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**POSSIBILITIES AND INTERESTS OF FREE TRADE  
AGREEMENTS BETWEEN MONGOLIA, CHINA,  
AND RUSSIA**

蒙古國與中國和俄羅斯自貿協定的可能性與利益

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蒙古國與中國和俄羅斯自貿協定的可能性與利益  
Possibilities and Interests of Free Trade Agreements  
Between Mongolia, China and Russia

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## ABSTRACT

With the modern globalization era, the economies of the countries are becoming increasingly interdependent and even mutually complementary with the economic integration. In this case, the international trade, economic cooperation of the national economy, the interests and influences of the citizens are growing more intensively each year. For Mongolia, its issues facing the trade industry to lower its domestic market due to the small amount of the customers/small population/geographical location/landlocked/ high transportation costs which are raising the prices but lowering the competition possibilities of the raw materials originated from Mongolia. Theoretically, there are three basic methods to reduce these costs of the transportation.

1. To develop the transportation infrastructure
2. To establish Free Trade Agreements /FTA/ in order to trade with the close-by countries
3. To sell products that must low transportation costs

The international experience shows that the use of these methods alone is better to use in combination to improve economic efficiency and competitiveness. The increasingly growing importance to improve the mining and industrial sectors of Mongolia will give more rapid economic development by joining certain economic groups and creating more FTAs. As it is possible to have positive and negative economic impacts from joining FTAs to the certain countries, it is important to make forecast analysis of the country's economy to see their influence in the economic sectors and the possibilities for the economic growth of the creation or establishment neither of the FTAs nor with which countries. In the following work, I will do a research analysis on the possibilities to make a trilateral FTA between Mongolia, China, and Russia; to analyze the importance and risks from the establishment of the FTAs to the country's political, social, economic and legal environments. By doing this, I will make a comparison to each country in terms of the international legal norms, recognized principles of the international relations and universally accepted the comparative evaluation of the summarized results to a number of techniques.

**Keywords;** Mongolia, Russia, China, FTA, economy and trade policy of Mongolia, foreign trade possibility in Mongolia

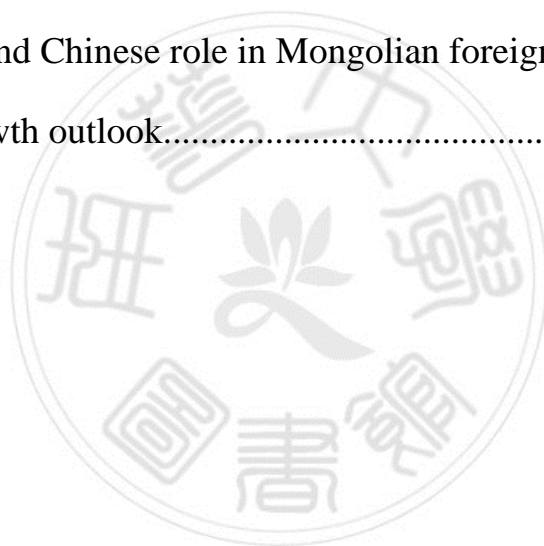
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# CHAPTER 1

## INTRODUCTION

In the studies of the economic and legal environment for creating of FTAs between Mongolian, China, and Russia, firstly, I studied their policies to each neighboring countries, secondly, the foreign relations, the cooperation works in foreign economies, trade and investment policies, thirdly, the found successes, progresses and disputes of these countries from their cooperation works. Mongolia is developing its own economic diversity policies as “the third neighbor” in order to neutralize the influence of the major powers on the basis of such benefit neighboring Mongolia where disproportionate and too big structures of these countries, such as China and Russia, are lowering its economy. This started to give its benefits and the investments from the third-countries are particularly increasing. Mongolia has set the goals to reduce their neighbors and import dependencies focused on measures to change the export structure. Regarding the Government programs for 2012-2016, the Government started to implement policy measures to intensify the implementation of the railway transport policy. The government approved the Food Safety and industrial programs in order to start the production of the construction materials in the country; to improve the agricultural production sectors by eliminating the dependency from individual and small countries in order to enhance its own competitiveness; to supply the mining and industrial products in the market prices prior to own country; to give privileged rights to the national companies goods supply, works and services to the subcontracted projects being implemented in the mining sectors; to reduce the export of the materials in raw forms in continuous stages and phases, to increase the export of value-added products by gradually adding the processing levels of the products according to international standards and policies; to build a metallurgical complex plant-based on modern technologies available in Darkhan and Selenge regions; to start the value-related and taxation policies to encourage value-added, finished or semi-finished products and raw materials produced in the mining industry; and finally to reduce the economic dependency from the mining sector by ensuring the long-term sustainable growth and competitiveness. In addition, in order to have mutual benefits with its neighboring countries measures were taken to ensure the economic growth through the implementation of quality reconstruction of the large-scale development projects.



## 1.1 Mongolian-Chinese relations

China regarded as a continuous and biggest trade and economic partner of Mongolia for the past 16 years from the second half of the 1990s. By 2016, the Mongolian-Chinese trade reached to USD5.9 billion with USD4 billion in exports and USD1.8 billion in imports.<sup>1</sup> Also, China became the largest investor in Mongolia for the last 17 years as the Chinese investment reached to USD384.4 million in 2016. In other words, its accounted 48.8% of all foreign investments in Mongolia which is 3 times bigger than the total sum of the investments made by Japan, United States, South Korea and the European Union altogether.

The Chinese influence and participation in the Mongolian economy continuously grows and gives a favorable influence but on the other hand, being too dependent on a single country will adversely affect the national security of the Mongolian state. Although between the two countries, Mongolia and China still have interest differences, the further relation approaches are increasing. By the establishment of the strategic partnership between Mongolia and China in 2011, it started the beginning of the new stage of the bilateral relations and principles have started. In 2012, the strategic program was established between Mongolia and China to develop its partnerships include:

1. Signed Memorandums of Understanding in the mining and oil sectors to build a plant for gasification of the brown coal deposits in Mongolia to export the produced gas by parties.
2. Confirmed the cooperation to increase the amount of fuel and oil supply from China.
3. To receive up to 10.000 tons of the MGL-93 gasoline per month, to build additional extension in the transportation equipment in Zamiin-Uud's port to receive 35-40 thousand tons of the liquid fuel per month. To build a railroad connecting the Mongolian Gahsuun Sukhait's and Chinese Gants Modnii border ports etc.

In doing so, China will have more profits from the supply of the materials as both countries made a joint reconstruction of the economic development. Which increase Mongolia's economic growth and the possibilities to go out from the economic dependency in other words.

The Chinese policies used for Mongolia is very similar to those for the Central Asian regions or can be regarded as the part of these policies. The Chinese interests in purchase natural resources and gas in above regions and to establish a strategic partnership with countries adapted

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<sup>1</sup> National statistics office of Mongolia "Foreign investment in Mongolia," *Mongolian statistical yearbook 2016*, (national registration and statistics office: Ulaanbaatar, 2017) pp.203-247.

similarly in Mongolia. Of course, the Chinese economy and market are still big for Mongolia but Mongolian mining products are very important for the Chinese economy and further it will be more necessary. The Chinese economy depends on the imports of Gold, Silver, Copper, Iron, Lead, Manganese, Nickel, Uranium, Potassium and oil reserves or deposits in their own territory. The mineral resources of Mongolia are included to the list of the most needed minerals in China. On the other hand, mineral rich resources are located in western, southern and eastern regions of Mongolia which are close to the Chinese borders. Thus, the China tends to use the Mongolian policy to use its own mineral resources in order to develop its own country by attending in the extraction of the mineral deposits which is considered to be guaranteed<sup>2</sup> for mineral resources essential to the economic development.

China is interested to enable its political and economic ties with Mongolia as it can be seen that they are trying to prepare the basis to deepen relations and cooperation by resolving understanding problems from its previous relations with Mongolia.

China and Mongolia have two different concepts and principles for the Mongolian history, also the Chinese citizens violates a lot the Mongolian laws during their stay in country which affects the relationship between two countries by giving anti-Chinese views by the local people.

China started to recognize those negative to affects and started to implement policies to correct these misguided impacts. During the reception of the Mongolian PM N.Altankhuyag in China, the Chinese President Xi Jinping noted about the needs to enhance the further mutual trust between two countries by emphasizing the importance of installation<sup>3</sup> of the strategic partnerships on the motivation of the people's desires. China is still citing that all problems affecting to the relations between two countries are from the Buddhism and political problems related to Tibet where Mongolia is highly involved but Mongolia wants to be non-related to Dalai Lama and to develop dependently the Buddhist religion. China is avoiding explaining their concepts and principles about the real Mongolian history in the political framework.

The established agreement of 2003 with China and Mongolia was named as "the neighborly relations based on mutual trust" which was used for the countries conflicted with

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<sup>2</sup> Mutual benefits based Mongolian-Chinese economy - trading relationship, Northeast Asian Economic Forum. (July.2011) vol.5, p.27,

<sup>3</sup> Xi Jinping's talk with the Mongolian Prime Minister N. Altankhuyag during their meeting (22.8.2014), <http://mass.mn/t/top?page=194>

China and later, these agreements were transferred to the “strategic partnership” types of the agreements which show the increase of the Chinese-Mongolian relationship ties. It also can be seen from the words of the Chinese President Xi Jinping told to Mongolian PM N.Altankhuyag during his visit to China their interest to promote the cooperation works between two countries. As he said “China wants to trigger a signal about the cooperation of medium- and long-term programs in Mongolia for strategic partnership. To do this we need to raise the levels of the practical actions and in the same time, to keep open the Chinese market, funds, labor force, techniques and road connections to Mongolia by using each other’s advantages by both sides by discovering together the mineral and natural resources, to build the infrastructure and to implement the banking and financial 3 sectors we must comply with the proposed general concept “by forwarding the three combined plans”<sup>4</sup>. In the recent times, the Chinese researchers started to note during their works about the Mongolians “We will not only protect the Chinese interests but also we need to think about the protection of the Mongolian interests. China has specific and certain political goals in giving aids to the educational sectors. The Russians still have a great attention to the preparation of the Mongolian specialists and professionals. It is easy to understand what people will do in the Russian-Mongolian relations when they have received their education in Russia”<sup>5</sup>, from where we can see another side of the Chinese educational aid policies.

## **1.2 Mongolian-Russian relations**

After the fall of the former Soviet Union, between 1991 and 2001, it is possible to say that the two countries were renewed their bilateral relations based on equality and the principles of the mutual benefits with non-intervention in the communication contents and as the era of the renewed forms, natures, measures and mechanisms. The official visit of the Russian President Vladimir Putin to Mongolian in November 2000 created effective mechanisms to the new levels by taking out the stagnation and also he signed a stimulated letter of Ulaanbaatar city to enable all relations between two countries.

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<sup>4</sup> Xi Jinping’s talk with the Mongolian Prime Minister N. Altankhuyag during their meeting (22.8.2014), <http://mass.mn/t/top?page=194>

<sup>5</sup> Mutual benefits based Mongolian-Chinese economy - trading relationship. Northeast Asian Economy Forum. 2011 vol.5 p.28,

From 2009, it's entered the qualitative new stage of the cooperation and to the strategically partnership levels. The most political and economic relations' concern of Mongolia and Russia was the issue related to the national debt given from USSR to the Mongolian People's Republic. This debt was arisen between 1949 and 1991 with the 34 agreements between two countries after receiving a credit of 11.8 billion of Russian rubles. Specifically, 9.6 billion from it was the outstanding debt and 2.2 billion rubles were the interests.

In order to solve this problem, the leader of the Mongolian Government, N.Enkhbayar made a negotiation with Russian PM M.Kasiyanov in 2003 by making Memorandums of Understanding and they were decided to transfer the debt of 11.8 billion of rubles to Russia but with the 97.8% discount over the total debt.<sup>6</sup> The remaining 2.2% or USD250 million was finally resolved in December 2010 which was a very important step to tighten the trade and finance relationship of two countries by giving a favorable opportunity for the investment co-development for further Mongolian-Russian relations.

Comparing to the Mongolian-Russian high leveled political relations the economic relations and cooperation works are left behind. Regarding the situation of the last 5 years, Mongolian foreign trade with the Russian Federation is decreasing by the share of the percentages. The exported goods and materials from Russia have a few names and types but the Russian export amounts are higher from Mongolian export amounts.

From another side, the decreases of the Mongolian export amounts are pushing to the trade deficit and lose of the balance. Although the total trade amounts of two countries are growing, for Mongolia, we have a high loss of the trade. By the situation of the first eleven months of 2013, the trade turnover amounts between Mongolia and Russia has reached to USD1.477.3 million and the balance of country side had a loss with the amount of USD1.366.6 million. This covers 68.5% of the total trade deficit in Mongolia.

While the amount of Mongolian exported good to Russia reached just to 1.79%, the imported goods from Russia were accounted for 26.94%. Mongolia was not mentioned in the major policy document of Russians with the compliance to the Foreign Policy Concepts adopted

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<sup>6</sup> Agreement between the Government of the Russian Federation and the Government of Mongolia on the settlement of Mongolia's financial obligations to the Russian Federation

[http://mid.ru/BDOMP/spd\\_md.nsf/0/2B1619D9A4372AC444257C6100351B9D](http://mid.ru/BDOMP/spd_md.nsf/0/2B1619D9A4372AC444257C6100351B9D)

in 1993 but during its update in 12 February 2012, in the section related to the Russian Federation's foreign policy concepts of the regional direction they were noted that they "will strengthen traditionally friendly relations with Mongolia".<sup>7</sup>

The Russian researchers still noting that the Russian policy for Mongolians is not optimal. For example, in his book "Russia and Mongolia: A new relations' model in the beginning of the 21<sup>st</sup> century", the author V.A.Rodionov wrote: "It is correct to Russia to deal with Mongolia for own political and economic interests but also it is not important to create own strong positions in this country. It is not a good idea to use the political and economic incentives as the main tool to reach to own goals. Russia must coordinate their own policies and activities to the already selected economic development models of Mongolians or will lose advantages left in this country from the socialist times if we will continue not understanding these issues. Also we must understand that there are no more special rights to control their mineral resources, Russia is only one of the countries participating in the competition so it is important, thus, the Russian leaders and Mongolian people must develop country own business competitiveness's".<sup>8</sup>

### **1.3 Russian-Chinese relations**

As Russia and China plays an important role in the global policies their coordination is essential component of the system. China and Russia are the neighboring great powers and as their profits or interests are always sharpened in the past, their relations were not stable and changed a lot.

The Chinese implemented a policy for Russians in 17 July 2001 as "the Good-neighbors, Friendship and Cooperation Agreement" which is based on the previously made agreement with the same name of 2005. Regarding to the provisions of these documents, the relations and cooperation between these two countries are intended to have long-term natures and to promote the development of the bilateral relations for their prosperities and foreign policies in order to protect their interests, cooperation and to deepen their activities and protect rights in international levels.

