

**MONGOLIA**

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**RURAL SECTOR STRATEGY AND BUSINESS PLAN**

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**WORLD BANK - EAST ASIA AND PACIFIC REGION**

**RURAL DEVELOPMENT AND NATURAL RESOURCES SECTOR UNIT**

# TABLE OF CONTENTS

COUNTRY/SECTOR CONTEXT .....	1
KEY STRATEGIC PRIORITIES .....	2
General.....	2
Regional Development.....	2
Livestock Sector.....	2
Crop Sector .....	3
Social Services .....	4
KEY ISSUES/CHALLENGES.....	4
Vulnerability to climatic events .....	4
Economic viability of herding .....	5
Access to livestock services and inputs .....	5
Increasing access and outreach of financial services.....	6
Market linkages & role of private sector .....	6
Irrigation for crop production .....	7
Access to good quality social services.....	7
OPTIONS FOR ENGAGEMENT .....	8
General.....	8
Current Lending Portfolio.....	8
Lending Scenarios.....	9
Analytical and Advisory Activities (AAA) .....	10
Partnerships/Donor Coordination .....	10

## COUNTRY/SECTOR CONTEXT

Mongolia, a country with vast surface area of about 1.5 million km<sup>2</sup>, has the lowest population density in the world (3 times the size of France, but a population which is 24 times smaller) and per capita income of about \$430. The transition from a centrally planned economy to a market economy since the early 90s has taken a very heavy toll on the country and only began to show signs of turnaround in the early 2000s. Despite high economic growth rates over the last couple of years (10.6% in 2004, highest in East Asia), poverty and inequality continue to be serious problems in both rural and urban areas.

Migration issues remain at the core of the challenges facing Mongolia's rural development. After the collapse of the collectives and other state owned enterprises in the 90s, most of the migration was from the urban to rural areas as household sought livelihoods through extensive livestock production. Due to various reasons, including the heavy toll of the *dzuds* of '99 through early '00s, the trend has reversed. The share of the population in rural areas decreased from 50 to 45 percent as migration to urban areas increased during the latter part of the transition and in 2004 it was reported that 34% of the population was officially registered in the capital, Ulaanbaatar, compared to only 15% in 1990.

The trend of migration from rural to urban areas continues, however, recent studies shows that the migration is less from the more remote rural areas, but rather from those regions closer to Ulaanbaatar. Earlier surveys found that the reasons for migration were primarily related to the desire for improved access to better social services, including health and education. The most recent surveys show livelihood improvement is now the most important motivation, and this has been confirmed given that the areas with the highest population inflows are those which have recorded high economic growth/employment opportunities. The institutional and policy reforms that have been put in place are causing rapid change in social, economic and environmental dynamics in rural areas.

Rural development is essential for Mongolia to achieve sustained economic growth and poverty reduction. According to the 2002/2003 HIES/LSMS, the poverty rate in rural areas was 43%, while in urban areas it was 30%. Livestock continues to provide rural households with an important source of income, jobs and food security, and a means for investing and storing their wealth. Over the past several years, the agriculture sector has witnessed a sharp decline in its contribution to the overall economy. In 1940, the livestock sector alone represented about 80% of the national income and 90% of the labor force. From 1993 to 2003, the share of agriculture GDP dropped from 40% to 28%, while the service sector increased from 36% to 57%. Presently, it is estimated that the agriculture sector accounts for around 20% of GDP, and provides 43% of employment (7 out of the 10 jobs are from livestock activities). These changes have had profound impact on the livelihoods of rural residents throughout Mongolia.

Several conclusions which emerged from the priorities voiced by participants in the Participatory Living Standards Assessment conducted in 2000 are still valid and suggest a number of priorities for public policy and action to help create an enabling environment within which people may achieve more secure and sustainable livelihoods. These include:

- A focus on ways of reducing vulnerability, including facilitating access to assets for the poor, and investment in public and private actions to reduce risk in pastoral livestock production
- Improvements in the provision of social services and infrastructure, particularly in rural areas and smaller urban centers, to enhance their effectiveness and increase community involvement
- Promoting access to information and giving greater voice to communities in establishing priorities in patterns of public spending.

