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Asia in 2019: Escalating international tensions and authoritarian involution

**Edited by
Michelguglielmo Torri
Nicola Mocci
Filippo Boni**

viella

A large, intricate, light blue mandala design is positioned on the right side of the cover, partially overlapping the text area. It features complex geometric and organic patterns.

CENTRO STUDI PER I POPOLI EXTRA-EUROPEI “CESARE BONACOSSA” - UNIVERSITÀ DI PAVIA

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The Journal of the Italian think tank on Asia founded by Giorgio Borsa in 1989

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CONTENTS

9	MICHELGUGLIELMO TORRI, NICOLA MOCCI & FILIPPO BONI, <i>Foreword. Asia in 2019: The escalation of the US-China contraposition, and the authoritarian involution of Asian societies</i>
25	SILVIA MENEGAZZI, <i>China 2019: Xi Jinping's new era and the CPC's agenda</i>
47	BARBARA ONNIS, <i>China's 2019: Xi Jinping's tireless summit diplomacy amid growing challenges</i>
73	AXEL BERKOFKY, <i>Mongolia 2019: Crisis, obstacles & achievements on the domestic, economic and foreign policy fronts</i>
93	MARCO MILANI, <i>Korean peninsula 2019: The year of missed opportunities</i>
125	GIULIO PUGLIESE & SEBASTIAN MASLOW, <i>Japan 2019: Inaugurating a new era?</i>
163	ANGELA TRITTO & ALKAN ABDULKADIR, <i>Hong Kong 2019: Anatomy of a social mobilisation through the lenses of identity and values</i>
185	AURELIO INSISA, <i>Taiwan 2019 and the 2020 elections: Tsai Ing-Wen's Triumph</i>
215	SOL IGLESIAS & LALA ORDENES, <i>The Philippines 2018-2019: Authoritarian consolidation under Duterte</i>
241	RUI GRAÇA FEIJÓ, <i>Timor-Leste 1945-2019: From an almost forgotten colony to the first democratic nation of the 21st century</i>
267	SALEENA SALEEM, <i>Malaysia 2019: The politics of fear and UMNO's renewed relevance</i>
287	NICOLA MOCCI, <i>Vietnam 2019: Pursuing harmonious labour relations and consolidating its reliable international role</i>
311	MATTEO FUMAGALLI, <i>Myanmar 2019: «The Lady and the generals» redux?</i>
327	DIEGO MAIORANO, <i>India 2019: The general election and the new Modi wave</i>
345	MICHELGUGLIELMO TORRI, <i>India 2019: Assaulting the world's largest democracy: building a kingdom of cruelty and fear</i>
397	YOGESH JOSHI, <i>India 2019: Foreign policy dilemmas and their domestic roots</i>
419	MATTEO MIELE, <i>Nepal 2019: Attempts at mediation in domestic and foreign policies</i>
435	FILIPPO BONI, <i>Afghanistan 2019: Between peace talks and presidential elections, another year of uncertainty</i>
451	MARCO CORSI, <i>Pakistan 2019: The challenges of the first PTI government</i>
473	PAOLO SORBELLO, <i>Kazakhstan 2018-2019: Change and continuity amid economic stagnation</i>
491	<i>Reviews</i>
523	<i>Appendix</i>

When this Asia Maior issue was finalized and the Covid-19 pandemic raged throughout the world, Kian Zaccara, Greta Maiorano and Giulio Santi, all children of Asia Maior authors (Luciano Zaccara, Diego Maiorano and Silvia Menegazzi), were born. We (the Asia Maior editors) have seen that as a manifestation of Life, reasserting itself in front of Thanatos. It is for this reason that we dedicate this issue to Kian, Greta and Giulio, with the fond hope that they will live in a better world than the one devastated by the Covid-19 pandemic.

MONGOLIA 2019: CRISIS, OBSTACLES & ACHIEVEMENTS ON THE DOMESTIC, ECONOMIC AND FOREIGN POLICY FRONTS

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This article analyses the main issues and developments on Mongolia's domestic, foreign economic and foreign policy agenda in 2019, and concludes that the country's almost complete dependence on Russia and China in terms of trade and energy is here to stay. On a positive note, the article concludes that Mongolia's democratically-elected institutions are able to address and reverse its president's anti-democratic power-grabbing and is able to stand its ground in a decisively non-democratic and authoritarian neighbourhood. The resource-rich Mongolia with estimated reserves of copper, coal and other minerals valued at US \$1-3 trillion, achieved economic growth close to 7% in 2019. This makes Mongolia one of the world's fastest growing economies although the country's economic growth rises and falls with commodity prices. Adding to its economic vulnerability is its near-complete dependence on China. In 2019, China was – as in previous years – by far the biggest purchaser of Mongolian coal and copper and China buys more than 90% of its exports. In March 2019, Mongolia experienced a constitutional controversy, which in November of the same year resulted in constitutional amendments. Mongolia's hybrid political system remains a recipe for political stalemate and the country's still rampant corruption contributes to that instability. In the year under review the country continued to diversify its foreign and foreign economic relations through its «Third Neighbour» Policy, i.e. the expansion of political, trade and economic and security relations with fellow democratic countries such as the US, India and Japan.

1. Introduction

Mongolia, at times referred to in the US and the West in general, as a «democratic oasis», is surrounded by the authoritarian states Russia and China. That «oasis», it is hoped among Mongolian policymakers critical of excessive Chinese influence on Mongolia's economy and politics, will join forces with the US and its Asian neighbours such as Japan and Taiwan and also India to counterbalance Chinese political and economic dominance in Asia.

This is part of Mongolia's so-called «Third Neighbour» policy. The term was first used in 1990 by then US Secretary of State James A. Baker who referred to the United States as Mongolia's «Third Neighbour» What Baker intended at the time was a US policy to develop relations with Mongolia, providing the country with an alternative to relations with its «first» and «second» neighbours: China and Russia. Mongolia later adopted the

«Third Neighbour» policy as a strategy to expand its relations with Japan, the United States and India seeking to reduce its economic dependence on China.¹

To be sure, that is easier said than done. Mongolia heavily depends economically on China and as the recent past has shown is very vulnerable to Chinese political and economic pressure, and indeed blackmail. While China buys more than 90% of Mongolia's exports, it supplies Mongolia with more than one-third of its imports. Mongolia's dependence on others, however does not stop there: Russia provides the country with 90% of its energy supplies.²

