

# *A Proposal for Establishing the Northeast Asian Coal Association*

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## ① Introduction

As one of the pillars of the Mongolian economy, the mining sector, especially coal, has been attracting a lot of attention. Having a GDP per capita of US\$4,800 in 2011,<sup>1</sup>

Mongolia is no longer in the low-income country classification, and mining revenues account for a large part of the state budget. Even though this indicates Mongolia's progress towards a market economy, Mongolia can do better than that. In other words, Mongolia is rich in mineral resources, and if some obstacles, such as difficulties in transportation, price fluctuation and its two neighbors' influence, are solved, then the country would witness more promising economic development. Therefore, this paper aims to propose some solutions for the abovementioned obstacles and the possibilities of facilitating Mongolia's active participation in Northeast Asian regional integration.

With ample natural resources, Northeast Asia includes six states: the Russian Federation, China, the ROK, the DPRK, Japan and Mongolia. The economic situation of the countries in the region greatly affects the global economy. In recent years the coal consumption of the region has been dramatically growing. For example, according to the Coal Statistics data, Japan was the leading coal importing country by its imports, while China ranked second and the ROK ranked third in the world in 2010.<sup>2</sup> But last year China became the largest consumer of coal in the world with total consumption of 182.4 million tons, overtaking Japan.<sup>3</sup> According to the estimation of the China Energy Council, the country's energy demand reached 4.19 trillion kWh in 2011, an increase of 14.56% compared to the previous year,<sup>4</sup> and China is projected to import one trillion tons of coal by 2030.<sup>5</sup> Currently, Mongolia has 175 billion tons of coal reserves, 205 million tons of oil and 68,000 tons of uranium reserves. With 30% of total reserves consisting of coking coal, Tavan Tolgoi has been attracting a lot of attention, but Mongolian coal is still outside of the economic circulation of Northeast Asia. Mongolia is making efforts to join the coal market due to both its domestic and foreign needs.

## ② However, these Efforts Are Being Constrained by some Obstacles that the Mongolian Mining Industry Has to Solve.

**Obstacle 1:** If Mongolia cannot solve the transportation issue, it will be difficult to export the commodity to the international market.

In Northeast Asia there are nine transportation trade corridors, and out of them the port of Tianjin is the closest one connecting to the Mongolian railway system, with its single north-south route, with the sea. Because the Mongolian railway system uses the broad gauge, it has the disadvantage of having to transfer freight to another train when coming to the Chinese railway system with its standard gauge. Recently the port has been exceeding its limits, and Mongolia has started to significantly export mining products. Therefore, there is no option but to use another port. The most suitable option for Mongolia is the port of Rajin in the Tumen River Corridor. In order to connect its strategically important mineral deposits to "third" markets, Mongolia will be able to use this port by building a railway to Dornod Aimag. In the railway development plan that will be completed by 2015, a railway connecting Mongolia to the Tumen River Corridor has been drawn up,<sup>6</sup> but currently the actual work has not been started yet (Figure).

**Obstacle 2:** How Do We Participate in Russia-China Cooperation?

In September 2010, Russia and China signed an agreement to cooperate in the energy sector in Blagoveshchensk, Russia. According to the agreement, the two sides agreed that Russia is to export 15 million tons of coal in the first 5 years of the agreement and 20 million tons of coal in the next 20 years, while China is to issue US\$6 billion of loans to Russia in exchange.<sup>7</sup> It indicates that our two neighbors have been deepening their energy cooperation. In this situation, there is a risk that Mongolia may not be able to take advantage of mineral resources, since our country is not the only one exporting to China.

**Obstacle 3:** Increasing the participation of third countries and a number of stable consumers will help to

<sup>1</sup> "The World Factbook: Mongolia": <https://www.cia.gov/library/publications/the-world-factbook/geos/mg.html>

<sup>2</sup> "Coal Statistics": <http://www.worldcoal.org/resources/coal-statistics/>

<sup>3</sup> "China overtakes Japan as biggest coal importer for the first time": <http://www.reuters.com/article/2012/01/26/coal-china-japan-idUSL4E8CQ3GS20120126>

<sup>4</sup> "2010年通年の電力使用量は15%増に一中国": [http://www.excite.co.jp/News/chn\\_soc/20110119/Recordchina\\_20110119002.html](http://www.excite.co.jp/News/chn_soc/20110119/Recordchina_20110119002.html) [in Japanese]

<sup>5</sup> "中国の石炭輸入が2030年には10億トンに激増": [http://www.asiam.co.jp/news\\_coal.php?topic=014357](http://www.asiam.co.jp/news_coal.php?topic=014357) [in Japanese]

<sup>6</sup> "Talking on connecting the strategic mines by railway": <http://numgeo.wordpress.com/>

<sup>7</sup> "China and Russia signed six billion U.S. dollars agreement to develop coal resources in the Russian Far East": <http://www.financeguider.com/china-and-russia-signed-six-billion-u-s-dollars-agreement-to-develop-coal-resources-in-the-russian-far-east/>

keep a balance.

