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Mongolia: Ex Post Assessment of Longer-Term Program Engagement

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MONGOLIA

Ex Post Assessment of Longer-Term Program Engagement

Prepared by a Staff Team from the Asia and Pacific, Fiscal Affairs,
and Policy Development and Review Departments[1]

Authorized for Distribution by the Asia and Pacific
and Policy Development and Review Departments

September 2, 2005

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I. INTRODUCTION

1. **This paper assesses Mongolia's progress in implementing its transition to a market economy, economic stabilization, and reform programs supported by the Fund during 1991–2004 and draws lessons for future Fund involvement.** Mongolia is a low-income transition economy; prolonged program engagement by the Fund to assist in tackling the formidable economic and structural challenges can thus be expected.

2. **The Fund-supported programs aimed to assist the transition from a centrally planned command system closely linked to the Soviet Union to a market-based economy, and later the tackling of poverty.** Critical for such programs' success would be the establishment of appropriate institutions to cope with the transformation and operate a market economy while reducing vulnerability to shocks (Box 1). Since the break with the past in 1991, Mongolia has clearly changed significantly. Classified as a "mature stabilizer" by the Fund, macroeconomic stability has been broadly achieved with growth restored and inflation generally under control, much of the state structure has been privatized or updated, and the economy and export base have diversified.[2] On the other hand, the economy remains very vulnerable to shocks, some key institutions are still functioning poorly, there are few employment opportunities and progress in reducing poverty has been limited.

II. INITIAL CONDITIONS

3. **In the 1980s, Mongolia's economic structure constituted a formidable obstacle to transformation.** Competition in all economic spheres was limited—state enterprises maintained monopoly control over key production activities, financial intermediation went through the State Bank, and almost all capital assets, including the housing stock, were owned by the government. Trading ties were with the other Council for Mutual Economic Assistance (CMEA) member countries, principally the Soviet Union, with which Mongolia had built up a very large negative balance in the decades leading up to the transition. Moreover, in the late 1980s, CMEA members were undergoing fundamental changes, disrupting the supply of key imports and demand for Mongolian goods.

4. **However, with abundant natural resources, Mongolia was reasonably well positioned to translate economic reform into growth and higher living standards.** About 80 percent of the country's land was suitable for extensive animal husbandry, and there were large deposits of coal, iron, tin, copper, gold, silver, other metals and semiprecious stones, while petroleum exploration was initiated in the late 1980s. Nonetheless, the remote geographic location was a major barrier to trade diversification, while necessitating relatively large investments to build the infrastructure for domestic economic integration as well as connecting the country with its trading partners. The agricultural sector was confined to low-

[2] Mature stabilizers are low-income countries that have achieved per capita income growth greater than 1 percent and inflation less than 10 percent. See *Monetary and Fiscal Policy Design Issues in Low Income countries (www.imf.org).*

Box 1. Mongolia: Fund-Supported Programs, 1991–2005

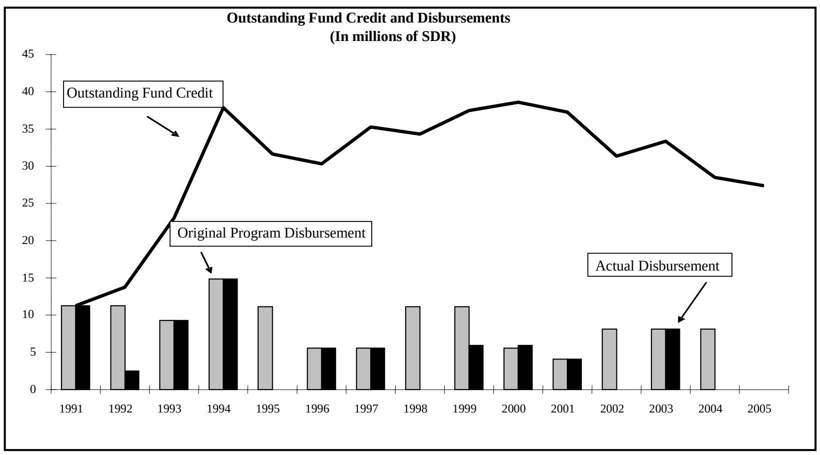
Since Mongolia became a member of the Fund in 1991, it had four financial arrangements with the Fund.

Mongolia: Arrangements with the Fund

Arrangement	Approval - Expiration	Millions of SDRs		Percent of Quota		Intended Disbursement Profile (in millions of SDRs)						
		Approved	Drawn	Approved	Drawn	1st	2nd	3rd	4th	5th	6th	7th purchase
SBA	Oct. 4, 1991 - Oct. 3, 1992	22.5	13.8	90	55	**11.3**	3.8	3.8	3.8			
Rephasing/extension through Dec. 31, 1992							**2.5**	3.8	5.0			
ESAF 1	June 25, 1993 - June 24, 1996	40.8	29.7	110	80	**9.3**	**9.3**	**5.6**	**5.6**	5.6	5.6	
ESAF 2	July 30, 1997 - July 29, 2000	33.4	17.4	90	47	**5.6**	5.6	5.6	5.6	5.6	5.6	
Rephasing		31.5					**5.9**	**5.9**	3.0	2.2	4.5	4.5
PRGF	Sept. 28, 2001 - Sept. 27, 2004	28.5	12.2	56	24	**4.1**	4.1	4.1	4.1	4.1	4.1	4.1
Rephasing/extension through July 31, 2005							**8.1**	4.1	4.1	4.1	4.1	

Bold and underlined numbers: purchases made.

An initial stand-by arrangement laid the foundation for an ESAF arrangement at a time when Mongolia's was not yet eligible to use concessional resources. The arrangement was envisaged to have one mid-term review, which was completed. The arrangement was extended to end-1992, but the envisaged second review was not completed.



The program supported by the first ESAF arrangement (1993-96) was acknowledged as ambitious at the outset. After the previous SBA had gone off track, an "indicative program"—effectively a staff-monitored program—with quantitative targets in December 1992 and March 1993 laid the basis for approval of the first annual ESAF arrangement. The mid-term review was completed on time, but the second annual arrangement was approved with some delay, while its mid-term review was completed only with a delay of one year.

The second ESAF (since 1999 PRGF) arrangement (1997-2000) concentrated a strong reform effort on the banking system. To ascertain the authorities' ownership, as well as to re-establish a policy track record following the expiration of the previous arrangement and slippages in policy implementation, it contained a very large number of structural conditions, mainly prior actions, of which the focus concentrated on the financial sector. However, despite the authorities' strong initial commitment, delays occurred in the completion of the mid-term review of the first annual arrangement. The approval of the second annual arrangement (with a small reduction in access) was delayed even further, and the mid-term review of that arrangement was completed only in 2000, shortly before the commitment period expired, and the arrangement allowed to lapse.

The PRGF arrangement (2001-2005) started more than a year after the previous arrangement had lapsed. It focused on fiscal consolidation, as the public debt level had risen precipitously in previous years. However, only the first review and second reviews were completed, with a year's delay in 2003. At that time, the arrangement was extended, but no further reviews were completed despite broad achievement of the macroeconomic objectives as governance concerns were highlighted.

intensity livestock rearing and crop cultivation limited by harsh weather conditions. The results were low incomes and other indicators of extensive poverty.

5. **The transition following the democratic elections in 1990 was also eased by reforms initiated earlier under the communist regime.** From the mid-1980s onwards, work started on rationalizing some ministries, public sector enterprises afforded some autonomy, monopolies in state trading eliminated, administered prices raised and in some cases freed, a simple two-tier banking system carved out of the monolithic state bank, new business laws promulgated, tax administration modernized, and the exchange rate significantly adjusted. These actions set the scene for the major structural reforms from 1991 onward that were supported by the Fund arrangements.

III. EVALUATION OF EXPERIENCE UNDER THE FUND-SUPPORTED PROGRAMS

6. **The programs supported by the Fund differed in their emphasis, in line with evolving stages of transition, the need to address emerging challenges, and the priorities of different governments.** There was much initial enthusiasm for reform on the part of the authorities, with the Fund at times even trying to slow the process so as to allow institution building to catch up. In the immediate aftermath of the early reforms and the withdrawal of Soviet assistance, the focus was on macroeconomic stabilization. To avoid too strong strains on the nascent political system, a cautious approach to economic liberalization was chosen. The decision to proceed gradually, while contributing to a relatively smooth adjustment, foreshadowed later lapses in performance, often associated with elections and frequent government changes (Box 2). Equally, the delay in some fundamental market reforms may have impeded growth and embedded distortions in the economy that developed.

7. **Mongolia's transition has been less painful than in many other post-communist economies, particularly compared with CIS countries** (Box 3). The initial output loss was relatively small, though growth has lagged that of the more successful Eastern European transition economies since 1993. Inflation proved harder to control than initially expected and remained above 10 percent for seven years, but, again, compared with other transition economies, performance has been equal or better. Trade has been radically reoriented, from Russia to China and the United States, although Russia continues to provide all oil.

8. **Fiscal policy made a significant contribution toward macroeconomic stability, with strong revenue performance but the public sector remains relatively large.** The overall fiscal deficit was reduced from about 11 percent of GDP in 1992 to about 2 percent of GDP in 2004. However, a direct unavoidable consequence of the transition strategy was a rapid accumulation of external debt. Government revenue, at almost 40 percent of GDP, is higher than other transition economies, and in particular, most low-income countries. Public investment is also relatively high, but does not appear to have crowded out private investment—principally in mining—which, at about 20 percent of GDP, is at a par with the more successful transition economies. Public consumption levels are high but similar to other transition countries, as the authorities strove to provide social services and a large civil service. Control over aggregate expenditure was inadequate, but much of the increase was

clearly part of the strategy of the various governments, which the Fund programs were unable to curb through understandings or conditions.

Box 2. Mongolia: Political Developments in Mongolia, 1991–2005

Until 1990, the Mongolian Government was modeled on the Soviet system; only the communist party--the Mongolian People's Revolutionary Party (MPRP)--officially was permitted to function. Mongolia's first multi-party elections for a People's Great Hural were held on 29 July 1990. The MPRP won 85 percent of the seats.

In 1992, a new constitution entered into force establishing Mongolia as an independent, sovereign republic—the new constitution created a unicameral legislature, the State Great Hural. The president would be elected by popular vote rather than by the legislature as before, for a 4-year term and limited to two terms. The president is the head of state, commander in chief of the armed forces, and head of the national security council. The government, headed by the prime minister, has a 4-year term. Since that time, the predominant party in Mongolia has been the MPRP. The MPRP's policies have favored market reforms, but with a strong role for the state sector. The main opposition party has been the Democratic Party, which also favors market reforms, but has closer links to the private sector. In general, there are no sharp political differences.

After the parliamentary elections of 1996, the Democratic Party controlled a governing coalition until 2000.

From 2000 to 2004 the MPRP was back in power, but results of the 2004 elections required the establishing of the first ever coalition government in Mongolia between the MPRP and the renamed Motherland Democratic Coalition (MDC), who obtained 37 and 34 seats respectively in the Great Hural, with 5 seats for other parties.

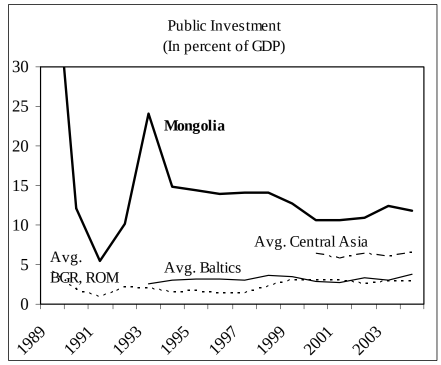
As part of the coalition agreement, the Prime Minister is currently Elbegdorj of the Democratic Party but the position is to be passed on to the MPRP in 2006.

In the presidential election of May 2005, the Speaker and former Prime Minister, Nambaryn Enkhbayar (MPRP) was elected to succeed Natsagiyn Bagabandi (also MPRP) as President.

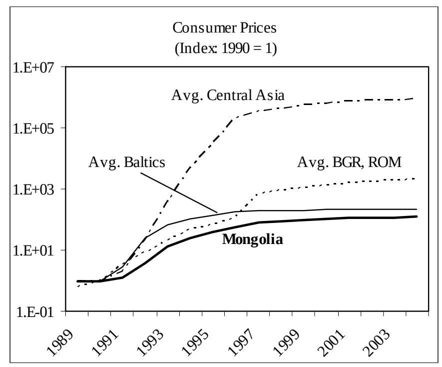
9. **Public debt rose to about 100 percent of GDP, higher than most comparators, but appears broadly sustainable.** The debt is almost all concessional, implying a still-high NPV of external debt of about 60 percent of GDP, or 110 percent of exports. At the same time, Mongolia has been able to extinguish its enormous debt carryover from the CMEA period. In a recent international sovereign rating credit analysis, Mongolia was rated B+ by Fitch, better than most CIS countries and other low-income economies. Prudent macroeconomic policies, with market-oriented reforms, and reform of expenditure policies, would permit the overall fiscal deficit to stabilize at about 3 percent of GDP while the debt ratio would gradually decline.

Box 3. Mongolia: Comparison with Other Transition Countries

Mongolia's economic history and geographic position suggests comparisons with ex-soviet countries of Central Asia. However, Mongolia opted for a relatively cautious pace of transition and reforms in a democratic political environment, not unlike slow reformers in Eastern Europe, e.g. Bulgaria and Romania, suggesting that a comparison with the experience of some Central and Eastern European countries is useful.[1] *A comparison with the Chinese Autonomous Region of Inner Mongolia is instructive as well, due its geographic proximity.*

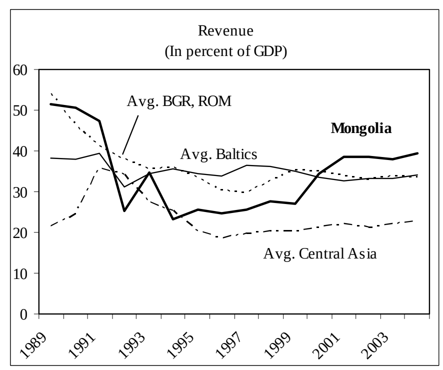


Mongolia has not yet fully regained its pre-reform per capita output. Nonetheless, it compares favorably with other transition countries in the region (with the exception of Kazakhstan and Turkmenistan, which have seen large gains in per capita GDP due to rapidly rising oil and gas production), and more broadly the ex-Soviet Union, with the notable exception of the Baltics, whose output has far surpassed pre-reform levels.