Since 1991 Mongolia's political system has been of a hybrid nature: a 76-member unicameral legislature with a directly-elected president. Governing power is shared by an elected president and a government which is elected by parliament and headed by a prime minister. It is a system of political cohabitation in which Mongolia's president – very much the case over the last 30 years – belongs to the parliamentary opposition, and is authorized to veto legislation and propose his own. Such a hybrid political system has created difficulties for governments wishing to implement their policy agendas, always fearful of a presidential veto. The Mongolian People's Party (MPP) holds 65 out of 76 seats in the parliament (the State Great Khural). The Democratic Party (DP) – the party of Mongolia's president – currently finds itself in opposition holding just 11 seats. The positions of both prime minister and MPP chairman have been occupied by Ukhnaa Khurelsukh since October 2017. In the case of Mongolia, the DP – MPP party duopoly, has often led to political stalemate.³ That together with corruption has been a constant problem for Mongolia which passed its first constitution in 1992 after decades of communist rule. One can be tempted to conclude – as Mongolia scholar Julian Dierkes does – that the above-mentioned political stalemate by default leads to or is accompanied by political instability. However, that is not necessarily always the case. While Mongolia's party duopoly has over the years indeed obstructed efficient decision-making and policymaking, it does have a democratically elected political mandate. Therefore, the party duopoly can also be cited as evidence that Mongolia's democracy is functioning and that the parties and politicians in power or opposition are making use of their con-

1. Mongolia is one of the least densely populated countries in the world with two people living per square kilometre. It is a US\$ 13.5 billion economy with a population of a little more than 3 million. Twice as many ethnic Mongols – more than 6 million – live in Inner Mongolia in neighbouring China (in the Inner Mongolia Autonomous Region of China); for details see also 'Country Report Mongolia July 1st, 2019', *Economist Intelligence Unit*, London, UK.

2. See 'Mongolia CIA World Fact Book', December 2019.

3. See Julian Dierkes, 'Mongolia Hamstrung by Political Paralysis and Corruption', *East Asia Forum*, 1 February 2019.

stitutionally-granted rights and mandates. The November 2019 constitutional amendments discussed below are further evidence that the system of checks and balances – albeit imperfect and prone to controversy – is functioning. The country has had 15 different cabinets since 1992, each lasting an average of 1.5 years.⁴ The current president, Khaltmaagiin Battulga, is a former wrestling champion and is, because of his populist and nationalist rhetoric and policies, at times described as the «Trump of the Steppe». He was elected in 2017, in part on a pledge to defend the country from Chinese economic and political hegemony in Asia. However, the Mongolian economy's dependency on commodity exports to China will continue to make sure that such an objective remains difficult to achieve. While Mongolia is self-sufficient in oil with, almost all of its crude oil is exported (mostly to China) and all of its finished petrochemical products are imported – more than 90% from Russia. Consequently, problem-free relations with both China and Russia are essential to Mongolia's economic stability and prosperity.

Back in 2016, Mongolia had a good taste of what angering China could lead to. As a predominantly Buddhist country, Mongolia decided to host a visit from the Dalai Lama, to which Beijing responded immediately by imposing punitive tariffs on Mongolian exports. Mongolia had *de facto* no choice but to submit to Chinese blackmail politics, apologize and promise not to receive Tibet's exiled spiritual leader ever again in order for Chinese tariffs to be revoked.⁵

Economic dependence on the authoritarian China and Russia, Mongolia's political leadership has decided, will continue to be counterbalanced by increased economic exchanges and security ties with the aforementioned non-authoritarian countries. Political pressure and indeed blackmail politics exerted by Beijing in the recent past has also probably done its share to convince the capital Ulaanbaatar to look for friends beyond its immediate geographic vicinity. To be sure, ties with Russia and even more importantly China will remain central to Mongolia's economic stability and prosperity, and it is probably fair to conclude that Mongolia's political weight and influence is not big enough for Moscow and Beijing to worry too much about increased political security ties with Washington and its allies.

2. Constitutional controversy and constitutional amendments

In March 2019, a constitutional controversy erupted when amendments to the Laws on the Legal Status of Judges, Public Prosecutor's Office

4. See 'I am not a Dictator: Mongolian PM Survives Attempted Ousting', *The Guardian*, 1 December 2018.

5. See James Crabtree, 'Mongolia Needs Allies to Withstand China's Looming Threat', *Nikkei Asian Review*, 9 October 2019.

and Anti-corruption was adopted in an emergency session of Parliament on 27 March 2019. The amendments authorized Mongolia's Judiciary Council and National Security Council to recommend the dismissal of judges, prosecutors and the head of the country's Anti-Corruption Agency. The new legislation was proposed by President Battulga and ratified by a majority of the ruling Mongolian People's Party (MPP), which holds 65 out of 76 seats in the parliament. The Democratic Party – the one to which Battulga belongs – as well as a minority of MPP parliamentarians voted against the law. Conversely, 82.1% of the lawmakers in parliament voted to amend the existing prosecutorial system.⁶

The law was in clear violation of the principle of separation of powers, given that the National Security Council is made up of the president, the prime minister and the speaker of the parliament, whereas the Judicial General Council is appointed by the president. As a matter of fact, Battulga immediately used his new power to dismiss the chief justice of the country's supreme court, the general prosecutor and his deputy (who supervise the appointment process of more than 500 Mongolian prosecutors).⁷

Battulga did so in an attempt to obstruct and/or terminate ongoing investigations into the 49 out of 75 Mongolian parliamentarians accused of corruption and misuse of public funds. At the time, the President and the above-mentioned 82% of parliament's lawmakers called the law a matter of national security and passed it within 24 hours.

The reason why the large majority voted in favour of the laws is explained by the fact that 49 out of 75 Mongolian parliamentarians are currently under investigation by public prosecutors and the Anti-Corruption agency over allegations that they misused public funds for small and medium-sized enterprises and distributed the loans to businesses of their own choice.

In mid-November 2019 then, the constitutional crisis became a constitutional opportunity. The Mongolian parliament submitted a number of constitutional amendments,⁸ aimed at strengthening the powers of the prime minister and equally importantly, to supersede the above-mentioned March 2019 legislation, the cause of the said crisis. Through these amendments, the prime minister – as is the case in most parliamentary democracies – will be thus armed with the authority to appoint and dismiss his cabinet members as opposed to parliament voting to appoint them. Parliament in turn has been given more oversight powers over the government's budget as well as the authority to set up investigative committees (as a result

6. See Anand Tumurtogoo, 'Mongolia's President Is Slicing Away Its Hard-Won Democracy', *Foreign Policy*, 29 March 2019.

7. See Transparency International, *Mongolia should Uphold the Independence of the Judiciary and Anti-Corruption Agency*, 29 March 2019.

