

INTERNATIONAL MONETARY FUND AND  
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

MONGOLIA

**Poverty Reduction Strategy Paper  
Joint Staff Assessment**

Prepared by the Staffs of the International Development Association and  
the International Monetary Fund

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## I. OVERVIEW

- 1. The Economic Growth Support and Poverty Reduction Strategy (EGSPRS) is the first full poverty reduction strategy paper (PRSP) prepared by the Government of Mongolia.** The EGSPRS builds on the strategy articulated in the interim report (I-PRSP) presented to the Boards of the International Development Association (IDA) and the International Monetary Fund (IMF) in September 2001, and it provides an adequate framework for implementing the government's development agenda.
- 2. The EGSPRS was produced following a broad-based and inclusive process and has a number of strengths.** *First*, the strategy is government-led and produced, although the extent of ownership in some politically sensitive areas may need to be reinforced through the development of more internal consensus in favor of the needed follow-up measures. More specifically, the EGSPRS has benefited from strong participation from sectoral ministries and civil society, with the Ministry of Finance and Economy (MOFE) playing a coordinating role. *Second*, there has been a rebalancing in the underlying poverty reduction strategy from one driven primarily by income transfers and safety net programs to one centered on growth-promoting macro-structural reforms and sustainable human development. *Third*, the EGSPRS is well grounded in sector strategies in the areas of health, education, environment, rural development, energy and information and communication technology (ICT) and it pays systematic attention to the important cross-cutting issues of institutional reform and gender. *Fourth*, it adopts a credible macroeconomic framework for its base case. *Finally*, the formulation of the EGSPRS has been accompanied by a stronger alignment of government processes and documents to facilitate implementation.
- 3. Several weaknesses and challenges will need to be addressed to ensure successful implementation over the medium term, however.** *First*, an updated assessment of the poverty diagnostics is absent from the EGSPRS, and the current monitoring and evaluation plans are weak, with limited attention paid to developing effective institutional arrangements for monitoring. *Second*, while there has been some progress in establishing key policies and programs, their costing remains to be done. This makes it difficult to assess whether the overall program can be credibly financed without threatening the achievement of the fiscal adjustment envisaged in the Medium Term Budget Framework (MTBF) recently approved by Parliament. In some sectors (e.g., infrastructure), appropriate scrutiny of the investment program is a key priority. *Third*, tensions remain in some important policy areas, including the adoption of market-based and transparent principles of resource allocation, in Mongolia's transition from a centrally planned economy to a market-led one. While the EGSPRS is purported to rely on private-sector led growth, the government's regional development strategy adopts an interventionist approach. A similar tension prevails in trade policy, where the government's efforts to promote processing industries would appear to conflict with its stated commitment to open market trade policies. *Fourth*, the EGSPRS is committed to private sector led growth, but this general policy statement needs to be supported by concrete measures to eventually create a competitive and efficient economy and an enabling business environment. *Fifth*, while there are broad statements of support for improved governance, specific actions also need to be developed and implemented to enhance transparency,

predictability, and accountability of public policies. *Sixth*, while Mongolia's highly literate labor force is a great asset, the capacity and skills to match the demands of a market economy have been slow to develop.

4. **The uncertain external environment and Mongolia's institutional capacity constraints pose clear risks to the strategy, but the biggest risks would likely stem from slippages in policy implementation in areas where political pressures need to be managed.** Political considerations in the run-up to the next general elections in 2004 could slow implementation of reforms. In particular, election-motivated increases in civil service wages and pensions and politically-driven investment projects could threaten the achievement of fiscal sustainability and broader growth and poverty reduction objectives.

## II. COUNTRY OWNERSHIP AND THE PARTICIPATORY PROCESS

5. **MOFE headed an inter-ministerial steering group chaired by the Minister, and were aided by a technical committee reflecting the same agencies and an NGO representative.** In turn, working groups were formed in each ministry and in Ulaanbaatar city to develop their inputs into the strategy with the Vice-ministers and Ministers of each sector responsible for the overall coordination at the sectoral level. Sector contributions were a central part of the strategy formulation and were embedded in existing government processes and strategies. An NGO working group representing 200 NGOs in Mongolia has coordinated NGO input into the EGSPRS.

6. **A broad participatory process underpinned the development of the EGSPRS.** Following presentation of the I-PRSP to the Bank and IMF Boards, a series of seven regional consultations were held in Mongolia led by the Prime Minister and other members of Cabinet and Parliament to disseminate the I-PRSP and solicit inputs for the full PRSP. The regional seminars were attended by a wide ranging audience, which included representatives from local governments, poor and vulnerable groups (e.g. herders), NGOs and the private sector. The Poverty Research Group, under the Ministry of Finance, summarized the issues raised in the consultations by sectors and provided them to the sectoral ministries as inputs to the development of their sector strategies and the EGSPRS.

7. **The partnership with the nongovernmental organizations (NGOs) was good throughout the process.** The technical committee and the NGO working group worked closely in the preparation and organization of the regional seminars noted above. Drafts of the EGSPRS were shared with the NGO working group and disseminated to other regional and local NGO branches. NGO groups prepared reports and comments on various drafts of the strategy, which were reflected in the document. In addition, NGOs organized independent consultations with various constituency groups to solicit inputs and improve citizen information on the EGSPRS process, and they produced a vision document as a statement of the NGOs on the I-PRSP. **The participation of Parliamentarians, the private sector, and local and rural communities was more limited.**

8. **The donor community has been actively involved in the preparation of the EGSPRS** and has provided comments and technical assistance in the formulation of the strategy. Workshops on governance, private sector development, urban development, ICT and gender were organized by donor support. A first draft of the EGSPRS was presented to the participants at the Mongolia Consultative Group Meeting in July 2002 and subsequent drafts have been submitted to donors for inputs.