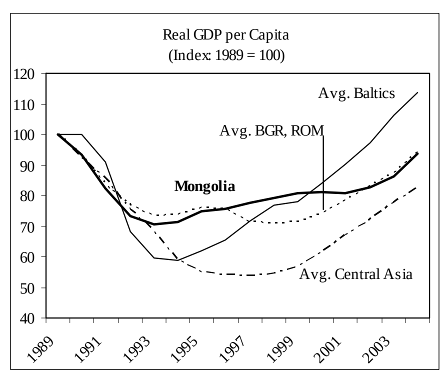


However, Mongolia's output trough in the initial reform shock was remarkably shallow; only Bulgaria and Romania had comparably small output losses (though a second crisis in 1997/98 in Bulgaria led to a further decline in GDP). This is particularly significant as Soviet assistance before the transition amounted to roughly 30 percent of GDP.

The subsequent output growth has also been weaker than in other transition countries, possibly due to the gradualist approach to macroeconomic and structural reforms. Annual output growth has averaged about 3 percent since 2000, compared with 7¾ percent in the Baltic countries, 5¾ percent in Bulgaria and Romania, and 6½ percent in Tajikistan and Kyrgyzstan. Only Uzbekistan continues to grow slower.



The post-reform price shock was more subdued in Mongolia than elsewhere. While the programs supported under the SBA and ESAF I arrangements envisaged a more rapid decline in inflation, Mongolia' performance was still remarkable. Only the Baltic countries brought inflation under control as rapidly as Mongolia, though not without an average spike of over 800 percent in 1992, far above Mongolia's high point of 268 percent in 1993. Further into the reform process, Mongolia's inflation has been comparable to other transition economies.

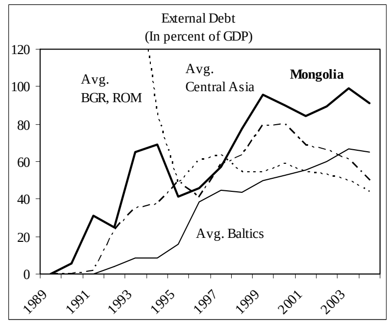


The role of the state remains comparably prominent. General government revenues account for about 40 percent of GDP, compared with about 30-35 percent in Eastern European comparators, and an average of 20 percent in Central Asian CIS countries. With public consumption broadly comparable to other transition economies, public investment is significantly larger in Mongolia, financed primarily extent from abroad. Correspondingly, public external debt has risen to over 90 percent of GDP (the net present value has been

[1] The data underlying the following comparisons should be interpreted with caution given the transition of economic concepts, exacerbated by the difficulty of reliable measurement, and lack of statistical capacity.

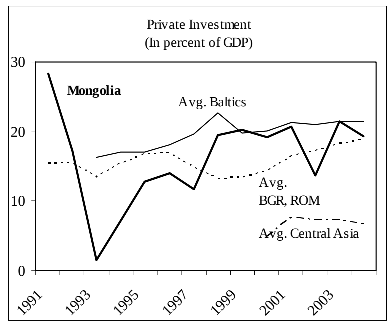
Box 3. Mongolia: Comparison with other Transition Countries (Continued)

contained at about 60 percent of GDP). This stands in sharp contrast to the Baltic countries, where the average external debt of almost 70 percent of GDP is owed almost entirely by the private sector. In CEE countries, external debt has been reduced during the reform period.

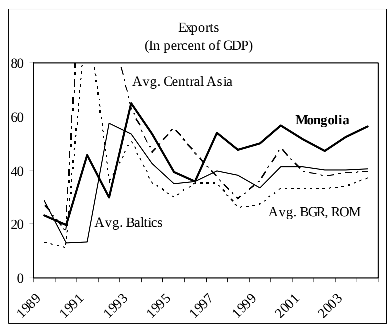


The high level of public investment has not constrained private investment, which has reached levels comparable to Eastern European and far ahead of Central Asian transition economies.

Mongolia is more open to trade than other transition economies, including the Baltics. The ratio of exports to GDP is the highest of the comparator countries; only Estonia reaches the same level. While this is in part the result of favorable terms of trade, export volumes have held up well. In addition, the geographic reorientation of trade from Russia to China and the United States exceeded that experienced in Eastern Europe.



Mongolia and neighboring Inner Mongolia share some similarities in ethnic background and economic structure. Seventeen percent of Inner Mongolia's population are Mongols, who have the same ethnic background as about 90 percent of Mongolia's population (more Mongols live in Inner Mongolia than in Mongolia). In 2003, the agricultural sector accounted for about 20 percent of both economies' GDP, and animal husbandry, with wool and cashmere as "flagship" products, has a strong tradition. Industries have grown up mainly around natural resources: copper and gold in the case of Mongolia; coal and iron ore in Inner Mongolia.

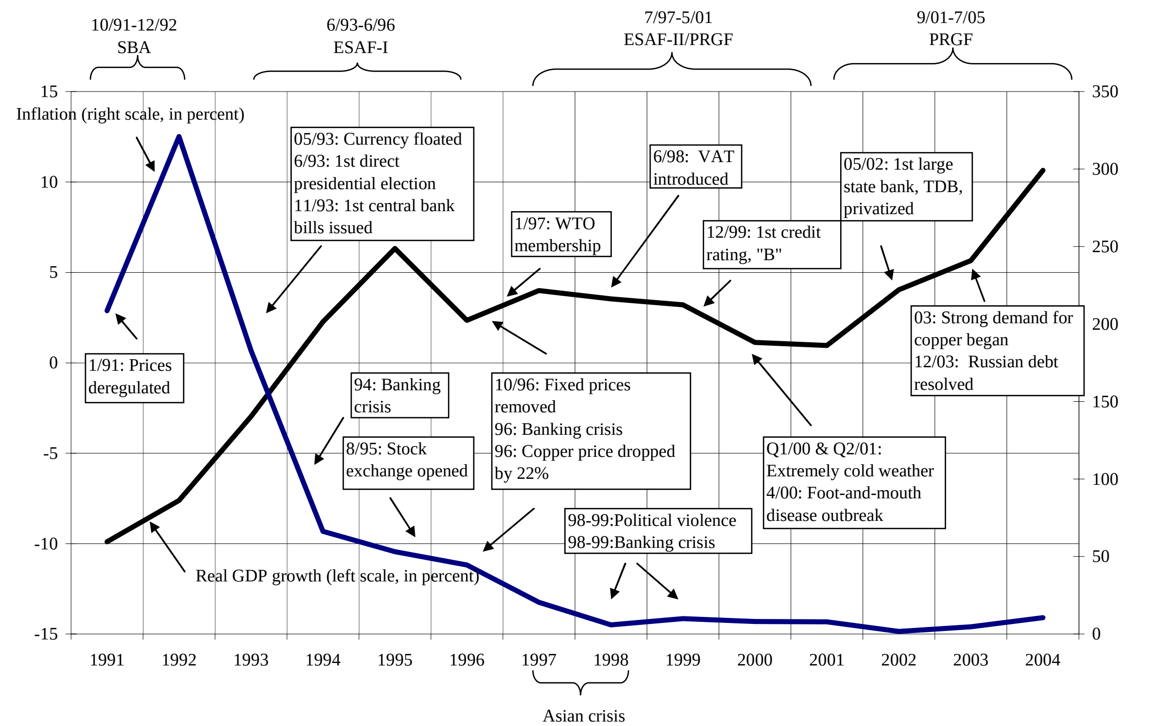


Since 1991, bilateral trade between Mongolia and Inner Mongolia has grown fast. A railway built in 1958, which links Russia and Lanzhou in China, connects their industrial centers and has supported trade. The total value of Mongolia's trade with Inner Mongolia has increased from $24 million in 1991 to $222 million in 2003. In that year, Mongolia's imports from Inner Mongolia were $50 million, while exports to Inner Mongolia amounted to $172 million, 27½ percent of Mongolia's total exports.

However, economic growth of Mongolia lagged behind that of Inner Mongolia. From 1994 to 2003, Mongolia's annual real GDP growth has averaged 3.3 per cent, compared with 10.8 percent in Inner Mongolia. By 2003, Mongolia's per capita GDP was $513, only half of Inner Mongolia's $1,091. An important factor for this outcome has been significantly larger amounts of foreign and domestic investment received by Inner Mongolia.

10. **Overall, Fund involvement appears to have been an important element in assisting the authorities' reform efforts, but ownership wavered.**[3] The Fund provided a key framework for reform as well as technical expertise that was not otherwise available. However, more than once the easing of financing constraints because of increasing export prices led to programs going off-track. On the other hand, the overloading of programs at a later stage with multiple goals, while understandable when the need for reform is large, appeared to make it more difficult for the government to focus on critical elements.

Figure 1. Mongolia: Important Economic and Political Events



A. The Stand-By Arrangement—1991–92

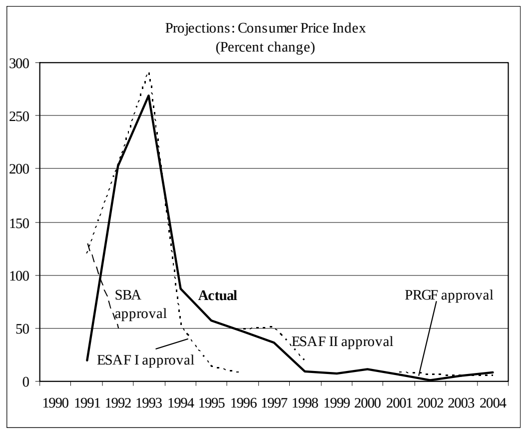
11. **The Stand-By Arrangement approved in 1991 spelled out the medium-term strategy that was to guide it and the subsequent ESAF arrangement.** Its emphasis was to

[3] Interviews with past and present Mongolian counterparts in the government and central bank confirm this impression. The point was frequently made that, even though the Fund arrangements were not completed as intended, they provided a critical structure for the implementing and monitoring of policies during the period. In this vein, the authorities continue to press the case for a renewed Fund arrangement, once the current PRGF lapsed in July 2005. Counterparts also welcomed as essential the technical assistance provided.

restore macroeconomic stability after the collapse of the CMEA system, and then build the institutional base for a market economy, focusing on privatization and the strengthening of institutions enabling indirect macroeconomic management.

12. **The main immediate goals of the Stand-By Arrangement were to contain the decline of output and bring down inflation.** To this end, the program aimed at restoring financial discipline, both in the fiscal and monetary sectors, as well as enabling the price mechanism to play its role in the allocation of resources. To support monetary control, guidelines to restrict automatic access to credit by state enterprises were to be developed, and ceilings on credit to commercial banks were introduced, but both measures proved insufficient. Finally, devaluation of the togrog contributed to restoring external viability.

13. **Transition proved harder than expected.** Growth over 1991–92 was broadly in line with projections, but inflation, which had been expected to slow down by end-1992, shot up briefly to 200 percent. The failure to contain inflation more decisively—partly because of monetary expansion needed to support the ailing state enterprises—caused considerable concern, but this performance proved better than in many other transition countries, where inflation remained higher for longer periods, and the cumulative output contraction was larger. Nonetheless, by the end of the arrangement in December 1992, the program was severely off track, while also because some structural measures were delayed due to a change in government.



B. Enhanced Structural Adjustment Facility I—1993–96

14. **While the impact of inflation had been comparatively benign, there was, nonetheless, a need to bring it down, lest inflationary expectations became entrenched.** As excessive credit to state enterprises had been a major source for monetary expansion, the indicative program in September 1992-March 1993 set ceilings on such credit. This helped set the stage for a reduction of inflation—though again considerably slower than projected.

15. **Approved in June 1993, the program supported by the first Enhanced Structural Adjustment Facility arrangement (ESAF I) was considered ambitious.** It called for restoration of positive economic growth and reduction of inflation to single digits by 1995. In addition, the program projected a substantial recovery of the almost-depleted reserves and the elimination of the external arrears that had accumulated. Substantial amounts of external (concessional) support were expected to be forthcoming, leading to a projected external debt buildup to a peak of over 100 percent of GDP by 2000. Apart from completion of price and more general economic liberalization, and further privatization, a core element of the structural reform agenda was the introduction of instruments for indirect monetary management.

16. **Overall, performance under ESAF I was mixed.** After an auspicious start, implementation ran into difficulties as financial restraint weakened in 1995 for reforms. Buoyant copper prices eased financing constraints. However, the program NIR targets, which included adjustments for high copper prices, were missed by wide margins. Consequently, the envisaged reduction of inflation to single digits was not achieved. On the other hand, the goal of restoring output to 90 percent of its pre-reform level was almost met. On the structural side, after some success in the introduction of indirect measures of monetary control (notably through central bank bills), the focus shifted back somewhat to reform of public enterprises, as problems in this area—including losses by public utilities—proved more persistent than initially thought.

C. Enhanced Structural Adjustment Facility II—1997–2001

17. **By 1996, the reversal of copper prices had led to a slowdown of economic growth, a widening of the budget and current account deficits.** Inflation also picked up. Banks' reserves were depleted, non-performing loans increased, and banks became increasingly illiquid as public confidence waned, prompting the central bank to provide extensive credit to keep the financial system afloat.

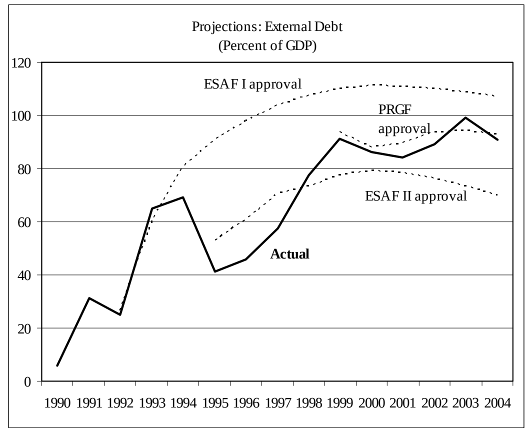
18. **The scope of the program supported by the next three-year arrangement (ESAF II), approved in mid-1997, was significantly broader than under the previous arrangement.** A new government, elected in mid-1996, focused on encouraging the private sector. The program focused on achieving single-digit inflation in its first year, through a re-tightening of financial policies. On the structural front, the program concentrated on financial sector reforms in the aftermath of the banking crisis. However, the program also called, in addition to tax reductions and zero-rating of import duties, for large-scale privatization, the elimination of remaining price controls, modifications to the legal system to strengthen property rights, and a restructuring of the education system. Fund conditionality did not cover all these areas.

19. **As with ESAF I, only two annual arrangements were completed.** The strong initial commitment of the authorities was undermined by a series of political crises, while spillovers from the Asian Crisis had a negative impact on output, export prices, and banks' balance sheets. Many of the structural measures agreed under the second annual program in 1999 were not implemented—in particular, actions aimed at privatizing ailing state banks and public enterprises. While the program was brought back on track by early 2000, allowing completion of the mid-term review, policy implementation again faltered in the run-up to elections in mid-2000. The Fund's counterparts during that period now are of the view that the political climate prohibited a sufficiently medium-term perspective.