8. For the second time since 1992.

of recent high-profile corruption scandals involving lawmakers and policy-makers, for details see below). Furthermore, the constitutional amendments stipulate that Mongolia's presidents' terms will, from 2025, be limited to one six-year term as opposed to the current two four-year terms.⁹ These constitutional amendments are scheduled to enter into force on 25 May 2020, and have yet to be approved by Mongolia's Constitutional Court.¹⁰ Ironically, the constitutional amendments aimed at reducing the president's powers and superseding the aforementioned law equipping the National Security Council with the authority to fire judges and prosecutors, were approved by President Battulga. This led Mongolia scholar Julian Dierkes to conclude that the majority Mongolian People's Party (MPP) – struck a deal with the president's Democratic Party to jointly endorse President Battulga's intention to again stand in the 2021 presidential election (to be elected for another 6 years).¹¹

3. Corruption

Mongolia's political stability continues to be challenged by high levels of corruption, leading to latent political instability.¹² Transparency International, the non-governmental organization documenting public corruption, ranked Mongolia 106 out of 180 countries in its 2018 Corruption Perceptions Index.¹³ In late-2018 Mongolian domestic politics were convulsed by a major corruption scandal related to a public-funded financing initiative for private businesses provided by the so-called SME Fund which offered low-interest loans to small and medium-sized private companies. It turned out that the large majority of firms receiving loans from the SME Fund in 2016 and 2017 had financial connections¹⁴ as well as family ties with government officials from both the governing and opposition parties. Another corruption scandal, the so-called «60 billion case», involved politicians from the Mongolian People's Party (MPP) and relates to audio recordings during the 2016 election campaign, which revealed that political posts had been assigned in return for financial donations. These revelations led to a leg-

9. See 'Mongolia Amends Constitution in Bid to End Political Instability', *Reuters*, 15 November 2019.

10. For further details see also Julian Dierkes, 'Constitutional Amendments Adopted', *Mongolia Focus*, 15 November 2019.

11. See Julian Dierkes, 'Preserving the Political Status Quo in Mongolia', *East Asia Forum*, 10 January 2020.

12. See Julian Dierkes, 'Corruption is a Cancer that Mongolia Can't Cut out', *East Asia Forum*, 12 January 2018.

13. See 'Transparency International Corruption Perceptions Index 2018', (<https://www.transparency.org/cpi2019>).

14. Received bribes.

islative shutdown for two months from November 2018 to January 2019. In November 2018, Prime Minister Ukhnaa Khurelsukh and his cabinet survived parliament's attempt to oust them over the aforementioned corruption scandal.¹⁵ Following these scandals, Mongolia has pledged to seek to tackle and reduce corruption. Accordingly, with the endorsement of the Mongolian authorities, the US is assisting Mongolia by among other ways, retraining its judges and prosecutors.

4. *The mining business and Oyu Tolgoi mining project*

Foreign direct investment (FDI) in Mongolia's extractive industries – copper, gold, coal, molybdenum, fluor spar, uranium, – has over the last decade fundamentally transformed Mongolia's economy away from its dependence on herding and agriculture. FDI in Mongolia from 1990 to 2018 amounted to roughly US\$ 24 billion, more than 70% of which came from the mining sector. With immense reserves of copper, coal and other minerals valued at US\$ 1-3 trillion, Mongolia became one of the fastest growing economies in the world.¹⁶ Thanks to the country's mining business boom, its economic growth reached a staggering 17% in 2011 and FDI connected to the mining sector poured into Mongolia. At the time, the country was referred to as «Minegolia» and by 2013 the country's GDP per capita reached US\$ 4,400 (today it is lower than this, roughly US\$ 4,100). After three years of double-digit growth driven by the mining revenues (2011-2013), however, commodity prices together with Mongolia's economic growth collapsed. By 2016, growth had fallen to 1.2% and the country had to ask for a bail out by the International Monetary Fund (IMF). All this was accompanied by a financial and fiscal economic crisis as the Mongolian tugrik's freefall collapsed against the US dollar by close to 80% between March 2013 and January 2017. Within a five-year span, FDI in Mongolia fell from US\$ 4.5 billion to just US\$ 94 million in 2015.¹⁷

During 2018 and 2019 the price for copper and coal¹⁸ recovered and with it Mongolia's copper and coal export earnings. Export earnings from coal over the first three months of 2019 reached US\$ 644 million, more

15. For details see also 'Cornered by Corruption', *Economist Intelligence Unit*, 16 January 2019.

16. See Tzolmon, Baatarzorig, Ragchaasuren, Galindev, Helene Maisonnave, 'Effects of Ups and Downs of the Mongolian Mining Sector', *Environment and Development Economics* Vol. 23 Special Issue No.5 October 2018, pp. 527-542.

17. See Nicholas Muller, 'Mongolia's New Mining Boom', *The Diplomat*, 22 October 2019.

18. Since 2017, Mongolia's coal exports have become more profitable than the country's copper exports, thanks to the rising price of coal and strong demand from China.

than 25% compared to 2018. China imported more coal from Mongolia when it decided to reduce imports from Australia (Chinese-Australian relations deteriorated dramatically during 2019).¹⁹

The Oyu Tolgoi mine (also referred to as OT), located in the southern part of the Gobi Desert roughly 550 kilometres south of Mongolia's capital Ulaanbaatar and 80 kilometres north of the Chinese border, is the crown jewel of Mongolia's mining industry. The mine's operator Rio Tinto has become Mongolia's biggest taxpayer and the mining project employs more than 15,000 workers, of whom more than 90% are Mongolian. Furthermore, the project supports another 45,000 jobs indirectly. Indeed, it is hard to overstate the importance of the Oyu Tolgoi mining project for Mongolia's economy. By the time the mine is fully operational, it will be the world's third-largest copper mine, with an estimated life of 50 years. It is by far the biggest foreign investment ever made in Mongolia and the costs so far amount to US\$ 11.9 billion (and will cost billions more before the construction is completed). However, Mongolia has yet to resolve questions related to ownership of the Oyu Tolgoi mining project. OT is jointly owned by the government of Mongolia, 34%, and Turquoise Hill Resources, 66%, of which Rio Tinto owns 51%.²⁰ Access to what is one of the largest copper deposits in the world will make an important contribution to economic growth in Mongolia, which relies on mining revenues to fund more than 30% of the country's national budget. Production from the surface part of the mine began in 2013. The underground expansion has been delayed by difficult ground conditions and extraction will go as deep as 1.3 kilometres. The completion of that phase – expected to increase production from 125,000-150,000 tons of copper concentrate a year to 550,000 tons – has already been delayed by more than two years and is now (notwithstanding further delays) scheduled to be completed by May 2022 at the earliest. Expected costs for that phase have risen by roughly US\$ 1.9bn from the original estimate of US\$ 5.3 billion.