9. **Moving forward, the main challenge will be to keep the momentum generated by this process through the implementation phase and ensure that civil society participation remains strong.** The government has applied to the PRSP trust fund to support institutionalization of participation in implementing and refining the EGSPRS.

### III. POVERTY DIAGNOSIS

10. **The EGSPRS draws on a broad range of quantitative and qualitative data sources to present a comprehensive and credible profile of poverty and the discussion of lessons from past government efforts to reduce poverty offers useful insights.** The data support the view that poverty in Mongolia is multi-dimensional and characterized by high levels of vulnerability. Notwithstanding the shortcomings of these data, the poverty profile is disaggregated by location and gender, and provides information on access to social services. The 2000 Participatory Living Standards Assessment strongly highlights the issue of vulnerability. The EGSPRS provides anecdotal evidence that rural poverty (particularly among herder households) increased over 1999–2002 due to the impact of successive drought and *dzud* episodes and the decline in herder terms of trade over the period of 1995–2001. The 2000 Population Census is used well to highlight demographic characteristics and to document the increasing migration to Ulaanbaatar and across regions. A good assessment is made of the gender dimensions of poverty.

11. **There are several weaknesses and challenges to be addressed with respect to the poverty diagnosis.** It is difficult to draw meaningful inferences about poverty trends because the household survey data are not comparable over time. As a result, the conclusions and interpretations presented in the EGSPRS are more forthright than the data may warrant. The causal analysis of the processes of impoverishment for different social groups during the economic transition period is somewhat fragmented, and poorly linked to the description of poverty trends.

12. **The EGSPRS commits to undertaking poverty and social impact analysis in several key areas.** The analysis of the distributional impact of energy pricing, pension and civil service reforms is planned in the next 18 months, with the World Bank and USAID providing support. It is important to note, however, that the extent to which the poverty impact of complex reforms can be assessed rigorously will be constrained by the quality of the data and methodological limitations.

13. **The shortcomings in the poverty data noted in the I-PRSP JSA led to some improvements to the Household Income and Expenditure Survey (HIES) starting in**

**2002.** The HIES has a long-standing tradition but has problems related to sampling and attrition of participating households. The revamped HIES addresses these problems and, to the extent feasible, incorporates the need to analyze emerging policy concerns (e.g., energy pricing). The 2002 HIES will serve as the baseline for poverty monitoring under the EGSPRS and should provide a robust and updated poverty profile. Data analysis is just beginning and an updated profile should be available by year-end, and could be reflected in the Progress Report.

**14. Going forward, the Government is encouraged to:** (i) update the poverty estimates and profile using the HIES 2002 and other available data (the Bank plans to assist the government in undertaking this poverty analysis) and use the results in its Progress Report; (ii) formulate a poverty monitoring plan that ensures comparability of the estimates over time and provides periodic updates; and (iii) provide open access to the unit-record household survey data so as to encourage analytical work to better understand the determinants of poverty and to assess policy options to improve living conditions for the poor. A public use data set and accompanying documentation should be available for interested researchers and the Progress Report could highlight this.

#### **IV. PRIORITY PUBLIC ACTIONS**

**15. The main policy priorities of the EGSPRS are appropriate.** The government's strategy to reduce poverty in its many manifestations is based on five main pillars: (i) ensuring macroeconomic stability and enhancing public sector effectiveness; (ii) establishing a sound institutional and regulatory environment to complete transition to a market economy and enable the private sector to become an engine of growth; (iii) enhancing balanced and environmentally sustainable development; (iv) fostering sustainable human development and equitable distribution of the benefits from growth through improved service delivery in education, health, and social welfare and (v) promoting good governance and gender equality.

##### **A. Macroeconomic Stability and Public Sector Effectiveness**

**16. The EGSPRS is underpinned by a plausible macroeconomic framework.** The growth rate of 5–5½ percent, which underpins the medium-term baseline scenario, seems realistic. Although annual growth averaged only 3.5 percent over the last 10 years, this reflected the collapse in output during the early years of the transition and, more recently, the extraordinary losses in the animal husbandry sector following three consecutive years of unusually harsh weather conditions (*dzud*). Indeed, GDP in the nonagricultural sector averaged an annual rate of growth of more than 10 percent during 2000–02. Thus, even if growth in these sectors slows markedly over the medium term, a reversion to a more normal pattern of growth in agriculture should suffice to attain the growth rates envisaged in the baseline scenario. The EGSPRS also discusses two alternative growth paths, including a low-case scenario, in which weak performance in the agricultural sector is compounded by an unfavorable external environment, and the annual average growth rate is 3.5 percent. The EGSPRS provides a good discussion of the rationale for the sectoral growth rates under each

of the three growth paths. However, more work is needed to flesh out the types of policies and reforms necessary to ensure that the targeted rates of growth can be achieved and, in particular, to cost the priority public actions and develop realistic links with the budget and credible plans to meet possible contingencies.

17. **The EGSPRS clearly indicates that the pursuit of a prudent monetary policy, coupled with a flexible exchange rate policy, will be key to the maintenance of low inflation and a continuing increase in Mongolia's net international reserves.** It also emphasizes that further financial deepening, based on intensified competition within the banking system and an increasing availability of financial services throughout the country, would play an important role in nurturing the development of a dynamic private sector. However, the government needs to monitor carefully rapid expansion of money and credit to ensure that the inflationary pressures that resurfaced in early 2003 do not become entrenched.