## KEY STRATEGIC PRIORITIES

**GENERAL:** The most comprehensive document relating directly to rural issues is the *draft Rural Development Strategy (RDS)*, which was based on the conclusions of survey work and a substantial stakeholder consultation undertaken in 2003. While the Government's *Economic Growth Support and Poverty Reduction Strategy (EGSPRS)* document does not include specific sections concerned with rural development, key elements of the draft RDS were incorporated. The key objectives of the draft RDS were as follows: i) improving management capacity for rural development; ii) livestock sector development; iii) crop sector development; iv) rural marketing, agribusiness and non-farm sector development; v) rural social development; iv) environmental protection and sustainable use of natural resources; and vii) rural infrastructure development.

The Government's Action Plan for Agriculture, prepared by the Ministry of Food and Agriculture (MoFA) relates specific actions and programs to the objectives set out in the EGSPRS. The main recommendations of the draft RDS are generally accepted as a basis of principles for development planning. The primary objectives for the agriculture sector are to:

- increase the sector's contribution to national wealth through improved efficiency and growth;
- through this growth, reduce rural poverty by: (a) improving income and employment levels of marginal and more viable agricultural producers, processors, and service providers; and (b) supporting the redeployment of non-sustainable, below subsistence, producers to other sectors; and
- ensure the long-term sustainability of the environment to support future generations.

**REGIONAL DEVELOPMENT:** Another important government policy related to rural development is that of *Regional Development*. This aims to strengthen regional economies through the promotion of well-serviced and connected regional and local centers that will assist in reducing migration pressures and help mitigate growing disparities between conditions in the more urbanized capital and the north-central region, and those in the more distant parts of the country. The main medium term objectives are to determine regional strategies for the four predominantly rural regions outside the capital. Key elements include improving the financial services and infrastructure network of each region and improving communications between regions, including both physical links, such as roads, and telecommunications. A first phase will concentrate on the development of two centers or 'pillars' in each region. The second phase will emphasize development of a number of subsidiary or local centers.

**LIVESTOCK SECTOR:** The importance of livestock to the livelihoods of poor rural households increased with the shift from collectivized farming to family-based herding during the 1990s. The number of herding households doubled between 1990 and 1997. This was primarily due to the role of the livestock sector as a safety net for those who lost their jobs in the public sector in the immediate aftermath of the collapse of the collectives, state farms, and other urban based state-owned enterprises. The gradual increase in stocking rates and households engaged in extensive livestock production has brought with it a series of new challenges which have significantly jeopardized rural livelihoods. In addition to the change in structure of production post-collectivization (i.e. heavily subsidized with significant industrial or large scale public sector support, Mongolia is prone to extreme climatic events that can cause high rates of livestock mortality. In particular, the frequent droughts and severe winters/springs (known as *dzuds*) can devastate herd numbers. For example, during the period between 1999 and 2002, one third of the national herd was lost in successive *dzuds*. At that time, many households lost all their livestock and their primary source of income; the impact was felt throughout the economy, with GDP growth being significantly reduced.

Based on the most recent Poverty Assessment, herder households constituted the single largest group amongst the poor. From a simulation, the study reported that in addition to the 33% of herders households that were determined to be poor in 2002, a further 40% were vulnerable to future poverty because of adverse livestock mortality shocks.

The Government of Mongolia has prioritized the development of the livestock sector and, with support from donors, is introducing a program of sectoral reform. This includes greater flexibility in pastureland tenure and increased investment in rural infrastructure and services. Key objectives are improvements in pastoral risk management and diversification of rural economic activities in order to support rural livelihoods, particularly for people whose livestock herds are too small for sustainability. Government policy recognizes the need to improve the availability of finance in the rural areas and to facilitate group action (e.g., herder associations and cooperatives) to improve access by the poorer sections of the community to finance, production inputs and access to markets.

