

## EBRD investments in Mongolia's mining sector

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With a poverty rate hovering just under 40 per cent, Mongolia is seeking to leverage its vast mineral wealth to stimulate economic growth. The plan has been generally successful, with Mongolian GDP growing nearly 17 per cent between 2010 and 2011, a third of which is based on revenues from extractive industries and mining. International mining companies and financial institutions, like the European Bank for Reconstruction and Development and the International Finance Corporation, want to help transform Mongolia into a modern mining nation, and to realise this plan they are banking on the vast coal, copper and gold deposits in the Gobi desert.

### Tavan Tolgoi and the Ukhaa Khudag coal mine

Tavan Tolgoi is one of the largest coal deposits in the world, with an estimated 6,4 billion metric tonnes of coal, about a quarter of which is estimated as the high grade coking coal needed for steel production and the rest being thermal coal. The vast majority of the deposit has not been tapped so far.

While the Mongolian government decides how best to use Tavan Tolgoi, a small portion of the deposit is already under development by a private Mongolian company "Energy Resources LLC" (Energy Resources). The company owns licences for 2962 hectares and 286 million tonnes of proven and probable reserves, respectively<sup>1</sup>, which equals four per cent of the entire Tavan Tolgoi deposit. Energy Resources started coal mining from the Ukhaa Khudag mine in 2009, producing a variety of high quality coking coal and thermal coal products.<sup>2</sup>

The EBRD owns a minority stake in Energy Resources and in 2010 provided a USD 180 million loan to the company for expanding the mine and constructing a coal washing plant<sup>3</sup>. Currently Energy Resources is implementing the second phase of the Ukhaa Khudag project, expanding its production from 2 million to 15 million tonnes annually.

CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

1. As of May 31, 2010 <http://www.energyresources.mn/projects>
2. In 2010 Mongolia was responsible for almost 40 per cent of China's coal imports: <http://bit.ly/OZ63k8>
3. EBRD press release "EBRD funds first coal washing plant in Mongolia", 6.7.2010: <http://www.ebrd.com/pages/news/press/2010/100706.shtml>

In 2010 the mine achieved its annual production target of 3,8 million tonnes of coal and has a target of 7 million tonnes for 2011.<sup>4</sup>

Ukhaa Khudag is located in the Tsogttsetsii soum (municipality) in the aimag of Omnogovi (South Gobi province), not far from another world class deposit – the Oyu Tolgoi copper and gold deposit, where Ivanhoe and Rio Tinto expect to start operations with the financial help of both the EBRD and. The EBRD is also considering a USD 350 million investment in the Tsagaan Suurga copper mine of MAK, a Mongolian company that has already received in 2007 a corporate loan of USD 45million from the EBRD for its coal mine. It is worth noting that the USD 350 million investment in MAK II will exceed the net business volume of the EBRD in Mongolia for the period 2006–2010<sup>5</sup> and will dwarf further the bank's investments in the non–mining sector<sup>6</sup>.

### Local governance, social services and benefit–sharing

Tsogttsetsii is a coal town and a soum center that has grown significantly in recent years, mainly due to the influx of people looking for jobs since Energy Resources started construction activities on the Ukhaa Khudag mine. Its population increased from 2.200 to 4.500 permanent residents, with up to 10.000 when counting temporary workers. The increased demand for municipal services has not been matched by increased financial and staff capacity for the soum administration, resulting in an overwhelmed hospital that has just ten beds and a school with only 400 places, as well as inadequate services for the supply of water, household waste management, power and heating.

There is little or no awareness among officials in

Tsogttsetsii about the health impacts of coal mining and thermal power generation. The soum has no equipment for monitoring of air quality or other impacts from the Ukhaa Khudag mine and relies entirely on the company's own monitoring data. The soum staff capacity is limited – with only one environmental specialist at the soum versus 18 at Energy Resources – and lacks expertise. However, the soum has no additional resources to invest in technical or language training.

Although many local people are expected to benefit from employment opportunities or improved access to communal services resulting from the development of Ukhaa Khudag and future mining projects in the South Gobi region, many also face the negative impacts associated with mining including:

- increased health problems – mostly respiratory – due to the deteriorating air quality caused by mining operations, coal power generation, transportation, land disturbances and construction of mine–related infrastructure like roads, fences, water pipelines and power lines;
- increased land degradation and desertification and pressure on traditional herders from pasture fragmentation and lowering water tables; and
- resettlement.

It is not immediately clear then how mining has contributed to improved resource sharing and governance at the local level or how the soum administration is in a position to make independent, competent and transparent decisions in the best interest of its citizens.

### Oyu Tolgoi project

The Oyu Tolgoi mining complex is the largest single foreign investment in Mongolia and is a prime example of the government's strategy of mining for development. The mine sits on what is considered to

4 Energy Resources Press release "Ukhaa Khudag mine production target achieved ahead of schedule":  
<http://www.energyresources.mn/news/show/id/6>

5 EBRD country profile for Mongolia:  
<http://www.ebrd.com/pages/country/mongolia.shtml>

6 The EBRD claims the following on its web site: "The EBRD will continue to play a crucial role, together with partner IFIs, in developing the transport, energy and municipal infrastructure in the country. The majority of future Bank investments (in terms of volume) are expected in the transport sector."

be one of the largest undeveloped copper deposits in the world, and when commercial production begins in early 2013 some expect it to increase Mongolia's GDP by up to 30 per cent. The mine also contains deposits of gold and silver.

