

Chairman's Closing Statement
Government of Mongolia-External Partners Technical Meetings¹

Ulan Bataar, October 9-10, 2006

Representatives of the Government of Mongolia (GOM) and donors gathered in Ulanbaataar on October 9-10 2006 to discuss progress in poverty reduction, economic development, environmental protection, and infrastructure development. Mongolia was represented by, among others, Minister Bayartsaikan of Finance, Minister Enkhtuvshin of Education, Science and Culture, Minister Erdenbaatar of Nature and Environment, Minister Tsengel of Roads, Transport and Tourism, as well as by distinguished Members of Parliament. Practically all of Mongolia's external partners, multilateral, bilateral, and NGOs were represented at the meeting.

I believe that I express the feelings of all of us if I say that the meeting was conducted in a constructive and open atmosphere, with substantive, frank and meaningful exchanges on a variety of topics. We have achieved a better understanding of the Government's priorities over the coming years, and on how the donor community can contribute to these priorities. I was particularly happy about the transparent nature of the meeting, with the press attending all of the sessions.

Macroeconomic Developments and Policies. I think we all agreed that Mongolia's economy has been doing very well in recent years. As Minister Bayartsaikan explained, supported by higher commodity prices, strong growth in services and construction, and some exceptionally good years in agriculture, Mongolia's GDP per capita is rising, although concerns remain as to how broadly this growth is shared, and we should keep in mind government estimates that still over one-third of Mongolians live in poverty. Thanks in part to high copper and gold prices, economic growth has been robust and inflation has been brought down to about 5 percent, the external current account has been in surplus, and Mongolia's international reserves have increased significantly. Increasingly, therefore, the Government's focus can shift from managing the difficulties of transition to the challenges of development.

This is not to say that macroeconomic risks have disappeared. Indeed, as discussed by the IMF and others during the meeting, Mongolia's considerable success has to some extent been built on a resource boom, and on prices for the country's natural resources that are unlikely to last over the medium term. Prudence is therefore required in management of the current windfall revenues to ensure fiscal sustainability in the period ahead. Some participants noted that the Government may wish to reconsider its medium-term budget forecasts and adjust its budget projections for next year accordingly, because a 4 percent of GDP deficit as currently proposed may simply be too large from a macroeconomic point of view and provide a pro-cyclical impulse to demand. It was noted that locking the Government into a high spending level while relying on volatile revenues makes Mongolia vulnerable to shocks, noting that Mongolia's debt levels, even though down substantially, are still far from safe levels. However, one participant said that the government should not be afraid of additional borrowings if used efficiently. In addition, such

¹ This statement is intended to capture the main thrust of the discussions and the conclusions and agreements reached. However, this is not an agreed document, and thus in the end reflects the impressions of the Chairman rather than the consensus of the meeting.

expenditure policy may preclude some of the spending needed to support the forthcoming National Development Strategy. Participants noted that the modalities of the proposed Development Fund would be crucial for the government's fiscal policy stance as well as the developmental impact of mining revenues. Some partners expressed concern over the impact of recent policy actions, such as the introduction of the windfall profit tax, on the private sector and on investment. The representative of the USA called on the government to renew its commitment to market economics, reforms, and private sector led growth, and to create a predictable environment for the private sector to thrive. The Minister of Finance reassured the meeting that Mongolia's commitment to the private sector remains very strong, stating that "*We do not want to go back, and there is no diversion from private sector-led growth.*" He further stated that Government would shortly review the impact of the tax on the mining industry. The minister also noted that concessional financing will remain the mainstay for Mongolia's financing, but that financing directly to the private sector such as from the EBRD, which does not create government debt, will play a bigger role in financing.