A major thrust of government and donor intervention is to respond to the risks inherent in livestock husbandry by supporting improved pastoral risk management (PRM) through the establishment clear and appropriate public-private initiatives. Improved PRM, coupled with existing government activities to mitigate the impact of *dzuds*, for example through the distribution of hay and fodder reserves, can lower livestock mortality in less extreme *dzud* events. However, such measures are ineffective against more severe weather events and cannot prevent high levels of mortality. In such instances, herders have to rely upon traditional informal coping mechanisms and *ad hoc* and unpredictable support from Government and international agencies. In addition, the government and donors are providing significant financial support for investment in the rehabilitation of pastureland wells and for the construction of new wells. This is in addition to the major recurrent expenditure on vaccines and medicines for the essential government function of the control of animal diseases.

In summary, the policy for the extensive livestock sector is primarily related to enhancing rural livelihoods, within the limits of a sustainable use of the natural resources.

**CROP SECTOR:** Compared with the importance of livestock, crop production is relatively limited in Mongolia. Since the end of the command economy period in 1990, production of the major crop, wheat<sup>1</sup>, has continued to decline and now represents only around 30% of the estimated national requirement. Since 1997, cereal production has fallen by 42% to 138.5 thousand tons in 2004. This decline has occurred despite a number of government support programs, particularly through loans for seed, input and machinery purchase, and fallow preparation.

A recent study<sup>2</sup> of the agriculture sector undertaken by ADB identified some of the following issues as key constraints for the development of the crop sector:

- low commercial viability based on limited physical and economic options;
- high economic and environmental risks;
- low productivity due to poor quality seedstock, disease susceptibility, inefficient harvesting, and poor post-harvest handling and marketing, but most of all due to inadequate management;
- poorly developed private sector input, service, and marketing systems;
- continued intervention by the state in product and input supply and pricing; and,
- inefficient use of public and donor resources due to poor program design, management, coordination, and impact evaluation.

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<sup>1</sup> In contrast to wheat, potato and other vegetable production is increasing significantly in response to demand by both urban and rural consumers. Both commercial and subsistence production have increased, reaching 79,000 tons of potatoes and 60,000 tons of vegetables.

<sup>2</sup> This ADB study is currently under final review, but yet to be published.

In terms of direct government support for investment in agriculture, the main expenditure programs are related to supplementary funding of irrigation schemes which are implemented by the private sector (roughly \$8 million) and through the provision of 800 small tractors and trailers at 50% of cost. This support relates directly to the widely-held position that the future of agriculture in Mongolia, particularly in terms of providing food for the urban consumers, will lie in the development of irrigated farms. The vision is that many of such farms will incorporate both crop and livestock activities and that livestock production will become increasingly intensive. This approach is consistent with the Government's objectives of:

- mitigating some of the risks associated with agriculture in the harsh Mongolian climate;
- increasing agricultural productivity; and
- moving towards the target of food self-sufficiency, particularly in wheat.

The government program of support for irrigation infrastructure and irrigated farm development is at an early stage. Because of the potential importance of these programs for future crop production, and livestock intensification, it is important to start to monitor as soon as possible the impact of government support to guide the design of possible changes in the support package. Many of the crop sector difficulties have stemmed primarily from farm management problems. Since irrigated agriculture is more capital intensive, the required management levels for sustainability tend to be more demanding. A monitoring program of farm performance should therefore be organized for irrigation schemes rehabilitated with government support. The monitoring should include socio-economic aspects in order to assess the extent to which this approach contributes to poverty reduction and could therefore justify some donor support.

