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Mongolian Participation in an Upgraded Eurasian Energy and Transport Grid

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Alicia Campi, President of the US-Mongolia Advisory Group, explains that “[Mongolia] needs to expand transport infrastructure for its rich minerals to reach new Asian trade partners, so it is pursuing its own long-range strategy, to maximize benefit from and minimize the dangers of rapprochement between its two giant neighbors.”

The world’s attention has been focused this year on the accelerating economic collaboration between Russia and China across Eurasia. The conflict in Ukraine has driven the two nations to consider energy and transport options that appeared far-fetched or too expensive only a year ago. While researchers have been quick to consider how China has taken advantage of this situation to drive down oil and LPG prices with Russian suppliers or to receive equity in Russian oil fields as part of financial investment packages, there has been little focus on successful Mongolian efforts to muscle into the Sino-Russian deals. Mongolian President Tsakhia Elbegdorj has seized the opportunity to offer a variety of proposals to deepen his democratic country’s participation in a new Silk Road Economic Belt of Eurasian rail and pipeline modernization.

Landlocked Mongolia does not want to be just a pawn in this Sino-Russian vision of a new Eurasian world. It needs to expand transport infrastructure for its rich minerals to reach new Asian trade partners, so is pursuing its own long-range strategy, called “Steppe Road,” to maximize benefit from and minimize the dangers of rapprochement between its two giant neighbors. In late August it signed five transport-related documents during a summit visit of Chinese President Xi Jinping to Ulaanbaatar. Ten days later, in a summit with Russian President Vladimir Putin, the Mongols obtained an agreement to modernize the key north-south Ulaanbaatar Railway (UBTZ), a Mongolian-Russian state-owned joint stock company that accounted for 60% of Mongolia’s freight traffic in 2013. On September 11th, Elbegdorj met again with Xi and Putin in a trilateral summit prior to the Dushanbe, Tajikistan meeting of the Shanghai Cooperation Organization and obtained their public agreement to explore Mongolia’s role in assisting Sino-Russian cooperation to improve transportation infrastructure interconnectivity and cross-border transportation.

Although Russia for years has considered forging closer energy ties with China, the lack of resolution to the 2014 political crisis with the European Union – Moscow’s main energy export market – revived momentum for Sino-Russian pipeline projects and eastbound rail construction options to Northeast Asian ports that have languished for years. Their energy cooperation had begun already in the oil sector in October 2013 when Rosneft, the state-owned Russian oil corporation, and China National Petroleum Corporation signed a \$270 billion, 25-year supply agreement, with about \$70 billion worth of prepayments. Rosneft also agreed to an \$85 billion, 10-year oil-supply deal with China Petrochemical Corp. (CNPC). But Russia was very reluctant to move forward with natural gas cooperation, because it could get higher prices by selling to European clients. It was not until May 2014, after one decade of negotiations, that Russia and China signed a \$400 billion deal to supply Siberian gas, at a unit cost perhaps as much as \$30 less per thousand cubic meters than the 2013 European price, to China by 2019 through a 4,000-kilometer (2,485 mile) pipeline called the “Power of Siberia.” In 2012, President Elbegdorj

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unsuccessfully had sought Sino-Russian agreement to redirect the pipeline through Mongolia to save 1,000 kilometers (622 miles) of pipe, but the two countries rejected the cost-savings involved in the shorter route in order to deliberately avoid transiting Mongolia.

Russia, since 2006, has been talking to the Chinese about its state-owned Gazprom developing a second, more expensive, ‘Altai Pipeline’ to Xinjiang. China had resisted cooperation since its major gas markets are in the east and Xinjiang is already well-supplied with LPG from Kazakhstan. However, the threat of increasing sanctions motivated Russia to reopen discussions about Chinese financing. President Putin, when breaking ground on the Power of Siberia pipeline in September 2014, announced that Rosneft was discussing permitting Chinese investment in its Vankor, Siberia oil operation that would be the biggest Chinese equity participation so far in onshore oil in Russia, and Russian authorities now support this idea. China also may be more interested because its National Energy Administration (NEA) cut its forecast of domestic shale gas production in 2020 by more than half. Mongolian President Elbegdorj in Dushanbe immediately took advantage of this developing situation to obtain a trilateral agreement to consider shifting the western route to cross Mongolia in order to overcome a high altitude construction problem through a nature preserve and thereby reduce Altai Pipeline costs.

The Russians traditionally have been opposed to Chinese investment in their aging Eurasian rail sector that has a non-compatible gauge to the Chinese standard one. The Trans-Siberian lines are the oldest and most overloaded in the Russian system, but there has been no progress on attracting western, Japanese, or Korean investment for three decades. Greatly increasing freight trade volume between China and Russia (predicted to hit \$100 billion in 2014) and deepening Sino-Russian energy cooperation were catalysts for the announcement of October 29th to construct a high-speed passenger rail that would reduce the 7000 kilometer Moscow to Beijing trip from six to two days, at a cost of \$230 billion on a 5-year construction schedule. This rail line would parallel Mongolia’s Ulaanbaatar Railway, which then could be utilized solely for freight traffic.

Mongolia consistently has offered to facilitate discussions between China and Russia on rail freight modernization so that Mongolia will become a “transit corridor.” In late October in Beijing there were bilateral talks to allow Chinese firms to invest and build additional Mongolian transit infrastructure, and this winter Ulaanbaatar will again host a meeting of its ‘Mongolian-Russian-Chinese Northern Railway,’ created in 2013. The Mongolian Development Bank has partially funded the design and survey of an 1800 kilometer ‘New Railway’ project and for a 243 kilometer line from the giant Tavan Tolgoi coal/uranium mine in the south Gobi to the Chinese border. Major new financing could be found in the newly organized Asian Infrastructure Investment Bank (AIIB), since the Mongolian parliament just passed a new National Rail Policy that finally permits construction of narrow-gauge railroad spurs.

President Elbegdorj has convinced his big neighbor counterparts that their dreams for a revitalized 21st century Silk Road should include, not exclude, Mongolia. Putin confirmed this on September 3rd when he said: “It therefore makes sense to put Mongolia’s transport possibilities to greater use than is the case today,” and Xi in Dushanbe agreed publicly to build a China-Mongolia-Russia economic corridor. For Mongolia the present challenge is how to allay the concerns of ‘third neighbors’ Japan, South Korea, U.S., and the European Community, which worry over how Mongolia’s strengthening transportation and energy cooperation with its border neighbors might shut them out of Mongolia’s rich mineral market and even endanger Mongolia’s commitment to democratic institutions as it becomes even more integrated into growing Sino-Russian economic plans.

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