

Mongolia: Initial Assessment of the Impact of the Coronavirus Pandemic on the Extractive Sector and Resource Governance

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Key messages

- The Mongolian economy is heavily dependent on its mining sector with China being the main buyer of Mongolia's minerals. Export of minerals dipped 40 percent in the first quarter of 2020 compared with the same period in 2019 due to the coronavirus pandemic.
- Mongolia closed its borders to China in the early stages of the virus, which decreased its coal exports. It has since reopened its borders and by May, coal exports had nearly returned to pre-pandemic levels.
- Movement and travel restrictions in have further delayed the long-awaited construction of the lucrative underground portion of Rio Tinto's Oyu Tolgoi mine.
- The coronavirus pandemic and associated economic challenges have underscored concerns about Mongolia's dependence on China and the country's very high levels of debt.

ABOUT THIS DOCUMENT

This is one of a series of country briefings produced by NRGi to summarize the evolving situation with respect to the pandemic and its economic impacts. The analysis it contains is subject to change with circumstances, and may be updated in due course.

SUMMARY OF ECONOMIC IMPACT OF THE CORONAVIRUS PANDEMIC

Mongolia's economy is likely to suffer significantly due to the coronavirus pandemic and associated movement restrictions. In the first quarter of 2020, its gross domestic product (GDP) shrank by 10.7 percent and exports and imports declined by 41.5 percent and 9.7 percent respectively, compared with the same period in 2019. Mining sector output also declined almost 30 percent. The other sector that contracted significantly is transportation, which is strongly linked to the mining sector. The Asian Development Bank (ADB) recently reduced its 2020 growth forecasts for Mongolia from 6.1 percent to 2.1 percent. The International Monetary Fund (IMF) was even less positive, projecting negative growth of minus 1 percent in 2020, down from its initial 5.4 percent growth projection.

Mongolia has limited capacity to cope with economic shocks. The country is highly indebted, with government debt standing at around 70 percent of GDP. Moreover, Mongolia is entering a period which requires significant repayment on its bonds. One of the most serious concerns is a swap agreement between the central banks of China and Mongolia, which is effectively a \$2 billion loan to Mongolia. In a prolonged recession, unless an extension to this loan is agreed, Mongolia may face difficult negotiations with China and could have to earmark extractives revenues to repay this debt.

Mongolia has received loans and grants from the World Bank¹ and ADB² to support its response to the pandemic. The World Bank has also stated that it will support Mongolia's MNT 5.1 trillion (\$1.8 billion) fiscal stimulus package, announced on 27 March 2020. The coronavirus crisis has reinforced concerns about Mongolia's excessive dependence on China and mineral exports. In terms of trade, China accounted for 89 percent of exports and 33 percent of imports in 2019. China is the main buyer of Mongolia's raw commodities, with refineries and smelters located on the Chinese side of the border. China also provides electricity to Mongolia's key mining project, Oyu Tolgoi, as Mongolia continues to struggle with providing a local power supply for this and other projects in the Gobi Desert mining region. The situation normalizing in China is critical for Mongolia's mining sector and economy. Any prolonged reduction in exports, coupled with the government's fiscal stimulus, could put major pressure on balance of payments, and \$4 billion in foreign reserves may quickly dissipate as the central bank tries to keep the Mongolian tugrik afloat.

IMPACT ON THE OIL AND GAS SECTOR

Mongolia produces only a small amount of crude oil (6 to 8 million barrels per year) and exports this oil to China. The exports of crude oil have already suffered significantly due to border restrictions and may not improve if the situation lasts longer. In the first three months of 2020, Mongolia exported only 322 thousand barrels of oil, which is about 20 percent of the exports for the same period in 2019.

IMPACT ON THE MINING SECTOR

The export of minerals dipped 40 percent in the first quarter of 2020 compared with the same period in 2019. The key export products are coal and copper concentrate. Since Mongolia closed its borders relatively early in the coronavirus pandemic (at the end of January 2020) the country experienced the trade shock quite early compared to many other countries.

Coal prices have remained stable. The main reason for decline in exports in the first quarter was the closure of borders with China. Although borders have re-opened (the Mongolian government lifted its temporary suspension of all shipments of coal on 23 March), stricter health-related requirements for truck drivers have continued to affect exports. However, by mid-May shipments of coal to China reached close to pre-pandemic levels.

The governments of both Mongolia and China have been determined to ensure that there are no interruptions in the exports of copper concentrate from Mongolia. Therefore key copper concentrate production and export by Oyu Tolgoi and Erdenet have not suffered much (although the price of copper dropped over the first four months of 2020). Difficulties linked to bringing in foreign engineers and managers who play key construction roles have delayed progress on the long-awaited underground development of Oyu Tolgoi mine.