18. **The fiscal framework envisaged in the recently approved MTBF is consistent with the macroeconomic objectives laid out in the baseline scenario of the EGSPRS.** The EGSPRS recognizes that fiscal consolidation is essential to place Mongolia's large burden of public debt on a sustainable path and ensure macroeconomic stability. To those ends, the EGSPRS envisages a progressive reduction in the general government's overall deficit from about 6 percent of GDP in 2003 to 4½ percent of GDP in 2006. The staffs endorse the government's overall strategy of fiscal consolidation. While there are questions as to whether the policies currently in place will be adequate to bring about the envisaged pace of expenditure reduction, revenue projections also appear to err on the conservative side. Thus, the EGSPRS's deficit reduction targets should be feasible even with a somewhat slower pace of expenditure adjustment, provided that tax policies remain prudent. A decline of the fiscal deficit in line with the EGSPRS baseline scenario would help to place the ratio of public debt to GDP on a clearly declining path over the medium term, even in the low-growth scenario.

19. **The EGSPRS appropriately emphasizes that Mongolia's already heavy burden of external public debt calls for a highly cautious approach towards the contracting of new foreign debt.** The staffs strongly support the government's plans to reduce gradually new government borrowing, while at the same time enhancing the screening, prioritization and effective utilization of new loan-financed projects. The staffs also welcome the government's intent to receive new loans only on concessional terms. At the same time, however, the staffs caution that any benefits from a prudent management of government debt could be largely negated by efforts to finance high-cost public investment projects through quasi-fiscal or extra-budgetary operations of the type discussed in para. 22. The EGSPRS acknowledges the special challenges posed by the large amount of pre-1991 transferable ruble debt to Russia, and the Progress Report could report on the ongoing negotiations on this important issue.

20. **While the staffs broadly support the baseline scenario's targets for the pace of deficit reduction, greater clarity in the policy measures required to achieve these targets would help improve the EGSPRS's credibility.** On the revenue side, the EGSPRS notes that the implementation of earlier plans to reduce the top rate of the corporate income tax rate

will be delayed at least until 2005. However, the other elements of the government's revenue policy over the medium term are less clear. The MTBF and the EGSPRS both envisage a reduction in the revenue-to-GDP ratio—from about 38½ percent in 2001–02 to 36½ percent in 2006—without indicating what, if any, changes in tax policies would bring about this decline. While conservative budgeting may be a principal factor underlying these projections, there are also questions about the extent and implications of ongoing government efforts to promote regional development and investment through tax concessions. An overly generous concessions policy would clearly complicate the task for the attainment of fiscal sustainability, and increase the already heavy burden of adjustment on the expenditure side.

**21. Current expenditure, projected to decline from 34 percent of GDP in 2002 to 30.5 percent in 2006, appears to have been under-budgeted in the MTBF.** This is especially likely to be the case in the social sectors, where the EGSPRS considers the privatization and contracting out of certain education and health services as a principal means of expenditure reduction. In the staffs' view, a devolution of social services from the budget should not be expected to generate any significant net savings in the short run and should, in any case, be viewed with great caution (see also para.46). Operations and maintenance expenditures also appear to have been under-budgeted in the MTBF, as they are not commensurate with the projected increase in the investment budget. Information on the overall envelopes for social spending and operations and maintenance is lacking from the EGSPRS's forward-looking fiscal projections, which makes it difficult to assess their adequacy with any degree of certainty. Bank technical assistance is expected to address these shortcomings. The Progress Report should include a review of the government's efforts to contain current expenditures without impinging on essential social services and, on that basis, it should update and reassess the government's strategy for fiscal consolidation.

**22. The EGSPRS captures the breadth of the ambitious public sector reform agenda launched by the government** over two years ago beginning with the passage of the Public Sector Management and Finance Law, and appropriately highlights the recent improvements made in public expenditure management. The implementation of the Treasury Single Account structure, in particular, has progressed quickly in recent months. The main remaining challenge identified in the EGSPRS is the need to develop improved rules and regulations for implementing procurement as a fundamental method to increase transparency. **In addition, the lack of comprehensiveness and transparency in the public investment budget could seriously threaten the achievement of the EGSPRS's objectives.** The staffs have been particularly concerned by the government's recent tendency to contract new foreign loans or incur other nondebt liabilities, outside the framework and discipline of the budgetary process. The conduct of such extra-budgetary operations is clearly out of line with the code of good practices on fiscal transparency, raises questions as to whether public resources are being effectively utilized, and undermines the credibility of official fiscal data. While the government's recent steps to integrate some previously unbudgeted investment projects into its MTBF are welcome, there is an urgent need to establish better and more rigorously enforced procedures and economic criteria for the Public Investment Program (PIP). The authorities are urged to supplement their efforts to improve fiscal governance with decisive steps to improve the flow of information and data reporting.

23. **The EGSPRS's civil service reform agenda aptly identifies the key areas needing attention in the short run, but it stops short of discussing some of the obvious policy implications.** The EGSPRS highlights the problems stemming from: (i) the unreliable and multiple estimates of the number of existing civil servants; (ii) fragmentation, duplication and overlap of administrative structures and functions; and (iii) an inappropriate functional composition, compensation regime, and skill mix. However, the EGSPRS is silent on some of the politically difficult measures that will need to be adopted to contain the growth of Mongolia's wage bill, which has been fueled by large successive wage increases in recent years. The implementation of a basic Human Resource Management and Information System (HRMIS) that is tailored to address Mongolia's capacity constraints should enable the government to modernize the civil service compensation and employment regime and improve the staffing mix over the medium term. Based on work already underway, the Progress Report will need to present a fully articulated civil service strategy that protects fiscal sustainability and enhances service delivery.

