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**Mongolia**  
**Trade and Transport Facilitation**  
**Action Plan**

Draft AAG  
January 20, 2009

World Bank

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## Introduction

Over the last decade there have been numerous reports written by international agencies on Mongolia's transport sector, and on its trade facilitation procedures<sup>1</sup>. These reports have generally identified the same constraints posed by trade and transport facilitation to the growth of the Mongolian economy, and they have made broadly similar recommendations and proposals. However, little has changed and the same constraints as were noted a decade ago still act to frustrate both import and export trade.

In this report we develop and expand on an approach most recently used by consultants' for the ADB in preparing their Mongolia: Trade Facilitation and Logistics Development Strategy Report, published in December 2006. In that report, the topic of trade facilitation and logistics was preceded by a short assessment of Mongolia's industry and international trade, with a focus on mining, livestock industries and processed products industries (this last category related to the processing of products in transit between Russia and China). This was followed by an review of the current situation of Mongolia's transportation and logistics services and recommendations for their improvement, but without a clear link between the review and recommendations and the transportation and logistics demands of the industries previously assessed.

Here we use a supply chain perspective, which is similar to the international trade introduction to the ADB report, but focusing more on the trade and transportation needs of the products and supply chains assessed. These specific needs are then compared with the trade facilitation services available, the gaps between these and the needs identified and, as with the ADB report, recommendations made for closing the gaps. Three export and three import products/product groups have been chosen, both for their potential growth and for the variety of their trade and transport facilitation needs. A recent analysis of Mongolian products<sup>2</sup> confirms that the three chosen export products are among those with the highest potential for export growth.

Given the recent dramatic decline in the market price of minerals and the drop in demand for them, diversification of Mongolia's economy and international trade has assumed renewed importance. The rise in significance of mineral exports and the associated increase in demand for mining equipment have diverted attention from the trade facilitation of conventional exports and imports. In this review we have combined attention to traditional exports as support for diversification of trade, while not ignoring the export of minerals and import of mining equipment as these will continue to be important.

The export supply chains that are considered here are:

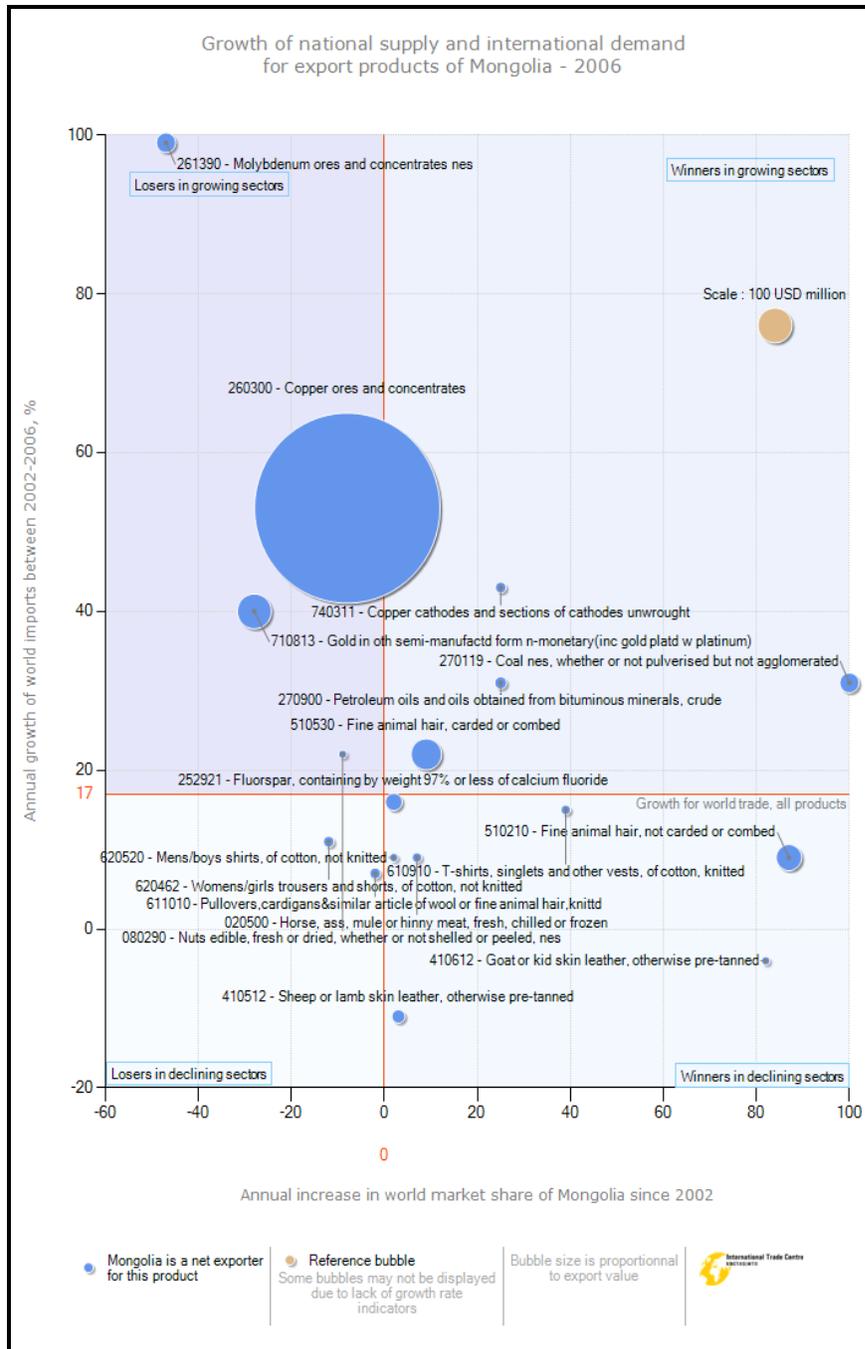
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<sup>1</sup> These include the World Bank (Trade and Transport Facilitation in Mongolia, 2005), the ADB (A Logistics Action Plan for Mongolia, 2006), CAREC (Mongolian Trade and Logistics, Assessment and Recommendations) and UNESCAP (

<sup>2</sup> A Mid-Term Trade Policy for Mongolia, A Trade Integration Strategy, UNDP, draft April 2008

- a. Mineral and mineral products, especially coal, copper and iron ore
- b. Cashmere and cashmere products
- c. Meat products

**Figure 1 Growth in international supply and demand for Mongolian export products**



*Source: A Mid-Term Trade Policy for Mongolia, A Trade Integration Strategy, World Bank,, draft April 2008*

To these we have added some import products, as the costs of imported goods contribute significantly to the relatively high cost of living in Mongolia (together with the high demands for heating and transport). The categories chosen made up about

30% of all imports if refined petroleum is excluded<sup>3</sup>. The import supply chains we have considered are those for:

- Mining machinery
- Cars
- Rice and flour

In the first section of the report we describe the supply chains for these three export and three import categories of products and goods, with a focus on the logistics and trade facilitation requirements. In the second section we describe the current logistics and trade facilitation services available to these products, while in the third section we highlight the gaps between the needs identified in the first section and the supply identified in the third. In the fourth section we make recommendations as to how these gaps might be filled, while in the fifth we provide an Action Plan which, if implemented, would result in the recommendations becoming realities.

## **a. Mining**

Mining is the biggest economic sector in Mongolia, contributing more than 50% of GDP. The main mining products by value are copper, gold, fluorspar, coal and gold. In this summary we focus on coal and copper as these are the mining products that will make the greatest demands on the transport and trade facilitation sectors.

Many of the recently discovered and exploited coal and copper deposits are in Omnogovi Province. About 20 mining companies have been granted licenses to conduct exploratory activities in the region of which four have already commenced exploration and production (but one of these is involved only in gold mining so is not considered further). There are four mines in the area that are expected to produce significant volumes of coal and copper over the next 30 years. These are:

- |      |                 |                                    |
|------|-----------------|------------------------------------|
| i.   | Tavan Tolgoi,   | 6,500m tones of coal <sup>4</sup>  |
| ii.  | Oyu Tolgoi      | 1,400m tons of copper and gold     |
| iii. | Ovoot Tolgoi    | 259m tons of coal                  |
| iv.  | Tsagaan Suvraga | 240m tons of copper and molybdenum |

### **i. Tavan Tolgoi**

The large scale coal deposits at Tavan Tolgoi were discovered in the 1950s. BHP held the rights to the project but judged the deposit too expensive to develop. More recently the construction of transport links with China and higher prices for coking coal have combined to make it more attractive. Tavan Tolgoi, one of the largest coal deposits in the world, is the second largest mining investment in Mongolia, with a potential to produce 30 million tons of coal annually for the next 30 years. Exploration and development rights are now held by Energy Resources but international mining companies BHP Billiton, Peabody Energy and China Shenhua Energy are also interested

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<sup>3</sup> International Trade Center, Mongolia imports 2006 (the latest year for which data is available)

<sup>4</sup> Volumes of deposits for mines include measured and indicated reserves but not those inferred.

in the mine. More than 700,000 tons of coal was mined at Tavan Tolgoi in 2006. At an average of about 60 tons per truck, this would have required rather more than 30 loaded truck movements per day. If output were to reach 30 million tons per year this would involve almost 1,500 trucks per day.

Near to Tavan Tolgoi, at Baran Naran, is another large coal deposit with estimated reserves of almost 200 m tons of coal. The license is owned by a Canadian company, QGX Ltd.

## **ii. Oyu Tolgoi**

Ivanhoe Mines Mongolia Inc (IMMI) is the longest established of the new mining companies<sup>5</sup> and has the license for the Oyu Tolgoi area, about 600km south of Ulaanbaatar. The main mineral reserves are copper and gold. It is reputed to be one of four of the largest undeveloped copper projects in the world. Production is scheduled to start in 2011 and reach production levels of 440,000 tonnes of copper and 320,000 ounces of gold per year. If all the copper were to be transported by truck it would require about 20 loaded truck movements per day and are expected to receive copper products from Oyu Tolgoi.

About 40km south of Oyu Tolgoi is the border with China at Gashuun Sukhait, and a further 280 km south is the Chinese city of Bayan Obo, itself about 500 km from Hohhot, the capital of Inner Mongolia and 450 km away from the major steel producing major city of Baotou. All three of these Chinese cities are currently importing coal from Mongolia.

## **iii. Ovoot Tolgoi**

Ovoot Tolgoi is a coal mine 45 kms north of the Mongolia China border, that started open-pit coal production in April 2008. A Chinese steel mill has funded and built a railway line to the Mongolia border, where a major, automated railcar loading facility is now operating. Coal is transported to the loading facility from the mine by truck. The Mongolian government is formally transforming the Ceke border point (close to where the loading facility is located) into a new full-time border crossing. Planned output from Ovoot Tolgoi for 2008 is 300,000 tonnes, with an increase to 400,000 tonnes planned for 2009 and an estimated maximum production of about 1.2 million tons per year. The mine will produce both thermal and metallurgical coal. While all the metallurgical coal will be transported to China, eventually a mine site power station will be built at Ovoot Tolgoi and this will consume much of the thermal coal. The electricity generated could be transmitted to Ulaanbaatar, used to supply a copper smelting plant that is planned for the Oyu Tolgoi mine, or transmitted to Inner Mongolia. If the average truck load is about 60 tons of coal, the 2009 output would require about 20 loaded trucks per day.

