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China breathes new life into Mongolia

By Daniel Allen

Mongolia, former homeland of the world's greatest empire-builder Genghis Khan, is in the ascendancy once again. For decades just another backward Soviet minion, the country is now the darling of the international mining community, as China's voracious economy fuels a frenetic global search for mineral resources.

On the back of rampant industrialization and urbanization, China has become the world's largest consumer of aluminum, copper, lead, nickel, tin, zinc and iron ore. Prices for minerals and precious metals are at their highest point in a decade, and

multibillion-dollar investment deals are on the Mongolian table, as both Chinese and overseas mining companies look to secure strategically placed underground assets.

The magnitude of potential investment and forecast revenues from deposit sales have led some to christen Mongolia the "El Dorado" of the new millennium. While this may be a slight exaggeration, the government's National Development Strategy 2021 anticipates per capita income in Mongolia increasing from US\$1,100 today to \$7,000 in five years and \$15,000 by 2021.

Many investors would like to see Mongolia become a second Chile, a democratic nation that is rich in mining resources, and which has a diverse, market-based economy driven by a strong private sector. Even without major new investments in mining, Mongolia has enjoyed averages of 7-11% annual economic growth over the past decade, and the country is set for 8% or

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higher growth this year.

China has reached a stage in its development where demand for metal commodities is especially intense. Its share of world metal consumption has leaped from 10% to 25% in the past decade. Since 1999, China has consumed two-thirds of the world's growth in base-metals output. Since 2002, China has accounted for half the world's growth in consumption of steel, copper and aluminum, almost all the world's growth of nickel and tin, and much of the growth of lead and zinc.

This phenomenal expansion has sent shock waves through the global mining industry. With most analysts predicting no significant slowdown in Chinese consumption for years to come, mining and metal companies are pouring capital into new production. Companies that have mines on line are generating record profits, while companies developing projects are racing to build mines before prices fall. Inflated cash flows have triggered a spate of mergers and acquisitions in the mining industry as companies look to consolidate.

William Adams, a London-based base-metals analyst, said, "The current 'metals rush' is largely driven by China, where the demand outlook across the board is strong. Chinese companies are increasingly looking to acquire overseas resources, and if Western mining companies don't buy other mining concerns, the Chinese can and will snap them up."

Mongolia is endowed with enormous untapped mineral wealth, and more than 30% of the isolated, windswept nation, nearly the size of western Europe, has been licensed for exploration and mining. The country is especially rich in copper, coal and gold. Although minerals currently account for 30% of its gross domestic product (GDP), it is projected that the three main mineral deposits currently set for extraction will eventually generate an annual revenue 10 times the entire value of the Mongolian economy.

Sandwiched between the two Asian heavyweights Russia and China, Mongolia's geography has profoundly influenced the nation's economy. During the Soviet era, Mongolia was almost exclusively dependent on its northern neighbor, relying heavily on massive Soviet loans and aid. In the early 1990s, when Mongolia turned its back on communism, the abrupt loss of Soviet financial assistance was a sharp blow that forced a rapid rethink in national economics.

Over the past 15 years, Mongolia has introduced free-market policies and liberalized foreign trade, achieving spectacular

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annual economic growth of about 10%. Nearly four-fifths of Mongolia's GDP is now generated by privately owned companies. Despite attempts by Russia to woo back its former satellite, the Mongolian economy has become increasingly oriented toward the ballooning Chinese market; China has been Mongolia's largest trade partner since 1999, and Chinese investment now accounts for more than 40% of foreign direct investment flowing into the country.

Last November, Chinese and Mongolian companies signed agreements in Beijing worth nearly \$100 million. Mongolian Prime Minister Miegombyn Enkhbold commented at the time that China's rapid economic growth was having a favorable influence on Mongolia's economy.

Enkhbold and Chinese Premier Wen Jiabao jointly vowed to push forward economic and trade cooperation in key areas such as infrastructure and energy exploration, with cooperation on the construction of Mongolian power stations, roads and railways. Bilateral trade hit \$1.13 billion in the first nine months of last year, up nearly 90% year on year.

China has been working hard to engender cordial relations with Mongolia. In addition to fending off corruption scandals and handling overtures from multinational companies, Mongolian President Nambaryn Enhbayar has been drawing down an unconditional \$300 million loan personally presented by Chinese President Hu Jintao.

Chinese mineral demand has now drawn 19 foreign mining companies to Mongolia, with capital investment from 22 countries. In June last year the Chinese copper company Jiangxi Copper signed a letter of intent with Vancouver-based Ivanhoe Mines to study the possibility of taking a stake in the massive Oyu Tolgoi (Turquoise Hill) project 150 kilometers north of the Chinese border.

According to Ivanhoe, the Oyu Tolgoi mining complex will eventually produce 450,000 tonnes of copper annually, or about 4% of global output. With China consuming 4 million tonnes of copper last year, or about 22% of the world's supply, it's likely that most of this copper will be directly transported across the nearby border. China's domestic copper mines can currently only meet about 25% of national demand.

Allan Trench, copper research manager at CRU Analysis, commented, "China's continued demand is key to Oyu Tolgoi's development. Copper prices will not be affected materially if the

project comes on-stream - even at full capacity - provided the dynamics stay as they are. The world needs more than one Oyu Tolgoi each year to keep pace with current consumption growth."

Last October, London's Rio Tinto gave its Mongolian project a show of support by agreeing to take a significant stake in the company. The world's second-largest mining group said recently that it would increase its 9.9% stake once the Mongolian government approves the Oyu Tolgoi venture. Ivanhoe had also announced a strategic-alliance agreement with China International Trust and Investment Corp to pursue international projects that will help China meet its rapidly growing demand for metals and energy.

In addition to the Oyu Tolgoi copper and gold deposit, the southern Gobi Desert contains a massive coal deposit called Tavan Tolgoi. Also situated close to the Chinese border, it is estimated to hold 6 billion tonnes, which would satisfy China's import requirements for three years. China's largest coal producer, Shenhua Group, is in talks with the Mongolian government to co-develop the site, and has announced conditional plans to build a rail line to transport the coal into China.

In addition to mining, the tourist dollar is also increasingly important for the Mongolian economy. Last year the tourism industry accounted for 18% of Mongolian GDP, while the number of inbound tourists increased by 14% to more than 385,000. The Mongolian Department of Tourism is predicting that as many as 450,000 tourists will arrive in 2007, with Chinese making up the largest percentage.

Increasing numbers of Chinese tourists have been visiting Mongolia every year since the country was approved as a tourist destination in 2003. Vassil Metchkarov, director of the 5-star Morin Nuur resort near the capital Ulan Bator, says the aim is to attract "high-spending tourists, of [whom] there are millions just across the border in China".

***Daniel Allen** is a freelance writer and photographer from London who has lived in China for the past three years.*

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