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<sup>7</sup> Priorities of the Russian Federation in solving global problems. The Concept of Foreign Policy of the Russian Federation. <http://www.mid.ru/bdomp/ns-osndoc.nsf/e2f289bea62097f9c325787a0034c255/c32577ca0017434944257b160051bf7f!OpenDocument>

<sup>8</sup> Radchyenko.S , "Sino-Russian competition in Mongolia, (Moscow: 2013)"pp.14-16.  
[http://www.lse.ac.uk/IDEAS/publications/Analysis-Archive/ideasToday/04/04\\_Mongolia.pdf](http://www.lse.ac.uk/IDEAS/publications/Analysis-Archive/ideasToday/04/04_Mongolia.pdf)

China has a high leveled strategic partnerships and relations with Russia, these two countries are mutually protecting their common interests, always show same views in the UN Security Council's meetings and by the views of some researchers, these two countries have similar positions in the Asian countries, also they have common issues on the UN reforms and opinions, has global cooperation within the framework of the Shanghai Cooperation Organization (SCO), Brazil, Russia, India, China and South Africa, joined together on the proposed establishment of the International Monetary Fund, participating together in the World bank's activities in order to control the international credit mechanisms and preparing the agreements with other powerful countries to restrict the dollar use in the trade and market activities which shows that their relations are improving from the previous decades. Although these two countries have competitive strategic partnership relationships, in real-time it is not working. This can be explained as they do not have a political trust between them. This also can be seen from the words told by the Chinese authorities to the Russians during their visits to Russia as "they need to strengthen and deepen their further relations". For example, just after coming to the government power in March 2013, Xi Jinping several times announced about the needs to deepen and strengthen two sides' strategic partnership between the two countries during his visit to Russia. The Russian policy for Chinese is passive from one side, and from other side, is "not clear" which can be explained as the Russia look to China not as a partner but the Competitor. The Russian uncertainties or their " not clear strategy " particularly reflecting directly to the bilateral relations or especially to the economic relations of two countries. The researchers are always noting that the relations between these two countries are lower from the minimum levels which can be seen from the Chinese investment amounts made to Russia. The European Union is the main economic partner of the Russian Federation; China is in the second position. In the Chinese list of 20 partner countries Russia is positioned in the 10th place. During the official visit of Mongolian PM N.Altankhuyag the Chinese also made their visit where they are made more than 20 agreements with the Russians but it is observed without any further sign of progress in their bilateral cooperation. Russia is concerned about the Chinese-nominated project "Silk Road" as this can make obstacles in their activities related to the Euro-Asian businesses. On the other hand, this project will not be limited in Central Asia but will also cover Southern and Eastern Asia including the Euro-Asia. It is possible to regard it as Russians have anti-initiatives to this project as the most of the Central Asian countries were in the sphere of the

Soviet Union and regarded as their own influence-making territories. In this way, China is increasing their influence in Central Asia by using their financial and economic opportunities while Russia is stopped to hide their view about China as their main competitor. The Chinese projects to build a railroad connecting China with the Europe via Kirgizstan, Uzbekistan, Iran, Turkmenistan and Turkey are in the way to fail as with the creation of this route there are a possibilities that the Russian “Trans-Siberian” and “Northern Sea Route” will become not important. Also, the Central Asia is already becoming a commodity market for the Chinese products. But due to the deterioration of their relations with the United States, their relations are getting closer. However, the specialists believe that these countries will not create an alliance against the US. Mongolia is always switched between the Chinese and Russian relations who can be seen as one competition field of these two countries. This is connected to the natural resources of Mongolia and the geopolitical issues of two countries. Russia is still using today the same policy that they used before during the Soviet Union. China is also always competing for its interests in Mongolia but it is not clear about country role in Chinese global and geopolitical plans. Although it sounds like this, Mongolia is supporting the China’s wish to strengthen their trade connections with Central Asian countries, Mongolian PM N.Altankhuyag is already declared to actively participate in the Chinese development if the “Silk Road’s Economic Free Trading Zone” which can be seen as the results of the cooperation and policy statements in the region.

Regarding to the Russian customs’ data, the total trade turnover between these two countries in 2000 has reached to USD5 billion which was increased by 16 times after 11 years or in 2011 has reached to USD83.5 billion which was 42.7% higher from the previous year, USD90 billion<sup>9</sup> in 2012, USD81.76 billion in 2013 where the amount from the import has reached USD36.518 billion and from the export to USD44.558 billion.

According to the Chinese statistics, the Chinese investment in Russia reached to USD30 billion. In 2012, the Chinese PM Li Keqiang signed 27 agreements for USD15 billion during his visit to Moscow city in Russian Federation where he also made some meetings related to other investment issues to the industry.

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<sup>9</sup> Official internet resources org the president of Russia, “Russia and China: New Horizons of Cooperation,” (Moscow: may.2012), <http://www.kremlin.ru/events/president/news/15547>



In recent years, China has defined new policies to their bordering countries where they started to focus on the development of the free trade and economic zones which are becoming some kind of the concept as “the Chinese economic circle” and which is already been taken. Mongolia, as the country bordering with China and Russia, is able to participate in the policy known as the “economic circle”. China is also interested to bringing two neighbors to their project which can be seen from their double reception of the Mongolian and Russian PMs in November 2013. There are the possibilities to build trilateral FTAs if favorable conditions will have in the Mongolian-Chinese and Chinese-Russian relations but this will highly depend on the courage of the Russians. “Thus, regarding the circumstances happening between the Chinese and Russian relationship problems it is possible to say that the great powers cannot make alliance (except some specific issues), they can become the competitors only” were concluded by the Russian researchers<sup>10</sup>.

#### **1.4 The current situation of the tripartite cooperation between Mongolia, Russia and China**

The trade should be added to the relatively high level of the economic integration in order to create the tripartite cooperation between Mongolia, Russia and China. So I tried to study and investigate the levels of the trilateral cooperation.

Currently, the highest leveled tripartite mechanism to create the tripartite cooperation between Mongolia, Russia and China is to organize a meeting for all three Ministers of Foreign Affairs. Until today, they were already 9 meetings. The 8th meeting organized on 29 October 2012 which was held in Moscow for the first was organized as the official meeting for all three Ministers of Foreign Affairs of Mongolia, Russia and China. The parties are regarded this meeting as very important as the sides were successfully challenged to the overcoming trilateral projects to discuss their mutual issues of the bilateral and multilateral cooperation. The sides also noted that there is absence of unresolved historic issues between the trilateral meeting participants and in the future the sides will express their commitment to mutual support for protecting their rights, security and vital interests, to continue the development of the real cooperation by exchanging the sectors such as the three-way trades in the economic and humanitarian aids and programs, to work together toward the achieving to the higher levels of

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<sup>10</sup> Dave Lodyga. “Russia and China Mongolia relations,” *Moscow Times*, Sept 1, 2016, pp.12-20



the strategic partnership between the three countries. Also the sides believe that the development and cooperation of three countries in three-way trades will give priority areas of the real economy which will improve the infrastructure mining, transit, transportation, construction, tourism and environmental protection sectors.

The project to build a transit way via Mongolia between China and Russia had a substantial progress by the help of the Mongolian side during the trilateral meeting of 17-18 January 2011 which was held in Beijing city of China for Mongolia, Russia and China. In 24 June 2016, a meeting between the member-countries of the Shanghai Cooperation was organized and held in Tashkent city of Uzbekistan. During this meeting, the leaders of Mongolia, Russia and China were signed the agreement to create an economic corridor between these three countries. In this program they are decided to implement 32 projects for the next five years and by the implementation of these projects there are will be a basis to establish the FTA between these three countries.<sup>11</sup>



## **CHAPTER 2 LITERATURE REVIEW**

This paper aims to serve as a contributor to extensive preparatory work for the potential free trade agreement (FTA) between Mongolia, China, and Russia. At the outset of this paper though, it is important to describe the notion of free trade and its historical origin, as a well as a free trade agreement and its different types.

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<sup>11</sup> Batbaatar.B, "During the trilateral meeting," Dally news, Jan. 30, 2017, p.2.

## 2.1 Origin of free trade

Over the past centuries, free trade policies have battled with mercantilist, protectionist, and isolationist, communist trade policies. Economists who advocated free trade believed the trade was the primary reason for nations to prosper economically. The nation of a free trade can be traced back to two British economists Adam Smith and David Ricardo, who later developed the idea of free trade into its modern form. Adam Smith laid the foundations of classical free trade theory by introducing the main concept of absolute advantage in his book *An Inquiry into the Nature and Causes of the Wealth of Nations*, usually known as *The Wealth of Nations* in 1776. The principle of absolute advantage refers to the ability of a country to produce a greater quantity of a good, product, or service than its competitors, using the same amount of resources. Smith argued that it was impossible for all nations to become rich simultaneously by following mercantilism – an economic theory and practice that was dominant in Europe from the 16th to the 18th century because the export of one nation is another nation's import. In countering this, he stated that all nations would gain simultaneously if they practiced a free trade without the restriction of government policy or interference and specialized in accordance with their absolute advantage<sup>12</sup> Smith also noted that the wealth of nations depends upon the goods and services available to their citizens rather than the amount of gold they reserved by promoting exports and discouraging imports as advocated by mercantilism.

However, since absolute advantage is determined by a simple comparison of labor productiveness, it is possible, for a party to have absolute advantage in nothing; in that case, according to the theory of absolute advantage, no trade will occur with the other party. To fill this critical void, David Ricardo developed the classical theory of comparative advantage in 1817 to explain why countries trade with each other even when a country has the absolute advantage over other countries. According to the comparative advantage theory, a country has a comparative advantage over another in producing a particular good if it can produce that good more efficiently (at a lower relative opportunity cost) than it produces other goods, which shall

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<sup>12</sup> Monica Das, "Absolute and Comparative Advantage," *Encyclopedia.com*, (June 9, 2017).

<http://www.encyclopedia.com/social-sciences/applied-and-social-sciences-magazines/absolute-and-comparative-advantage>

be imported. The principle of comparative advantage holds that under free trade, a country should specialize in producing more of and consume less of a good for which it has a comparative advantage. Ricardo's theory demonstrates that international trade owes more to comparative advantage than absolute advantage.

Guided by these theories of Adam Smith and David Ricardo, the nature and scope of bilateral trade treaties saw a major shift in the 19th century as the countries started abandoning mercantilism and moved towards more openness and liberalization. This shift was prompted by a huge expansion in international trade by Great Britain's rapid rise as the world's economic power and a staunch supporter of free trade. Most notably, it led to the signing of the Cobden-Chevalier Treaty between Britain and France in 1860,<sup>13</sup> which for the first time involved significant reciprocal tariff reductions between the two countries and included a strong most-favored-nation clause (MFN clause - the principle of not discriminating between one's trading partners). It further led to successive agreements between other countries in Europe and also created an early form of the multilateral trade agreement.

## **2.2 Free trade agreement and its types**

As one can imagine, tariffs, non-tariff barriers, and prohibitions are the main instruments that regulate international trade. Trade agreements are one way to reduce these barriers, thus bringing the benefits of increased trade. Such agreements involve cooperation among participating countries to reduce trade barriers and to increase trade of goods and services with each other. Therefore, in general, an FTA can be described as a negotiated agreement between countries or customs territories under which they agree to lower tariffs, as well as reduce non-tariff barriers, on goods and services imported from the other members.

International trade is closely connected to economic integration between countries as the elimination trade barriers leads to a deeper economic integration. According to the Hungarian economist, Bela Balassa's Theory of economic integration,<sup>14</sup> economic integration can take several forms that represent varying degrees of integration. These are a free-trade area, a customs union, a common market, an economic union and complete economic integration. A free trade

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<sup>13</sup> John Ravenhill, *Global Political Economy, edition*, vol.5, (Oxford University, 2017), pp. 3-26,

<sup>14</sup> Bela Balassa, *The Theory of Economic Integration*, (Great Britain: Richard D.Irwin 1961 ) pp.1-21,

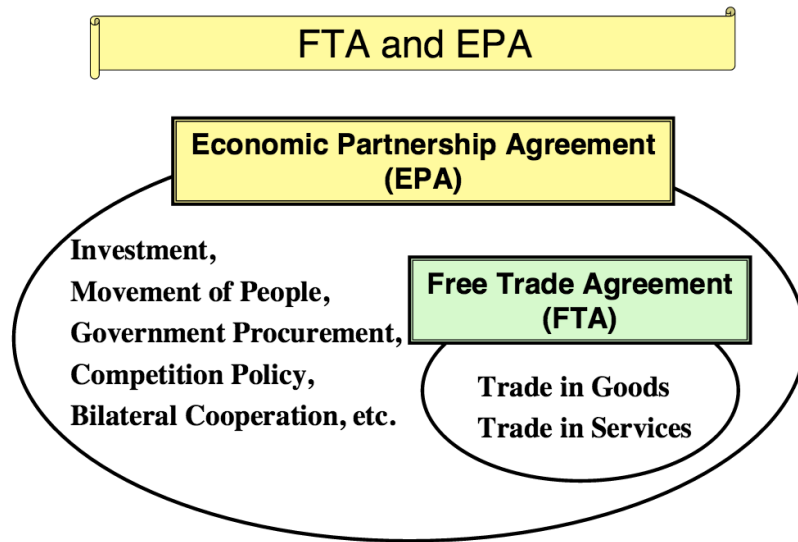
area can be described as a region where countries have signed an FTA. Therefore, in terms of economic integration, an FTA represents the first degree of economic integration, where tariffs (and quantitative restrictions) between the participating countries are abolished, but each country retains its own tariffs against non-members.

There are many types of FTA as they can be categorized and divided into several groups in terms of their number of participants, and coverage.

In terms of participants, an FTA can be bilateral, plurilateral or multilateral – that is, between two states or more than two states, or involving numerous of states. For example, China-Chile Free Trade Agreement is a bilateral treaty, while North American Free Trade Agreement (NAFTA) or Asian Free Trade Area (AFTA) can be classified as a plurilateral agreement. It has to be noted though that the term plurilateral agreement is primarily used in the WTO context and it implies that member countries would be given the choice to agree to new rules on a voluntary basis. This contrasts with the multilateral agreement, where all members are party to the agreement, examples of which are General Agreement on Trade and Tariffs (GATT) and General Agreement on Trade in Services (GATS).

As for the level of coverage, an FTA can cover goods and services separately or combined, or put a diversified focus on goods, services, investment, as well as include issues such as government procurement, competition, and trade facilitation, or environment protection. In fact, growing number of countries negotiate more advanced or modern FTAs as they aim to liberalize and promote trade in both goods and services, as well as establish a transparent and predictable investment regime, and to explore new areas of economic cooperation, including freedom of labor and movement of persons.

Such arrangements are sometimes referred to as next generations of FTA since modern trade arrangements go far beyond simply reducing tariffs and often provide for a preferential regulatory framework for mutual services trade. The most sophisticated and modern FTAs not only cover conventional trade but also include advanced rules on investment, competition, environment, and labor etc. Not surprisingly, a major trading country like Japan has already started using the term Economic Partnership Agreement (EPA) for those agreements that cover not only trade in goods and services, but also deal with unconventional areas of trade, as well as other fields in economic cooperation. (*See, diagram, below*)



**Conceptual Diagrams of FTA and EPA**

Figure 2.1 Conceptual Diagrams of TFA and ERA

Source: Ruri Kawashima, FTA and EPA, <https://economicsblog.wordpress.com/>

In Japan's case, this means that contents of an FTA are a part and parcel of an EPA but some countries such as China and Australia still retain the term FTA for its agreements that cover the same or similar scope of EPA. Therefore, for the purpose of this paper, the term FTA will be used in general.

## 2.3 FTA and WTO

### 2.3.1 WTO rules on FTAs

As mentioned earlier, the Cobden-Chevalier Treaty signed between Britain and France in 1860 was the first free trade agreement between different states that involved significant reciprocal tariff reductions and included a Most Favored Nation (MFN) clause. Apart from contributing to an expanding network of bilateral trade treaties in Europe, it also helped create an early form of the multilateral trade agreement.

The foundations of the modern multilateral trading system were laid in the aftermath of the World War II as major countries set up the GATT in 1947,<sup>15</sup> which quickly became the world's most important multilateral trade arrangement. In 1995, the GATT became the WTO and now has 164 members (WTO database, 2017). The WTO oversees four multilateral trade agreements: the GATT, the General GATS, and agreements on Trade-related Intellectual Property Rights (TRIPS) and Trade-Related Investment Measures (TRIMS).

The cornerstones of WTO trade law are the principles of MFN and national treatment. Under the MFN rule, countries cannot normally discriminate between their trading partners. For example, if one WTO member grants another member a special favor (such as a lower customs duty rate for one of their products), it has to do the same for all other WTO members with some exceptions.<sup>16</sup> Whereas, national treatment principle holds that imported and locally-produced goods should be treated equally. Although the WTO embodies the principle of non-discrimination in international trade, WTO members are however permitted to form 'free-trade areas' and 'customs unions' among themselves under specific conditions, which are prescribed in the following sets of rules:

1. Paragraphs 4 to 10 of Article XXIV of GATT (as clarified in the Understanding on the Interpretation of Article XXIV of the GATT 1994) provide for the formation and operation of customs unions and free-trade areas covering trade in goods;
2. Article V of GATS governs the conclusion of Regional Trade Agreements (RTAs) in the area of trade in services, for both developed and developing countries
3. The 1979 Decision by the Contracting parties of the GATT on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries (the so-called Enabling Clause) refers to preferential trade arrangements in trade in goods between developing country Members.