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<sup>5</sup> We distinguish between the Erdenet operation, north of Ulaanbaatar and some of the fluorspar mines that have been in operation for twenty years or more, and the more recent mines particularly in Omnigovi closer to the Chinese border, that have been in operation for five years or less.

iv. **Tsagan Suvarga**

The Tsagaan-Suvarga porphyry copper-molybdenum deposit is located approximately 150 km to the northeast of the Oyu Tolgoi deposit. The estimated reserves are about 240 million tons with a mineral content of 0.53% copper and 0.018% molybdenum. With an expected output of about 1 million tons of copper per year, if transported by road this would require about 50 loaded trucks per day

**Other large mining projects**

While several new mineral discoveries have been made in South Gobi in the last year or so, it is likely to be many more years before any of them enter their production phase. In the meantime there are many other large mining projects outside of the South Gobi region that are closer to production or close to a major expansion of production. Among these are:

- Tumertei Ovoo: 230m tons of iron ore, about 250km north east of Ulaanbaatar.
- Dornod : 16m tons of uranium, about 650 km to the east of Ulaanbaatar.
- Bor Ondor: 50m tons of fluorspar, about 360km east of Ulaanbaatar, of which about 360,000 tons exported in 2007, mostly to Russia and Ukraine

**Table 1 Summary of projected output of South Gobi mines**

Mine	Output		Trucks per day	
	tonnes 2009	tonnes 2015	2009	2015
Talvan Tolgoi	800,000	27,000,000	45	500 <sup>1,</sup>
Oyu Tolgoi	0	400,000	0	25
Ovoot Tolgoi	400,000	1,000,000	25	60
Tsagaan Suvraga	0	1,000,000	0	60
Other mines in South Gobi	500,000	2,000,000	30	120
Total	1,700,000	31,400,000	100	1,765

*Source: own estimates based on mining company information*

**Mine trucking companies**

Tavan Tolgoi Trans Co Ltd transports export coal from the Tavan Tolgoi mine. In 2006 it transported 270,000 tons of coal making 4,000 trips with an average load of just under 70 tons. It has about 100 trucks.

Tavan Tolgoi Shin Co. Ltd despite its name, it has been transporting coal from Nariin Sukhait since 2006. It has a fleet of about 150 trucks.

Puushin Mon Co Ltd got its license in May 2006 and since then until the end of the year transported 115,000 tons making 1,500 trips with an average load of just over 75 tons per trip. It has about 75 trucks.

JML Co Ltd transports equipment and construction material for Ivanhoe Mines to its base in Oyu Tolgoi through the border crossing point Gants Mod. It has only 5 trucks

Qinhua-MAK-Nariin Sukhait Co Ltd transports export coal from Nariin Sukhait through the Shivee Khuren border crossing, but does not have a license for transportation on the territory of Mongolia and yet it operates a fleet of 240 trucks with 60-70 tons capacity each. In 2006 Nariin Sukhait mine produced 1.2 million tons of coal and Qinhua transported 1.1 million tons of coal.

Monport Co. Ltd. has been transporting export coal from Tavan Tolgoi and Nariin Sukhait, since 2005. It currently has about 100 trucks.

### **Southern Gobi Regional Development**

The World Bank recently implemented a technical assistance project aimed at institutional strengthening of Mongolia's mining sector. In a parallel activity, PPIAF and AusAid are funding support of a Southern Mongolia Regional Infrastructure Strategy. Part of this is aimed at developing a road and rail strategy for Southern Mongolia that will take account of the infrastructure capacity needed for transport coal and copper from the mines. In preparing this Regional Strategy more precise estimates will be made of the quantities of minerals and mineral products to be transported, of how the development of new mining communities will be managed and funded and of what transport and urban infrastructure should be developed and how it might be funded.

One proposal is to develop a new city in Hanbogd soum for more than 5,000 mine employees. While there are no existing plans for a free trade zone for Southern Gobi, some mining companies have expressed support for such a project. If it were to go ahead it could attract development that would otherwise locate at the Zamyn Uud FTZ.

In October 2008, international development organizations, local and international NGOs, and embassy representatives met in Ulaanbaatar to discuss the current economic and political climate of Mongolia's minerals industry. While the recent dramatic falls in mineral prices and demand for consumer goods are of concern to the mining companies and their investors, the coal and copper mines in Southern Gobi and believed to be financially viable at mineral prices below what they were before the surge in prices in 2007.

### **Trade and transport facilitation for mining**

The trade and transport facilitation needs of the mining sector are rather different during the development phase to the production phase of activity. The sector is currently in the early stages of transition from the development to the production phase, so the facilitation needs combine some elements of both.

### *Development phase*

During the development phase the needs are for the import of exploratory and eventually mining production equipment, and for the materials needed for construction of the housing and infrastructure for the mining communities. There is also a need for the straightforward entry and exit of foreign specialists. The production phase is more demanding, needing infrastructure for the transport of mining output, for the transport of spare parts for mining equipment and for the support of the mining population. As for the development phase, the entry and exit of foreign specialists should be facilitated.

There were many interruptions in the early stages of the import of exploratory equipment, exacerbated by the lack of clarity of national laws and of the relative rights and obligations of national and aimag levels of government, and border disputes between China and Mongolia, and rent seeking by public officials. Some of the problems have been resolved at a practical level but many remain.

**Figure 2 Coal being transported by road from Ovoot Tolgoi to the border with China**



The current organization of road freight transport from Tavan Tolgoi is controversial. While Mongolian drivers are permitted to drive only 100km beyond the border into China (not far enough to reach any of the coal consumers), but Chinese trucks are now driving all 260km to Tavan Tolgoi to pick up coal. This is in violation of the bilateral transport agreement between Mongolia and China. The Government of Mongolia tried to manage the indiscriminate trucking of coal to the Chinese border over unmade roads and by Chinese trucks, but without much success. An attempt to impose a single concession for trucking coal within Mongolia to a Mongolian company was frustrated when the concession was won by a company that did not have the financial resources to implement its concession.

A new border crossing has been opened at Gashuun Sukhait and is open daily for freight but only open for people to cross on the first 20 days of each quarter, and then only for Chinese and Mongolians. The many foreign specialists who need to travel between the South Gobi mines and their Chinese customers must travel via Ulaanbaatar rather than via Gashuun Sukhait. All the export cargo (currently mostly coal from Tavan Tolgoi, 260km from the border) is transported by trucks. Most import freight through Gashuun Sukhait is equipment for Oyu Tolgoi mine.

*Production phase*

There will be need for a railway within South Gobi when production from the various mines that would use it reaches a total of about 5 million tons per year. Until this volume is reached road transport involving up to about 250 loaded trucks per day will be good enough, but beyond this level a railway begins to be feasible as a lower cost alternative.

**Fig 3 Queue of coal trucks awaiting loading at Ovoot Tolgoi mine**



From the projections shown in Table 1 it appears that development of Tavan Tolgoi will be the key to timing of the need for the railway. Figure 1 shows the rail links from South Gobi to China that are preferred by the mining companies. The new links within Mongolia would be built to the Chinese 1435mm gauge and not the Mongolian railways 1520mm gauge. The Government's preference is for an East West connection to the current 1520mm gauge railway at or near Sainshand on the Ulaanbaatar to Zamyn Uud line. Under this proposal it would be necessary to either provide a 1435mm gauge railway parallel to the 1520mm railway between Sainshand and Zamyn Uud within Mongolia, or to provide gauge transfer facilities at Sainshand. A dual gauge line between

Sainshand and Zamyn Uud is not technically feasible because of the relatively small differences between the gauges. Other dual gauge railways are possible in countries where the difference between their broad gauge (1600mm) and standard gauge (1435mm) is more than in Mongolia.

**Fig. 4 Loading terminal at Ceke (China) for Mongolian coal**



The main rail options, both physical and institutional, were described in an earlier WB report on Infrastructure Strategy<sup>6</sup> and the options are likely to be expanded and developed in the on-going South Gobi Strategic Plan.

In October and December 2008 the Mongolian Government announced two decisions on rail links for coal exports. A 270km rail line from Tavan Tolgoi to Nariin Sukhait was agreed to, with funding to come exclusively from Energy Resource LLC. The other agreement, made in December 2008 was for Mogolian Gold MAK LLC to build a rail line from Nariin Sukhait to the Shivee Khuren border to link up with the rail line within China at Ceke. Again the funding would come exclusively from the mining company, with 51% ownership of the infrastructure becoming government owned after ten years or when the investment cost has been recovered from operating revenue, whichever comes first. In both cases supervision of the construction and operation will be the responsibility of the Ministry of Road, Transport, Construction and Urban Development.

In addition to the transport of mining output, there will also be a need to provide trade and transport facilitation for support of the mining activity and the mining

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<sup>6</sup> Mongolia: Foundation for Sustainable Development; Rethinking the Delivery of Infrastructure Services, World Bank, June 2007

communities. These will need more developed cross-border facilities than are available at present.

For a mining output of about 30 million tons per year it might be necessary to develop a town with a population of about 15,000 people. The town would have to be totally supplied from other regions of Mongolia and by imports and the climate and soil of South Gobi would not support any food production. Development of the town could generate a demand for building materials of perhaps 25,000 tons per year in its first ten years, and then perhaps about 10,000 tons per year in support materials after that. Given that most of this material would come from China, it could provide backhaul loads for the railway or sustain a significant trucking service. Moving this volume of freight across the border with China would need a significant development of at least one and perhaps two border crossings.

**Fig 5 Ovoot Tolgoi coal on Chinese trains at Ceke (China)**



It is possible that a Free Trade Zone could be used as a facility to add value to some of the mining products. The nearest Free Trade Zone to the South Gobi mines is more than 400km away at Zamyn Uud. This is too far to be of practical use to the mining communities and it would be preferable for a new FTZ to be provided closer to the mines, perhaps at Gashuun Sukhait. This possibility is expected to be considered in preparation of the South Gobi Strategic Plan as well as for a South Gobi Infrastructure Project, scheduled by the Asia Development Bank for 2009

## **b. Meat and meat products**

Since the zuds of the late 1990s, Mongolia's livestock numbers have been growing, and as at the end of 2007 the total reached a record high of 40.8 million. Increasing number of livestock results in increased reserves of meat, although the

volume of meat production both for the domestic and export markets has not increased. This growth in herd size comes the interest of herders to increase number of their livestock as quickly as possible following their large stock losses from the dzuds in 1999 and 2000, but in doing this they have created herds that include fewer meat producing animals and that have a lower productive weight in the meat yielding (mostly cattle, horses and camels).

As recently as the 1990's Mongolia produced over 270,000 tons of meat for domestic consumption and over 40,000 tons for export. Despite the record numbers of livestock, in 2007 only 170,000 tons of meat were produced for domestic consumption and only 20,000 tons were exported, 90% of which was to Russia.

At present there are around 100 small and medium scale meat processing and production plants spread throughout the country, of which over 30 procure livestock from individuals to produce industrially prepared meat, and only 10 companies of medium size that regularly export. The companies supply domestic market with meat and meat products, of which over 70 are small scale production lines that produce processed and semi-processed sausages and canned meat products.

Although Mongolia exports beef, horse meat and small amount of mutton, canned products, by products, processed intestine and animal food, most meat exports are beef and horse meat to Russia and a small amount of boneless horse meat to Japan, lamb to Saudi Arabia, and canned meat products and animal food to Japan, Korea and Russia. Mongolia currently exports only processed intestines to EU.

Although Mongolia has the potential to export much more than the 40,000 tons of meat achieved in the 1990s, there are at least five reasons why this potential is not reached:

- i. There is little demand on international markets for the mostly mutton and goat meat that Mongolia could provide. Mongolian herders are reluctant to slaughter animals less than three years old, but there is only a small world market and only very low prices for meat from animals this old. The preference is for meat from animals slaughtered at less than eighteen months of age. A very small number of herders have reached a compromise by which their sheep are slaughtered at two years of age and their carcasses exported by air as halal meat to Saudi Arabia and Iran;
- ii. International food security requirements, such as those of the European Union, require a minimum of three generations genealogy of the animals from which the meat is taken. Given the free ranging herding methods used in Mongolia, such records are difficult to compile and maintain.
- iii. Russia has applied strict quotas on the amount of Mongolia beef it will import, and these quotas are applied to producers in its regions that border Mongolia. In 2008 the total Russian quota for imported frozen beef was 445,000 tons, of which more than 350,000 tons was allocated to the EU. Other large quotas were for the United States, Paraguay, Australia, Argentina and Brazil. Chilled beef

imports were limited to just 30,000 tons, with most of the allocation going to the EU. Mongolia's quota for both frozen and chilled beef was 18,000 tons.

- iv. Even when they are allowed, the procedures for exporting meat to Russia are complex, requiring Russian inspectors visiting Mongolia to certify and stamp the meat for export. However, certification stamps of one region of Russia are not accepted by another, so an exporter to more than one region (oblast) has to request visits from inspectors from each of them.
- v. The price paid by Siberian food processing plants for Mongolian meat is less than half that paid for ready to consume imported beef from Australia. At the prices available, and given the cost of inspection, exporting to Russia is only marginally profitable.