**SOCIAL SERVICES:** During the socialist period, social services in the areas of education, health, and social welfare were very well developed and sufficiently provided throughout the country. Since the transition to a market economy, the social sector has witnessed considerable deterioration due to significant budget reductions and, as a result, has become the single most important concern of rural residents. Concerted efforts are currently underway by the government and through various donor-financed projects and donor-driven initiatives to address these issues. Unfortunately, this has also been an area in which politicians have decided to make their campaign pledges and one of the principal platforms for the formation of political allegiances. As a result, the policy agenda has been severely affected from taking its due course of analytical rigor and public expenditure rationalization, to that of finding mechanisms by which to achieve the stated objectives of the particular electoral platform/commitment.

## KEY ISSUES/CHALLENGES

**VULNERABILITY TO CLIMATIC EVENTS:** The effects of *dzud* and consequent high levels of livestock mortality have had a major impact on rural poverty. This is a reversal of the situation before the recent 1999-2002 *dzuds* when urban poverty was most severe. Rural areas also show a much higher seasonality of poverty, related closely to livestock production characteristics and limited market integration, which inhibits a smoothing of consumption. Effective measures are being sought to mitigate the socio-economic impact of livestock losses due to *dzud* in order to achieve government policy objectives related to poverty reduction.

The value of animals which were lost to *dzuds* during 1999-2002 has been estimated to exceed the equivalent of US\$ 200 million. Consequent reductions in the production of livestock products (such as cashmere, meat, hides and skins) have had a significant impact on GDP and major social impacts for

herders whose losses have reduced their livestock holdings to below sustainable levels. During the period 1999-2002, national GDP grew by approximately 2% but this includes a negative growth for agriculture while industry increased by 24% and services by 44%.

Mongolia has been highly successful in maintaining an environmentally sustainable livestock sector, notwithstanding recent pressures that have led to a decline in pastoral mobility and a rise in localized overgrazing and conflict over pasture. The national-level legislative and policy framework facilitates and underscores the importance of pastoral mobility, and includes constitutional protection of pasture land as public land to be held and managed by communities as common property. The pastoral risk management component of the Sustainable Livelihoods Project addresses some of the recent pressures directly. However, it is recognized that the pastoral livestock sector cannot continue directly to support as many herding households as at present, and that many of the 'newcomers' to herding in the 1990s would rather pursue alternative livelihoods if they had the opportunity to do so. It is therefore recommended that support for livestock-based livelihoods be enhanced through initiatives in risk management; while parallel support for livelihood diversification for those who would prefer to make a living by means other than pastoral livestock production (i.e. income generating activities supported through microfinance).

**ECONOMIC VIABILITY OF HERDING:** The structure of the national livestock herd (comprising camels, horses, cattle, sheep and goats) is such that the majority of herds continue to be below the size necessary for sustainability. The owners of small herds do not have the resources to move as often as those of larger herds and their grazing tends to be concentrated closer to *sum* (district) centers. This is a major contributor to the increasing problem of over-grazing and pasture degradation in these areas. It is clear that environmental degradation will increase unless an effective system of pasture management, with defined group rights and responsibilities, can be introduced. The latest land law has removed many of the legal difficulties and, following stakeholder consultation, further amendments are proposed to address this issue.

Even with technical improvements in the management of pastures and livestock, including improved supplementary feeding in winter and spring, it seems clear that the extensive livestock system cannot provide an acceptable livelihood for the number of people currently involved. Better market access, through group association and action, is being promoted as a means of improving the producers' terms of trade but rural economic diversification will be essential to promote broader rural livelihood opportunities and reduce the migration pressures. For this, it is necessary to have improved access to finance in the rural areas. Currently, barter transactions are still a prevalent form of trade and the shortage of cash weakens the position of producers relative to traders. Cash expenditure on livestock production is very small relative to the value of the herd.

During the past few years, the most noticeable trends in the national livestock herd have been an increase in the goat population, responding to the ready market for cashmere, and a sharp decline in the cattle population, falling from 3.1 million to 1.8 million between 2000 and 2003, respectively. Government efforts to improve cashmere quality by promoting the introduction of higher quality breeding males have had limited success, partly because most cashmere continues to be sold, ungraded, to Chinese traders.

