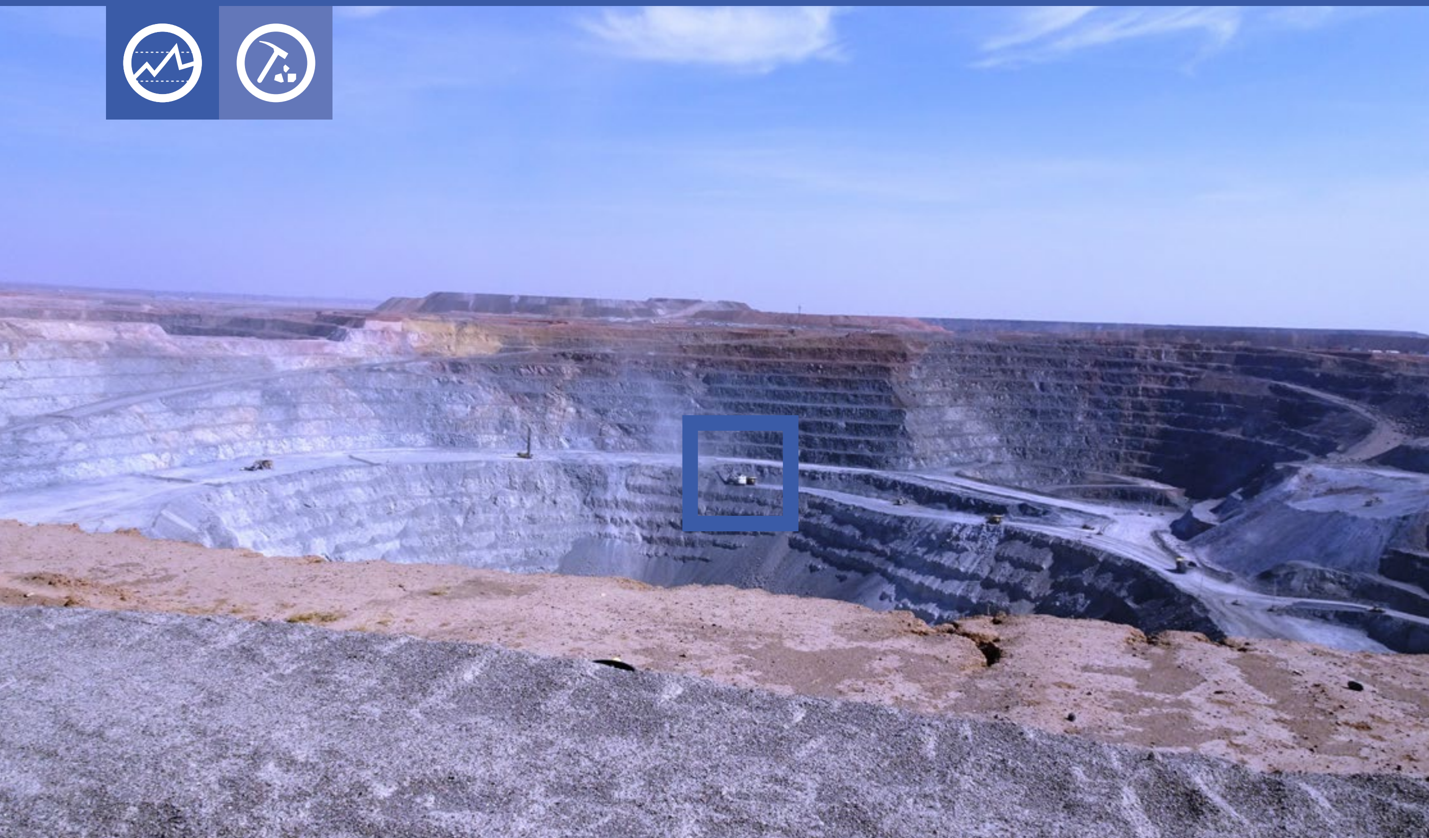
Undermining Mongolia

Corporate hold over development trajectory



Rhodante Ahlers & Vincent Kiezebrink & Sukhgerel Dugersuren

February 2020

Colophon

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Authors: Rhodante Ahlers, Vincent Kiezebrink, Sukhgerel Dugersuren
Layout: Frans Schupp
Cover photo: Tserenjav Demberel

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Oyu Tolgoi Watch

Ulaanbaatar, 46A Mongolia
T: 976-98905828

Oyu Tolgoi Watch is a non-profit, non-governmental organization established in 2009 to monitor Oyu Tolgoi project's compliance with the international environmental and human rights norms and standards. OT Watch was established by a group of CSOs which have actively engaged with govern-ment and protested against signing the unfair investment agreement. Since its establishment OT Watch is working in partnership with national, international civil society networks in advocating for fair and accountable mining and investment practices respectful of human rights in the development process.

Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

Sarphatistraat 30, 1018 GL Amsterdam
The Netherlands
T: +31 (0)20 639 12 91
info@somo.nl – www.somo.nl

The Centre for Research on Multinational Corporations (SOMO) is a critical, independent, not-for-profit knowledge centre on multinationals. Since 1973 we have investigated multinational corporations and the impact of their activities on people and the environment. We provide custom-made services (research, consulting and training) to non-profit organisations and the public sector. We strengthen collaboration between civil society organisations through our worldwide network. In these three ways, we contribute to social, environmental and economic sustainability.

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Amsterdam, February 2020

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Executive summary

This report exposes, using leaked cables from the US embassy, how mining companies Rio Tinto and Turquoise Hill Resources (formerly Ivanhoe Mines) and the powerful states backing it, such as the US, Canada, and the UK, managed to push the Government of Mongolia into a deal that ineffectively safeguards the interests of its people.

Mongolia signed an Investment Agreement for the Oyu Tolgoi Project that privileges "western" corporate interests by offering generous corporate oriented incentives that do not fill public coffers. We show that the power inequities and pressure on Mongolia to comply with international expectations were facilitated by a context dramatically restructured to a market economy narrowly focused on mining. Policy that is argued to support 'good governance' and 'rule of law' to protect the market against unwanted influence from the state, in practice has dismantled public checks and balances. Other factors of influence, such as the political instability and manoeuvring of Mongolia's political elite along with the 2007-2008 financial crisis left Mongolia with increasingly weak negotiating power and susceptible for corruption.

The largest mining project in Mongolia, the gold and copper mine Oyu Tolgoi, has been pivotal in shaping Mongolia's politics and legislation in the past decades. With mining as the main focus of the economy, Mongolia struggles to find a balance attracting Foreign Direct investment (FDI), stabilizing national debt, and providing social and environmental security.

The Oyu Tolgoi Investment Agreement (OTIA) has been questioned by members of parliament, politicians, and civil society actors since negotiations began in 2003. The Mongolian parliamentary working group reviewing the Oyu Tolgoi project's disappointing profits and cost overruns concluded that to salvage Mongolia's revenue from the mine, changes to the Oyu Tolgoi arrangements between Rio Tinto and the Government of Mongolia are sorely needed. In November 2019, the Mongolian parliament unanimously passed a resolution that all the agreements related to the Oyu Tolgoi Mine should be reviewed and measures taken for the benefit of the Mongolian people.

This report highlights that the World Bank group has not implemented the lessons learned from its 2003 Extractive Industries Review that details how resource wealth does not easily translate into sustainable development, especially because the contracts governments are encouraged to sign with corporate parties inhibit the possibility of environmental and social regulation in the future.
The Oyu Tolgoi project hijacked Mongolian policy with its fiscal stabilization and arbitration clauses supported by international investment treaties and taxation agreements, consolidated by the too-large-to-fail financing structure signed in 2015, and the weight of the western international community behind the agreement, both politically and financially.

In support for more democratic control over resources, we present a number of recommendations that emphasize:

- The review of the agreements to ensure more revenue capture for the Mongolian people,
- A renegotiation of Bilateral Investment Treaties to safeguard public interest legislations,
- Increased respect for Mongolian nomadic cultural and unique ecology,
- Awareness and implementation of the EIR recommendations by all diplomatic and financial actors involved in extractive industries, in particular regarding economic diversification and community decision-making and revenue sharing.
- Stop prioritising economic growth for few at the cost of many and align of national and international economic interests with sustainable development, and in line with the 2015 ParisAgreements.

For Mongolians to have access to, and control over their resources, the globally legitimized looting of it by Multinationals must stop. This means that we have to demand that notions of 'good governance' and 'rule of law' are redefined away from corporate interest and profit seeking and towards a healthy planet and the benefit of all.

1 Introduction

[In 2004] "Canadian exploration company Ivanhoe Mines held the mining license rights [to Oyu Tolgoi] […] Ivanhoe's chief legal counsel, John Fognani, explained that the leadership had been extremely encouraging, going so far as to "promise" that they would conclude the deal on its own initiative. Top MPRP leaders asserted that the PM had the power to force an agreement on Mongolia – regardless of any legal or regulatory requirement to consult with Parliament or the public. Fognani explained that the business community believed a narrow band of post-socialist barons led by Enkhbayar could do what they wanted; and so, businesses had only to deal with them. However, Mongolia had become a functioning democracy by the mid-1990s, and the impact of the vote and a constitution that vested power in Parliament had begun to limit what the socialist era barons could force down the throats of the public or Parliament. […]"

US Embassy 2009 diplomatic cable, Ulaanbaatar, Mongolia[1]

The largest mining project in Mongolia, the gold and copper mine Oyu Tolgoi has been pivotal in shaping Mongolia's politics and legislation in the past decades. According to the IMF, Oyu Tolgoi would become a key driver of the Mongolian economy and future copper and gold production at Oyu Tolgoi could account for a third of Mongolia's GDP by 2021.[2] The above quote illustrates the context within which negotiations over the exploitation of the mine took place.

The focus of this report is the negotiations behind the Oyu Tolgoi Investment Agreement (OTIA) that started in 2003 and concluded in 2009. Although the OTIA is often defended as being legitimate because it was signed by a democratically elected government, this rather conveniently disregards the particular political conjuncture in which the government was pushed to do so. The government that signed the agreement was established after post-election riots in 2008 related to Mongolians resource politics[3], that led to a 4 day state of emergency, leaving 5 killed, over 300 injured and 700 detained[4]. By the end of 2008, the global financial crisis had brought the Mongolian economy to its knees. Since its signing in 2009, the Oyu Tolgoi Investment Agreement (OTIA) has been questioned by members of parliament, politicians, and civil society actors. In 2019, a parliamentary working group concluded that the OTIA should be revised in favour of the Mongolian people, and recommends that a second agreement signed in 2015 should be scrapped[5]. In november

1 Wikileaks, Mongolian Mining Debate Suggests Presidential Power on the Wane, 30 March 2009, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR87_a.html, (26April 2019).

2 IMF, 2009, https://www.imf.org/external/pubs/ft/scr/2009/cr09311.pdf (11December 2017, Mining Technology 2017, https://www.mining-technology.com/features/featuresearching-for-another-oyu-tolgoi-mongolias-big-mining-expansion-5805870/ (07 December 2018).

3 Bulag, U. E. 2009, Myadar, O. and S. Jackson, 2019.

4 Amnesty international, https://www.amnesty.org.uk/press-releases/mongolia-call-restraint-after-violent-protests, Branigan, Tania, https://www.theguardian.com/world/2008/jul/02/1, (18 April 2019).

5 Davaasharav, M, April 2019: https://www.reuters.com/article/mining-mongolia-oyutolgoi/mongolia-lawmakers-seek-to-rewrite-oyu-tolgoi-deal-idUSL8N21M4EV, (21 December, 2019).

an administrative court found the 2015 agreement did not follow due process.[6] The Mongolian parliament in November 2019 unanimously passed a resolution that all the agreements related to the Oyu Tolgoi Mine should be reviewed and measures taken for the benefit of the Mongolian people.[7]

With an economy highly dependent on mining revenues that account for 90% of exports (IMF2017:16), the importance of the OT mine on the Mongolian economy cannot be underestimated. With an estimated lifetime between 60 to 120 years (USAID 2011:11), the Oyu Tolgoi copper reserves are of increasing interest with rising global demand as copper plays a crucial role in the energy transition away from fossil fuels. The copper concentrate produced at Oyu Tolgoi is exported to China. The mine's multibillion-dollar investment package includes the largest public financing agreement in mining history. The megaproject includes an extensive underground operation, an airport, a 70 km water pipeline, paved roads and power lines to the Chinese border. Soon it will be powered by Tavan Tolgoi, a coal-fired power plant to be constructed nearby.

The mine situated in a water scarce area, meets its huge demand in water by drawing it from underground aquifers. Operations for the open pit mine required the diversion of the Undai river, affecting both water and pasture resources. The mining area includes 2 protected areas with endangered species.[8] Along with the construction of infrastructure and mining operations, the inflow of labour has tremendous social and environmental impacts on the fragile ecosystem of the South Gobi desert.[9] Consequently, local herders successfully filed complaints in 2012 and 2013 to the Compliance Advisor Ombudsman (CAO) of the International Finance Corporation (IFC) because the impacts jeopardize their indigenous culture and livelihood.[10] After many years of negotions an agreement was reached between herders, local government and OT LLC to resolve herder complants. Based on signing of the Compalint Resolution Agreement in May 2017, the CAO closed the mediation phase of the complaint. Its monitoring phase was closed in March 2019 despite remaining doubts by complainants. [11]

Mining is the main focus of Mongolia's economy heavily dependent on Foreign Direct Investments. This makes for a challenging context where the GoM struggles to balance attracting Foreign Direct investment (FDI), stabilizing national debt, and providing social and environmental security. The National Statistics Office of Mongolia[12] shows that that average poverty in Mongolia is 28,4%

6 Oyundari, E, June 25, 2015, MP O.Sodbileg: Oyu Tolgoi deal in Dubai is not valid in arbitration court http://ubpost.mongolnews.mn/?p=15074, (December 1, 2019).

7 Hume, N, November 21, 2019, https://www.ft.com/content/e55cc25a-0c62-11ea-b2d6-9bf4d1957a67, see also https://lehmanlaw.mn/newsletter/parliament-calls-for-revisit-of-key-oyu-tolgoi-agreements/, (21 December, 2019).

8 Tricario, A & R. Regine, 2017, Blessed are the last for they shall be first! Re:Common, https://www.bothends.org/uploaded_files/document/Mongolia-biodiversity_offsetting_april_2017.pdf, (April 08, 2019).

9 Jackson, S.L. 2018, Meesters, M.E. & J.H Behagel, 2017.

10 CAO, 2013, http://www.cao-ombudsman.org/cases/case_detail.aspx?id=196), (December, 07, 2017).

11 Accountabilitycounsel, 2019,https://www.accountabilitycounsel.org/2019/02/a-long-road-to-remedy/ and https://www.accountabilitycounsel.org/client-case/mongolia-south-gobi-mining/#case-story (April 08, 2019).