20. **Overall, while the program accommodated some of the adverse external circumstances, its main macroeconomic achievement was preserved:** inflation fell to below 10 percent in 1998 and has remained there until very recently. However, the structural reform agenda proved overly ambitious. While progress was made in bank restructuring—a potentially large crisis was averted—and further privatization and liberalization, overall

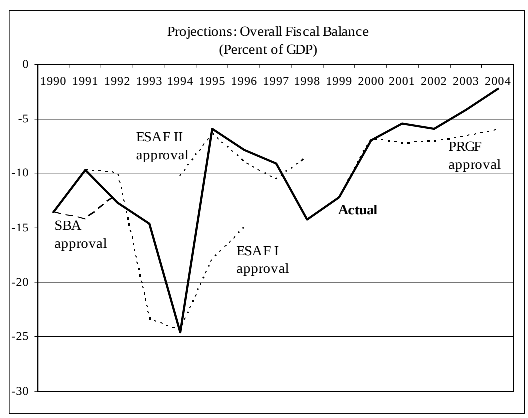
results fell short of expectations. A relatively high proportion of structural conditions were not fulfilled on time or at all.

D. Poverty Reduction Growth Facility (PRGF)—2001–05



21. **When the PRGF arrangement was approved in September 2001, fiscal sustainability had moved to the foreground.** Inflation had finally been contained, monetary control improved, and fiscal deficits had largely been financed from abroad. External debt, albeit concessional, had surpassed 90 percent of GDP in 1999. Although that ratio was lower than earlier envisaged and fell to 88 percent in 2000, the new PRGF arrangement focused on restoring fiscal sustainability, necessitating a modest reduction of the fiscal deficits.

22. **The structural aspect of the program re-focused on the Fund's core areas of responsibility.** Conditionality was initially aimed at improving fiscal management, but shifted, at the time of the first and second reviews, to the financial sector to strengthen the management and supervision of the banking system. The PRGF-supported program also, for the first time, emphasized the goal of poverty reduction explicitly, though the policy content in the Fund's core areas of responsibility was not noticeably different from previous programs. With the National Poverty Alleviation program (NPAP) of 1994, the authorities' approach to poverty reduction had already begun to move away from income transfers and social safety nets to human development (Box 4).



23. **Strong economic performance helped achieve most of the macroeconomic goals of the program, but the arrangement could not be completed.** The easing of financing constraints due to buoyant export prices led to disagreements between the staff and the authorities on the use of this windfall and a delay in the completion of the first review. More recently, the arrangement was held up by governance concerns. Questions focused on the independence, financial integrity, and safeguards of the Bank of Mongolia (BOM), the

Box 4. Mongolia: The Role of Poverty Reduction Strategies

Mongolia developed a comprehensive strategy with the direct and explicit aim of reducing poverty only during the most recent Fund-supported program. Under both preceding ESAF arrangements, the authorities' approach to poverty reduction focused on income transfers and social safety net programs. Correspondingly, the Policy Framework Papers guiding ESAF I and II laid out the macroeconomic and structural problems faced by the country and the policies to address them, but did not put the reduction of poverty directly at the center of their strategy. In 1994, the authorities launched a National Poverty Alleviation Program (NPAP), with financial support from the UNDP, the World Bank, the AsDB, and bilateral donors. Within the NPAP, small scale projects were undertaken to, *inter alia*, create temporary and permanent jobs, support basic education, enhance basic medical services for the rural population, and strengthen the development of social infrastructure.

Poverty reduction became a more central goal of economic policy and was fully integrated with macroeconomic policies with the Interim Poverty Reduction Strategy Paper (I-PRSP), finalized in 2001. In 2003, a full PRSP was completed as the Economic Growth Support and Poverty Reduction Strategy (EGSPRS), incorporating to some extent the Millennium Development Goals. The government has set its own goals for achievement by 2015, committing itself to (i) reduce the number of people in extreme poverty by 25 percent by year 2005, and by 50 percent by year 2015, (ii) provide universal primary education to all people and (iii) reduce infant and child mortality by 50 percent by year 2005.

To achieve these goals, the PRSP includes a considerable number of short-term priorities, including deepening of reforms to ensure macroeconomic stability, improving the health of the banking sector, supporting export-oriented industries, regional development, and infrastructure, but also mainstreaming gender dimensions in poverty interventions to promote gender equality. Medium-term policy is expected to be focused on the expansion of sources of economic growth, prioritizing the development of processing industry based on domestic raw materials, mining and extraction, tourism, IT, and infrastructure.

The PRSP benefited from strong participation by sectoral ministries and civil society—and contains correspondingly strong sectoral strategies. It envisages a shift away of the underlying poverty strategy from income transfers to one centered on growth-promoting macro-structural reforms and sustainable human development, and the poverty reduction strategy is based on a credible macroeconomic framework. However, the Joint Staff Assessment (IMF Country Report No. 03/302) identified a number of challenges for its successful implementation, in particular the tension between the goal of fostering private sector-led growth and the government's commitment to open trade policies on one hand and the interventionist strategy for regional development and promotion of processing industries on the other.

The recently completed EGSPRS progress report, which reflects the endorsement of the current coalition government of the earlier strategy, concludes that the recent high growth has been beneficial but cannot be the basis for substantial employment given its narrow concentration on mining and primary sector industry. The report further highlights high rural poverty. Areas for future increased attention include deepening education sector reform, strengthening delivery of basic health services, improved governance, and establishing a priority regional development framework. The Joint Staff Advisory Note provides suggestions for improved costing and priority setting, and highlights the need for bringing together the various medium –term strategies and guidelines into a single document—the Medium-Term Budget Framework—while enhancing poverty monitoring.

relationship between the BOM and the government, and the transparency of the settlement of the pre-1991 Russian debt.[4] The latter focused on both the basic transaction—an upfront payment of $250 million in December 2003 to the Russians via a third country intermediary—and the full impact of the financing of the transaction on the BOM.[5]

24. **Since March 2004 the authorities have continued to report performance relative to the indicative targets discussed during several staff visits.** The visits served to maintain a close policy dialogue between the Fund staff and both the former MPRP government and the new coalition government, culminating in the Article IV discussions in June 2005. Macroeconomic performance was generally on track. Attention focused on rising inflationary pressures and possible tax and spending reforms in the context of the favorable external environment and the need for further progress on fiscal sustainability. The existence of a coalition government suggested the possibility for establishing broad–based ownership of the program medium-term objectives and policies. However, with public attention still focused on election promises, only limited progress has been made on this front.

IV. Key Structural Policy areas

25. **The transition from a centrally planned to a market-based economy entailed a very large structural reform agenda.** In the Fund's core area of expertise, key reform efforts aimed at modernizing the fiscal system, and establishing a modern, well-supervised financial sector. Closely related to fiscal issues, restructuring and privatization of public enterprises also featured prominently in the transition strategy.

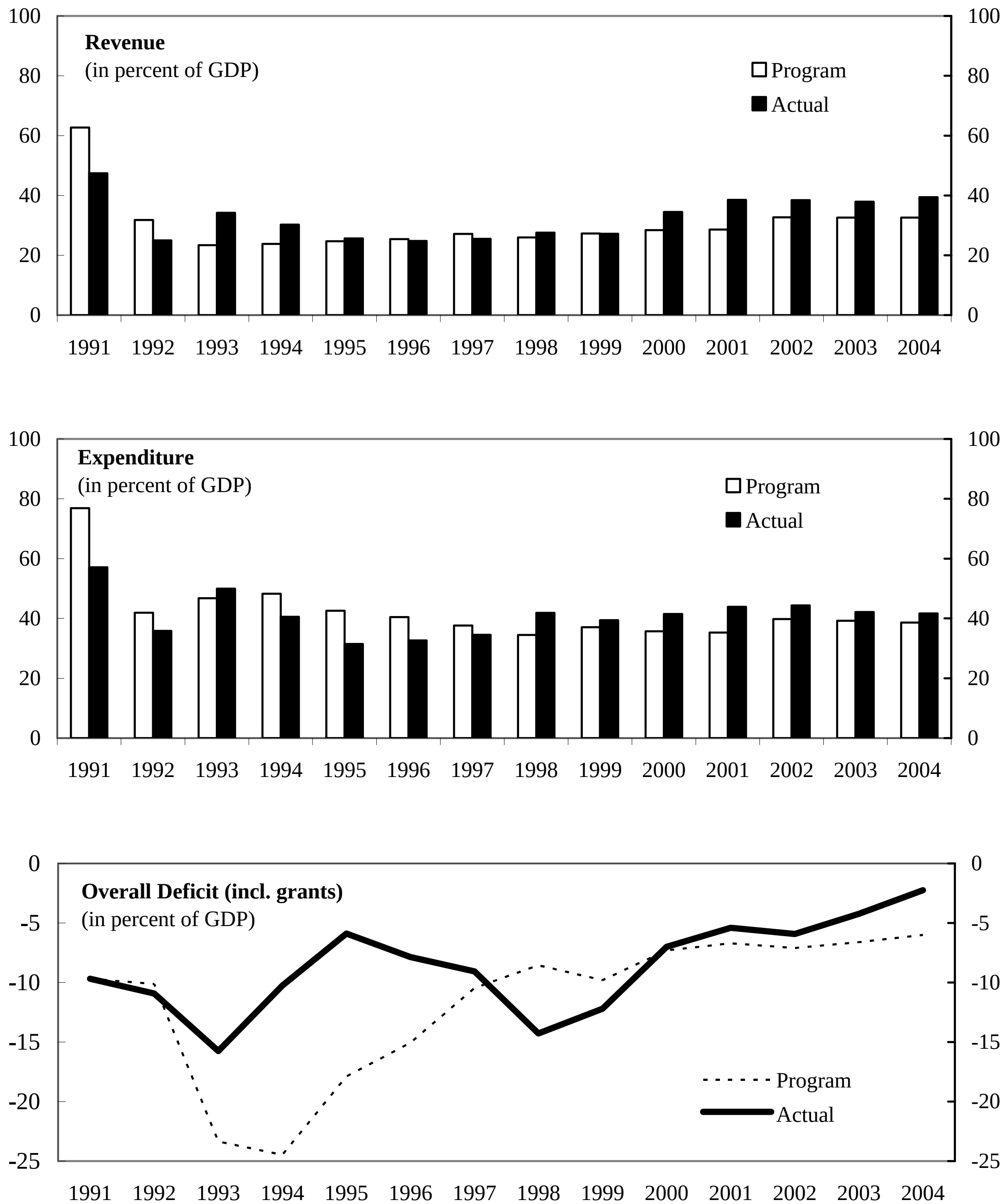
A. Fiscal System

26. **An early transformation of the tax system succeeded in mobilizing revenues, which increased by 15 percentage points of GDP.** Fund fiscal technical assistance was extensive, complementary to the programs, detailed and very specific. A Value Added Tax (VAT) was successfully introduced and the extractive industry provided an expanding and easily targeted tax base, although very vulnerable to fluctuations in prices of Mongolia's exports. Despite provision of extensive technical assistance on public expenditure

[4] The overhang of Mongolia's pre-1991 transferable ruble (TR) debt to Russia had been a longstanding issue between the two countries. Fund staff had encouraged the authorities to resolve the issue in a manner compatible with the fiscal and debt sustainability objectives. In view of the uncertainty on the timing and terms for such a resolution, the TR debt had been excluded from the staff's external debt estimates and projections in the context of Fund-supported programs. However, in 2002 the staff's debt sustainability analysis suggested that Mongolia would need to secure highly favorable terms on the settlement of this debt to ensure that its overall debt burden would not rise to unsustainable levels (IMF Country Report No. 02/252).

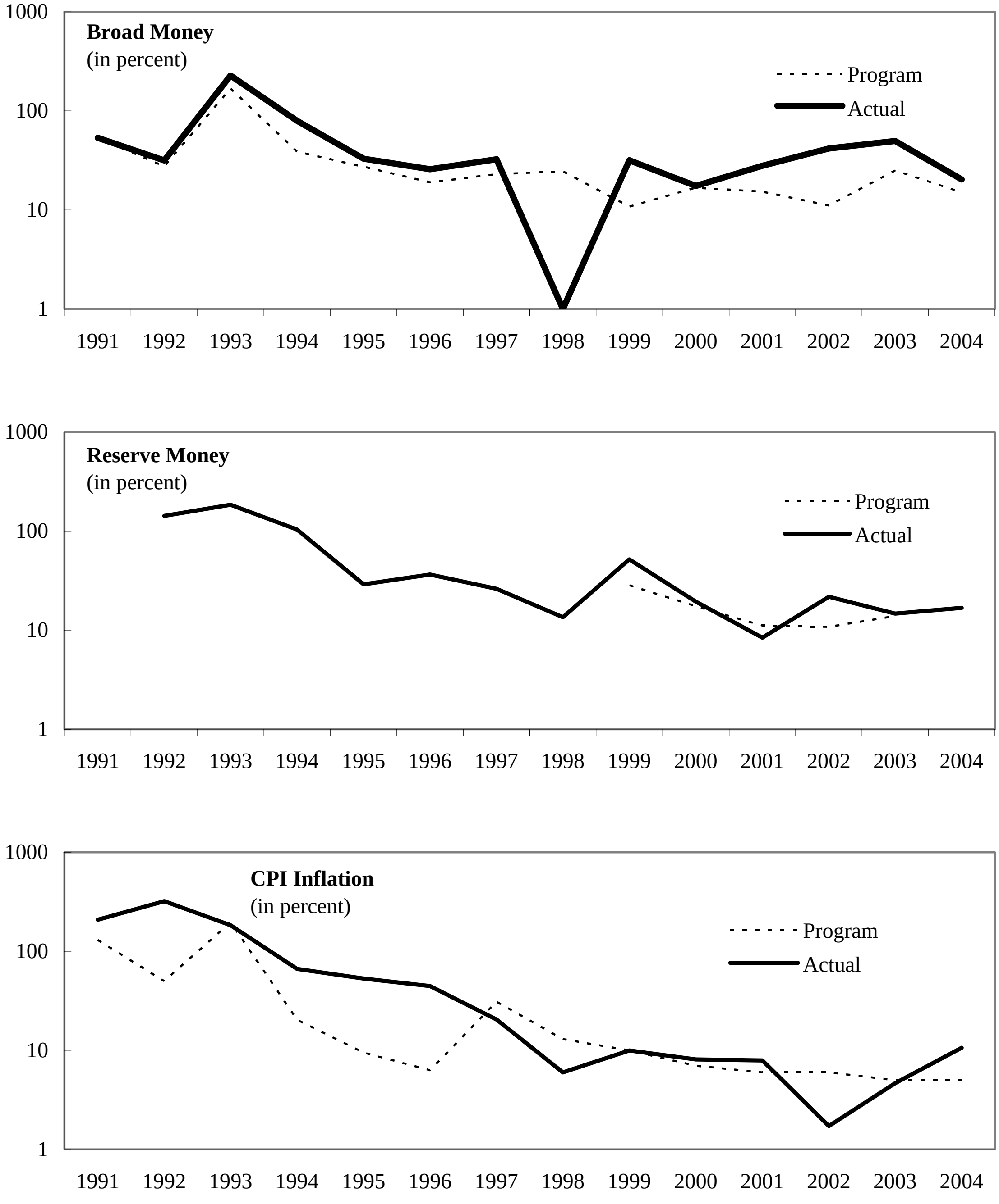
[5] Several program targets were missed in early 2004, partly as a specific side effect of the debt settlement but also because of related slippages in monetary management, in the servicing of public debt, and on measures aimed at strengthening of BOM safeguards.