When a WTO member enters into a regional integration arrangement through which it grants more favorable conditions to its trade with other parties than to other WTO members'

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<sup>15</sup> World Trade Organization, "The Multilateral Trading System: 50 years of achievement," May, 1998, [https://www.hse.ru/data/2011/12/04/1271809389/50%20years\\_e.pdf](https://www.hse.ru/data/2011/12/04/1271809389/50%20years_e.pdf)

<sup>16</sup> World Trade Organization, "Principles of the trading system," May, 2017 [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm)

trade, it constitutes a major departure from the guiding principle of non-discrimination defined in Article I of GATT, Article II of GATS, and elsewhere. The preconditions laid down in Article XXIV for a customs union or FTA to be waived from MFN obligations are: first, the signatories commit to liberalizing “substantially all trade” (Generally, 90 percent level is common for FTAs worldwide) in goods and “substantially all sectors” of services; and second, after the formation of a customs union or FTA, barriers on trade with non-members must not be more restrictive than those that members had prior to their forming a customs union or FTA.

When WTO members (previously, Contracting parties of the GATT) participate in RTAs they are bound to notify such arrangements to the WTO. Before the WTO replaced the GATT, examination of such agreements was conducted in individual working parties. In February 1996, the WTO General Council established the Committee on Regional Trade Agreements (CRTA), which was entrusted with two principal duties: to examine individual regional agreements; and to consider the systemic implications of the agreements for the multilateral trading system and the relationship between them. However, the General Council substantially revised the work of the Committee in December 2006 by adopting a Decision on a “Transparency Mechanism for Regional Trade Agreements”.<sup>17</sup> Consequently, RTAs falling under Article XXIV are notified to the Council for Trade in Goods (CTG), which transfers the agreement to the CRTA for examination. While RTAs covering trade in services concluded by any WTO Members, whether developed or developing are notified to the Council for Trade in Services (CTS). The CTS may decide to pass the agreement to the CRTA for examination, but unlike the case of RTAs notified under Article XXIV of the GATT, such examination is optional, not mandatory. The notification of agreements falling under the Enabling Clause is made to the Committee on Trade and Development (CTD), but generally, no in-depth examination in the CRTA is requested by the CTD probably due to the very nature of the 1979 decision.

The CRTA’s examination of an RTA is intended to ensure the transparency of RTAs and evaluate its consistency with WTO rules. The examination is conducted on the basis of information provided by the parties to the RTA, through written replies to written questions posed by WTO Members or through oral replies to questions posed at CRTA meetings. Once the

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<sup>17</sup> Decision of the General Council of the WTO, “Transparency mechanism for RTA,” *WTO secretariat*, December.18. 2006, [http://ptadb.wto.org/docs/pta\\_transparency\\_rta\\_en.pdf](http://ptadb.wto.org/docs/pta_transparency_rta_en.pdf)



factual examination is concluded, the WTO Secretariat drafts the examination report. Thereafter, consultations are conducted and once the report is agreed by the CRTA, it is submitted to the relevant superior body for adoption. However, no examination report has been finalized since 1995 because of lack of consensus.<sup>18</sup> Main contributing factors to which are the long-standing controversies over the interpretation of the WTO provisions on RTAs, and absence of or discrepancies between WTO rules and those contained in some RTAs.

As a result, under the Doha Development Round - the latest round of trade negotiations among the WTO membership that began in 2001, Members agreed as part of a mandate of negotiating improved WTO rules, to launch negotiations aimed at “clarifying and improving the disciplines and procedures under the existing WTO provisions applying to RTAs, while taking due account of the developmental aspects of these agreements. Currently, the negotiations centered on “systemic issues” (For more detailed information on the topic, please refer to the note prepared by the CRTA WT/REG/W/37) regarding RTAs, such as: how to interpret the WTO requirement that RTAs cover “substantially all the trade”; regulations that could restrict trade such as rules of origin under preferential schemes; and how regional agreements relate to development. The outcome of the negotiations on improved WTO rules however is closely tied to the results of the other negotiations on controversial and highly divisive topics such as agriculture and non-agriculture market access, since virtually every item of the Doha Round negotiation, except the Dispute settlement system, is part of a whole and indivisible package and cannot be agreed separately, which is also known in the WTO context as the “single undertaking”: “Nothing is agreed until everything is agreed.” Therefore, it is probably too early to predict the outcome of the current rules negotiations, not to mention the potential impact on existing and future RTAs. Nonetheless, even in a rather optimistic scenario, one can safely assume that the WTO members will not drastically change the existing rules so as to jeopardize what is actually working between them in terms of further trade liberalization at a time it is becoming increasingly difficult under the multilateral setting as proved by the Doha Round talks.

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<sup>18</sup> WTO, Committee on Regional Trade Agreements, Decision of February. 6. 1996,  
[https://www.wto.org/english/tratop\\_e/region\\_e/127.pdf](https://www.wto.org/english/tratop_e/region_e/127.pdf)



### 2.3.2 RTAs notified to the WTO

All the WTO members have notified participation in one or more RTAs. Notifications may also refer to the accession of new parties to the existing RTAs. In the period between 1948-1994, the GATT received 124 notifications of RTAs relating to trade in goods, and since the creation of the WTO in 1995, over 400 additional arrangements covering trade in goods or services have been notified. According to the WTO's latest figure as of 1 December 2017, some 646 notifications of RTAs (counting goods, services and accessions separately) had been received by the GATT/WTO. Of these, 425 notifications were made under Article XXIV of the GATT 1947 or GATT 1994; 41 under the Enabling Clause; and 150 under Article V of the GATS. Of these 646 RTAs, 425 were in force. These WTO figures correspond to 452 physical RTAs (counting goods, services and accessions together), of which 266 are currently in force. The overall number of RTAs in force has been increasing steadily and this trend likely to be continued given a large number of RTAs currently under negotiations.

Table 2.1 RTAs in force, sorted by Type of Agreement (29 March 2016)

	Enabling clause	GATS Art. V	GATT Art. XXIV	Grand total
Customs Union	8		11	19
Customs Union - Accession	1		9	10
Economic Integration Agreement		133		133
Economic Integration Agreement - Accession		6		6
Free Trade Agreement	15		223	238
Free Trade Agreement - Accession			2	2
Partial Scope Agreement	16			16
Partial Scope Agreement - Accession	1			1
Grand total	41	139	245	425

Source: Mia Mikic, Economic Integration Agreements

[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1506107](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1506107)

Table 2.2 Physical RTAs in force, by Coverage (29 March 2016)

Goods	138
Services	1
Goods and Services	132
Total	271

Source: WTO secretariat Source: Mia Mikic, Economic Integration Agreements

[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1506107](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1506107)

The following Chart shows all RTAs notified to the GATT/WTO (1948-2017), including inactive RTAs, by year of entry into force

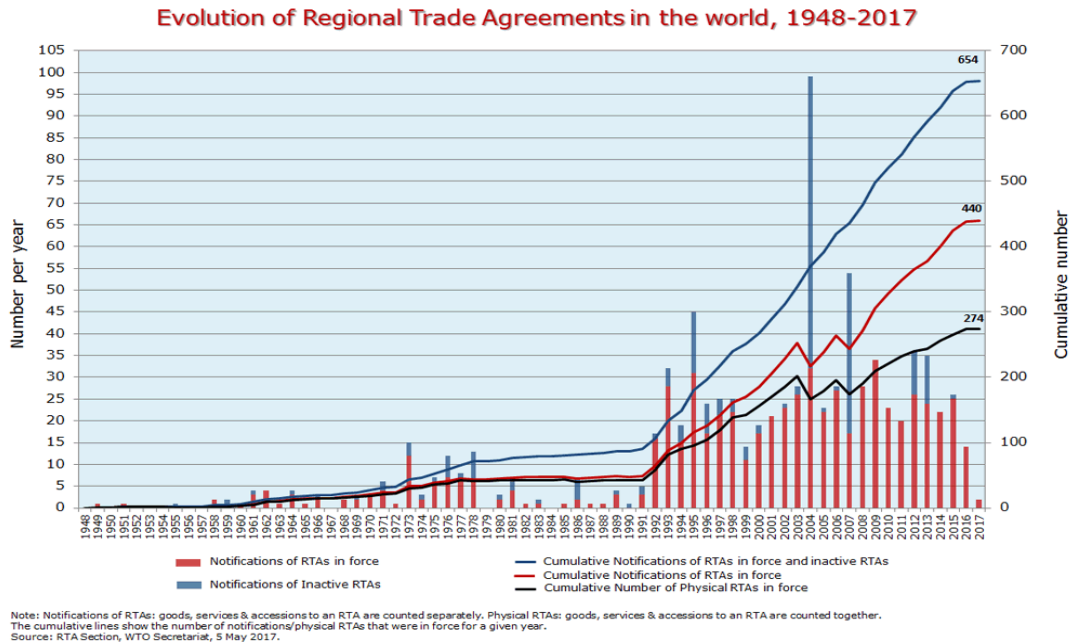


Figure 2.2 Physical RTAs in force

Source: WTO secretariat [https://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](https://www.wto.org/english/tratop_e/region_e/regfac_e.htm)

### 2.3.3 Regionalism (Bilateralism) vs. Multilateralism

The proliferation of FTAs is the phenomenon started in the early 1990s, particularly, after the establishment of the WTO in 1995. According to various sources, it is estimated that vast part of world trade is now conducted under agreements of this kind. The expansion of FTAs around the world is thirsty connected with the difficulty faced by the WTO in extending liberalization of international trading system as the progress in the Doha Round has stalled because of disagreements over agriculture, industrial tariffs and non-tariff barriers, services, as well as trade

remedies between developed nations led by the United States America (USA), European Union (EU) and Japan and the major developing countries led by India, Brazil, China, and South Africa. Although the successful adoption of the Agreement on Trade Facilitation by the WTO members in December 2013 may be seen as a step forward, this achievement fulfills only a small part of the Doha Round agenda and the ultimate success is far from certain. This explains why many countries have turned away from the multilateral process and prefers to negotiate bilateral or regional trade agreements. In fact, up until 2015, all WTO members except Mongolia belong to at least one RTA. Mongolia removed itself of this inconvenient\ name tag when signed its first ever FTA with Japan in February 2015.

In comparison to multilateralism, the bilateralism or regionalism gives the country more room to customize the arrangements according to their specific needs and relationships. It allows the governments to conclude the types of agreements which are more closely aligned with their own and their partner's interests under bilateral approach. It is easier for the countries to make strategic decisions about which goods to liberalize, which services to protect. In general, the bilateral approach allows more flexibility, creativity, political expediency, and ownership over the provisions.<sup>19</sup>

Another principal advantage of concluding an FTA is that areas not covered by the WTO agreements may be included in agreements. The recent trend suggests that countries have signing more advanced or high and FTAs that provide a higher level of liberalization, covering wider sectors, and greater areas for cooperation. Enhanced investment regime and additional rules on unconventional issues such as government procurement, competition, and environment protection into FTAs signed become negotiable. However, there are conflicting views by anthers regarding FTAs and WTO with attention to FTAs complement or undermine the development of the multilateral trading system. Support for FTAs stems from the belief that FTAs act as a building block to multilateral trade liberalization.<sup>20</sup> It argues that instead of breaking up global trade into protectionist blocs, FTAs assist in cause of multilateral trade negotiations,<sup>21</sup> and

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<sup>19</sup> Jun Zhao and Timothy Webster, "Taking stock: China's first decade of free trade agreements", *University of Pennsylvania Journal of International Law*, Vol.33 pp. 65.

<sup>20</sup> Jeffrey A. Frankel, Ernesto Stein, Shang-Jin Wei, *Regional Trading Blocs in the World Economic System*, (Washington DC, Peterson Institute,1997), p. 207.

<sup>21</sup> Michael Ewing-Chow, *Southeast Asia and Free Trade Agreements: WTO Plus or Bust*, Singapore Yearbook of International Law (Singapore: 2004) volume (10) pp.193-206.

facilitate deeper integration between the member states, which may, in turn, facilitate integration with the rest of the world. On the other hand, as Jagdish Bhagwati described, the “spaghetti bowl” problem of regional trade arrangement including FTAs where various idiosyncratic preferential trade agreements, complicated rules, and variable tariffs will increase unexpected costs and finally defeat the objective in reaching a clean tariff regime under WTO.<sup>22</sup>

The driving engine of the Mongolia-China Comprehensive Strategic Partnership is trade and economic cooperation. China has been Mongolia’s largest trading partner and foreign investor over the last 15 years. In 2014, Mongolia’s trade with China accounted for 61.7% of Mongolia’s total foreign trade with the total trade turnover of around USD 6.8 billion USD. Mongolia’s export to China accounted for almost 80% of the country’s total export and its import from China accounted for 30% of Mongolia’s total import. In the period starting from 1990 to 2013, the volume of Chinese investments in Mongolia reached 3.8 billion USD, which accounts for 26.4% of total foreign direct investments in Mongolia.<sup>23</sup>

Mongolia has been developing intensive cooperation with China in the mining, energy and infrastructure sectors. Mid-term program on trade and economic cooperation was adopted in 2008 and renewed later in 2014. Meeting of Mongolia-China Intergovernmental commission on economic, trade, science and technical cooperation, has been held biannually since 1989.

## CHAPTER 3 METHODOLOGY

### 3.1 Trade and investment Mongolia, China, and Russia

**Current trade situation:** Foreign trade of Mongolia hit the rock bottom during transitional period. In 1991, foreign trade declined in two folds, compared to previous year (1584.7 million USD in 1990) and trade cycle reached 708.9 million USD. However in 2000, it

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<http://www.commonlii.org/sg/journals/SGYrBkIntLaw/2004/12.html>

<sup>22</sup> Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*, (Oxford University Press 2008), pp. 61-71.

<sup>23</sup> Ministry of Foreign Affairs of Mongolia, “Information on Bilateral relations – China”, <http://www.mfa.gov.mn/?p=38461&lang=en>

hit 1 billion USD for the first time and since then, except for the global economic crisis period, it increased continuously. As of 2012, Mongolia had 11.1 billion USD of foreign trade in which (Compared to last year it decreased by 2% or 193.3 million USD. The fact that import increased by 239.6 million USD, but export decreased by 432.9 million USD affected this decrease. 65% or 281.4 million USD of the export decrease was caused by change in quantity and 35% or 151.5 million USD was caused by change in price. Mongol bank.) export counts for 4384.6 million and import counts for 6738.9 million USD (In 2013, Mongolia had trade with 135 countries. Preliminary report shows that total goods circulation in foreign trade was 10627.4 million USD out of which export amount was 4272.7 million USD and import amount was 6354.7. compared to 2012 the amount decreased by 495.7 million USD or 4.5 percent out of which export by 112.0 million USD or 2.6 percent, import by 383.7 million USD or 5.7 percent)<sup>24</sup>

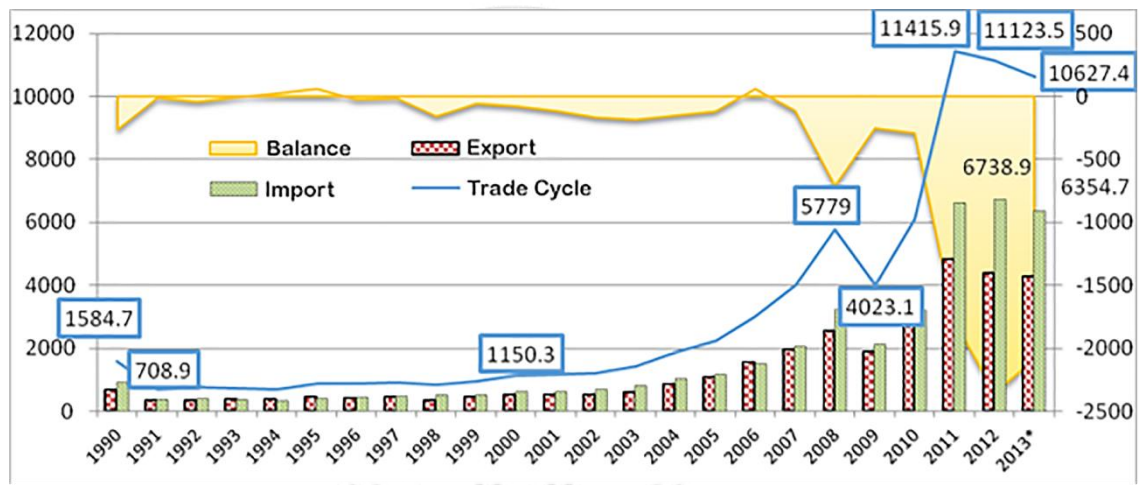


Figure 3.1.1 Foreign trade of Mongolia, (million USD),

Source: Mongolian statistical yearbook 2014

To economies of Russia and China, foreign trade plays an important role and with its positive balance, it is a big factor to increase of foreign-exchange reserves. The chart below (2.2 - 2.3) shows foreign trade situation of two countries in 2001 - 2013.