12 NSO, 2018, Mongolian Statistical year book, http://1212.mn/BookLibraryDownload.ashx?url=YEARBOOK_2018.pdf&ln=Mn (December 21, 2019).

in 2018.[13] Economically, Mongolia has been suffering from boom-bust cycles as its narrow economic base has made it one of the most commodity dependent countries in the world.[14] Its Sustainable Development Vision (SDV) 2030[15] shows a desire to diversify the economy[16] and thus mitigate the boom and bust cycles. However, two decades of focus on mining, demanding high foreign investment, driven by international financial institutions (IFIs) have left Mongolia with a crippling debt and an excessive budget deficit.[17] With debt repayment and servicing usurping a third of Mongolia's 2018 budget,[18] it is not surprising that the government is politically responsive to mining companies' demands.[19] Nevertheless, these circumstances raise concerns about the extent of corporate influence on Mongolia's development trajectory and the wellbeing of her people.

1.1 A short history of the Oyu Tolgoi Gold and Copper Mine

The recent history of the Oyu Tolgoi mine and the resulting Oyu Tolgoi Project starts in 1996 when BHP Minerals International Exploration Inc. obtain licenses to explore for copper and gold in the South Gobi Desert and finds porphyry copper deposits at Oyu Tolgoi[20]. After acquiring 98% of the licences from BHP, Ivanhoe Mines confirms the extent and scale of high-grade copper and gold deposits in 2001. Late 2003, Ivanhoe provides the GoM a USD50 million loan to "eliminate the Soviet-era debt to the Russia Federation, to speed up Mongolian acquiescence.[21] In 2006, in search for capital, Ivanhoe Mines signs a strategic partnership with Rio Tinto[22] that results in a takeover by Rio Tinto who becomes majority owner and operator of the Oyu Tolgoi mine in 2011. Another interest in the extensive Oyu Tolgoi deposits is Canadian Entrée Resources, which in 2004, entered

13 UN figures show poverty rates at 29,76 in 2018: Trankmann, B. 2018, UNDP, http://www.undp.org/content/undp/en/home/blog/2018/Nomads-no-more.html, and UNDP, 2019, Mongolia: Human Development report 2019, http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/MNG.pdf, and ADB, 2019, Poverty In Mongolia, https://www.adb.org/countries/mongolia/poverty, (21 November 2018).

14 Li, Gupta, and Yu, 2015, and Hatcher, P. 2016a. For detailed data see: Global finance at https://www.gfmag.com/global-data/economic-data/countries-highest-gdp-growth and International Monetary Fund country data at http://www.imf.org/en/Countries/MNG#countrydata, (9 December 2018).

15 GoM, 2016, Mongolia Sustainable Development Vision 2030, http://www.un-page.org/files/public/20160205_mongolia_sdv_2030.pdf and UNEP, 2018, http://unepinquiry.org/wp-content/uploads/2018/11/National_Sustainable_Finance_Roadmap_of_Mongolia.pdf accessed (December 17, 2018).

16 For a more detailed analysis, see Lander, J. 2014.

17 Jubilee debt, 2017, https://jubileedebt.org.uk/countries/mongolia and Jubilee debt, 2019 https://jubileedebt.org.uk/press-release/crisis-deepens-as-global-south-debt-payments-increase-by-85, (April 18, 2019).

18 UNEP, 2018, http://unepinquiry.org/wp-content/uploads/2018/11/National_Sustainable_Finance_Roadmap_of_Mongolia.pdf. Page 46. (December 17, 2018).

19 Davaasharav, M & B. Lewis, May, 22, 2018, https://www.reuters.com/article/us-riotinto-mongolia/rio-tinto-presses-mongolia-to-shore-up-copper-investment-idUSKCN1IN18K, (August 6, 2018), For more detail see Lander, 2020;

20 Wu, J.C.1999, https://s3-us-west-2.amazonaws.com/prd-wret/assets/palladium/production/mineral-pubs/country/1999/9319099.pdf, (6 December 2018).

21 Ivanhoe Mines, august 17, 2004, Ivanhoe Mines welcomes pledge by Mongolia's President of continuing support for development of Oyu Tolgoi mine project, 2004, https://www.turquoisehill.com/site/assets/files/4639/2004-08-17_nr.pdf (6 December 2018).

22 Rio Tinto makes the partnership contingent on whether the Investment Agreement is actually signed, 2007, https://wikileaks.org/plusd/cables/07ULAANBAATAR119_a.html#help_2, (April 18, 2019).

a joint venture with Oyu Tolgoi LLC for a substantial section of the underground deposits as well as licenses to exploit the area around the current Oyu Tolgoi open and underground mine.[23]

Until 2019, the Oyu Tolgoi mine is ruled by three main agreements:
- the Investment Agreement (IA) in 2009;
- the Amended and Restated Shareholders Agreement (ARSHA) in 2011 and the
- Oyu Tolgoi Underground Mine Development and Financing Plan (OTUMDFP) in 2015.

Each of the three agreements[24] are in line with the World Bank technical assistance programmes in that they support legislative change in Mongolia that include investment risk reduction, stabilization against possible policy reform and the guarantee of returns for investors[25].
In the words of the World Bank:

"The Bank has been supporting and nurturing the development of the regulatory framework for private sector led mining sector exploration and development for more than 10 years. During this time the focus of activities has been on establishing the legislative and fiscal regimes to apply to mining".[26]

The Tavan Tolgoi Power Services Framework Agreement (PSFA) is the fourth major agreement related to the megaproject. Although an important element of the Oyu Tolgoi development from the beginning, the history of power supply for the OT mine and the negotiations over Tavan Tolgoi were settled when the PSFA was signed on the 31 December 2018. How this will unfold is beyond the focus of this report.

Today, Oyu Tolgoi is 66% owned by Canadian based Turquoise Hill Resources (TRQ) and 34% owned by the Mongolian state-owned enterprise Erdenes Oyu Tolgoi LLC. In turn, Turquoise Hill Resources is majority owned by mining firm Rio Tinto, which operates the Oyu Tolgoi mine.

Never a dull moment with Rio Tinto In Mongolia

The past two years clearly illustrate the turbulent relationship of the Government of Mongolia (GoM) with Rio Tinto. In January of 2018, the GoM slapped Turquoise Hill Resources (TRQ) with a USD155M tax bill for from the Mongolian government, closely followed by international coverage of SOMO's Mining Taxes report explaining TRQ's tax avoidance architecture.
On February 1st, TRQ received a letter from its second largest shareholder SailingStone Capital (11%), demanding more transparent corporate governance, questioning the independence of TRQ management from Rio Tinto. Because issues with the Mongolian

23 Entrée Resources website, https://www.entreeresourcesltd.com/corporate/about-us/, 9April 18, 2019).

24 In our previous report Mining Taxes (2018), https://www.somo.nl/nl/mining-taxes/, we provided a detailed description of the 2009 Investment Agreement (IA) and its 2011 amended shareholder agreement (ARSHA).

25 Hatcher, P. 2012 on Mongolia and Hatcher, P. 2014 on Asia.

26 World Bank, 2009, "Project Information Document."cited in Hatcher, P. 2016b:185.

Tax authority could not be resolved, TRQ filed a notice of dispute that could result in a procedure at the London Court of International Arbitration.[27] On March 15th Oyu Tolgoi LLC sent what is called 'a notice of dispute' to the GoM, followed by a claim to the Mongolian Administrative Court on April 13, 2018 which later suspended the case.

Meanwhile, in March, the Mongolian Independent Authority Against Corruption approached Oyu Tolgoi LLC with a request for information. A week later, a Swiss federal court ruled legitimate the seizure of Swiss bank accounts belonging to former Mongolian finance minister Bayartsogt Sangajav, as part of the ongoing investigation of possible corruption related the signing of the Oyu Tolgoi Investment Agreement in 2009.[28] Bayartsogt was arrested early April by Mongolian anti-corruption agency, who later also detained two former Mongolian prime ministers accused of abuse of office, related to the Oyu Tolgoi Investment Agreement in 2009 and Oyu Tolgoi underground development and financing plan in 2015.[29] Bayartsogt was released from jail in June, only to be rearrested in January of 2019, after which he made bail.[30] At the time of writing (January 2020), the investigation into possible corruption around Oyu Tolgoi's Investment Agreement is ongoing.

At Rio Tinto's Annual General Meeting in London in April 2018, both Rio Tinto's chair and CEO made an effort to emphasize the benefits of the Oyu Tolgoi mine for the Mongolian people and Rio Tinto's shareholders. In May, TRQ unexpectedly retired its CEO, hiring Ulf Quellman as the new CEO in July. Quellman, who comes from Rio Tinto, was closely involved in securing the USD 4, 4 billion financing for Oyu Tolgoi's second phase development.[31]

In October, TRQ reported that underground production would be delayed until Q3'21 instead of Q1'21 due to "challenging ground conditions". In the very last week of 2018, GoM and Oyu Tolgoi LLC signed a Power Source Framework Agreement (PSFA) that enables the construction of the Tavan Tolgoi coal-fired power plant to ensure domestic energy provision for the Oyu Tolgoi mine. The relatively nearby plant will be majority owned by OT LLC and is meant to wean the mine off Chinese sourced power. Finance is sought

27 Sanderson, Cosmo, 2018, https://globalarbitrationreview.com/article/1166728/mongolia-risks-lcia-claim-over-mining-tax-bill, and TRQ website, https://www.turquoisehill.com/site/assets/files/3655/tur-nr-15-03-2018.pdf, (07 December 2018).

28 SWI, March 19, 2018, https://www.swissinfo.ch/eng/business/mining-and-corruption_swiss-court-upholds-asset-seizure-in-case-of-mongolian-ex-minister/43983526, S&P Global, March 19, 2018, https://www.spglobal.com/marketintelligence/en/news-insights/trending/dygtvgsqwzrakmhmzn4lmq2, Miller, J. & T. Edwards, march 21, 2019, https://www.reuters.com/article/us-rio-tinto-oyu-tolgoi/swiss-probe-rio-tinto-over-possible-bribes-ex-mongolian-minister-expects-to-be-cleared-idUSKBN1GX2WL (07 December 2018).

29 Turquoise Hill Resources website, https://www.turquoisehill.com/site/assets/files/3726/nr-march-13-2018.pdf, Jamasmie, C. March 13, 2018, https://www.mining.com/anti-corruption-body-asks-rio-oyu-tolgoi-related-info/, and Jamasmie, C. May 22, 2018, http://www.mining.com/rio-tinto-says-investors-take-stance-oyu-tolgoi-test-case/, (18 April 2019).

30 Davaasharav, M & B. Lewis, Jan. 29, 2019, https://www.reuters.com/article/us-mining-riotinto-mongolia/mongolia-overseas-investigators-probe-oyu-tolgoi-corruption-claims-as-ex-minister-re-arrested-idUSKCN1PN0OY,(18 April 2019).

31 Hume, N. July, 31, 2018, New TRQ CEO gets cautious welcome from shareholder, https://www.ft.com/content/72dedf86-94d8-11e8-b67b-b8205561c3fe (18 April 2019).

through the planned public listing of 30% of state owned Erdenes Tavan Tolgoi in 2019, expected to raise up to USD 3 Billion[32]. In July of 2019, Rio Tinto announced a delay of 16 to 30 months at Oyu Tolgoi's underground construction, costing Oyu Tolgoi's corporate and public owners an additional $1.9 billion.[33]

The Mongolian parliamentary working group reviewing the Oyu Tolgoi project's disappointing profits and cost overruns concluded that to salvage Mongolia's revenue from the mine, changes to the Oyu Tolgoi arrangements between Rio Tinto and the Government of Mongolia were needed.[34] Furthermore, they stated that the 2015 Underground Mine Development and Financing Plan was not approved by Mongolia's parliament, and therefore was not legally binding.[35]

In November 2019 an administrative court upheld claims that the signing of the 2015 Dubai agreement did not follow due process, but arbitration rules built into the earlier agreements complicate the implementation of possible measures. Even though, it is unclear how this will impact Oyu Tolgoi's continuing development and operation, parliament unanimously approved a thorough review of the OTIA to bring it into compliance with the law and protect the rights and interests of the Mongolian people.[36]

1.2 Objective and layout of the report

The arrangements that govern Oyu Tolgoi and the context that facilitated them, are the focus of this report, the most prominent of which is the 2009 Investment Agreement (OTIA). This report aims to provide insight into the negotiating process that led to the agreement, and to clarify how Oyu Tolgoi's corporate owners and the powerful states backing it managed to push the Government of Mongolia into a deal that ineffectively safeguards the interests of its people.

Chapter 2 provides an analysis of how IFIs pushed Mongolia towards mining-based economic development, before describing widely known academic findings on the detrimental effect such a mining focus has for a country's people. The next chapter shows how negotiations around Oyu Tolgoi were skewed in favour of Rio Tinto and its corporate partners, due to a coordinated inter-

32 Ker, P. November, 2018, https://www.afr.com/companies/mining/mongolia-wants-rio-to-work-with-tavan-tolgoi-20181031-h17cdm, January 21, 2020.

33 Hume, N. July 16, 2019, Rio Tinto warns of delay and cost blowout at Mongolia copper mine. https://www.ft.com/content/a69d8a48-a751-11e9-984c-fac8325aaa04, (7 September, 2019).

34 Stanway D. et al, July 19, 2019, https://www.reuters.com/article/us-mongolia-oyutolgoi/rio-tinto-under-fire-as-mongolia-presses-for-mine-deal-changes-idUSKCN1UE1P1, (7 September, 2019).

35 Cision website, https://www.prnewswire.com/news-releases/turquoise-hill-notes-administrative-court-proceedings-in-mongolia-300960721.html, (11 December 2019).

36 https://lehmanlaw.mn/newsletter/parliament-calls-for-revisit-of-key-oyu-tolgoi-agreements/, Hume, N, November 21, 2019, https://www.ft.com/content/e55cc25a-0c62-11ea-b2d6-9bf4d1957a67 (21 December, 2019).

national campaign of diplomatic pressure. Using diplomatic cables from the US' Mongolian Embassy, an extraordinary glimpse into the world of Western diplomacy in Mongolia is provided, illustrating how diplomatic power is used to further corporate interests. Chapter four shows how the deal resulting from these skewed negotiations on Oyu Tolgoi has provided disappointing results for Mongolia, and how arbitration clauses agreed to in these negotiations stop Mongolia from changing any of the agreements governing Oyu Tolgoi, thereby limiting the country's sovereign right to legislate in its public's interest. The report concludes with a summary of the main findings, as well as the recommendations that follow from those findings.

1.3 Methodology

This report is part of SOMO and OT Watch's work on exposing and countering the social and economic injustices that have come with the development of Oyu Tolgoi. It follows the 2018 report *Mining Taxes*, which details how tax has been avoided on Oyu Tolgoi's profits, as well as how Rio Tinto effectively pushed the Mongolian government into an inequitable investment agreement.

Various sources have been used in the research for this report, including academic literature, media reports, corporate information databases like Reuters Eikon and Orbis, financial reports and annual accounts of Oyu Tolgoi and its owners, as well as information from independent experts like OpenOil. Information gathered through discussions with Mongolian government officials has been used as background to the report, while references have exclusively been done on an anonymous basis, as per the interviewees' request. Finally, the report exposes the contents of US diplomatic cables from the US Embassy in Ulaanbaatar, which were first published by Wikileaks in 2011.[37]

Research finding have been reviewed by 4 different experts on Mongolian political economy and resource governance, on International Finance Institutions, on Mongolian legislation, and on the financial model behind the Investment Agreement. We gratefully acknowledge their willingness and time taken to critically review this report and share their valuable insights. We have honoured their request to stay anonymous but have referenced their contributions where necessary.