Mongolia is a land-locked country so exports of meat or meat products by land transport to third countries have to transit either Russia or China. Since the SARS epidemic in China in 2003 it has banned the transit of all animal products through its territory. However, some relaxation of this ban occurred in 2006 when China agreed to the transit of meat from Mongolia to South East Asia (Vietnam) if such trades were to be made.

### **Prospects for meat exports**

Russia accounts for about 95% of Mongolia's meat exports and still represents its best potential market. The current quota restrictions are expected to be lifted when (or if) Russia joins the WTO, although there might be a negotiated transition phase for removing them. Even when the quotas are relaxed or lifted, Mongolian beef will find it difficult to compete with imports from other countries. This is largely because Mongolia exports whole or quarter sides of beef which then need to be processed into the appropriate cuts and packaging for retail sale, whereas Australian beef imports have already been processed for final sale and so enjoy a high price advantage over Mongolian beef.

At current prices it is only just profitable to export beef to Siberia, but if the product had been better tailored to the market, and if it could have earned half the price of Australian beef, it would have been a highly profitable venture. It appears that Russia might reduce meat import quotas as a negotiating tactic in advance of their negotiation as part of Russia's entry procedure to the WTO. This could temporarily reduce Mongolia's exports.

Ukraine sought to import 50,000 tons of meat from Mongolia, with a high proportion mutton and goat meat to be included. An agreement was reached on the veterinary and hygiene standards to be applied, and exports were scheduled to begin in 2006 subject to agreement on prices and on Ukrainian inspectors being satisfied with the production environment. These agreements were never made and the export was not made. Mongolian meat processing companies suggested that such a volume of meat exports is currently not feasible for two reasons. First, the logistics of

processing, inspecting and assembling such a large volume of meat for export is not possible given the current limited production capacity to international standards, and the second the difficulties of transporting an average of 1,000 tons of chilled or frozen meat from Mongolia, across Russia and Belarus to Ukraine. The political tension between Russia and Ukraine is likely to be another barrier to the trade taking place.

Both Vietnam and the Philippines have shown interest in importing Mongolian meat products, but exports to these countries and others in Southeast Asia would have to transit China the meat to be transported through China. However, China has agreed that if Southeast Asian countries import Mongolian meat and meat products, that it would agree to their transit through China.

Since 2003, Mongolia and the European Union have been discussing ways of obtaining EU-certification for Mongolia's meat exports, for example the matter of dispatching veterinary experts from the EU with the aim of introducing more hygienic slaughtering methods, and of studying and advising on the structure and conditions in the veterinary sector. However, the remaining barrier of required genealogical records has not been resolved and is far from being so. Until certification of Mongolian slaughtering facilities and acceptable genealogical records are available, meat exports to EU countries will not be possible.

Three or four Mongolian meat processing companies have experimented with the export of meat products for pet food to South Korea and Japan, but none have progressed beyond test marketing. A recent study by USAID<sup>7</sup> found evidence of a relatively large potential market for pet food exports from Mongolia to South Korea and Japan and that Mongolia had the resource in the form of a large supply of low-cost meat, including that from sheep, goats and horses. The same report provided a marketing strategy for Mongolian meat processing companies to access this market, but did not indicate the potential scale of Mongolian exports of pet food.

Mongolian meat and animal by-products such as sausage casings and blood and bone meal, have potential markets in Central Asia, the Middle-East, Japan, and China. Exports could be increased with the introduction of better packaging, as well as chilling and refrigeration facilities, but particularly with greater awareness of what the potential markets are looking for.

The Ministry of Industry and Trade recognizes the obstacles to meat exports based on the sanitary conditions for slaughtering, veterinary, and strong international (EU) requirements. According to UNIDO (2002), the presence of diseases in Mongolian livestock impedes the export of raw and processed meat. Other constraints are inadequate meat quality control, (93 percent of the animals are slaughtered in backyard facilities).<sup>8</sup> UNIDO has recommended that Mongolia adopt the guidelines of the Code of

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<sup>7</sup> Potential target export markets for Mongolian pet food products, USAID, June, 2005

<sup>8</sup>"Mongolia Trade and Policy Review," Pragma Corp.,2003, p.81-82.

Meat and Meat Products (Codex Alimentarius).”<sup>9</sup>

For meat exports to existing markets to increase and for exports to reach other markets, Mongolian meat processing methods would need to change. The changes that would be needed include:

- Determining from UNIDO the requirements that Mongolia has to comply with for being removed from the blacklist on meat, and implementing the changes needed for compliance;
- Bringing Mongolia meat processing and genealogical records to international standards.
- The Ministry of Industry and Trade, in collaboration with Mongolia State Professional Inspection Office, meat industry officials to agree on a new procedure operation of abattoirs and meat processing plants that is aimed at export rather than domestic markets.

### **Trade and transport facilitation for meat and meat products**

The main transport problem for meat exports is the current lack of sufficient refrigerated transport services other than those provided by Russian trucks and one Mongolian trucking company. The main facilitation issue is that of phytosanitary and veterinary inspections.

Even once the Russian and Chinese constraints on the import and transit of meat products are relaxed, Mongolia will not have the transport infrastructure or services to facilitate the transport of meat products.

Until now only one Mongolian trucking company has found it worthwhile to invest in the refrigerated trucks needed to transport frozen meat, and Mongolian Railways does not offer a regular refrigerated container service.

While some meat exports to Russia are transported in Russian refrigerated trucks, which generally have higher tariffs than Mongolian trucks, most are transported in specially ordered refrigerated rail wagons from Russia. The wagons must be ordered at least eight days in advance and accompanied by two Russian mechanics to ensure their service and operation. The exporter must pay the costs of the mechanics, the costs of the wagons and a charge of U\$20 for operation of the refrigeration system.

It would require an agreement between the exporting members of the Mongolian Meat Producers Association to consolidate their shipments to Russia to make it worthwhile for a Mongolian trucking or freight forwarding company to invest in refrigerated trucks. Even then, the uncertainties of the Russian inspection system, with the timing of inspections in Mongolia being unreliable, such coordination between competing producers would be difficult. The potential advantages to all of them are such that the possible location of a meat processing plant within the Free Trade Zone at

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<sup>9</sup>”Mongolia Trade and Policy Review”, Pragma Corp.,2003, p.65.

Altanbulag would merit consideration. This would avoid the need for refrigerated road transport within Mongolia, and make the task of inspection by Russian health and hygiene easier and the timing of inspections more reliable.

The potential meat exports to Ukraine could use the Mongolian Vector rail container service, provided that this service can operate refrigerated containers. An export volume of 1,000 tons per week would require about 60 wagons and at least two unit trains per week. The Mongolian Vector is currently a weekly container train from Hohot in Inner Mongolia to Brest in Belarus, via Ulaanbaatar with a transit time between Ulaanbaatar and Brest of between 8 and 14 days. An additional three days would be needed to reach Kiev giving a total of between 11 and 17 days. The comparable time by sea via Tianjin and Hamburg would be more than 30 and up to 50 days.

Use of refrigerated containers on non-electrified railways requires the use of small clip-on diesel generators to supply power to independent refrigeration units on each container. While the technology is quite simple, the requirement for frequent refueling of the diesel generators over a long transit time (up to two weeks would require perhaps five refuellings) can be a logistical problem.

A similar problem of using refrigerated containers on non-electrified railways will arise with the export of meat to Vietnam and Philippines, although the time period of the rail transit from Ulaanbaatar to Tianjin might be short enough not to require refueling of the generators. As with the export of meat to Russia, location of a meat processing plant at the FTZ on the border (this time at Zhamyn Uud) could have enough logistic advantages to make the administrative problems of coordination between competing exporters worthwhile. Location of the processing plant at the border would facilitate inspections by Chinese agencies that would otherwise have to send inspectors to Ulaanbaatar.

Although the air transport of meat and meat products is feasible if expensive, the lack of demand means that there are no refrigerated air cargo services and the few international passenger services have very limited capacity for refrigerated cargo. Pet food exports to South Korea and China could make use of the belly freight of passenger aircraft as these products would not need refrigeration and the frequency of passenger services is high enough for the markets to be supplied on at least a weekly schedule.

### **c. Cashmere and cashmere products**

Cashmere is a luxury fiber extracted by combing the hair of a goat. In Mongolia a fully-grown animal which has survived two winters yields, on average about 300 grams of greasy cashmere. Total world supply of cashmere is about 16,000 tonnes and approximately 20 per cent of this comes from Mongolia. The major supplier is China which supplies more than 60 per cent of world supplies

Herders sell raw cashmere to a range of middlemen. They can sell direct to domestic processors and their representatives or to other traders. In areas remote from urban centers, middlemen visit the herder and offer the trader either cash or barter goods, or a mixture of both. In these situations the herders may receive a cash advance

prior to combing with the balance when the raw cashmere is delivered. Usually the middleman purchases all the herder's available cashmere, whatever the quality. In some cases the middleman sorts the cashmere and sells different qualities to different purchasers. For those herders closer to Ulaanbaatar, there is a market in Eastern Ulaanbaatar ("Tsaiz") where purchasers and herders can trade<sup>10</sup>.

Given the choice, herders almost invariably prefer to sell, or at least obtain prices, at a large market such as the Tsaiz, even if it involves them in transporting their cashmere over long distances and difficult terrain, rather than selling to a single buyer who comes to them. They may get prices from the Tsaiz market and then approach processors in Ulaanbaatar.

Sometimes the price of raw cashmere paid to Chinese herders is marginally higher than that paid to Mongolian herders because of the saving in transport costs when sourcing from China. But more often the Mongolian price (whether paid by Chinese or Mongolian traders) is only about two thirds that in China. Some herders prefer to sell to Chinese middlemen as they provide full cash payments, whereas often selling to a Mongolian trader involves a delay until the cashmere is sold on the world market before full payment is made, and this can be several months.

Prices paid for raw cashmere are determined by the demand for cashmere products, and there is a very fast reaction in raw cashmere prices to any indications of a change in demand.

Mongolian cashmere can be acquired for domestic processing or for export as raw cashmere usually to China. Exported raw cashmere can be exported legally, in which case it is liable for an export tax of 4000 togrog per kilo, but much of it is smuggled.

Once the cashmere is acquired by the processor it is washed. After washing it is dehaired. The dehairing process involves passing the washed combings over rollers so that the coarse outer fiber remains on the rollers and the fine inner down is collected at the end of the dehairing chain. This inner down is the material used for cashmere knitting.

### **The Domestic Processing Industry**

There are three stages in the production of cashmere garments from the raw cashmere: dehairing, dyeing and spinning, knitting and weaving. The following table shows how much cashmere passes from each stage to the next (although the data is for 2004 and the total production of raw cashmere has increased by up to 30% since then, the distribution between the different production stages should be about the same).

Of the approximately 3,200 tonnes of raw cashmere produced, a little less than 20% is exported legally and about 30% illegally. The other 50% (about 1,600 tonnes) is purchased by domestic processors for dehairing. After dehairing the weight is reduced to about half.

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<sup>10</sup> The Mongolian Cashmere industry, Richard Filmer for the World Bank, April, 2001

**Table 2 Production of cashmere by industrial stage (2004)**

	Production tons	Export Tons	Import tons	Input to next stage tons
Raw cashmere	3,	1	0	1,600
Dehairing	80	6	0	184
Dyeing and spinning	14	6	18	341
Knitting	31	3	0	0
Weaving	30	2	0	0

*Source: A Value Chain Analysis of the Mongolian Cashmere Industry, USAID, May 2005*

About 75% of the dehaired cashmere (just over 600 tons) is exported without further processing in Mongolia. A little of that which is dyed and spun is exported, but to make up the weight that is knitted, more dyed and spun cashmere is imported than is produced in Mongolia (180 tons imported, 153 tons produced domestically). All the dyed and spun cashmere is exported, either as knitted (just over 300 tonnes) or woven garments (about 20 tonnes).

The major problem faced by domestic processors is that they do not have access to sufficient raw cashmere to make best use of their industrial capacity. This problem is closely associated with the difficulty of raising the necessary funds to purchase raw cashmere. Currently, only about one third of available capacity is utilized. It is theoretically possible for all the entire production of Mongolian raw cashmere to be dehaired using currently available capacity.