Figure 2. Mongolia: Fiscal Indicators, 1991-2004



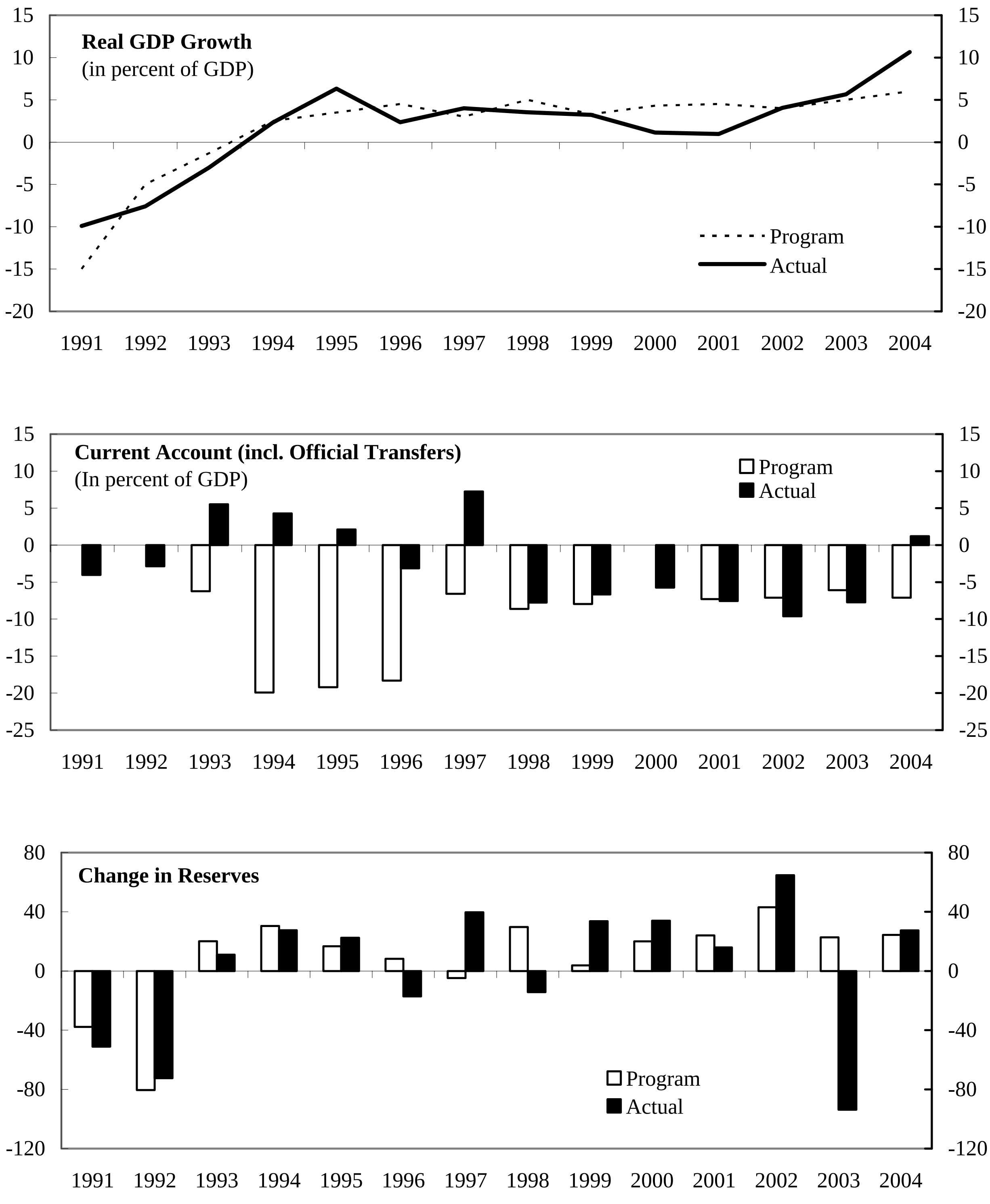
Source: Mongolian authorities and IMF staff estimates.

Figure 3. Mongolia: Monetary Indicators, 1991-2004



Source: Mongolian authorities and IMF staff estimates.

Figure 4. Mongolia: Growth and External Indicators, 1991-2004



Source: Mongolian authorities and IMF staff estimates.

management (PEM), and the authorities' repeated commitments to reducing and controlling spending, the level of expenditures remained high.

27. **With considerable Fund technical assistance, the authorities introduced a range of modern taxes.** Customs duties were raised in 1991 and the Harmonized System implemented in 1993. Major market oriented taxes, such as the corporate income tax (CIT), the personal income tax (PIT), the sales tax and excises were introduced in 1993, albeit in rudimentary form. The VAT replaced the sales tax in 1998. The authorities progressively broadened the tax base. They also progressively reduced the number of customs duty exemptions granted.[6]

28. **Mongolia's tax effort and its revenue productivity (especially that of the VAT) compare favorably with those of countries at similar levels of development.** However, the tax system continues to exhibit areas for improvement. The base of the CIT limits deductions and has no provision for loss carry forward. The dual rates create economic distortions. The threshold of the PIT is low, bringing too many low-income individuals into the tax net. The high level of social security contributions imposes a relatively high tax burden on labor. The VAT has a significant amount of cascading, mainly because the refund system does not work well and there are many exemptions. The system of tax incentives is distortionary and is not cost effective. Similarly, export taxes on raw materials are inefficient and inconsistent with Mongolia's open trade policy.

29. **Despite Mongolia's high level of government spending, the quality of government services is often no better than in countries spending less.** In the early years, the sheer magnitude of the task of rebuilding the fiscal management structure made it difficult to focus on more than a few issues. The interlinkages between different areas of reform reinforced this difficulty. The Fund programs did promote expenditure reforms but often with little success. There seems to have been insufficient incentive for the authorities to follow through on the key reforms that would often be to the disadvantage of interest groups. Recent World Bank studies point to the lack of citizen access to government information as a key constraint. Where priorities were not clearly outlined, the government may have been overwhelmed by the complexity of the task (and distracted by many other policy challenges). The size of the civil service remains large, its composition skewed in favor of support staff, and wage scales highly compressed. Key concerns include:

- Repeated commitments by the authorities in Fund supported programs to implement **civil service** reform were not met.

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[6] In a radical effort to reduce the tax burden and minimize economic distortions customs duties were eliminated in 1997, and the number of rates of the CIT cut to two. The government also reduced the number of PIT rates from five to three. The Fund supported the authorities' decision to re-instate customs duties (albeit at a low uniform rate of 5 percent in 1998) following a decline in revenue caused by a steep fall in export prices. They also abandoned plans to unify CIT rates.

- Key elements for successful reform of the **pension system—**increased retirement age and reduced minimum pension—were not incorporated in the official strategy. Currently, the pension system is not self-financing and has low retirement ages. The contribution base is narrow relative to the coverage, and there are contribution arrears.
- In **education and health—**where the very sparse population outside the capital exacerbates the problems—the reforms failed to eliminate structural inefficiencies.
- **Social assistance** for the poor and vulnerable is badly targeted: some groups (families with children) receive overlapping benefits while others (herders) get none.
- Government **net lending** often circumvents the budget appropriations process and on-lending granted without hard budget constraints.

30. **Since 2002, there has been an enhancement of public financial management.** With support from the World Bank, the government has implemented the Government Financial Management Information System to allow improved fiscal reporting and control over funds. A key feature of the system is the consolidation of government cash balances into the Treasury Single Account (TSA), introduced in 2003 with Fund technical support. FAD technical assistance also helped improve fiscal reporting and to prepare Public Expenditure Management legislation. Further recent work has focused on internal and external audit control functions and cash management capacity. Unfortunately, there is as yet no expenditure tracking survey to improve efficiency.

B. Public Enterprise Restructuring and Privatization

31. **The restructuring and privatization of state-owned enterprises (SOEs) has been a central element of the authorities' reform strategy.** It has been driven by two overriding aims: first, the creation of a market economy after the abandonment of central planning and, second, the restoration of financial viability of SOEs. While the withdrawal of the state from small-scale companies was successful, larger-scale privatizations proved problematic. In addition, many companies remaining in public hands were a heavy burden on the budget, in particular the energy sector, despite tariff increases.

32. **Privatization began in 1991 with divestment of small enterprises and agricultural assets through a voucher scheme.** The use of vouchers for the privatization of medium and large enterprises proved less successful, as the wide dispersion of ownership impeded effective management and the government retained majority ownership of the largest enterprises. The voucher-based privatization program, completion of which was part of Fund conditionality, was concluded by mid-1994, with a delay of about half a year, and accounted for nearly half of state assets.

33. **With the voucher privatization completed, the focus shifted to improving the financial position of SOEs and cash privatization.** Conditionality during 1994 concentrated on raising utility tariffs, establishing orderly financial relations between the state and public enterprises, and comprised privatization targets. However, the financial

position of state-owned enterprises failed to improve sufficiently, in particular in the energy sector. Consequently, the program supported by ESAF II called for further increases in utility tariffs and a more ambitious privatization program. Conditionality covered the key steps, including revenue targets for asset sales. However, progress was again slower than envisaged, with large privatizations delayed and utility price increases insufficient to achieve cost recovery (though conditionality in these areas was met).

34. **The PRGF-supported program in 2001 broadened the restructuring effort, in particular through a comprehensive energy sector reform.** The latter, designed by the World Bank, included, for the first time, eventual privatization in this sector. In other areas, the privatization of other "most-valued companies" was to be reinvigorated. Not included, however, was the country's main exporter and revenue-raiser, the Erdenet Mining Corporation, a joint venture with Russia. In line with streamlining policies implemented at that time, the Fund retreated from conditionality in these areas. This may have been a mistake, but more important would have been monitoring of improvements to operations of the non-privatized enterprises.

35. **Overall, the strategy of restructuring and privatization of SOEs suffered from three interrelated problems.** First, the authorities could have signaled early in the transition the intention to privatize eventually most SOEs; a negative list of enterprises to remain in state hands might have been useful in providing an incentive for enterprises to improve efficiency even before their sale. Second, the legislative and regulatory framework was inadequate. The existence of such a framework, backed by Fund and World Bank conditionality, might also have encouraged the authorities to contemplate earlier the privatization of the energy sector, as proper regulation is a *sine qua non* for the efficient and equitable provision of this especially important service. Third, the early focus on asset sales may have drawn attention away from operational improvements, including costs. A review of the current income positions of the state enterprises shows clearly that, while the 8 joint ventures (led by Erdenet) have significant net income, most of the other 68 enterprises still in the public sector consistently lose money—in 2004 Tg. 25 billion (1½ percent of GDP).

36. **Looking forward, any new Fund-supported program would need to examine clearly the link between the budget and operations of SOEs, in particular the energy sector.** While sector reforms are not in the Fund's core area of expertise, conditionality can be appropriate, where there are direct linkages with the budget. There may be a case for including some enterprises, for instance in the energy sector, in a broader measure of the public sector deficit.

C. Creating a Modern Financial Sector

37. **The current Mongolian financial system is quite extensive, including 17 banks, 115 nonbank financial institutions (NBFI) and 300 savings cooperatives (CSC).** With foreign currency deposits accounting for 37 percent of broad money, Mongolia is also highly dollarised.

38. **All the key elements of MFD technical assistance relevant for Fund arrangements were identified as early as mid 1993.** These included technical assistance in the following areas: monetary management; foreign exchange operations; clearing and payments systems; bank supervision; bank restructuring; and legal issues. Although Fund conditionality was little applied in the early years, Fund arrangements pursued and monitored implementation of recommendations on of these issues.

39. **However, the banking sector has remained consistently vulnerable—**banking crises occurred in 1994, 1996 and 1998/99. Though they were triggered mainly by outside events, a host of factors contributed to and aggravated them: the government or political groups influenced banks' loan decisions, leading to inherited and directed loans; the weak governance structure of banks resulted in connected lending with asset stripping by major shareholders; and banks themselves lacked experience and skills. Furthermore, inappropriate legal settings for enforcement of loan repayments encouraged "intentional bankruptcy" by borrowers. The NBFIs are monitored, but with few resources allocated to their supervision. Meanwhile, the savings cooperatives are not supervised at all and openly ignore legal restrictions. Lastly, the BOM, instead of strictly applying supervision rules, tended to provide emergency credits under favorable terms to the ailing banks.

40. **After the serious banking crisis of 1998/99, the government adopted a comprehensive plan to strengthen the banking system.** The strategy sought to restructure ailing banks, reduce government ownership, improve BOM's ability to enforce compliance with prudential regulations, and strengthen market discipline and incentives for sound bank management. Given its importance, the financial sector accounted for 8 prior actions, 8 performance criteria and a further 12 structural benchmarks in the ESAF II second annual arrangement approved in June 1999.

41. **Despite partial implementation, the plan was successful in restoring confidence in the banking sector, fuelling remonetization.** The ratio of broad money to GDP, which had been almost flat during the 1990s, rose to 47 percent at end-2004 from 25 percent in 2000. Most leading banks, which have grown rapidly in recent years, maintain relatively good financial positions, and there has been some improvement in loan techniques at some individual banks as well as in the application of prudential regulations by the BOM.

42. **However, the financial system is still vulnerable to unexpected shocks, and lending rates remain very high.** Non-performing loans (NPLs) have increased, after the recent rapid credit expansion. Several banks have liquidity constraints and two could have solvency problems if some recent letters of credit operations are not resolved favorably. Despite improvements in some banks, lending practices generally are still weak, with little screening of borrowers in many institutions. Therefore, despite low inflation rates, borrowing rates for all but the best customers remain very high, discouraging productive activity in favor of short-term trading.

43. **Furthermore, although bank supervision has improved noticeably in recent years, the BOM still needs significant strengthening, in both its operations and its balance sheet.**

- *The BOM's capital position is not sound, with losses recorded at times*, because of problems with non-interest earning assets (loans to government) and inadequate internal controls.

- *Several needs identified by the Safeguards Assessments remain,* including the gold operations of the BOM, adherence to the central bank law, treatment of losses, and accountability of activities involving foreign exchange reserves. Although progress has been made to establish independent oversight of the BOM's operations through a supervisory board, that body is not yet sufficiently active.