As part of SOMO's internal quality assurance policies, we provide the investigated parties with the opportunity to respond to the research findings, before they are published. In this case the generous response from Rio Tinto and Turquoise Hills Resources has been incorporated into the report where these concern misrepresentation of events. The full response from Rio Tinto and Turquoise Hill Resources on the draft version of this report can be found on the SOMO website.

37 Wikileaks Website, https://wikileaks.org/, (8 April 2019).

2 Out in the open: Paving the way for extraction

2.1 Mongolia's transition to a free market economy

Mongolia re-established its independence in 1990 and rather than realign with either Russia or China, it sought a balanced relationship with its neighbours (Reeves 2011). To access the necessary funds that the Soviet Union no longer provided, Mongolia turned to the International Financial Institutions (IFIs) and particularly the International Monetary Fund (IMF), the World Bank (WB) and the Asian Development Bank (ADB), who ushered in a set of neoliberal measures to reform a state led economy to a "free market" one.[38] Mining figured prominently with WB and ADB technical assistance informing the 1997 Minerals Law and the 1993 and 2002 Foreign Investment law[39].

The subsequent set of Structural Adjustment Policies (SAPs), introduced in 1991, conditioned far reaching austerity measures, and reduced public control over resources by privatising state assets and downsizing and decentralising the public sector. By 1995, 95% of Mongolia's public assets in livestock, trade and services had been privatised.[40] Furthermore, they produced an institutional framework facilitating foreign direct investment so as to fully capitalize on mining as a central revenue source for the Mongolian economy. This entailed deregulating the mining sector, allowing for extensive private property rights, and a corporate-friendly fiscal policy including a lowering of tax rates and mining royalties, resulting in the 1997 Minerals Law.[41] Policies to attract foreign investment were accompanied by price liberalisation and currency devaluation for Mongolians.[42] The social economic consequences are amply discussed by Rossabi (2005) and Jargalsaikhan (2016), summarized as: hyperinflation, increasing unemployment, wages reduced by 50%, increasing inequality, and the percentage of people under the poverty line increasing from 16 to 26% between 1990 and 2000. (Hatcher 2016, Reeves 2011, Shagdar 2007, World Bank 1994). Less state control and increasing funds made available by the IFIs attracted mining firms like BHP, Ivanhoe Mines and later Rio Tinto seeking access to Mongolia's substantive mineral wealth, especially with the proximity to, and increasing demand for minerals from neighbouring China.

While incentives were made available for Multinational mining firms to invest in Mongolia, Mongolians faced the dismantling of their social welfare state. The process clashed severely with

38 Hatcher 2016a, Rossabi 2005, Shagdar 2007.

39 See Hatcher 2012 and 2016 a,b for a detailed discussion on the focus on mining as cornerstone of development, in for example Mongolia, by the International Financial Institutions, especially the World Bank. See also Lander (2020: pp 107-131) for a detailed discussion of legislative changes related to Oyu Tolgoi.

40 Lander, 2020: 93, citing Goyal, 1999: 636

41 Hatcher 2016a,b; Jargalsaikhan, S. 2016, Reeves 2011, Rossabi 2005, Shagdar 2007.

42 For a full chronology of devaluation rates see Shagdar 2007:3, based on Amarjargal 2002. In 1990 the USD1 = 5.6 MNT, in 1993 USD 1 = 400 MNT. Today, USD 1 = 2,629.93 MNT (3 April 2019).

Mongolia’s largely nomadic population[43] and its historically communal use of resources. Following Byambajav (2012) and Jargalsaikhan, S. (2016), the Mongolian people face three dimensions of dispossession:

- A policy reform strongly induced by IMF and World Bank conditionality and focused on Foreign investment has resulted in increasing **public debt**.
- Multinational corporations **extracting natural resources** that cause environmental destruction and social disruption.
- The previous two result **in loss of future options** with an unclear livelihood future with the landscape depleted of its valuable minerals, with its geology and hydrology irreversibly changed, impacting biodiversity and ecological resilience, as well as the erosion of Mongolia’s nomadic identity as cultural heritage.

Negative impacts related to extractive economies tend to facilitate discussions about the ”resource curse” or ”resource trap”, where resource wealth is offset by environmental degradation, corruption, conflict, and debt, all resulting in lower economic growth rates. However, such focus on resource curse disregards the historic institutional context and the global financial architecture that encourage, and make conditional, the restriction of protective legislation so as to attract as much FDI as possible.

The World Bank and the resource curse

The World Bank commissioned 2003 Extractive Industries Review (EIR)[44] reveals clearly that potential resource wealth seldom results in sustainable economic growth, an insight supported by research findings worldwide.[45] The EIR reports that the majority of resource rich states also suffer from violent conflict and civil strife,[46] and that a negative correlation exists between extractive industry dependence and economic growth. Contracts signed between governments and corporate parties lock countries into trajectories that do not allow for environmental and social regulation in the future.[47] Regardless of these unsettling findings, the World Bank has continuously promoted the expansion of large-scale mining and the need for generous investment incentives to attract FDI due to the high-risk character of the industry.[48] This translates into policy that deregulates, liberalises, and privatises the mining sector, providing it with fiscal ease, stripping state interference and minimizing public control.[49]

43 Earlier SOMO research (2014) revealed the negative impact of an iron ore mine in Mongolia: https://www.somo.nl/nl/impacts-of-the-global-iron-ore-sector, see also S. Dugersuren, 9 March 2015: https://www.theguardian.com/global-development-professionals-network/2015/mar/09/mongolian-nomads-displacement-mining-impact-development-projects, (16/12/2019).

44 Salim,E. 2003.

45 Bebbington et al 2008, Salim,2003, Rosser, 2006.

46 Salim, E. 2003, p. 27

47 Salim, E. 2003: p.30

48 Hatcher, P. 2012.

49 Salim, E. 2003, p.28

Hatcher (2012:428)[50] shows how the framework pushed by the WB in Asia, and Mongolia specifically, advocates a retreat of the state in favour of private sector monitoring and regulation, thereby driving a particular "politics of mining". In a very recent publication, Lander (2020, p. 104) explains how such neoliberal politics becomes internalised within states like Mongolia through the disciplinary mechanisms of debt financing and FDI dependence, and is intertwined with a specific approach to regulation that privileges global market interests. As part of the World Bank Group, the Multilateral Investment Guarantee Agency (MIGA) provides political risk guarantees and the International Finance Corporation (IFC) supports and provides finance for corporate investments. Efforts by the United Nations Conference on Trade and Development (UNCTAD)[51] as well as academic research[52] find no empirical evidence to support the assumption that FDI is beneficial for a country's development, or that liberal policies attracting Multinationals have positive economic effects. What Besada and Martin (2013) describe concerning mineral rich African countries closely reflects the situation in Mongolia:

"[T]he pressures introduced by international donors and financial institutions, along with the post-independence history of underperformance by state-run enterprises in the mining sector, led to the widespread adoption of liberalized mining codes across the African continent. These reforms most often restricted the role of the state from one of owner-operator to a benign "facilitator" of private sector investment. To the extent that natural resource management strategies directed at environmental or social protections informed these legislative shifts, they remained heavily reliant on "self-regulation" by private sector operators".[53]

In sum, the negative impacts of mining and its active negation by IFI's is a structural global political economic reality.

2.2 Attracting FDI in Mongolia

Between 1991 and 2012, the World Bank financed 9 mining related projects valued at almost USD193 million, 6 were directed at policy development favourable to the private sector and foreign investment, (rather than local industry or public sector development).[54] As a result, the 1993 foreign investment law and the Mineral Law of 1997 facilitated foreign investment by protecting the rights and property of the investors, in addition to easy access to exploration licenses. Concentrating on mining-related foreign investment for its development has made Mongolia vulnerable to both commodity price and FDI shocks.[55] Furthermore, data from the Mongolian National Statistics Office

50 Hatcher, P. 2012.
51 Agosin and Mayer, 2000.
52 Alfaro et al 2002, Carcovic and Levine 2002; Lyroudi et al, 2004, Borensztein, De Gregorio and Lee, 1998.
53 Besada, H & P. Martin (2013), p.10.
54 Hatcher, Pascale (2014)
55 Baatarzorig, T. et al, 2018, see also World Bank website, https://www.worldbank.org/en/country/mongolia/overview, (22 December 2018).

(NSO) show that the mining sector in 2019 serves only 2,11 per cent[56] (down from 3.6 per cent in 2016[57]) of total employment.

The Oyu Tolgoi mine was pivotal in attracting foreign direct investment, which steadily increased after the OTIA is signed in 2009 to peak in 2011.[58] Because the resources extracted from the mine are argued to substantially fuel the Mongolian economy over a long period of time, decisions concerning the mine strongly influence Mongolian policy and politics. When the GoM questioned a USD 2 billion cost overrun reported by TRQ late 2012, Rio Tinto reacted with: "all funding and work on the underground development will be delayed until these matters are concluded and a new timetable has been agreed."[59]

Taking cue from Rio Tinto, other mining corporations cancelled their mining deals[60]. As a result, FDI inflow decreased substantially and together with falling commodity prices, Mongolia economic growth fell from 17%in 2011 to just under 8% in 2014.[61]

Even though the ensuing tensions between Rio Tinto and the GoM[62] remained unresolved until 2015[63], Mongolia responded to the decline in FDI in 2013 by passing the Investment Law of Mongolia, a law that reaffirms the interest of foreign investors and increases their property rights. Contrary to the 2012 Investment Law (SEFIL) –which was retracted – this new investment law provides foreign investors with the same protections as domestic investors and eases regulatory approval requirements for foreign private investment, along with tax incentives: "The purpose of this Law is to protect the legal rights and interests of investors in the territory of Mongolia, to establish a common legislative guarantee for investment, to encourage investment, to stabilize

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56 Data based on NSO, 2019/12, Socio Economic Situation of Mongolia, http://www.1212.mn/stat.aspx?LIST_ID=976_L04&year=2019&q=3, accessed 21012020.

57 Baatarzorig, T. et al, 2018, p.527.

58 Development Finance Assessment for Mongolia Diversifying finance for sustainable development (2018) http://www.asia-pacific.undp.org/content/dam/rbap/docs/dg/dev-effectiveness/RBAP-DG-2018-Development-Finance-Assessment-Mongolia.pdf, p. 40 (22-11-2018).

59 Reuters, July 29, 2013, https://www.reuters.com/article/mongolia-riotinto-financing-idUSL4N0FZ1M620130729, retrieved 7 September 2018.

60 Lazenby, H. 2012, http://www.miningweekly.com/article/turquoise-hill-rejects-review-mongolian-of-mining-contract-2012-10-15/rep_id:3650, (7 September 2018).

61 It fell rock-bottom to 1% in 2016, but has since recuperated to 5, see World bank website, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2018&locations=MN&start=1996, (10 December 2019).

62 2012 brings election victory to the Democratic Party, supported by public demand for increased control over their natural resources. The Strategic Entities Foreign Investment Law (SEFIL) (Business Entities Operating in Sectors of Strategic Importance), is passed in May 2012 and limits foreign investment and ownership in certain sectors, including mining, to 49% and made all foreign takeovers of assets in strategic sectors like mining and banking be approved by parliament. The mining and financial sector in unison, along with the WB, accuse the GoM of resource nationalism. In October, the GoM expresses the desire to raise the government's stake in the OT mine to 40% from 34%, change the set royalty rate of 5% to a sliding rate up to 20% in line with copper prices, and eliminate the income tax allowance.

63 For a full discussion see Lander,2013, and UNDP, 2018, Development Finance Assessment for Mongolia Diversifying finance for sustainable development (2018) http://www.asiapacific.undp.org/content/dam/rbap/docs/dg/dev-effectiveness/RBAP-DG-2018-Development-Finance-Assessment-Mongolia.pdf, p. 41, (22-11-2018). For the law itself: https://www.mofa.gov.mn/new/images/banners/regulation/investmentlaw.pdf, (7 September 2018).

the tax environment, to determine the rights and obligations of investors and the competences of a government body related to investment and to regulate other relations pertaining to investment" (Article 1, Law on Investment of Mongolia).[64] In an interview held in 2013 with Sereeter Javkhlanbaatarin,[65] the head of the Invest Mongolia Agency created by this new law, Javkhlanbaatar stated the hope that the law will increase FDI to help fund the OT mine. The Natural Resource Governance Institute (NRGI) published an analysis of the whole process, how it led to an agreement in 2015 and the release of the necessary funding for the underground phase 2 of the OT mine.[66] They argue that the decreasing price of copper since 2012, along with declining demand from the Chinese market, exacerbated by declining FDI into Mongolia, dissipated the Mongolian government's negotiating power for fiscal reform. What we have showed here is that decades of structural adjustment to develop a market economy highly dependent on mineral wealth makes its extremely vulnerable for commodity price volatility that subsequently allows global corporations such Rio Tinto, backed by IFI's, to exploit that vulnerability in their favour.

64 Law of Mongolia on Investment, October 3, 2013, http://crc.gov.mn/contents/en/raw/12/30/34/19._Law_on_Investment.pdf, (7 September 2018).

65 Dettoni, J. Nov 27, 2013, http://thediplomat.com/2013/11/sereeter-javkhlanbaatar/, (7 September 2018).

66 Shafaie, A. June 24, 2015, https://resourcegovernance.org/blog/rio-tinto-mongolia-and-art-negotiating-amidst-price-volatility, retrieved 7 December 2017.

3 Behind the scenes: Pressuring Mongolia into Oyu Tolgoi

"Having joked privately that "we will be lucky if only 80% of the public opposes the plan", chief GoM negotiator Ministry of Finance State Secretary Khurelbaatar is anxious to shepherd the [Oyu Tolgoi] deal through to cabinet and parliamentary approval with minimal public agitation before the State Great Hural's (parliament) summer recess at the end of July."

US Embassy July 2007 diplomatic cable, Ulaanbaatar, Mongolia [67]

Wiki leaks data on diplomatic cables sent from the US Embassy in Ulaanbaatar, Mongolia between 2006 and 2010 provide insight into how the Mongolian government was pressured into signing a deal on OT. The cables show which arguments different parties bring to the negotiations and how economic and geopolitical interests come into play. While the GoM struggled to manage the overwhelming political and economic weight of the Oyu Tolgoi mine, several 'western' economic interests aligned with the mining companies to the detriment of Mongolia. As a result, a number of powerful national and international actors contrived with Rio Tinto and Ivanhoe Mines to pressure Mongolia into an agreement that favours international corporate interests over Mongolian public needs. The cables also reveal how Mongolian politicians struggled in brokering an arrangement on OT without coming across as though they were selling out to foreign interests.

This chapter first provides a short chronological description of the OTIA negotiations, followed by an analysis supported by US embassy cable on how the US, and several other 'western' states, participated and influenced the negotiation. This leads us to the IMF's financial support to Mongolia and how it is was leveraged to the benefit of Oyu Tolgoi's investors. Finally some insight is provided into how Mongolian politicians juggled economic interests with public needs while seeking political gain.