And there are other Mongolian mines with enormous resources. The Khushuut coal mine, for example, located in the Khovd Province. Since 2007, the Khushuut mine has been controlled by the Mongolia Energy Cor-

19. The year in which Australia, together with other countries, began to express its concerns over human rights abuses in the Chinese province of Xinjiang, and accused Beijing of seeking to recruit and plant a spy in the Australian parliament as well as when it continued to ban the Chinese telecommunications company Huawei from supplying equipment to Australia's 5G mobile network. All of this of course was dismissed as «hysteria» and «unfounded allegations» in Beijing and led the Chinese political leadership to retaliate economically by reducing coal imports from Australia. For details see e.g. Christina Zhou, 'China-Australia Relations Became Complex in 2019 with Spy Claims and Human Rights Abuses', *ABC News*, 7 January 2020.

20. For details of the agreement see 'Oyu Tolgoi Investment Agreement between the Government of Mongolia and Rio Tinto International Holdings Limited', *Turquoise Hill*, 6 October 2009.

poration (MEC), a Hong Kong-based company. The volume of coal exported to China from Khushuut in 2018 reached 36.2 million tons, of which 27.7 million tons was coking coal, above all for use in China's steel industry. Estimated to have reserves amounting to 460 million tons of coking coal, it is among the largest reserves in Asia. And then there is the Tavan Tolgoi coal mine, like the Oyu Tolgoi mine also located in the Gobi Desert. It is one of the world's largest untapped coking and thermal coal deposits. It has a total estimated resource of 6.4 billion tons, one-third of which is high-grade hard coking coal.²¹ Mongolian miners, however, must deal with temperatures ranging from minus to plus 40 Celsius in the Gobi Desert, which is why mining is limited to the period March to November. Most other mining-rich regions on the other hand operate all year round. Mongolians have long complained about the inability of its leadership to allow larger parts of the population to benefit from the country's natural resources. Opinion regularly shows overwhelming support for the public ownership of natural resources, and the November 2019 constitutional amendments include provisions which stipulate that the Mongolian people must receive major benefits from the country's «strategic deposits», in essence Mongolia's main copper and coal mines. How exactly such a provision will be translated into reality remains yet to be seen.

4.1. *Renegotiating the terms*

In April 2019, a group of parliamentary lawmakers requested the renegotiation of the OT mining contract terms in order to increase the state's ownership stake.²² In addition, they sought to review the 2015 so-called Dubai Agreement, which created the legal basis for the underground extension of the project. The group of lawmakers submitted a 200-page review to Mongolia's National Security Council and a parliamentary standing committee on economic matters.²³ At the end of November 2019, parliament completed a two-year investigation with a resolution demanding improvement to the terms of the two most important contracts governing the project: the first, surface-mine phase signed in 2009 and the second signed in Dubai in 2015 which gave Rio Tinto the go ahead to work on the underground mine. The Mongolian parliament and government are aiming to reduce the interest rates on loans it uses to fund its share of development costs. The government does not receive any dividends from its 34% stake in the Oyu Tolgoi mine and is obliged to repay the funds borrowed from Rio Tinto to finance its invest-

21. See Vinicy Chan, Dinesh Nair, Carol Zhong, Julia Fioretti, 'Mongolia's Tavan Tolgoi Ramps Up Work on \$ 1 Billion Hong Kong IPO', *Bloomberg*, 30 October 2019.

22. See Munkhchimeg Davaasharav, 'Mongolia Lawmakers Seek to Rewrite Oyu Tolgoi Deal', *Reuters*, 5 April 2019.

23. See 'Mongolia Seeks Better Terms for its Vast Mining Project', *The Economist*, 26 November 2019.

ment. At the current pace of debt repayment, it is estimated that the government will not receive any dividends before 2030 at the earliest. Furthermore, the government is requesting Rio Tinto to build a power plant to provide electricity for the mining complex.²⁴ Until a planned local power plant comes on stream (estimated for 2023 at the earliest) the Oyu Tolgoi mine will continue to pay about US\$ 130 million for electricity to Chinese providers annually. If all of the above-mentioned parliamentary recommendations were to be implemented and the contract terms changed, this could inject further uncertainty into the regulatory environment and possibly further delay the implementation of the mining development's second phase.²⁵ The US government holds a 35% American equity-ownership stake in the Oyu Tolgoi mine and in mid-2019 US Ambassador to Mongolia Michael Klecheski described OT as a «bellwether» for foreign investors.²⁶ What he meant was that the OT mining project is a test as to whether Mongolia – together with foreign investors – will be able to fully exploit its estimated US\$ 1-3 trillion mineral wealth.

5. *Growth, debts and resource curse*

The health of Mongolia's economy is heavily dependent on global commodity market prices. When the first contract between the Mongolian government and Rio Tinto was signed in 2009, copper from the Oyu Tolgoi mine was expected to add 5% per year to the country's annual growth rate between 2013 and 2020. But then the price for copper collapsed and fell by almost 50% between 2011 and 2015. While Mongolia's economic growth reached an eyebrow-raising 17% in 2011 (before the price for copper collapsed), it sank to 1.2% in 2016. As a result of collapsing copper prices, Mongolia had to be bailed out twice by the International Monetary Fund (IMF), in 2009 and 2017. In 2017, Mongolia received a three-year IMF-led bail-out, in the form of an Extended Fund Facility (EFF). This consisted of contributions from the IMF (US\$ 434.3 million, which was distributed in Mongolia until late 2019), US\$ 3 billion from bilateral donors, and contributions from the Asian Development Bank and the World Bank. The 2017 bail-out has eased the pressure on Mongolia's fiscal accounts by helping to fulfil some of the country's external public-debt obligations due in 2019.