### **B. Private Sector Development**

24. **The EGSPRS recognizes that the private sector will have to be the driving force for sustainable growth and poverty reduction.** It acknowledges the importance of continued privatization of remaining public enterprises and development of its extensive mineral endowment, and promotion of small- and medium-sized enterprises (SME). However, the broad policy statements need to be further defined in a coherent private sector development strategy which includes specific policy actions. The objectives of such a strategy would include: (i) a smaller and more efficient government; (ii) improved integration of Mongolia's private sector in regional and global markets; and (iii) the removal of remaining physical, legal, regulatory and financial constraints to create a level playing field and an enabling investment climate. The World Bank plans to assist the government to gain further knowledge of these issues through an Investment Climate Assessment (ICA); an associated Study on Supply Chains in the context of the East Asian regional markets; an analysis of the mining sector, including its medium-term growth potential and regulatory constraints; and technical assistance for strengthening the economic regulatory framework. The staffs suggest that the first Progress Report reflect the findings from these studies.

25. **An effective legal system is key to the investment environment and the successful implementation of policy reforms under the EGSPRS.** Mongolia has been good at adopting appropriate laws, but challenges remain in enhancing access to justice, especially for the poor; disseminating new laws to the public; and enforcing existing laws.

26. **The EGSPRS reflects the tensions between the interests of protective and open market trade policy advocates within Mongolia.** While the EGSPRS recognizes the need for a liberal trade regime and less government intervention, it stops short of acknowledging the important linkages between trade growth and poverty reduction. Indeed, a number of government proposals appear to favor increasing the level of protection accorded to domestic industries that process raw materials of animal origin, without much regard for the possible adverse effects on the incidence of poverty among herder households. The government's

draft medium-term Regional Development Strategy, key elements of which are reflected in the EGSPRS, includes proposals for the application of differentiated tariffs and subsidies to promote export-oriented and import-substituting production in remote regions, the granting of tax concessions and establishment of free trade zones, and a ban on exports of unprocessed materials. Quality and sanitation standards, which have recently been applied for large categories of raw materials exports, may amount to non-tariff restrictions on exports if they are not administered judiciously, with highly undesirable effects for growth, external sustainability, and the incomes of the rural poor. A more unambiguous commitment to open trade policies would be important both for the efficient development of domestic industry and as a clear and consistent signal to domestic and foreign investors.

### **Financial Sector Reforms**

27. **An efficient, competitive and well-governed banking system is required for the achievement of the EGSPRS objectives.** The EGSPRS highlights the adverse effect of high interest rates on the access to financial services, especially in the rural areas. The staffs would like to emphasize that a rising number of financial institutions, as suggested in the EGSPRS, is not the obvious solution, since high interest rates may be caused by high levels of actual non-performing loans and operating expenses, as well as lack of scale economies of the majority of Mongolian financial institutions. In this connection, the staffs endorse the Bank of Mongolia's (BOM) plan to raise the minimum required capital of commercial banks in order to facilitate the much needed market consolidation. The staffs also recommend avoiding an unsustainable expansion of bank credit, as this could ultimately destroy public confidence in the banking system, which is a key prerequisite for improved access to finance. Moving forward, the continued strengthening of the BOM's regulatory framework is needed to allow effective monitoring of systemic risks and the adoption of prompt corrective actions where required. Enhanced financial intermediation cannot be achieved without strong corporate governance of financial institutions to avoid corruption, self-dealing and nepotism. The staffs have noted that the BOM, with assistance from the Bank and the Fund, intends to adopt the Basel guidelines for enhancing corporate governance of commercial banks, and is working on a regulation governing anti-money laundering policies and procedures. The staffs recommend that the Progress Report review progress in these areas and assess the need for follow-up policy actions.

28. **Safeguards also need to be put in place to protect the autonomy and financial integrity of the BOM itself, including by insulating it from pressures to engage in quasi-fiscal activities.** The authorities have recently taken important steps in this direction by suspending earlier plans to issue BOM loan guarantees to support foreign borrowing by private entities or joint-venture companies and by amending the Central Bank Law to strengthen the governance of the BOM. Follow-up actions will be needed to institute an independent oversight board and prevent the conduct of operations that are unrelated to the functions of the central bank. The staffs strongly endorse these initiatives and urge the authorities to pursue their efforts to strengthen BOM's governance.

## **Mining**

29. **The EGSPRS recognizes the importance of actively promoting the private development of Mongolia's extensive mineral endowment.** The relatively new minerals legislation reflects international good practice and, together with government's diminished role in the sector, is beginning to attract significant investment interest. Continued stability in the legal, regulatory and fiscal environment, and fair access to mineral properties is essential to maintain investor interest. The recent increase in budgetary allocations for government-sponsored geological survey work is appropriate but should be restricted to general mapping and data dissemination. Also, the government should discontinue reservation of exploration rights over extensive areas and avoid resuming any operational interest in the sector. The EGSPRS does not adequately deal with the rapid rise of artisanal mining primarily in and around the commercial gold operations nor does it attempt to accommodate, support and regulate this activity within the existing legal framework or any rural livelihoods strategy. The staffs generally concur with the expected growth estimate of around 8 percent in the short to medium term but caution against the promotion of further downstream processing of mineral products (e.g., hydrometallurgical processing of copper concentrates) on anything other than economic considerations.

## **Infrastructure**

30. While the EGSPRS appropriately identifies the importance of infrastructure, the public investment program needs to be developed based on economic considerations and insulated from political pressures, if it is to support the government's growth and poverty reduction objectives. Departures from economically viable and sound investments could be costly and undermine the government's efforts in implementing its strategy.

## **Energy**

31. **The EGSPRS identifies the energy sector as critical for the country's development prospects and highlights the main elements of a credible sector strategy as well as the main challenges facing the sector.** The Energy Law has been in implementation for over a year now, and while it has led to the separation of policy, operational and regulatory roles, the sector still faces challenges. These include strengthening the regulatory and institutional capacity of the sector, enhancing the fiscal sustainability of energy companies and improving access for rural consumers and the poor.

