



David Stanway
Commodities & Energy Correspondent

david.stanway@thomsonreuters.com
+86 10 6627 1200

RISKS TO WATCH

MONGOLIA

Landlocked **Mongolia** sits on vast quantities of untapped mineral wealth and could be someone of the fastest growing economies of the next decade, as well as a key investment target for global mining giants. The \$5 billion Oyu Tolgoi project, jointly owned by **Ivanhoe Mines** and the Mongolian government, will be the world's biggest copper mine outside Chile once full operation starts in 2013. Plans are also under way to develop the Tavan Tolgoi coking coal mine, the world's biggest untapped deposit of its kind. But foreign investors are watching to see whether the fledgling democratic government can build infrastructure, maintain stability, improve the rule of law and - most crucially - negotiate its way through the geopolitical pressures exerted by its two large neighbours, Russia and China.

POLITICAL INSTABILITY

The capricious nature of Mongolia's democratic government can complicate foreign investment projects. The 5-year negotiations on the Oyu Tolgoi property were conducted against a backdrop of damaging political and legal uncertainties, including local ownership requirements and a windfall tax on mining profits that was only rescinded last year.

Frequent replacement of key personnel at the top levels of Mongolia's government has also caused concern, with the changes often accompanied by nationalist rhetoric and populist promises to secure more control over the country's assets. Analysts also complain about the weakness of Mongolia's political parties and its poor regulatory capacity. Corruption - especially "rent-seeking" activities - may also prove to be a long-term problem. Transparency International rated Mongolia 116th in its 2010 corruption index, up from 120th in 2009 but down from 102nd in 2008.

Growing public frustration about how the dividends from the mining sector are spent, as well as the impact of mining on the fragile environment, could also be a source of instability. Activists recently opened fire at a foreign-invested gold mine accused of violating regulations.

What to watch:

- How will Mongolia use the proceeds from its mining projects? It has set up education and fiscal stabilisation funds, but it has also promised direct dividends for Mongolian citizens.
- How will it deal with rapid economic change as foreign investment transforms large parts of the country's mainly rural economy? Investment in the Oyu Tolgoi copper deposit alone stands at roughly the equivalent of the country's entire GDP of 2009.

REGULATORY RISK

In April, Mongolia's president ordered a halt to the issuance and transfer of mineral exploitation licences until the government enacts a stricter law on mining investment. The directive has rekindled some of the uncertainty that for years surrounded mining investment in the country. It is unclear how long it would take to pass a new law. President Tsakhia Elbegdorj's proposed amendments were discussed by the Great Khural, Mongolia's parliament, in June, and a final decision is expected to be reached before the future of Tavan Tolgoi is settled later in the year.



Analysts say that while the move is unlikely to affect major projects already agreed like Oyu Tolgoi and Tavan Tolgoi, it further raises the risk levels for doing business in Mongolia. "The purpose of the suspension appears to be aimed more at creating more regulatory oversight in the mining sector by weeding out the thousands of small, domestic miners who may have obtained licences illegally. But it is also a government response to a popular clamour against "selling out" the country's resources," said Eurasia Group analyst Damien Ma.

One of the big casualties has been Canadian exploration company **Khan Resources Inc**, which saw its two subsidiaries lose their uranium mining and exploration licenses. The move was declared illegal by a court in Mongolia but that is unlikely to be the end of the dispute.

In November, the Ministry for Energy and Mineral Resources said it would suspend a further 254 gold mining licenses and review another 1,700 believed to contravene the country's Water and Forest Law.

What to watch:

- Hints on the likely shape of the new law.
- How will the government handle populist pressures to maintain greater control over the country's strategic assets?