National Development Strategy. Partners welcomed the Government's initiative to draft a National Development Strategy. Such a strategy can be a powerful tool in shaping the country's further development, and many donors expressed their willingness to support the development and implementation of the strategy. Partners welcomed the Government's commitment to keep poverty reduction as a key building block of the strategy, while recognizing that the long term strategy, unlike the PRSP or the MDGs, would cover more than poverty reduction alone. They also raised the need for the strategy to include a set of measurable targets and indicators. Indeed, the Ministry of Industry and Trade (MIT) announced that within the context of the National Development Strategy an Industrial Strategy will be developed, with support of UNIDO, and will should involve a review of government support, including subsidies, to specific industries. Participants discussed the elements that could make the strategy successful, including broad-based consultation, realism in goal setting, an appropriate role for government, grounding in thorough analysis, and the need for a process by which the strategy will link with the government's MTBF, SEGs, budget, and with sector strategies. All of the speakers encouraged a much wider consultation among stakeholders, and several participants noted the need for an inter-ministerial body to support the articulation and implementation of a development plan. It was noted that the role of government should be considered carefully, recognizing that economic growth will rely on the private sector.

Governance and Private Sector Development. Donors welcomed the progress the Government has made on the governance agenda over the last 6 months. They shared the view that governance and the concerns over corruption have become a key issue for Mongolia's development. Indeed, recently released Governance Indicators suggest that several aspects of governance and notably control of corruption have deteriorated of late in Mongolia. The Government has taken some action to address this. Notably, the Anti-Corruption Law was adopted during the spring parliamentary session that provides a legal basis for setting up a new anti-corruption council and instituting an asset and income disclosure system. An anti-money laundering law was also passed. The Government announced that two priority actions from the February technical meetings have been implemented: a one-stop shop for business approvals has been initiated and that now on-line copies of all licensing and permit procedures can be obtained by businesses at the MIT website. Furthermore, a step-by-step review of key laws and

regulations in tax, customs, environment, and other inspections is under way with the aim to reduce regulatory burdens and opportunities for corruption. The working group on private sector noted that changes in the law on tax administration are needed to rebalance the power of tax inspectors versus private enterprises, and that lack of clarity and transparency about government regulations hinders businesses. Discussants noted that many of Mongolia's product standards stem from the 1970s and 1980s and need to be updated, along with capacity of laboratories to implement them. The private sector working group noted that significant reforms in law have been undertaken, but that more is needed in the area of bankruptcy, collateral registration, and others, whereas capacity in the courts on business issues needs to be boosted.

Education. We received a very helpful update on the actions in education agreed at the previous technical meeting. Donors congratulated the Government on the adoption of a comprehensive and participatory Education Master Plan and inclusion in the global Fast Track Initiative (FTI) as important achievements since the February meeting. The Ministry of Education, Science and Culture and partners noted that the master plan has been an important mechanism for coordination that helped the country become eligible in September for up to \$29.5 million in FTI grant funding. The Ministry noted that partners' support has been crucial for building a common approach and accessing FTI. Participants noted that while progress has been made, significant challenges remain, including high drop-out rates, disparities in rural-urban access, especially for upper grades, low pre-school enrollment, mismatch between curriculum and labor market demand (including for vocational education), need to increase capacity of staff, need for additional resources, to harmonize procedures, and to complete the transition to a 12 year primary-secondary system, including associated capacity building, materials, and curriculum reforms. Institutional reforms, including improved monitoring and evaluation systems, review of quality standards, especially as applied to private institutions, and improved expenditure management and budget transparency, will be important for achieving goals and will be needed if a sector-wide approach is to be pursued. Partners stressed the need for a focus on implementation, including developing a mechanism of annual implementation plans, coordination of education information (including through development of a database), and further strengthening the education donors consultative mechanism. Partners stressed the need to align internal procedures with those of the government, and cautioned that external support should supplement, not replace, the government's own education budget resources. As a followup action, I applaud the commitment of the Ministry and of the education donors to further coordinate implementation of the new master plan, with a first annual implementation plan to be finalized in December.