Thanks to stable prices for commodities, 2019 was a very good year for Mongolia's economy and growth rates. According to the Asian Develop-

24. See Neil Hume, 'Mongolia Says Rio-led Copper Projects will go Ahead', *The Financial Times*, 26 November 2019.

25. At the end 2019, negotiations between the Mongolian government and Rio Tinto on the contract terms were ongoing.

26. See Roncevert Ganan Almond, 'Can Mongolia Shape the World Once Again?', *The Diplomat*, 7 July 2019.

ment Bank (ADB) high copper prices Mongolia's fiscal position has in 2019 significantly improved as the deficit declined from 15.3% of GDP in 2016 to a surplus of 2.6% in 2018 and 3.4% from January-July 2019.²⁷ However, according to World Bank statistics Mongolia's current total external debt – both public and private – amounts close to US\$ 30 billion, more than double the amount of its US\$ 13.5 billion economy. In 2018 the government announced a sovereign wealth fund.²⁸ However, the establishment of the fund was delayed (now scheduled to take place sometime in 2020) due to a legislative backlog caused by the 2018 corruption scandals. The envisioned fund is called Future Heritage and the government has announced it will be set up with an estimated US\$ 219 million initial capital. An additional US\$ 400 million will be added each year thereafter.²⁹ Like similar funds in other countries, it is envisaged that it will be used to stabilize fiscal expenditure in the event of revenue volatility – something to which Mongolia is vulnerable on account of its dependence on external demand for commodities, above all coal and copper.

Mongolia's attempt to expand trade and investment ties with countries other than China (above all the US, Japan and India, for details see below) is part of the country's efforts to disengage itself from what is referred to as «resource curse», i.e. the concept that countries with enormous natural resources find themselves highly vulnerable to economic boom-bust cycles.³⁰ The «resource curse» (also referred to as «resource trap») is a paradoxical situation, in which countries with an abundance of non-renewable natural resources experience low economic growth or even economic contraction. This situation occurs when a country focuses all of its production means on a single industry, such as mining or oil production, neglecting investment in other industrial sectors. As a result, the country in question becomes overly dependent on the price of commodities, and the overall GDP becomes extremely volatile – as was the case in Mongolia between 2011 and 2015 when the price for copper collapsed.

6. *Suspicious of and depending on China*

Mongolians have cherished their democracy ever since its «democratic revolution» of 1990, after decades of Soviet Union influence and hegemon-

27. See 'The World Bank in Mongolia – Overview', 10 October 2019.

28. See 'Mongolia to Establish Sovereign Wealth Fund', *Mongolian News Agency*, 1 October 2018.

29. Funding for the wealth fund will above all be generated from mining royalty fees, dividends of government shares, revenues from oil and natural gas production sharing agreements.

30. See Lucy Hornby, 'Mongolia: Living from Loan to Loan', *The Financial Times*, 12 September 2016.

ony. Therefore it is no surprise that they are fundamentally suspicious of communist China, for decades having been subject to Soviet influence and interference in Mongolian politics until the country's transition to democracy 30 years ago.³¹ Indeed, Mongolia's involvement in China's Belt and Road Initiative (BRI) is – at least for the time being – limited and even if the country is in desperate need for infrastructure, opinion polls reveal that the majority of the Mongolian people is opposed to depending too much on Chinese BRI infrastructure investments. However, Mongolia's dependence on China as its main buyer of commodities could not be greater. China receives roughly 90% of all Mongolian exports: coal, copper and other ores, crude oil, and unprocessed cashmere. At the same time, China supplies Mongolia with more than one-third of its imports and is also the country's single largest foreign investor. China has been building or funding hundreds of coal-fired power plants in Asia and elsewhere. Coal's share of China's total energy consumption amounts to roughly 60% and it today consumes more coal than the rest of the world combined.³² Consequently, unless there is a major and abrupt economic slowdown in China, it will continue to import coal on a large scale from Mongolia.

Indeed, China will in the years ahead continue to remain Mongolia's largest export market, and Beijing's financial and technical assistance under China's Belt and Road Initiative will ensure that economic and trade ties with China remain central. Mongolia's inclusion in the BRI encompasses Chinese investments in Mongolian transport links. To be sure, Beijing, as previously mentioned, has never failed to punish Mongolia economically whenever it dared to «misbehave» politically («misbehave» obviously as defined by Beijing).

Indeed, it probably does not do justice to the overall quality of Mongolian-Chinese relations to conclude that Beijing will always and by default resort to economic and/or blackmail politics in order to address disagreements and conflict between the two countries. Specifically, the imposition of tariffs on Mongolian exports in 2016 after hosting the Dalai Lama is not necessarily representative of how China will deal with Mongolia in the case of disagreements and bilateral conflict. It should not go unmentioned that a very harsh reaction to hosting the Dalai Lama – from Beijing's perspective a separatist challenging China's territorial integrity –

31. For an excellent analysis of Mongolia's contemporary history, politics and its transition to a democracy see Michael Dillon, *Mongolia. A Political History of the Land and its People*, London: I.B. Tauris Bloomsbury 2018. See in particular chapter 6 ('Democratic Revolution: Mongolia after the Collapse of Soviet Power') and chapter 9 ('The Mongols and China: Inner Mongolia and Ulaanbaatar's Relations with Beijing').

32. For details see also 'How is China's Energy Footprint Changing', *China Power Project, Center for Strategic and International Studies (CSIS) Washington D.C.* 10, February 12 2020.

falls under what Beijing defines as defending the country's non-negotiable 'core interests'.³³

Furthermore, Mongolia is not alone in finding itself subject to Chinese pressure and sanctions.³⁴ In 2016, China temporarily interrupted banana imports from the Philippines after the Permanent Court of Arbitration (PCA) ruled that China's territorial claims over much of the South China Sea have no legal basis. It also ruled at the time that China cannot claim what it calls 'historical rights' over territories in the South China Sea that are also claimed by a number of other countries, among them the Philippines (which in 2013 submitted the case to the PCA).

In July 2019 Beijing reminded Mongolia that teaming up with China's rivals does not go unnoticed. It warned Mongolia not to «misbehave», on this occasion by teaming up with Washington on a level too close for comfort for Beijing. President Battulga had just announced the adoption of the (below-mentioned) strategic partnership with the US. Beijing reacted by ordering its state-controlled media to warn Mongolia that it would sooner or later fall under Chinese suzerainty. This in turn led to concern among some Mongolian policymakers and lawmakers that the strategic partnership with Washington would inevitably be interpreted in Beijing as a provocation as well as an act directed against it. Conversely, some in Mongolia's law and policymaking circles critical of Chinese meddling in Mongolia's internal affairs were also concerned that the government was caving in to Chinese pressure to avoid the impression that Ulaanbaatar was developing Mongolia's relations with Washington at the expense of those with China. These same circles cited Chinese government speeches which, in their view, indicated that the year 2049 – the 100th anniversary of the foundation of the People's Republic of China (PRC) – will be the year when Mongolia (together with Taiwan) is absorbed by Beijing.³⁵ Of course, all this was in line with the usual pattern of Chinese-style interference and threats to play by Chinese rules or face the consequences.

