

Korea-Mongolia Economic Relations: How Can They Be Reinforced?

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The Rise of Eurasia and Strategic Importance of Mongolia

Since the establishment of diplomatic relations between Korea and Mongolia in 1990, the two countries have promoted cooperation in various areas including politics, economy, society, and culture, and have even made impressive strides in several fields. Nonetheless, compared to other areas of cooperation, progress in economic cooperation between the two countries has been relatively slow. This is due to the fact that Mongolia is still viewed by Korea as a landlocked country with a small domestic market.

However, since the recent surge of the economic and political importance of the Eurasian continent, the strategic value of Mongolia has grown exponentially for Korea. Mongolia is not only one of the world's top ten countries with the most mineral resources, not to mention an agriculture and livestock sector that holds high potential, but also lies geographically in the junction connecting Europe and Asia. In addition to that, Mongolia is strategically located with direct access to China and

Russia, two of the largest emerging markets.

In this context, the strategic partnership with Mongolia from the Korean perspective is important for a number of reasons. Not only can Mongolia provide food and mineral resource security to Korea, but it can also act as a logistical bridgehead for Korea to make inroads into the Northern regions in the future. This is why the Park Geun-hye administration has chosen Mongolia as one of Korea's strategic partners in establishing Eurasian transport logistics, energy resources, and a trade network, goals pursued by the Eurasia Initiative. In this context, the purpose of this article is to review Korea-Mongolia economic relations for the past 26 years and to seek measures to reinforce economic cooperation between the two countries.

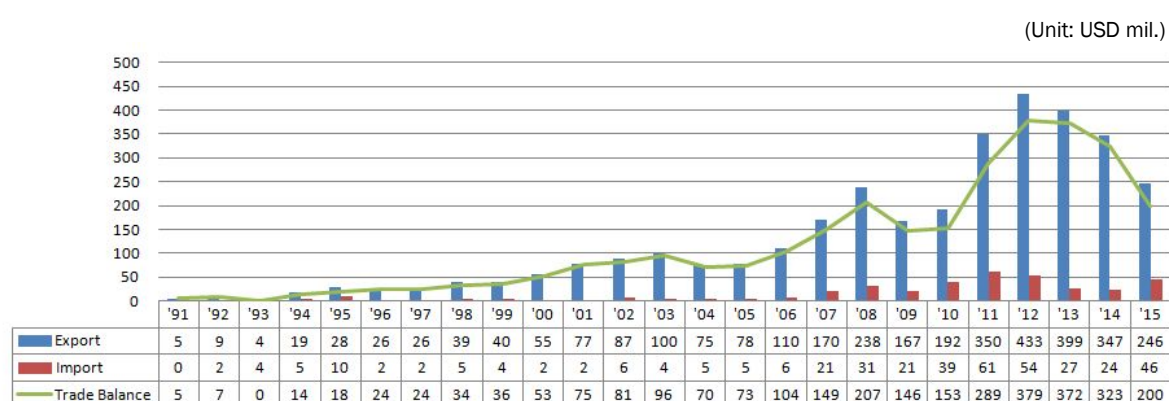
Current Status and Assessment of Korea- Mongolia Economic Relations

Korea-Mongolia bilateral trade jumped greatly from USD 5.73 million in 1991 to USD 487 million in 2012. Since 2012, however, trade be-

tween the two countries has steadily declined to record USD 292 million in 2015. (Mongolia's annual trade with China and Japan stood at USD 5.14 billion and USD 326 million, respectively, in 2015). On top of this, the bilateral trade structure is confined to a limited number of commodities. Korea mostly exports vehicles and mechanical appliances to Mongolia, and imports mineral resources such as copper from Mongolia.

Korea's top five export commodities to Mongolia in terms of 2-digit HSK headings make up 49.27% of total export to Mongolia. Meanwhile, Korea's top five import commodities from Mongolia make up 92.93% of total import from Mongolia. Such concentration on a narrow range of products makes the Korea-Mongolia trade structure vulnerable to external shocks.

