

MONGOLIA
Government of Mongolia – External Partners Technical Meeting
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Opening Remarks
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Excellencies, Ladies and Gentlemen:

Good morning. I would like to welcome all of you to the second Technical Meeting between the Government of Mongolia and its external partners. I would like to thank Minister Bayartsaikhan for taking initiative in preparing this process, for co-chairing these sessions and engaging in this dialogue on Mongolia's development program.

Over the next two days we will review Mongolia's macroeconomic situation, take stock of progress made over the past half-year, including the actions agreed at our February meeting and then take a more in-depth look at two areas of special importance to Mongolia's development: the environment and infrastructure. Before we move into our discussions, I would like to make several comments.

First, I think it is important to keep in mind where Mongolia stands in relation to the transition it began in 1990. In comparison with many countries, Mongolia has managed its transition well. The country has put in place a framework of laws, policies, and institutions to support a market-based system, and continued to implement structural reforms. These "first generation" reforms, and favorable external conditions, have contributed to high rates of GDP growth and a per capita income that has not only achieved but has surpassed pre-transition levels. There is also renewed progress toward attaining several of Mongolia's MDG targets.

Since we last met, Mongolia's economy has continued to expand rapidly—with GDP growth expected to be around 7 percent in real terms in 2006. High international prices for copper and gold have sustained export earnings growth this year, bringing Mongolia's trade balance to near balance as of the end of August. Inflation has declined, from 9.2% in 2005 to 5.3% as of August 2006, on a year-to-year basis. A fiscal surplus is expected for the second consecutive year, with revenues expanding 47% in the first seven months of this year while expenditures increased by only 21% during this period. Government revenues increased largely due to the exceptionally high mineral prices, the introduction of a windfall tax linked to the international price of copper and gold, and due to higher level of economic activity, notably in the services and construction sectors.

But as we all know, major challenges remain. Despite strong growth and a slight decline in the unemployment rate, about a third of the population remains below the country's poverty line. Inequality remains high. Growth has also relied heavily on external factors,

particularly high minerals prices and weather, as the structure of the economy remains relatively concentrated around a few activities. The private sector, particularly the small and medium enterprises which typically exhibit the greatest potential to contribute to a country's future growth, is facing a range of constraints that we began to discuss in February.

More broadly-shared and sustainable growth will be critical if Mongolia is to accelerate poverty reduction and progress toward achieving other favorable development outcomes. Towards this end, "second generation" reforms targeted at increasing competitiveness, strengthening market institutions, as well as increasing transparency and accountability will be crucial. It will also lead to the much needed diversification of the economy and to build on the good market foundations that have been laid down already in recent years.

Mongolia's recent revenue windfalls bring new opportunities for the country to achieve its development goals. But, as the experiences of other natural resource-rich countries have shown, temporary windfalls themselves are unlikely to automatically lead to long-term development benefits for all citizens. International experience suggests that only a few economies have successfully converted similar windfall gains into better livelihoods for broad segments of their population. The successful cases of Kazakhstan and Malaysia come to mind in this regard. Unfortunately, the more usual occurrence is to the contrary, where large segments of the population of countries remain poor despite episodes of windfall revenue earnings. For example, Nigeria's GDP per capita has remained flat (at \$245/per capita) from 1965 to 2000 despite large increases in its oil revenues over the same period.

How Mongolia manages these windfalls will, therefore, be crucial for achieving more sustainable growth and maximizing the development benefit from these resources. First, Mongolia's windfall revenues can be saved for future commodity price downturns. Second, they can be used to support growth-inducing and poverty-reducing investments in infrastructure. Third, they can provide a cushion for difficult second generation reforms – such as reforming the civil service, privatizing remaining large state-owned enterprises, and improving governance – that can bring lasting development benefits. The government has already embarked on a concrete set of actions towards such reforms over the past seven months. We will be discussing these in our upcoming sessions.

While the current fiscal situation is good, recent and proposed fiscal policy changes put Mongolia in a more vulnerable position and can undermine future macroeconomic stability. Specifically, recent and planned expansions of social welfare entitlements, large increases in civil service salaries without accompanying civil service reform measures, and reductions in the non-mineral tax base that will increase the government's dependency on volatile copper and gold prices make Mongolia's budget more vulnerable to shocks in the future. More importantly, these may not help achieve the development outcomes of private sector-led growth and poverty alleviation. Mongolia also needs to review whether the newly introduced fiscal regime for mining will allow the country to continue to attract investment in this sector.

