



**The World Bank**

Second Economic Management Support Operation (P167485)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

ON A PROPOSED LOAN

IN THE AMOUNT OF US\$20 MILLION

AND

ON A PROPOSED CREDIT

IN THE AMOUNT OF SDR 58.1 MILLION  
(US\$80 MILLION EQUIVALENT)

TO MONGOLIA

FOR THE

ECONOMIC MANAGEMENT SUPPORT OPERATION

SECOND DEVELOPMENT POLICY FINANCING

June 28, 2019

Macroeconomics, Trade And Investment Global Practice  
East Asia And Pacific Region

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Mongolia

**GOVERNMENT FISCAL YEAR***January 1 – December 31***CURRENCY EQUIVALENTS**

(Exchange Rate Effective as of May 31, 2019)

Currency Unit

Currency Unit	Mongolian Tugrug
US\$1	MNT 2,649

**ABBREVIATIONS AND ACRONYMS**

ADB	Asian Development Bank	IPSAS	International Public Sector Accounting Standard
AFCCP	Authority for Fair Competition and Consumer Protection	JICA	Japan International Cooperation Agency
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism	M&E	monitoring and evaluation
AQR	Asset Quality Review	MNAO	Mongolia National Audit Office
BEPS	Base Erosion and Profit Shifting	MoF	Ministry of Finance
BoM	Bank of Mongolia	MoFA	Ministry of Foreign Affairs
CAR	Capital Adequacy Ratio	MoLSP	Ministry of Labor and Social Protection
CMP	Child Money Program	MPP	Mongolian People's Party
CPS	Country Partnership Strategy	MTFF	Medium-Term Fiscal Framework
DBM	Development Bank of Mongolia	NDA	National Development Agency
DICOM	Deposit Insurance Corporation of Mongolia	NPL	non-performing loan
DPC	Development Policy Credit	OECD	Organization for Economic Cooperation and Development
DPF	Development Policy Financing	OT	OT and Gold Mine
DSA	Debt Sustainability Analysis	PAYGO	pay-as-you go
EFF	Extended Fund Facility	PBoC	People's Bank of China
EMSO 2	Second Economic Management Support Operation	PEFA	Public Expenditure and Financial Accountability
ERP	Economic Recovery Plan	PER	Public Expenditure Review
EU	European Union	PFM	Public Financial Management
FDI	Foreign direct investment	PIM	Public Investment Management
FMD	Foot and Mouth Disease	PIMA	Public Investment Management Assessment
FRC	Financial Regulatory Commission	PIT	Personal Income Tax
FSL	Fiscal Stability Law	PLR	Progress and Learning Review
FSP	Food Stamp Program	PMT	Proxy Means Test
GAAR	General Anti-Avoidance Rule	PPP	Public Private Partnership
GAVS	General Authority for Veterinary Services	PPR	Peste des Petits Ruminants
GDP	Gross domestic product	PROST	Pension reform options simulation toolkit
GFMS	Government Financial Management Information System	PSIA	Poverty and Social Impact Analysis
GRS	Grievance Redress Service	PSP	Price Stabilization Program
FSP	Food Stamp Program	PwC	PricewaterhouseCoopers

GAAR	General Anti-Avoidance Rule	SCD	Systematic Country Diagnostic
GAVS	General Authority for Veterinary Services	SDR	Special Drawing Rights
GDP	Gross domestic product	SFFS	Strengthening Fiscal and Financial Stability
GFMS	Government Financial Management Information System	SMEs	Small and Medium Enterprises
GRS	Grievance Redress Service	TA	Technical Assistance
HMP	Housing Mortgage Program	TFA	Trade Facilitation Agreement
IBL	Integrated Budget Law	TIP	Trade Information Portal
IBRD	International Bank for Reconstruction and Development	TSA	Treasury Single Account
IDA	International Development Association	TT	Tavan Tolgoi Coal Mine
IFRS	International Financial Reporting Standards	WBG	World Bank Group
IMF	International Monetary Fund	WTO	World Trade Organization
IPC	Investment Protection Council		

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**MONGOLIA**

**SECOND ECONOMIC MANAGEMENT SUPPORT OPERATION**

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**SUMMARY OF PROPOSED FINANCING AND PROGRAM**

**BASIC INFORMATION**

Project ID	Programmatic	If programmatic, position in series
P167485	Yes	2nd in a series of 3

**Proposed Development Objective(s)**

The Program Development Objective is to support the Government of Mongolia in restoring debt sustainability, strengthening the social protection system, and enhancing competitiveness.