**ACCESS TO LIVESTOCK SERVICES AND INPUTS:** The Mongolian livestock sub-sector has undergone considerable change during "transition" from the socialist command economy to a market economy. Both positive and negative factors are affecting the form and function of the livestock sub-sector and participants in the sub sector. All players in the value chain – from primary producers to retailers are having to adjust to changing dynamics. A current and realistic understanding of change, the forces inducing change, and the direction on-going development is taking in the sub-sector is needed.

Historically Mongolian livestock production has been dependent almost solely on forage produced by natural pastureland. As such, livestock production is highly susceptible to risk from natural (i.e., weather and climate) and anthropogenic (natural resource exploitation) pressure. Droughts and severe frosts cause losses in livestock productivity or abnormal livestock mortalities. The infrastructure needed to support Mongolian livestock production does not adequately meet producer needs in averting environmental and financial risk. Lack of access to inputs, especially livestock feed inputs, is a major limiting constraint to sustainability and development of the sub-sector. Livestock feed production from sources other than natural pastureland is insufficiently developed to allow livestock producers to produce or purchase supplies of animal feed needed to improve animal productivity and mitigate environmental and financial risk. Pastureland and risk management programs are not institutionalized in either the public or private sectors, which is creating an environment leading to both overt and covert exploitation of natural resources.

**INCREASING ACCESS AND OUTREACH OF FINANCIAL SERVICES:** There is a substantial and ongoing demand for credit in rural areas. For many families, commercial banks and non-bank financial institutions (NBFIs) have provided important access to finance during household emergencies or for business development purposes. The development of competition in the rural financial market in recent years has had a profound impact on rural livelihoods options and poverty reduction. Experience from the microfinance activities of the SLP, and others, has indicated that competition has been directly attributed to increasing access (i.e. better lending terms) and outreach (i.e. increased number of microfinance providers).

Despite these successes and the high volumes of capital available for lending in rural areas, there are nevertheless some important groups who are still unable to access finance under current conditions. For most rural borrowers, interest rates are charged at up to 4% per month and all the normal commercial terms apply in relation to collateral, etc. For the most impoverished groups, without livestock or other cash or non-cash assets, the microfinance market would appear to remain inaccessible. It should be pointed out, that the proportion to whom the financial institutions remains entirely inaccessible is quite small. Nevertheless, since many government policies and international donor programs aim to address poverty and “the poorest of the poor”, it is important to bear in mind that most credit programs that are implemented by risk averse commercial banks and NBFIs may not, in fact, be accessible by the most vulnerable groups.

In this context, special programs to improve access to finance for the poorest of the poor may be worthy of further consideration. It is clear that programs (such as the government supported Revolving Loan Funds - RLFs) implemented outside of the mainstream financial sector have not worked well. On the other hand, NBFIs and commercial banks have little interest in serving asset-less clients. In this context, there is a need to consider additional efforts that would provide the financial sector with more incentives to lend to the most vulnerable groups, in a sustainable manner.

**MARKET LINKAGES & ROLE OF PRIVATE SECTOR:** As mentioned previously, there is a need to further develop access to markets and enhance the role of the private/commercial sector throughout the rural areas of Mongolia. To be successful and sustainable, such development should be led by the growth of remunerative market opportunities rather than by central plans. Market ‘thickening’ should be expected to facilitate such developments, not the converse.

Urban markets for livestock products are growing and changing. The main urban centers of Ulaanbaatar, Darhan and Erdenet continue to grow, and now comprise about one half of the national population, and their households’ consumption patterns and retail food purchasing preferences are beginning to follow the paths trail-blazed by other Asian cities, including the emergence of an increasingly affluent urban middle

class. Demand is growing for dairy products and beef in particular, along with higher quality cuts and better presentation for all meat.