### **Prospects for cashmere exports**

There is little possibility for the number of cashmere producing goats to increase beyond the present number of a sustainable basis. There is some doubt as to whether it is worthwhile for Mongolia to focus on producing high quality cashmere as in the past or to move towards producing more cashmere but of a lower quality. The latter policy would be implemented by accelerating the on-going change in the breed of goats being used for cashmere towards those producing more but coarser cashmere.

If the former policy is followed, the only way for the earnings from cashmere to increase (other than through changes in world prices for high quality cashmere products) would be for more value to be added. This would come from exporting less dehaired cashmere and using it instead to produce more knitted garments. This change would have some impact on the transport and trade facilitation needs, as less would be exported in regular containers and more would be exported in high value containers and more would be air freighted. But the impact would be small as the overall transport needs for dehaired cashmere are currently only about 200 containers per year, and even if all the dehaired cashmere were used for local production of garments, there would only be about 70 extra container loads of finished garments (the volume to weight ratio

for garments is much less than for dehaired cashmere). Overall there would be a reduction of more than 50% in the number of containers needed.

If the latter policy were to be followed there would there be an increase in transport needs. If the average yield of raw cashmere per goat were to increase from 300gm to 300gm, the output of raw cashmere could increase to about 4,000 tons per year. If half of the additional 800 tons were to be exported legally as raw cashmere it might need an extra 300 containers per year, while the other half could produce about 400 tons of dehaired cashmere, which if exported without further processing could need another 120 container loads, giving a total increase of about 420 container loads per year.

### **Trade and transport facilitation for cashmere**

Raw cashmere has a very high volume for weight ratio, so when it is transported it is the volume constraints of the vehicles (trucks or railway wagons or containers) that determine how much each of them can carry. A two axle truck that has a nominal capacity to transport about 8 tons of cargo would be able to transport less than half of that weight of cashmere before reaching its volume capacity. So if the maximum load per truck were 4 tons, the transport of 3,200 tons of cashmere would require at least 800 truck movements.

However, it is unlikely that all herders would produce enough raw cashmere to fill a truck to capacity. To produce one ton of raw cashmere would require a herd of about 3,000 goats. Estimates of the average goat herd size vary widely, as do estimates of the distribution of herd sizes, but very few herds would reach 3,000 goats. So the number of truck movements to transport the raw cashmere either to local markets, or to the stores of middlemen would be far in excess of the 800 estimated. For the 50% of raw cashmere that is dehaired within Mongolia, perhaps half is transported by the herders themselves in partial truckloads to markets such as the Tsaiz in Ulaanbaatar, whereas the remainder is transported by middlemen in full truckloads.

The 30% of cashmere production that is exported illegally is transported in trucks owned and operated by Chinese traders. They probably make up full truckloads to minimize their transport costs so would require about 400 truck movements per year. They avoid border formalities and so are not involved in trade facilitation procedures. There is a possibility that the raw cashmere export tax, the avoidance of which is the basis for the illegally trade, might soon be abolished. If that happens, it is possible that most the cashmere that is currently exported illegally will follow the same procedures as that which is exported legally. This would involve some documentation and record keeping and so might still be avoided by some Chinese traders. The current procedures for the legal export of cashmere would be simplified as the verification of quantities and of the payment of the export tax would no longer be necessary. There is a chance that these changes would bring about some consolidation in the transport of raw cashmere for export.

The 600 tons or so of dehaired cashmere that is exported is transported more conventionally, mostly by rail. Its volume to weight ratio is smaller than for raw cashmere so the vehicles can be filled more to their weight than to their volume capacity. At about 8 tons per teu, the 600 tons of exported dehaired cashmere would need about 75 container loads.

Dehaired cashmere and knitted cashmere garments face additional barriers due to excessive paperwork delays on entering China to transit to Tianjin port. Erlian Customs at the border stated that “the quarantine on Mongolia agriculture products has not ended.” This quarantine was imposed in 2001 due to the fear of transmission of disease, but that risk is not present anymore. An example of a Chinese requirement that should be relatively easy to resolve is that all wool and cashmere products arriving at Erlian from Ulaanbaatar by rail be loaded to trucks at Zamyun Uud before entering China for inspections. This procedure of physically transferring all wool and cashmere to trucks takes from 8-15 hours and adds about U\$150 to the cost of a container.

In Ulaanbaatar, Mongolia Customs have authorized laboratories and a State Professional Inspections Office so that businesses can have the wool and cashmere tested before it leaves for Tianjin. The State Inspection Office documents and certifies the quality and hygiene of wool and cashmere. However, the Mongolian tests are not acceptable to Chinese authorities, even to allow transit through into China by rail.

The Chinese Ministry of Railway gave a different interpretation of the reloading requirement. In Erlian, on the Chinese side of the border, there is only an inspection warehouse for goods arriving from Ulaanbaatar by road, and it is claimed that the volume of Mongolian exports by rail are not sufficient to operate a separate rail facility – a surprising claim since all Mongolian exports arrive at the border by rail and none by road.

The 340 tons of knitted and woven cashmere garments have a much higher value for weight ratio than either raw or dehaired cashmere and can tolerate the high costs of air transport. The high value also makes land transport unattractive because of the high risk of theft, despite the Mongolian Vector container train having armed guards throughout its transit to Brest. The Gobi Corporation is the largest Mongolian exporter of finished garments. Their 350,000 export garments are mostly transported in rail containers to four main destinations, the EU, North America, Japan and South Korea. For large customers a container load is worth about U\$50,000 and includes between 8,000 and 10,000 garments. A shipment to the US West Coast takes about 45 days and costs up to U\$5,000 but charges over the last two years have been very volatile.

While the transport of raw cashmere is managed by the middlemen, that of dehaired and knitted cashmere is managed by freight forwarders. They have been managing this business for more than a decade and have made many improvements in documentation and the quality of logistics and transport services. Some of the responsibility for the logistics of exports of dehaired cashmere is passed on to smaller and less experienced freight forwarders as a cost saving measure. But their lack of experience and financial support has led to mishandled shipments and unnecessary

costs being incurred by the traders, such that in the end it could have been less costly to use a more experienced freight forwarder.

#### d. Imports

Liquid fuels (petrol and diesel) made up 60% of imports in 2007, up from 43% in 2000. If these two products are excluded the growth in volume and value of mining equipment can be seen from the data in Table 3.

**Table 3 Composition of imports**

Products	Unit	2000		as of Dec 2007		Share of value	
		Volume	value 000 \$	Volume	value 000\$	2000	2007
Rice	thous t	13	4,372	28	8,148	4%	<b>2%</b>
Wheat and four	thous.t	94	15,992	101	26,150	13%	<b>8%</b>
Alcohol drinks	thous.l	17,242	9,869	16,226	14,247	8%	<b>4%</b>
Electricity	mln.kwt.h	182	5,276	195	6,017	4%	<b>2%</b>
Bulldozers, graders etc	no.	94	4,549	1,224	52,695	4%	<b>15%</b>
Parts for machinery	thous. pcs.	101	8,997	436	31,264	7%	<b>9%</b>
Machinery for mixing of stones	thous. pcs.	24	13,450	21	23,439	11%	<b>7%</b>
Communication apparatus		194	18,013	151	39,207	15%	<b>11%</b>
Cars	no.	11,509	30,901	21,214	87,314	25%	<b>26%</b>
Trucks	no.	3,061	11,259	13,043	53,413	9%	<b>16%</b>
<b>Total</b>			<b>122,678</b>		<b>341,893</b>	<b>100%</b>	<b>100%</b>

*Source: A Mid-Term Trade Policy for Mongolia, A Trade Integration Strategy, World Bank,, draft April 2008*

Considering just the category that includes bulldozers and graders, the volume increased from less than 100 pieces to more than 1,200 pieces and the value from less than U\$5 million to more than U\$50 million. The share of import value increased from 4% to more than 15%. There were similar but much smaller increases in machinery parts (from U\$9 million to more than U\$30 million) and in trucks (from U\$11 million to U\$53 million).

While the volume of rice imports more than doubled that of flour increased less than 10% although its value increased by almost two thirds, a result of the increase in unit costs in the last two years. Imports of cars increased from about 3,000 to about 13,000 (a little more than four times) and their value by a rather more.

#### Mining equipment

Most mining equipment is sourced from China, with that from Canada and the United States also being significant. It nearly all enters Mongolia through China and most of that through Zamyn Uud, but an increasing proportion now enters through Gashuun Sukhait border crossing. There are now several freight forwarding companies specializing in the import of mining machinery and at least one trucking company also specialized in this trade. Most equipment that is not too large comes on flatbed rail

wagons to Zamyn Uud and is transported by truck from there (or from Gashuun Sukhait) to the mine site. While Mongolian trucks are used from Zamyn Uud, there is still a high proportion of equipment coming through Gashuun Sukhait that is transported in Chinese trucks.

Border crossing facilities for the import of mining equipment are not well organized, with many rent seeking activities that delay their import and add significantly to their cost.

### **Wheat, rice and flour**

Most rice and flour is imported through China and most, but far from all, in containers. The 2007 imports totaling about 130,000 tons required about 16,000 teu of capacity. The containers for rice originate from several cities in China, generally travelling a longer distance in China than the flour containing flour, many of which comes the port of Tianjin with aid wheat from Japan. Aid wheat from Russia comes by rail through Altanbureg, which together with the Japanese wheat aid will amount to about 50,000 tons this year (2008)

In an attempt to stabilize bread prices the Government of Mongolia is proposed to import rice and sell to bread producers, but the latter have objected to having to pay cash and store up to 1,000 tons of flour.

### **Motor vehicles**

Motor vehicles is one of the fastest growing categories of imports, with the number doubling between 2000 and 2007 and their value increasing by nearly three times. A notable feature of car imports, most of which are imported second hand, is the change from Eastern Germany and Europe as a main source to Japan and South Korea. Japanese imports are easy to recognize as they are built for right hand rather than left hand drive. In 2004 only about 4,000 used cars were imported from Japan but this increased to more than 17,000 in 2007 and more than 14,000 in the first six months of 2008. Japanese used cars are popular because of the strict testing they must pass and the good condition of the roads on which they operate and their low mileage for a given age of car. Similar reasoning supports the interest in South Korean used cars, but in 2007 less than 3,000 were imported from this source. When the used cars came from Europe they entered through Altanbureg but now most come through Zamyn Uud having entered China through Tianjin port.

The most common new car used to be the Russian Jeep, but these do not comply with current Mongolian vehicle emission standards so their popularity has declined rapidly in favor of the used cars from Japan and South Korea, which for a similar or even lower price provide a much higher specification.

Many used cars are imported speculatively as small business enterprises, with several small freight forwarders also specializing in this trade. The small size of the cars means that two can fit easily into a 20ft container and up to five in a 40ft container.

In an attempt to control traffic congestion in Ulaanbaatar the Government of Mongolia is considering a doubling of the vehicle excise tax, which varies according to the engine capacity and year of production. Taken together with the value-added tax, importing a 1997 Nissan Sunny with a 1,500 cc engine, incurs charges of about US\$1,000, which would increase to US\$2,000 under the proposal.

**e. Transit traffic**

In the first years of this decade Mongolian Railways developed a substantial traffic in transit traffic between Russia and China. This started with refined petroleum from Russia, and later expanded to include timber, and then consumer goods including some food from China to Russia. With the collapse of UKOS, the private Russia oil producing company and the increase in Mongolian Railways tariff for transit oil, this traffic came to an end. Transit rail freight in 2007 was almost 50% below its peak of over 5.4 million tons in 2005. Revenues from transit freight, particularly oil, have allowed Mongolian Railways to constrain its tariffs for other freight. When a 50% increase in those tariffs was announced in November 2008, the loss of the revenue from transit oil was cited as the main reason for the large operating deficit (equivalent to US\$20 million) that needed to be reduced.

The current volume of about 250,000 tons per month of transit freight, of which 86% is from Russia to China, is made up of about 180,000 tons per month of timber from Russia to China, (about 72% of all transit freight), about 20,000 tons per month of chemicals from Russia to China (about 8% of total transit freight) with the only significant freight from China to Russia being about 17,000 tons per month of coal and coke (about 6% of total transit traffic).

Since the transit traffic is nearly all bulk products that are not time sensitive they do not face any trade facilitation problems at the borders. When large volumes of oil were being transported from Russia to China there were problems of locomotive availability and to a lesser extent of track capacity for the transit trains, but the loss of the oil traffic has eliminated the capacity problems.