Two economies have been on the rise except for the global economic crisis period. In 2013, foreign trade cycle of Russian Federation reached 844.2 billion USD and of China hit 4160.5 billion USD which is 5 times higher than that of Russia. China and Russia contributed large sum for foreign trade cycle of Mongolia

<sup>24</sup> National statistics office of Mongolia “Foreign investment in Mongolia,” *Mongolian statistical yearbook 2016*, (national registration and statistics office: Ulaanbaatar, 2017) pp.203-247.

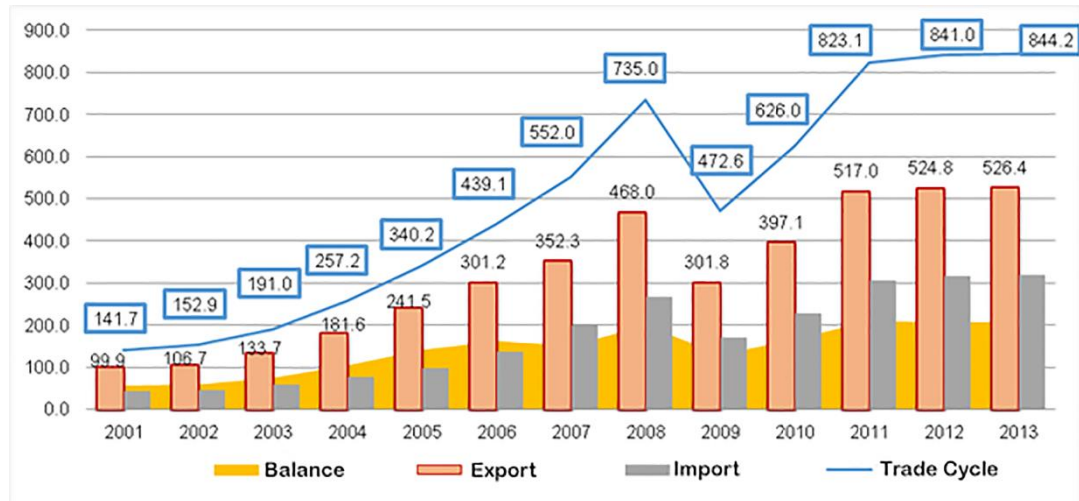


Figure 3.1.2 Foreign trade of Russia, billion USD.

Source: International Trade Center statistics 2014

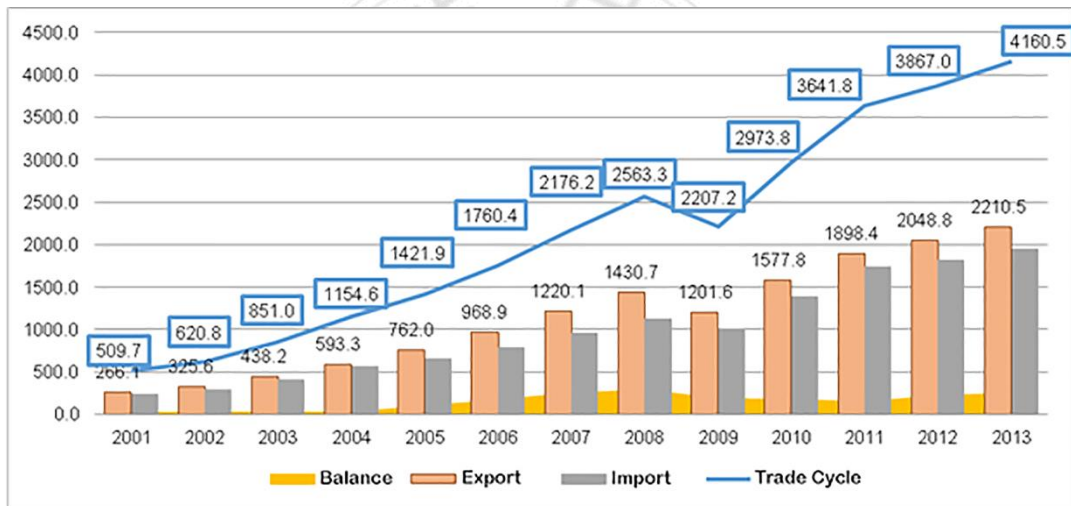


Figure 3.1.3 Foreign trade of China, billion USD

Source: International Trade Center statistics 2014

China is considered the main market for Mongolian exports and in 2012, China alone accounted for 92.6% of total exports. Russia continuously ranked top in Mongolian imports. However since 2008, it lost its place with 2011, its percentage in Mongolian imports reached 24.6% and in 2012, 27.4%. China took Russian place in imports.<sup>25</sup>

<sup>25</sup> Mongolian customs, "Mongolian export 1990-2016," Mongolian export and import report, April 2017, pp.75-126.

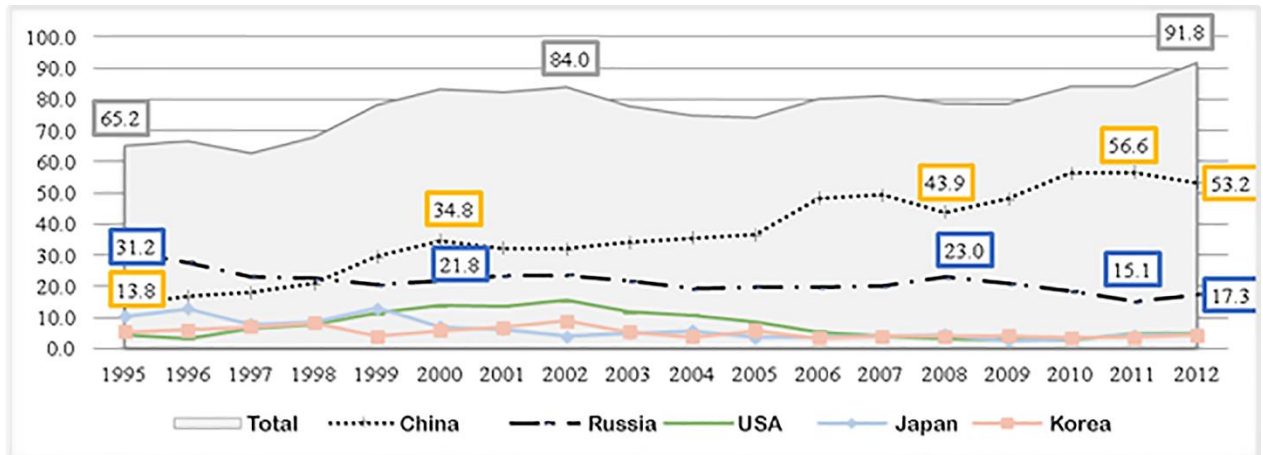


Figure 3.1.4 Russian and Chinese role in Mongolian foreign trade, percentage

Source: Mongolian statistical yearbook

Although out two neighbors plays big part in Mongolian foreign trade, Mongolian part in this countries' foreign trade is very small which is shown in table below (2.1-2.2) where Mongolia is compared to their top 10 trading partners.



Table 3.1.1 The percentage of China and Mongolia in Russia's exports import trading

Exports							Imports						
	2001	2005	2010	2011	2012	2013		2001	2005	2010	2011	2012	2013
<b><i>Mongolia</i></b>	<b><u>0.2</u></b>	<b><u>0.2</u></b>	<b><u>0.2</u></b>	<b><u>0.3</u></b>	<b><u>0.4</u></b>	<b><u>0.3</u></b>	<b><i>Mongolia</i></b>	<b><u>0.09</u></b>	<b><u>0.02</u></b>	<b><u>0.03</u></b>	<b><u>0.03</u></b>	<b><u>0.02</u></b>	<b><u>0.01</u></b>
Netherlands	4.7	10.2	13.4	11.8	14.5	13.3	<b><i>China</i></b>	<b><u>3.93</u></b>	<b><u>7.36</u></b>	<b><u>17</u></b>	<b><u>15.7</u></b>	<b><u>16.4</u></b>	<b><u>16.7</u></b>
Italy	7.4	7.9	6.1	5.4	5.3	7.5	Germany	13.9	13.4	11.6	12.2	12.1	11.9
Germany	9.2	8.2	4.0	4.4	4.6	7.0	USA	7.79	4.63	4.3	4.21	4.9	5.27
<b><i>China</i></b>	<b><u>5.6</u></b>	<b><u>5.4</u></b>	<b><u>5.0</u></b>	<b><u>6.7</u></b>	<b><u>6.8</u></b>	<b><u>6.8</u></b>	Ukraine	9.19	7.92	6.12	6.53	5.68	4.97
Turkey	3.3	4.5	3.5	2.9	3.1	4.8	Italy	4.1	4.47	4.38	4.34	4.25	4.58
Ukraine	5.3	5.1	3.4	3.5	2.8	4.5	Japan	2.08	5.91	4.48	4.9	4.96	4.27
Belarus	5.3	4.2	4.6	4.8	4.1	3.8	Belarus	9.41	5.79	4.35	4.74	4.11	4.27
Japan	2.4	1.5	3.1	2.8	3.0	3.7	France	3.68	3.72	3.59	3.21	4.37	4.1
Poland	4.2	3.6	3.6	4.1	3.8	3.7	South Korea	1.74	4.06	3.18	3.78	3.47	3.25
Kazakhstan	2.8	2.7	2.7	2.7	2.8	3.3	Kazakhstan	4.82	3.27	1.94	2.26	2.98	2.84
<b>Total</b>	<b><u>50.4</u></b>	<b><u>53.5</u></b>	<b><u>49.6</u></b>	<b><u>49.4</u></b>	<b><u>51.2</u></b>	<b><u>58.7</u></b>	<b><i>Total</i></b>	<b><u>60.7</u></b>	<b><u>65.8</u></b>	<b><u>65.0</u></b>	<b><u>60.5</u></b>	<b><u>61.0</u></b>	<b><u>61.9</u></b>

Source: based on International Trade Center statistical data 2014



Table 3.1.2 the percentage of Russia and Mongolia in China's exports import trading

Export							Import						
	2001	2005	2010	2011	2012	2013		2001	2005	2010	2011	2012	2013
<b><u>Mongolia</u></b>	<b><u>1.07</u></b>	<b><u>1.1</u></b>	<b><u>1.39</u></b>	<b><u>1.54</u></b>	<b><u>1.67</u></b>	<b><u>1.67</u></b>	<b><u>Mongolia</u></b>	<b><u>0.1</u></b>	<b><u>0.1</u></b>	<b><u>0.2</u></b>	<b><u>0.2</u></b>	<b><u>0.2</u></b>	<b><u>0.2</u></b>
<b>Hong Kong</b>	17.5	16.3	13.8	14.1	15.8	17.4	<b>Korea</b>	9.6	12	9.9	9.3	9.3	9.4
<b>USA</b>	20.4	21.4	18	17.1	17.2	16.7	<b>Japan</b>	18	15	13	11	9.8	8.3
<b>Japan</b>	16.9	11	7.67	7.81	7.4	6.8	<b>Taiwan</b>	11	11	8.3	7.2	7.3	8
<b>Korea</b>	4.7	4.61	4.36	4.37	4.28	4.13	<b>USA</b>	11	7.4	7.4	7.1	7.4	7.9
<b>Germany</b>	3.66	4.27	4.31	4.02	3.38	3.05	<b>Australia</b>	2.2	2.5	4.4	4.7	4.7	5.1
<b>Holland</b>	2.74	3.4	3.15	3.13	2.87	2.73	<b>Germany</b>	5.7	4.7	5.3	5.3	5.1	4.8
<b>England</b>	2.55	2.49	2.46	2.32	2.26	2.31	<b>Malaysia</b>	2.5	3	3.6	3.6	3.2	3.1
<b><u>Russia</u></b>	<b><u>1.02</u></b>	<b><u>1.73</u></b>	<b><u>1.88</u></b>	<b><u>2.05</u></b>	<b><u>2.15</u></b>	<b><u>2.24</u></b>	<b>Switzerland</b>	0.7	0.6	1.2	1.6	1.3	2.9
<b>Vietnam</b>	0.68	0.74	1.46	1.53	1.67	2.2	<b>Brazil</b>	1	1.5	2.7	3	2.9	2.8
<b>India</b>	0.71	1.17	2.59	2.66	2.33	2.19	<b>Saudi Arabia</b>	1.1	1.9	2.4	2.8	3	2.7
<b>Malaysia</b>	1.21	1.39	1.51	1.47	1.78	2.08	<b><u>Russia</u></b>	<b><u>3.3</u></b>	<b><u>2.4</u></b>	<b><u>1.9</u></b>	<b><u>2.3</u></b>	<b><u>2.4</u></b>	<b><u>2</u></b>
<b><u>Total</u></b>	<b><u>73.14</u></b>	<b><u>69.6</u></b>	<b><u>62.58</u></b>	<b><u>62.1</u></b>	<b><u>62.79</u></b>	<b><u>63.5</u></b>	<b><u>Total</u></b>	<b><u>66.2</u></b>	<b><u>62.1</u></b>	<b><u>60.3</u></b>	<b><u>58.1</u></b>	<b><u>56.6</u></b>	<b><u>57.2</u></b>

Source: Based on International Trade Center statistical data 2014

The table above shows that exports and imports of Russian Federation and PRC is not highly dependent on one country. China plays big role in Russian foreign trade and since 2001, it took 5-7% in Russian export annually (20-25 times more than Mongolia) and since 2010, it took first place in imports which is 15-17percent. Russia is one of 15 trading partners of China and since 2005, 2 percent of exports and 2-3 percent in imports of China.

### **Exports and imports goods structure**

Statistical data of Mongolian foreign trade shows in recent years, minerals, and raw materials consists most of the export goods and value added end products makes up most part of imported goods. This implies that Mongolian trade has gone on for many years without real profit with unprocessed raw materials and value added products.

Chinese export goods consist of wide varieties of goods with value added end products. China focuses on importing raw materials and equipment and developing processing, assembling manufacture and exporting end products. Therefore, China will continue importing raw materials from Mongolia, not end products.

The Russian export goods structure is based on a natural resource which is similar to countries, 60-70 percent of it consisting of oil, coal, iron, steel, aluminum, gold, diamond, nickel, wood and so on. As for imported goods, machine and equipment make up main part and they are being imported from China. Manufacturing of above-mentioned export goods is not developed in Mongolia; therefore, we are buying these goods in end products, not in raw material form.

When determining goods that Mongolia can export to Russia and China, we made an assessment using Balassa comparative advantage index. This assessment shows that group 2 and 25 goods can be exported to Russia and group 25, 26, 41, 51 and 74 (more details see in Appendix A) goods have the highest possibility to be exported to China. (China stands at first place in the world on importing these groups of products) However, value added carpet and cashmere products that Mongolia is interested in exporting are export comparative advantageous product of China, therefore, they will be country main competitor in this group. As for group 27 product, coal which makes up most part of Mongolian exports, compared to other mining

products, it doesn't have high comparative advantage to Chinese import goods, therefore, export of coal can be decreased in the future.

China is one of the leading countries in manufacturing, consumption and exporting of metals such as steel and copper, therefore, it's considered a country with a high demand for mining raw product. If Mongolia signs free trade agreement with China, it can increase competition of strategic raw material necessary for metal manufacturing and raw materials of leather processing and textile factories sale at a country domestic market for a long time. The primary goal in scope of free trade agreement is to create a market for high competency mining raw materials and end products.

We aimed for determining products that can be imported from Mongolia two neighbors based on comparative advantage overlapping of Mongolian imports and these two countries exports.

Russia has exports comparative advantage on nickel, fertilizer, mineral fuel, wood and woodenware and mineral fuel and grain overlaps Mongolia imports comparative advantage. Therefore, Mongolia importing mineral fuel and grain from Russia has the highest possibility.

China has exports comparative advantage on more than 40 groups of products (out of which 25 have higher an advantage) on Harmonized system and most of them are value added end products. Moreover, group 86, 63, 73, 68, 20, 69, 70 products (more details see in appendix A) overlap with Mongolia's import comparative advantage, therefore, there's big possibility for Mongolia to import these products.