A chronology of the Oyu Tolgoi Investment Agreement negotiations between 2003 and 2010[68]

The negotiation between Ivanhoe Mines and GoM for the IA began in 2003 when the extent and quality of the copper and gold deposits at Oyu Tolgoi were confirmed as one of the world's largest copper and gold deposits[69]. Then sitting Prime Minister Enkhbayar was also favourably inclined to make a deal. By this time, Ivanhoe has acquired the full 100% ownership of the exploration rights from BHP, and been granted full mining

67 Opposition Grows As Parliament Debates Controversial Oyu Tolgoi Copper Mine Deal, 2007, July 23, 2007, https://wikileaks.org/plusd/cables/07ULAANBAATAR425_a.html#help_2, (April 18, 2019).

68 For a complete time line of legislative, financial and political events related to Oyu Tolgoi between 1990 and 2019 see mongolia.somo.nl (available from 2 April 2020).

69 Ivanhoe Mines, Feb 26, 2003, https://www.turquoisehill.com/site/assets/files/4775/03feb26_longsection.pdf, (December 8 2017.

licenses over an area of 238 km2, valid for 60 years and renewable for another 40[70]. To facilitate an agreement, Ivanhoe provided the GoM in 2003 with a USD50 million loan to "eliminate the Soviet-era debt to the Russia Federation.[71] Nonetheless, the OTIA is not signed because Mongolians question their access to the revenues from the mine, the sovereignty over its resources, and the potential involvement of Chinese investors or partners.

In May 2006, the Mongol parliament passed a 68% "Windfall profits" tax on copper and gold, to be levied when their respective prices topped $2600/tonne and $500/ounce.[72] The purpose of this tax was to encourage valued added processing within Mongolia, as it would not be applied to ore smelted in Mongolia.[73] Two months later, in July 2006, it passed the new Mining Law that shifted authority to approve sizable mining agreements from government to parliament. Furthermore, this law allowed the Mongolian government to acquire up to 34% of 'strategic mineral deposits that were discovered in privately financed explorations and up to 50% of publicly financed discoveries in partnership with private parties.[74] Simultaneously, the royalty tax on extracted minerals was increased to 5% from 2,5% and losses deducted from tax up to two years after incurring them.

A few months later, in October 2006, Rio Tinto entered the negotiation process when it created a strategic partnership with Ivanhoe Mines for the construction and operation of Oyu Tolgoi, but with an escape clause if no agreement is reached[75].

The cables from the US embassy show that the negotiation process accelerates in 2007 to produce an approval of the deal by the cabinet on June 26th in 2007.[76] This is subsequently stalled by then president Enkhbayar, who insists on 51% ownership of the mine. By 2008, this 51% ownership stake became a condition supported by both political parties, MPRP and DP. Nevertheless, Ivanhoe Mines and Rio Tinto rejected it outright.[77] Relations deteriorate and all negotiations are postponed until after the 2008 elections. However, the elections were accompanied by demonstrations and resulted in a four day State of Emergency,

70 Ivanhoe Mines, Dec 23, 2003, https://www.turquoisehill.com/site/assets/files/4701/2003-12-23_nr.pdf, (April 4,2019.
71 Ivanhoe Mines, Aug 23, 2004, https://www.turquoisehill.com/site/assets/files/4639/2004-08-17_nr.pdf, (April 4, 2019).
72 USGS, 2006, Minerals Yearbook: Mongolia. https://s3-us-west-2.amazonaws.com/prd-wret/assets/palladium/production/mineral-pubs/country/2006/myb3-2006-mg.pdf, (January 30, 2020).
73 Reuters, Aug20, 2009, https://www.reuters.com/article/mongolia-mining/mongolia-lawmakers-seek-metals-windfall-tax-repeal-idUSPEK21383720090820 (September 7, 2018).
74 The Minerals Law of Mongolia, July 8, 2006, http://extwprlegs1.fao.org/docs/pdf/mon149656E.pdf (September 7, 2018)
75 Ivanhoe Mines, Oct 18, 2006, https://www.turquoisehill.com/site/assets/files/4448/2006-10-18_nr.pdf Parkinson, D. Oct. 18, 2006, https://www.theglobeandmail.com/report-on-business/ivanhoe-mines-soars-on-rio-tinto-deal/article20415539/ (September 7, 2018).
76 Opposition Grows As Parliament Debates Controversial Oyu Tolgoi Copper Mine Deal, 2007, July, 23 https://wikileaks.org/plusd/cables/07ULAANBAATAR425_a.html, (April 17, 2019).
77 2008, Feb 6, Mining Sector Wrap Up: One Step Forward, Two Steps Back, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html, (April 17, 2019).

with 5 dead and 300 imprisoned[78]. The 2008 financial crises hit Mongolia as food prices went up and copper prices went down, weakening not only the Mongolian economy but also Mongolian negotiating power, forcing it back to the negotiating table.[79]

When the World Bank Mining sector technical assistance project, worth USD9,3million and involving the design of model mining contracts and agreements is up and running, the GoM establishes a Working Group to prepare a Terms of Reference for the investment agreement. Meanwhile, Ivanhoe and Rio Tinto let go 40% of the OT workforce, pressuring the government into finalising an agreement for both OT and Tavan Tolgoi.

Early 2009, The Mongolian National Security council votes two to one in favour of the deal[80]. When an agreement is finally presented to parliament in March 2009, it is followed with not only a fourth IMF loan facility in April, but also with a WB development credit for USD 40 million. By August 2009, Ivanhoe and Rio Tinto have successfully negotiated that the corporate income tax must be eased, losses carried forward for eight years instead of two,[81] with the repeal of 2006 Windfall Profit Tax as a condition for the OT project to proceed. In total 4 laws were altered and 7 more were later amended[82]. The Water Law was amended to facilitate miners' access and use rights over water[83]. According to the amended Minerals Law, Oyu Tolgoi is a 'strategic deposit' and thus OT's water access rights last 30 years (instead of the usual 20 years).This access can be extended for periods of 20 years (while others have only 5 year extensions). In the OTIA, Oyu Tolgoi can access and use 'self-discovered' resources to the extent that it meets the "project's operational requirements" up to 870 litres per second (OTIA 6.13.1), with water use fees being tax deductible (OTIA, 2009 6.14). This provides OT with a private water right to a collective and water source, the costs of which are covered by the public.

78 Bulag, U. E. 2009. Mongolia in 2008: From Mongolia to Minegolia. Asian Survey 49 (1):129–34. 2008, December https://wikileaks.org/plusd/cables/08ULAANBAATAR521_a.html, (April 17, 2019).

79 Global Financial Meltdown Dissolves Mongolian Resistance To Mining Projects, December 1, 2008, https://wikileaks.org/plusd/cables/08ULAANBAATAR521_a.html, (April 17, 2019).

80 Mongolian Mining Debate Suggests Presidential Power On The Wane, 2009, March 3 https://search.wikileaks.org/plusd/cables/09ULAANBAATAR87_a.html, (April 17, 2019).

81 August 25, 2009, https://www.reuters.com/article/mongolia-ivanhoe-tax-idUSPEK9463520090825, Behrman, E.August, 26, 2009, https://www.marketwatch.com/story/mongolia-clears-way-for-oyu-tolgoi-mine-2009-08-26, (7 July 2017).

82 Ministry of Mineral Resources and energy, https://siteresources.worldbank.org/INTMONGOLIA/Resources/Zorigt_ENG.pdf, April 17, 2019.

83 For an extensive discussion on the social and ecological implications of the amended water law for the Oyu Tolgoi landscape and its users see: Jackson, S.L. 2018. Abstracting water to extract minerals in Mongolia's South Gobi Province. Water Alternatives 11(2): 336-356.

The formal signing of the OT Investment Agreement[84] finally takes place in October of 2009. The World Bank promotes the agreement "to be the model agreement for future mining projects." [85]

After the signing of the OTIA, the required capital to develop OT forces Ivanhoe Mines to seek more financial support and participation from Rio Tinto. In addition to becoming the operator of the OT mine, Rio Tinto provides capital for the project, purchases shares from Ivanhoe and helps secure project financing. In 2011, Erdenes Oyu Tolgoi LLC, Ivanhoe Oyu Tolgoi Ltd, Oyu Tolgoi Netherlands B.V. and Oyu Tolgoi LLC sign a new shareholder agreement. In 2009, the WB rolls out its Mining Infrastructure Investment Support (MINIS) project worth USD 25 million and Mongolia experiences 17,3 % growth as copper prices peak.

This is when Rio Tinto exposes its desire to take over Ivanhoe Mines, in a somewhat hostile take-over[86]. In January 2012, Rio Tinto becomes majority shareholder of Ivanhoe Mines which is renamed Turquoise Hills Resources (TRQ).

3.1 A foot in the door: Expanding US interests in Mongolia

The US Embassy, in the leaked cables, repeatedly describes itself as a mediator between Mongolia and Oyu Tolgoi's investors. The Embassy – or post – describes its diplomatic efforts as follows:

"Over the last six years [2004-2009], Post has steadily built up relations with industry and the GOM that allowed both sides to avail themselves of a player perceived of as non-partisan, reliable, and fair. These qualities made Post [the US Embassy] the go-to Mission for verifying respective intentions." [87]
Aug 2009

While positioning itself as an interlocutor between the Mongolian government and Oyu Tolgoi's investors, the US shows a clear interest in Oyu Tolgoi's development going through. To quote Embassy personnel, failure to reach a deal on OT before 2009 had "*cost U.S. export interests an estimated USD 200 million in equipment sales and other contracts*".[88] OT was also seen as the first big mining deal that would show Mongolia was open for business, while US coal mining company Peabody Energy had its eyes on Tavan Tolgoi, the coal mine that would provide energy to Oyu Tolgoi.[89]

84 OTIA 2009, http://ot.mn/investment-agreement-en/, (September 7, 2017).

85 World Bank, 2009, http://documents.worldbank.org/curated/en/440051468053404598/pdf/ICR12820P115737.pdf, p.15, (December 7, 2017).

86 Paul, S. December13, 2011, https://www.reuters.com/article/us-ivanhoe-rio/rio-tinto-wins-fight-against-ivanhoe-poison-pill-idUSTRE7BC0A420111213, MacNamara, W. Jan 18, 2012, https://www.ft.com/content/17a3b0fc-41f5-11e1-9506-00144feab49a, (December 7, 2019).

87 Mongolian Parliament Passes Long Awaited, Absolutely Essential Mining Deal, Aug 26, 2009, (June 17, 2019).

88 2009, July, 30, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR208_a.html; (June 17, 2019).

89 2008, Feb 6, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html; (June 17, 2019).

"For U.S. commercial interests [in Mongolia] such as mining firms Peabody Energy and Rio Tinto and equipment makers Caterpillar, Ingersoll-Rand, Bucyrus, and John Deere, mining is THE industry [in Mongolia] that will provide the income necessary to ensure long-term purchases of U.S. goods and services"[90]
July 2009

The Oyu Tolgoi negotiations were a perfect vehicle for the US to strengthen its economic presence[91] and diplomatic standing and lobby for Rio Tinto and Peabody Energy:

"The Department of Commerce, through its Advocacy Center, has granted advocacy support to both Peabody and Rio Tinto, recognizing that their involvement at Tavan Tolgoi and Oyu Tolgoi, respectively, offers substantial, long-term export potential for U.S. manufacturers, as well as promoting U.S. free-market and democratic goals for Mongolia."[92]
February 2008

The US embassy provided this support to Rio Tinto while being aware of the existing disparity in negotiating capacities between the company and the Mongolian government. In diplomatic cables, officials from the Ministry of Mining and Energy (MOME) expressed that:

"In their opinion (and the opinion of longtime observers of the Mongolian mining scene), Mongolia has suffered from a lack of world-class expertise at the negotiating table. Past negotiations have pitted woefully amateurish Mongolians against the deeply skilled agents that corporations like RT can bring to the table". [93]

Throwing its political weight behind Rio Tinto, the US embassy only increased the existing gap in negotiating power between Rio Tinto and Mongolia, weakening Mongolia's position.

When the Investment Agreement was signed in 2009, Embassy officials called it a "*commercial diplomacy [which] has cemented the U.S.'s position among the key players in crafting these sorts of agreements in Mongolia*".[94] Construction of Oyu Tolgoi's mine and facilities was set to start, and was subcontracted to U.S. contractor Fluor Corporation, employing 2,000 Chinese workers.[95]

The Embassy's own analysis concluded that Mongolia's economic woes in 2008 had pushed the government to agree to a deal that supposedly balanced its own interests and those of the investors, Rio Tinto and Ivanhoe Mines. Brief mention was made in Embassy accounts of lingering concerns among some of Mongolia's donor countries who were worried that the government gave away too much in the deal.[96]

90 2009, July 30, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR208_a.html (June 17, 2019).
91 NAMBIC (North-America Mongolia Business Council was for many years led by former USAID consultants. Lead lobby institution, which is now re-named Mongolia Business Council and is led by a Mongolian.
92 2008, February 6, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html, (April 26 2019).
93 2008, December 1, https://wikileaks.org/plusd/cables/08ULAANBAATAR521_a.html, (June 17, 2019).
94 2009, August 26, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html (June 17, 2019).
95 2009, August 26, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html (June 17, 2019).
96 2009, August 26, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html (June 17, 2019).

3.2 The concerted international lobby for Oyu Tolgoi

Mongolia's geographic position between Russia and China, makes it an important country geopolitically. In order to keep itself from being dominated by one of its two powerful neighbours – Russia and China – Mongolia introduced the so-called 'Third Neighbour Policy'. This policy entails strengthening diplomatic relations with other countries, in order to balance the influence of its geographical neighbours.

The US uses Oyu Tolgoi as a lever to consolidate its presence in the region and warns the Mongolian government that:

"…without western firms (and their Governments) to counter- balance Chinese and Russian influences, Mongolia would essentially have to cede its economic independence to whichever neighbor gained control of the asset and the rights to operate it."[97]
2008

In a meeting between diplomats from several of Mongolia's donor countries and representatives of 'Western' business operating in the country, the British Ambassador to Mongolia characterized the impact of the Third-Neighbour Policy as follows:

[The British Ambassador to Mongolia] "noted that Mongolia had not really grasped the implications of its "Third-Neighbor" policy. Her Majesty's government was reconsidering its level of engagement with Mongolia because Britain had little of substance on the ground. If Mongolia wanted the British relationship to continue or increase, it had to do what was necessary to get British investment. If Mongolia really wants to balance China and Russia with investment and political support from Britain, the U.S., Canada, Japan, etc., then it must create and sustain an environment conducive to investment."[98]
Jan 2008

The US was central but not alone in its diplomatic efforts to encourage Mongolia into the deal. In January of 2008, Canada's then International Trade Minister David Emerson visited Mongolia and held meetings with Mongolian government representatives, various diplomats, and representatives of corporations active in Mongolia. In one such meeting, organized by the North America-Mongolia Business Council – an interest group for multinationals in Mongolia – and attended by various diplomats and business representatives, a discussion took place on the strategic cooperation these actors could employ to best service their interests in the country:

"During the January 10 breakfast, Minister Emerson and his delegation also heard a range of viewpoints regarding the GOM's approach to mining. Mining representatives delivered consistent points to the Minister. Firms stated they are able and willing to handle the commercial aspects of their respective businesses, but they want and need foreign governments to project a united front to the GOM to cover their political flank. In short, the mining companies told Canada to join U.S., British, Japanese,

97 2008, February 6. https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html (April 26 2019).
98 2008, February 6. https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html (April 26 2019).