**f. Summary of trade and transport facilitation facilities required**

The three export industries reviewed have many trade and transport facilitation requirements in common, but their relative importance is different for each of them.

The requirements relate to freight forwarding services, trucking services, rail transport. (for cashmere products air transport is also important) and border crossings and trade facilitation procedures. Transport infrastructure to support international transport services is also deficient but is being addressed through the paving of the road from Ulaanbaatar to Zamyn Uud and the expansion of railway capacity on the main North South line.

## **Freight forwarding**

The availability of efficient and experienced freight forwarding services are crucial to the success of any export industry based on manufactured goods. For mineral and some large scale agricultural exports the producers themselves have sufficient resources to provide their own freight forwarding services. But even the mining industry in its development phase depends on freight forwarders to arrange the logistics of bringing its equipment to the mining locations.

For meat exports, the industry is still highly dependent on Russia and the complexity of importing food into Russia means that the logistics of importing are largely managed by the Russian food processing industry. As Mongolia meat exports develop new markets, such as Ukraine, Vietnam and Philippines, the role of Mongolian freight forwarders will become more important.

Exports of spun and woven cashmere is already handled by Mongolian freight forwarders, as is some of the export of dehaired cashmere. The Mongolian forwarders have developed extensive contacts with forwarders in the destination countries as well as with international transport companies (such as Chinese and Russian railways and international shipping lines) such that the complexities of the logistics of cashmere export are well managed. If the illegal export can be brought under control, there is scope for the export of raw cashmere industry also being managed by Mongolian freight forwarders.

## **Trucking services**

The trucking services required by the mining industry are quite different to those required for the export of meat and cashmere. The transport of coal and copper from South Gobi to China will require a fleet of some 1,750 high capacity (80 tonnes payload) trucks by 2015. The import of mining equipment will require a much smaller but more specialized fleet of trucks, while support of the mining communities will require another large fleet of standard two or three axle trucks. At present no Mongolian trucking company has the number of trucks of financial capacity to satisfy any of these three needs.

The export of meat to Russia requires a fleet of refrigerated trucks that is not available from Mongolian trucking companies, and so is provided by the Russian processing plants. When exports of meat to Ukraine begin it is probable that the main transport will be by rail, and that a fleet of standard non-refrigerated trucks will be needed to transport the carcasses from the abattoirs to the railway terminal.

Raw cashmere has a very high volume to weight ratio so is preferable transported in trucks that also have a high volume to weight capacity. At present standard two axle trucks are used, but are inefficient for this purpose. Unless a more efficient distribution and marketing system is developed for raw cashmere it is unlikely to be worthwhile investing in a vehicle fleet just for the transport of raw cashmere, so the current inefficient trucks are likely to continue being used.

## **Rail transport**

The mining industry will depend on rail transport once it gets beyond its initial production phase. The many options for providing rail infrastructure and operating rail services are being assessed in the South Gobi Regional Strategy that is due to be completed in the first semester of 2009. The recommendations are expected to include the choice of location for the rail lines within Mongolia, and how they will be funded and their use charged to the railway operating companies; how the rail services will be organized, the relative roles of Mongolian and foreign companies in any railway operating company and whether mining companies themselves will have a role, and how the operating concession(s) might be regulated.

Although rail transport does not have a role in the export of meat to Russia, it will have a role in meat exports to Ukraine, Vietnam, Philippines and other countries. Despite many suggestions for introducing some form of competition into Mongolian railway operations, this is not likely in the foreseeable future, so it is the existing Mongolian Railway company that will have to adapt containers to take refrigerated containers and ensure that they are serviced in route to their railway destinations.

It is the freight forwarders who will need to provide large scale refrigerated storage facilities, these will need to be built quickly if the exports are to start soon. As a short term measure, use could be made of available space in existing cold storage warehouses in Ulaanbaatar.

The most secure and least cost way of transporting finished cashmere products is by containers on rail services. Air transport is a viable alternative given the high value to weight ratio of spun and woven cashmere garments. However, since Chinese customs require that cashmere transiting China can only be inspected in road based facilities, it is possible that once the road between Ulaanbaatar and Zamy Uud is completed, the additional cost of road transport to the border will be more than offset by the saving in mode transfer costs for the border inspection process.

## **Trade facilitation**

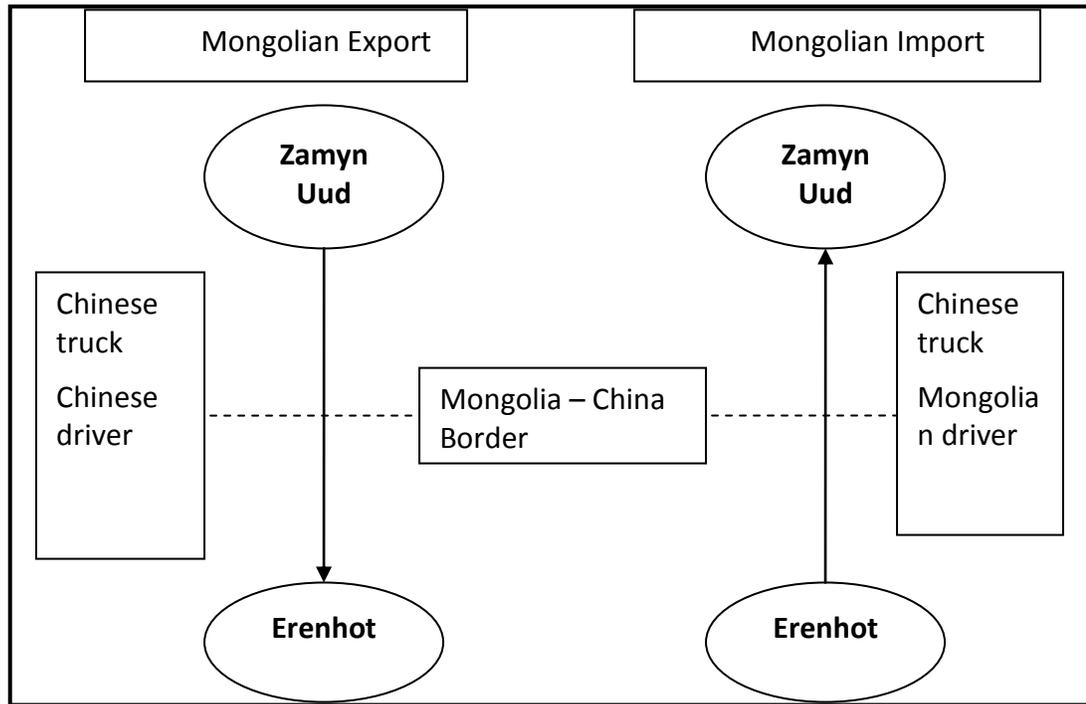
Trade facilitation looks at how procedures and controls governing the movement of goods across national borders can be improved, to reduce associated costs and maximize efficiency while safeguarding legitimate regulatory objectives.

Mongolia has been a member of the WTO since 1997. The WTO defines trade facilitation as “The simplification and harmonization of international trade procedures” where trade procedures are the “activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade”. This is a much narrower definition since it relates only to data processing.

We use the broader definition which includes the physical processes of movements of goods and their inspections, as well as the processing of data. We do go as far as the UN which includes trade finance in its definition of trade facilitation.

An ideal trade facilitation system would be one where goods crossing an international border are not stopped other than as part of a risk assessed inspection or for national security reasons. Most border impediments to freight movements are not necessary and could quite easily be eliminated. The situation at the borders between Mongolia and China and Mongolia and Russia are far from this ideal.

**Fig 6 Arrangements for road freight to cross the border at Zamyn Uud**



*Vehicle and driver facilitation*

Many countries have implemented procedures that allow vehicles and drivers to pass borders with a minimum of delay. For example, Thailand and Laos are implementing a three stage process that should allow trucks and drivers to pass freely across their border with only risk assessed and security inspections and these to be carries out in a facility operated by both countries. A bond system, similar to the TIR<sup>11</sup> is being implemented to reduce the need for customs and other duties to be paid at the border.

In contrast, containers crossing the Zamyn Uud border between China and Mongolia incur delays of up to five days and incur avoidable costs of about U\$120. The delays arise from the need to transfer rail freight leaving Mongolia to road transport for the border crossing and Chinese inspections, and the need for a Chinese truck with a Mongolian driver to bring road based containers from China into Mongolia. Inspections

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<sup>11</sup> Transport Internacional por la routier, a convention with 66 participating countries that allows goods to pass from one to another (and through another if necessary) with payment of duties being guaranteed through a bond system.

made by Mongolian agencies are not accepted by Chinese agencies and any customs and other duties have to be paid even for transit freight as there is no bond system that allows them to be paid later and then only if the freight does not exit China in a specified time.

### *Goods facilitation*

Trade facilitation increases when both countries involved in a border have a common system for classifying goods on which duties need to be paid and a common system for their payment. Many countries use one of the versions of ASYCUDA for this purpose, but in 2001 Mongolia abandoned its use in favor of a less costly national system (GAMAS).

The objectives of GAMAS are to simplify and automate customs clearance procedures, facilitate international trade, digitize logistics process and to initiate an automatic system of customs information,

It aims to increase the efficiency of links between customs office and business entities, freight forwarding companies, customs brokers, banks, and government authorities, and to create an environment in which technical tasks (computing, digitally storing, transferring etc) and manpower assignment (relationship between inspectors and customers) are clearly separated. GAMAS links Ulaanbaatar Customs to Zamyn Uud Customs on line. Since it is designed to work on the Windows operating system on standard PCs and is written in Mongolian, it is easy to use and apply. It already covers more than two thirds of all customs clearances and generates more than 90% of customs revenues

Its main disadvantage is that it is incompatible with the systems used in China and Russia (neither of which countries used ASYCUDA). A connection to Tianjin port cannot be made due to objections from China, even though Mongolian experts claim that it is technically feasible.

The lack of information system linkages between Mongolia and China presents the problem of false documentation, inaccurate valuations, and poor statistics which slows external trade. Mongolian Customs claim that documents for container imports are altered in Tianjin and that some documents are not presented in Mongolia, as required.

Chinese customs allege that many Chinese and Mongolian traders present false documents often in collaboration with Chinese and Russian traders. However, according to the Ministry of Industry and Trade, Mongolia the price list used for valuation by Customs is not accurate, so this inter-ministerial dispute creates further delays for clearing consignments.

The **World Customs Organization's (WCO) Columbus Programme** is a Customs capacity building program that works to promote Customs modernization and implementation of WCO standards to secure and facilitate world trade. The

*Framework of Standards to Secure and Facilitate Global Trade ("SAFE")* is an international Customs instrument containing 17 standards that promotes security and facilitation of the international supply chain. Given SAFE's complexity, the WCO launched its Customs capacity building program (the *Columbus Programme*) which focuses on comprehensive needs assessments for WCO Members using the WCO Diagnostic Framework tool.

The Columbus Programme lifecycle is based on the WCO Diagnostic Framework Project Lifecycle. The seven steps are (1) Project Identification (WCO Member requests assistance from the WCO Secretariat or a donor Member; donor coordination); (2) Initial Assessment (WCO Self-Assessment Checklist); (3) Needs Assessment (diagnostic missions); (4) Project Preparation (action plan and business case if necessary); (5) Implementation; (6) Monitoring; and the last step (7) Evaluation (evaluation of project objectives and outcomes). While this is the appropriate sequencing, there is of necessity some overlap.

Following an initial self diagnosis of its capacity to meet the SAFE standards, in April 2006 the Customs General Administration of Mongolia (CGAM) requested a needs assessment and preparation of an Action Plan for implementing measures to bring it into compliance with the SAFE standards. A Final Report was submitted in May 2006 that included the assessment and Action Plan comprising 39 actions. Many of these were incorporated in the ADB Mongolia Customs Modernization Project (2007) while others were covered by a technical cooperation agreement on capacity building between the CGAM, the Dutch Tax and Customs Administration and the WCO (Dec,2008).

Zamyn Uud Customs states that there is a lack of cooperation with China on tallying border trade for statistical purposes. Since in principle, Mongolian export numbers should be the same as Erlian import numbers, such discrepancy is mainly due to the lack of information technology linkages.