32. **Moving forward, the government will need to go from the overall strategy to developing a framework for implementation that provides for the sequencing of the energy sector reform agenda, including its costing and financing.** The Progress Report could include a time bound action plan to create conditions for private sector participation in the future. In the short run, a realistic action plan, supported by donors, would aim to: (i) improve the financial management of the main energy companies including through audits; (ii) restructure inter-company arrears; (iii) revise and adopt a transition strategy for

energy tariffs to align them with economically efficient prices; and (iv) conduct a thorough economic analysis and justification of proposed energy projects.

### *Transport*

33. **The EGSPRS provides useful background on the characteristics and recent accomplishments in the roads, rail and air transport sector.** This confirms the importance the Government attaches to a well-functioning transportation system in achieving its economic development goals. The discussion is organized by mode, with primary focus on the provision of transportation infrastructure rather than services. To enable a more explicit link to Mongolia's growth and poverty reduction goals, it would be useful to identify specific objectives for the sector, such as strengthening of international trade through well-functioning trade corridors, facilitating internal integration, and reducing the vulnerability of rural and urban populations through better access to markets and services. Proposed investments and reforms could then be assessed according to their contribution to these objectives, which would provide a sound basis for establishing priorities for investment and reform.

34. **The staffs recommend, therefore, that the transportation strategy be updated and reflected in the Progress Report.** The new strategy and the associated investment program need to pay strong attention to the quality of the public investment program and the cost and sustainability of these investments. The Millennium road is given high priority overall in the EGSPRS but needs to be considered, on a section by section basis, in light of other priorities. The regulatory framework and importance of competition are mentioned, and further work is anticipated in these areas to ensure proper alignment within and across modes.

### *Information and Communications Technologies*

35. **The EGSPRS gives due importance to the cross-cutting nature of using ICT in development** emphasizing the appropriate policy, legal, and regulatory framework needed to overcome constraints to service provision and pro-poor access. Several challenges must be overcome if ICTs are to be widely utilized. In the near term, the Government could focus on: (i) developing a universal ICT access strategy to increase access especially in rural areas; (ii) encouraging affordable use of existing alternate communications infrastructure like Mongolia Railways' fiber network; (iii) increasing private participation in service provision; (iv) rebalancing telecommunication sector tariffs; and (v) developing government capacity to use ICTs and implement ICT programs to gain internal process efficiencies. A shortcoming of the EGSPRS in this area is the inadequacy of sector targets and performance monitoring indicators. The government could adopt concrete, realistic targets and indicators to monitor and assess progress in the Progress Report.

## **C. Balanced and Environmentally Sustainable Development**

### **Regional Development**

36. **The EGSPRS presents the government's commitment to balanced regional development and its vision for attaining it.** Regional development presents a challenge to many countries and is especially so with Mongolia's widely dispersed population. International experience has shown that picking winners and deciding the location of industries is often not successful. While the staffs recognize the government's desire to give all the people in the country equal opportunities, they urge a careful assessment of the financial and environmental costs and the appropriate policies and instruments to attain these objectives.

### **Urban Development**

37. **The EGSPRS recognizes the central role of Ulaanbaatar in Mongolia's economy where over one third of the country's population lives.** Key issues for Ulaanbaatar, including the poor living conditions in the informal settlements (ger areas) are recognized but the EGSPRS does not do adequate justice to the challenges involved in making Ulaanbaatar a livable, well-managed, and financially-sound city.

38. **The EGSPRS does not adequately reflect the Municipality of Ulaanbaatar's (MUB) strategy, in particular in providing urban services,** (e.g., water supply, sanitation, drainage etc). Despite donor-supported investments and initiation of policy reforms, MUB faces major challenges in service coverage and quality, especially for the ger area residents, in particular the large number of unregistered migrants. Charges for water supply remain regressive, even though some corrective action has been taken in recent years through selective tariff increases for apartment dwellers. MUB has also initiated the process of increased cost recovery for water supply and sewerage, especially from the better-off, although much remains to be done to achieve financial sustainability. While a Master Plan has been developed for 2020, greater attention needs to be paid to urban planning and land management in light of the rapid increase in the city's population and the recent land privatization.

39. **The EGSPRS does not address finance issues, which have a significant impact on the ability of MUB to provide improved services to the urban poor.** Municipal finances of MUB are affected by the Public Sector Finance and Management Law as well as by the centralization of key tax revenues, including VAT, income and excise taxes. In addition to better expenditure management and revenue enhancement through fees and charges, fiscal priorities in the medium term include assessment of the prospects for introducing immovable property tax on residential apartment properties. While the EGSPRS does not discuss MUB's desire to raise funds through the issuance of special purpose bonds and through establishment of nonbank financial institutions, the staffs are concerned that such initiatives could undermine fiscal discipline and financial stability and urge great caution in this area.

## Rural Development

40. **Broad-based stakeholder consultation in the formulation of the rural strategy extended well beyond the boundaries of the Ministry of Food and Agriculture (MoFA), but the rural dimensions of the EGSPRS, particularly outside agriculture, could be strengthened.** The medium-term agriculture growth scenarios presented are plausible and the priority public actions for achieving more widely shared rural growth are also broadly appropriate. In the staffs' view, the key priorities among those actions identified include: (i) achieving stronger outreach and greater competition in rural areas among financial sector intermediary institutions; (ii) promoting greater efficiency in processing of livestock products including, but not restricted to, cashmere; (iii) developing a comprehensive approach to risk management in the pastoral livestock sector; and (iv) addressing transport and other constraints to marketing to improve the terms of trade for rural inhabitants, including measures to support cooperation among rural producers. There are a number of weaknesses in how the EGSPRS approaches rural development. Most importantly, there is little prioritization among the desired public actions listed under rural development, and insufficient specificity in some priority areas (e.g., pastoral risk management). There is inadequate discussion of the relative successes and failures of past investments in agriculture and primary processing activities, which also points to serious weaknesses in monitoring and evaluation capacity within the relevant public institutions.