**Organizations**

Borrower: MONGOLIA

Implementing Agency: MINISTRY OF FINANCE

**PROJECT FINANCING DATA (US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	<b>100.00</b>
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**DETAILS**

International Bank for Reconstruction and Development (IBRD)	20.00
International Development Association (IDA)	80.00
IDA Credit	80.00

**INSTITUTIONAL DATA**

**Climate Change and Disaster Screening**

This operation has been screened for short and long-term climate change and disaster risks

**Overall Risk Rating**

High



Results

<p><b>Result Indicators</b></p>	<p><b>Pillar I: Restoring Debt Sustainability</b></p> <ol style="list-style-type: none"> <li>1. Capital expenditure financed by the Development Bank of Mongolia (DBM) is eliminated: MNT 252 billion (2016) to MNT 0 billion (2020).</li> <li>2. Bank of Mongolia’s (BoM’s) net financing to the Housing Mortgage Program is ended: MNT 404 billion (2016) to MNT 0 billion (2020). BoM’s outstanding loans for the Price Stabilization Program is fully withdrawn by end-2019 and the corporate bond holdings are kept at no more than the 2016 level.</li> <li>3. Tax exemptions and incentives as a share of total tax revenue are reduced by at least 1.5 percentage points in 2020 from 14.5 percent in 2016.</li> <li>4. General Anti-Avoidance Rule is included to tax laws and regulations.</li> <li>5. Capital expenditure budget for clearance of promissory notes is eliminated: MNT 672 billion (2016) to MNT 0 billion (2017–20).</li> <li>6. Efficiency of public investment is improved by restructuring all non-performing projects based on the Rationalization Guideline, evidenced by the project performance evaluation document included in the 2019-2020 Guideline.</li> <li>7. Government Special Funds that extend loans and grants are channeled exclusively through banks in good standing as assessed by the Assets Quality Review of BoM by 2020.</li> </ol> <p><b>Pillar II: Strengthening the Social Protection System</b></p> <ol style="list-style-type: none"> <li>8. The total budget for the Food Stamp Program and poverty-targeted programs is tripled in 2020 in relation to its 2016 level.</li> </ol> <p><b>Pillar III: Enhancing Competitiveness</b></p> <ol style="list-style-type: none"> <li>9. Number of permits and licenses in 2020 reduced by more than 10 percent from 2016.</li> <li>10. At least 70 percent of investor grievances received by the Investment Protection Council (IPC) are successfully resolved (2020).</li> <li>11. Number of animals vaccinated for PPR (<i>Peste des Petits Ruminants</i>) in 5 western <i>aimags</i> is increased: 10.4 million (2016) to at least 20 million (2019-20).</li> <li>12. Five western <i>aimags</i> become free of PPR outbreaks (2020).</li> <li>13. Proportion of shipments selected for physical inspection at the border customs are reduced from 90 percent (2016) to 70 percent (2020).</li> <li>14. Average customs clearance time is reduced by 20 percent relative to 2016.</li> </ol>
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## 1. INTRODUCTION AND COUNTRY CONTEXT

**1. This program document proposes a Second Economic Management Support Operation (EMSO 2) for Mongolia in the amount of US\$100 million from IDA (SDR 58.1 million or US\$80 million equivalent) and IBRD (US\$20 million) resources.** EMSO2, the second in a series of three programmatic Development Policy Financing (DPF) operations, supports the implementation of the country's Economic Recovery Program (ERP), which helped Mongolia avert a macroeconomic crisis while protecting its poor. The Program Development Objective is to support the Government of Mongolia in restoring debt sustainability, strengthening the social protection system, and enhancing competitiveness. The ERP is backed by a US\$5.5 billion joint donor program comprising the Asian Development Bank (ADB), China, the International Monetary Fund (IMF), Japan, the Republic of Korea, and the World Bank Group (WBG).