Environment. We had a very good discussion on environmental issues facing Mongolia. As the donor working group statement submitted to the meeting rightly observes, Mongolians, and especially many among the poor, rely on the environment for their livelihoods—be they herding livestock, working in tourism, relying on forests for heating, or on rivers and groundwater for drinking water. Participants noted that good environmental management is important for economic growth as well as for poverty reduction, and that Mongolia can develop ecologically friendly products which could find a niche market. It was quite striking that environment expenditures account for only 0.5% of GDP, given the large contribution of environment and natural resources in the key sectors such as livestock, tourism, and mining. Participants noted the need for a better estimate of the monetary contribution of the environment and environmental

services to the Mongolian economy, and I think it will be a large number. They also noted that mechanisms have been developed in other countries to channel budget resources to local communities to provide environmental services, and these can work in Mongolia, because, as was noted, the clear link between poverty and environmental degradation.

We made good progress in getting a better grip on some of the burning issues in this priority area, not least because of studies that were done under a Dutch trust fund on widespread illegal logging, on devastating illegal wildlife trade in Mongolia, and on the major problems faced by the many tree planting initiatives. Some of these studies note the important role that corruption plays in the disappearance of the country's natural resources. Also, the Ministry of Nature and Environment presented us with some data on degradation in land quality, pollution from mining and air pollution in cities, and I must say that the emerging picture from these studies is not encouraging and that this is taking on proportions that should raise concerns for impacts on the economy and people's livelihoods.

I believe there was broad agreement among the participants that it will be important to strengthen environmental governance and management to ensure sustainable use of natural resources. Participants noted that this will require review of budget allocations to environmental management and protection (for example to management of protected areas, which appears to be significantly underbudgeted), better enforcement of existing environmental regulations, institutional capacity building, and greater engagement of communities, civil society, NGOs and the private sector. One core action will be improvement in the environmental monitoring system. The few MDG targets defined in relation to environmental protection and sustainable use of natural resources will be insufficient to be able to register a general improvement up to 2015 as a result of the implementation of the NDS. A more specific and extensive set of indicators and targets could be selected in the field of surface water, ground water, forests, grasslands, protected areas, air pollution, desertification, health, etc., and a sustainable monitoring system could be set up in the near term.

A further area in which Mongolia could make a breakthrough is in the management of protected areas and especially of national parks. There is an opportunity in the on-going discussions on the new amendments to the Law on Protected Areas, for the Ministry of Nature and Environment to liaise with the Ministry of Finance to capture more of the value of these much-visited areas which suffer from grossly inadequate operational budgets. The administrations of these gems of the Mongolian landscape, many of them sacred sites, surely need to be allowed to generate *and use* the revenues generated from entry tickets, guiding, sales of local handicrafts, etc. to supplement the allocated budgets. Piloting such schemes in Mongolia and designing implementing the necessary mechanisms seems to be an opportunity to improve environmental management.

There were very welcome comments on the need for donors to strengthen the effectiveness of our own loans and grants, as well as to improve our own coordination on strategic priorities – through a greater orientation on outcomes rather than on projects, to make longer-term financial commitments, to back these up with ambitious outcomes-based targets, to improve coordination on strategic priorities as well as implementation, with longer-term financial commitments

backing these up, building partnerships, and pursuing greater harmonization. I agree with others that we hope to see more detailed priorities in the NDS in half a year's time.

The Minister welcomed the discussion of the importance of Mongolia's environment, its fragility and important to poverty reduction, and he acknowledged the challenges. He noted that the environmental sector contributes at least Tg 28 billion to the national budget - but that only one-third of this goes back to environmental management. In his summary of the discussion he concurred that there was a need to improve the execution of the legal framework, and to continue the work on ecological awareness and the need to involve citizens - including children, and to give greater emphasis on results.