41. **In the near term, the staffs recommend that the agencies concerned (primarily MoFA and MOFE) focus on:** (i) costing and prioritizing among the priority public actions identified; (ii) articulating more clearly how support for pastoral risk management, outreach of financial intermediation in rural areas, and rural infrastructure provision more broadly, will help to foster more widely-shared and robust rural growth; and (iii) improving monitoring and evaluation capacity within MoFA so as to provide a sound basis for tracking the efficiency and impact of rural public investments. These issues need to be set in the context of the regional development agenda, while also being seen as distinct from it.

## Environment

42. **The staffs welcome the environment strategy articulated in the EGSPRS, which represents a significant improvement since the I-PRSP.** The document shows a clear understanding of most of the key issues (forest and water resources management; solid waste collection and management; air and water pollution) in the sector and their linkages to poverty reduction. Another welcome development is that over the past year, the counterparts in the Ministry of Nature and Environment (MNE) have participated more effectively in the EGSPRS process and worked in collaboration with other ministries.

43. **There are still outstanding challenges in the environment aspects of the strategy, with inadequate attention paid to institutional development, forests and wastewater.** *First*, issues pertaining to institutional development and strengthening as well as implementation of existing environmental laws and regulations are not expressly addressed. Human and financial capacity seems to be inadequate for the MNE to manage its

responsibilities at the national and local levels. *Second*, while there has been progress in the extent of prioritization and sequencing, further refinement is required including to ensure that they are within the available resources. *Third*, illegal timber felling and increased fuelwood use, especially by the rural poor, are seen as mounting concerns, although no concrete actions are proposed to address these unsustainable practices. Attention and resources continue to be devoted to tree planting programs and to forest pest control programs despite little evidence of their success. Staffs recommend that economic and tenurial incentives, and provisions for sustainable harvesting, especially in community-based schemes, and planting of nontimber forest products should be considered in forest management programs. *Fourth*, wastewater issues pose a major challenge yet progress towards preparing a national strategy on this topic has been slow.

44. **In the near term, the staffs recommend the MNE focus on:** (i) strengthening its institutional and legal capacity at the national and local levels; (ii) developing sustainable forestry and wastewater management policies; (iii) improving its ability to prioritize among issues; and (iv) costing and sequencing any specific policy intervention needed to adequately address the most pressing environmental and natural resources management issues.

#### **D. Human Development**

45. Social indicators in Mongolia are recovering after a deterioration in the mid-90s. The Government has adopted the MDGs and the human development pillar of the EGSPRS puts forth a credible strategy to meet some of the objectives.

##### **Education**

46. **The EGSPRS recognizes some key challenges in the education sector, but requires strengthening and clarification in important aspects, in particular resource allocations and the role of the state.** The EGSPRS identifies the key issues and challenges facing the education sector, including access to schooling, especially the rural-urban and gender differences; internal efficiency constraints with high dropout rates and low quality resulting from inadequate educational inputs (e.g., teacher quality, curriculum, educational materials, infrastructure, etc.) and the institutional framework. The EGSPRS describes the main objectives for education and the ways to achieve them, but does not present a sequenced approach. Analysis of disparities and options for improving targeting such as refining the norms system is limited. Resource allocation plans over the medium term particularly between tertiary, secondary and primary education expenditures, as well as the financial implications for the reduction of age at entry are not clearly discussed. While it was a source of constant debate throughout the EGSPRS process, the issue of privatization in the education sector is conspicuously absent in the strategy, perhaps reflecting the lack of consensus on this topic. The staffs suggest that the government postpone all privatization plans until an overall framework is developed and a credible and transparent accreditation system is put in place. Finally, the document does not seem to consider cost-effectiveness criteria when proposing investment in education inputs, as reflected in the proposal to channel about 86 percent of total investment resources to infrastructure.

## Health

47. **The health strategy is comprehensive with a focused and cogent analysis followed by a delineation of long-term strategies and actions for the medium term.** The analysis rightly identifies that the poor in Mongolia have lower health status (infant and maternal mortality), have a higher incidence of disease (malnutrition and infectious diseases) and spend a higher share of their income on health care. The strategy calls for improving maternal and child health services and control of infectious diseases; strengthening primary health care which is the part of the health system most accessible to the poor; and ensuring that health insurance covers and protects the poor. The strategy was discussed within the Ministry of Health (MOH) and workshops to discuss the strategy were conducted in some soums and aimags with Asian Development Bank (ADB) assistance.

48. **However, a notable omission is the issue of reform of the health sector in order to finance the improvements that have been identified.** First, there is a clear need to restructure hospital services in Mongolia. There are simply too many hospitals, public sector hospital beds and personnel, (mostly in Ulaanbaatar) and hospital services account for 75–80 percent of the budget. Inefficiencies are further exacerbated by inappropriate hospital admissions and clinical practices, poor distribution of technology, fragmentation of funding sources and administrative services, and inflexible budgeting and planning. Unless these issues are addressed through a hospital reform program, funds will simply not be available for strengthening primary health care, serving remote and rural areas and controlling infectious diseases. Second, pharmaceuticals are another important part for the reform agenda which are not addressed beyond a haunting quote on a citizen's concern about the quality of medicines which opens the health sector of the strategy. The ADB is working with the government in primary health care strengthening and some aspects of health financing reform. The World Bank provided technical assistance through grants to develop a process for restructuring and rationalizing the hospital sector and to support the development of National Health Accounts.