For Mongolian traded manufactured goods to pass more easily through China, closer coordination is needed between Chinese and Mongolian customs. Since such coordination is more pressing for Mongolia than to China, Mongolia should take the initiative in negotiations. A beginning could be made by Mongolian Customs adopting a software system that is acceptable to the Chinese Customs agency. It would be an advantage if Russian were to have a compatible system as well.

The Customs Agency is no the only one involved in border trade facilitation. Also involved are State Inspection Agencies (to verify the quality of imported manufactured goods), Agricultural and Food Agencies (to verify the quality of food imports) and the Public Health Agency (to verify that imported goods do not bring any risk to human health). Veterinary and phytosanitary control for Mongolia is conducted by the Border Professional Inspection Unit of the State Professional Inspection Authority.

To simplify the work of these agencies involved in cross border trade, a so called “One-Stop-Service” (OSS) was introduced in 2002. This service is intended to terminate the separate dues and fees collected by individual institutions and consolidate them into single dues which are imposed by the customs and were remitted to the state budget. In addition, an OSS usually aims to coordinate the inspection processes of the various agencies, so that the documentation can be processed in parallel rather than in sequence and with inspections based on a risk assessment, goods should be subject to one time risk of inspection rather than a risk of sequential inspections. Not only should the OSS simplify for the cross border procedures but also reduce the average and variability of time taken to cross the borders.

In reality there are still many impediments other than Customs to crossing Mongolia’s borders. These derive from a lack of information and knowledge of the rules and regulations on border control and customs (often these are changed without freight forwarders being aware of the changes) and from the rule and regulations themselves being unclear, cumbersome and bureaucratic. The procedures for dealing with the rule and regulations are cumbersome and take a lot of time. In addition, various non-transparent charges and discretionary fees and penalties are imposed.

#### **g. Current trade and transport facilitation facilities**

##### **National Committee on trade and transport facilitation (NCTTF)**

The NCTTF was established following the recommendations of a UNESCAP sponsored workshop in April 2005. It was created under Resolutions 66 and 245 of the Government of Mongolia in 2006 and its structure defined under order 10 of the then Ministry of Roads, Transport and Tourism in January, 2007. It has 25 members from six ministries and three private sector organizations, the National Chamber of Commerce and industry, the National Road Transport Association and the Mongolia Freight Forwarding Association. At its first meeting it discussed a Draft Action Plan that included 26 specific actions, many of them related to construction and electrification of a second north south railway line.

##### **Freight forwarding**

The Mongolian freight forwarding industry is fragmented. There are over 40 domestic freight forwarding companies and about fifteen representative offices of foreign freight forwarding companies. This is far too many to handle international trade that amounted to less than U\$1.4 billion of imports and U\$0.8 billion of exports in 2005. Given that about 75% of exports by value are minerals that do not need freight forwarding services, this gives an average business to handle only about U\$26 million of trade to each company. Of the 40 domestic companies there are only three that are FIATA<sup>12</sup> certified. These three handle the bulk of the business. However, there are also a myriad of small operators competing at the bottom end of the market, and due to the

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<sup>12</sup> FIATA, the International Federation of Freight Forwarders Associations

operation of these small operators, the oligopolistic practices of the large operators is reduced to an extent.

Many export and import companies allege that the three large companies offer identically high rates and inadequate services. One of the three large freight forwarding companies is the International Freight Forwarding Center (IFFC). This is 100% owned by Mongolia Railways and is perceived to use its close relationship to the railway and the government to enhance its market share.

However, the small companies are unable to offer even the minimum quality of service that a trading company would look for, so these small companies mainly serve the smaller family trading enterprises. Few of the small enterprises provide insurance services or issue bills of lading (BOL). When large traders try to use the small logistics companies to take advantage of the lower rates, they frequently have in the end to ask one of the three larger companies to take over the contract. (In one instance, a rice donation from Taiwan of 5,000 tons in 93,000 bags, handled initially by one of the smaller Mongolia freight forwarding companies, was transported in a chartered North Korea vessel that sank resulting in some loss of cargo and considerable damage to the remainder. The remaining shipments in the consignment were eventually handled by a more experienced Chinese freight forwarding company).

Although there is a Mongolian Association of Freight Forwarders, it lacks sufficient institutional capacity or ability to control its members or negotiate with the government.

Anecdotal evidence shows that in Mongolia as in many developing countries there are many 1-2 person freight forwarding businesses described as “bed companies” or “briefcase companies.” They often do not have a formal office and operate out of the homes of the owners. They have no financial backing and survive by offering very low cost services to small international traders. They can survive in Mongolia as the only formal requirement for operating a freight forwarding business is to demonstrate availability of start up capital of U\$ 2,000

The lack of a qualified and competitive industry leaves many niche logistics opportunities unfilled. For example, there is a less than trailer or container load (LTL/LCL) market made up of small family size importers and exporters. Lack of suitable freight forwarders or agents means that these traders have to travel to China to purchase goods. These traders have no confidence in the Mongolia freight forwarders large or small to service their needs at competitive prices.

Many developing countries have followed the practice of developed countries in requiring professional credentials and qualifications in order to conduct freight forwarding business. Customers in developed countries rely on logistics service providers (LSP) in deciding optimal modes of transportation from point of origin to point of destination. The skills, service offerings and prices needed involve forwarding, packing, insurance, warehousing, invoicing, and Customs operations.

In the context of the new Tripartite Transit Agreement, the Government of Mongolia could question China's current requirement that Mongolia logistics providers use Chinese logistics companies when importing goods through the port of Tianjin.

### **Trucking companies**

The transition from a state owned enterprise system to private ownership for road transportation has not fared well in Mongolia. Currently, there is a single shareholding Mongolian trucking company, "TAV" Transportation Co.,Ltd. This company is constrained by truck capacity, poor roads, and limited cross border access into China and Russia. Four companies have been licensed to transport minerals (mostly coal) to China and another large company is transporting large volumes of coal (more than 1 million tons) without a license. Other road transport services are provided by numerous independent truck operators, mostly with just one small or medium-size and ageing Russian-built truck. These operators provide inefficient and not particularly low cost domestic transport and to the Russian border, with occasional trips to the Chinese border at Zamyn Uud.

Regulation of the road trucking industry appears to be excessive with a large number of laws, of which the most significant are the Law of Mongolia on Road Transportation, the Law of Mongolia on Licensing of Commercial Activities, and the regulations on Licensing of Services for International Freight and Passenger Transportation by Road Vehicles, dated August 2006. Enforcement and implementation of the laws, legal acts, rules and regulations on road transport is the responsibility of the State Professional Inspection Authority. The Road Transport Law of 1996 separated the responsibilities for road transport between various government agencies and levels of government. It also established a standard contract for road transport based on the Mongolian Civil Code.

Four classes of permits are issued for international road transport, of which only one, a Type C is for freight transport. Permits are issued for each trip and 9,000 of these were issued for transport to Russia and 15,000 for transport to China in 2007 (although there are no paved roads to China). These permits are issued by the Transport Services Department of the Ministry of Roads, Transport and Tourism (now the Ministry of Roads, Transportation, Construction and Urban Development) or its designated provincial delegated agencies. The permits are required to have seals and signatures of the officials of the authorizing

### **Transport infrastructure**

Transport infrastructure to support international transport services is deficient, especially in the South Gobi region. Until the recent expansion of mining activity in this Region there was insufficient demand to justify the construction of a road network. That situation has now dramatically changed, with road trucks now doing irreparable harm to the desert environment, and the need to construct new roads linking the mines to the Chinese border as quickly as possible. Despite delays in planning the new rail links, the

authorizations given for two privately funded rail lines in South Gobi should result in large volumes of coal and copper exports being transported by rail by 2012.

Mining output and transit freight is also putting pressure on the capacity of the current North South railway line. A project being funded by the Millennium Challenge Account will create a new state-owned company that will be managed and operated by a private sector company. The state-owned company will own new freight locomotives, freight wagons and track upgrading and maintenance equipment and a new signaling and communications system. These assets should allow for a doubling of the capacity of the railway south of Ulaanbaatar and significantly increase the operating capacity to the north.



All but the last 62km leading to Zamyn Uud of the north south road connecting Russia and China via Ulaanbaatar is either reconstructed (325km north from Ulaanbaatar to Altanbulag), newly constructed (200km south from Ulaanbaatar to Choir) or under construction (365km going south from Choir via Sainshand towards Zamyn Uud).

Completion of the road from Ulaanbaatar to Zamyn Uud will provide competition in the transport of goods to and from China and, through the port of Tianjin, to the rest of the world. Although the Mongolian Railways currently has a monopoly of transport to the border at Zamyn Uud it does not appear to exploit this position. It offers a fast and frequent service for freight in both directions, whether

containerized, in bulk or as general freight. The problems with rail freight derive from the need to change wagon axles at the border (or to transfer freight to or from Chinese wagons) and from reliance of China Railways for onward transport to destinations in China or to Tianjin port. For freight requiring faster road transport within China, Chinese Railways has a monopoly subsidiary company.

While completion of the paved road from Ulaanbaatar to Zamyn Uud will not in itself change the China Railways monopoly of road transport of Mongolian freight in China, it will provide an opportunity for road transport policy between the countries to be reviewed. This review could include allowing Chinese trucks access to Ulaanbaatar in return for China allowing competition for the road freight of Mongolian freight within China, including the use of Mongolian trucks and trucking companies.

### **Trilateral Transit Agreement**

International road transportation communication is of key importance for Mongolia's trade development as until now it has been dependent on rail transport, with its neighboring railways being largely indifferent to Mongolia's needs.

A Trilateral Transit Traffic Agreement (with China and Russia) has been under negotiation for at least fifteen years, with UNCTAD acting as facilitator. Although it is close to final acceptance, there are still last minute delays, The Agreement is intended to facilitate transit trade between the three contracting countries. It will do this in part by filling the gaps in the international trade and transit treaties, conventions and agreements to which the three countries are already parties.

The agreement will provide a legal framework for efficient transit systems to and through Mongolia. In particular, it will guarantee freedom of transit by all modes of transport and promote simplification, harmonization and standardization of customs, administrative procedures and documentations. Consideration is being given to a quota system for trucks that give predetermined market shares to China and Mongolia for trucking services between the countries. While giving a measure of protection to Mongolian operators, in the long term such arrangements are contradictory to the concepts of competition and have proved almost impossible to regulate, and are not recommended. It would be better to restructure the Mongolian trucking industry so that it can compete in terms of service quality and price.

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Mongolia and China are both members of the World Trade Organization. Russia is intending to join the WTO, but the provisions and obligations of WTO membership, when it comes to the facilitation of trade and transit traffic, do not yet apply to the Russian Federation. It is possible that the proposed quota system for trucking services between Mongolia and China could be considered contrary to the terms of membership

of the WTO, as would most of Russia's restrictions on Mongolian trucks operating in its territory.

### **TIR Carnets**

Mongolia and the Russian Federation have both acceded to the Customs Convention of the International transport of Goods under cover of TIR Carnets 1975 (TIR Convention). As early as 2002, China expressed the intention to accede to the TIR Convention, but so far has not done so. The TIR Convention provides important facilitation measures for road transit traffic. However, there are certain constraints to use of the TIR System, which currently inhibit Mongolia from taking full advantage of its membership. In addition, if China were to accede to the TIR Convention it would have to permit trucks from its neighboring countries to operate freely within its territory, a measure that it has so far strongly resisted.

Mongolia is connected with Safe TIR network of the International Road Transporters' Association operational for 24 hours and within this framework General Customs Department of Mongolia updates and transmits international transportation information based on reports from customs at border crossing points and inland customs offices. The Mongolia National Road Transport Agency (MNRTA) is the accredited organization in Mongolia for issuing TIR carnets. The small scale of Mongolian international trucking operations creates many difficulties for the MNRTA. For example, after first accreditation the MNRTA purchased the minimum quantity (150) of carnets that have a two year validity before they expire. But in the first two years less than 40 carnets were issued, resulting in a substantial financial loss for the Agency. Through the support of TRACECA the NRMTA and its members received training in the use of TIR carnets and the NRMTA was provided with a training facility. In addition, the Asian Development Bank sponsored a two day training seminar for traders and customs staff on TIR in Ulaanbaatar in October 2007. Despite this support (that from TRACECA ended in 2003) and although Mongolia has ratified the TIR convention, it does not yet have national standards to organize transportation under TIR procedures. The main reason for delay in ratification is that Mongolia does not have adequate experience of conducting international road transportation.