Figure 1. Korea's Exports and Imports with Mongolia

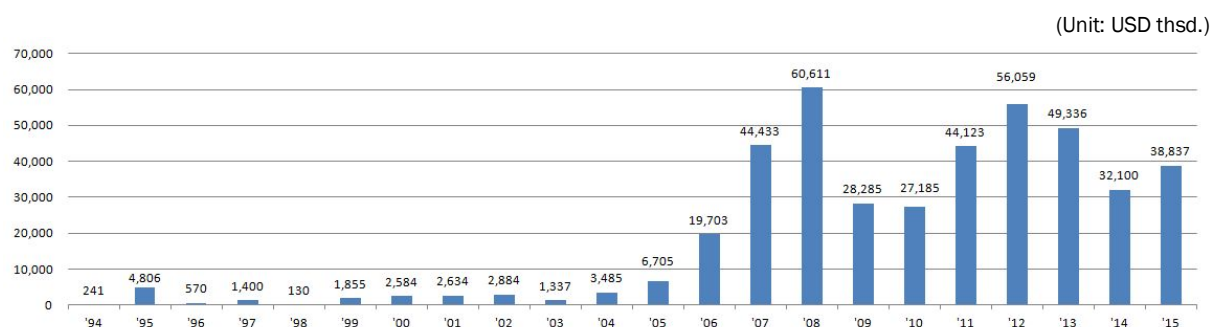


Source: Korea International Trade Association. (www.kita.net)

Korea's outward direct investment (ODI) in Mongolia which recorded only USD 241 thousand in 1994, has consistently exceeded USD 30 million since 2011. Still, IMF reveals that Korea's share in Mongolia's total inward investment position stood at only around 1.13% in 2014. According to the Export-Import Bank of Korea, Korea's ODI was mainly concentrated in the mining industry (33.88%), wholesale and retail trade (19.23%), and construction industry (17.33%) during 2010~2015. During the same period, small and medium-sized enterprises (SMEs) constituted 53.42% of total ODI, followed by large enterprises (33.87%).

Since the establishment of diplomatic ties, Korea-Mongolia relations have witnessed a stable growth, however in terms of economic cooperation, the two countries are still far from reaching full potential. The major hurdles that stand in the way of full economic cooperation is Mongolia's poor economic environment, such as frequent revisions of the law, serious corruption, an opaque administrative process, frequent changes of personnel, and breach of contract. On top of that, Korean firms face a lack of access to adequate market information in Mongolia.

Figure 2. Korea's Annual Direct Investment to Mongolia



Source: Export-Import Bank of Korea. (www.koreaexim.go.kr)

Promising Areas of Cooperation between Korea and Mongolia

In order to bring Korea-Mongolia cooperation to a higher level, first and foremost Korea must identify promising areas of cooperation. In this paper, it is recommended that future economic cooperation should focus on key areas indicated below.

Transportation and logistics infrastructure

Hemmed in between China and Russia, Mongolia is a landlocked country with no sea gate. Not only that, but due to low demand for transportation infrastructure owing to a low population density, Mongolia's transportation infrastructure, including roads and railroads, is outdated and in great need of modernization. According to the 2016 Logistics Performance Index by the World Bank, Mongolia was ranked 108th out of 160 countries. However, a recent surge in integration efforts in Eurasia is leading to growth in demand for transport and logistics infrastructure in Mongolia. In line with this trend, the Mongolian government is calling for greater efforts to improve the country's transportation and logistics infrastructure. The Mongolian government has developed the

Transportation Sector Development Strategy to build transportation infrastructure such as roads, railways, seaports, airports, and to establish a legal, institutional and regulatory framework.

The Mongolian government has also expressed interest in shipping bulk cargo from South Korea to Europe via the Mongolian railroad. The passage of transit cargo on the Korea-Europe route through Mongolia will lead to the rapid growth of Ulaanbaatar, and consequently to the development of infrastructure and reserved resources.

In 2013, China proposed the construction of an economic corridor linking Russia, China, and Mongolia. Mostly Chinese firms are expected to take part in the economic corridor project. However, there should be available opportunities for foreign firms in the finance and construction parts of the project. In fact, there is a possibility that countries through which Chinese economic corridors pass may become concerned over their dependence on China. The participation of Korean firms could ease such concerns.

Mineral development and processing

Even though the most promising area of economic cooperation between Korea and Mon-

golia has been identified as mineral resources development, bilateral cooperation is still insignificant. In the past, Korean firms, the majority being state-owned enterprises, sought aggressively to enter the mineral resources development industry, mostly to no avail. While some succeeded in developing mineral resources, they faced difficulties in shipping the products to Korea, due to the compulsory transit through China or Russia. Therefore, it is crucial for Korean firms to secure the cooperation of China and Russia when investing in the Mongolian mineral resource industry. The Korean government should negotiate customs procedures with the Chinese and Russian governments as well as railroad transport permits and quotas. Korean firms find it challenging to export mineral resources from Mongolia, as it is hard to obtain space on Chinese freight trains, not to mention the high rates for using the port of Vladivostok. One of the ways to overcome such challenges is for Korean firms to form joint ventures with Chinese or Russian firms.

