small city in China. It lacks key infrastructure, with a visible gap between the stages of industrial and infrastructure development. Like many foreign investors, Chinese businesses find Mongolia's investment environment unattractive. The country's political system is unstable due to constant competition between its political and economic factions. The legal environment and rule of law are weak. Lingering anti-Chinese sentiment and negative attitudes against Chinese nationals render the situation even harsher for Chinese businesses. Chinese scholars conclude that Mongolia's "third neighbour" foreign policy, unstable domestic economic policy, outdated infrastructure and irregular behaviour of participants in the bilateral market have restricted the sustainable development of bilateral economic and trade cooperation between the two countries.[11]

China from the Mongolian economic perspective

Mongolian political leaders need to strike the balance between two important choices: to benefit from the world's second-largest economy or reduce its dependency on it. To manage this dilemma, Mongolia finds itself in an extremely vulnerable situation. Because of its locale in the landlocked area between China and the Russia and its isolation from the global economy, Mongolia has no other option but to diversify its economic partners. It can either delay any major connectivity projects or improve the interconnectivity to and through China.

Two factors tip that dilemma in favour of the first option: One is domestic. Mongolian politicians support policies that restrict Chinese investments to reduce economic dependency. In 2010, for example, the National Security Concept of Mongolia was revised to include a clause restricting the total investment of one country's foreign investment to a maximum of one third of total foreign investment.[12] The other factor is the Russian Federation's geopolitical or geo-economic interests. The Russian Federation appears to be pressuring Mongolia to join its regional initiatives, such as the Eurasian Economic Union, and to support its plans to develop its Far East.[13]

Economically, China is the most attractive direction, given its market size, its growing centrality in the global and regional economy and its development of new technologies and know-how. China's economic importance for Mongolia is immense. In terms of Mongolia's commodity exports, such as mineral and agricultural products, China is the largest and only neighbouring market. Other countries—the Russian Federation, Kazakhstan and the Democratic Republic of Korea—are competing to export their commodities to China.

China possesses funds, technology, materials and cheap skilled labour for constructing infrastructure. Chinese roads, rails, logistical centres and ports are the closest and the most cost-efficient choice for Mongolians to transport goods from and through China. In contrast, the Russian rails and ports are slow and impose higher custom tariffs than their Chinese counterparts. Based on this rationale, Mongolian businesses support stronger ties with China and are pressuring the government to open up new opportunities for Mongolian businesses in China. The debate over Mongolia's potential membership in the Shanghai Cooperation Organization has somehow been linked to the economic benefit argument.[14] According to this argument, the upgrade to membership would be the only way to promote economic collaboration with China and the Russian Federation, whether it is the economic corridor or specific projects like the natural gas pipeline.

Mongolians are fearful of China in several regards. The most popular concern relates to the country's independence and sovereignty. The increased dependency on China would gradually decay that sovereignty and independent statehood and pull Mongolia into China's orbit. This fear is based on two logical apprehensions: Similar to any small State, Mongolia feels vulnerable due to its geographic location next to populous, armed and expansionist major powers—China and the Russian Federation. Memories of Chinese and Russian colonization are still vivid and recent. Another argument is more economic. If Mongolia permits large-scale Chinese investments or state-owned companies, Chinese businesses will become powerful economic actors that can easily influence and even control the country's political system. Also, any closer economic collaboration or projects would trigger concerns among Mongolian businesses (of all size) that are competing for the domestic and international markets and are afraid of being marginalized by Chinese businesses and investments. In the past, similar concerns and negative campaigning were organized by the cashmere, meat and agriculture producers and banking businesses. Additionally, Mongolians, like many other ethnic groups, are concerned with the population's "purity of blood" or being demographically taken over, which would lead to loss of ethnic identity.

Concluding thoughts

In theory, Mongolia and China could strengthen their economic interconnectivity based on all the favourable conditions. Tapping proximity to China's markets, infrastructure, technology and labour, Mongolia could increase its infrastructure connectivity to and through China as well as to its northern neighbour. Despite high-level agreements and developmental plans with China, little progress has been made to increase their economic interconnectivity. The gap between the talk and the actual work could be explained by examining the differing perspectives as well as domestic politics and the Russian Federation's geopolitical and economic interests.

Because of these domestic and external factors, Mongolia continues to face the dilemma of whether to link its economy and infrastructure with China or to seek ways to slow down or restrict future economic interaction. Mongolia's dream of a globally, or at least regionally, linked economy can only be facilitated by using the Russian or Chinese infrastructure networks, whether to reach its closest subregions (Central and East Asia) or markets in the Asia–Pacific region or in Europe. In other words, Mongolia's only option is to develop its infrastructure connectivity through China and the Russian Federation to strengthen the economic cooperation with its third neighbours: the United States, Japan, European Union countries, India, Republic of Korea and Turkey.

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