The mine is located in Mongolia's South Gobi. Oyu Tolgoi is 34 per cent owned by Erdenes Oyu Tolgoi (a state company) and 66 per cent owned by Vancouver-based Turquoise Hill Resources, formerly known as Ivanhoe Mines, and the London-based mining company Rio Tinto, which manages the mine. The mine itself is operated by Oyu Tolgoi LLC, a subsidiary of Turquoise Hill/Rio Tinto and Erdenes MGL. The total project cost is estimated by Oyu Tolgoi LLC to be USD13,2 billion<sup>7</sup>, a significant portion of which will be financed by the World Bank and EBRD.

The EBRD and IFC have both proposed funding Oyu Tolgoi LLC as part of a coalition of financial institutions.<sup>8</sup> The package, which is expected to reach up to USD 4 billion, is supported by the IFC, EBRD, Export Development Canada, Standard Chartered Bank, BNP Paribas and the US Export Import Bank. In addition to IFC financing, the Multilateral Investment Guarantee Agency is considering providing risk insurance to the project. The Australian Export Finance and Insurance Corporation (EFIC) has also stated its intent to finance the mine.

## Issues of concern

Oyu Tolgoi's environmental and social impact assessment (ESIA) has been delayed for several years. It was released only in August 2012 for public review and comment even though project construction is advancing toward its planned start in 2012, with

commercial production set for the first half of 2013.<sup>9</sup>

The project poses significant environmental and social risks to the local community in *Khanbogd*<sup>10</sup>, the closest settlement to the mine, and the nomadic herders who live on or near the land covered by Oyu Tolgoi's mining license in the *Javhlant* and *Gavliut baghs*<sup>11</sup>. Water resource management remains the primary concern for communities in the fragile and arid Gobi desert. While the company maintains that the water contained in the *Gunii Hooloi* deep aquifer will be sufficient for current mining operations and will not impact the wells used by the nomads and citizens of *Khanbogd*, there is no information about where water will come from for the daily use by the mine workers, the planned airport, a coal-fired power plant and other associated facilities. The government has proposed diverting several fragile watersheds to alleviate the lack of water in the Gobi, but these carry their own risks, including transboundary impacts that could negatively impact international lakes not only in Mongolia but in Russia and China as well.

Concerns have also been raised over the loss of mining revenues to foreign interests, especially to China. For instance most of the minerals extracted will likely be exported immediately to China for manufacturing after being condensed on site. The company is also currently in negotiations with the Chinese to import electricity for the mine, but Oyu Tolgoi will have to build a 450 MW coal power plant to fuel the huge complex within four years to meet its contractual obligations to the government. This power plant poses another problem in and of itself.

Other emerging problems with the project include the lack of transparent and appropriate consultation, involuntary resettlement and the loss of livelihoods, threats to biodiversity, public health and safety, labor issues, and the need for cumulative impact and cumulative risk assessments.

7 Oyu Tolgoi Project IDOP Technical Report, p 450  
[http://www.ivanhoemines.com/i/pdf/IDOP\\_2012Mar29\\_Tech\\_Report.pdf](http://www.ivanhoemines.com/i/pdf/IDOP_2012Mar29_Tech_Report.pdf)

8 Project Summary Document, OT LLC, EBRD:  
<http://www.ebrd.com/english/pages/project/psd/2012/41158.shtml>;

Summary of Investment Information, OT LLC, IFC:  
<http://www.ifc.org/ifcext/spiwebsite1.nsf/ProjectDisplay/SII2900Z>

9 [http://www.ivanhoemines.com/s/Oyu\\_Tolgoi.asp?ReportID=379189](http://www.ivanhoemines.com/s/Oyu_Tolgoi.asp?ReportID=379189) (accessed 16 Sept.2012)

10 Second-level administrative division or district (subset of aimag)

11 Smallest rural administration unit (subset of soum)

## South Gobi water: common issues for concern

In spite of optimism about mining, local herders and CSOs are worried about the future availability of water, as more mining projects are advancing and information that reaches locals tends to be limited and inconclusive, focusing on phases of separate projects and lacking cumulative impact assessment and guarantees for the long-term. If project promoters had to be honest, they would acknowledge the concern that the absence of comprehensive hydrological studies and data make it difficult to predict the impacts of water use.<sup>12</sup>

The EBRD stresses that water from deep aquifers will not affect the shallow water table yet omits mentioning that mine dewatering can indeed cause lowering of the surface water table, drying up springs and shallow wells, stressing desert steppe soils and plants. The World Bank's study argues that dewatering impacts *"are not of great consequence in the context of the entire SGR [South Gobi Region], but they can be quite significant on a local or subregional scale in the context of herders and their animals, resident and migratory wildlife, and land degradation"*.<sup>13</sup>

### The case for sustainable water use at Ukhaa Khudag

The EBRD is keen to present the Ukhaa Khudag project as a model case for sustainable water use, and Energy Resources has implemented a number of measures to reduce and minimise the project's water demand. Additionally the company has built a potable water treatment plant and is providing drinking water to the Tsogttsetsii soum center. However there are some worrying facts.