- *The capacity to take prompt corrective actions against troubled banks needs improvement.* Tighter provisioning requirements, issuance of appropriate warnings, more targeted on-site examinations, and the adoption of an effective risk-based approach to bank supervision based on a comprehensive assessment of risks assumed by banks and the effectiveness of their own controls in mitigating these risks would help in preempting difficulties at an earlier stage.

44. **Overall, while Fund-supported programs, conditionality and technical assistance have contributed to strengthening the Mongolian financial system, significant weaknesses remain.** In any future financial arrangement, the further strengthening of the banking system would need to be a central element of the reform program, in particular in the areas of bank corporate governance, supervision, and strengthening market discipline.

V. PROGRAM CONDITIONALITY AND COMPLIANCE

A. Quantitative Performance Criteria and Benchmarks

45. **Quantitative conditionality was comparable to other arrangements.** Conditions referred to net international reserves (NIR), net domestic assets (NDA of the banking system initially, of the Bank of Mongolia in the PRGF arrangement), net credit to the government, external arrears, and contracting of nonconcessional external debt. Only in the initial SBA was the NDA criterion replaced by one on currency issuance, as the National Bank was split into commercial and central banking entities at the time, precluding the setting of traditional performance criteria on NDA. Some auxiliary performance criteria and indicative targets, designed to monitor specific problem areas, were used in almost all arrangements (Table 2).

46. **Compliance with quantitative conditionality was mixed.** Slower-than-programmed adjustment in the public enterprise sector led to breaches of the NDA targets (or its predecessor, the currency issue target) in the SBA arrangement and through much of ESAF I, as public enterprises were not cut off decisively from financing through the banking system. Also in ESAF I, an adjuster to NIR to reflect deviations of the copper price from projected levels triggered breaches by large margins of the adjusted NIR targets when prices increased, reflecting difficulties in maintaining policy discipline in the face of unexpected windfalls. Such adjusters were subsequently not used. More generally, maintaining policy discipline over the electoral cycle and in the face of non-programmed developments proved difficult. While performance criteria at the time of test dates were mostly met, slippages between test

dates frequently necessitated lengthy re-adjustment to bring programs back on track, and led to delays in completion of reviews.

B. Prior Actions, Structural Performance Criteria and Benchmarks

47. **After the initial SBA when no structural conditions were set, the next three Fund arrangements contained extensive conditionality.** Notably, the first annual arrangement of the ESAF I in 1997 set 19 separate prior actions related to fiscal and banking issues, while the second annual arrangement in 1999 had 29 performance criteria and benchmarks. Such a volume of conditionality indicates the need for corrective measures to bring the structural agenda back on track after the financial crises of 1996 and again 1998. Understandably, the extensive range of prior actions was needed to ensure good starts to each of the arrangements. However, compliance with criteria and benchmarks was poor in the 1999 program. The successor PRGF arrangement had fewer conditions but compliance was again poor, with delays affecting most of the conditions relating to improving budget operations.

48. **Following the guidelines to streamline, a significantly smaller number of conditions accompanied the 2003 completion of PRGF First and Second Reviews.** Those conditions were all met or, in one case, the action required was superseded by an alternative approach endorsed by the staff.

VI. Collaboration with the World Bank

49. **Fund-Bank collaboration was complementary and policy advice was consistent.** The Fund and the Bank have worked closely in areas of overlapping interest, helping to limit conditionality at times. They always agreed on the direction of reforms, although timing differences were important. Both the Fund and Bank staff expressed satisfaction with the collaboration between the two institutions, with overlapping missions and frequent dialogue contributing to resolution of issues as they arose. From the perspective of the authorities, the two agencies were seen as moving closely together, even when there were prolonged delays in the Fund arrangements. While the Fund took the lead on tax policy, revenue administration, establishment of a treasury, and public expenditure management, the World Bank led in a number of fiscal areas, including the medium-term expenditure framework. Its non-lending operations included a public expenditure review and a report on the consequences of large-scale privatization. Similarly, while the Fund took the lead in the macroeconomic aspects of financial sector reform, the World Bank supported bank restructuring and privatization.

50. **Collaboration between Fund and Bank staff was especially important in the PRSP and the PRGF processes.** The most recent World Bank Country Assistance Strategy, approved in April 2004 is broadly aligned with the PRSP, and the framework for the first proposed Poverty Reduction Support Credit (PRSC), focusing on public sector and institutional reform, has been worked out with the authorities but completion has been put on hold while the governance issues are being resolved. Any future Fund-supported program would need to be closely interlinked with the PRSC. One specific area for cooperation will

be technical assistance on both the financial sector and the fiscal operations—especially public expenditure management and civil service/pension reform.

VII. LESSONS FOR PROGRAM DESIGN

51. **The main messages of the four Fund arrangements can be summarized as follows:**

- Macroeconomic performance under the programs was generally good, with the initial output loss manageable while inflation has been broadly kept in check. While revenue overperformance has financed expenditure overruns, allowing fiscal deficits to fall, removal of distortions and some easing of the overall tax burden would likely elicit a positive supply response.
- International reserves have been built up. External debt has grown rapidly and until recently by design, but the situation looks sustainable, and the overhang of pre-1991 CMEA debt was removed.
- Public enterprise reform has been extensive, but remains incomplete.
- The banking system, including the central bank, remains vulnerable despite considerable program conditionality and technical assistance.
- Poverty reduction was not an early priority and has been limited.
- Program conditionality was broadly appropriate with respect to quantitative targets and the main structural agenda. The breadth of the structural changes required meant that conditionality might at times have been too broad.
- Ownership of each program was initially strong, but flagged as events occurred. Favorable copper prices often led to reduced program commitment.

52. **Overall, program design for macroeconomic policies has generally been appropriate.** The level of intended financing provided by the Fund was adequate, given the large amounts of other donor support. All programs assumed that additional aid would be absorbed and spent partially, with a small reserve allowed to boost international reserves, given the external vulnerabilities. Even though the arrangements were frequently delayed and incomplete, the level of official grants and lending from other donors was generally as projected and constant.

53. **However, there appears to have initially been a too relaxed view toward buildup of external and public debt, which had to be corrected later.** For example, the 1993 ESAF envisaged public debt increasing from 26 percent of GDP to over 100 percent in the six years of the medium-term framework, fueled by fiscal deficits as high as 19 percent of GDP and a modest recovery of international reserves. Correctly, the concessional nature of the financing was stressed. For the future, the Fund will have to work closely with the World Bank to prevent a reoccurrence.

54. **Since moving from a peg in 1993, the floating exchange rate policy has proved to be a strong feature of the macroeconomic policies of all three subsequent Fund-supported programs.** Although at times there seems to have been stickiness in the rates at times of shocks, there continued to be a large amount of confidence in the mechanism.

55. **The structural agenda was, of necessity, very broad, but could have provided for greater focus on specific areas.** However, institution building, so critical to the overall success of the transition, has been only partially successful. Thus, notwithstanding the technical assistance provided by the Fund and others, the staff often cited a lack of institutional capacity as a reason for governments not being able to stay the course. The program efforts to improve capacity seem to have been adversely affected by a lack of priority in the very early stages and only partial commitment by the authorities to put in place all the required elements.

56. **Even with the adoption of the EGSPRS in 2003, the linkages of the programs to poverty reduction were limited.** The approved budgets reflected the overall fiscal stance of the EGSPRS but with little regard to the composition of spending. Part of the reason for this "disconnect" is that some of the simple solutions to addressing immediate poverty issues, including spending more on education, health, and the social safety net, are not appropriate, as the levels of spending are quite high. Issues relating to the quality of service provision are relevant, but these are essentially outside the remit of the Fund and best left to the World Bank and other donors.

57. **Governance came to dominate program discussions at the expense of other structural agenda aspects.** The Russian debt settlement—and related transparency issues—was not covered by the PRGF conditionality, but the concerns about governance at the BOM fell squarely within the parameters of the earlier Safeguards Assessment. This raises a critical issue of the effectiveness of the large range of structural conditions relating to the financial sector over the years, which though generally met, may not have targeted governance sufficiently and have not resulted in enough capacity building in this important area within the Fund's expertise.

58. **The failure to complete the Fund-supported programs, even when many of the key objectives were met, suggests lack of sustained ownership.** Each new administration was keen to resume a Fund arrangement and there appeared to be commitment at the highest level of government at the onset of each new program. Yet, none of the programs bridged the frequent changes in government. In the run-up to elections, reforms slowed and afterwards key personnel were changed frequently and initiatives amended. To minimize disruptions of future programs, it would appear important to encourage broad agreement across parties on the key measures to be undertaken—perhaps including through formal means such as declarations of opposition parties to support the program. This may take some time, delaying the process, but would probably improve implementation.

Figure 5. Mongolia: Structural Conditionality, 1991-2004
(Types of Conditions)

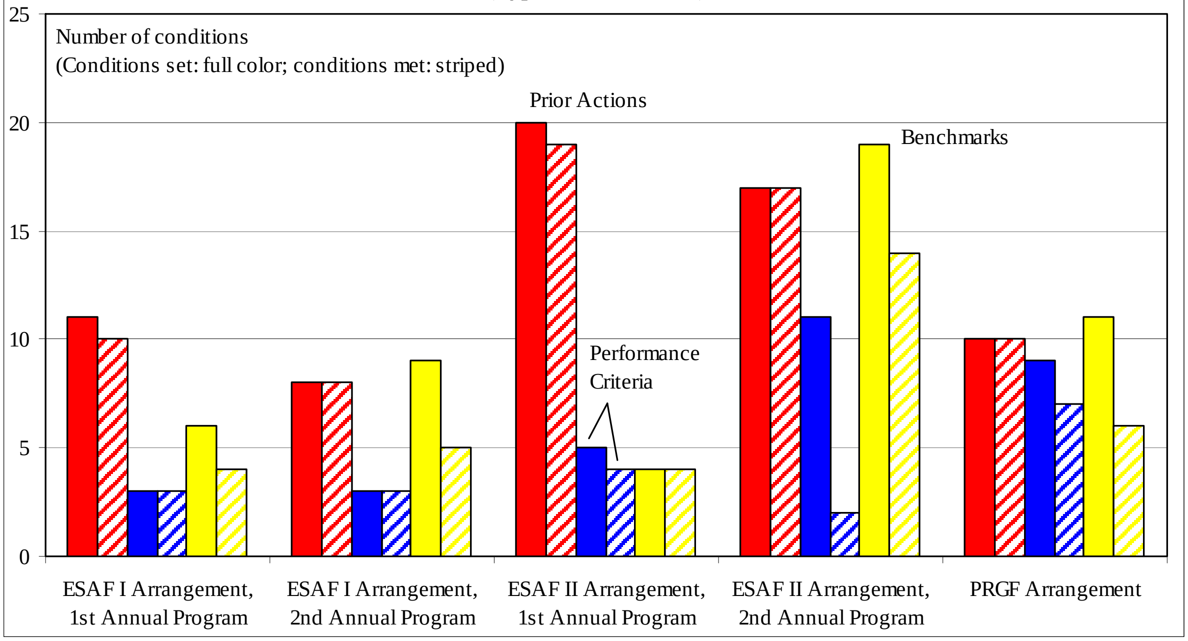
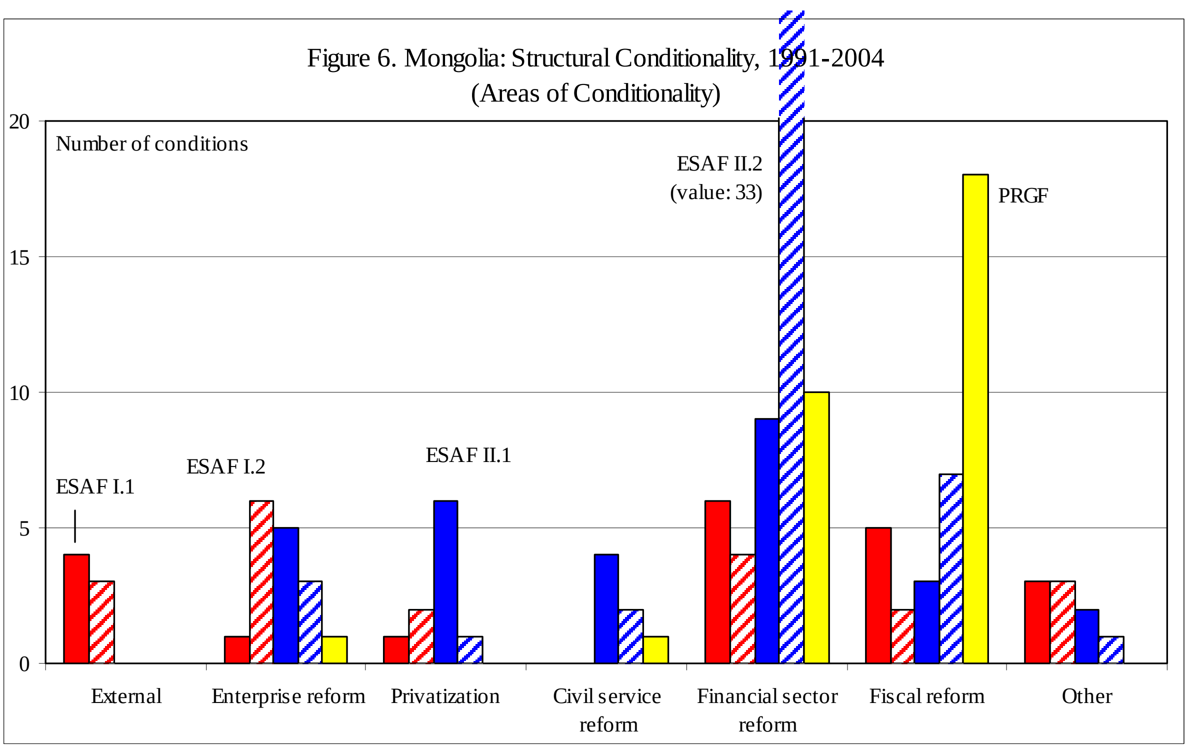


Figure 6. Mongolia: Structural Conditionality, 1991-2004
(Areas of Conditionality)



VIII. MEDIUM TERM DEVELOPMENT GOALS AND STRATEGY FOR FUTURE FUND ENGAGEMENT

59. **While there are dangers in remaining reliant on one sector for exports and revenue—mining—to boost the incomes of a low-productivity livestock-based economy, there are no real alternatives in the medium term.** Nor does it seem that the mineral wealth is only a transitory resource to be treated as a windfall. Mongolia needs to exploit its mineral wealth as efficiently as possible and use that wealth to reduce, if not eliminate, its vulnerability to external and domestic shocks and underlying poverty. Much progress is needed if the Millennium Development Goals are to be met. A major task will be to generate greater employment, given the limited opportunities arising from modern mining technology.