## Employment and Social Welfare

49. **The EGSPRS strategy on employment and social welfare has correctly highlighted the main issues that add to budget pressures and the related needs for reform.** Cash transfer programs represent a significant source of pressure on the overall budget, accounting for about 17.7 percent of government expenditure as of 2000. Public pensions alone, whose share in expenditures continues to rise, amount to the equivalent of 7 percent of GDP. In 1999, the government undertook a reform of the overall pension policy and the linkage between contributions and benefits was significantly strengthened. Beyond recent reforms, several short and long term initiatives are required (e.g., raising the retirement age, and developing a transition policy) to deal with the rising cost of the pension system and improve equity. The policy priorities identified in the EGSPRS to improve the adequacy, equity and sustainability of the social insurance and social assistance programs are broadly appropriate.

50. **There are several weaknesses, however.** *First*, further work is required to strengthen the discussion on *labor market and employment policies*. In particular, the strategy does not acknowledge the main policy and institutional barriers that resulted in the issues identified (e.g., low productivity, weak competitiveness, and lack of mobility), but jumps directly into the proposed active labor market policies. The sustainable impact and cost effectiveness of such proposed active measures are highly questionable in many cases. The staffs stress the need for a better understanding of the main labor market concepts and more rigorous assessment of the effectiveness of active labor market programs. *Second*, the policy proposals regarding the reform of *social assistance programs* are presented in broad terms and lack specifics. Based on an analysis of the incidence of current programs using household survey data (as part of the Bank's Poverty Assessment), the government should develop a strategy to improve the effectiveness of social assistance programs giving consideration to alternative program designs. *Third*, while the staffs understand the importance of providing *old age protection* to herders and the self-employed, designing such a scheme is technically difficult, financially costly, and difficult to implement. The staffs strongly recommend more in-depth analysis in order to design a program that is feasible and affordable. *Fourth*, there is no discussion in the EGSPRS of the governance issues related to financial management of the pension fund. The staffs recommend that the findings from the independent audit of the State Social Insurance Government Organization (SSIGO) be incorporated in the Progress Report in the form of an action plan to improve financial management. *Finally*, there is a general lack of financial analysis of almost all policy proposals. A timetable to correct this should be included in the Progress Report.

## **E. Governance and Gender**

### **Governance**

51. **The EGSPRS emphasizes good governance but implementation challenges remain.** The priority areas include improving accountability of government, ensuring independence of the judicial system, fighting corruption, and enhancing participation and voice of different stakeholders. Overall, while Mongolia faces less severe governance problems than many other countries in the Region, there is concern that it is an emerging problem that needs to be addressed before it becomes entrenched. In addition to the need to develop rules and regulations for implementing procurement to enhance transparency, another area of concern is the lack of transparency in the public investment program, particularly the tendency to contract new loans outside the budgetary process.

### **Gender**

52. **Gender issues are well addressed in the EGSPRS.** The document identifies important gender gaps in poverty dimensions of Mongolia and draws on the comprehensive strategy of the National Program on Gender Equality (NPGE). The staffs have the following comments. *First*, while this is a good effort to ensure consistency in government policies and directions, the interventions need to be more specific. *Second*, the newly established National Commission for Gender Equality (NCGE) is not adequately staffed to lead the gender

equality and mainstreaming efforts in poverty reduction. While the document recognizes that successful implementation of the NPGE requires support for strengthening the national secretariat and mechanisms, there are no specific steps or recommendations outlined. *Third*, along with capacity enhancement of the key institutions, coordination among key stakeholders needs to be improved to mobilize resources and knowledge for securing gender equality. *Fourth*, government and stakeholders need to ensure that steps taken to enhance gender equality are in line with the MDGs.

## V. TARGETS, INDICATORS, AND MONITORING

53. **The EGSPRS outlines the key monitoring indicators through the year 2006, although in some cases further development is needed.** These indicators are well linked to the areas covered by the Millennium Development Goals (MDG), and include poverty, education and health indicators and are derived from the MDG Report for Mongolia. The strategy's inclusion of monitoring indicators for governance and gender equality, including targets, and qualitative surveys for monitoring, such as Citizen Report Cards, are commendable. Looking ahead, the choice of indicators could be better linked to the issues identified in the relevant sector. For example, while the quality of education is highlighted as a major policy issue, indicators to measure progress in this area are inadequate. For infrastructure, indicators are available on transport and ICT, but not for energy. Each of the priorities presented in the private sector development strategy could be accompanied by a set of outcome and intermediate indicators, drawing on for example, the proposed investment climate survey that will be carried out in the coming year. In many cases disaggregation of the indicators (on a geographic basis, by gender, and by expenditure quintile) may be appropriate. For example, disaggregating education outcome indicators by urban/rural and poverty rates for urban and rural areas would be useful. Finally, while the indicators for governance are noted, it is not clear how these will be monitored. Technical assistance to develop a results-based monitoring and evaluation system to monitor the EGSPRS is being provided through a World Bank grant.

54. **Currently, targets have not been set in some key areas of sustainable human development.** While these may be lacking the analytical underpinnings, a more systematic effort could have been made to derive targets based on historical trends and sound judgment. The Progress Report should be able to develop poverty targets based on the analysis of the 2002 HIES.

55. As noted in Section III, **the staffs urge the government to build on the improvements to household survey data and the quality and availability of monitoring indicators in the context of a comprehensive program of statistical capacity building.** This includes institutionalizing a system of household survey data collection paying adequate attention to: sampling methods and level of disaggregation; the frequency of data collection; and comparability of key indicators over time. Information available through surveys needs to be complemented with intermediate indicators that are available on an annual basis. These data could include budget allocation and execution in key priority areas, administrative data from possibly education, health, agriculture and infrastructure, and certain key prices.