Australian and German efforts to encourage (cajole, harangue, etc.) the GOM into staying out of the mining business while creating a transparent, predictable, best practice-based, rule of law approach to regulating and profiting from its resource base. The British Ambassador echoed these sentiments." […] The [US] Charge' [notes] "the USG had consistently and constantly encouraged the GOM to create and sustain a solid market environment for all investors. He added that attracting investment also depended on Mongolia giving full and careful consideration as well as a timely decision to major development project proposals such as the copper-gold mine at Oyu Tolgoi."[99]
2008

Although some of the mentioned talking points – such as transparency and rule of law – are not controversial, the collaborative effort by the business community, large corporate mining interests and powerful states to encourage the Mongolian government into a deal on Oyu Tolgoi is likely to have limited the Mongolian government's negotiating power and ability to safeguard its country's interests in negotiations with Rio Tinto and Ivanhoe Mines. Not only is Mongolia financially indebted to Western financial institutions and states, but these international actors have significant impact in influencing Mongolia's reputation as a viable trade and business partner. A former member of the Oyu Tolgoi Investment Agreement Working Group described the relationship between the Mongolian government and Rio Tinto as 'very unbalanced and unequal'[100]

That states like the US, Canada or Britain would "cajole" and "harangue" the Mongolian government into a *laissez faire* attitude towards the mining industry exposes how Mongolia's democratically elected government was approached and influenced by foreign diplomatic services. It also reveals how these states value corporate interests over democratic values.

"Post [US Embassy] and mining firms have engaged in quiet efforts to lay the groundwork for a more market-oriented approach following the 2008 Parliamentary/2009 Presidential election cycle."[101]
March 2008

The plans to diplomatically pressure Mongolia on Oyu Tolgoi, discussed during the January 2008 breakfast meeting, came to fruition after a turbulent election year that ended with Mongolia facing the impacts of the global financial crises and falling commodity prices. As negotiations on OT appeared to be breaking down, and Mongolia was researching the option of replacing Rio Tinto and Ivanhoe Mines with Chinese or Russian investors[102], the US Embassy coordinated with other donor countries to push through a deal. Together, they "*sent a clear and credible, message to the GOM that it was in Mongolia's best interest to work out its disputes with the Western firms, and to the companies that the GOM was committed to reaching a deal*"[103] (2009).

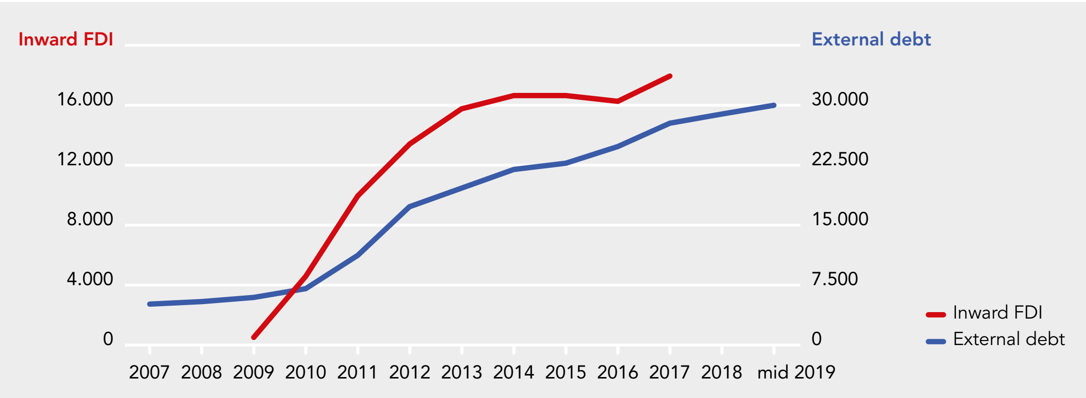
99 2008, February 6. https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html (April 26 2019).
100 Lander, 2020: 119.
101 2008, March, 19, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR118_a.html; (June 17, 2019).
102 2008, February 6. https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html, 2009, 26 Augustus: https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html, (April 26 2019).
103 2009, 26 August, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html, (April 26 2019).

3.3 Mongolia's legal and financial instability and western mining interests

Over the past three decades, Mongolia has repeatedly sought the International Monetary Fund (IMF) to provide it loans in times of financial difficulty. An economy heavily dependent on mining is not only vulnerable to fluctuating commodity prices but also suffers from high debt loads due to uncertain returns that demand high investment and risk.[104] Currently, Mongolia is one of 7 countries where the debt situations is judged "very critical.[105]" Since Mongolia became a member in 1991, the IMF has provided the country with six loan packages. The sixth, a bailout loan,[106] provided in 2017, increased Mongolia's external debt to US$11.2 billion, twice its GDP.[107] The conditionalities underpinning these loans demand budget reforms[108] involving austerity measures that include wage freezes and a personal income tax increase.[109]

Mongolia – debt and foreign investment

Figures in $ millions



Mongolia's incoming FDI and external debt

104 See for detailed discussion UNCTAD (2019) at https://unctad.org/meetings/en/SessionalDocuments/cimem2d46_en.pdf. (28 October 2019).

105 Global Sovereign Debt Monitor (2019): pg. 4. https://erlassjahr.de/wordpress/wp-content/uploads/2019/05/Global-Sovereign-Debt-Monitor-2019.pdf, (28 October 2019).

106 International Monetary Fund website, 2017, at https://www.imf.org/en/News/Articles/2017/05/24/17193-imf-executive-board-approves-financial-arrangement-for-mongolia, see also Bloomberg, 2017, at https://www.bloomberg.com/news/articles/2017-02-19/imf-to-loan-mongolia-440-million-as-part-of-5-5b-bailout, (June 12, 2017).

107 Mongol bank, Mongolia's Gross External Debt Position at https://www.mongolbank.mn/eng/liststatistic.aspx?id=4_3; Financial Times, Mongolia: living from loan to loan, September 12, 2016 at https://www.ft.com/content/4055d944-78cd-11e6-a0c6-39e2633162d5; Focus Economics at https://www.focus-economics.com/country-indicator/mongolia/external-debt; https://www.gfmag.com/global-data/country-data/mongolia-gdp-country-report, (August 2017).

108 For a discussion on IMF conditionality, and for Mongolia in particular, see Brunswijck, G. (2018) Unhealthy Conditions, https://eurodad.org/files/pdf/1546978.pdf, (December 17 2018).

109 Bloomberg, 19 April 2017, at https://www.bloomberg.com/news/articles/2017-04-19/mongolia-clears-hurdles-needed-for-5-5-billion-imf-led-bailout, (August 8, 2017).

With its loan packages act as lifelines to the Mongolian government, the IMF is a hugely powerful actor in Mongolia. Within the IMF, voting rights are divided between member countries based on the amount they contribute to the fund. With 16.5% of the IMF total voting rights, the US is by far the largest contributor to the IMF[110], and as such has a de-facto veto right. The dependence of Mongolia on the IMF makes it subsequently highly susceptible to US influence.

The Embassy cables show how Oyu Tolgoi's Investment Agreement is discussed in relation to IMF and US assistance:

"Summary. On April 2 [2009], the [Deputy Assistant Secretary] for China and Mongolia […] met in Ulaanbaatar with Mongolian Foreign Minister Batbold […]. Batbold expressed satisfaction with the recent IMF Stand-By Agreement (SBA) with Mongolia and said the GOM is still seeking [US Government] budgetary assistance in connection with the SBA. The [Foreign Minister of Mongolia] said a transparency agreement (TA) with the United States was the way forward for our trade relations and that the GOM has a serious commitment to passing the Oyu Tolgoi investment agreement (IA) once Parliament takes up the issue again on April 6."[111]
2009

The quote above shows how US officials discussed IMF assistance and passage of the Oyu Tolgoi Investment Agreement through Mongolian parliament seemingly in the same breath. Important to note in this regard, is the fact the US has an effective veto power within the IMF and the World Bank,[112] meaning it is a pivotal player in decisions those IFIs make with regard to supporting Mongolia financially. Furthermore, Mongolia is heavily dependent on the IMF for its financial stability. This dependence is shown again in February of 2017, when the Mongolian government and the IMF agreed on the latest loan package[113] to bail the country out of another period of financial distress. At that time, Mongolia's parliament was working on banking legislation, which would require all foreign multinationals to use local commercial banks to transfer funds in and out of the country. The law, announced in April, was meant to increase the country's foreign currency reserves, while also strengthening the Mongolian banking sector. Having corporate financial transactions flow through Mongolian banks has been on the political agenda since 2013, when then President Elbegdorj of the Democratic Party stated publicly that – like other companies in Mongolia – Rio Tinto should have all of Oyu Tolgoi's financial transactions go through Mongolian banks: "Since they operate in Mongolia, they should contribute to the nation's development."[114]

110 The second largest share of the vote is Japan with 6.15%, followed by China with 6.09%. https://www.imf.org/external/np/sec/memdir/members.aspx#U, (April 26 2019).

111 2009, April 9, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR94_a.html, retrieved, (April 26 2019).

112 On the IMF veto: https://fas.org/sgp/crs/misc/IF10676.pdf, and the World Bank veto: https://www.worldbank.org/en/country/unitedstates/overview (April 26 2019).

113 IMF, Feb 19, 2017. https://www.imf.org/en/News/Articles/2017/02/19/PR1754-Mongolia-IMF-Reaches-Staff-Level-Agreement-on-3Yr-EFF, (October28, 2019).

114 Monday, February 4th, 2013, http://ubpost.mongolnews.mn/?p=2780, (December 17, 2018).

In response to the new banking law, in April of 2017 Rio Tinto reportedly filed a complaint with the IMF voicing its opposition to the law.[115] Rio Tinto argues that clause 9.4 of the OTIA states that "investor can make international transactions freely and without any obstructions in its chosen currency." The IMF withheld the lending package shortly after.[116] At the time, a senior member of the ruling Mongolian People's Party stated the following:

"Without the grant from the IMF Mongolia can't move forward ... Because the economy is in a dire state, Mongolia first needs to be part of the grant, after that we will discuss whether foreign investment should go through a Mongolian bank." [117]

Within three days, Mongolia's legislature cancelled the law.[118] On May 24th 2017, the IMF approved a 3 year loan under the Extended Fund Facility for USD 425 Million.[119] The loan is part of a financing package for a total of USD5,5 Billion provided by the IMF, Asian Development Bank, World Bank, Japan, and China. Rio Tinto's objections to a Mongolian law and the IMF response led lawmakers to reverse their decision on the law. This highlights first how the democratic process seeking to prevent resources leaking out of Mongolia can be undermined by corporate power mobilizing the OTIA, and second that the OTIA is not favourable to the Mongolian public.

Investment climate reports produced by the U.S. State Department and the IFC in 2018 and 2019 evidence the international pressure on Mongolia to conform to international expectations of market-friendly laws.[120] For example, the U.S. State Department's Investment Climate Statement on Mongolia condemns potential renegotiation of the Oyu Tolgoi Investment Agreement, whilst in the same breath acknowledging that 'Mongolia's market is free of access barriers' and that 'investors also face few meaningful investment restrictions in Mongolia, enjoying mostly unfettered access to the market'[121] Combined with Mongolia's dependence upon FDI and debt burden, direct pressure from the IFC and the U.S. regarding what constitutes legitimate law reform demonstrates the inordinate degree of international influence on Mongolia's democratic institutions.

115 Bayartsogt, K. May 2, 2017 https://asia.nikkei.com/Politics/Mongolia-to-revise-new-law-after-IMF-postpones-bailout2, (April 26 2019).

116 Hornby, L. May, 2, 2017, IMF delays approval for Mongolia package over forex clause https://www.ft.com/content/07ed751a-2f0e-11e7-9555-23ef563ecf9a, Edwards, T. May 2., 2017, https://www.reuters.com/article/mongolia-economy/update-1-imf-delays-mongolia-bailout-due-to-banking-requirements-for-foreign-firms-idUSL4N1I41PL, (December 17, 2018).

117 Bayartsogt, K. May 2, 2017, https://asia.nikkei.com/Politics/Mongolia-to-revise-new-law-after-IMF-postpones-bailout2, (April 26 2019).

118 Edwards, T. May 5, 2017, https://www.reuters.com/article/us-mongolia-imf/mongolia-annuls-forex-regulation-to-pave-way-for-imf-bailout-idUSKBN1810TF, (December 17, 2018.)

119 IMF 2017, https://www.imf.org/en/Publications/CR/Issues/2017/05/31/Mongolia-2017-Article-IV-Consultation-and-Request-for-an-Extended-Arrangement-Under-the-44954, (December 7,2018.

120 Lander (2020: 233). For more analysis of the impact of the role of investment risk indicators promulgated by the World Bank on the political space to negotiate development see Perry-Kessaris, A. (2011) 'Prepare Your Indicators: Economics Imperialism on the Shores of Law and Development.' International Journal of Law in Context 7(4): 401-421.

121 U.S. Department of State cited in Lander, 2020: 233.

This power dynamic raises concern regarding the negotiating space Mongolia has in dealing with Rio Tinto, and questions to what extent it is able to defend Mongolian priorities when facing corporate power backed by International Financial Institutions and donor states like the US.

3.4 Political gain or Mongolian welfare

The cables show how Mongolia's room to manoeuvre in deciding its own development trajectory is curbed by the global political economy where corporate interests are supported and protected by international diplomacy by, for example, the US and the IMF. During the negotiation of the Oyu Tolgoi Investment Agreement, the Mongolian government struggled to make the deal acceptable to the Mongolian people.

From the cables, we learn that four issues were central during the negotiations:
1. The equity stake of Mongolia in the mine ranging from 34% to 51%, and whether this equity would be have to be paid for (via a loan from Rio Tinto) or would be Mongolia's sovereign ownership.
2. The importance of local energy (Tavan Tolgoi) to supply Oyu Tolgoi rather than importing energy from China.
3. Retaining value in Mongolia, either through taxation, value added processing (a smelter) or through other national commercial services (such as banking).
4. Convince the Mongolian people that the agreement does not under sell Mongolia's wealth.

Negotiations on the Oyu Tolgoi Investment Agreement were turbulent and controversial. The GoM initially moved from seeking an agreement quickly in 2004 under the leadership of Prime Minister Enkhbayar (MRPR), to being more critical after elections and increasing social unrest in response to mining activities[122]. Following public outcry over the perceived sale of Mongolia's mineral assets to foreign investors, the GoM introduced a 68% Windfall Profits Tax in 2006. Continued public resistance to the project[123] appear to have led Mongolian politicians to repeatedly call for what they considered a better deal for Mongolia. In 2007, the same Enkhbayar, now President, called for a 51% Mongolian equity stake in the mine. During the 2008 election cycle both major political parties adopted this demand.[124] According to the US embassy:

122 Center for Citizens' Alliance/ ICSFD, 2005, State of Civil Society in Mongolia 2004-2005, http://www.civicus.org/media/CSI_Mongolia_Executive_Summary.pdf, (17 September 2019). See also Lander, 2020: 114-115; 172-177.

123 Simonov, E, nd, Rivers without Boundaries, https://www.transrivers.org/documents/rivers-and-mining/the-short-history-of-the-law-with-long-name/, (December 11, 2018).