60. **The endowment with natural resources poses two key challenges for Mongolia's medium-term strategy.**

- *First, the distribution of uses of mineral wealth.* The competing demands of poverty reduction, employment creation and economic diversification on one hand, and reduction of vulnerabilities through the creation of reserves call for a well-designed medium-term fiscal strategy that balances these needs. Modern mining technology limits the direct employment opportunities in the sector. Use of revenues from the mineral export sector would need to be carefully calibrated to minimize the emergence of the Dutch Disease. To assess the fiscal position, a commodity revenue adjusted deficit measure could be used. Estimating the net value of Mongolia's known copper and gold deposits would allow consideration of the optimal path of the natural resource wealth consumption over time.

- *Second, and relatedly, the prevention of the resource curse.* The large share of extractive industries in the economy creates, apart from the political risks it carries, the familiar risks of spending public resources on unproductive activities, such as patronage-driven increases in the civil service, or more serious governance problems. While such governance problems are to a degree outside the Fund's core area of responsibility, there are macroeconomic and structural policies that can assist in reducing the probability of serious misappropriation of resources.

61. **An enhanced Medium Term Budget Framework would go a long way to bringing together and prioritizing the poverty and macroeconomic agendas.** This would need to replace and subsume the current mixture of MTBF, policy guidelines, EGSPRS, social action plans and the like. It is not possible for the 2006 budget announced in October 2005 to be grounded in such a document, given the time lags involved but its development could be the core of donor-supported programs for 2006.

62. **With macroeconomic imbalances receding, the country faces a range of viable policy options.** Should fiscal space be used to reduce distortions in the tax system as well as reduce the tax burden, reduce high levels of external debt or raise public spending rather than improve the quality of its composition? Given its relatively high tax ratio, Mongolia may reasonably prefer to give higher priority to revenue-neutral reforms that aim at improving the

efficiency of the tax system, widening the tax base, and improving revenue administration. All of which would allow for marginal reductions in rates. In terms of expenditure priorities, focus needs to be given to civil service and pension reform, improving the quality of health and education spending, greater targeting of the social safety net, and stopping the abuse of net lending to circumvent budget appropriations. In addition, public expenditures should be geared towards increasing the overall productivity of the economy.

63. **On the other hand, Mongolia's external debt is considerably more than the 40 percent threshold above which the risk of debt distress increases markedly.** Though much of the debt is concessional, further borrowing must be carefully monitored, and reserves be built. This is particularly important, as Mongolia is already becoming a possible recipient of very large commercially based lending proposals aimed at major infrastructure projects.

64. **The strengthening of key economic institutions and policies would need to be the decisive element of the structural reform agenda going forward.** In particular, monetary policy is likely to become increasingly important as monetization trends weaken while the floating exchange rate would continue to ensure competitiveness and contain external vulnerabilities. Efforts to establish modern financial systems are clearly still a work in progress and the possibility of a fourth banking crisis cannot be ruled out. Concentration on building up the supervision and monetary policy role of the BOM would thus be appropriate. Such efforts would need to focus on enhancing the legal framework as well as changes in structure and operations to enhance the capacity of the institution. While the financial system deserves priority, other institutions that should be built up over time would include the tax and budget departments as well as regulatory bodies to oversee the public utilities as they are corporatized or sold to the private sector. To underpin sound fiscal policies, further steps also will be needed in the area of public enterprise restructuring and privatization.

65. **The scale and duration of the structural reforms Mongolia still needs to address suggest that the country cannot be expected to graduate soon from the use of Fund resources.** As such, an explicit exit strategy may not be appropriate yet. However, the role of Fund financing is very much one of catalyst—PRGF resources would be small in relation to total donor financing (and are not nearly as concessional as those of the World Bank), while other external inflows could be considerable. This suggests that future involvement should be based on low access and focus on the value of the operational framework a Fund arrangement provides for the authorities—something welcomed by all current and former official Fund counterparts.

66. **The prominence that institution building is likely to take in any future Fund-supported program would also require further technical assistance to complement program conditionality.** The provision of technical assistance by the Fund will be critical in helping achieve key structural improvements, in particular for the BOM and tax administration. The World Bank could take the lead in other areas, such as civil service restructuring. Joint assistance may be considered for pension reform and provision of an effective and affordable social safety net.

67. **The EPA team sees a strong case for a continued close policy dialogue between the Fund and the Mongolian authorities, backed if possible by a financial arrangement.** Macroeconomic stability remains fragile, tax and expenditure reforms need to be enhanced further, and the financial sector strengthened—all areas of Fund expertise. The current strength of the economy and external prospects indicate that there is time to build up both a track record of adherence to prudent macroeconomic policies and cautious structural reform and to build a consensus among the various political parties and civil society for major reforms of key institutions and governance. Conversely, a new PRGF-supported program should not in fact go forward unless there is such a political consensus in favor of a critical mass of structural reforms. Otherwise, the election cycle will continue to provide excuses for delays and slippage. In this goal, the presence of a coalition government of both main parties should be useful. The current pause in Fund financial involvement in Mongolia has provided a useful period for reflection on the direction of policies. However, an extended delay in resuming discussions could undermine the value of Fund involvement during the critical period as the coalition government sets its medium term fiscal strategy.

68. **The main risk to a future Fund-supported program would come from the evolving political situation.** The periods of uneven policy-making have coincided with the various election events. Nevertheless, the broad political support for Fund involvement should be leveraged to produce concrete steps to address governance issues that can underpin a broader growth strategy led by both the private and public sectors. An external public relations policy under a successor program would help prepare public perceptions for the focus on governance.

Table 1. Mongolia: Selected Economic Indicators, 1991–2004

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
(Percent change)														
Real GDP	-9.9	-7.6	-3.0	2.3	6.3	2.4	4.0	3.5	3.2	1.1	1.0	4.0	5.6	10.6
Consumer prices (end period)	208.6	321.0	183.0	66.3	53.1	44.6	20.5	6.0	10.0	8.1	7.9	1.7	4.7	10.6
(In percent of GDP)														
General government revenue	47.4	24.9	34.2	30.3	25.6	24.8	25.5	27.6	27.2	34.5	38.5	38.4	37.9	39.4
Taxes, fees and charges	42.7	22.5	31.2	23.7	19.2	18.7	19.7	18.8	19.7	25.6	29.4	28.9	28.8	32.3
Nontax	4.7	2.4	1.2	5.2	5.5	5.4	5.0	7.7	6.8	8.4	8.2	8.9	8.5	6.8
Grants	0.0	0.0	1.8	...	0.9	0.7	0.7	1.0	0.7	0.5	0.8	0.6	0.6	0.3
General government expenditure	57.1	35.9	49.9	40.5	31.5	32.7	34.5	41.9	39.4	41.5	43.9	44.4	42.1	41.7
Current expenditure	51.7	23.6	25.8	25.7	18.4	20.1	23.1	27.2	26.7	30.8	32.9	33.5	29.8	29.9
Wages and salaries	9.8	6.1	5.2	5.7	4.9	5.7	5.4	6.8	6.9	8.5	8.3	8.5	8.0	7.7
Capital expenditure and net lending	5.4	12.3	24.1	14.9	13.0	12.6	11.4	14.6	12.7	10.6	11.0	10.9	12.4	11.8
Current balance	-4.3	1.4	6.6	3.2	6.2	4.0	1.6	-0.7	-0.2	3.2	4.8	4.4	7.6	9.2
Overall balance	-9.7	-10.9	-15.8	-10.3	-5.9	-7.9	-9.1	-14.3	-12.2	-7.0	-5.4	-5.9	-4.2	-2.2
Foreign financing (net)	9.7	9.3	12.0	5.4	7.3	5.4	11.1	8.4	11.4	6.5	6.5	6.6	-7.9	3.8
Domestic financing	0.0	1.6	3.7	4.8	-1.4	2.5	-2.0	5.9	0.8	0.5	-1.1	-0.7	12.1	-1.6
Total public debt	212.9	143.8	62.4	52.8	43.4	63.4	65.7	91.8	104.7	98.8	89.1	91.7	113.9	99.0
NPV of total public debt	148.3	102.2	29.9	28.2	29.6	45.7	46.3	65.8	74.8	67.0	62.8	62.7	80.2	60.2
(Percent change)														
Broad money	53.5	31.7	227.6	79.5	32.9	25.8	32.5	-1.7	31.7	17.5	28.0	41.9	49.7	20.3
Reserve money	...	142.6	184.5	103.8	29.0	36.4	26.2	13.5	51.8	19.4	8.4	21.7	14.7	16.8
Velocity (GDP/M2)	9.0	4.0	3.9	3.7	5.4	5.0	5.5	5.0	4.3	4.0	3.4	2.6	2.1	2.1
(In percent of GDP)														
Current account balance, including official transfers	-4.0	-2.9	5.5	4.3	2.1	-3.1	7.3	-7.8	-6.7	-5.7	-7.6	-9.6	-7.7	1.2
Financial and capital account balance	...	...	-1.7	-5.4	-2.8	0.9	-1.8	4.8	8.3	9.3	9.0	15.6	0.1	0.7
Exports, fob (percent change)	-22.1	2.7	2.8	0.3	32.0	-12.6	34.3	-18.7	-1.8	18.0	-2.4	0.1	19.7	39.0
Imports, cif (percent change)	-51.0	-16.5	-10.5	-1.1	32.0	4.5	5.4	8.2	-2.6	19.2	2.5	8.6	9.8	23.5
Export prices (percent change)	...	-7.5	-9.8	22.9	22.3	-21.6	6.8	-18.1	-7.0	13.6	-11.6	-4.7	6.6	23.1
Import prices (percent change)	...	-3.5	-2.6	4.3	9.1	2.6	-0.4	-6.8	-2.4	2.5	-2.3	2.3	5.4	15.1
Terms of trade (percent change)	...	-4.1	-7.2	17.9	12.2	-23.6	7.2	-12.1	-4.8	10.8	-9.5	-6.9	1.1	7.0
(In millions of U.S. dollars; unless otherwise indicated)														
Gross official reserves	126.3	53.9	64.9	92.4	114.9	97.8	137.5	123.2	156.8	190.9	206.8	271.5	177.7	205.1
(in weeks of imports of goods)	13.1	7.0	9.0	13.0	12.2	10.0	13.3	11.0	14.4	14.7	15.5	18.8	11.2	10.4
Change in reserves	-51.1	-72.4	11.0	27.5	22.5	-17.1	39.7	-14.3	33.6	34.0	15.9	64.7	-93.8	27.4
External public debt service (in percent of exports)	...	17.3	6.5	11.0	12.2	11.8	6.3	6.7	5.7	3.8	5.3	4.5	34.0	7.5
Nominal GDP (billions of togrogs)	19	47	166	283	550	647	833	817	925	1,019	1,116	1,241	1,461	1,808
Nominal GDP (millions of U.S. dollars)	2,360	1,320	563	880	1,227	1,179	1,054	972	906	946	1,016	1,118	1,274	1,516

Table 2. Mongolia: Quantitative Conditionality, 1991-2004

	SBA (Oct. 4, 1991 - Dec. 31, 1992) Indic. Prog.					ESAF I (June 25, 1993 - June 24, 1996)															
	1991	1992				1993				1994				1995				1996			
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Number of targets	6	6	8	8	8	8	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7
Of which: Met	5	3	4	4	7	7	5	4	5	4	4	5	5	4	4	5	6	...	...	...	...
Net domestic assets (ceiling, in billions of tugrik) 1/																					
Target							22.8	25.1	**24.6**	27.3	32.0	50.6	55.3	**58.2**	63.2	68.4	70.4	84.8	91.1	91.9	90.2
Outcome							2.5	32.4	**25.6**	33.4	39.7	49.7	55.3	**64.5**	71.1	71.0	66.1				
Met?							*yes*	*no*	*no*	*no*	*no*	*yes*	*yes*	*no*	*no*	*no*	*yes*				
Net credit to the government (ceiling, in billions of tugrik)																					
Target	**-1.4**	**-1.3**	**-1.8**	**-1.7**	-1.7	-1.7	-4.0	-3.9	**-4.1**	-7.9	-8.6	-0.9	-5.4	**-5.8**	-6.6	-7.0	-7.5	-3.5	-3.5	-6.5	-9.5
Outcome	**-1.7**	**-1.7**	**-1.9**	**-2.2**	-2.6	-3.2	-2.8	-4.6	**-6.7**	-6.6	-6.8	0.9	0.9	**2.4**	2.2	-8.9	-18.3				
Met?	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*no*	*yes*	*yes*	*no*	*no*	*no*	*no*	*no*	*no*	*yes*	*yes*				
NIR stock (floor, in millions of US$) 2/																					
Target	**9.6**	**17.5**	**12.9**	**46.9**	3.0	6.0	15.1	15.6	**16.6**	19.0	21.5	37.5	50.8	**91.2**	112.0	136.0	154.6	52.5	55.0	57.5	60.0
Outcome	**18.0**	**7.7**	**-10.6**	**9.0**	5.4	14.5	8.9	2.8	**27.2**	37.8	31.3	38.7	37.2	**45.8**	42.4	53.8	50.0				
Met?	*yes*	*no*	*no*	*no*	*yes*	*yes*	*no*	*no*	*yes*	*yes*	*yes*	*yes*	*no*	*no*	*no*	*no*	*no*				
External arrears (ceiling, in millions of US$) 3/																					
Target			**29.0**	**6.0**	-17.7	-31.7	24.6	20.1	**15.5**	7.8	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Outcome			**50.8**	**57.2**	-5.5	-23.5	21.4	22.4	**28.2**	15.1	14.1	8.4	0.0	**0.0**	0.0	0.0	0.0				
Met?			*no*	*no*	*no*	*no*	*yes*	*no*	*no*	*no*	*no*	*no*	*yes*	*yes*	*yes*	*yes*	*yes*				
New nonconcessional external debt (ceiling, in millions of US$)																					
0-1 years																					
Target	**0.0**	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Outcome	**0.0**	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0				
Met?	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*				
1-12 years																					
Target	**30.0**	**30.0**	**21.8**	**21.8**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Outcome	**20.0**	**21.8**	**21.8**	**21.8**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0				
Met?	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*				
o/w: 1-5 years																					
Target	**10.0**	**10.0**	**21.8**	**21.8**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Outcome	**20.0**	**21.8**	**21.8**	**21.8**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0				
Met?	*no*	*no*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*	*yes*				
TEMPORARILY USED TARGETS																					
Currency issue (ceiling, in billions of tugrik)																					
Target	**2.2**	**2.0**	**2.5**	**2.7**																	
Outcome	**2.0**	**2.1**	**2.7**	**2.9**																	
Met?	*yes*	*no*	*no*	*no*																	
Cumulative change in net credit of Central Bank to commercial banks (ceiling, in billions of tugrik)																					
Target			**1.0**	**0.9**	0.0	0.0															
Outcome			**3.2**	**0.9**	-0.1	-0.3															
Met?			*no*	*no*	*yes*	*yes*															
Net credit to state enterprises and private sector (ceiling, in billions of tugrik)																					
Target					22.5	24.0															
Outcome					19.3	22.8															
Met?					*yes*	*yes*															