1 The World Bank provided \$26.9 million from its COVID-19 emergency fund (grant) to implement a project on health sector support. It also allocated \$2.2 million to purchase medical and diagnostic equipment from the Digital Healthcare project and reallocated \$750 thousand from the Governance Strengthening Project to COVID-19 mitigation (funded by the European Union).

2 ADB allocated a \$1 million grant to Mongolia to fight the coronavirus and reallocated a further \$1.4 million from the Health Sector Development project to boost coronavirus preparedness. The package also includes a \$225 thousand technical assistance project.

Truck drivers who are transporting coal and copper to China are subject to testing at the border, and if they test positive for COVID-19 they are subject to quarantine. The country may close its borders again if there is a spike in coronavirus cases. This means there are still risks of significantly slower transportation turnover adding to the costs of Mongolian exports of copper concentrate and coal.

The pandemic's impact on gold extraction may be positive as gold prices have increased and the government prioritizes this sector. It is important, however, that environmental standards and government revenue are not jeopardized. Most of the gold produced is purchased by Mongolbank, which sends the purchases for refining, using the gold to either boost foreign reserves or to trade in the open market. Gold produced by Oyu Tolgoi is sold to smelters in China, within the copper concentrate. The amount of gold sold to Mongolbank increased substantially in the first quarter of 2020 compared with the same period the previous year. The chief economist of Mongolia's central bank stated that this may be related to either the price hike during the pandemic or the border closures, which made the illegal exodus of gold almost impossible, or both.

Overall, plans for new investments in mining and infrastructure projects are likely to suffer if the situation does not improve significantly. Mongolia may have to postpone some extractive-linked projects such as renovating the truck hauling road connecting the Tavan Tolgoi and Oyu Tolgoi mines to the Chinese border, or railways from Tavan Tolgoi to the Chinese border. A prolonged downturn in investments might lead to changes in policies on attracting investors and/or reduce the bargaining power of the government, potentially reducing Mongolia's revenues and benefits from new investments. The government may also be tempted to increase state ownership of mining companies.

Recently, the government announced its plans to invest in a coal-fueled power plant around the Tavan Tolgoi coal mine area. The power plant would feed key mining projects including Oyu Tolgoi. The estimated cost of the project is around \$500 to 600 million. Whether the government can raise these funds at a time when many funders are moving away from coal remains doubtful. As of today, Oyu Tolgoi spends \$150-\$200 million annually on electricity from China.

IMPACT ON REVENUES FROM THE EXTRACTIVE SECTOR

Mining revenues have recently constituted around 25 percent of government revenues. The slowdown in demand and subsequent dip in prices due to the coronavirus pandemic may lead to the significant shortfall of revenues for the government. The country is highly dependent on exports of minerals, largely to a single market (China), as noted above. Revenue from oil exports is lower but the reduction in exports and prices will add to the government's revenue shortfall.

IMPACT ON NATURAL RESOURCE GOVERNANCE

Mongolia is a member of the Extractive Industries Transparency Initiative (EITI), a global good governance standard for oil, gas and minerals. While formal EITI processes may continue with little interruption, the reforms planned under EITI and beyond may be stalled. Such reforms include: creating a legal base and procedures for disclosure of beneficial ownership; state-owned enterprises (SOE) disclosures; and ensuring public consultation and participation.

The parliament has recently adopted the Law on Preventing and Combatting the Coronavirus Contagion Pandemic (COVID-19) and Mitigating Negative Social and Economic Impacts. The legislation may affect civil society's ability to operate freely. For instance, the law suggests monitoring and limiting media and social networks and obliging individuals and organizations to disclose to the authorities any information they may hold. It also suspends the normal budget procedures for economic measures by the government, and leaves it to courts for any dispute resolution, which may be time consuming and costly for civil society or individuals.

Mongolia will hold its parliamentary elections on 24 June 2020. Extractive governance issues, including a fair distribution of mining revenues to the population to combat poverty and rising inequality, is at the heart of political agenda of most candidates. Some candidates and former or current officials were arrested in the run up to the elections in relation to mining licensing and contracting decisions.

LOOKING FORWARD

Mongolia's high indebtedness, the large fiscal stimulus package announced by the government and the remaining uncertainty about sustainable exports of coal and copper to China due to the coronavirus pandemic require the government to review its fiscal sustainability position more carefully. Whether Mongolia succeeds in extending its swap deal with the People's Bank of China and sustaining uninterrupted exports of coal and copper to China will be critical.

Returning to compliance with fiscal rules and tightening control over large capital expenditures, especially those of extractive projects and state-owned enterprises (SOEs), will be important. Good management of mining revenues remains fundamental, including increasing transparency around the role of SOEs in revenue management. More robust transparency and better oversight of major extractive-related projects, including addressing corruption risks, are also essential.

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