Mongolian horsemen pass a row of traditional tent houses known as "ger" near a horse race venue during the Naadam Festival at Khui Doloon Khudag village, some 35 kms (21 miles) outside the capital Ulan Bator
REUTERS/ Claro Cortes IV

RISK DATA BOX

Sovereign foreign currency:	
S&P	BB- (stable)
Moody's	B1 (stable)
World Governance Indicators:	
Voice & Accountability	48.8
Political Stability	55.2
Govt Effectiveness	22.9
Regulatory Quality	40.5
Rule of Law	43.4
Control of Corruption	23.8
IHS Global Insight	
Country risk	3.22
Sovereign	B- (positive)

FOR REAL-TIME NEWS ON 3000 XTRA, INPUT:

Political news	[POL-MN]
Top news	[NEWS-MN]
Politics/Policy	[TOP/G]



REUTERS™



KEY DATES

- **Early 2011**
Mongolia plans a debut international bond issue of \$500-600 million
- **2013**
Full operation of Oyu Tolgoi project, world's biggest copper mine, due to start

RISK DATA

JLT Group	
Strikes, riots & civil unrest	4
Terrorism	1
War & civil war	2
Economic risk	7
Currency risk	7
Sovereign risk	7
Expropriation	5
Contract repudiation risk	6
Legal & regulatory risk	6
Coface	
Country rating	D
Business climate	C
Transparency International	
Corruption Perceptions Index Score	2.7
Rank (of 180)	120
World Bank Doing Business	
Rank (of 183)	60
WEF Global Competitiveness	
Score	3.75
Rank (of 133)	99
Reporters Sans Frontières	
World Press Freedom Index Score	19.42
Rank (of 175)	76

DEPENDENCE ON CHINA, RUSSIA

The precarious nature of Mongolia's independence was illustrated in 2002 when the exiled Tibetan spiritual leader, the Dalai Lama, was invited to Ulan Bator. Beijing opposed the visit of the man they regard as a separatist and shut down the country's only rail link for two days, stranding 500 passengers. The People's Republic of China officially relinquished its claims to Mongolia in 1950, but there remains a deep suspicion among Mongolian people that Beijing seeks to reclaim the territory it lost after the collapse of the Qing dynasty in 1911. China already dominates Mongolia's economy, buying more than 70 percent of the country's exports last year. Some Mongolians fear China's bulging population will increasingly lead to immigration into Mongolia for work - especially if Chinese firms take over the bulk of its mining sector. Russia has also been exerting pressure on its former satellite, especially over uranium. Khan Resources has accused Moscow of working behind the scenes to force it out of a deposit in the northeast. The problem of competing influences was evident in the recent imprisonment of former government advisor Ts. Jargalsaikhan, who was sentenced to 17 years in prison for emailing sensitive information to China about a parliamentary visit to Russia. It even complicates transport infrastructure, with the location, direction and gauge of planned rail projects subject to geopolitical wrangling. Round one was won by Russia, with the Mongolian government recently agreeing to build a rail link between Tavan Tolgoi and the Russian border.

What to watch:

- The growing dominance of China in Mongolia's economy has prompted many of Mongolia's elite to lean further towards Russia, but China is unlikely to step aside, and will also have much to say on where and how Mongolia builds its roads and railways.

- China rejected the bid for Khan Resources by state nuclear firm CNNC after Ulan Bator revoked the company's licenses. Is Russia now in the driving seat in the battle to secure more Mongolian uranium? What will be China's next move?

BALANCING "THIRD NEIGHBOURS"

Mongolia has sought to carefully balance the interests of China and Russia, and to press ahead with its "third neighbour" policy aimed at courting allies like the United States, but analysts say no nation has the clout to underwrite Mongolia's independence or undermine Russia or China's influence. While the country hopes to develop its resources as quickly as possible, many of its bigger projects have been stymied by geopolitical concerns. The Tavan Tolgoi coal mine attracted the interest of consortia in Japan, South Korea, China and Russia as well as global mining giants Rio Tinto and Peabody. But Mongolia eventually decided to cancel an auction for the property - a move some thought was partly motivated by a desire not to offend any of the powerful bidders. A final decision on the ownership of Tavan Tolgoi is expected to be ratified by parliament later this year.

What to watch:

- Will Mongolia's efforts to bring in overseas investment be derailed by the pressures being exerted by Russia and China?
- Mongolian mining minister Dashdorj Zorigt told Reuters in September that the government would maintain 100 percent ownership of the Tavan Tolgoi property, but was likely to consider selling stakes to foreign bidders in the next phase of its development. Will this be the ownership model in other key "strategic resource" projects, or will Mongolia be forced to sell properties outright in order to kickstart economic growth?