Over the next two days we will learn more about the Government's plan to use its windfall revenues, the priority short-term development results that it seeks to achieve, and to discuss trade-offs of various approaches to achieving them. Infrastructure, which we will be discussing tomorrow, could be an important avenue to convert some of the windfall into investments and services that can spur future growth and poverty reduction. But maximizing the development benefit from scarce infrastructure resources will require clarity on priority development goals that it supports and careful analysis of the development costs and benefits of different investments.

Second, I believe that the technical meeting process is an opportunity for building a common understanding of Mongolia's priority development results and improving our effectiveness in supporting them. I think the meeting also serves for taking stock of progress made toward these priorities, as well of the most important policy reforms, institutional changes, and resources needed to achieve results. In addition to rapidly rising government revenues, Mongolia continues to benefit from high levels of ODA, which have contributed the equivalent of nearly 20% of GDP over the past decade, but have declined (relative to GDP) in recent years, and now make up some 10 percent of GDP. These levels are still very high and concerns continue about whether Mongolia is getting adequate development benefit from these resources. By clarifying the priority results that the GoM wants to achieve and reviewing progress toward them, the technical meeting provides an opportunity to improve the impact of these resources.

Today we will hear from the Government on the National Development Strategy, and the draft 2007 Socio-Economic Guidelines and Budget, which taken together spell out the GoM's priorities. We will also hear back on actions taken in specific sectors discussed at our February meeting. I believe there are some notable concrete achievements to report, and I would like to congratulate the Government with the progress made on private sector development, governance, and education since we met in February. Notably, the Anti-Corruption Law that was adopted during the spring parliamentary session provides a legal basis for setting up a new anti-corruption council and instituting an asset and income disclosure system. In education, Mongolia finalized the education master plan and conducted an assessment of the plan under the global Fast Track Initiative. These have together enabled Mongolia to qualify for up to \$29.5 million in grant funding from the FTI Catalytic Fund. I think this is a good example of an instance in which clarifying priorities and coordinating actions has enabled Mongolia to potentially access additional donor resources that can improve results in a sector that is crucial for achieving the MDGs. I also look forward to hearing the results of the PSD working group's work to develop a short-list of concrete actions to support private sector development, which we discussed at our February meeting.

We will then devote the remaining sessions to two areas that play a central role in Mongolia's development, the environment and infrastructure. Mongolia heavily depends on natural resources and the environment for economic growth and for improving and sustaining livelihoods. Recent research provides compelling evidence that many natural resources are being exploited at unsustainable rates and in ways that can unnecessarily damage the environment. World Bank work, supported by the Netherlands Government,

documents the rapid decline of economically and ecologically important wildlife, over-harvesting of forests, and weak enforcement of environmental regulations in the mining sector. Despite a decent legal and regulatory framework, there are serious problems with the management of natural resources and the enforcement of related laws. The research also indicates that natural resource and environmental management are underfunded, but effective use of additional financial resources depends on institutional reforms – for example, better monitoring of key environmental indicators to measure progress toward desired results; and stronger institutions to better enforce existing laws and regulations. A team from the Ministry of Nature and Environment will provide brief us on key environmental challenges, the Government’s priority results, and some ideas on key areas requiring additional government and donor support. The needs are great, and I hope that during this session we can agree on some concrete next steps during the next six months to address these priorities.

Maximizing the development benefit from Mongolia’s relatively scarce infrastructure resources will also be a core challenge, especially given the country’s vast land area, harsh climate, and dispersed rural population. Recent windfall revenues provide an opportunity to improve critical infrastructure, but even with a continued favorable external conditions, the country’s infrastructure plans far exceed available resources. We will be discussing the outlines of a new draft infrastructure strategy, which seeks to identify key results that infrastructure can contribute to, and feed into a broader effort to identify priority results, policy and regulatory reforms, and additional investments that can improve the impact of infrastructure on desired development results.

Finally, I would like to invite you to have a discussion, during the closing session tomorrow, to take stock of the technical meeting process and to share ideas on how the process can be improved. Our February meeting initiated a shift to a new format for Government-external partner cooperation -- a format involving regular six-monthly meetings, aligned with Mongolia’s own planning and budget cycle, and focused on improving management for development results. I look forward to constructive suggestions on how we can refine this mechanism, as well as to ensure that the work between meetings moves forward effectively.

I look forward to an interesting and productive discussion.