Linkages between these markets and domestic producers are developing and are expected to strengthen. For Ulaanbaatar, the number of peri-urban dairy farmers is growing, and meat processors/retailers are experimenting with contractual supply arrangements with hinterland herders to manage quality and supply scheduling. In smaller urban centers, other types of market arrangements are in evidence, including cooperatives and less formal links of producers to sales outlets.

Traditionally, Mongolia has looked to export markets, in particular Russia and China, to dispose of its potential for surplus production of meat, cashmere, wool and hides. The potential for these markets has received considerable attention and analysis in various reports, supported by donor and bilateral assistance. Monopsony market realities (for cashmere and hides) and stringent quality standards (for meat) severely constrain growth potential in these markets. Meanwhile, there is considerable potential through growth of domestic markets, driven by urbanization and income growth. Moreover, the trends that can well be expected to define this evolving domestic market, including increasing preferences for quality, and growing private sector involvement in organizing this retail trade and in defining quality parameters, are potentially constructive building blocks towards ultimately improving access to external markets.

In order to provide government with information from evidence-based research, in 2003 the Bank supported a survey of over 100 farms in the semi-intensive dairy sector. This study showed that small farms specializing in “off season” milk production for the urban market could be highly profitable and that such farmers were prepared to invest in livestock breed improvement to increase productivity. These immediate examples should be extended in the medium term to a permanent and wider ranging system of impact assessment and support for government and donor coordination.

With regionalization, improved transport networks should create new market opportunities for production and distribution in some areas with currently limited accessibility to the main urban markets in the central region. For farmers and herders, the requirement of access to financial resources and farm management information is also necessary to take advantage of new opportunities. Improvement in the availability of rural finance is thus a key component for most projects, as seen through the efforts of the Microfinance Development Fund of the SLP, as is emphasis on “grass roots” participation in establishing priorities for local initiatives.

**IRRIGATION FOR CROP PRODUCTION:** At this time, information available on irrigated crop production is very limited. The design of a project or program where these are significant elements will require an improved data base. Since these are important elements in the Government’s strategy for growth in the crop sector, it would be appropriate to support the necessary initial surveys and analysis. The surveys should identify the major technical, market and financial constraints, including the regulatory environment, and the potential of the initial group of irrigation schemes for employment generation and poverty reduction.

**ACCESS TO GOOD QUALITY SOCIAL SERVICES:** While a number of initiatives and significant political support has been put forth to improve the quality and access to social services in rural Mongolia, most of these efforts focus on dealing with the symptoms and not the causes. Given the importance of social services to rural residents, it is often one of the first campaign promises and is therefore a political mandate that must be achieved, or at least perceived to do so. What this inevitably means is implementation of new policies or programs undergo minimum technical scrutiny, poorly implemented, and highly ineffective.

Concerted effort is now required in addressing the structural and technical issues facing the line ministries charged with providing these services. Good progress is currently underway with strategy formulation within some government ministries, namely the Ministry of Education and the Ministry of Health. Effort has been made to identify the root causes of some of the key challenges, master plans have been elaborated to effectively address these challenges, and it is envisaged that support would be forthcoming through donor and government financed initiatives.

In the mean time, the Local Initiatives Fund (LIF) of the Sustainable Livelihoods Project has played a critical role in providing urgently needed resources for the upgrading/improvement of rural schools, dormitories, health centers, and other social service infrastructure needs. All these activities are identified, prioritized, selected and implemented by community members for their respective *sums* (districts).

## OPTIONS FOR ENGAGEMENT

**GENERAL:** The World Bank's Country Assistance Strategy (CAS) for Mongolia for the period 2003 - 2008 has a core objective of reducing rural vulnerabilities. In the Fall of 2005, the CAS pillars were refined as follows:

- Pillar 1: Maintaining private-sector led growth – focus on private sector led development to stimulate growth, and sustain growth through macroeconomic stability, deepening integration with regional/global economy, reducing regulatory and bureaucratic burdens to the private sector, and improving the legal and regulatory framework for private sector investment (i.e. infrastructure, mining)
- Pillar 2: Reforming the public sector – strengthening public sector framework by introducing specific reforms to the civil service, improving public financial management and disclosure, and improving donor coordination.
- Pillar 3: Reducing household vulnerability – through better targeting of social protection programs, reducing herder vulnerability, improving access to basic social services, and enhancing sustainable management of natural resources.