33. China has decided that Tibet, Taiwan and large parts of the South China Sea are integral and indisputable parts of Chinese territory and at the center of China's 'core interests'. Consequently, challenging China's territorial claims has in the past led and will continue to lead in the future to harsh sanctions imposed on those who 'dare' to contest the definition and expansion of Chinese national territory as defined by China. For an analysis on China's 'core interests' see e.g. Shaun Breslin, Jinghan Zeng, 'Securing China's Core Interests: The State of the Debate in China', *International Affairs* 91 (2) March 2015, pp. 245-266.

34. For details see also Suisheng Zhao, 'China and the South China Sea Arbitration: Geopolitics versus International Law', *Journal of Contemporary China*, Volume 27, 2018, pp.1-15.

35. See Michael Green, 'The United States Should Help Mongolia Stand up to China', *Foreign Policy*, 26 September 2019. The US scholar (and former Senior Director for Asian affairs at the US National Security Council, NSC) Michael Green bases his conclusions on numerous conversations with Mongolian scholars, lawmakers and policymakers in Mongolia in 2019.

6.1. *China-Russia-Mongolia Economic Corridor (CMREC)*

In 2014, Chinese President Xi Jinping announced the establishment of the China-Mongolia-Russia Economic Corridor (CMREC) as part of the Belt and Road Initiative's (BRI) objective to develop infrastructure and industrial projects to establish free trade and economic cooperation zones in cross-border cities. The China-Mongolia Cross-border Economic Cooperation Zone from Erenhot (in the Inner Mongolia Autonomous Region along the Sino-Mongolian border) to Zamiin Uud (in the Dornogovi Province in south eastern Mongolia) and the Northern Railway Corridor which extends railway network connections between Mongolia, Russia and China can be cited as examples. In June 2016 then, China, Mongolia and Russia signed another agreement to build an economic corridor to increase transport links between the three countries. Among others they agreed to cooperate in transport infrastructure connectivity and port construction.³⁶ It was announced that Mongolia would be used as what is referred to as a «transit corridor» to facilitate oil and gas deliveries from Russia to China.

Russia in turn announced in September 2019 that it would provide Mongolia with a US\$ 1.5 billion fund to build infrastructure. The Mongolian President Battulga pledged to use the funds to build new railroads in order to further expand coal and mineral exports to Russia. Battulga also plans to build a Mongolian terminal in a Russian port in order to facilitate the exporting of natural resources through Russia. At a joint ceremony to mark the occasion, Russian President Vladimir Putin and his counterpart Battulga signed a permanent treaty on friendly relations and comprehensive strategic partnership. Part of that partnership is Moscow's commitment to continue modernizing the Ulaanbaatar Railway in order to increase freight traffic along the CMREC.³⁷

7. *Relations with the US*

In April 2019 the US Congress took the initiative to strengthen trade and investment ties with Mongolia when it submitted the so-called «Mongolia Third Neighbor Trade Act».³⁸ That act authorizes duty-free treatment for certain articles imported from Mongolia, namely cashmere wool. Mongolia produces over a third of the world's raw cashmere, but most Mongolian

36. See 'China, Russia, Mongolia Ink Economic Corridor Plan – Xinhua', *Reuters*, 24 June 2016.

37. See Russia, 'Mongolia Sign New Treaty To Bring Partnership To Whole New Level', *Radio Free Europe*, 3 September 2019.

38. See Congress of US, *116th US Congress (2019-2020), H.R. 2219 – Mongolia Third Neighbor Trade Act*.

raw cashmere is exported to China, and the US in turn buys nearly all of its cashmere products from China.

In June 2019, Mongolia and the US co-sponsored the 17th iteration of Khaan Quest, a military exercise simulating United Nations peacekeeping operations involving military troops from 31 countries. Roughly 10% of Mongolia's armed forces are currently serving in UN peacekeeping operations. US-Mongolian military interoperability has been tested and strengthened through contributions to US-led military and coalition campaigns in Afghanistan and Iraq from 2003-2009.³⁹ The following month, Mongolia and the US signed a bilateral Strategic Partnership Agreement. Mongolia has in the recent past adopted strategic partnerships with four other countries, namely Russia in 2006; Japan in 2010; China in 2014; and India in 2015. Through the bilateral agreement Washington and Ulaanbaatar pledge to strengthen security cooperation in the Indo-Pacific region, promote international law and transparency and the protection of human rights, media and internet freedom. The timing of the agreement's adoption complemented the US Department of Defense's May 2019 Indo-Pacific Strategy report, which refers to Mongolia as one of the «democracies in the Indo-Pacific, that are reliable, capable, and natural partners of the United States».⁴⁰

Furthermore, in July 2019 both countries agreed to cooperate in the area of law-enforcement, to strengthen cooperation in multilateral engagements such as peacekeeping, humanitarian assistance, disaster preparedness and relief operations, and pledged to expand trade and investment relations.⁴¹ The US-Mongolia strategic partnership furthermore aims at strengthening Mongolia's economic security by increasing the flow of foreign direct investment, supporting small and medium enterprises (SMEs), involving state-owned enterprises, and further exploring emerging new markets such as technology, science, and space exploration.⁴² Finally, the June 2019 bilateral strategic declaration calls for the utilization of the US International Development Finance Corporation (DFI), the US development bank. Among others, the DFI offers debt financing programmes, equity financing, political risk insurance as well as technical assistance and

39. From 2003 to 2009, Mongolia contributed in ten rotations a total of 1,200 troops to the Polish-led military operation «Multinational Division South-Central Iraq». In 2009, Mongolia deployed 115 troops to Afghanistan, where they contributed to the operations «Enduring Freedom» and «International Security Assistance Force.» For further details see e.g. Christopher Pultz, 'The Role of Peacekeeping in Mongolia's Military Strategy: A New Paradigm for Security', *Asia Policy*, No. 17, 2014, pp. 127-146.

40. See US Department of Defense, *DOD Releases Indo-Pacific Strategy Report*, 31 May 2019.

41. See US Department of State, *Declaration on the Strategic Partnership between The United States of America and Mongolia*, 31 July 2019.

42. See Bolor Lkhaajav, 'US Becomes Mongolia's 5th Strategic Partner', *The Diplomat*, 5 August 2019.

development in developing and emerging economies (e.g. Mongolia).