Infrastructure. The Government provided the meeting with the emerging themes and conclusions from the ongoing infrastructure review, which the Government announced will be completed in February. The review will establish a common understanding of the main cross-sectoral issues affecting the infrastructure sector; outline key strategic options to address the identified investment and institutional development gaps; and to take into account the distributional or affordability impact. Of course, infrastructure, from transport to heating to electricity and water is in many ways central to Mongolia's further development, and it was widely recognized that Mongolia, supported by donors, already made a tremendous effort in developing infrastructure, with annual investments of about 10 percent of GDP. Indeed, MP Mr. Ochrikhuu recalled the early days in the transition with very regular power outages and interruptions in heat and power supply, and we are all glad that those days are long gone. Mr. Ochrikhuu welcomed the strategy, emphasized the integration of the strategy with the budget, and stressed prioritization of projects within the strategy.

Other speakers emphasized that prioritization must take into account Mongolia's increasing urbanization, the relative importance of investments (with one speaker suggesting that investments should focus on energy, water, and sanitation rather than transportation given population migration patterns), and that the infrastructure strategy should be linked with the National Development Strategy and there is a need to deepen the process of consultation between now and final delivery. The Government expressed the need for an investment level of about 15 percent of GDP, which it recognized was not possible without further reforms in the sector, and much more private involvement including through privatization. A discussant reviewed the key factors shaping Mongolia's infrastructure demand, including the geographic distribution of growth, the changing pattern of growth, and the increasing integration with the rest of the world. The demand, he argued, can best be distinguished into urban, connectivity, and mining infrastructure. He also noted that improving the efficiency of *existing* infrastructure should be as much a focus as new infrastructure.

Participants agreed that the overriding barrier to more sustainable investments was regulations, notably on tariffs, which remain well below the cost recovery levels needed for private suppliers to enter or public providers to be financially sustainable, and is one of the key barriers to private sector participation. As some mentioned, the high levels of investment are not matched by commensurate spending on operation and maintenance, as even recurrent costs were often not covered by prevailing tariffs. This tariff policy is motivated by the government's desire to protect the poor, but the result is that often the poor are excluded from services such as water,

district heating and electricity, and have to revert to alternatives that are much more expensive than the public services provided to the better off. Partners noted that the government could make more headway in tariff reforms, if it were to pursue a policy of “lifeline” tariffs for the poor, while charging cost recovery rates for the non-poor.

Some of the participants noted that it was not more investments that Mongolia needed, but better management of those investments, and more attention to the “software” of infrastructure, such as transport corridor agreements. The Minister of Construction and Urban Development noted the need for linkages between the different development strategies but that articulation of the infrastructure strategy and national development strategy are proceeding quite slowly, and that the lack of central coordinating body or ministry is part of the problem. He suggested that an integrated infrastructure strategy, followed regardless of political party or government, would be important for attracting private investments.

There was some debate as to Mongolia’s options in attracting private investment in infrastructure. All agreed that these options were present in the area of telecoms, and some felt that the government’s involvement in the housing sector went well beyond its social obligation, and much more could be left to private financing, as around the world housing is one of the most bankable investments. The World Bank’s inputs into the draft Infrastructure Strategy argue that investment in mining-related infrastructure is of a very different nature than other infrastructure, and can also be largely left to the private sector within a context of government regulations. In some of the other areas where private investment would be possible, including electricity and water, required further institutional development and tariff reforms. Separately, some donors encouraged the government to pursue more aggressively agreements that would lower transaction costs, including a transit agreement with China, and an “open skies” policy to lower air transportation costs.

The Government of Japan announced its attention to support the development of a master plan for city planning of Ulaanbaatar, the United States representative noted that the Mongolian and U.S. governments hope to conclude a Millennium Challenge compact in the spring of 2007. Several donors discussed ongoing projects and intentions to continue to provide financial support to the infrastructure sector.