It is important to determine sensitive sectors and products that can be produced domestically even it has imported comparative advantage. Meat and meat products, milk and dairy products, wheat, flour, wheat products, potato, vegetables, alcoholic and non-alcoholic drinks, leather clothing, carpet and textile products are considered sensitive products. Therefore, import customs tariffs need to be properly set on these products and they need to be included in "X" products list of which tariff doesn't need to be discussed during free trade agreement with Russia and China.

Mongolia imports strategic products such as petroleum, diesel fuel, flour and wheat from Russia and they take a big part in imported products total price from Russia.

If free trade agreement is signed, based on GATT Article 24, (if there will be no change in goods structure imported from Russia in coming few years), in scope of the agreement, tariff on oil products needs to nullify

Generally, if Mongolia signs free trade agreement with Russia, first of all, exports comparative advantage of Russia and Mongolia are similar, therefore, Russia has limited exporting opportunity, secondly, if Mongolia develops oil and chemical production based on oil resource, Russian export can have a negative effect on country production of these products.

Mongolian Statistical data shows that 40 percent of total imported goods from China are group 84 and 85 machines and equipment. However, Chinese export data reveals that 20 percent of total exported goods are the group 61 textile goods and 24 percent is group 84 and 85 machine and equipment which is very different date from that of Mongolia. This implies that two countries need to work on exchanging and matching statistical data.

Mongolian general customs data shows structure and amount of imported goods from China didn't have a significant change in past three years. Some Harmonized System group 84, 85 and 90 goods imported from China has "zero" customs tax. If Mongolia signs free trade agreement with China, based on GATT Article 24, (if there will be no change in goods structure imported from Russia in coming few years) customs tariff on group 84, 85, 87 and 90 goods such as equipment, technical devices and other end products needs to be dropped as part of the agreement.

Generally speaking, if Mongolia signs free trade agreement with China in this situation, first of all, imports comparative advantage of China and exports comparative advantage of Mongolia overlaps in raw material-wise, therefore, Mongolian export could be increased and it has lower significance to sign agreement based on export structure, secondly, when Mongolia develops processing industry based on raw materials resource, we have high possibility to export products like refined copper and coke at the market of industrial countries like Japan, Korea and USA and in order to do that we need to make agreements with China on transit transportation sector.

**Current investment situation:** Foreign investment in Mongolia is protected by Mongolians laws and country ratified international agreements. As a result, foreign investment in Mongolia is increasing rapidly. Big mining projects played the main role on foreign direct investment increase. For example, foreign direct investment made in 2011 and 2012 takes up half of total foreign direct investment made in Mongolia since 1990. Mongolia main trading partner, China and Russia who makes up 73.4% of Mongolia total foreign trade is responsible for 31% of total foreign direct investment flow and 55.6% of total registered business entities with foreign investment.<sup>26</sup>

Sectors that are seeing highest increase in foreign direct investment are geological and mining search sector and it is due to contracts with investors to use Mongolian large strategic mining fields.

Looking at companies with foreign direct investment registered in Mongolia sector by sector, 68.4% of the companies are running business in trade and food sector, 3.3% in geological and mining sector, 3.1% in engineering construction and construction materials sector and 2.5% in tourism sector.

Out of total investment from China in Mongolia, 71.9% is in geological and mining sector, 18% in trade and food sector, 1.2% in construction and construction material sector 0.7% in light industry, 0.7% is in animal husbandry raw material processing sector and 0.2% in transportation sector.

Out of total investment from Russia in Mongolia, 64.9% is in geological and mining sector, 12.6% in trade and food sector, 6% in transportation sector, 3.2% in construction and construction material sector, 3% in bank and finance sector, 2.9% in food processing sector, 0.8% in agriculture, farming and animal husbandry sector and 0.6% is in energy sector<sup>27</sup>.

As a result of reform and encouragement policy in trade and investment in China, foreign direct investment increased drastically in earlier 1990s. Foreign direct investment in China

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<sup>26</sup> Mongolian mining association, “Mongolian mining investment report, “ august. 11. 2015 p.1.

<http://www.mongolianminingjournal.com/contentlist/category373.shtml?sel=652>

<sup>27</sup> National statistics office of Mongolia “Foreign investment in Mongolia,” *Mongolian statistical yearbook 2016*, (national registration and statistics office: Ulaanbaatar, 2017) pp.203-247.

decreased from previous year down to 90 billion USD, but in 2010, it reached up to 114 billion USD and in 2011, to 116 billion USD.

Looking at the sectors with foreign investment, 28.8% was put in business sector, 5.7% in wholesale and retail sector, 3.6% in chemical and chemical products sectors, 3.2% in equipment sector, 2.9% in electronic equipment sector, 2.7% in transportation devices and equipment, 2.3% in non-metal mineral products, 2% in transportation, storage and communication sectors.<sup>28</sup>

Foreign direct investment in Russian Federation decreased from 27 billion USD to 13.8 billion USD in 2008-2010 due to global economic fall and financial crisis. However, situation seems to be improving since 2011. For instance, in 2011 foreign direct investment reached to 18.4 billion USD, in 2012 it reached 18.7 billion USD which brought total foreign direct investment value in Russia up to 136 billion USD.

Leading countries investing in Russia are Switzerland (13.7%), Cyprian (10.6%), Netherlands (8.7%), Great Britain (7.4%), Germany (4.6%), Luxemburg (3.0%), France (2.7%) and Belarus (2.3%).

31.6% of total foreign direct investment was made in industrial sector, 18.4% in wholesale and retail sector, 17.1% in mining sector, 11.2% in real estate sector. Looking at annual foreign direct investment sector by sector, there is no significant difference between sectors, however in 2012, investment in financial mediation sector increased and made up 28.1% of total foreign direct investment value.

Looking at entities with foreign investment in Russia sector by sector, 30% is doing business in wholesale and retail trade, 20.3% in business sector, 10.2% in transportation and communication sector, 6.4% in construction sector, 5.2% in metal production, 4.4% in equipment and 3.7% in financial sector.<sup>29</sup>

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<sup>28</sup> Selin Özyurt, China's Economic Outlook after 30 Years of Reform, LAMETA, jan.1. 2010,

<sup>29</sup> Trading economics Russia, "Russia Foreign Direct Investment 1994-2017 Data," Moscow: 2017

<https://tradingeconomics.com/russia/foreign-direct-investment>

## **Goods that can compete at global market, invested by Russia and China in Mongolia**

Looking at technological capacity of Mongolian export products, products without technological capacity is making up most part of the export. Therefore, it is important to attract foreign investment to medium and higher technology products manufacturing sector.

In order not to have Mongolian economy solely dependent on mining the sector, it is essential to attract foreign investment to other sectors, particularly to agricultural sector that has exported comparative advantage (manufacturing based on farming and animal husbandry). For instance, Russia is at 5<sup>th</sup> place for meat and by-products imports, therefore, Mongolia need to attract foreign investment to this sector that has exports comparative advantage and export goods that meets international quality standards.

### **Working force movement and mutually agree on possible sectors**

Russia and China often include regulations on working force movement in their free trade agreements and mutual investment agreements with other countries. For example, Russia agreed on lowering visa requirements for professional and skilled employees from foreign countries.

Working force movement is deeply connected with service and trade mode 3 and 4. For this reason, China assumed obligation on certain sectors in GATS service supply mode 3 and 4 when discussing working force movement in its free trade agreement with New Zealand, Chile and Pakistan (“mode 3” or commercial involvement , “mode 4” or individual service). Except for horizontal commitment in sample schedule of commitment in GATS, service supply mode 4 often does not require any commitment. But other modes 1, 2 and 3 assume commitment related to entering the market in full or in part and domestic regulations.<sup>30</sup>

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<sup>30</sup> World Trade Organization, “The General Agreement on Trade in Services (GATS): objectives, coverage and disciplines” [https://www.wto.org/English/tratop\\_E/serv\\_e/gatsqa\\_e.htm#top](https://www.wto.org/English/tratop_E/serv_e/gatsqa_e.htm#top)

China grants 6 months of visa for business visitors from the countries with free trade agreement, however, they allow three years of visa for employees from abroad within corporation working force movement.

### **3.2 Analysis of trade, investment and legal environment in Mongolia, China and Russia**

**Legal environment of trade:** In 2012, Mongolia ranked at 159 in foreign trade section, doing business index by World Bank Group, however, in 2013, this rank went down to 181. Import and export expense of foreign trade and documents related to these increased therefore affected foreign trade performance. If we sign free trade agreement with Mongolian neighbors, it is necessary to discuss on easing and collaborating with them on those foreign trade issues.

#### **Trade tariff and non-tariff measurements**

The Harmonized Commodity Description and Coding System, also known as the Harmonized System (HS) of tariff nomenclature is an internationally standardized system of names and numbers to classify traded products. It came into effect in 1988 and has since been developed and maintained by the World Customs Organization (WCO) (formerly the Customs Co-operation Council), an independent intergovernmental organization based in Brussels, Belgium, with over 200 member countries

Mongolia can export group 02, 25 products to Russia and group 25, 26, 41, 51 and 74 products to China. Below table shows how Russia and China lowered and freed tariffs on these groups of products with their trading partners with free trade agreement.



Table 3.2.1 Decrease in ad valorem tax for trading partners that has free trade agreement with Russia / As for goods that can be exported from Mongolia /

HS code	25	2
MFN tariff	2.9	31.1
Serbia	0.2	8
Turkmenistan, Tajikistan, Kyrgyzstan	0.1	0
Azerbaijan, Armenia, Ukraine, Moldavia	0.6	0
Kazakhstan, Belarus	0	0

Source: data of Russian customs

Table 3.2.2 Decrease in ad valorem tax for trading partners that has free trade agreement with China /As for goods that can be exported from Mongolia/

HS code	25	26	41	51	74
MFN tariff	2.9	0.1	6.6	22.6	1.7
New Zealand	0.2	0	1.2	0.6	0.2
Chile	0.1	0	0.2	18.5	0.5
Pakistan	0.6	0	3.7	20.3	0.6
Peru	0	0	2.3	20.5	0.4
Singapore	0	0	0	17.7	0
Macao	2.4	-	6.6	19.8	1.5
Hong Kong	2.1	0.1	3.6	20.6	1.3

Source: Source: data of China customs

### Non-tariff measurements

Import license system of China is regulated by Foreign Trade law of China, modified in 2004. Goods information related to import license is annually shown on “Goods import license management list” by Chinese Ministry of Trade. It is prohibited to transfer import license.

As for Russia, they use traditional methods such as import license, quote and import special permission to control export and import products. These methods are regulated by many

different agreements among Customs Union members, Eurasia economic union (for instance, “United non-tariff measurement agreement on good from third country” 2008.01.25) and domestic laws and regulations. Import and export limits aren’t followed in trade among members of Customs Union and trade limitations (except for certain conditions) are approved and implemented by three countries in unison. Russia will follow WTO limitations after it becomes member an of WTO.

### **Dumping, subsidy and protection measurements**

In 1997, China approved “*Anti-dumping, subsidies measures regulations of China*”. This regulation includes anti-dumping measures and control by China. After China became WTO member, in accordance to WTO agreements, re-determined its regulations such as “Anti-dumping regulations of PRC”, “Reimbursement regulations of PRC” and “Protection measures of PRC”.

China regulates its reimbursement measures with Foreign Trade Law of China and Reimbursement regulations of China. As for trade protection, it is regulated by Foreign Trade Law of China and Protection Measures of PRC.

Russia approved independent law on “protection, anti-dumping and reimbursement measures during goods imports” in 2003. Below table shows Russian anti-dumping, reimbursement and protection measures laws and regulations

Table 3.2.3 Russian anti-dumping, reimbursements and protection measures laws and regulation

Agreement on implementing protection against the third country, anti-dumping and reimbursement measures 2008. 01. 25
Agreement on implementing protection, anti-dumping and reimbursement measures during transition period 2010.11.19
Customs Union committee decision No. 339 on “Eurasian economic union implementation of protection, anti-dumping and reimbursement measures on customs common territories of Customs Union” <sup>31</sup> 2010.08.17
European economic commission decision on “some issues of protection, anti-dumping and reimbursement measures at Customs Union customs common territory” 2012.03.07
Article on protection and usage of actual information necessary for research and organizational obligations on information ownership 2012.03.07
European economic commission decision planning and regulations on protection, anti-dumping and reimbursement 2012.03.07
European economic commission decision No. 44 on “Protecting domestic market”, 2012.05.16
Protocol assistance on gathering true information for research and making pre-research on protection, anti-dumping and reimbursement measures in regards to third country

Source: Russian Trade Remedy Laws, Regulations and Rules

<http://enforcement.trade.gov/trcs/downloads/documents/russia/>

Mutually lowering and exempting tariffs greatly affected expanding trade between free trade agreement countries and measures for decreasing technical obstacles in trade in scope of free trade agreement are also very important. Moreover, joint working team is set up for standard and health and collaborates on easing trade and lowering non-tariff obstacles.

<sup>31</sup> Russia- Kazakhstan –Belarus Customs Union or Eurasian economic committee (EurAsEC)

Since China entered WTO, they have been putting so much emphasis on improving technical regulations, laws and regulations on standard estimating in order to unite good list, coordinate necessary requirements, standards and balance estimate procedure, matching up import goods quantity, safety permission and certification system. Therefore, Chinese measures for technical barriers are designed in accordance to WTO agreement on technical barriers.

Russia is a member state of Russia-Kazakhstan-Belarus Customs Union /CU/, Eurasian Economic Union. Technical regulations, standards and balance estimate system of Russia is regulated by Eurasian economic committee of Customs Union and domestic laws and regulations. Member states of Customs Union agreed on uniting their domestic policies and regulations on technical barriers.

Russian technical standard and certification granting institutions have more complicated system. Although Technical Control and Measures Authority of Russia is main institution for technical standards and certification, other agencies of the government such as Ministry of Agriculture on agricultural products, Ministry of Health on hospital equipment and medications, State Committee for Communications equipment and service and State committee for mining monitoring /mining equipment, petroleum and natural gas equipment/ also take part in setting technical standards and granting certification.

**Legal environment of investment:** Mongolian investment policy is implemented by development policy and planning documents and legal documents such as National Development policy based on Millenium Development goals, Concept of regional development, Law on Budget stability, Law on management and financing of government offices, Tax law, Foreign investment law, government action plan, Main direction for social - economic development, mid-term budget notification and annual state budget. This documents determined the main direction of Mongolian domestic and foreign investment policy and laid legal grounds for it.

Except for production and service that are prohibited by Mongolian law, foreign investment opportunity is granted by “Mongolian law on foreign investment”. As part of that law, condition to protect foreign investment is set in accordance to international standards.

Decreasing number of license and permission for doing business with “Law on special permission” also has positive impact on creating favorable environment for business.

Mongolian government made agreements on supporting foreign investment with 39 countries and double tax agreements with 34 countries.

Russian legal system included supporting regulations for foreign investment; however, it has been criticized that it cannot be seen in real life.

Russian government states that foreign investment and technological transfer is essential for economic reform and development. However, with “Law on strategically significant sectors” in 2008, they have been limiting foreign investment in strategically significant sectors in order to maintain national security.

Investment law, approved in 1991 prohibits confiscating foreign investment into state ownership; however, it also stated that due to national interest, the foreign investment could be taken into state ownership with court rulings. If investors’ property is taken into state ownership, investors shall be reimbursed in short amount of time.

China raised certain foreign investment goals in its “Foreign investment guidance list in industrial sector”. The list included economic sectors that “support”, “limit” and “prohibit” foreign investment and not listed sectors are allowed to receive foreign investment.

Sectors that can benefit from foreign aid and technologies are listed as foreign investment supporting sector. And sensitive sectors where foreign investment doesn’t meet Chinese economic development and sectors that can affect national security are included in foreign investment limiting and prohibiting sectors. The list also determined sectors where foreign investment share needs to be limited in jointly invested entities. By determining minimum share amount for domestic investors in jointly invested entities, it created opportunity to learn from foreign developed technologies and spreading its benefit to domestic entities.

Chinese national and regional development and reform committee monitors and grants permission for each individual foreign investment based on the sector and investment amount. Monitoring individual foreign investment made in China allows authorities who are monitoring new investment projects to put unconditional limitation and include domestic competitors’ interest in their decision. This system lowers transparency of foreign investment regulation in China and increasing uncertainty for investors.