During his visit to the US in July 2019 Mongolian President Battulga raised the above-mentioned expansion of security cooperation with Washington in the Indo-Pacific by announcing that Mongolia will become an active contributor to the May 2019 US Indo-Pacific Strategy. While it would be unwise to overestimate Mongolia's geo-political and geo-strategic influence and impact on Asian security, its endorsement of Washington's Indo-Pacific Strategy would not be welcome in either Moscow or Beijing. Not least because China and Russia see themselves as the «target» of that strategy: a US-driven containment strategy, supported by the expansion of bilateral security with Japan, India, Australia.

In August 2019, US Secretary of Defence Mark Esper visited Mongolia. Washington's strategy to intensify its ties with Mongolia has to be understood in light of the fact that Mongolia is bordered by the two countries which the US Pentagon identifies as posing the greatest long-term threat to the United States: Russia to the north and China to the south. Esper announced that Washington plans to increase its trade ties with Mongolia to help the country reduce its dependency on China. He also discussed the possibility of expanding joint US – Mongolian military training.⁴³ In the past, Mongolia has contributed to the US-led military operation in Afghanistan and today continues to allow US military troops to conduct cold-weather training on Mongolian territory.⁴⁴

8. *Ties with Tokyo*

In 2015, Japan became Mongolia's first «third neighbour». The rapidly increasing Chinese political and economic influence in the region has encouraged Japan to develop new political and economic alliances, and Mongolia is one the countries with which Tokyo is planning to upgrade its ties. Back in October 2015, Japan and Mongolia signed a Memorandum of Understanding (MOU), which among others agreed to jointly develop mining and infrastructure at Tavan Tolgoi, the country's biggest coal mine.⁴⁵ In the same year, Japan and Mongolia also adopted a free trade agreement.⁴⁶ Over the first two years since the agreement entered into force in June 2016,

43. See Lara Seligman, 'In Rare Mongolia Stop US Defense Secretary Get an Unusual Gift', *Foreign Policy*, 8 August 2019.

44. See Mendee Jargalsaikhan & Julian Dierkes, 'US Offensive Toward Mongolia', *Mongolia Focus*, 28 August 2019.

45. See Lkhaajav Bolor, 'Mongolia's Third Neighbor Policy Blooms', *The Diplomat*, 28 March 2016.

46. The Japan-Mongolia Economic Partnership Agreement (EPA). The agreement went into force in June 2016; for details see 'Japan-Mongolia Economic Partnership Agreement (EPA)', Ministry of Foreign Affairs of Japan, 3 June 2016.

Japanese-Mongolian bilateral trade volume increased by a very impressive 72%. By the end of 2018 it amounted to US\$ 98.5 million.⁴⁷

Japanese Prime Minister Shinzō Abe in 2015 also announced he would reduce tariffs on Mongolian exports and provide the Mongolian government with an additional US\$ 330 million in loans at 0.1% annual interest for the construction of a new international airport in Ulaanbaatar.⁴⁸ In March 2016 Japan's Marubeni Corporation won the Tavan Tolgoi Power Plant project tender to build a power plant adjacent to Tavan Tolgoi. Coal resources at Tavan Tolgoi, one of the world's largest untapped coking and thermal coal deposits located in the Umnugovi Province in southern Mongolia, are estimated to amount to 6.4 billion tons, one quarter of which is high quality coking coal.⁴⁹

In mid-2019 Tokyo turned to Mongolia for support in its efforts to resolve the so-called «abduction issue»: Tokyo's attempts to receive credible as opposed to bogus information from Pyongyang on the fate of those Japanese citizens kidnapped by North Korean secret service agents in the 1970s.⁵⁰ Mongolia's friendly relations with Pyongyang, Tokyo hopes, will help Japanese efforts to resume a dialogue with Pyongyang on the matter.⁵¹ In June 2019, Tokyo was planning to talk to Pyongyang on the side-lines of the the annual Ulaanbaatar Dialogue on Northeast Asian Security.⁵² Pyongyang, however, cancelled its participation and the Mongolian-brokered Japanese-North Korean encounter did not take place. But by mid-2018 Mongolia had sought to facilitate Japanese-North Korean talks.⁵³ Like its previous attempts, however, their efforts were not successful.

Finally, Japan in 2019, as in previous years, has been Mongolia's largest donor of development aid, charging just 1% interest for Japanese loans.

9. Strengthening Ties with India

India's prime minister Narendra Modi became the country's first prime minister to visit Mongolia in 2015. At the time the visit was inter-

47. See 'Japan-Mongolia Trade Turnover up by 71.2 percent as result of FTA', *Mongolian News Agency*, 11 April 2018. The data for bilateral trade for the year 2019 is not yet publicly available.

48. Scheduled to be completed by mid-2020.

49. See Erdene Kash, 'Japan's Marubeni Wins Tavan Tolgoi Power Plant Investment Tender', *The UB Post*, 2 March 2016.

50. Which Pyongyang in 2002 officially admitted.

51. See 'Japan Seeks Cooperation from Mongolia in North Korean Abduction Issue, Denuclearization', *Japan Times*, 16 June 2019.

52. See Jo He-rim, 'Tokyo's Attempts at Talks Fails as Pyongyang Skips Ulaanbaatar Dialogue', *The Korea Herald*, 6 June 2019.

53. See 'Mongolia Intends to Help Realize Japan-North Korea Summit', *Kyodo News*, 28 July 2019.

puted as New Delhi's attempt to strengthen relations with countries willing to reduce their dependence on China. In September 2019, Battulga visited India with the goal of expanding already ongoing cooperation in the fields of infrastructure development, energy, disaster management, defence, security and capacity building.⁵⁴ During that visit Mongolia and India agreed to expand bilateral trade and investment ties, including in the field of agricultural commodities, dairy products and animal husbandry, mining, information technology and pharmaceuticals. The Ministry of Agriculture of Mongolia and the Indian Ministry of Fisheries, Animal Husbandry and Dairying signed an agreement on cooperation on animal husbandry and dairy products. That agreement facilitates the export of animal raw materials to India and the import of Indian high-quality animal pharmaceuticals.⁵⁵

As mentioned above, Mongolia and India adopted a strategic partnership in 2015 and in the framework of that partnership India announced during Battulga's September 2019 visit an increase in its financial contributions to the Mongol Refinery Project by another US\$ 236 million. India's overall financial contributions to the project are estimated to amount to roughly US\$ 1.2 billion, provided by an Indian soft credit line to Mongolia established in 2015. In February 2019, the state's wholly-owned Mongol Refinery State Owned LLC signed a memorandum of understanding with Engineers India Ltd. (EIL) to jointly contribute to Mongolia's first refinery project under construction in the Altanshiree Soum district in the south eastern province of Dornogovi. India's contribution to the project is expected to help Mongolia reduce its energy dependence on China and Russia. When completed, the refinery will process Mongolia's own shale crude, with an annual production of 560,000 tons of gasoline, 670,000 tons of diesel, and 107,000 tons of liquefied gas for domestic use. This production will also help Mongolia to reduce its refined product imports from Russia.⁵⁶ The petrochemical refinery is expected to be completed by 2022. In addition to providing funds for the construction of the refinery, India is also financing the supporting infrastructure in the Altanshiree Soum district. So far, Indian contractors have built 27 kilometres of railway line, 17.5 kilometres of road and 19 kilometres of power transmission lines connecting the refinery to already existing networks.⁵⁷

54. See 'Mongolian President Receives Ceremonial Reception at Rashtrapati Bhavan', *The Times of India*, 20 September 2019.