Energy. The Government provided a comprehensive presentation on the importance of energy for Mongolia, recent accomplishments, and the current status of supply and demand, including projections that energy demand will soon outstrip existing supply, and that many rural households still lack access. The Government presented strategic directions for developing a unified power grid and options for developing new energy sources such as the Egiiin Gol hydro project, a new Ulaanbaatar combined heat and power plant, and to supply planned mines in the south Gobi region. The Government provided its estimates of medium-term financing requirements of about \$1 billion through 2010. Priorities for energy sector restructuring and institutional capacity building were also discussed, including the need to continue to clean up inter-sectoral arrears, ensure sustainable management of (mostly ODA-financed, concessional) debt, and to improve energy efficiency, access, and access. Continued policy reforms are planned to improve the investment environment, encourage renewables, and promote efficiency. The Government referred to several pieces of new or amended legislation planned to be

considered in the coming few months, as well as plans to revise the Energy Master Plan, to further study energy pricing and tariffs, and to introduce consumption based billing.

Partners welcomed the Government's plans and expressed their willingness to support the energy sector while underscoring that the major new investments needed in the sector will far exceed both government and donor resources, and will require actions to attract major private investments. Partners emphasized that tariff reforms to improve cost recovery (given that current tariffs recover only about half of energy production costs) will be critical if the country is to attract significant private investment. The point was also made that tariff rebalancing should address current inequities, with apartment dwellers pay much lower fees for heat and water than ger district residents. The Minister Bayartsaikhan acknowledged the need for tariff reform but noted that it will be difficult for the Government to make heat tariff adjustments in the short term given the coming winter and rapidly rising fuel prices. Participants also emphasized the need to ensure that current and future donor assistance in the energy sector is effectively used, and I think work is needed on all sides to improve our effectiveness. This can include, as the Government and partners discussed, building consensus on a revised master plan for the sector, including actions to clarify responsibilities between the regulatory authority and the ministry, and to address constraints on private investment such as tariff rebalancing and ongoing arrears. Partners also welcomed the Government's increasing emphasis on renewables and energy efficiency.

Transportation. Ministry of Road, Transportation and Tourism State Secretary Bat-Enkh presented the draft national road transport strategy for Mongolia. The government envisions a considerable expansion of the roads network, and a significant part of that expansion is donor-financed. Although the envisioned investments in rail, air, and maritime transport indicate very high investment needs, the vice-minister of finance cautioned that the investments as set out are simply too large -- not least because of associated operation and maintenance -- and that further prioritization and hard choices are required, based on anticipated demand for transportation. He also noted that public investment cannot finance even a more modest program, that railways and the Ulan Bataar monorail are suited for private investment, but that this would require improvements in the legal framework and pricing policies. Participants questioned whether all the roads planned are needed, and whether a more focused program would be more effective.

A discussant pointed out that one should not consider demand from a too narrow a perspective, and transport infrastructure can be a key generator for exports and catalyze Mongolia's integration in the global economy, and move way from the "village economy." Other participants emphasized that the principles of connectivity and economic geography as well as financing constraints should drive the priorities in the road expansion plans. Among the implementation issues, procurement processes and transparency were mentioned. Minister Tsengel played down the significance of the large numbers presented, and emphasized the need for infrastructure to promote economic development of a landlocked country, singling out the Asia Road Network as particularly important. He was keen to expand private sector investment, but felt that in the current economic circumstances tariffs could not be raised much. He felt that guarantees from government would be needed to give investors adequate returns. The Minister of Finance also emphasized the importance of infrastructure, and announced that road net work will be further expanded in 2007. In light of the discussion I think it is fair to say that achieving

efficient, effective, safe, and environmentally safe transport in Mongolia as one discussant put it still requires further thoughts and discussion.

Finally, we discussed the role and function of the technical meetings themselves. In summary, the GOM finds the twice-yearly format useful. These meetings should reinforce and not undermine in-country donor coordination efforts including the work of sectoral working groups. It was suggested that one of the two meetings should include a break-out session/plenary format, with the working groups reporting back on various commitments made. Further discussion is needed with the authorities on the ways that the technical meeting process can foster two-way accountability, link planned donor disbursements with Mongolia's budget planning and track the effective use of resources in ongoing and future development assistance programs. We are very pleased that the Prime Minister attended this closing session and we are grateful for his warm words supporting cooperation between the Government and External Partners.