In 2011, the mining sector accounted for 89% of Mongolia's total exports, and exports to China accounted for 92% of the total export volume. There is no guarantee that China's imports will not decrease or the market price will be stable over time. Chinese coal exports from Australia increased 12-fold from 3.5 million tons to 44.6 million tons within just one year.<sup>8</sup>

As mentioned above, there are many leading coal-importing countries in Northeast Asia. Countries such as Japan and the ROK, which are called Mongolia's "third neighbors", have expressed their interest in participating in the Tavan Tolgoi project, but progress has not yet been seen.

The main barrier to trade is difficulties in transportation, while the only viable option for transporting commodities from Mongolia to third countries is transporting via China. Due to China's insufficient capacity for transit transportation, Mongolia's trade with third countries has been stagnant.

**Obstacle 4:** Price volatility negatively affects the domestic economy and increases the foreign trade deficit.

The Mongolian economy is influenced by Chinese domestic price fluctuations, since Mongolia exports to only a few countries and uses the coal price in China as a benchmark price. In previous years, Mongolia was heavily impacted by the price volatility of copper. There are a lot of consequences for Mongolia when the copper price falls.

There is an established "Coal Export Price Council" in Mongolia aimed at stabilizing the domestic coal price.<sup>9</sup> Most of the council members are foreign invested companies, such as South Gobi Sands, MAK, Chinhua MAK and Nariin Sukhait; thus there is an anxiety that this council would create advantages for the benefit of foreign investors. Therefore, there is a need to establish a proper price management mechanism in Mongolia.

According to the Monthly Macroeconomic Review of Mongolia's Economic Policy and Competitiveness Research Center, in June 2012 Mongolia's exports increased by 14% from the previous year due to the increased exports of the mining sector, including 48% for coal export growth, 30% for ore export growth, and 41% for crude oil export growth. However, the foreign trade deficit increased by 18%, exceeding US\$1 billion.<sup>10</sup>

Although the economic situation is not good enough, Mongolia defines the mining sector as a key driver of its future economic development. One of the leading directions specified in the Millennium Development Goals-based Comprehensive National Development Strategy of Mongolia is to exploit strategically important mineral deposits to build up savings, ensure a high rate of economic growth, and develop modern processing industries.<sup>11</sup> Therefore it can be argued that one of the potential solutions

for all these obstacles, in a comprehensive manner, is to establish a coal association in Northeast Asia.

### **③ How Would the Abovementioned Obstacles Be Solved by Establishing the Northeast Asian Coal Association?**

The solutions for the abovementioned obstacles and other accompanying benefits by establishing the coal association are as follows:

#### **Solution to Obstacle 1:** Difficulties in transportation

By establishing the coal association Mongolia would receive international support for opening a new gateway to the sea, and it would facilitate the country's foreign trade. As the building of the domestic railway system is highly dependent on Russia's position, and current railway transportation is under the significant influence of China, international support would be the most important driver for solving these obstacles. With the support of this coal association, Mongolia would be able to solve its transportation difficulties and facilitate commodity trade with Japan and the ROK, which is currently idling due to the transit transportation impasse of China.

In Article 125 of the UN Convention on the Law of the Sea landlocked states' right of access to and from the sea was defined, while transit customs duties, taxes and other charges were mentioned in Article 127.<sup>12</sup> Also, WTO's GATT (The General Agreement on Tariffs and Trade) specified in detail landlocked states' transit rights, and all duties and other charges related to the transit.<sup>13</sup>

#### **Solutions to Obstacles 2 and 3:** Chinese and Russian cooperation and third countries' participation

The participation of the ROK and Japan in the association will facilitate Mongolia's "third neighbor" policy. In Mongolia's National Security Concept it is specified that investments of any foreign country do not exceed one third of overall foreign investment into the country. But currently investments from China have already exceeded 50% of Mongolia's total FDI made after 1990. Thus, the establishment of the coal association will be an important step for the fulfillment of the Concept principle. In other words, the coal association will be aimed at increasing and stabilizing investments from third countries into the Mongolian economy, which is already dominated by China. In doing so, not only Mongolia, but all other countries in the region would have a fair platform for discussing mutually beneficial ways and solutions for effectively utilizing one of Mongolia's abundant natural resources, coal.