Plant and Construction

Korean firms need to invest not only in upstream, but also downstream projects. Mongolia holds a negative perception of foreign firms extracting and exporting raw resources without processing the materials inside the country. The Mongolian government, for the sake of job creation and the enhancement of the industrial structure, encourages foreign firms to process raw resources locally. In this regard, the demand for copper smelter, steel mills, oil refineries, and coal preparation plants will likely rise in the near future. Korea should therefore give positive consideration to entering these markets. On a different note, Mongolia's urban development, housing, and construction markets are other promising areas in which Korean firms can consider expansion.

These sectors will be supported by the government's Ulaanbaatar 2030 Master Plan to build satellite cities to help reduce overcrowding in major cities. In addition to that, there is also growing demand for housing, commercial buildings, and hotels centered on Ulaanbaatar. Such demand is projected to grow if global commodity prices were to rise.

Financial Sector

The Mongolian financial sector, still in a very rudimentary stage, is mostly comprised of a banking sector and the capital market that do not play a leading role. Since the banking sector typically provides short and mid-term maturity loans only, Mongolia is faced with limited long-term financing for economic development. Therefore, the Mongolian government's desire to improve the financial sector is strong yet the shortage of highly-skilled specialist and financial knowledge has been a major stumbling block in developing the sector. In this respect, it will be mutually beneficial for both Mongolia and Korea if Korean firms decide to enter the Mongolian financial sector. This will promote financial knowledge spillovers in Mongolia, and Korean firms will be able to gain a competitive advantage in market share. However, when entering the market, Korean firms should consider forming joint ventures with Mongolian stakeholders, so as to minimize risks by allocating responsibilities.

Agriculture and Livestock

The agricultural and livestock sector of Mongolia hold great economic potential, as hormone-free organic qualities of meat and organic grocery are in high demand in international market. Yet the existence of poor quality and inadequate domestic infrastructure to meet international standards and trade requirements has prevented Mongolia from expanding export markets. Therefore, there are a

lot of business opportunities in improving herders' living standards and infrastructure, which are worthy of attention from Korea. In conjunction with that, Korean firms can produce environmentally friendly organic grocery and meat product in Mongolia to export to circumjacent countries such as China and Russia.

Tourism

Mongolia, a country with rich and ancient heritage, unique culture and astounding natural beauty offers great potential in the tourism sector. It is therefore no surprise that the tourism sector is viewed as a strategic and priority sector by the government of Mongolia, which has set a target to achieve one million annual visitors by 2020. Despite the government's ambitious plan, achieving this goal will not be a smooth ride in the absence of bold measures to improve tourist infrastructure and services. According to the Travel and Tourism Competitiveness Report 2015, Mongolia ranked 99th place among 141 nations, and poor infrastructure has always been regarded as a big obstacle for attracting international travelers to Mongolia in the past. In this respect there is growing internal demand for better tourist infrastructure, which should be taken into consideration by Korean firms.

framework for long-term strategies on political and economic cooperation, and should therefore be held on a regular basis. Second, a visa exemption agreement and free trade agreement should be negotiated. Thus, it is important for the two countries to conduct joint research, and for Korean FTA experts to share their past experiences and expertise with Mongolian experts. Third, with regard to Korea's cooperation with Mongolia, channels for high-level cooperation should be fully utilized to reinforce high-level personal networks. Revising and strengthening the Korea-Mongolia Parliamentary Friendship Group is important, since major decisions, including mineral resources exploitation rights, are determined by the Parliament of Mongolia. Last but not least in order to strengthen economic cooperation between Korea and Mongolia, the two parties must lower airfares by increasing flights. Flight time between the two countries is about three hours, yet an expensive round trip airfare and a limited number of flights have been pointed out as one of the obstacles to expanding cooperation between two countries. **KIEP**

Recommendations for Strategic Economic Cooperation between Korea and Mongolia

The following are policy proposals for strengthening and deepening economic ties between Korea and Mongolia. First, Korea and Mongolia must hold regular summits. Bilateral summits provide an institutional