### **Border crossings**

Mongolia operates total of 38 regular or temporary road border crossings, 12 with China and 26 with Russia. Among these crossings only three with Russia (Altanbulag, Tsagaannuur, and Ereentsav) and four with China (Zamyn Uud, Bichigt, Bulgan and Sumber) are open for international communications. All the others are open for national traffic only and then only for part of the year.

The international border crossing points with Russia are all open for customs clearance under TIR procedures. Inland customs clearance under TIR procedures takes place at the inland customs offices in Ulaanbaatar, Darkhan, Erdenet, Selenge, Bayan-Ulgii, Khovd, Uvs and Dornod province centers. All these border crossing points except

Ereentsav are provided with necessary terms and conditions to undertake customs clearance continuously for 24 hours.

Existing border crossings are not compliant with international requirements, in that they do not provide comfort, adequate facilities and services, and they only have low handling capacities. Highly bureaucratic border crossing procedures on the Mongolian side are compounded by equally if not more bureaucratic procedures on the Russian and Chinese sides of the borders.

### **Free Trade Zones**

There have been many previous studies of Mongolia's trade facilitation, so have there been many studies of the Free Trade Zones. We do not repeat the content of those studies more than is needed to give to context to how the FTZs could be used to help in trade facilitation.

Following legislation passed in the two previous years, in 2006 Mongolia established three Free Trade Zones, one on its border with China at Zamyn Uud, and two on the border with Russia, one on the main route north from Ulaanbaatar at Altanbulag and the other in Western Mongolia at Tsagaanuur, on the Russian border of the planned new north south connecting road to China. As with Free Trade Zones in other countries these are designed to provide complete industrial development services and offer favorable tax and land concessions.

The Altanbulag Free Trade Zone is aimed at the reprocessing of already partially processed and semi-processed products and exporting of final products to foreign markets. The main activities that it is hoped to attract are in the food processing and electronics industries. There is as yet no rail link to the FTZ, and this is a severe impediment to its development. The nearest the railway comes to the FTZ is about 25km at Sukhbaatar, at the border between Mongolia and Russia.

The Zamyn-Uud Free Trade Zone has similar objectives but is more oriented to commercial and tourism than industrial activities. Given the large range of Chinese products imported to *Mongolia* through Zamyn Uud this FTZ has more opportunities for value adding activities than the Altanbulag FTZ. There is also a hope that further processing of Mongolian products, including minerals based products, destined for China could take place within the Zamyn Uud FTZ

Both ADB and USAID have been active in advising on Mongolia's FTZ. This advice has resulted in some changes in the way that the program of FTZs is being implemented, but many of the recommendations still have to be adopted. More advice and progress has been given and made in relation to Zamyn Uud than to Altanbureg, largely stimulated by the congestion at Zamyn Uud during the summer of 2007 when there was a surge in imports to Mongolia to China. ADB is now assisting with detailed feasibility studies for the operation of new road and rail transfer and border crossing facilities at Zamyn Uud (and at prospective additional border crossings with China in South Gobi).

The four main recommendations of a 2004 USAID review of the FTZ program were that the Government of Mongolia should:

- undertake an economic cost-benefit analysis of the FTZ projects;
- undertake a full commercial feasibility study for the Zamyn-Uud Free Trade Zone;
- revise the legal and regulatory framework of its FTZ Program in accordance with best international practices;
- explore a leisure development concession in Zamyn-Uud in response to the identified market niche opportunity and potential investors' interest provided by its proximity to Erlian City in China.

So far as we are aware the first two recommendations have not yet been followed, although a feasibility study of the development of major facilities at the Zamyn Uud FTZ is now being funded by the ADB. Full cost-benefit studies and commercial and financial feasibility studies of both Zamyn Uud and Altanbureg still have to be made. The fourth recommendation should be included as part of the feasibility study of Zamyn Uud, and we understand that the legal and regulatory framework of the FTZ Program has been made.

**Figure 8 Current small scale trading activities at Zamyn Uud FTZ**



#### **h. Gaps in coverage of trade and transport facilitation**

There are some large gaps between what is needed to satisfy the demands for trade and transport facilitation and what is currently provided. Some of these gaps are being filled by projects of the ADB, but many remain.

## **Freight forwarding**

There are now eight relatively large freight forwarding companies that handle a minimum of 1,000 containers per year and have trained staff and adequate (but not necessarily good) terminal equipment and facilities. But the thirty or so smaller freight forwarding companies deal with a large number of smaller import consignments at a lower charge and with a much lower quality of service. It is these smaller companies that are in need of stronger financial backing and more training of their staff. They mostly lack terminals or adequate terminal equipment. These companies would be the main beneficiaries of any new Container Terminal or Logistics Center that might be provided.

## **Trucking**

Apart from the specialized trucking companies serving the mining sector, there are no large trucking companies in Mongolia involved in international trade, largely because until now there has been little demand for them. Most freight transport is undertaken by small trucking companies for small clients. Two of the freight forwarding companies have more than 10 large trucks for container transport while three others have between three and seven large trucks for this purpose.

Once the Ulaanbaatar to Zamyn Uud road is completed it is probable that there will be a large transfer of rail freight to road transport. Because of the distances involved (almost 800km) only relatively large trucking companies will be able to provide services. Unless these are created, either new or by amalgamations of current small companies, Mongolian trucking will be uncompetitive with Chinese companies and they will lose the market.

Given that it will be at least three years before the road is completed, there is still time to provide a regulatory and financial context within which mid-size Mongolian trucking companies could be operational in time for opening of the road. The regulatory context will need to include replacement of the current requirement of a permit for every international trip by a simple quality licensing scheme. The financial context will need to provide funding for the purchase of fleets of large trucks (costing about U\$200,000 each) and for the establishment of trucking terminals and maintenance facilities. Training of employees in the management of truck fleets and the marketing of services will also be necessary.

The current volume of international traffic, with total imports equivalent to about 20,000 trucks per year and non-bulk exports equivalent to only about 3,000 trucks per year, might be sufficient to support one combined logistics and trucking terminal for Ulaanbaatar. The present lack of a central logistics facility and of a trucking terminal where imports from China (currently by rail but soon also by road) can easily be transferred from international trucks (typically 5-axle semi trailers or 6-axle truck trailers) to trucks suitable for Mongolia's national roads (typically 2 or 3-axle rigid trucks), indicate that one such a center might be financially viable. Even in the unlikely outcome that all non-bulk international traffic were to transfer to road transport and

adding on the current volume of non-bulk transit traffic there would not be sufficient demand to support more than one such terminal. Even for one terminal to be viable, it would need to attract most of the international traffic current being handled by the three existing freight terminals

### **On-going and proposed ADB trade facilitation actions**

The ADB has been more active than the World Bank in studies and measures to facilitate trade and transport in Mongolia. ADB is currently funding a Customs Modernization Project and has recently completed a Trade Facilitation and Logistics Development Strategy Report. In addition, ADB is contributing to the funding of a road in Western Mongolia that is intended to facilitate better trade contacts between this region and the Xinjiang Autonomous Region in China and the Russian Federation.

#### *Mongolia Customs Modernization Project*

Mongolia's customs system will be upgraded through a US\$5 million loan recently (May, 2007) approved by ADB to improve efficiency, transparency, and sustainability in customs services and administration.

The current customs system is operated manually and labor intensive - i.e., traders must move from one customs processing point to another to seek official stamping and signatures. Human intervention in this process causes delays in customs clearance and is vulnerable to corrupt practices. It leads to lack of transparency and to unpredictability.

The existing capacity of the server and network system is low. Modern customs business processes such as risk management and post-clearance audits cannot be effectively or widely introduced because of the lack of an internet-enabled system and a centralized database.

The loan will upgrade the system to an internet-based technology and integrate it into a national system for e-government. It will also finance the improvement of the facilities at selected major customs houses and border posts.

The loan is from ADB's Special Funds resources (Asian Development Fund). It will have a repayment term of 32 years, including a grace period of 8 years, with interest charged at 1.0% every year during the grace period and 1.5% thereafter. The loan is supplemented by a \$500,000 grant from the Republic of Korea e-Asia and Knowledge Partnership Fund, which is funded by the Government of the Republic of Korea and administered by ADB. The grant portion will finance institutional strengthening. The Mongolian Government will provide the remaining \$1.26 million as counterpart financing.

The project is a response to the recent accession of Mongolia to the International Convention on the Simplification and Harmonization of Customs

Procedures (Revised Kyoto Convention) and the forthcoming enactment of a new Customs Law in Mongolia. It will also support the Government's recent initiative toward e-government and its effort to gear up the fight against corruption. The project will be implemented over three years by the Mongolian Customs General Administration.

#### *Trade Facilitation and Logistics Development Strategy Report*

The ADB has recently (December, 2006) completed a Trade Facilitation and Logistics Development Strategy Report. This was designed to lead to a Trade Facilitation project based on upgrading and expanding the Free Trade Zone at Zamyun Uud. Although the terms of reference were very ambitious, the final Report was rather modest. It did include an Action Plan, with infrastructure and policy actions included. Many of the proposals were expressed in very general terms ("build roads in Western Region", "promote meat processing"). While most of the actions are uncontroversial many of them are too general to be implementable. Some of those that are more specific ("Create a Lead Agency for Transport and Logistics Services") have already been implemented.

One group of actions (both in the infrastructure and policy areas) relates to providing improved container handling and storage facilities in Ulaanbaatar. If the Actions are implemented they would result in a smaller number of better equipped terminals than are currently provided. These terminals would include warehousing, cross-dock loading facilities, and facilities for freight forwarding and trucking operations. Most of the actions to bring this about would be taken by private operators who would need to give up some of their independence to operate from a joint-use terminal with other operators.

#### *Mongolia Western Regional Road Corridor Development Project*

With funding assistance from the Asian Development Bank (ADB), Mongolia has embarked on an ambitious road project that will link the nation's western region with the People's Republic of China (PRC) and the Russian Federation.

The Western Regional Road Corridor Development Project, at a total estimated cost of just under US\$200 m, will span nearly 750 km and become part of the Asian Highway Network, a 141,000 km road system traversing 32 Asian countries with links to European roadways.

The Project, which will be implemented in two phases, will also help Mongolia's economic growth through increases in tourism by opening the Altai region, one of the few ecologically unchanged sites left in the world. The area's uniqueness will attract conventional tourists, but it is also home to a range of archaeological sites that are expected to garner international attention.

For the first phase of the Project, ADB provided US\$37 million grant to Mongolia with the Government allocating US\$75 million. This phase covers 431 km of road from the border of the PRC to the Hovd province in western Mongolia. Construction will begin in the second quarter of 2009 and be completed in the first quarter of 2012.

## **i. Proposed Priority Actions**

The recent Trade Facilitation and Logistics Development Strategy Report published by the Asian Development Bank included a set of eleven Investment and fifteen Policy proposals. The CAEC Report on Mongolia Trade and Logistics: Assessment and Recommendations also includes 31 recommendations in relation to trade and transport facilitation, categorized as those aimed at facilitating international trade, those aimed at regional trade and those related to domestic trade. Through various reports and workshop presentations, UNESCAP has also provided many recommendations for improvements to Mongolia's trade facilitation. USAID has had a long term on-going project<sup>13</sup> to help improve the international competitiveness of Mongolia's exports. Among the many actions under this project have been assessments and recommendations for improvement to Mongolia's free trade zones and border crossing facilities.

There is a high level of commonality between the recommendations from these agencies, and many of the recommendations are supported by the analysis presented here. The first Annex to this report provides an indication as to which of the recommendations made here are new and which have been made in the ADB, CAREC, USAID and UNESCAP reports.

Several of the recommendations made here are new. The focus of the analysis and recommendations in this report is more on Actions that could be taken in the short term to facilitate a growth in trade, than on creating a framework for a Logistics Strategy which was the focus of the ADB report. All the proposed Actions have a high priority and many of them need to have their implementation completed before the Ulaanbaatar to Zamyn Uud paved road is open to traffic.