World Bank support to rural development began in 1990s with a poverty alleviation project and analytical activities. The program currently focuses on the livestock sector (through pastureland and risk management), rural financial services, and community-driven development through support to rural social services provision. Because of the experience of the SLP, the Bank has a comparative advantage in rural development programs where the extensive livestock sector plays a dominant role in the local economy.

**CURRENT LENDING PORTFOLIO:** *Sustainable Livelihoods Project (SLP)* – The Sustainable Livelihoods Program is a 12 year Adaptable Program Loan (APL) which intends to support the shift in Mongolia's national anti-poverty strategy away from welfarist measures towards those that promote secure and sustainable livelihoods for all. The program development objective (see Annex 1) is: “*target groups and individuals adopt improved livelihood strategies that build and maintain human, social, financial, physical and natural capital while reducing vulnerability to shocks*”. This would be achieved through investments in four components: pastoral risk management, microfinance outreach, local initiatives fund, and program management and policy support. The program is divided into three phases,

the build-up of which is determined by the performance of program components and the pace of institutional reform and capacity-building at all administrative levels.

The first 4-year phase is expected to be completed by December 31, 2006. The IDA credit for the first phase is approximately US\$22 million and the project became effective in 2002. The activities are currently under implementation in all 143 *sums* (towns) of the eight pilot *aimags* (provinces) and implementation is on-track to achieve its key objectives. The first phase of the program has provided support for: (a) the development of a national strategy and investments to improve pastoral risk management; (b) microfinance outreach, particularly in rural areas; and (c) community-driven investments in local infrastructure and social services provision.

*Index-Based Livestock Insurance Project (IBLIP)* - Insurance is a logical complement to pastoral risk management activities as it has the potential to protect herders against unavoidable livestock loss and replace the need for government re-stocking programs. Although insurance is recognized as a key element of risk mitigation, the conventional approach to livestock insurance (based on individual losses) has been found to be ineffective in Mongolian conditions. Conventional livestock insurance is unpopular with both insurance companies and livestock owners. It suffers from moral hazard and the consequent difficulties and high costs of verifying individual losses.

Based on a feasibility study conducted in 2001, and more detailed product design activities under the first phase of the SLP, the World Bank approved a stand-alone project to pilot this initiative in mid-2005 with cofinancing from the Japanese Government and the FIRST Initiative (total project cost of about US\$9.4 million). The development objective of the project is *to ascertain the viability of index-based livestock insurance (IBLI) in Mongolia to reduce the impact of livestock mortality for herders*. The index based livestock insurance product is being piloted in three provinces of Mongolia – Bayankhongor, Uvs and Khenti. A successful demonstration of viability during this pilot phase would provide a basis for future expansion.

The IBLI approach to be piloted under this project is highly innovative and combines self-insurance, market-based insurance and social insurance. Herders retain small losses that do not affect the viability of their business, while larger losses are transferred to the private insurance industry and only the final layer of catastrophic losses is borne by the government. The index-based insurance is not linked to the *dzud* event itself but to the outcome that is of most concern – high levels of livestock mortality. The insurance would pay out to individual herders whenever the mortality rate in the local region (*sum*) exceeds a specific threshold.

**LENDING SCENARIOS:** *Sustainable Livelihoods Project II* - The second 4 year phase of the 12 year Sustainable Livelihoods Program is expected to begin in January 2007, assuming that all triggers and key objectives are met. The objective of the second phase would be to ‘scale up’ and ‘scale out’ the tried and tested institutional innovations to national level. It would also extend successful initiatives that were limited in scope during Phase I due to inadequate institutional capacity. The envisaged outcome of the second phase would be integration of project innovations in line ministries programs/budgets and targeted poor using improved, effective and sustainable livelihood strategies to improve long term outcomes at household and community levels.