First the ESIA for the Ukhaa Khudag Phase II project failed to include an alternative scenario for the coal handling and preparation plant ("so-called coal-washing plant"), which will consume the most water during the production phase.<sup>14</sup> At full capacity, it will require approximately 125L/s during operation, of a total 177L/s water required for the project. Although there may be obvious benefits of locally improving the quality of the coal products before transportation, a more careful consideration for the water scarcity in the region would call for studying this option.

More broadly, the Ukhaa Khudag mine represents just four per cent of the entire Tavan Tolgoi deposit, while the mine is allowed to use 25 per cent of the Naimant Depression deep aquifer that is located 20 kilometres north from the mine. Other known water sources are located at a much further distance e.g. the Balgasyn Ulaan Nuur groundwater resource is located 70 kilometres west from the mine site,<sup>15</sup> and additionally *"there are many other areas under investigation for further exploration which are expected to significantly increase the overall water resources base in this region."*<sup>16</sup>

In conclusion, unless the questions of water use are regarded from the cumulative and long-term perspectives, the false pretense for sustainability will not rest comfortably with local herders and concerned CSOs. The current water efficiency measures may be meaningful from the point of view of securing enough water for long-term mining operations in the region but does not address honestly the question about the future of traditional livestock herding. Perhaps this is the reason why the EBRD in its Country Strategy for Mongolia carefully chose as its strategic priority the "sustainable

12 World Bank study "Southern Gobi Regional Environmental Assessment (REA)", Jan. 2010:  
<http://siteresources.worldbank.org/INTEAPREGTOPENVIRONMEN T/Resources/SouthernGobiREAtext.pdf>

13 WB, Southern Gobi REA, 2010:  
<http://siteresources.worldbank.org/INTEAPREGTOPENVIRONMEN T/Resources/SouthernGobiREAtext.pdf>

14 Ukhaa Khudag ESIA, Phase II

15 Environmental and Social Impact Assessment for Phase II of Ukhaa Khudag mine. (Ukhaa Khudag ESIA, Phase II)

16 Letter of response from Alistair Clark, EBRD, dated 14 September 2011.

development of the natural resources sector<sup>17</sup>, not the sustainable development of Mongolia.<sup>18</sup>

## Recommendations

European public money must not be used to finance climate damaging coal infrastructure.

### The EBRD should:

- diversify its portfolio in Mongolia;
- distribute better its investments in other sectors that it has declared to be strategic, “including agribusiness, cashmere/textile, hotel and tourism, property and services, which will contribute to the diversification of the economy”<sup>19</sup>;
- focus investments in municipal infrastructure e.g. water supply, wastewater, household waste management, especially in rural areas like the South Gobi region and not mining-related; – assist the Mongolian government in devising solutions for improved benefit-sharing with local governments in mining areas, in order to empower local administrations to take a more active and aware role in decision-making, monitoring and regulating extractive industry’s impacts on water, air, soil, biodiversity;
- measure the human development results of the projects it finances and the wider associated projects, in order to be able to better understand whether its financing really has positive impacts for people and the environment.

17 PSD for MAK II, Transition impact “The project is part of a broad approach in support of the sustainable development of the Mongolian mining sector.”, <http://www.ebrd.com/english/pages/project/psd/2011/41547.shtml>

18 EBRD Country Strategy for Mongolia, October 2009

19 EBRD’s Country Strategy for Mongolia, As approved by the Board of Directors at its meeting on 21 October 2009 : <http://www.ebrd.com/pages/country/mongolia/strategy.shtml>

### If the EBRD intends to finance mining projects in Mongolia, the bank should:

- assess project sustainability through the lens of long-term cumulative impacts before financing any new mining projects in Mongolia like the Oyu Tolgoi mine;
- not finance mining projects that do not have proven supplies of water for the project lifetime, taking into account the competing needs of local communities and other planned or expected projects in the area;
- ensure that projects it supports consult in a meaningful way affected communities, address local people’s concerns adequately and openly, and compensate fairly and adequately all households whose livelihoods are impacted; – ensure that the assessment of extractive industries projects includes adequate gender impact assessment and mitigation measures;
- ensure that its clients regularly disclose monitoring and research data on water levels and air quality and that population health surveys should be regularly be published by the EBRD’s clients;

### The EBRD must:

- stop investments in coal mining and should not invest directly or indirectly in any coal power generation projects;
- balance its past investments in fossil fuel projects in Mongolia with investments in renewable energy and energy efficiency in the country; – improve its methodology for assessing the climate impacts of its projects, and should carry out such assessments for the whole project and all its components, not only for the phases or parts that it finances.