### **3.3 Analysis to calculate positive and negative impacts on Mongolia Economy and society upon signing FTA with China and Russia**

**Positive and negative impacts on economy:** In a scope of this thesis, I studied how free trade agreements with our neighbors, China and Russia, would affect Mongolia's economy and output certain sectors.

At international level experience, Computable General Equilibrium (CGE) model and The Gravity model are being used broadly to study issues related to free trade agreement.

When studying free trade agreement impact on economy, using Computable General Equilibrium model, following indicators have been taken into consideration the are:

- Impact on economic growth
- Impact on production and consumption
- Impact on budget income and expense
- Impact on trade balance
- Impact on income distribution

To study free trade agreement impact with above mentioned Computable General Equilibrium model, Hiro Lee, David Roland-Holst method (1998) where 2 levels of Computable General Equilibrium models were used to study the impact. Kazuo Sato (1969) proposed an idea to change consumption function responsive to regular need into Armington elasticity, as well as de La Grandville (1989), Klump and de La Grandville (2000) and de La Grandville (2009) methods in Computable General Equilibrium models were each used.

#### **Free Trade Agreement impact on production, consumption, GDP and exports**

At first stage, I made a prognosis on Mongolian economy until 2025, using 2012 National Statistics Office data on intersector balance and investment on two of premium mining projects operator by Rio tinto Oyutolgoi and Tavantolgoi mining which was updated in 2013.

Prognosis were made in three versions which are as follows:

1. Conditions include Didn't use of large projects
2. In a case where Oyutolgoi mining is working at its full power and Tavantolgoi mining is mining 20 million tons more coal than now.
3. In a case where Oyutolgoi mining is working at its full power and Tavantolgoi mining is mining 40 million tons more coal than now.

These three versions further divided into three prognoses at three different price levels as current price level, 20% of increased and decreased levels. Impact of free trade agreements with Russia and China on economy in situations where economy is at three different price levels and mining fields are operating and not operating was evaluated.

Study used inflation rate as predicted in Oyutolgoi and other large projects which is 8% annually, population growth at current rate, price of gold, copper and silver as stated in Oyutolgoi project feasibility study and coal price at 95 USD.

This research looks into possibilities to simultaneously sign FTA with Russia and China and its impact on economy and different economic variants in 2012, 2017, 2020 and 2025. The variants include situations where FTA with China and Russia being signed when Oyutolgoi and Tavantolgoi minings are not under operation and under operation. Before evaluated impact of FTA, Tavantolgoi and Oyutolgoi mining fields impact on Mongolian economy at above mentioned 3 versions and 3 price levels.

## Simulation results

### **Gross domestic product (GDP)**

Economy of Mongolia grew fast during 2011-2013 at average growth rate of these three years reached 13.73%. This was the peak of Mongolian economy since 1990.

Statistical data for 2012 shows that USD annual rate was 1359.4 tugriks where as GDP has reached 13.94 trillion tugriks. When divided by total population, GDP per capital came at 3576.7 USD. This is first point to show further results of the study.

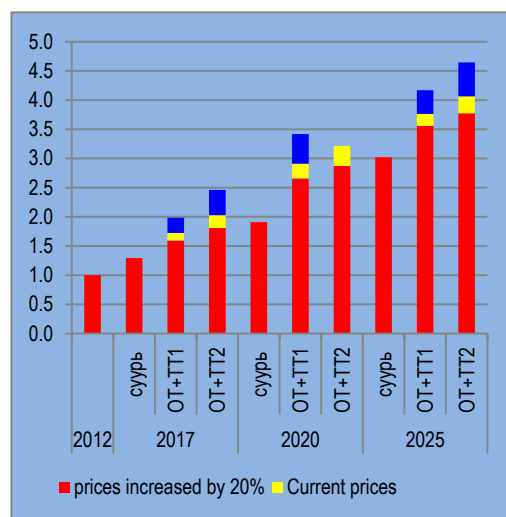


Figure 3.3.1 GDP growth outlook.

Future development of Mongolia's greatly economy depends on large-scale mining projects which are of significant importance at the global level. this study shows that if those large-scale projects were not implemented and basic direction of economic development from previous years continues, GDP rate will increase by 91% by 2020 and by 201.9% by 2025 from the base year.

If average population growth of last 10 years stable stable by growing at 1.5% per year, GDP per capita would reach 4490.7 USD in 2017, 6157.5 USD in 2020 and 9032.1 USD in 2025.





Table 3.3.1 Prognosis of Mongolia GDP growth

	Without the large projects				OT + TT 1 (20 million tons )			OT + TT 2 (40 million tons )		
	2012	2017	2020	2025	2017	2020	2025	2017	2020	2025
<b>GDP growth /GDP 2012=1.0/</b>										
At current price level	1.0000	1.2934	1.9105	3.0190	1.7242	2.9112	3.7623	2.0266	3.2136	4.0647
Price decrease by 20%					1.5942	2.6576	3.5591	1.8091	2.8725	3.7740
Price increase by 20%					1.8541	3.1647	3.9654	2.2441	3.5547	4.3554
<b>GDP growth /million USD/</b>										
At current price level	10257.6	13267	19597	30968	17685.8	29861.9	38592.0	20788.1	32964.1	41694.2
Price decrease by 20%					16353.2	27261.0	36507.8	18557.5	29465.2	38712.0
Price increase by 20%					19018.5	32462.7	40676.1	23018.8	36463.0	44676.4
<b>GDP per capita USD /population in 2012 is 2867.7 thousand, annual growth 1.5%/</b>										
At current price level	3577.0	4490.7	6157.5	9032.1	5986.3	9382.5	11255.6	7036.4	10357.3	12160.4
Price decrease by 20%					5535.3	8565.4	10647.8	6281.3	9257.9	11290.7
Price increase by 20%					6437.4	10199.7	11863.5	7791.4	11456.6	13030.2

Source: National Statistics Office of Mongolia and Institute for Strategic Studies Mongolia

GDP structure shows that dead-weight of mining industry and business service sector is looking out to increase and dead-weight of other sectors besides trade sector is going to decrease.

The dead weight of mining industry in GDP of 2012 was 21.9%. however depending on mining industry products price at global market and large projects implementation, a dead weight of the sector shall increase 39.9 – 49.3% in 2025.

Trade sector made up 10.7% of total GDP in 2012. But depending on the project's implementation, the rate is predicted to increase to 8.7-10.7%. Business sector weight in GDP was 12.15% in 2012 and the rate can fluctuate by 11.4-14.1%. The weight of agriculture, processing industry, construction, transportation, communication and social service sectors in GDP are looking out to decrease. Above estimate shows that mining industry dead weight shall increase faster than other sectors.

Signing FTA with China and Russia and depending on large projects implementation and increase of main export goods price at global market, GDP annual growth is predicted to increase by 0.33-0.34%. If the growth rate is shown by numbers, depending on mining minerals rate and change in main exports goods, GDP is looking out to increase by 48.6 – 91.8 billion tugriks in 2015, 106.6 – 146.5 billion turgriks in 2020 and 140.0 – 175.7 billion tugriks in 2025. Following table shows changes on sectors' place in GDP.

Table 3.3.2 Prognosis GDP sectoral structure in Percentage

	2012	OT+TT1 20 million tons									OT+TT2 40 million tons								
		2017			2020			2025			2017			2020			2025		
		Base year	At current price level	Price decrease by 20%	Price increase by 20%	At current price level	Price decrease by 20%	Price increase by 20%	At current price level	Price decrease by 20%	Price increase by 20%	At current price level	Price decrease by 20%	Price increase by 20%	At current price level	Price decrease by 20%	Price increase by 20%	At current price level	Price decrease by 20%
Agriculture	14.8	13.5	12.8	11.4	10.1	10.9	9.4	8.4	9.2	7.7	9.1	9.7	8.7	8.6	9.6	7.8	7.6	8.5	6.9
Mining industry	18.6	16.6	15.2	12.6	34.6	30.2	38.5	40.5	35.9	44.4	27.7	24.2	30.8	42.8	37.2	47.2	45.1	39.9	49.3
Processing industry	6.2	4.6	3.9	3.1	3.5	3.8	3.2	2.6	2.8	2.4	2.5	2.7	2.4	3.0	3.3	2.7	2.3	2.6	2.1
Energy water supply	2.0	2.1	2.1	2.8	1.6	1.7	1.5	1.4	1.5	1.2	2.2	2.3	2.1	1.3	1.5	1.2	1.2	1.4	1.1
Construction	1.6	1.7	1.4	1.1	1.3	1.4	1.2	0.9	1.0	0.8	0.9	0.9	0.8	1.1	1.2	1.0	0.8	0.9	0.7
Business service	10.3	14.9	21.2	30.3	11.2	12.1	10.4	13.9	15.3	12.8	24.3	25.7	23.1	9.5	10.6	8.6	12.6	14.1	11.4
Trade	9.1	17.8	16.2	14.2	13.3	14.4	12.4	10.6	11.6	9.7	11.4	12.0	10.8	11.3	12.7	10.2	9.6	10.7	8.7
Transportation and communications	9.9	8.8	7.8	5.8	6.6	7.2	6.2	5.1	5.6	4.7	4.7	4.9	4.4	5.6	6.3	5.1	4.6	5.2	4.2
Social service	13.9	6.2	5.7	5.0	4.7	5.1	4.3	3.7	4.1	3.4	4.0	4.3	3.8	4.0	4.5	3.6	3.4	3.8	3.0
Direct tax	13.3	13.8	13.8	13.7	13.1	13.3	13.0	12.9	13.0	12.7	13.2	13.3	13.1	12.8	13.0	12.7	12.7	12.9	12.5

Source: National Statistics Office of Mongolia and Institute for Strategic Studies Mongolia

this study was based on **General Equilibrium model** which showed us that even with FTA with China and Russia, profit from the Russian and Chinese market will not increase significantly. There is a general understanding among researchers that it is possible to speed up economic growth by attracting investments with a purpose to export to Chinese and Russian market with FTAs with these two countries. However those people should consider that Russia and China have far more advantage than Mongolia when it comes to their business environment and neglect their abstract ideas. Mining sector which makes up 30-50% of GDP production has this level of profit out of FTA and other sectors have less profits.

If savings and salary increase can be kept at same level as new production price increase, total salary and savings of economic sectors shall increase by 0.31 – 0.34% in average, equally to GDP.

This means FTA is supposed to give a country to use its production relative advantage in foreign trade and production and sale of sectors that sell its products with relative advantage at foreign market shall increase faster than other sectors. there are, with FTA, agricultural and mining industry which has production relative advantage of Mongolia are expected to grow faster, in comparison to others.

But resource data shows that with FTA GDP of mining industry shall grow more than other sectors when agricultural sector growth is the lowest with only 0.17 – 0.18% increase. The reason for this is because Mongolia agricultural sector is not intensified and its growth depends on the environment rather than anthropic factors. Therefore, it shows that demand possibility due to FTA will not affect agricultural sector that much.

When looking at the possibility that mining industry can grow faster than other sectors with FTA, it indicates that the agreement does not help but worsens “Dutch disease” symptoms growth of mining sector limits other sectors’ growth and competency drastically.

Possibility in of GDP change after FTA reveals that some service sectors such as construction, business, and social service can increase its production relatively faster which attracts Mongolia's interest because these sectors depend on Russian and China, especially technology capacities and raw materials and these countries are geographically close to Mongolia.

In a case of signing FTA with Russia and China, domestic production rate shall increase by 200.6 – 255.3 billion tugriks by 2020 and 247.4 – 296.3 billion tugriks by 2025. Increase shall be relatively lower in agricultural sector which accounts 0.17 – 0.18%, 0.2 – 0.25% in trade sector, highest in construction sector which is 0.47 – 0.48% and 0.3 – 0.4% at average in other sectors.

Nevertheless with FTA, low-priced imports shall increase, following that, goods price at domestic market shall lower and domestically produced goods turnover shall decline. According to country plan, depending on major projects implementation and price escalation of main goods at global market, domestic goods turnover will decrease by 92.5 – 408.4 billion tugriks by 2020 and 110.9 – 416.2 billion tugriks by 2025.

## Exports

FTA signing with Russia and China will not Simultaneous increase the export rate of Mongolia much. According to the calculation, with signing an economic partnership agreement, total exports of Mongolia is predicted to increase by 0.36% only and this will be at the different rate in every sector.

Table 3.3.3 Change in trade balance with FTA

Possible variations	Without the mining fields			OT+TT1 20 million tons			OT+TT2 40 million tons		
				Million USD			Million USD		
	2017	2020	2025	2017	2020	2025	2017	2020	2025
Exports	26.2	35.1	47.8	41.5	69.2	73.4	51.8	79.3	83.5
Price decrease by 20%				37.1	60.8	66.5	44.5	68.1	73.9
Price increase by 20%				45.9	77.6	80.1	59.0	90.4	93.1
Imports	56.7	68.0	81.6	178.3	239.9	249.7	209.8	271.3	281.0
Price decrease by 20%				167.0	218.7	232.5	190.4	242.1	255.8
Price increase by 20%				189.7	261.0	266.8	229.2	300.4	306.2
Balance	-30.5	-32.9	-33.8	-136.8	-170.6	-176.3	-158.0	-191.9	-197.5
Price decrease by 20%				-129.9	-157.9	-166.0	-145.9	-174.0	-182.0
Price increase by 20%				-143.8	-183.4	-186.7	-170.2	-210.0	-213.1

In case major projects aren't implemented, with FTA, Mongolian exports is predicted to increase by 35.1 million USD by 2020 and 47.8 million USD by 2025. In case Oyutolgoi mining field is on full power and Tavantolgoi mining field mining rate is increased by 20 million tons per year, total exports of Mongolia will increase by 69.2 million USD per year by 2020 and 73.4 million USD by 2025. When main goods price at global market drops by 20%, exports rate is predicted to decrease to 60.8 million USD by 2020 and 66.5 million USD by 2025. In reverse, when price increase by 20%, the rate will increase to 77.6 million USD by 2020 and 80.1 million USD by 2025. In case Oyutolgoi mining field is on full power and Tavantolgoi mining field mining rate is increased by 40 million tons per year, depending on main goods price escalation at global market, with FTA total exports of the country is expected to increase by 35.1 – 90.4 million USD by 2020 and 47.8 – 93.1 million USD by 2025.

The reasons why exports rate is increasing by relatively small number after FTA are as follows: Mongolia's exports goods to Russia and China have lower price sensitivity; Russian Federation, in particular, protect its agricultural sector which Mongolia enter global to increase exports, with non-tariff measures rather than tariff measures. Therefore if we want to get more benefit out of FTAs, Mongolia should propose Russia and China to lower their non-tariff barriers for agricultural products and ease on their standard requirements on veterinary, sanitation and plant barriers in particular.

### **Consumption**

Signing FTA with Russia and China could result in domestic consumption. Because with FTA, both parties shall reduce tariffs on their most goods being exported to each other. Thus following “zero-ing” of customs tariff, market prices drops. Caused by this price drop, price sensitive products consumption shall increase and price insensitive products consumption increases at relatively slower speed.

For Mongolia, export and import are both insensitive in general. It relates to the fact that import replacing manufacturing is not well-developed yet and due to Mongolian smaller market capacity, excess products manufactured are ready to be sold at any price.

“As of 2012, the total consumption rate of Mongolia was 21.47 billion USD out of which 57.36% or 12.31 billion USD worth consumption was supplied by domestic products and

services in contrast 42.64% was supplied by imported goods and service. 42.64% of total consumption and 52.13% of total import was from both Russia and China. 31.7% of goods consumed was used for manufacturing purpose and 68.3% for end users.”

With FTA, following increase of cheap imported goods and domestically manufactured products’ consumption shall decrease by 92.5 – 408.4 billion tugriks by 2020 and by 2025, it is predicted to decrease by 110.9 – 416.2 billion tugriks. Implementation of large-scale projects that can directly affect purchasing power at domestic market and price change of main export products at global market shall have an important role in this as well.

Demands of domestic products and services decreasing due to lower priced import lead to decrease in domestic production and have a negative impact on domestic employment rate.

### **Import**

With FTA, it is predicted that domestic goods consumption shall decrease by 1.1 – 1.2 % and import goods consumption shall increase by 0.32 – 0.42%/. Since imports growth shall be higher than domestic production, domestic products shall have a lower weight in total consumption rate.