1/ Of the banking system in ESAF I and II; of the Bank of Mongolia in PRGF.
2/ In the indicative program December 1992 - March 1993 refers to change in reserves.
3/ In the indicative program December 1992 - March 1993 refers to change in arrears.
Bold numbers indicate test dates

Table 2. Mongolia: Quantitative Conditionality, 1991-2004 (concluded)

	ESAF II (July 30, 1997 - July 29, 2000)																PRGF (September 28, 2001 - July 31, 2005)												
	1997				1998				1999				2000				2001				2002				2003				2004
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Number of targets	0	9	9	9	9	9	0	0	0	7	7	7	7	0	0	0	0	0	8	8	8	8	0	8	8	8	8	8	8
Of which: Met	...	7	9	9	...	...	...	...	...	4	7	...	...	...	...	...	...	...	...	5	5	5	...	7	6	8	...	...	...
Net domestic assets (ceiling, in billions of tugrik) 1/																													
Target		68.4	75.6	**49.7**	63.3	80.9				14.4	**10.1**	-2.9	-1.5						-24.8	**-27.3**	-31.1	**-27.7**		-62.0	-57.4	-61.8	**-68.8**	-81.7	**-76.5**
Outcome		65.3	59.2	**39.0**						28.6	**9.5**									**-30.4**	-32.6	**-10.1**		-67.0	-58.6	-68.3			
Met?		*yes*	*yes*	*yes*						*no*	*yes*									*yes*	*yes*	*no*		*yes*	*yes*	*yes*			
Net credit to the government (ceiling, in billions of tugrik)																													
Target		0.0	43.1	**32.9**	19.5	21.7				63.5	**53.7**	57.1	66.1						-7.1	**-16.2**	-0.9	**1.0**		-26.5	10.9	39.1	**-5.0**	-20.8	**5.0**
Outcome		39.2	32.6	**19.9**						68.7	**44.2**									**-18.7**	4.3	**9.3**		-27.7	-4.5	-13.0			
Met?		*no*	*yes*	*yes*						*no*	*yes*									*yes*	*no*	*no*		*yes*	*yes*	*yes*			
NIR stock (floor, in millions of US$)																													
Target		28.7	37.6	**67.1**	83.2	83.5				60.0	**75.0**	87.5	72.5						148.2	**159.7**	163.0	**166.8**		188.5	214.5	215.7	**245.0**	250.0	**250.0**
Outcome		59.4	80.5	**92.0**						58.8	**84.0**									**158.9**	159.7	**169.3**		219.4	212.7	233.9			
Met?		*yes*	*yes*	*yes*						*no*	*yes*									*no*	*no*	*yes*		*yes*	*no*	*yes*			
External arrears (ceiling, in millions of US$)																													
Target		4.5	4.5	**0.0**	0.0	0.0				0.0	0.0	0.0	0.0						0.0	**0.0**	0.0	**0.0**		0.0	4.1	0.0	**0.0**	0.0	**0.0**
Outcome		4.5	0.5	**0.0**						0.0	0.0									**4.8**	0.0	**0.0**		0.0	0.0	0.0			
Met?		*yes*	*yes*	*yes*						*yes*	*yes*									*no*	*yes*	*yes*		*yes*	*yes*	*yes*			
New nonconcessional external debt (ceiling, in millions of US$)																													
0-1 years																													
Target		0.0	0.0	**0.0**	0.0	0.0				0.0	**0.0**	0.0	0.0						10.0	**0.0**	0.0	**0.0**		0.0	0.0	0.0	**0.0**	0.0	**0.0**
Outcome		0.0	0.0	**0.0**						0.0	**0.0**									**0.0**	0.0	**0.0**		0.0	0.0	0.0			
Met?		*yes*	*yes*	*yes*						*yes*	*yes*									*yes*	*yes*	*yes*		*yes*	*yes*	*yes*			
1-12 years																													
Target		0.0	0.0	**0.0**	0.0	0.0				0.0	**0.0**	0.0	0.0						0.0	**0.0**	0.0	**0.0**		0.0	0.0	26.5	**26.5**	26.5	**26.5**
Outcome		0.0	0.0	**0.0**						0.0	**0.0**									**0.0**	0.0	**0.0**		0.0	0.0	26.5	**0.0**	0.0	**0.0**
Met?		*yes*	*yes*	*yes*						*yes*	*yes*									*yes*	*yes*	*yes*		*yes*	*yes*	*yes*			
o/w: 1-5 years																													
Target		0.0	0.0	**0.0**	0.0	0.0				0.0	**0.0**	0.0	0.0						...	...	...	...		...	...	...	...	...	...
Outcome		0.0	0.0	**0.0**						0.0	**0.0**								...	...	...	...		...	...	...	...	...	...
Met?		*yes*	*yes*	*yes*						*yes*	*yes*								...	...	...	...		...	...	...	...	...	...
TEMPORARILY USED TARGETS																													
Net domestic financing of general government (ceiling, in billions of tugrik)																													
Target (at approval of arrgt.)		-10.0	-3.6	**-13.8**	-1.7	2.2																							
Outcome		-7.5	-14.1	**-26.8**																									
Met?		*no*	*yes*	*yes*																									
Privatization receipts (floor, iin billions of tugrik)																													
Target (at approval of arrgt.)		4.0	5.0	10.0	2.0	6.0																							
Outcome		4.1	7.1	13.0																									
Met?		*yes*	*yes*	*yes*																									
Domestic interest arrears (ceiling, in billions of tugriks)																													
Target (at approval of arrgt.)																			0.0	**0.0**	0.0	**0.0**		0.0	0.0	0.0	**0.0**	0.0	**0.0**
Outcome																			0.0	**0.0**	0.0	**0.0**		0.0	0.0	0.0			
Met?																				*yes*	*yes*	*yes*		*yes*	*yes*	*yes*			
Indicative target: NDA of the banking system (ceiling, in billions of tugrik)																													
Target (at approval of arrgt.)																			84.3	**71.7**	80.5	**93.2**		169.5	198.2	254.6	**240.0**	252.0	**269.5**
Outcome																				**113.2**	127.6	**178.3**		172.3	199.2	239.4			
Met?																				*no*	*no*	*no*		*no*	*no*	*yes*			

1/ Of the banking system in ESAF I and II; of the Bank of Mongolia in PRGF.
Bold numbers indicate test dates.

Table 3. Mongolia: Summary of Structural Conditionality, 1991-2004

	Prior Actions		Performance Criteria		Benchmarks		Area of Conditionality						
	Set	Met	Set	Met	Set	Met	Fiscal reform	Financial sector reform	Enterprise reform	Privatization	Civil service reform	External	Other
Stand-By Arrangement, 1991-92							No structural conditionality						
ESAF I Arrangement, 1st Annual Program													
At approval (June 25, 1993)	6	6	3	3	6	4	4	4	1	1	0	2	3
Mid-term review (March 16, 1994)	5	4	--	--	--	--	1	2	0	0	0	2	0
ESAF I Arrangement, 2nd Annual Program													
At approval (November 23, 1994)	8	8	3	3	9	5	2	4	6	2	0	3	3
Mid-term review (February 14, 1996)					Implementation of program to meet conditions to complete review.								
ESAF II Arrangement, 1st Annual Program													
At approval (July 24, 1997)	19	18	5	4	4	4	3	9	5	5	4	0	2
Mid-term review (April 8, 1998)	1	1	--		--	--	0	0	0	1	0	0	0
ESAF II Arrangement, 2nd Annual Program													
At approval (June 10, 1999)	9	9	10	2	19	14	4	28	2	1	2	0	1
Mid-term review (January 24, 2000)	8	8	1	0	--	--	3	5	1	0	0	0	0
PRGF Arrangement													
At approval (September 28, 2001)	8	8	5	3	7	3	15	3	1	0	1	0	0
First and Second Reviews (September 12, 2003)	2	2	4	4	4	3	3	7	0	0	0	0	0
Total	66	64	31	19	49	33	35	62	16	10	7	7	9

Table 4. Mongolia: Structural Conditionality, 1991–2004

	Date	Implementation	
		Yes/No	Remarks
Stand-By Arrangement, 1991-92: No structural conditionality			
ESAF I Arrangement, 1st Annual Program			
At approval (June 25, 1993)			
Prior Actions			
Exchange system reform including transfer of foreign exchange reserves and their management to the Bank of Mongolia and establishment of prudential guidelines for banks.	--	Yes	
Implementation of the sales tax.	--	Yes	
Introduction of a reserve measure on copper concentrate.	--	Yes	
Adjustment of the minimum interest rate on commercial bank deposits.	--	Yes	
Issuance of revised trade policy regulations.	--	Yes	
Elimination of remaining mandatory state orders.	--	Yes	
Structural Performance Criteria			
Elimination of domestic public sector arrears and implementation of strict rules on payments by budget units and state enterprises; and establishment of regulations on seizure of assets, in case of nonpayment by nonbudgetary units	30-Sep-93	Yes	
Refrain from introducing export licensing and quotas except for bona fide purposes (with exception of licensing of live animals, meat, and wheat, which will be considered at the midterm review); and export taxes other than royalty-	Continuous	Yes	
Identification of nonperforming loans of the banking system and finalization of procedures for dealing with such loans. In addition, progress in implementing these procedures will be examined as part of the mid-term review of the	31-Dec-93	Yes	
Structural Benchmarks			
Establishment of treasury function in Ministry of Finance.	31-Dec-93	Yes	
Elimination of consumer rationing and replacement with need-based support.	31-Dec-93	Yes	
Enact securities law as a basis for secondary market trading of corporate shares and other financial securities.	31-Mar-94	No	Delay
Create unit within Ministry of Finance to register and manage external debt.	30-Sep-93	Yes	
Complete the voucher-based privatization program.	31-Dec-93	No	Delay
Establish new procedures of corporate governance for remaining state-owned enterprises including requirements for fixed term performance based management contracts and outside Boards of Directors.	31-Dec-93	Yes	
Mid-term review (March 16, 1994)			
Prior Actions			
Introduce excise tax on petroleum products.	--	Yes	
Remove import duty exemptions on flour and other food items.	--	Yes	
Higher reserve requirements for commercial banks.	--	Yes	
Announcement of bank lending ceilings through March.	--	Yes	
Finalization of rescheduling agreements.			
ESAF I Arrangement, 2nd Annual Program			
At approval (November 23, 1994)			
Prior Actions			
Increase urban bus fares by 200 percent.	--	Yes	
Terminate central bank lending to public enterprises.	--	Yes	
Establish the monthly repayment schedule of outstanding budgetary loans by public sector flour mills and the power	--	Yes	
Agree that all receipts from cash privatization will be incorporated in the budget and earmarked for public	--	Yes	
Increase the price of gasoline by 25 percent.	--	Yes	
Prepare a list for cash privatization of public enterprises and a timetable for their sale, with the intention of yielding at least Tug 2 billion for the 1995 budget.	--	Yes	
Eliminate remaining external payments arrears.	--	Yes	
Increase electricity tariffs for commercial use by 28 percent and heating tariffs by 60 percent on average.	--	Yes	
Structural Performance Criteria			
Establish a regulatory commission to review the tariffs for public utilities and to introduce a mechanism for	31-Mar-95	Yes	
Introduce central bank refinancing facility.	31-Mar-95	Yes	
Refrain from introducing new restrictions and conditions (licensing, quota, and taxes) on exports, except for royalty-type tax@ on nonrenewable resources and limits for environmental, cultural, and security reasons.	Continuous	Yes	

Table 4. Mongolia: Structural Conditionality, 1991–2004 (Continued)

	Date	Implementation	
		Yes/No	Remarks
Structural Benchmarks			
Enact legislation on land ownership and other property rights.	31-Dec-94	Yes	
Identify and rectify remaining g legal and regulatory constraints on foreign direct investment.	31-Dec-94	Yes	
Adjust the prices of petroleum products other than gasoline.	31-Dec-94	Yes	
Raise domestic heating tariffs for residential use by 60 percent.	15-Jan-95	Yes	
Sell one fourth of the list of public enterprises earmarked for cash privatization in 1995.	31-Mar-95	No	Delay
Complete repayment of outstanding directed credits.	31-Dec-94	No	Partially
Undertake provisioning against losses and recapitalization of banks on the basis of recommendations made by the	31-Mar-95	No	Partially
Abolish the ban on raw cashmere exports.	31-Mar-95	No	Envisaged 10/96
Agree on a timetable for implementation of improvements in price, government finance, and balance of payments	31-Mar-95	Yes	
Mid-term review (February 14, 1996)			
A program was implemented to meet conditions for completing the midterm review, including observance of the monthly targets for budget revenue and expenditure, net official international reserves, net credit to government, and net domestic assets of the banking system for October-December 1995; and the development of a financial and structural program for 1996, consistent with existing commitments.			
ESAF II Arrangement, 1st Annual Program			
At approval (July 24, 1997)			
Prior Actions			
Agreement on, and parliamentary passage of, an amended 1997 budget and associated tax legislation.	--	Yes	
Agreement on a quarterly financial program for the first year of the program and achievement of the targets for March and June 1997.	--	Yes	End-March achieved
Establishment of an Economic Policy Committee, including senior representatives of the of the Office of the Prime Minister, the Ministry of Finance, the Bank of Mongolia, and Parliament.	--	Yes	
Maintenance of significantly positive real interest rates on central bank bills and government securities.	--	Yes	
Agreement on a framework for linking civil service wage increases to economies achieved in staffing.	--	Yes	
Agreement on a maximum civil service wage bill for 1997 of Tug 46.8 billion, including severance payments of no more than 6 months' pay, with any additional nominal wage increase only to be awarded on the basis of already-	--	Yes	
Implementation of a comprehensive monitoring system for the wage bill, wage rates, and civil service employment levels on a quarterly basis.	--	Yes	except employment monitoring
Agreement on a list of enterprises and assets to be privatized by the end of each year and passage of legislation to abolish reservation prices.	--	Yes	
Achievement of privatization sales of at least Tug 4 billion, including at least one large enterprise.	--	Yes	
Establishment of quarterly structural benchmarks for privatization sales for the first year of the program.	--	Yes	
Repayment in full by April 1, 1997 of the $10 million (equivalent) borrowed by the Neft Import Concern (NIC) from the government in 1996. Commencing March 1997, the government and the Bank of Mongolia to refrain from providing further loans or loan guarantees to the NIC.	--	Yes	
Development of a system for monitoring financial support-including budgetary subsidies, grants, lending, government guarantees, and bank credit-for seven large public enterprises.	--	Yes	
Completion of the liquidation procedures for the Ardyn and Insurance Banks, including all book entries, and allocation of all their assets and liabilities to the successor institutions, and the issuance of government bonds for	--	Yes	except bonds to TDB
Completion of special inspections of the Savings Bank and Reconstruction Bank, introduction of written internal regulations; and enforcement of capital adequacy rules.	--	Yes	
Replacement of all nonperforming assets of the Reconstruction Bank with government bonds and the transfer of these nonperforming assets to MARA.	--	Yes	
MARA to be fully operational and preparation of monthly financial statements.	--	Yes	
Strict enforcement of the Bank of Mongolia's MOUs with BIT1 and Agricultural Bank; implementation of a corrective strategy if necessary.	--	Yes	
Elimination of passive clearing loans by BOM to banks.	--	Yes	
Amendment of the civil code and other necessary legislative steps to streamline the procedures for debt collection and the disposal of collateral.	MT review	?	

