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Copper-bottomed

Mongolia seeks better terms for its vast mining project

Oyu Tolgoi, the world's third-largest copper mine, runs into more trouble

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IT IS HARD to overstate the importance to Mongolia of the Oyu Tolgoi mine. By the time it is completed it will be the world's third-largest copper mine, with an expected life of 50 years. It will also yield gold. The biggest foreign investment ever made in the country, it has already cost $11.9bn, and will cost billions more before it is finished, in an economy with an expected GDP this year of just $13.5bn. So it is not surprising that, in the decade since construction started, Oyu Tolgoi has been subject to ferocious political scrapping. But it is also a telling example of the strains that appear when a poor but resource-rich country opens itself to the global market and the might of big multinationals.

The project passed a new milestone on November 21st when Mongolia's parliament wrapped up a two-year investigation with a resolution demanding "comprehensive measures" to improve the terms of the two most important contracts governing the project: the one on its first, surface-mine phase, signed in 2009; and one signed in Dubai in 2015 covering the much bigger second, underground, phase.

It says something about the project's troubled history that this was cheered as good news in the London headquarters of Rio Tinto, a huge Anglo-Australian mining company. Rio also shrugged off a Mongolian court's decision, two days earlier, to uphold a complaint by a local NGO that the Dubai agreement was improperly authorised and hence illegal. The mining company operates Oyu Tolgoi and owns 51% of Turquoise Hill Resources, the firm building it in a joint venture with the Mongolian government, which has a 34% stake. At least, the optimistic take goes, this will bring some certainty to a venture that has been beset by virtually every problem that can afflict massive foreign investments: environmental worries; corruption scandals; technical setbacks; cost overruns.

Oyu Tolgoi is very remote—in the southern Gobi desert, some 550km south of the capital, Ulaanbaatar, and just 80km north of the Chinese border. It is a bleak landscape, home to nomadic herders who fear displacement and drought as the project sucks up the available water.

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As for alleged corruption, it was perhaps inevitable that the money suddenly sloshing around Mongolia as its potential as a mining cornucopia began to be realised would lead to allegations that some was being siphoned off. Two former prime ministers—the incumbents in both 2009 and 2015 when the contracts were signed—were last year detained for two months by an anti-corruption watchdog. In 2016 a former finance minister was among those named in the "Panama Papers" (leaked documents from an offshore law firm, Mossack Fonseca), in revelations about transfers of millions of dollars to a Swiss bank account in his name.

Production from the surface part of the mine began in 2013. The underground expansion has been delayed by difficult ground conditions and "stability risks". It will involve extraction as much as 1.3km deep. Completion of this phase—expected to increase production from 125,000-150,000 tonnes of concentrate a year to 560,000 tonnes—has been put back by more than two years, to May 2022 at the earliest. Expected costs have risen by as much as $1.9bn from the original estimate of $5.3bn.

In the competitive democracy Mongolia has become since freeing itself from Soviet domination in 1990, it was also inevitable that Oyu Tolgoi would become a political football. Rival parties vie to complain, when in opposition, about how the country is being robbed blind by grasping foreign investors. Two factors make this worse.

The first is that the bonanza Mongolia expected from the project is yet to materialise. The global copper market moved against it soon after construction started: between January 2011 and December 2015, the metal's price fell by more than half. When the first contract was signed in 2009, Oyu Tolgoi was expected to add five percentage points a year to Mongolia's annual growth rate between 2013 and 2020. Growth did indeed reach an astonishing 17.3% in 2011 as the mining frenzy took hold. But it sank back to 1.2% in 2016 (before recovering to 6.9% last year and about 6.5% in 2019). Twice in eight years, Mongolia had to turn to the IMF for a bail-out.

The mine's operators point to the benefits it has nevertheless already brought. It is the country's biggest taxpayer and directly employs more than 15,000 people, 93% of them Mongolians, and, says the minister of mining and heavy industry, Sumiyabazar Dolgorsuren, supports 45,000 other jobs. But politicians think it should be paying more and complain that the government receives no dividends from its 34% stake (because it has to repay the money borrowed from Rio to finance the investment). Indeed, analysts estimate it will get none until 2030, probably later.

The second is that Oyu Tolgoi's customer is China. The project's rationale is as a conveniently located supplier to the voracious mineral demands of Mongolia's southern neighbour. But this has always raised fears of a kind of colonisation by a country viewed by many Mongolians with suspicion. Economically, Oyu Tolgoi and its district are far more integrated with China than with Ulaanbaatar. It does not help that, until a planned local power plant comes on stream, in 2023 at the earliest, Oyu Tolgoi pays China about $130m a year for electricity.

Even so, few in power in the country think it can risk a definitive rift with Rio. As Mr Sumiyabazar puts it, Oyu Tolgoi "is a symbol of the mining sector and whether the world will trust in Mongolia." In London this week hoping to drum up more foreign investment in mining, he listed four areas where "improvements" are needed in the Oyu Tolgoi arrangements—taxes, power-supply arrangements, the interest rate Mongolia pays on the loans it has taken to finance its equity and the money that goes to development projects in the south Gobi.

Such modest enhancements are indeed probably the best the government can hope for. But Mongolia also knows that Oyu Tolgoi is hugely important to Rio, too—the company calls the mine "its biggest growth project". And its development was long overseen by Jean-Sébastien Jacques, Rio's chief executive, when he was head of the firm's copper division. Both sides have an incentive to reach a compromise. The risk is that each overestimates the strength of its position.