#### **Solution to Obstacle 4:** Price volatility and the national economy

By establishing the coal association, it would be

<sup>8</sup> "拡大する中国の石炭輸入": <http://eneken.ieej.or.jp/data/3287.pdf> [in Japanese]

<sup>9</sup> "Council for coal exporting price": <http://www.mongolchamber.mn/index.php/councils/coal>

<sup>10</sup> "Monthly Macroeconomic Review": [http://ecrc.mn/images/stories/Macro\\_overview\\_201206.pdf](http://ecrc.mn/images/stories/Macro_overview_201206.pdf)

<sup>11</sup> "National Development Comprehensive Strategy": <http://www.mecs.gov.mn/article-120-306.mw>

<sup>12</sup> "United Nations Convention on the Law of the Sea (UNCLOS) and its attachments": [http://www.monmarad.gov.mn/index.php?option=com\\_content&view=article&id=60%3A2012-05-03-07-13-55&catid=6%3A2010-11-01-06-44-08&Itemid=78&lang=mn](http://www.monmarad.gov.mn/index.php?option=com_content&view=article&id=60%3A2012-05-03-07-13-55&catid=6%3A2010-11-01-06-44-08&Itemid=78&lang=mn) [in Mongolian]

<sup>13</sup> "モンゴルの地下資源開発・利用と国際関係" 松岡克武, *ERINA Report No. 105*, pp. 69-70 [in Japanese]

possible to ensure coal price stabilization by negotiating and determining prices and supply quotas with the participation of all member states. Therefore, the domestic price fluctuations of China would no longer impact Mongolia's coal export prices and it would bring positive developments for the Mongolia's economy.

**Other accompanying benefits:** If we see that Mongolia's landlocked position is hindering its development, development based on the mining sector will be accelerated by solving this issue. Both the public domestically and foreign countries are eagerly waiting for it.

Therefore, establishing the Northeast Asian Coal Association will provide Mongolia with new opportunities from which the country can economically benefit, cooperate with its two neighbors in mutually beneficial ways, join regional economic integration based on its infrastructure, and the "third neighbor" policy, one of Mongolia's foreign policy priorities, can successfully be implemented.

④ **Learning from Others' Experiences**

After studying the mining associations and cooperation organizations which are successfully operating in various regions, it is argued that OPEC<sup>14</sup> and the European Coal and Steel Community can be models for the establishment of the Northeast Asian Coal Association.

- The European Coal and Steel Community was established in 1951, comprised of the Benelux,<sup>15</sup> West Germany, France and Italy. The community was intended to end the hostility between Germany and France through the agreement to jointly exploit coal and steel, which was the most

important commodity in war. In other words, this agreement helped to overcome political tension.

- The Organization of the Petroleum Exporting Countries was formed by a treaty signed by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela in September 1960. Before the founding of OPEC the world petroleum price used to be determined by the "Seven Sisters".<sup>16</sup> Yet these companies were challenged by the increasing influence of OPEC, and now OPEC holds the right to set the global petroleum price.

With 12 member states, OPEC aims to unify and coordinate members' petroleum policies, ensure the stabilization of prices in international oil markets and supply petroleum to consuming nations in an efficient and regular manner. In order words, one of the organization's main functions is to ensure the stabilization of prices and avoid potential risks. With this function, OPEC will become a good example for forming a coal association in Northeast Asia.

We will establish the coal association with the same functions and aims that OPEC has, but strive to have all exporting and importing countries of the Northeast Asian region join and promote their active participation.

⑤ **Conclusion**

In Northeast Asia there are positive factors necessary for regional integration, such as Russia's natural resources, Japan's high technology and the workforces of China and the two Koreas. China, the ROK and Japan agreed to establish an FTA in May 2012, and Mongolia's two neighbors are expanding their relations. These

**Figure: Mongolia's Railway Development Plan**



<sup>14</sup> "OPEC" = The Organization of the Petroleum Exporting Countries

<sup>15</sup> The Benelux is a customs union in Europe comprising three neighboring countries: Belgium, the Netherlands and Luxembourg.

<sup>16</sup> The "Seven Sisters" is a group of dominant petroleum companies comprising Anglo-Persian Oil Company, Royal Dutch Shell, Standard Oil of California, Standard Oil of New Jersey, Standard Oil of New York, and Texaco.

developments suggest that Mongolia needs to begin participating in the regional integration process. Otherwise, Mongolia would remain outside of the integration process.

Moreover, coal is a vital national resource for ensuring energy security in the future. In recent years, the coal market has been expanding significantly, and many countries are increasing their attention on coal due to the Fukushima nuclear disaster.<sup>17</sup> Therefore, Mongolia needs to take steps, using its advantages, and make efforts towards establishing the Northeast Asian coal association.

On the other hand, even though Mongolia would get a number of benefits from the establishment of the proposed

coal association, the reactions and views of other countries should be considered. As Japan and the ROK are interested in entering the Mongolian coal market, it is hoped that they would participate actively in the project. But China may have negative reactions to the proposal. Accordingly, Mongolian governmental bodies, such as the Ministry of Mineral Resources and Energy, the Mineral Resource Authority, and the Ministry of Foreign Affairs, along with other research institutes' efforts, will surely be important in terms of studying the proposal and initiating efficient measures to realize this proposal and properly addressing the reactions and mitigating the potential risks.

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<sup>17</sup> "日本の大地震が中国の石炭市場に与える影響は": [http://japanese.china.org.cn/business/txt/2011-03/28/content\\_22239443\\_3.htm](http://japanese.china.org.cn/business/txt/2011-03/28/content_22239443_3.htm) [in Japanese]