Although, some design changes may be appropriate in the light of the experience of the first phase, both the government and WB senior management are keen on scaling-up the project in the second phase. In addition, the proposed second phase will try to address the strategic perspectives and key challenges, as identified above.

*Land Administration and Management Project (LAMP)*: This proposed project in FY09 would build on the work already undertaken by the World Bank and other donors relating to land-use planning, cadastral surveys, contractual relations between herder groups and local government, and the strengthening of local government institutions. The proposed project would specifically build on the activities currently under implementation under the first phase of the SLP on pastureland tenure financed through a Japanese Government grant (JSDF) and a land reform study undertaken by the World Bank. In addition to this, it would build upon the project and analytical work undertaken by the ADB since the early 2000s in this areas, and if possible, more direct collaboration options would be explored.

**ANALYTICAL AND ADVISORY ACTIVITIES (AAA)**: Over the past several years, various pieces of major analytical work have been undertaken by the rural sector of the World Bank, namely:

- Options for Land Reform (1999)
- Participatory Living Standards Assessment (2000)
- Feasibility study for index-based livestock insurance (2001)
- Draft Rural Development Strategy (2002)
- Semi-Intensive Dairy Sector Study (2003)

In addition to the above, a series of more specific studies and technical notes were commissioned during the preparation of the Sustainable Livelihoods Project and the Index-Based Livestock Insurance Project.

*Ongoing AAA: Livestock Sector Study* - Given the importance of the livestock sector to the rural economy, and as a result of the proposed new regional development strategy of the government, it was determined that a comprehensive review of the livestock sector was required to better assist and inform government on the future of the sector.

The main objective of the study is to identify the major drivers of change in the livestock sector, the implications for sector growth and distribution among livestock households, and priority adjustments in government policies and investments to facilitate beneficial livestock sector development. Policy recommendations from the study will form the basis of dialogue with and within Government, potentially linking to the PRSC program.

Through this work, a secondary objective will be achieved, namely to broaden the World Bank's knowledge and understanding of the livestock sector, beyond the substantial, but partial, base acquired through the SLP and IBLIP activities, and recent ESW, including the 2004 semi-intensive dairy study. This will permit a better informed choice and design of future Bank support to the sector, initially during the design of the second phase of the SLP.

**PARTNERSHIPS/DONOR COORDINATION**: Several strong partnerships have been formed in the rural portfolio. In general, the Japanese Government has been a very strong supporter of WB rural sector operations. They have provided significant project preparations grants for both the SLP and the IBLIP, they have provided a JSDF grant to assist with Social Mobilization under the SLP, and they are covering about 70% (US\$1.3 million) of all international technical assistance for the IBLIP. We have recently begun discussions with them on potentially cofinancing SLPII as well and they have expressed keen interest in having additional discussions.

The FIRST Initiative in the UK has provided significant TA resources for the preparation of the IBLIP and are also cofinancing approximately 30% (US\$0.6 million) of the international TA costs of the IBLIP. They too have expressed interest in having additional discussions regarding cofinancing of the microfinance aspects of SLPII.

The European Union and the Bank have had numerous discussions in Mongolia, Beijing, and Brussels regarding the potential cofinancing of SLPII. They have confirmed including SLPII in their next multi-year program, but are awaiting official approval on their allocation for Mongolia before announcing the level of cofinancing to be provided.

Lastly, the Bank is involved in various technical donor working groups in Mongolia in the rural sector. These working groups have provided an invaluable opportunity to share ideas and agree on common objectives with regards to financing and approaches. Nonetheless, significantly more is required to better organize/harmonize the activities of the donors working in the rural areas, particularly in the agriculture sector. Discussions have begun with the Ministry of Food and Agriculture on how best this can be done and the potential role that the World Bank could play.