55. See Government of India, Ministry of External Affairs, *Joint Statement on Strengthening the Strategic Partnership between India and Mongolia*, 20 September 2019.

56. See *Oil and Gas Journal*, 11 February 2019.

57. See 'EIL to Soon Start Work on \$1.2 Bn Mongolian Refinery Project', *The Economic Times*, 7 October 2019.

10. *Timid in Shanghai, Active in Korea*

Mongolia – at least for the time being – remains reluctant to join the Shanghai Cooperation Organization (SCO⁵⁸), a regional security forum dominated by Russia and China, as full member. Currently, Mongolia – like Afghanistan – has observer status and has so far resisted joint and regular Chinese-Russian encouragement to join the organization as full member – the last time being the occasion of the SCO Summit in the Kyrgyz capital of Bishkek in June 2019. Mongolia has had SCO observer status since 2004 and Mongolian policymakers and lawmakers are divided between those who maintain that full SCO membership would increase trust and cooperation with Russia and China, and those who warn that membership could compromise Mongolia's «Third Neighbour» policy.⁵⁹ Opponents of full Mongolian SCO membership furthermore point out that Mongolia's policy priorities are not compatible with those of the SCO and hence full membership is no added value to Mongolian foreign policies. SCO member countries put the fight against separatism, terrorism and extremism at the top of its joint policy agenda, none of which features prominently on Mongolia's foreign policy agenda. Besides, with the exception of India, the image of the SCO is that of an «authoritarian club». Three more authoritarian countries – Iran, Afghanistan and Turkey – are currently seeking SCO membership, which leads Mendee Jargalsaikhan & Julian Dierkes to conclude that the democratic Mongolia would not do itself any favours by opting for membership of such an organization.⁶⁰ And so far Mongolia's leadership has proven to be steadfast, sending out the message that it values democracy – albeit a fragile version of it and as we have seen, one not immune to constitutionally controversial power-grabbing tactics – enough to resist Russian and Chinese invitations to join an organization of largely authoritarian regimes and dictatorships. To be sure, China and Russia can continue to live without Mongolian SCO membership and are unlikely to use that membership as an instrument of political and/or economic power over Mongolia. Finally, opponents of Mongolian SCO membership warn that the country's too-close involvement in the SCO could be perceived as anti-American and anti-NATO.⁶¹ Instead, they urge the government to intensify and expand the country's «Third Neighbour Policy».

58. The SCO was founded in 2001 and its members are: China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and since 2017, India and Pakistan.

59. For a comprehensive analysis on the pros and cons of Mongolian's SCO membership see e.g. Anthony Rinna, 'The Shanghai Cooperation Organisation and Mongolia's Quest for Security', *Indian Journal of Asian Affairs* Vol. 27/28, No. 1/2 (2014-2015), pp. 63-80.

60. See e.g. Mendee Jargalsaikhan & Julian Dierkes, 'Mongolia doesn't Need to Join the SCO', *Mongolia Focus*, 7 June 2018.

61. See Elizabeth Wishnik, 'Mongolia: Bridge or Buffer in Northeast Asia', *The Diplomat*, 19 June 2019.

On the Korean Peninsula Mongolia is seeking to make an active contribution to help defuse the nuclear crisis on the Korean Peninsula. The country was mooted as a possible location to host the first Trump – Kim Jong-un meeting in June 2018. Instead, Singapore was chosen as the venue, but Mongolian Foreign Minister Damdin Tsogtbaatar continues to show a strong interest in assuming a mediating role on the Korean Peninsula.

Hence, expect Mongolia, thanks to its good relations with North Korea, to seek resuming its mediating role once meetings and negotiations – either between North Korea and the US, North Korea and South Korea or North Korea and Japan, resume.⁶²

11. Conclusions

Mongolia's economic dependence on Russia and more importantly China is here to stay and trade and energy ties with both countries will remain central for Mongolia's economic growth and well-being. A Chinese economic slowdown and a further decrease of growth rates, as caused by the economic consequences of the ongoing corona virus crisis⁶³ – will inevitably be felt in Mongolia. The re-negotiation of the Oyu Tolgoi mining project will continue to occupy the country's lawmakers and policymakers in 2020, while Mongolia will not see the project's (full) economic and financial benefits before 2030. Calls from the public and parliament for the country's wealth to be more quickly distributed have been frequent in 2019. However, re-negotiating the Oyu Mining project agreements with Rio Tinto are expected to be difficult and time-consuming.

Mongolia's hybrid political system continues to be a recipe for political stalemate, although its constitutional amendments which equipped the country's prime minister with additional powers and competencies were a step in the right direction to safeguard the rule of law and the principle of separation powers. The crisis in 2019 which preceded the constitutional amendments is worrying evidence that Mongolia is not immune to President Battulga's strongman politics, populism and attempts to insert authoritarian policymaking into Mongolian politics.

Either way, Mongolia is a fragile democracy but still a democracy, with ambitions to continue expanding relations with its «Third Neighbours» the US, Japan and India in order to reduce economic dependence and strategic and political pressure from Russia, and more importantly,

62. For further details see e.g. Alicia Campi, 'How North Korea-Mongolia Relations have Jump-Started the Korean Peninsula Peace Process', *Asia Pacific Bulletin*, No. 457, East-West Center Honolulu Hawaii February 2019.

63. Which most analysts think is likely although there is no agreement on the extent of the epidemic's impact on Chinese economic growth in 2020.

China. However, it is fair to conclude that Mongolia's geopolitical might and reach, together with the expansion of security ties with the US, Japan or India, are not nearly significant enough to set off any geopolitical alarm bells in Moscow or Beijing.