124 2007, February 23, https://wikileaks.org/plusd/cables/07ULAANBAATAR119_a.html; 2008, 1 December, https://wikileaks.org/plusd/cables/08ULAANBAATAR521_a.html; 2008, February 6, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html; https://search.wikileaks.org/plusd/cables/08ULAANBAATAR227_a.html; 2008, March 19, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR118_a.html; https://search.wikileaks.org/plusd/cables/09ULAANBAATAR201_a.html; 2009, March 3: https://search.wikileaks.org/plusd/cables/09ULAANBAATAR87_a.html, (April 26 2019). See also after the signing of OTIA in 2012: Kohn, M. July 11, 2012 https://in.reuters.com/article/mongolia-election-mining/miners-fear-anti-foreigner-voices-in-new-mongolia-government-idINL3E8IA3AO20120711, (January 22, 2019).

"The GOM must claim that it stuck it to the foreign investors, or risk being savaged by its political opponents as selling out Mongolia."[125]
2007

Within the US Embassy, the perception was that Mongolian government officials, the media, and Rio Tinto had oversold Oyu Tolgoi to the Mongolian people, creating the expectation that it would "*start paying immense dividends immediately*".[126]

Both Rio Tinto and US Embassy officials were reportedly aware of the fact that Oyu Tolgoi would not pay dividends to the GoM for many years, as profits would first go to repaying the debt Mongolia took on to finance its 34% share of the project.[127] In order to cover for this discrepancy, Rio Tinto agreed to provide the GoM with a US$250 million loan following the signing of the Investment Agreement. Embassy personnel describe the arrangement as follows: "*Even though it is a loan, a cash-strapped [Government of Mongolia] eagerly proclaimed the first tranche a revenue-plus for Mongolia's citizens, who might expect some pocket money in the near future*".[128]

"As a carrot, if some solution could be found, RT has indicated a willingness to deliver advance payments to the GOM... The GOM, Parliament and the various parties have already promised voters rewards from mining, and the advance payments would certainly be needed to honor election commitments (a point not lost on any of those involved in this dispute)."[129]

The advance payment referred to in the quote above consisted of a US$250 million loan used by the Mongolian government to sell the Investment Agreement to the Mongolian public. An analysis of media sources and anecdotal evidence led US officials to conclude that the Mongolian public saw the US$250 million as proof that OT would yield benefits to Mongolia. In fact, the loan was to be paid back in full, adding to the billions of dollar in loans the GoM was required to take on to finance its 34% share of Oyu Tolgoi.[130]

"In the end, it came down to altering four main laws on roads, water, the windfall profits tax, and corporate tax respectively before a formal signing of the agreement. Parliament completed these amendments on the night of August 25, and the GOM plans to sign the agreement next week. It will then receive its first USD 100 million of a USD 250 million advance payment."[131]

125 2007, feb 23, https://wikileaks.org/plusd/cables/07ULAANBAATAR119_a.html, (April 26 2019).
126 2009, October 29, Key Mongolian Mining Deal Still On Track, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR315_a.html, (April 26 2019).
127 2009, Oct. 29,https://search.wikileaks.org/plusd/cables/09ULAANBAATAR315_a.html, (April 26 2019).
128 2009, Oct. 29, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR315_a.html, (April 26 2019).
129 2008, March 19, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR118_a.html, (April 26, 2019).
130 2009, October 29, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR315_a.html, (April 26, 2019).
131 2009, Augustus 26, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR244_a.html, (April 26, 2019).

The desire for an increased stake in Oyu Tolgoi returns again in 2011.[132] The size of the Oyu Tolgoi project and its potential success for the political actors involved caused political strife during the negotiating of the agreement as well as afterwards. Between 2000 and 2015, Mongolia had 8 prime ministers different prime ministers. The Mongolian politicians playing a determinative role during the negotiations were N. Enkhbayar (prime minister when the negotiations began later President), Z. Enkhbold, S. Bayartsogt (Finance minister when OT was signed), D. Zorigt (Minister of Mineral Resources and Energy) followed by S. Bayarbat, and S. Bayar (prime minister when OTIA was signed).[133] Notably, the then CEO of Erdenes Mongol LLC – B. Byambasaikhan – was lauded for his role as the key negotiator of the Dubai Agreement for the Mongolian government. Byambasaikhan was formerly President of the North America-Mongolia Business Council and following the signing of the Dubai Agreement, was consequently appointed to the Board of Directors for Oyu Tolgoi.[134]

In 2018, Mongolia's anti-corruption agency arrested S. Bayartsogt (Finance Minister/OTIA) was signed, B.Byambasaikhan (former CEO of Erdenes Mongol LLC/Dubai 2015) and Ariunsan (Gen. Dept. of taxation /2015).[135]. The Prime Minister when OT IA was signed, S.Bayar, and Ch.Saikhanbileg who was Prime Minister when the 2015 Dubai agreement was signed were also both detained.[136] All of them were released but Bayartsogt was re-arrested in January 2019.[137]

132 Bouw, Branda, September 25, 2011: *Politicians seek larger stake of Oyu Tolgoi project; Ivanhoe says agreement is binding*: "A group of 20 parliamentarians has submitted a petition to the Mongolian government asking have its stake in Oyu Tolgoi increased to 50 per cent from the current 34 per cent." https://www.theglobeandmail.com/report-on-business/international-business/mongolia-wants-bigger-stake-in-massive-ivanhoe-copper-mine/article595583/, (18 April 2019).

133 Myadar & Jackson (2019).

134 see Lander, 2020: 136, footnote 34.

135 Daariimaa Batnasan, April 5, 2018, https://theubposts.com/s-bayartsogt-b-byambasaikhan-and-b-ariunsan-to-be-detained-for-30-days-over-oyu-tolgoi-deal-allegations/, (18 April 2019).

136 Davaasharav M. & D. Stanway, April 11, 2015, https://www.reuters.com/article/mongolia-oyutolgoi/mongolia-anti-graft-agency-arrests-two-prime-ministers-amid-mine-probe-idUSL3N1RO3OP, Jamasmie, C. March 13, 2018, https://www.mining.com/anti-corruption-body-asks-rio-oyu-tolgoi-related-info/, Jamasmie, C. May 22, 2018, http://www.mining.com/rio-tinto-says-investors-take-stance-oyu-tolgoi-test-case/, (April 22, 2019).

137 Davaasharav M. &B. Lewis, January, 29, 2019, https://www.reuters.com/article/us-mining-riotinto-mongolia/mongolia-over-seas-investigators-probe-oyu-tolgoi-corruption-claims-as-ex-minister-re-arrested-idUSKCN1PN0OY, (April 18, 2019).

4 Who benefits from Oyu Tolgoi?

SOMO's 2018 report *Mining Taxes* reported on how Rio Tinto and Oyu Tolgoi's other investors managed to lower their taxes through tax benefits negotiated with the GoM, and tax avoidance schemes using mailbox companies in the Netherlands and Luxembourg. The report found that the Canadian government had lost an estimated US$470 million in tax revenue due to Rio Tinto's tax avoidance, while Mongolia had lost approximately US$230 million in taxes due to tax benefits the government had granted Oyu Tolgoi.

4.1 Tax revenue losses for Mongolia

In analysing the tax practice of Oyu Tolgoi, SOMO came across a so-called fiscal stabilization clause, enshrined in the Oyu Tolgoi Investment Agreement of 2009. The effect of this clause is that in taxing Oyu Tolgoi, Mongolian tax authorities are only allowed to apply the tax laws and tax treaties that were in place in 2009 at the signing of the Investment Agreement.

Advising countries on providing fiscal stabilization clauses, the OECD writes that countries should always consider limiting the duration and scope of such stabilization clauses.[138] Furthermore, the OECD advises countries to charge insurance premiums for such stabilization clauses, to cover the revenue risk that fiscal stabilization can pose for a country. In the case of Oyu Tolgoi, these safeguards were not implemented.

In 2013, an IMF publication advised Mongolia to review four of its tax treaties, because they were deemed to be conducive to tax avoidance.[139] Shortly after the IMF report came out, the GoM unilaterally cancelled all four of the treaties, two of which were treaties with the Netherlands and Luxembourg. Because the fiscal stabilization clause froze all tax legislation and treaties at the 2009 level, however, the cancellation of these treaties had no effect on Oyu Tolgoi. As such, the fiscal stabilization of OT allows Rio Tinto and its fellow investors to continue to make use of low tax rates enshrined in tax treaties which have long since been cancelled. In Mining Taxes SOMO argued that this fiscal stabilization clause is problematic, as it nullified Mongolia's fiscal sovereignty with regard to OT. The absence of an end date to the fiscal stabilization clause means that Mongolia will never be able to correct any flaws in its legislation or poorly designed tax treaties, or close any tax loopholes that Oyu Tolgoi's corporate investors can make use of.[140] Furthermore, the Mongolian government has conceded that in the case Mongolia agrees to treaties or legislation that would

138 OECD website, 2019, https://www.oecd.org/tax/beps/hidden-cost-of-tax-incentives-in-mining-draft-toolkit-oecd-igf.pdf, September 22, 2019).

139 IMF, 2012, https://www.imf.org/external/pubs/ft/scr/2012/cr12306.pdf, (September 22, 2019).

140 Technically, Mongolia will regain its fiscal sovereignty with regard to Oyu Tolgoi when the Investment Agreement's end date is past. However, as the Investment Agreement will be in effect for an initial 30 year period, with an optional 20 year extension Rio Tinto can choose to take, this will likely come too late. See also OT website, 2019, http://ot.mn/media/ot/content/about_us/IA/Oyu_Tolgoi_IA_EN.pdf see articles 1.1. and 15.11. (September 22, 2019).

lower tax rates below the 2009 level, Oyu Tolgoi's corporate investors may elect to apply those lower rates.[141] What can Mongolia expect to receive from Oyu Tolgoi?

In response to SOMO's Mining Taxes report, several other publications defended Oyu Tolgoi's tax arrangements. An interesting comment to the report was that even though the tax income for Mongolia was effectively lowered due to fiscal stabilization, the Oyu Tolgoi deal as a whole was still "good for Mongolia". Considering that tax is only one aspect of the arrangements governing a mega-project like Oyu Tolgoi, this certainly seems possible. This brings up the question: who benefits from Oyu Tolgoi?

Leading up to a mining deal, negotiating companies and governments try to make an estimation of the financial consequences such a deal might have. To do so, they use complex financial models that predict how costs and benefits from a mine will be divided. An estimation is made of what the costs of constructing and operating the mine will be, and what the costs will be to secure finance for the project. Assuming that the mineral prices stay the same, an estimation is then made of how much revenue can be expected from the mine, how these revenues will be divided between the company and state (in the case of shared ownership), and how much tax will have to be paid over the mine's revenue.

In this manner, financial models make a cost/benefit analysis for a potential mining project. It is important to note, however, that such models do not include a potential value for the unmined reserves in calculating the costs and benefits for the state. This makes sense, as it is difficult to assess the value of an unmined mineral. Yet it is also important to keep in mind, because the mineral reserve is what governments bring to a mining deal, and lose as a result of it.

According to Mongolian government sources – none of which were willing to go on record due to the contentious nature of the Oyu Tolgoi Agreement – the Mongolian government contracted Goldman Sachs in 2009 to create a financial model for the mine.[142] Though the model is not publicly available, the division of profits from Oyu Tolgoi was reportedly estimated to be 47% for Rio Tinto and its fellow investors, and 53% for the Mongolian government[143]. In 2016, consultancy firm Open Oil published a different model, detailing how the government could expect to receive approximately 57% of Oyu Tolgoi's profits, with the remaining 43% going to Rio Tinto and its fellow investors.[144]

However, Mongolian government sources indicate that neither of these models now seem realistic, and that the government take from Oyu Tolgoi is likely to turn out substantially lower. One major reason for this is that the benefits Oyu Tolgoi enjoys as a result of the fiscal stabilization clause, were

141 OT LLC, 2019, http://ot.mn/media/ot/content/about_us/IA/Oyu_Tolgoi_IA_EN.pdf see article 2.24.2. (September 22, 2019).

142 The assistance provided by Goldman Sachs is also referenced in the following source: Ш. Адъяамаа, April 11, 2014, https://news.mn/en/140219/, (September, 22, 2019).

143 In the 2015 Oyu Tolgoi Underground Mine Development and Financing Plan the Mongolian government and Rio Tinto restate their belief in this estimate of 53% of Oyu Tolgoi's profits going to the Mongolian State, in the form of taxes, royalties, and dividends. http://ot.mn/media/ot/content/Agreements/2015-05-18_OTUMDAFP.pdf, p.3, (September, 22, 2019).

144 OpenOil, 2016, https://openoil.net/portfolio/oyu-tolgoi-model-and-narrative-report/ (September, 22, 2019).

not calculated in these models. Specifically, the now defunct treaties Oyu Tolgoi can use due to the stabilization clause, allow the mine's investors to continue making use of the tax treaties Mongolia once had with the Netherlands and Luxembourg. This lowers the taxes due on payments[145] made abroad by Oyu Tolgoi.[146] Using the publicly available Open Oil financial model and adjusting for these lower taxes, the Mongolian Government's take from Oyu Tolgoi decreases from 57% to 45%.[147]

Based on Open Oil's model, the 45% of profits from Oyu Tolgoi for Mongolia is composed mostly of VAT, royalties, income taxes and dividends. Rio Tinto reports that between 2010 and 2018, Oyu Tolgoi has paid $2.3 billion to the Mongolian Government,[148] which is likely to have been composed primarily of VAT and royalties. Starting in 2031, the Open Oil model estimates that Oyu Tolgoi will start paying income tax and dividends to the GoM. Between 2031 and the end of the mine's lifespan in 2055, Open Oil estimate the present value of these dividends to be around $200 million.[149] With regard to dividends from Oyu Tolgoi, Otgochuluu Chuluuntseren, on the Board of Director of OTLLC and chief economist at Erdenes Mongol LLC since September 2013[150], observed when he was Director General of the Mongolian Ministry of Mining's Department of Strategic Policy:

"Because the Mongolian government committed to bearing 34 percent of all the mine's costs, as costs rise so do the country's debts with Rio Tinto. It will take us decades to pay back the loan. We expected to see the first dividends on the mine in 2019. But it turns out it will be 20 or 30 years before we receive a share of the profits."[151]

Securing a 34% share in the Oyu Tolgoi mine – and the dividends resulting from that share – was an important sticking point for the Mongolian Government in negotiations with Rio Tinto.[152] As Mongolia did not have the financial means to invest in the mine, the Government made the

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145 Such payments can come in the form of interest, royalties, dividends, and management- or technical fees

146 For a full explanation of the structures employed to avoid and decrease taxes owed by Oyu Tolgoi, please see SOMO's 2018 publication https://www.somo.nl/riotinto-taxschemes-mongolia.

147 This can be done by lowering interest withholding tax from 20% to 6.6%, dividend withholding tax from 20% to 0%, and withholding taxes on management fees from 20% to 5%. These lower withholding tax rates are enshrined in the former tax treaty between the Netherlands and Mongolia http://www.itc-leiden.nl/UserFiles/Documents/Mongolia%20ENG.pdf (September, 22, 2019).

148 Rio Tinto, 2019, Taxes paid: Our economic contribution, 2018, https://www.riotinto.com/search#main-search_q=taxes%20paid&main-search_e=0 (September, 22, 2019).