Table 3.3.4 Imports consumption increase

Possible variations	Imported goods consumption											
	Before FTA, million USD			After FTA, million USD			Change, million USD			Change, percentage		
	2017	2020	2025	2017	2020	2025	2017	2020	2025	2017	2020	2025
Without large projects in calculation												
At current price level	10695.9	12828.9	15387.3	10752.7	12897.0	15468.9	56.7	68.0	81.6	0.53	0.53	0.53
Oyutlgoi + Tavantolgoi (annual mining rate 20 million tons)												
At current price level	15066.9	20141.4	21127.5	15245.2	20381.2	21377.2	178.3	239.9	249.7	1.18	1.19	1.18
Price decrease by 20%	14161.1	18457.5	19760.7	14328.0	18676.3	19993.2	167.0	218.7	232.5	1.18	1.18	1
Price increase by 20%	15972.8	21825.2	22494.4	16162.5	22086.2	22761.2	189.7	261.0	266.8	1.19	1.20	1
Oyutlgoi + Tavantolgoi (annual mining rate 40 million tons)												
At current price level	17575.5	22643.5	23625.3	17785.3	22914.8	23906.3	209.8	271.3	281.0	1.19	1.20	1.19
Price decrease by 20%	16030.4	20320.4	21619.2	16220.8	20562.6	21875.1	190.4	242.1	255.8	1.19	1.19	1.18
Price increase by 20%	19120.6	24966.6	25631.4	19349.8	25267.0	25937.6	229.2	300.4	306.2	1.20	1.20	1.19

Source: National Statistics Office of Mongolia and Institute for Strategic Studies Mongolia



With FTA, consumption of domestic products shall decrease, and consumption of imported goods shall increase. It was calculated that increase of 56.7 – 229.2 million USD in 2017, in 2020 by 68.0 – 300.4 million USD and in 2025 by 81.6 – 306.2 million USD are expected. This increased rate shall have influence from implementation of large-scale projects and price change of main exports products at the global market.

With FTA with Mongolian two neighbors, imports from China seen to increase remarkably faster than imports from Russia. For instance, with FTA and without large-scale projects implementation imports from Russia in total consumption of Mongolia shall increase by 0.03% where imports from China expected to increase by 0.1%. With or without FTA, goods from China in total consumption shall increase and goods from Russia shall decrease.

Table 3.3.5 Changes of China and Russia weight in total imports with FTA

Calculation conditions	Before FTA				After FTA			Change %		
	2012	2017	2020	2025	2017	2020	2025	2017	2020	2025
Change of Russian weight in total imports with FTA, %										
Condition without mega projects										
Basic condition	9.92	6.44	6.44	6.44	6.47	6.47	6.47	0.03	0.03	0.03
OT + TT1										
At current price level		8.17	8.66	8.05	8.27	8.77	8.15	0.10	0.11	0.10
Price decrease by 20%		7.88	8.27	7.73	7.98	8.37	7.83	0.10	0.10	0.09
Price increase by 20%		8.44	9.00	8.34	8.54	9.12	8.45	0.10	0.11	0.10
OT + TT2										
At current price level		8.86	9.16	8.56	8.97	9.27	8.67	0.11	0.11	0.11
Price decrease by 20%		8.46	8.70	8.16	8.56	8.81	8.26	0.10	0.11	0.10
Price increase by 20%		9.21	9.54	8.92	9.32	9.66	9.03	0.11	0.12	0.11
Change of Chinese weight in total imports with FTA, %										
Condition without large-scale projects										
Basic condition	12.31	15.31	15.31	15.31	15.40	15.40	15.40	0.10	0.10	0.10

OT + TT1										
At current price level		13.77	13.34	13.87	13.93	13.49	14.03	0.16	0.15	0.16
Price decrease by 20%		14.03	13.68	14.16	14.19	13.84	14.32	0.16	0.16	0.16
Price increase by 20%		13.53	13.03	13.62	13.69	13.18	13.77	0.15	0.15	0.15
OT + TT2										
At current price level		13.16	12.90	13.42	13.31	13.04	13.57	0.15	0.15	0.15
Price decrease by 20%		13.52	13.30	13.78	13.67	13.45	13.94	0.15	0.15	0.16
Price increase by 20%		12.85	12.56	13.11	13.00	12.70	13.26	0.15	0.14	0.15

Source: National Statistics Office of Mongolia Institute for Strategic Studies Mongolia

Due to implementation of large-scale projects and price of main export products at the global market, import place in total consumption is seen to increase by 42.65 – 50.63% and FTA affects import increase by 0.1 – 0.3% of total consumption. Signing FTA with China and Russia at the same time shall result in increasing of imported goods and services from China by 23.6 – 54.9 million USD at the end of 2017, 28.3 – 68.8 million USD by 2020 and 34.0 – 76.2 by 2025; and from Russia by 6.4 – 43.2 million USD by end of 2017, 7.6 – 57.8 million USD by 2020 and 9.2 – 56.6 million USD by 2025.

Table 3.3.6 Change in goods and service imports with FTA, million USD

Possible variations	Without large-scale projects			OT+TT1			OT+TT2		
	2017	2020	2025	2017	2020	2025	2017	2020	2025
Russian	6.4	7.6	9.2	31.2	43.6	43.3	38.6	51.0	50.7
Price decrease by 20%				28.5	38.6	39.2	34.1	44.1	44.7
Price increase by 20%				33.9	48.5	47.3	43.2	57.8	56.6
China	23.6	28.3	34.0	49.0	61.7	69.6	52.6	65.4	73.3
Price decrease by 20%				47.6	59.3	67.6	50.4	62.0	70.4
Price increase by 20%				50.3	64.2	71.6	54.9	68.8	76.2

Possible variations	Without large-scale projects			OT+TT1			OT+TT2		
	2017	2020	2025	2017	2020	2025	2017	2020	2025
Other countries	26.7	32.1	38.4	98.2	134.6	136.8	118.6	154.9	157.1
Price decrease by 20%				90.8	120.9	125.6	106.0	136.0	140.8
Price increase by 20%				105.5	148.3	147.9	131.1	173.8	173.4

Source: National Statistics Office of Mongolia and Institute for Strategic Studies Mongolia

Goods from Russia and China made up 22.23% in total consumption structure in 2012 and this rate shall not change much with FTA. My calculation shows that as a production of mining industry increases, population income increases and purchasing capacity improves in Mongolia. However, Russian and Chinese role in total imports is predicted to decrease. It indicates that as income increases, people prefer higher quality products from the third country even with higher tax.

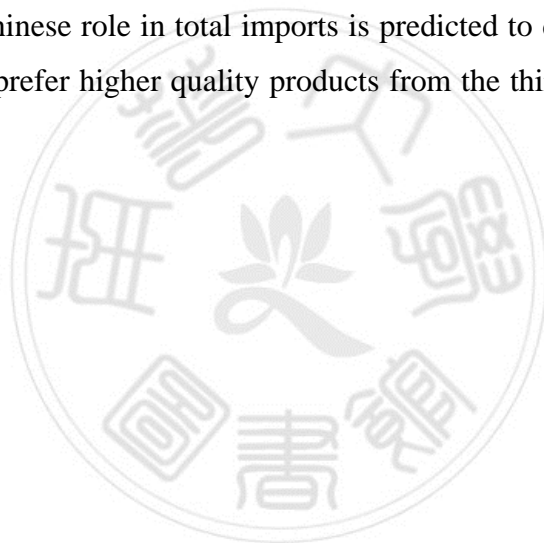


Table 3.3.7 Change of imported goods and services weight in total consumption, million USD

Possible variations	Imports in total consumption, %							Russia and China in total consumption, %						
	Before FTA				After FTA			Before FTA				After FTA		
	2012	2017	2020	2025	2017	2020	2025	2012	2017	2020	2025	2017	2020	2025
Without large projects in calculations														
At current price level	42.65	44.14	44.14	44.14	44.37	44.37	44.37	22.23	21.75	21.75	21.75	21.87	21.87	21.87
At current price level		49.89	50.60	49.19	50.49	51.21	49.78		22.02	22.05	21.99	22.28	22.31	22.24
Price decrease by 20%		48.94	49.52	48.23	49.52	50.11	48.80		21.97	22.00	21.94	22.23	22.26	22.20
Price increase by 20%		50.72	51.52	50.03	51.33	52.14	50.63		22.06	22.10	22.03	22.32	22.36	22.29

Source: National Statistics Office of Mongolia and Institute for Strategic Studies Mongolia

### **Foreign trade balance**

As of 2012, a deficit of Mongolia in with goods and service trade balance equaled to 42.9% of GDP and FTA with Russia and China, the trade balance is predicted to decline.

Foreign trade balance prognosis shows that as mining sector production increases, Chinese role in exports biggest partner total exports shall increase where is Russian role shall decrease. According to the calculation, weight of Chinese goods and services in total exports shall increase from 80.0% to 87.6% in 2012 – 2025 and Russian role in Mongolia is exports shall decrease from 6.4% to 4.4%. During the same period, Russian role in total import predicted to decrease from 23% to 16.9% and Chinese role to decrease from 28.9% to 26.2%. In general, Mongolia's main exports partner, Chinese economic structure needs raw material import more and as Mongolia increases raw material export to China, the dependence on China shall increase for Mongolia.

### **Budget**

With FTA, state budget revenue for Mongolia expected to decrease by 148.3 – 183.0 billion tugriks than its standard by the end of 2017, by 173.0 – 218.8 billion tugriks by 2020, and by 197.5 – 237.1 billion by 2025. The main factor for the decline in budget income relates directly to decline in import tax revenue. By signing FTA with China and Russia simultaneously, due to the fact that decreasing tariffs on more than 90 percent of products from China and Russia who make up more than 90 percent of Mongolian exports and 60 percent of country's imports, Mongolia will lose a chance to annually bring 165.1 – 298.0 0 billion tugriks of imports tax revenue to state budget. Thus customs tariff on imported goods, an important part of state budget shall decrease by 43.8- 44.1% and result in a deficit in budget balance.

Calculation shows that with FTA signed, revenue sources to budget besides imports and exports shall increase slightly for Mongolia. For example, direct tax on goods and service, corporate and personal income tax, social insurance tax and other taxes shall increase by only 0.33 – 0.34%.

## **Income distribution**

Signing FTA with Russia and China simultaneously, GDP shall increase by 0.32 – 0.34 percent depending on large-scale projects implementation and main exports products global market

Price, GDP rate shall increase by 48.6-91.8 billion tugriks 2017, by 72.2-146.5 billion tugriks by 2020 and 115.4-175.7 billion tugriks by 2025 for Mongolia.

Calculation shows that in case salary and savings ratio in GDP does not change, in agricultural sector where the most of the population works, salary shall increase by the lowest percentage which is 0.17 – 0.18%. In mining and processing industry, by 0.37 – 0.39%, in energy, water supply, business service, transportation and communications sectors, by 0.31 – 0.34%, in trade sector, by 0.24 – 0.25%, in social service sector, by 0.39 – 0.40%, in construction sector, by highest percentage which is 0.47 – 0.48%.

Calculations also show that income distribution change as a result of FTA will be different in every economic sectors. Salary growth is the lowest in agricultural, trade and service industries where most of working force is employed, but in mining industry, construction and processing sectors where small part of working force works and where labor use is low, salary and income equaling to it, is predicted to increase.

**Positive and negative impacts on society:** The result of the study shows that signing FTA with China and Russia where 9/10 of Mongolia exports and more than 3/5 of country's imports belongs to shall deepen country economic dependence on these countries. And considering its impact on society is as important as the economic impact.

Trade between countries can be divided into an inter-industry trade which takes place between different economic sectors and intra-industry trade, a trade between same economic sectors. Inter-industry trade mainly based on industrial specialization and expands a market for goods and services, but intra-industry trade raises competition between manufacturers and degrades manufacturing conditions.

In Mongolian-Chinese and Mongolian-Russian trade which both based on industrial specialization, main products are raw materials of mining industry such as copper and molybdenum concentrate, iron and zinc ore, coal, chalk, oil products, animal-derived meat, leather, cashmere, and wool.

The best part of products Mongolia exported to China is mining and minerals products and our Chinese economic structure is set up to mainly purchase not primarily or processed products, but non-renewable minerals.

The calculation proves that signing FTA with China will increase the weight of mineral resource export in total export and it can lead to following risks to Mongolia economy these are:

1. Minerals trade pollutes and damages environment the most. Therefore, increase in mineral resource trade will result in damage to Mongolians' living situation such as damage to grassland, lack of water resources, chemical pollution of soil, plant, water, and air, extinction of plant and animal species and destruction of historical and cultural artifacts.
2. FTA with China will support unprocessed raw minerals product trade and limit the chance to develop processing industry for this sector. Because FTA will allow Chinese citizens and companies to directly purchase raw materials at the domestic market and domestic businesses will have to compete with them for raw materials.
3. Selling mining products without processing shall cut possibilities to create new jobs, extra income, bring in investment and increasing revenues in budget.

Although an increase of export in mining industry can bring above risks, this makeup most of the national foreign currency resource and budget revenue and this revenue creates demands in other related sectors and is used as an investment to them. If we can manage revenue flow from minerals sector and use it as an investment in other sectors, we can prevent from "Dutch disease".

Another very important product that is traded based on industrial specialization is oil products and with FTA, oil products from Russia could be imported at a lower price. However, the extended use of oil product can increase luxurious and extravagant consumption, pollute air and soil in cities in the urban area particular and create negative impacts on human health. if not

properly transported, stored and consumed Moreover, decrease in oil products price can negatively impact on Mongolian government plan to oil-chemistry industry based on country own resources.

With FTA, construction sector which based on cheap working force is predicted to grow faster than any other economic sector. Working force movement due to construction sector development can bring more problems such as illegal immigration and compliment as well as a lack of job in the construction sector.

There are goods and services that are included in intra-industry trade and that can compete well with goods and services of China and Russia with FTA. They are agricultural products such as vegetables, varieties of food products, textile product, construction materials, education and health services

With FTA import tariff shall decrease and prices at domestic market shall decrease which will results in more supply of all previously mentioned products at the domestic market. Even tough decrease in price can be beneficial to consumers, but domestic production of goods replacing same imported goods can suffer a good deal as a consequence. Especially cheap priced food products, vegetables, textiles and construction materials supply increase and price collapse can lead to following problems such as failure of those industries which employ large percentage of Mongolia working forces, increase in unemployment, inequality, poverty and crime rate, human rights violation and increase in foreign and domestic working force migration. As price drops, a normal working condition can be lost and labor value could be lowered, most importantly.

It can give manufacturers from Russia and China good opportunity to purchase raw materials of textile and food industry at a competitive price and domestic manufacturers may have to compete with them for their own supply of raw materials. It can result in raw materials supply deficit in some domestic industrial sectors.

When assessing the social impact of FTA, there are many negative impacts than positive effects and it can lead to many unwanted consequences. It can especially damage domestic



production of goods by replacing imported goods and create an obstacle for Mongolia's envisaged path to develop its own national industry in many sectors.

There is a common concept among Mongolian researchers that signing FTA with both Russia and China and developing its own further economy by attracting potential investors who are interested in exporting their products to these countries is a great possibility exist. I should point out that there are, therefore, a vast number of private person, organization who has this idea at policy developing and decision-making level. However, I would like to explain that first of all, why they think those investors would prefer Mongolia over Russia or China who has far better investment environment evaluation and secondly, how it is advantageous that transporting their resources to Mongolia just to export to China and Russia rather than using country raw materials resource available in Mongolia



## CHAPTER 4

### Risk Evaluation of trilateral FTA

Due to issues such as faster globalization progress, global climate change, energy security and environmental protection, FTA changing in its scope and content as its content becomes deeper and multifaceted. For example, investment, competition, environment, labor force and movement are all incorporated into FTA which has surpassed its original trade only purpose and has become means to resolve regional and global issues.<sup>32</sup> While traditional FTA emphasized ensuring trade rights and economic growth while ignoring environmental asset, modern FTA focuses on mutual gain and future development. On the other hand, FTA can also hit country's economic development, culture, society, and politics.<sup>33</sup> Therefore, researchers note that future development trend has to be considered with impact and risks which may arise with FTA.<sup>34</sup> Based on change in FTA purpose and content, analysis on positive and negative impacts of Chinese and Russian FTAs with certain countries has been made in the frame of this thesis .