Table 4. Mongolia: Structural Conditionality, 1991–2004 (Continued)

	Date	Implementation	
		Yes/No	Remarks
Structural Performance Criteria			
Contain growth of overall wage bill to 30 percent in 1997.	31-Dec-97	Yes	
Implement interim treasury system and consolidate all government accounts into a single treasury account at the central bank.	31-Dec-97	No	alternative measures implemented
External audit of the Bank of Mongolia.	31-Dec-97	Yes	
Increase energy prices by an amount to achieve full operating cost recovery.	31-Dec-97	Yes	
Achieve privatization sales of Tug 10 billion for cash privatization receipts.	31-Dec-97	Yes	
Structural Benchmarks			
Plan to extend sales tax base to trade and service sectors and implement credit mechanism with a view to implementing a VAT in 1998.	31-Dec-97	Yes	
Eliminate subsidies and concessional lending to all enterprises, except to enterprises being restructured under ASDB and World Bank programs loans, and subsidies for urban public transport.	31-Dec-97	Yes	
Implement a mechanism for automatic monthly adjustments in energy prices to compensate for changes in import prices and the exchange rate.	31-Dec-97	Yes	
Achieve privation sales of at least Tug 5 billion, including at least one large enterprise.	30-Sep-97	Yes	
Mid-term review (April 8, 1998)			
Prior Actions			
Issuance of a short list of ten large enterprises which are being readied for sale.	--	Yes	
ESAF II Arrangement, 2nd Annual Program			
At approval (June 10, 1999)			
Prior Actions			
Parliamentary approval of a supplementary budget for 1999 consistent with understandings with Fund staff.	--	Yes	
Establish a High Level Steering Committee (HLSC) for banking sector reform.	--	Yes	
Establish a Restructuring Working Group (RWG) with participation of IMF, AsDB, USAID, and the World Bank.	--	Yes	
Parliamentary approval of bank restructuring strategy.	--	Yes	
BOM to draft legal amendments to strengthen provisions related to conservatorship, receivership, and recovery of	--	Yes	
Appoint conservators at Reconstruction Bank (RB), IT1 Bank, and Agriculture Bank (AB).	--	Yes	
Appoint external advisors at RB, ITI Bank, and AB to assist conservators in rationalizing operations.	--	Yes	
Initiate international financial and portfolio audits of 1998 accounts of RB, IT1 Bank, and AB.	--	Yes	
Issue licencing, prudential, and regulatory framework for all types of nonbank financial intermediaries.	--	Yes	
Structural Performance Criteria			
Bring Trade and Development Bank to the point of sale.	30-Sep-99	No	
RB: Bring the bank to the point of sale.	30-Sep-99	No	
ITI Bank: Recapitalize with private capital; if recapitalization fails, bring the bank to the point of sale.	30-Sep-99	No	
AB: Prepare a plan, based on the recommendations of an external consultant, to decouple the bank's government payment functions from commercial bank operations.	30-Sep-99	Yes	
RB: Appoint receiver under the Banking Law, as necessary, if sale does not materialize.	31-Dec-99	Yes	Process initiated
ITI Bank: Appoint receiver under the Banking Law, as necessary, if sale does not materialize.	31-Dec-99	No	Process initiated
AB: Implement the recommendation of the external consultant with regard to an alternative payments mechanism for government transactions.	31-Dec-99	No	
AB: Recapitalize with private capital; if recapitalization fails, bring the bank to the point of sale.	31-Dec-99	No	
Bring Gobi and NIC to the point of sale.	31-Dec-99	No	Technical preparations completed
AB: Appoint receiver under the Banking Law, as necessary, if sale does not materialize.	31-Mar-00		
Structural Benchmarks			
Fully enforce Banking Law provisions for insolvent banks: Strict enforcement of the current hierarchy of claims under the Banking Law (household deposits have the highest priority; Write down of shareholders' equity when a	Continuous	Yes	
BOM to cease credit and liquidity support to insolvent banks.	Continuous	No	
No recapitalization of banks with public funds prior to privatization.	Continuous	Yes	
Submit to Parliament draft legal amendments, prepared by the BOM and the MOJ in consultation with the IMF and the AsDB, to strengthen provisions related to conservatorship, receivership, and recovery of bad debts.	30-Jun-99	Yes	
Conservators and advisors to draw up restructuring plans to achieve a resolution of the problems of insolvent banks.	30-Jun-99	Yes	
Conservators to convene meeting of banks' shareholders and present plans.	30-Jun-99	Yes	
Publish a quarterly list of identified loan defaulters.	30-Jun-99	Yes	
Establish an arbitration mechanism to regularize financial claims and arrears between the government and BOM.	30-Jun-99	Yes	
MOF to ensure that VAT refunds are paid within the deadline prescribed by Law.	30-Jun-99	Yes	
MOF to amend reporting procedures to allow full reconciliation of budgetary entities' revenues and expenditures with their cash balances on a monthly basis.	30-Jun-99	Yes	
Issue cabinet resolution instructing the Mongolian members to call on the Board of Directors to initiate annual audit of Erdenet by an international accounting firm.	30-Jun-99	No	Delay
BOM to review all existing bank licenses, and initiate action against those not found "tit and proper."	30-Sep-99	Yes	
Prepare a plan, based on the recommendations of an external consultant,to resolve outstanding issues related to the Buligaar leather factory.	30-Sep-99	No	Delay
Government to clear interest arrears on its restructuring bonds and be current on future interest payments to banks.	30-Sep-99	No	Delay
Develop a medium-term treasury reform plan.	30-Sep-99	Yes	
Announce a civil service reform plan consistent with agreements with the AsDB, including targets for public sector employment reduction and wage decompression in 2000 and beyond.	31-Dec-99	Yes	
AB: Fully operationalize alternative payment mechanism for government transactions.	31-Dec-99	Yes	
Prepare a plan to replace restructuring bonds with marketable securities.	31-Dec-99	Yes	
Introduce notionally defined individual pension accounts.	31-Mar-00		

Table 4. Mongolia: Structural Conditionality, 1991–2004 (Continued)

	Date	Implementation	
		Yes/No	Remarks
Mid-term review (January 24, 2000)			
Prior Actions			
Clear all arrears on domestic interest payments	--	Yes	
Sign agreement to regularize all financial relations between MOF and the BOM.	--	Yes	
MOF to sign a contract with the BOM, as the government's fiscal agent, to ensure automatic transfer of interest due from the government's central budget account to the payees' accounts on the last business day of each month.	--	Yes	
Secure parliamentary approval of budget for 2000 consistent with understandings reached with Fund staff.	--	Yes	
Incorporate the principle of downsizing for the Agriculture Bank (AB) in the monetary policy guidelines for the	--	Yes	
Develop a restructuring plan for AB in consultation with Fund staff.	--	Yes	
Revoke the licenses of Reconstruction Bank and ITI Bank.	--	Yes	
Issue cabinet resolution instructing the Mongolian members to call on the Board of Directors to initiate an annual audit of Erdenet by an international accounting firm.	--	Yes	
Structural Performance Criteria			
Submit to Parliament a proposal for the sale of Trade and Development Bank, which includes the recommendations of an external consultant.	31-Mar-00		
PRGF Arrangement			
At approval (September 28, 2001)			
Prior Actions			
Issue government decree specifying the structure of civil service wage increases to take effect during the remainder of 2001 and submit to Parliament an amendment to the 2001 budget, in line with the understandings reached with	--	Yes	
Raise cut-off rates on BOM bills and increase quantity of bills sold as needed to bring the monetary program on track to meet the indicative targets for end-September 2001 as set out in Table 1, including by ensuring that the BOM's NDA and reserve money as of end-August are both smaller than or equal to their levels as of end-June 2001.	--	Yes	
Complete an inventory of all government bank accounts and adopt a Cabinet resolution requiring all central budget entities and extra-budgetary funds (EBFs) to provide a detailed monthly report on the balances of all their bank accounts, with supporting bank statements.	--	Yes	
Adopt a Cabinet resolution to establish a treasury single account (TSA) at the Bank of Mongolia (BOM), transfer to the TSA all foreign-currency government deposits owned by central budget entities and EBFs, and send letters to all donors seeking their concurrence to transfer to the TSA all Project Implementation Units (PIUS) and other related government accounts held jointly with donors.	--	Yes	
Adopt a Cabinet resolution to initiate the pilot phase of the TSA, institute a cash warrant system and subaccounts in the BOM for all pilot entities, close all their offbudget accounts, and begin to have their payments routed through zero-balance commercial bank accounts or centrally authorized and processed by the treasury.	--	Yes	
Sign memorandum of understanding between the MOFE (in coordination with the GDNT, Customs, and the Social Security Funds) and the Baganuur Coal Company, the Energy Authority, Erdenet, and NIC verifying each entity's payables and receivables related to the budget, and establish monthly reporting and a time-bound plan for the elimination of noncash transactions and the settlement of cross debts.	--	Yes	
Standardize stock of restructuring bonds and sign contracts between the MOFE and the main holders stipulating the terms for the servicing of their restructuring bonds.	--	Yes	
Finalize the BOM's decision regarding the disposition of recent or prospective bank license applications by foreign institutions consistent with the MEFP's stipulation that applicants be limited only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision, and ensure that the commencement of operations by any new banks is phased in so as not to jeopardize the achievement of the BOM's monetary program targets, in consultation with IMF and World Bank staff.	--	Yes	
Structural Performance Criteria			
Secure Parliamentary approval of amendment to Budget Law to clarify and strengthen the accountability of local government officials with respect to the control and reporting of bank accounts and the enforcement of Cabinet regulations and directives from the head of treasury, including by specifying the penalties for arrears accumulation	31-Dec-01	Yes	
Secure Parliamentary approval of legislation to centralize the proceeds from VAT collected at all levels of government and assign a fixed percentage of VAT receipts to the local government sector as a whole.	31-Dec-01	Yes	
Complete transfer of all pilot entities' deposits to the TSA, adopt a Cabinet resolution to extend the TSA to all line ministries and Ulaanbaatar City and close all their offbudget accounts, and initiate transfer of remaining central government deposits to the TSA.	31-Dec-01	No	Delay
Require local governments to adopt the same reporting standards on bank accounts as the central government and to provide monthly reports on their account balances	30-Apr-02	Yes	
Obtain parliamentary approval of 2002 Budget in line with the macroeconomic framework agreed with the IMF, including adequate allocations for a continuing reduction of arrears and expenditure saving reforms and a wage and employment policy consistent with the maintenance of current spending within the agreed envelope.	31-Dec-01	No	

Table 4. Mongolia: Structural Conditionality, 1991–2004 (Concluded)

	Date	Implementation	
		Yes/No	Remarks
Structural Benchmarks			
Enforce legal requirement to report semi-annually to the MOFE on all government entities, including EBFs, and prepare semi-annual report for consolidated central government and available data on local governments, including comprehensive data on public employment (end-September 2001), with the first semi-annual report to cover data for	30-Sep-01	No	Partially
Submit bill to the Parliament to reassign the Corporate Income Tax and the excise tax on alcohol to the central budget starting in 2002 and develop a new equalization transfer model to be used as a guide for the 2002 budget.	31-Dec-01	Yes	
Adopt joint action program agreed by Treasury and SFSA to monitor budget entities' bank accounts, ensure that payments arrears problems are properly addressed, and establish a time-bound plan for the progressive reduction and elimination of arrears.	31-Dec-01	No	Delay
Adopt legislation requiring all general government entities, including EBFs, to report quarterly to the MOFE, including on the number of staff employed disaggregated by agency.	30-Jun-02	Yes	
Implement arrears reduction plan and meet arrears reduction targets set for each debtor agency under the Treasury/SFSA joint action program.	30-Jun-02	No	
Complete transfer of all central government and Ulaanbaatar City deposits and EBFs to the TSA, close all off-budget accounts held by central government and Ulaanbaatar City, and ensure that at least 75 percent of total central government and Ulaanbaatar City expenditures are routed through the TSA system.	30-Jun-02	No	
Adhere to best international standards for the licensing of new banks, including by limiting prospective applicants only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision, and consult with IMF staff about the appropriate interpretation of these standards when considering	Continuous	Yes	
First and Second Reviews (September 12, 2003)			
Prior Actions			
Secure Parliamentary approval of Medium-Term Budget Framework in line with understandings reached with Fund	--	Yes	
Secure Parliamentary approval of amendment to the Central Bank Law to prohibit the conduct of quasi-fiscal operations and establish oversight of the Bank's operations by an independent Supervisory Board, and prepare draft terms of reference for the Supervisory Board, in consultation with Fund staff, for consideration by the fall session of	--	Yes	
Structural Performance Criteria			
Secure Parliamentary approval of terms of reference (TOR) for BOM's Supervisory Board in line with the understandings reached with the staff.	31-Oct-03	Yes	
Establish Supervisory Board empowered to carry out independent oversight of BOM operations along the lines indicated in the above-mentioned TOR and begin to enforce the amendments to the Central Bank Law approved in	30-Nov-03	Yes	
Complete special audits of the BOM's NIR as of end-June and end-September 2003, with a view to ensuring appropriate valuation of gold-related and derivatives transactions and contingent liabilities, including any impairment, guarantees or commitments against gold deposits or other reserve assets	30-Nov-03	Yes	
Increase BOM's provisioning requirements on commercial banks from 25 percent to 50 percent for substandard loans and from 50 percent to 75 percent for doubtful loans.	31-Mar-04	Yes	
Structural Benchmarks			
annual and annual fiscal reports the adjustments to spending plans due to excess own-revenues by economic classification.	31-Oct-03	Yes	
	31-Oct-03	No	
Adopt ministerial regulation that obliges budget managers to make commitments strictly according to their monthly apportionments of budget appropriations and report monthly to the Treasury on commitments entered, and develop Treasury cash plans to prevent the accumulation of arrears.			Superseded by new reporting mechanism
Tighten enforcement of prudential controls on the banking system by requiring banks to submit internal audit reports to the BOM in accordance with the new supervisor's manual issued in December 2002.	31-Oct-03	Yes	
Fully adopt IAS, including IAS 39, in 2003 and all future BOM financial statements	31-Mar-04	No	Only partly