149 OpenOil calculated this present value of the dividends, using a Net Present Value with a 10% discount rate. OpenOil, Oyu Tolgoi Project Fiscal Model Narrative Report, https://openoil.net/portfolio/oyu-tolgoi-model-and-narrative-report/ (September, 22, 2019).

150 OT LLC: https://www.ot.mn/otgochuluu-chuluuntseren/ (January 07, 2020).

151 Zand, B. August 7, 2013, https://www.spiegel.de/international/world/mining-the-gobi-desert-rio-tinto-and-mongolia-fight-over-profits-a-915021-2.html, (December 8, 2017.

152 2007 February 23, https://wikileaks.org/plusd/cables/07ULAANBAATAR119_a.html,2008, 1 December https://wikileaks.org/plusd/cables/08ULAANBAATAR521_a.html, 2008, February 6, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR68_a.html, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR227_a.html; 2008, March 19, https://search.wikileaks.org/plusd/cables/08ULAANBAATAR118_a.html, https://search.wikileaks.org/plusd/cables/09ULAANBAATAR201_a.html, 2009, March 3: https://search.wikileaks.org/plusd/cables/09ULAANBAATAR87_a.html, (April 26, 2019), see also Hook, L. October 15, 2012. Mongolia seeks to renegotiate Oyu Tolgoi deal, https://www.ft.com/content/f74417d0-16dc-11e2-8989-00144feabdc0. (April, 22 2019.

concession that it would borrow the money from Rio Tinto, and then pay back the loans from its dividends. Furthermore, the overall sum invested in Oyu Tolgoi consists of 75% debt, and 25% equity, which in Mongolia is the upper limit where interest on debt can be deducted from income tax. To service this debt, Oyu Tolgoi LLC (the owner of the actual mine) will be paying interest to its creditors abroad, which are Rio Tinto group companies. This decreases the amount of profit Oyu Tolgoi LLC can expect to make, which in turn decreases the dividends the Mongolian Government can expect to receive. Taking the assumption that the Mongolian Government receives $200 million in dividends after its loans have been repaid from a mine for which total investments will come to at least $14.6 billion.[153] Considering Mongolia's 34% stake in the mine, this comes to a mere 4% return on investment for the Government of Mongolia.[154] However, given the combination of credit, loss carry forward and the repeated cost overruns and delays, it remains very unclear how much dividend will end up in Mongolia's coffers. The delay of production reported by TRQ in October 2018 from Q1 2021 to Q3 of that same year,[155] was followed by a year later, in July of 2019, by Rio Tinto reporting problems with the construction of the underground mine, leading to a total delay of between 16 and 30 months, and mining expected to start in June 2023 at the latest.[156] These delays mean any tax payments and hypothetical dividends for the Mongolian government will arrive later than expected. More importantly, though, the delays are likely to increase the cost of the project by US$1.2 to US$1.9 billion.[157] This increase will lengthen the cost recovery phase of the project – where the owners recover their investment before they start to pay taxes on their mining income – thereby further diminishing any dividends the Mongolian Government can expect to receive from Oyu Tolgoi. Other major shareholders, such as SailingStone Capital share these concerns.[158]

As a recent report in the Financial Times[159] confirms, the 34% share of Oyu Tolgoi the Mongolian Government owns may be near to worthless. In hindsight, the Mongolian Government's focus on securing ownership of Oyu Tolgoi may have been misguided, as its lack of control over the project, and particularly projects costs, as a minority shareholder in combination with Oyu Tolgoi's financing structure means Mongolia's share in the mine will likely not live up to expectations.

153 Rio Tinto website, 2018, https://www.riotinto.com/documents/RT_Oyu_Tolgoi_Past_Present_and_Future_EN.pdf p. 11, (April, 22 2019.

154 As total investment will have been $14.6 billion, Mongolia's investment will have been 34% of that, or $4.9 billion. Dividing the $200 million by $4.9 billion gives the return on investment of roughly 4%

155 TRQ, News Release February 26, 2019, https://www.turquoisehill.com/site/assets/files/5016/2019_financial_guidance_and_underground_development_update_final_26_feb_2019.pdf, (December 18, 2019).

156 Rio Tinto, July 16, 2019, Update on Oyu Tolgoi underground project, https://www.riotinto.com/news/releases/Oyu-Tolgoi-underground-project-update (December 18, 2019).

157 Ibid.

158 SailingStone Capital, April 23, 2019, https://sailingstonecapital.com/pdf/SailingStone%20Capital%20Vote%20No%20TRQ%20Letter%20(04-23-2019).pdf, (December 18, 2019).

159 Sanderson, H,. & N. Hume, July 23, 2019, https://www.ft.com/content/7d8101c0-a7e3-11e9-b6ee-3cdf3174eb89?accessToken=zwAAAWxsCUa4kc99gQHAp-MR6dO27jzfMXTriQ.MEUCIQC8YjAgbr7s9hDPtEUpJN-CyzOEAY59byqtqaCzglogKQI-ge520TxaRqMDWXZyjwm_sNOyoQ9Q-GgmAwZbbHooNOlg&sharetype=gift?token=24cc25bf-67ed-432e-b4d1-468a30513f4f, (August 8, 2019).

The practice of overestimating gains and underestimating complications, is common in megaproject developments and has been for a long time.[160] Cost overruns and schedule slippage are thus to be expected but not fully accounted for in the financial models. Furthermore, financial modelling of these projects generally ignore the many externalities related to mining operations. For example, the ecological damage caused by Oyu Tolgoi; difficult to quantify, but with long term impacts on the people and landscape around Oyu Tolgoi. The combination of both open pit mining and huge underground block cave mining renders a huge area in danger of collapse. In addition to the soil and water pollution related to mining, fragile ecosystems such as the Gobi desert suffer drought and biodiversity loss due to the diversion of water ways and water extracted for Oyu Tolgoi.[161] Although the disruption of the lives and livelihoods of nomadic herder communities living in the area around Oyu Tolgoi was recognised when herders won a claim filed against Oyu Tolgoi LLC in 2017[162] and attempts are made to alleviate this disruption, the ecological degradation and social fragmentation have not been solved[163].

4.2 Oyu Tolgoi lock-in

Several turbulent years followed after the signing of the OTIA in 2009 and before the signing of the underground 2015 Underground Mine Development and Financing Plan, commonly known as the Dubai agreement, fully explained in Box 3, the chronology of the OTIA investment agreement and its aftermath. During the ten years that have passed since the signing of the OTIA all attempts to renegotiate has failed.[164].Recent attempts in 2019 see the Mongolian parliament passing a resolution that all the agreements related to the Oyu Tolgoi Mine should be reviewed and measures taken for the benefit of the Mongolian people.[165] Contentious issues concern how much and when Mongolia benefits from Oyu Tolgoi's profits, and how much tax should be paid. However, having become integrated in the global mineral market and the FDI regulatory regime, Mongolia has limited room for manoeuvre. With the OTIA, Mongolia is bound to its international legal constellation, in particular the bilateral treaties it has signed and the Investor State Dispute settlement clauses it has included in its agreement. The 2015 Dubai agreement consolidates these issues, thus locking Mongolia into a development trajectory emphasizing a safe investment climate rather than benefits for its people

160 Besant- Jones et al 1994: 42, see also Flyvberg, B. (Ed) 2017.

161 See Jackson 2018.

162 Accountability Councel: https://www.accountabilitycounsel.org/2017/06/mongolian-herders-secure-historic-agreement-with-oyu-tolgoi-mine-government-to-protect-herds-health-and-livelihoods, Sophie Edwards, devex, August 2017, https://www.devex.com/news/how-a-group-of-mongolian-herders-took-on-a-mining-giant-and-won-90765, (07 December, 2018). For further detail see also: https://www.theguardian.com/global-development-professionals-network/2015/mar/09/mongolian-nomads-displacement-mining-impact-development-projects, (18 September 2017).

163 Rod Austin, April 8, 2019, https://www.theguardian.com/global-development/2019/apr/08/mongolian-herders-corporate-behemoth, (December 1, 2019).

164 Oyundari, E, June 25, 2015, MP O.Sodbileg: Oyu Tolgoi deal in Dubai is not valid in arbitration court http://ubpost.mongolnews.mn/?p=15074, (December 1, 2019).

165 Baljmaa.T, November 21, 2019 https://www.montsame.mn/en/read/207811, https://www.reuters.com/article/us-mongolia-oyutolgoi-idUSKCN1UE1P1, (December 1, 2019), Hume, N, November 21, 2019, https://www.ft.com/content/e55cc25a-0c62-11ea-b2d6-9bf4d1957a67, see also https://lehmanlaw.mn/newsletter/parliament-calls-for-revisit-of-key-oyu-tolgoi-agreements/, (21 December, 2019).

4.2.1 Investor State Dispute Settlement

What is not often discussed, however, is that the GoM is very limited in the demands it can make of Rio Tinto and its fellow investors, as it is bound in the means with which it can enforce such demands. This is due to so-called Investor State Dispute Settlement (ISDS) clauses enshrined in both the Oyu Tolgoi Investment Agreement and the Mongolia-Netherlands Bilateral Investment Treaty. An ISDS clause allows investors to sue host governments in the case of investment disputes. The legal challenge is then brought before an independent court where judges decide whether the investment protection articles enshrined in the applicable ISDS clause were violated. Originally intended to stop arbitrary abuse by states singling out foreign investments, ISDS has devolved into a mechanism that allows corporations to interfere with states' sovereign right to legislate in their people's public interest.[166] The ISDS system has been found to be one-sided – only allowing corporation to sue states, but not the other way around – inscrutable, and costly,[167] and allows corporate interests to challenge legitimate public interest legislation.[168]

In the case of Oyu Tolgoi, both the 2009 Investment Agreement as well as the Mongolia-Netherlands Bilateral Investment Treaty contain an ISDS clause. As discussed at length in the report *Mining Taxes*, the corporate investment made in Oyu Tolgoi was provided through mailbox subsidiaries in tax havens Luxembourg and the Netherlands. As such, 66 per cent of the shares of Oyu Tolgoi LLC, the Mongolian legal entity that controls the mine, belong to Dutch Oyu Tolgoi Netherlands B.V., which is part of the Turquoise Hill Resources group. Oyu Tolgoi Netherlands B.V. has no employees, and seems to exist solely as a conduit for financial flows going to Mongolia, as well as a way to secure investment protection for Rio Tinto and its fellow corporate investors. This illegitimate way of securing benefits enshrined in bilateral treaties by using legal entities without any real economic substance subverts the purpose of those treaties. The practice is generally known as treaty shopping.

In the case that Rio Tinto and its fellow investors consider the GoM to have violated the terms in the Investment Agreement, they could sue Mongolia before the United Nations Commission on International Trade Law (UNCITRAL).[169] If, on the other hand, Oyu Tolgoi's corporate owners believe that the terms of the Mongolia-Netherlands Bilateral Investment Treaty have been violated by Mongolia – and these include ambiguously worded conditions like 'fair and equitable treatment' of investors – they can choose to sue the country before the International Centre for Settlement of Investment Disputes.[170] In a 2008 discussion US Government representatives warned their Mongolian counterparts that any expropriation of US corporate assets would lead to such a case:

166 Provost, C. 2016, https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf, (December 1, 2019).

167 Hughes, L. 2017, https://www.ciel.org/governments-look-narrowly-problems-undemocratic-investor-state-dispute-settlement/, (28 September, 2019).

168 https://www.documents.clientearth.org/wp-content/uploads/2017-03-15-towards-a-more-diligent-and-sustainable-system-of-investment-protection-ce-en.pdf, (28 September, 2019).

169 2009 OTIA Investment agreement, article 14.2, http://ot.mn/media/ot/content/about_us/IA/Oyu_Tolgoi_IA_EN.pdf, (28 September, 2019).

170 Netherlands-Mongolia BIT, https://investmentpolicy.unctad.org/international-investment-agreements/treaties/otheriia/2563/mongolia---netherlands-bit-1995-, (28 September, 2019).

"The [US] Charge also noted that the uncompensated "taking" of such a government share in an existing investment could trigger U.S. anti-expropriation laws and provisions under the existing US-Mongolian Bilateral Investment Treaty (BIT)."[171]

Most of the incidences of conflict between Rio Tinto and the GoM that have become public knowledge concerned taxes in one form or another. From the contentious 2006 windfall profits tax – which was cancelled in 2011 – to the various Mongolian attempts to increase the tax income from Oyu Tolgoi between 2012 and 2019,[172] tax and the division of profits from Oyu Tolgoi has been the focus of conflict between Rio Tinto and its fellow investors on the one side, and the Government on the other. Elsewhere, the ISDS system has led to over 40 tax-related legal cases, with corporations challenging legislative changes or the application of law by tax authorities.[173] The fact that the system allows for such court cases around tax makes it likely that – barring a resolution of the conflict – the Mongolian Government will be sued before an international tribunal. In fact, after the Mongolian Government sent Turquoise Hill Resources a $155 million tax bill in March 2018, the company filed a notice of dispute with the Mongolian Government, which is the first step towards initiating an ISDS case.[174]

The ISDS clauses enshrined in the Mongolia-Netherlands Bilateral Investment Treaty and Oyu Tolgoi Investment Agreement likely limit Mongolia's room to manoeuvre in negotiations with Rio Tinto, or even to enforce demands in the public interest. By locking in the current arrangements around Oyu Tolgoi, these ISDS clauses compound the existing issues with the Oyu Tolgoi Investment Agreement.

4.2.2 The 2015 OTUMDFP/ Dubai Agreement

The OTUMDFP is the financing agreement supporting the second (underground) phase of the OT mine. The second phase underground agreement strengthens the initial Investment Agreement. This agreement was signed in Dubai in 2015 and is notable for three reasons: First, it involves the largest mining deal financed by public and semi-public institutions, totalling 4.4 Billion USD.[175] Second, it removes all practical options for the GoM to change any terms of the 2009 Investment Agreement. Third, an administrative court upheld claims that due process was not followed for the Dubai agreement as it was not discussed by parliament before it was signed.[176]

This huge Public finance deal consists of a USD 400 million loan from the European Bank for Reconstruction and Development (ERBD),[177] known as an A loan, and the syndication of up to 1 billion to

171 https://search.wikileaks.org/plusd/cables/08ULAANBAATAR227_a.html, (28 September, 2019).

172 https://www.somo.nl/wp-content/uploads/2018/01/Mining_taxes_V_1.2.pdf, p.22-23, (28 September, 2019),

173 https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf, (28 September, 2019).

174 Sanderson, Cosmo, March 16, 2018, https://globalarbitrationreview.com/article/1166728/mongolia-risks-lcia-claim-over-mining-tax-bill (28 September, 2019).

175 http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/ogm+home/priorities/mining/oyutolgoi2c; http://www.riotinto.com/documents/151215_Oyu_Tolgoi_signs_Project_Finance_agreement.pdf, (28 September, 2019).

176 http://theubposts.com/has-the-oyu-tolgoi-s-dubai-deal-been-voided/, https://www.riotinto.com/news/releases/Administrative-court-proceedings-Mongolia, (November 23, 2019).