#### 4.1. Positive and negative impacts from Chinese FTAs with other countries

China sets certain criteria for signing FTA with other countries which were listed. Vice Minister of Finance for China, Xiao Jung they are: Have good political and diplomatic relations with China; Have economic structure and trade from that is mutually beneficial to China or to a country that joined a FTA (ASEAN, NAFTA, APTA, MERCOSUR) with other countries in the region. Researchers agree upon the first criterion to be the most important. because Countries which had close relations with China such as Pakistan (has been a close ally for a long time), New Zealand (Supported China to join WTO) and Singapore (Supported China during Western sanction on China due to Tiananmen protest in 1989) signed FTA with China one after another.

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<sup>32</sup> Su Taiwan, "Modern FTA changes and reforms," Economic Outlook Bimonthly, Taiwan, Nov.11.2012. p.13.

<sup>33</sup> Marri Gibbs, "Trade policy," United Nations Economic and Social Affairs Department, 2007, p. 25.

<sup>34</sup> U Zyadun, "SPS also an important factor in the new generation of FTA's agricultural sector agreement," Economic Outlook Bimonthly. Taiwan, Nov. 11. 2012, p23.

The second criterion is not realistic, according to researchers. Because some countries that have FTA with China has economic structure and trade from that mutually beneficial China (Singapore and Hong Kong in a service industry and New Zealand, Chile and Peru in the agricultural sector), however, some raises competition and not cooperation with China. If the country has already joined regional FTA (for example, Singapore has FTA with USA, Japan, and Australia), it is very cost-effective for China as it's entering into an already set up market.<sup>35</sup> Which is very realistic criterion As Mongolia is making research on FTA with China, they have to consider above criteria very carefully. Firstly, if three countries have trust in each other in political and diplomatic relations and Mongolian economic structure and trade form of Mongolia's mutually beneficial to all parties and how the third criterion met when signing three party FTA etc.

#### **4.2. Positive and negative impacts from Russian FTAs with other countries**

Russia signed FTA with some teen countries of Commonwealth of Independent States (CIS) in the early 1990s and lately with Serbia in 2000. Considering trade extent with Russia, examples of Kazakhstan, Kyrgyzstan, and Georgia chose for comparison. Goods turnover between these countries and Russia is different. Goods turnover between Kazakhstan and Russia in 2012 was 24.3 billion USD (Ukraine 32.7 billion USD and Belarus 34.3 billion USD), between Kyrgyzstan and Russia was 1.8 billion USD (Azerbaijan 3.4 billion USD and Turkmenistan 1.4 billion USD) and between Georgia and Russia was 782.3 million USD (Armenia 748.5 million USD and Tajikistan 746.5 million USD and Moldavia 870.3 million USD).

The reason goods turnover of Kazakhstan with Russia has stable exports growth and high goods turnover rate compared to other countries that have several reasons of FTA between Russia and Kazakhstan it is traded structure which is more diversified and based on higher goods supply. As for Kyrgyzstan, its economic capacity is low, depending greatly on gold and other minerals mining and susceptible to raw materials price change at global market and trade with Russia shows a deficit. The example of Kyrgyzstan shows that FTA has a negative impact on developing countries like Mongolia that has low trade diversity. other example is a sudden drop in Russia-Georgia total goods turnover is Georgian industrial capacity is low, a decline in an

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<sup>35</sup> Henry Gao. "China's Strategy for FTA: Political Battle in name of Trade," Dec.2009, pp.10-17.  
[http://www.networkideas.org/ideasact/dec09/pdf/Henry\\_Gao.pdf](http://www.networkideas.org/ideasact/dec09/pdf/Henry_Gao.pdf)

agricultural and industrial sector and unstable railway communication between Russia and Georgia due to Abkhazia, crisis. on the other word political relation between countries which signed FTA is very important.

The main purpose of Russian FTA with Serbia was to have a new pipeline for uninterrupted supply of natural gas to Europe excluding Belarus and Ukraine with 1500 kilometers long “Yujniy Potok” natural gas pipeline with a capacity of 60 billion cube meters per year. The fact is that Serbia has FTA with Belarus and Kazakhstan also very beneficial to Russia. Because it’s entering into the already well-established market. Along with its cost-effective benefit, Serbia has trade with Customs Union members with 80 percent tariff reduction on exports and imports.

**Customs Union:** Since first agreement on Customs Union in 1995, as a result of 40 agreements over two stages for 15 years, Customs Union of Russia, Belarus and Kazakhstan was established on January 1, 2010. Customs Union aims for removing economic barrier between member states, ensuring stable economic development, freeing goods turnover; creating common economic zone and creating situation for member countries to enter global market.

Customs Union statistical data shows that trade between member states increased by 33% in 2011, but in 2012 trade turnover was 68.6 billion USD and increased only by 8.3% compared to 2011. In 2013, trade declined by 5.9% which indicates economic crisis in Customs Union. Decline in trade turnover between member states can be explained by raw material dominance in exports, low competition capacity of other goods and industrial goods decline.

According to “Common customs tariff protocol”, third countries are divided into two categories such as developing countries and underdeveloped country and separate import tariffs are imposed and according to common tariff regulations, same customs tariff are imposed on each of them.

#### **4.3. Some possibilities for Mongolia on signing FTA with China and Russia**

The reason Mongolia looking into signing trilateral FTA with Russia and China rather than signing separate FTAs understood that it is due to country's strategy to balance its relations with two neighbors at a same level as well as a policy to ensure trade (exports and imports) security. For example, if Mongolia sign FTA with either one of them, other side’s interest can be compromised, therefore, Mongolia avoids pressure from either side. Statement by high-

level officials from Russia and China indicates that both countries want to build deeper trade and economic relations with Mongolia. For example, President of China, Xi Jinping and Prime Minister Li Keqiang's statement when signing Medium and long-term strategic cooperation program with Mongolia.. Agreement to establish "Dornod Uranium" joint-company during Russian Prime Minister V. Putin's official visit to Mongolia in May, 2009 and President D. Medvedev in August, 2009 and the fact that in March 2014, in an article on the Russian Customs Union, Mongolia was named one of the possible new members of Customs Union along with Iran and Macedonia shows Russian interest in signing FTA with Mongolia.

Chances for signing trilateral FTA depend on political trust in each other, range of China and Russia geopolitical policy and compatibility of their geo-economic interest. Positive and negative impacts expected from three-party FTA are as a result of this study:

during a study of international practice and Russian and Chinese FTAs with other countries, following positive examples were noticed. Rapid increase of exports in member states as a result of FT., Different growth rate of GDP in member states, as a result of expanding production capacity, lowering of goods price and increasing compatibility at global market, selling some types of goods at non-profitable price, but making up the loss with other goods and making lots of profit, in some cases imports goods price dropped 2 folds which increased purchase capacity of that country and played important role in enhancing economy and creating economic profit equaling to GDP growth. Moreover, for underdeveloped countries, expanding domestic production base, changing its management methods and lowering its risk of economic crisis, increasing investment and employment, collaborating with other member states to overcome market pressure and exploring new production pathway are few of many possibilities.

International practice shows that besides above mentioned positive impacts, there are negative examples on joining FTA for countries with low GDP growth, limited types and amount of export goods brings an increase in a trade deficit. Signing FTA when already in the trade deficit, brings a double hit of failure, losing income from tax with reduced or "zero" rate of customs tariff and deterioration of domestic production competitive capacity too. There is some serious adverse impact from FTA such as depending on a difference in development rate and economic capacity of FTA member states. One of the countries can become dependent on the other or dependency grows deeper, become politically dependent, go under other country's

geopolitical influence. In a country with high corruption rate, affluent group of people with social influence can gain more control with FTA, make decisions to affect interests of disadvantaged social group through conspiring with the opponents and disturb social stability, due to raw material dominated exports structure and fewer products with VAT, inflation rate can go up and due to elimination of customs tariff, common commodities will be exported in large quantities and domestic market shall see insufficient supply of common commodities. It can be concluded that there are many positive outcomes from FTA, however, we should keep in mind that there is more serious adverse outcome from FTA such as being dependent on other country and growing dependency. Kyrgyzstan and Pakistan who encountered above-mentioned problem upon signing FTA with Russia and China has a very similar situation to Mongolia. Therefore it indicates signing three-party FTA can bring above mentioned risks and adverse outcomes.



## CHAPTER 5 CONCLUSIONS

- Future plans and proposed industrial structures must have been taken into consideration for signing FTA rather considering current industrial structure of the country. Such an agreement may be regarded as “tradeless” but the expected importance in the near future is beyond of that most high priority.
- Both China and Russia share great part in Mongolian trade in contrast to Mongolian share in their trade. Therefore, signing bilateral FTA with each separately will have low economic value, on the other word it will be tradeless agreement. In case Mongolia include both them in FTA, it can be highly profitable for the economy of both China and Russia.
- Signing a trilateral FTA with China and Russia has important value for Mongolia to increase its trade volume, initiate economic cooperation by eliminating tariff and nontariff barriers from these countries for Mongolian export goods with added value which will improve competitive capacity same time. Creation of new market for mining product which will avoid Dutch disease is possible.
- China attracts international direct investment greatly in business sector, wholesale and retail business, chemical industry, machinery, electronic equipment supply. As for Russia, major share of direct foreign investment goes to industrial sector, wholesale and retail businesses, mining and realstates. There is an actual need and wide range of possibilities exist to expand economic cooperation between them based on observations on their business environment, trade and investment situations.
- Signing FTA with China and Russia may lead to direct foreign investment and economic development which will be influenced by production and sale of goods dedicated to their market.
- Study shows that list of export goods to Russia and China from Mongolia includes HS code chapters 26, 05, 51, 71, 41, 74, 02 and 25 which are raw materials from natural resources and animal derivatives. Chapter 26 and 05 goods has the highest relative advantage and good competitive capacity.

- China has relative advantage in value added end products. Chapter 20, 63, 68, 69, 70, 73, 86 goods overlaps with Mongolia's imports relative advantage, therefore, there is big chance for Mongolia to import these goods. In contrast, Russia has export relative advantage in mineral fuel, nickel, logs and wooden furniture and mineral fuel as well as crops which overlap with Mongolian imports relative advantage. As for Mongolia, it is able to export only two chapters of goods in Chapter 02 and 25 (meat and fluorspar). If Mongolia solve its problem care of veterinary, sanitation, health and transportation in animal husbandry products, it can expand its export in meat and food by-products.
- Signing FTA with China and Russia may lead to direct foreign investment and economic development which will be influenced by production and sale of goods dedicated to their market Further result of Mongolia evaluation based on General balance equation shows that there is a possibility to see remarkable changes in Mongolia's economy in short term with FTA with Russia and China. In the case of long run, though, mining industry can go up rapidly and export income will increase which may result in "*Dutch disease*". Both of "*Dutch disease*" and cheap import has adverse impact on non-mining sector production and employment. "*Dutch disease*" affects domestic production cost to increase and FTA will decrease the goods and service price. Increased cost of production and lower price of goods and income rate can put domestic business under pressure and in some cases can accelerate "*Dutch disease*".

"Dutch disease": In economics, the Dutch disease is the apparent causal relationship between the increase in the economic development of a specific sector (for example natural resources) and a decline in other sectors (like the manufacturing sector or agriculture). The putative mechanism is that as revenues increase in the growing sector (or inflows of foreign aid), the given nation's currency becomes stronger (appreciates) compared to currencies of other nations (manifest in an exchange rate). This results in the nation's other exports becoming more expensive for other countries to buy, and imports becoming cheaper, making those sectors less competitive.

While it most often refers to natural resource discovery, it can also refer to "any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment".



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### APPENDIX A: HS code

Code	Name		2003	2004	2005	2006	2007	2008	2009	2010	2011
51	Textile products produced with livestock fine, bulky wool and horse yarns	RXA	47.40	43.11	63.71	90.36	94.62	46.68	55.96	40.96	29.57
		RMA	7.58	18.52	3.07	6.02	1.84	1.13	0.53	0.95	0.63
		RTA	6.25	2.33	20.74	15.01	51.55	41.20	105.07	43.18	46.81
		RC	1.80	0.80	3.00	2.70	3.90	3.70	4.70	3.80	3.80
26	Ores and concentrates, slag and ash	RXA	72.50	70.99	53.49	64.07	65.49	62.33	52.05	32.22	27.22
		RMA	0.04	0.01	0.01	0.00	0.00	0,14	0.00	0.01	0.01
		RTA	1674.4	6869.3	9643.9	30289	23465	459.0	40775	6472	4193.5
		RC	7.40	8.80	9.20	10.30	10.10	6.10	10.60	8.80	8,30
25	Saline, sulphur, dust mineral, clay minerals and lime and cement	RXA	13.05	9.91	9.41	9.15	9.52	11.10	12.50	11.24	8.84
		RMA	2.76	2.81	2.93	3.45	3.67	2.88	3.21	3.06	3.04
		RTA	4.72	3.53	3.21	2.65	2.59	3.85	3.90	3.67	2.91
		RC	1.60	1.30	1.20	1.00	1.00	1.30	1.40	1.30	1.10
05	Livestock products	RXA	21.04	18.80	17.12	10.42	8.70	7.99	9.23	5.65	5.98
		RMA	0.11	0.20	0.16	0.39	0.04	0.24	0.01	0.23	0.02

		RTA	188.16	95.16	107.97	26.73	222.67	33.69	797.28	25.08	400.25
		RC	5.20	4.60	4.70	3.30	5.40	3.50	6.70	3.20	6.00
41	Skin hide, leather raw materials and produced skins	RXA	27.21	9.03	10.62	11.76	9.72	1.80	3.01	2.74	2.81
		RMA	0.01	0.08	0.03	0.00	0.01	0.54	0.42	0.55	0.39
		RTA	3968.8	113.79	313.43	4401.36	888.91	3.31	7.26	4.96	7.21
		RC	8.30	4.70	5.70	8.40	6.80	1.20	2.00	1.60	2.00
71	Jewelry and items made of precious stones and precious metal, jewelry metal clad them metal	RXA	11.71	13.89	16.46	8.80	5.97	4.24	3.23	2.62	1.83
		RMA	0.01	0.01	0.01	0.01	0.01	0.04	0.36	0.04	0.06
		RTA	1423.2	1902.4	1820.5	1247.70	417.30	112.80	9.06	66.56	28.51
		RC	7.30	7.60	7.50	7.10	6.00	4.70	2.20	4.20	3.40
02	Meat and edible products	RXA	3.42	1.53	1.32	1.91	1.56	1.61	2.63	1.64	0.93
		RMA	0.14	0.12	0.14	0.30	0.20	0.35	0.22	0,36	0.30
		RTA	23.71	12.21	9.11	6.33	7.72	4.52	12.18	4.62	3.10
		RC	3.20	2.50	2.20	1.80	2.00	1.50	2.50	1.50	1.10
74	Copper and copper articles	RXA	0.72	1.18	1.07	0.98	1.06	1.46	1.20	1.09	0.46
		RMA	0.07	0.06	0.07	0.03	0.06	0.07	0.09	0.07	0.08
		RTA	9.93	19.24	15.97	29.39	17.45	21.67	13.46	16.12	5.78
		RC	2.30	3.00	2.80	3.40	2.90	3.10	2.60	2.80	1.80

27	Mineral fuels, ...and their products, bitum minerals, mineral wax	RXA	0.22	0.27	0.28	0.31	0.63	0.97	1.83	2.56	2.67
		RMA	1.87	1.86	1.90	1.96	1.86	1.39	1.18	1.19	0.93
		RTA	0.12	0.14	0.15	0.16	0.34	0.70	1.55	2.16	2.87
		RC	-2.10	-1.90	-1.90	-1.80	-1.10	-0.40	0.40	0.80	1.10
57	Carpets and woven mats	RXA	1.23	1.14	0.93	1.00	1.25	0.84	0.75	0.56	0.49
		RMA	0.86	0.42	0.43	0.41	0.44	2.53	2.68	2.32	1.75
		RTA	1.43	2.70	2.19	2.43	2.87	0.33	0.28	0.24	0.28
		RC	0.40	1.00	0.80	0.90	1.10	-1-10	-1.30	-1.40	-1.30
61	Textile clothing and textile equipment	RXA	6.46	7.15	3.92	2.54	0.71	1.85	0.63	0.73	0.58
		RMA	0.92	0.94	0.69	0.58	0.16	0.75	7.02	3.92	5.61
		RTA	7.05	7.62	5.67	4.35	4.40	2.48	0.09	0.19	0.10
		RC	2.00	2.00	1.70	1.50	1.50	0.90	-2.40	-1.70	-2.30