Four of the Policy Actions are related to the upgrading of Free Trade Zones and two to the restructuring the Mongolian freight forwarding and trucking industries. The creation of a Logistics Center in Ulaanbaatar is also categorized as a Policy Action as the role of the Government should be to facilitate its creation and not to invest in the Center. A final Policy Action is to decide how the Ulaanbaatar to Zamyn Uud road is to be operated.

### **Policy Actions**

#### **1. Expand and update the World Customs Organization needs assessment based on the SAFE program objectives**

The Needs Assessment of the Columbus Program of the World Customs Organization has been completed, and many of the recommended actions are incorporated in ADB's Customs Modernization Project, while some of the training

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<sup>13</sup> Economic Policy Reform and Competitiveness Project, active since 2003

actions are included in the technical cooperation agreement with the Netherlands. However, many of the policy actions included in the Needs Assessment remain to be addressed. There is now a need to reassess the proposals of the Needs Assessment, to determine which of its recommendations remain to be dealt with and to expand (to include other border agencies) and update the Customs Modernization Plan to take account of what still needs to be done.

*World Bank Action: Suggest that CMAG request update and expansion of Columbus Program needs assessment to take account of changes already made, and to expand the assessment to include other border agencies, particularly the SSIA, Following the update and expansion, the World Bank could provide funding for implementation of any remaining changes needed to comply with the SAFE program that are not covered by the ADB or Dutch Government activities.*

## **2. Establish genuine One Stop Shopping at all main border crossings**

The WCO Needs Assessment recognized the long term nature of establishing a Single Electronic Window (another way if considering “One Stop Shopping”) and the lack of coordination between Customs, Border Police and the SSIA. A National Committee on the Establishment of a Single Electronic Window (SEW) has been established under the leadership of the CGAM.

The ADB Customs Modernization Project will deal with the single window so far as it relates to Customs, but not the other border agencies, nor with the integration of Customs inspections with those of other agencies. USAID has a provided technical assistance to help establish a Single Electronic Window system for international trade, which might fill some of the gaps in the ADB project. But neither project will deal with inspections by the State Specialized inspections Agency (SSIA). Unless this agency’s inspections are coordinated with those of Customs there will not be genuine one stop border crossing procedure. Also, the SSIA will need vastly expanded testing facilities at Zamyn Uud if the inspection process that involves sending samples to Ulanbaataar for analysis is to no longer be an impediment to trade facilitation at the border.

*World Bank Action: Suggest to the State Specialized Inspection Agency that they request World Bank assistance to update their risk assessment procedures and to make the resulting risk assessment system compatible with that of Customs, so that any Single Electronic Window that is developed cover SSIA as well as Customss*

## **3. Complete the Customs Modernization Program**

The Customs Modernization Project (jointly funded by ADB, the Government of South Korea and the Government of Mongolia) will deal with risk management among many other issues, but again does not appear to be addressing combined risk management of Customs with that of other agencies. There also appears to be a financing gap of about U\$4 million in the implementation of the U\$32 million customs modernization program (based on the SAFE assessment undertaken by the

WCO). It appears that one of the main unfunded activities is the establishment of an effective post-clearance audit process.

*World Bank Action: Propose to CGAM that they request World Bank assistance in filling the implementation gaps in their Customs Modernization Program.*

*The three activities described could form components of a World Bank Trade Facilitation Support Project. It would support Mongolia's compliance with the WCO SAFE Program, ensure that any SEW covers all border procedures and provide funding for the post-clearance audit procedures in the Customs Modernization Program*

### **3. Assess the feasibility of the meat exporting industry to establish abattoirs and processing plants in the FTZs**

Two of the main logistics obstacles to development of the meat exporting industry are the lack of refrigerated transport within Mongolia and the need for Russian inspectors to visit Mongolian abattoirs to inspect sides of beef destined for Russia. Establishing abattoirs and processing plants at the Altanbuleg FTZ would address both these issues. There would be a predictable and reliable market for the use of refrigerated trucks within Mongolia and there would be a concentrated meat processing facility where phyto sanitary inspections could be made. Such an arrangement would greatly facilitate the export of meat products to Russia, Ukraine, and other countries of Central Asia and of the European Union.

For the development of meat processing plants in Altanbuleg FTZ to come about would need the active support of the private (Meat Producers Association and its members) and public (Ministry of Agriculture, Ministry of Foreign Affairs, Ministry of Transport). A commercial and financial feasibility study would be the first action to be taken in furtherance of this objective.

*World Bank Action: The World Bank would support USAID in proposing a commercial and financial feasibility study of the Altanbuleg FTZ. This study would include the feasibility of establishing meat processing and storage facilities at the FTZ, and of investing in a rail link to the FTZ. If this study should produce a positive outcome, follow up studies would indicate how the developments could be funded and the organizational structure within which they could be developed.*

*The World Bank/IFC could support any justifiable infrastructure investment including food processing and cold storage plants.*

### **4. Facilitate restructuring of international freight forwarding industry**

Facilitation would include training for FIATA examinations, and a system of accreditation of qualified companies. Accreditation would preferably be voluntary for companies fulfilling minimum financial, human resource and international certification requirements.

The International Association of Freight Forwarders (FIATA) has already expressing willingness to run training courses for obtaining its qualifications and certificates and the Mongolian Freight Forwarders Association has expressed interest in such support for its members.

Since it would take a minimum of one year for logistics operators to gain the qualifications, the new requirements could not come into force until 2010. While the new requirements are being prepared, the Ministry of Trade could also establish a new insurance law for international trade.

*World Bank Action: Technical assistance to establish a freight forwarders training course and to develop a certification process for freight forwarders could be included as a component of the Trade facilitation Support Project*

## **5. Facilitate the creation of more medium-size trucking companies**

When paving of the road to Zamyn Uud is completed, Mongolian trucking companies will face competition for transit and international traffic from more efficient and better capitalized Chinese trucking companies. While it would be possible to create a quota system that would guarantee a share of the China to Mongolia market for Mongolian truckers, this would result in unequal competitive advantage for trading companies able to use Chinese rather than Mongolian truckers, unless the relative efficiency of Mongolian trucking companies can be increased.

To better face this competition, or to be in a position to better negotiate joint venture agreements, Mongolian trucking companies need to be larger, better managed, have better access to finance and to upgrade their vehicle fleets. The efficiency of small trucking companies can be improved by schemes that give incentives for consolidation into larger companies and that give them access to better financial terms for the purchase of new and larger trucks and that give them incentives to provide a better service. Such schemes have been successfully designed and implemented in some African countries under conditions similar to those pertaining in Mongolia

A line of credit supported by an escrow account and managed by Mongolian banks could provide the financing for a first round of truck replacements and equipping maintenance depots. Training in management and truck operations would begin to make the companies more market oriented.

*World Bank Action: Establishing a procedure that would support the creation of a trucking industry that was competitive with that of China for cross border and transit trade could be another component of the Trade Facilitation Support Project. The World Bank has successfully re-regulated the trucking industry of Mexico to better face competition from US companies when the NAFTA was being designed and has successfully supported schemes that facilitated consolidation of the trucking industries in Nigeria and Zimbabwe.*

## **6. Facilitate the creation of a Logistics Center in UB, including a Cold Store in UB for the transport of meat to Ukraine**

Freight terminals in Ulaanbaatar are small, poorly equipped and (except for IFFC) badly located with respect to the rail and road networks. Private development of a new terminal (perhaps on the IFFC site) could overcome these deficiencies but will require concerted action by the public and private sectors. A cold store for the export of meat to Ukraine is also needed. Since the meat would be transported by rail, the cold store should be rail connected, and a good site would be the IFFC terminal.

There are now three other large freight forwarding companies so it is no longer necessary for Mongolian Railways to have its own freight forwarding company. Its privatization would reduce accusations that MR unduly favors its own subsidiary company. The current location of the railways freight forwarding terminal is one of the potential sites for a UB Logistics Center.

*World Bank Actions: The World Bank could suggest that the Ministry of Transport and Urban Development request World Bank assistance to review the needs for freight terminals in Ulaanbaatar to service international freight consignments. The review should cover the commercial, operational and financial feasibility of one or more new freight terminals for UB as well as assess the most favorable location(s). The review could be undertaken by the World Bank/IFC and possibly in coordination with USAID and ADB. If the review indicates that new investment would be justifiable, this could be supported by the WB or IFC, depending on the institutional and commercial framework proposed.*

## **7. Operation of the UB to ZU road**

The railway is expected to cover the costs of its infrastructure from the revenue from its operations. For road/rail competition to be equitable in the UB/ZU corridor, there would need to be some mechanism for the users of the road to contribute towards its maintenance costs and preferably also to cover the amortization costs of the loans taken for its construction. There are several ways in which user charges could be implemented to make charging for use of the road compatible with charging for use of the railway infrastructure. There is time between now and the opening of the road for these alternatives to be considered and, if appropriate, a charging system designed for implementation at the opening of the road.

*World Bank Action: The World Bank could suggest that the Ministry of Transport and Urban Development request the World Bank to include an operational and financial assessment of the UB to ZU road as part of the proposed Trade Facilitation Support Project*

## **8. Finance completion of the Ulaanbaatar to Zamyn Uud road**

Over the last ten years the ADB has already financed construction of about 730km of the 790km of this road. Funding of the remaining 62km was intended to be the contribution of the Mongolian government to the project to complete this road, but the resources were not available. The cost for 62km is estimated at about U\$28 million at current prices. An attempt was made to use a post-construction funding facility in which a private construction company would finance the civil works, with subsequent refunding by the government. This attempt was unsuccessful.

Until the road is completed it will be impossible for most of the benefits of completing the other sections to be realized. Once the road is completed, and provided implementation of the Transit Agreement with China and China's acceptance of the TIR Agreement are forthcoming, Mongolia's access to the large Chinese market will completely change as will its access to other markets.

*World Bank Action: Financing of the remaining section of this road involves some diplomatic considerations with the ADB, as funding of this section was supposed to be the Government of Mongolia's contribution to the ADB funding of a much longer section of the road. The World Bank could speak with ADB and the Ministry of Finance to see if there is any support for the World Bank to fund this last section of the road so that the benefits of the whole road can be realized. The total cost of the last section would be of the order of U\$30m to U\$35m.*

#### **9. Implement whatever comes out of South Gobi Regional Study related to trade facilitation**

*The South Gobi Regional Study is supported by the World Bank we would expect to be involved in its implementation. The ADB has already agreed to support many of the projects that would be expected to emerge from the Study.*

## Three Possible World Bank Projects

### **Trade Facilitation Support Project**

- i. *Update and expand WCO SAFE Needs Assessment (U\$0.25)*
- ii. *Update border risk assessment procedures of the SSIA (U\$0.50)*
- iii. *Complete the port clearance audit component of the Customs Modernization Plan (U\$0.25)*
- iv. *Commercial and Financial Feasibility Study of Altanbureg FTZ (U\$0.50)*
- v. *Commercial and Financial Feasibility Study of international freight terminals for UB (U\$0.50)*
- vi. *Implement training and certification scheme for international freight forwarders (U\$0.25)*
- vii. *Restructure international Road Transport Industry (U\$0.50)*
- viii. *Operational and financial assessment of UB to ZU road (U\$0.50)*

*This project would be mostly technical assistance but could lead to investment projects (Altanbureg FT, Ulaanbaatar International Freight Center). The project would be of up to U\$5 million if all the components were included.*

### **Road Infrastructure Project**

*Complete UB to ZU road*

*Review current designs, review construction contracts,  
Implement civil works, supervise construction*

*This would be a conventional lending project with a value of about U\$30 million. Given that all the final designs have already been completed, the project could be implemented very quickly.*

### **Urban Transport Development Project.**

*Although not part of this Trade and Transport Facilitation Action Plan, we include the following proposed Urban Transport Development Project that was prepared as a component of an Infrastructure Services Delivery Project in 2007.*

- *Traffic Management civil works, including junction improvements*
- *Bus priority system for Peace Avenue*
- *Traffic Safety measures, including an enhanced driver testing system*
- *Restructuring of urban bus services, including replacement of trolleybuses on Peace Avenue and more formal concessioning and financing of deficits*

- *A new “smart card” fare system that would allow interchange between buses without a fare penalty and be part of a new tariff system that changed the current general subsidy into a targeted subsidy*

*A PHRD grant had been secured to prepare this project, and this might still be available. The expected amount of the IDA contribution to the Project was expected to be about U\$15 million.*

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