56. **The biggest challenge in monitoring and evaluating EGSPRS implementation is to set up an institutional structure that will engage different stakeholders to demand and use the information collected and to refine the strategy in light of this information.** While the Poverty Research Group is charged with monitoring and reporting on the EGSPRS, the roles and responsibilities of different agencies (Ministries, National Statistics Office, civil society) need to be articulated more explicitly. Capacity for monitoring, especially in line ministries, and at local levels, is weak and a plan for strengthening capacity for monitoring and evaluation is needed. Ensuring open access to data and transparent reporting on the EGSPRS can enhance the understanding around difficult policy reforms and help forge consensus on the main policy directions.

## VI. DONOR COORDINATION

57. **The staffs welcome the Government's intention to improve the alignment of strategic planning documents, and move towards using the annual socioeconomic guidelines serving as the main monitoring document for the EGSPRS, MDGs and the Government Action Plan.** The Government plans to update the EGSPRS every three years and prepare a progress report annually to present at the Consultative Group (CG) meetings. This presents a good opportunity for the Government and donors to jointly assess progress in implementing the EGSPRS and for donors to align and coordinate their assistance to support the Government's program.

58. **The EGSPRS recognizes that effective aid coordination and donor alignment in support of the strategy is key to its successful implementation.** The EGSPRS represents the first formal articulation of the Government's overall strategy for sustainable growth in support of the overarching goal of poverty reduction. The staffs agree that the relations with donors could be improved through the government's call for simplification and harmonization of procedures (for example, in procurement).

## VII. RISKS TO THE STRATEGY

59. **Implementation could be hampered by a range of risks, which are only partly acknowledged in the EGSPRS.** The low-case macroeconomic scenario highlights how economic growth could be adversely affected by a **worsening external environment, possibly including climatic or terms of trade shocks, declining world demand, and/or the outbreak of human or animal diseases.** However a temporary worsening in the external environment should not be expected of itself to threaten ultimate success of the government's poverty reduction program. Greater attention on the part of the government to private sector development and staying the course on fiscal consolidation should help minimize any long-lasting effects of exogenous shocks. Moreover, as long as policies remain on track, donor support should remain strong and adequate concessional financial assistance should help cushion the effects of the shocks in the short run.

60. **Institutional weaknesses and capacity constraints may also undermine implementation of the program, but this risk should also be manageable through**

**technical assistance and improved donor coordination.** Capacity constraints are evident in many key areas, especially at lower levels of government. The EGSPRS illustrates how capacity constraints have hindered effective implementation of procurement legislation and lays out a plan to remove these constraints in the period ahead. Technical assistance programs aimed at enhancing capacity could help strengthen the ability of institutions to deliver on the strategy. Improved donor coordination in the provision of technical assistance, and avoidance of duplication, would greatly enhance the effectiveness of this assistance.

**61. Implementation of the government's regional development plan without a careful assessment of the costs and benefits of alternative policies and instruments could pose serious risks for the budget as well as for other development objectives.** In particular, some of the priorities for rural development could drive the investment program, especially in infrastructure, and encourage private investments that are viable only with subsidies or tax concessions, and hence could prove to be both financially and environmentally costly.

**62. The biggest risk would stem from slippages in key fiscal policy areas where political pressures need to be managed.** This is especially so in the highly sensitive area of civil service wage and pension policies, where the government is under strong pressure to deliver on the populist promises included in its Action Plan. The risks of such slippages would probably be heightened in the run-up to the next general elections, which are tentatively planned for June 2004. Politically-driven investment spending may also lead to a failure to adhere to the MTBF's fiscal targets.

**63. A failure to address concerns about governance in a timely manner would also pose a serious threat to implementation.** While the accelerated implementation of the Treasury Single Account through most of the general government has probably reduced the risk of backtracking in the area of treasury management, fiscal transparency has continued to be undermined by inadequate disclosure by the government of recent or incipient changes in key policies and/or new reform measures. These have included, most notably, unreported quasi fiscal and/or extra-budgetary activities and inadequate reporting of debt-financed investment projects that have not been integrated in the budgetary process. A backsliding on civil service reform could also be detrimental.

## VIII. CONCLUSION

**64. Notwithstanding the above risks, the Bank and Fund staffs broadly support Mongolia's poverty reduction strategy as presented in the EGSPRS.** The strategy is based on well-developed sectoral components in education, health, rural development, environment, and public expenditure management, energy, and ICT, although further prioritization and more detailed action plans are required in these areas. In the areas of private sector development and transport, the strategy needs to be developed or significantly updated.

65. **The staffs encourage the authorities to attach the highest priority in implementing this strategy to reform measures to enhance fiscal transparency and accountability.** The government should adhere firmly to clear and transparent rules and regulations in procurement, and in investment and external debt contracting, including by making every effort to ensure that investment decisions are based on rigorous selection criteria and strictly economic considerations.

66. **Successful implementation of the strategy will require continued strong leadership from the MOFE, and sustained participation of stakeholders within the government, including local governments, civil society and development partners.** Strengthening the monitoring and evaluation plans of the EGSPRS will also be essential to ensure successful implementation, building on the commendable progress made towards aligning the EGSPRS process with the budget cycle.

67. **Going forward, the EGSPRS Progress Report could** (i) present updated poverty statistics and poverty profile based on the 2002 HIES; (ii) provide an updated monitoring and evaluation plan, with refined indicators and targets and a better articulation of the institutional arrangements for monitoring implementation; (iii) develop more concrete action plans for private sector development, energy and transport, and strategies for civil service and pension reform; (iv) develop options for regional development, including indicative assessment of financial and environmental costs; and (v) progress towards prioritizing/costing, including through review of public investment program, especially for infrastructure.

68. **The staffs of the World Bank and the IMF consider Mongolia's EGSPRS a credible poverty reduction strategy that provides a sound basis for Fund and IDA concessional assistance.** The staffs recommend that the respective Executive Directors of the IMF and the World Bank reach the same conclusion.