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Breaking the Dependence?

The Mongolian energy sector remains a highly interesting and at times sensitive area. With important recent developments in the wind and solar sectors, is it possible for Mongolia to break its dependence on its neighbours, the Dragon and the Bear?

Energy policy

Mongolia's energy policy targets are separated into two phases. The first, 2015–23, aims to achieve a doubling of the current installed capacity of just over 1100MW, combined with the objective of achieving 20 per cent of that capacity through renewable sources. In addition, the policy envisages completion of certain specific projects, including Combined Heat and Power Plant No. 5, supplying Ulaanbaatar, the Tavan Tolgoi Power Plant to support principally Oyu Tolgoi, a thermal power plant at Baganuur, a coal power plant at Shivee Ovoo aimed at exporting electricity to China, and various hydropower projects to achieve the renewables target. Beyond 2023 to 2030, the targets increase the renewable capacity to 30 per cent of overall capacity and to become a new exporter of electricity.

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Near the end for coal?

One of the key developments in recent times in the energy sector worldwide has been a move away from coal mining and coal based power projects. Witness the US elections of 2016, where Democratic candidate, Hillary Clinton, said "we're going to put a lot of coal miners and coal companies out of business". Of course, this move away from fossil fuels, with an emphasis on green and renewable energy solutions in the context of climate change, is unhelpful for Mongolia which is blessed with very significant coal resources.

However, it is clear that the availability of financing for coal mining and coal based power projects is diminishing rapidly. In the past two years alone, major international commercial banks have been adjusting their policies on coal projects, either not financing any further projects, limiting their involvement by reference to emissions targets, or reducing their ongoing financing exposure to projects in the coal sector. Banks such as ABN AMRO, Deutsche Bank, SocGen, Credit Suisse, HSBC and a host of others now have policies restricting their financing of coal projects.

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Likewise, international financial institutions that are active in Mongolia, such as ADB, IFC and EBRD, have limitations on their ability to finance power projects. This brings Mongolia into the realm of geopolitics – while China has the ability and willingness to provide finance, together with a policy of reducing emissions from its own coal sector, this potentially increases Mongolia's dependence on China economically.

Clearly, the window for coal financing internationally is closing quickly, and this trend is only likely to continue.

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Is hydropower the new coal?

International sentiment on hydropower projects is also moving in the wrong direction for Mongolia, as evidenced by the International Union for the Conservation of Nature, an advisory body to the World Heritage Committee operating under the auspices of UNESCO.

In 2015, the IUCN stated that dams pose a growing and serious threat to natural World Heritage, including in cases where the impacts come from dams in a neighbouring country.

According to the director of IUCN's World Heritage Programme, "Dams can have a huge impact on World Heritage sites, reducing precious natural wetland areas, changing river flows and impacting local communities ... it is essential to consider better alternatives that avoid such constructions where possible". On the other hand, another key issue for the Mongolian environment is desertification. The construction of a large reservoir can have significant benefits in that direction.

As a result of pressure applied through NGOs, the Russian government and the changing international attitude to hydropower, the majority of Mongolia's proposed hydropower projects, including Orkhon, Shuren and Egiin Gol are effectively on hold, pending implementation of the World Heritage Committee's recommendations for extensive environmental, social and strategic impact assessments primarily relating to Lake Baikal and the transboundary ecological system.

Clearly, while the impact on Lake Baikal is hugely important and needs to be properly assessed, there are undoubtedly political elements at play here as well. Russia has no desire to see Mongolia gain any form of energy independence, as this would limit its level of regional influence. Once again, we then see a geopolitical aspect to the energy development of Mongolia.

Renewables – growing quickly

It's not all bad news. We have recently seen two further wind farm projects come online, the 50MW Tsetsii Wind Farm sponsored by Newcom and Softbank, with financing provided by the EBRD and JICA, and a 55MW Sainshand wind park, sponsored by Ferrostaal with financing from EIB and EBRD. These two projects build on the Salkhit wind farm completed in 2012, significantly in creasing the level of installed renewable energy capacity.

In the solar sector, several new projects with Japanese involvement have been completed or are in process, which again is positive.

In time, the Asian Super Grid concept promoted by Softbank CEO, Son Masayoshi, may provide excellent opportunities for a more integrated renewables strategy. That said, at present the projects completed in the renewables sector are almost exclusively in the private sector and it is not clear how these projects ultimately fit into state-led energy plans.

Legal framework

Mongolia's legal system does not currently have express provision for "public-private-partnerships", but does contemplate concession type arrangements such as "Build-Transfer" and "Build-Operate-Transfer". Therefore, PPP structures need to be set up on a bespoke basis. This has its pros and cons, but should be possible within the existing legal framework.

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A more difficult issue is that due to economic constraints, and within the context of the fiscal discipline imposed by the IMF Extended Fund Facility, there is limited scope for the provision of government guarantees for major projects. This requires a more focused emphasis on high quality feasibility studies for a limited number of key strategic projects and detailed environmental impact assessments to ensure their viability.

Where do we go from here?

Clearly, there are international political and geopolitical issues intricately linked with the development of Mongolia's energy network. It is obvious that the window for financing of coal projects is closing fast and therefore arguably key projects in this sector, such as TTPP (which relies more on the covenant of Rio Tinto than the Mongolian government), should be prioritised, and can build a platform for expansion projects to support further energy sector development. Over time, it is likely that China will become one of the few sources of finance in the coal sector.

The future for hydropower projects in Mongolia looks difficult in the short term with widespread international concern, strong pressure from prominent NGOs and objections from the Russian Federation.

The international emphasis on renewable and green energy in the context of climate change means that perhaps greater importance should be placed on development of this sector as part of a revised and integrated energy policy.

Breaking the dependence? Unlikely in the short term.