177 European Bank for Reconstruction and Development, Project Number 41158, http://www.ebrd.com/work-with-us/projects/psd/oyu-tolgoi-.html 12 December 2016.

commercial banks, known as a B loan. Another USD 500 million comes from the U.S. Export Import Bank[178] in addition to a USD 1,2 billion loan facility provided by the International Financial Corporation (IFC)[179] that includes a syndicated debt of USD 821 million[180] The Multilateral Investment Guarantee Agency (MIGA) provides a guarantee of 1billion USD to 13 of these institutions.[181] A debt cap of USD 6 billion was agreed, providing the option for an additional USD 1.6 billion of Supplemental Debt if needed. These loans were already approved in 2013[182], but signed only in 2015 after Rio Tinto had been able to counter all possible attempts by the GoM to renegotiating the 2009 OTIA.

Not only are the rather staggering amounts of public and semi-public finance and MIGA guaranteed finance for this project remarkable. The 2015 OTUMFDP consolidates the terms and conditions of both the earlier OTIA and ARSHA. The development of the controversial Tavan Tolgoi coal fired power plant is explicitly confirmed (Art 3.4) in addition to exploring the development of a copper smelter (Art 3.5). Also agreed upon is the total costs of the open pit construction (first phase) and that this amount cannot be contested by any of the parties (Art 4.3). By signing the agreement all the financial statements from 2010 until 2014 are approved (Art. 4.4), as are an accrued tax credit of 0.6 billion and the balance of losses 0.25 billion (Art. 4.5).

The Dubai Agreement was lauded as a step towards healing Mongolia's reputation as a safe destination for foreign investment. As then Prime Minister Ch. Saikhanbileg stated in a Rio Tinto press release:

"Mongolia is back to business. Oyu Tolgoi is a world-class copper-gold mine and its further development is of great economic significance for Mongolia. We have finalised a way forward with our partners which re-establishes the foundations of a new and constructive relationship based on mutual trust and our joint long-term commitment to Mongolia's growth."[183]

In essence, by signing the OTUMFDP, yet another door closed for renegotiating a better deal for the Mongolian public.

178 $494,565,125; Export-Import Bank of the United States, "Ex-Im Approves $500 million to Finance U.S. Exports for Use in Mongolian Mine", 16 May 2013, http://www.exim.gov/newsandevents/releases/2013/ExIm-Approves-500-million-to-Finance-US-Exports-for-Use-in-Mongolian-Mine.cfm (16 July 2014). http://www.exim.gov/news/minutes/board-meeting-minutes-2013-05-16.

179 International Finance Corporation, Project number 29007, 28 February 2013, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/ProjectDisplay/SII29007 (July 18 2018). See also https://www.ebrd.com/news/2015/ebrd-arranges-us-12-billion-syndicated-loan-for-oyu-tolgoi-mine.html, (December 11, 2019).

180 The lenders implicated are the Export Development Canada, the Australian Export Finance and Insurance Corporation, Standard Chartered, BNP Paribas, Canadian Imperial Bank of Commerce, KfW-IPEX, Netherlands Development Finance Company (FMO), the Australia and New Zealand Banking Group (ANZ), National Australia Bank, ING bank, Intesa Sanpaolo, Natixis, Société Générale CIB, Crédit Agricole, Hongkong and Shanghai Banking Corporation (HSBC), The Bank of Tokyo-Mitsubishi UJF and Sumitomo Mitsui Banking Corporation (SMBC), https://www.gtreview.com/news/asia/oyu-tolgoi-financing-agreed/, (July 8, 2017)

181 MIGA, 2016, https://www.miga.org/project/oyu-tolgoi-llc, (January 20, 2020).

182 See footnotes 180 and 181.

183 https://www.riotinto.com/en/news/releases/Oyu-Tolgoi-shareholders-agreement-signed, (07 December 2017).

5 Conclusion

"For now, the Oyu Tolgoi agreement is not benefiting Mongolian citizens…It is good to attract foreign investment but that doesn't mean foreign investment should only benefit the foreign side."
Battumur Baagaa, July 2019, member of the Mongolian parliamentary working group.[184]

Mongolian civil society and politicians have questioned their access to the revenues from the Oyu Tolgoi copper and gold mine and demanded more sovereignty over its resources since negotiation over the Investment Agreement began in 2003. This report confirms that Mongolians have ample reason to question the intent of the OT investment agreement, as well as the very limited benefits they may possibly receive. Mongolia signed an Investment Agreement that privileges "western" corporate interests by offering generous corporate oriented incentives that do not fill public coffers. We show that the negotiations were riddled with power inequities and pressure to comply with international expectations, in a context dramatically restructured by institutional reform from a state-led to a market economy, narrowly focused on mining.

With this report, we want to emphasize how resource rich countries are integrated in global mineral markets ruled by international regulation that leaves them with limited room for manoeuvre. This report paints a grim picture of the role played by 'western' governments and Bretton Woods institutions in Mongolia's development. The World Bank and IMF were instrumental in the liberalisation of Mongolia's markets, and stimulated the country's focus on mining as its principal vehicle for development by creating an enabling context for foreign capital to exploit the extractive potential of Mongolia. This was done despite the detailed World Bank commissioned 2003 Extractive Industries Review (EIR) that details how resource wealth does not easily translate into sustainable development, especially because contracts signed between governments and corporate parties inhibit the possibility of environmental and social regulation in the future.

While the World Bank ushered Mongolia further into the mining industry, behind the scenes the US – the World Bank's largest shareholder – pressured Mongolia to lower its demands from mining companies looking to access the Oyu Tolgoi mineral reserves. Exploiting both Mongolia's desire for so-called 'third neighbours' – political counterweights to Russian and Chinese influence in the country – as well as its dependence on IMF finance, the US and its allies were apparently successful in furthering their commercial interests. Judging from updated financial models and testimony from Mongolian officials, the resultant agreements governing Oyu Tolgoi have been financially disappointing for the Mongolian Government. Hence, the country was first directed towards letting foreign companies enter its mining industry in order to achieve economic development, only to then be pressured out of protecting its interests in negotiations with those same mining companies.

The US diplomatic cables discussed in this report illustrate the failure of Mongolian politicians' to negotiate an agreement favourable to the Mongolian people, but also their mismanagement

184 Dairtan, A. November, 21, 2019, https://www.reuters.com/article/us-mining-riotinto-mongolia/rio-tinto-faces-having-to-renegotiate-terms-of-mongolian-copper-project-idUSKBN1XV278, (December 13, 2019).

of public perceptions around Oyu Tolgoi. However, between the US' unwavering support for Rio Tinto, Mongolia's other donor states rallying behind the mining company, Mongolia's dependence on the IMF and the US' dominance within that institution, and Mongolia's dependence on mining as a vehicle for economic growth, it seems unlikely that an effective Mongolian course of action could have counteracted the power imbalance in the negotiations on Oyu Tolgoi.

Oyu Tolgoi seems to have hijacked Mongolian policy making in three ways. The first is the OTIA and its stabilization and arbitration clauses supported by international investment treaties and taxation agreements. Irrespective of any amendments to laws or regulations that the government of Mongolia may try to enact, the provisions of the 2009 agreement safeguards Rio Tinto's profits from being affected and provide the possibility to challenge government interventions. Investment protection constrains the Mongolian government in reregulating tax legislation. The incentives offered in Mongolia to foreign investors foreclose the necessary policy space to harness investment to serve sustainable development.

By signing investment agreements and bilateral investment treaties that favour corporate over public interests in order to attract FDI, the government has left itself little room to defend Mongolia's interests. Policy that is argued to support 'good governance' and 'rule of law' to protect the market against unwanted influence from the state, in practice has dismantled public checks and balances.

The second way in which policymaking has been hijacked is the 2015 Dubai agreement. In addition to consolidating the terms of the OTIA, its too-large-to-fail financing structure that includes public IFIs such as the IFC and the EBRD make renegotiation improbable. The third reason concerns the weight of the western international community behind the agreement, both politically and financially, as the cables from the US embassy so aptly show.

Mongolia never really had a fair chance to negotiate a deal that would serve the people of Mongolia. The global economic and regulatory context, with its legal and institutional frameworks, is geared towards a development paradigm that favours economic growth and free capital flows. This translates into an emphasis on a safe investment climate, rather than a healthy environment for people and planet. Other factors of influence, such as the political instability and manoeuvring of Mongolia's political elite along with the 2007-2008 financial crisis left Mongolia with increasingly weak negotiating power. Consequently, the influence of a Global mining giant such as Rio Tinto backed by 'western' governments on Mongolia's policy space and its ability to monitor, regulate and control resource extraction has an adverse impact on its development trajectory. It was made painfully clear in 2017 how the democratic process in Mongolia is undermined by corporate power, when the IMF positively responded to Rio Tinto's compliant against the GoM's efforts to have corporate financial transactions flow through Mongolian banks. The negotiations over Oyu Tolgoi show how foreign and corporate interests harness diplomatic, institutional and political power to define development trajectories counter to democratic control over resources and social and ecological wellbeing.

The Oyu Tolgoi Investment Agreements was signed 6 years after the Extractives Industry Review published its critique of the World Bank Group practices in 2003. The main recommendation made by the EIR was to support sustainable development through economic diversifications.

Sadly, the analysis of the EIR holds just as true for Oyu Tolgoi, and many of its recommendations, if implemented, could have benefited the people of Mongolia as well as the Oyu Tolgoi Project itself.

The size and scale of the project has launched Mongolia into the international political economy and regulatory regime of Foreign Direct Investment that privilege corporate interests. Any change to it, therefore, demands action at international scale. This demands recognition and action from the International Financial Institutions, in particular the World Bank, the IMF, IFC and EBRD to stop conditioning states to strip their public checks and balances.

For Mongolians to have access to, and control over their resources, the globally legitimized looting of it by Multinationals must stop. This means that we have to demand that notions of 'good governance' and 'rule of law' are redefined away from corporate interest and profit seeking and towards a healthy planet and the benefit of all of its people.

6 Recommendations

To Rio Tinto

- Rio Tinto should reconsider Mongolian concerns regarding the limited revenues the country can expect to receive from the largest mineral reserve exploited within its territory. Considering the continued conflict over resource rents in the Oyu Tolgoi case, Rio Tinto would do well to return to the negotiating table to reach a more equitable agreement with the Mongolian Government. Volunteering to lift Oyu Tolgoi's stabilization clause could be a good first step towards a more constructive and sustainable relationship between Rio Tinto and the Mongolian Government.

- Rio Tinto should provide full disclosure of all key documents concerning lending terms and conditions of contracts related to and signed after the 2015 Dubai agreement

- Rio Tinto should provide transparency about transfer prices paid for minerals produced at Oyu Tolgoi, as well as the mine's profitability, in order to clarify or alleviate concerns regarding the mine's future profitability and the corresponding income the Mongolian Government can expect to receive from the mine.

- Rio Tinto should have all EPC (engineering, procurement, construction) contracts go through OT LLC to ensure transparency in operational costs and facilitate Mongolian accountability.

- Respect, and comply with, the implementation of Resolution #92 of 21 November 2019 of the State Great Hural of Mongolia on "Securing the interests of Mongolia in the exploitation of the Oyu Tolgoi deposit."

To the Mongolian government

- Mongolia should in future investment agreements, avoid far-reaching tax incentives for foreign investors such as fiscal stabilization clauses and tax holidays.

- Regarding Oyu Tolgoi, Mongolia should follow OECD recommendations and should seek to renegotiate the Investment Agreement and to revise the financial stabilization clause provided therein.

- Mongolia should seek to renegotiate Bilateral Investment Treaties it has with partner countries that include corporate arbitrage. The ease with which companies can create artificial corporate structures to gain access to the benefits enshrined in such treaties endanger public interest legislation and governance in Mongolia. Therefore, Mongolia should seek to ban arbitrage clauses from all BITs it currently has and will agree to in the future. In (re-)negotiating BITs in the future, Mongolia should at least:

- not accept 'umbrella clauses', which elevate contract breaches to the level of international treaty breaches;
- push for strong taxation carve-outs;
- exclude ISDS, or propose additional requirements, such as requirement to exhaust domestic remedies.

- The Mongolian government could develop its own BIT model containing some of the elements mentioned above with strong CSR, public interest and sustainable development language.

- Mongolia should prioritize renegotiating the BIT with the Netherlands. The BIT will automatically be renewed for 10 years on 1 June 2021, and would otherwise need to be terminated before 1 December 2020. Mongolia should push the Dutch government to enter into renegotiation of the BIT in order to remove the arbitration clauses enshrined in it. If that fails, Mongolia should consider cancelling the treaty altogether, in order to safeguard the country's power to legislate in the public interest.

- Mongolia should review how investment agreements are negotiated. In this process, Mongolia should seek technical assistance that prioritises public wellbeing and ecological integrity, while involving stakeholders that are less influenced by short-term political interests and more by long-term sustainable development, such as local civil society, environmental governance and resource governance experts.

- Mongolia should provide information on investment agreements covering sizeable resource extraction projects to the Mongolian public in a more transparent and comprehensive manner. All positive and negative projections need to be made public so that potential risks and who will bear the cost are part of public debate. Realistic estimations of the timing and the amount of revenues Mongolia can expect to receive from such projects need to be made available before final decisions are made. Consultations with local stakeholders need to be meaningful and involve CSO representation, the reports of which should also be made available to the public.

- Financial models used for the prognosis of the benefits of extractive projects need to include the fiscal impact of investment agreements, as well as the long term environmental impacts on water, soil and biodiversity and the impact on climate change.

- Mongolia should have parliament approve all financing arrangements with IFIs.

- Mongolia should introduce a code of conduct for politicians and diplomatic staff to prevent all possible conflict of interests with regard to Oyu Tolgoi and other strategic deposits. Such a code of conduct should include a three-year cooling off period for taking any job with potential conflict of interest.

To the US government and its diplomatic partners

- Review the EIR 2003 to understand the destructive force and incentive for conflict that a self-centred promotion of companies and resource extraction produce. Instead they should listen and act upon the repeated calls by Mongolia civil society to respect Mongolian human rights and cultural dignity, and the ecological integrity of its unique landscape.

- Diplomatic efforts should realign national and international economic interests with sustainable development instead of prioritising economic growth for few at the cost of many.

To the International Financial Institutions involved in Mongolia

- Learn from past mistakes and implement valuable recommendations provided by IFIs independent evaluation offices, including the World Bank's EIR 2003, as well as the recommendations collected by the Bretton Woods project.[185]

- Remove economic policy conditions that undermine sovereign policy making, inhibit alternative development trajectories and limit public checks and balances.

- Shift policy emphasis on promoting economic diversification and sustainability;

- Make consultations with (potentially) affected communities mandatory and meaningful and involve CSO representation, the reports of which should also be made publicly available.

- Make revenue sharing with local communities mandatory with all loans.

- Disburse financing only after local civil society and national experts have approved the Social and Environmental Impact Assessments. Provide resources for the monitoring for human rights and environmental protection.

- Integrate and develop capacity within IMF and the World Bank Group to capture and support recipient countries cultural, political and economic priorities. In the case of Mongolia, this means a better understanding of its cultural heritage and how that translates into social economic and environmental priorities.

- Honour the climate pledges made in line with the 2015 Paris Agreements, and provide resources for those communities that are suffering the consequences of investments in the past, such as the affected communities by the Oyu Tolgoi project investment.

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