**2. Mongolia's economy has recovered strongly from the brink of a macroeconomic crisis in 2016, but underlying vulnerabilities remain.** The economy grew by 6.9 percent in 2018, compared to 1.2 percent in 2016. Growth has been driven primarily by robust private consumption, strong foreign direct investment (FDI) inflows, and a revival in mineral exports. The country's fiscal stance has improved substantially as the deficit declined from 15.1 percent of GDP in 2016 to a surplus of 2.8 percent in 2018. This improvement led to a nearly 13-percentage-point reduction in the public-debt-to-GDP ratio in the past two years. The 2019 budget caps the fiscal deficit at around 1 percent of GDP while projecting strong revenue performance, as well as a step-up in capital expenditures, after two years of compressed spending levels. Monetary policy was loose in 2018, prompting high import growth and putting some pressure on the balance of payments. The Bank of Mongolia has, however, tightened its stance since the last quarter of 2018, and gross reserves ended the year around US\$ 3.5 billion (about five months of imports) up from 4.3 months in 2017. Enhanced policy credibility and good market conditions supported new external bond issues, contributing to reserve accumulation.

**3. Poverty increased during the economic slowdown of 2014-16, but declined only moderately during 2017-18, pointing at continued challenges in the labor market and the need for strong social support policies.** Declining growth rates during 2014-16 led to higher unemployment, sluggish household income growth, and higher poverty. The economic recovery of the past two years, coupled with sustained spending on social sectors, has led to a strong increase in real average household incomes by 8.8 percent and a moderate recovery of private consumption - by 3.9 percent in 2018. However, the poverty rate declined only moderately from 29.6 percent in 2016 to 28.4 percent in 2018. To ensure that growth benefits the poor more effectively, the proposed operation includes measures to promote employment creation outside the mining sector and better targeting of social policies.

**4. Mongolia has experienced some political volatility during the implementation of the ERP, reflected in partial policy reversals, but the commitment to sound macroeconomic management has been maintained.** The EMSO program was prepared and appraised under one government but is being implemented by another.<sup>1</sup> The change in government has not affected the overall commitment to macroeconomic stability, fiscal adjustment and structural reforms. However, popular resistance against some of the structural fiscal

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<sup>1</sup> The current government mostly consists of the members of the Mongolian People's Party (MPP), which won 65 of the 76 seats in the Parliament in the June 2016 general elections. But following the Party's loss in the presidential election in August 2017, MPP's parliamentarians voted to oust their own prime minister. Hence, a new prime minister and a new cabinet, including a new finance minister, came to power in September 2017.



measures motivated a change in reform priorities. Specifically, in February 2018, the new government took the decision to partially reverse two policies supported by EMSO 1. It restored the flat income tax structure instead of progressive taxation and slowed the pace of the increase in the retirement age. The policy reversals and slow progress in meeting the agreed triggers led to delays in preparing the current operation (EMSO 2).

**5. Recently, progress on structural reforms supported by EMSO has accelerated, and this, together with strong fiscal performance and a sound 2019 budget<sup>2</sup> have created an environment conducive for the World Bank's policy lending support to resume.** The preparation of EMSO 2 comes at a particularly sensitive time for Mongolia. One year before the next parliamentary elections, the authorities are keen to lock in critical reform gains. However, the sixth review of IMF's External Fund Facility, which continued to disburse throughout 2018, has been delayed due to slower than expected progress in the recapitalization of the banking system. The resulting risks to Mongolia's financial sector stability have prompted the team to incorporate additional measures related to the banking sector recapitalization program as an effectiveness condition in EMSO 2 and a trigger in EMSO 3. With these additional measures and given strong progress in other reform areas and the maintenance of a sound macroeconomic framework, EMSO 2 is being presented at this time, prior to the conclusion of the sixth review of the EFF.

**6. The proposed Development Policy Financing (DPF) aims to further stabilize Mongolia's economy and move it toward a sustainable development path.** The reform program seeks to (i) restore the country's debt sustainability through fiscal adjustments, (ii) strengthen the social protection system with an emphasis on poor and vulnerable groups, and (iii) enhance competitiveness of the economy through structural reforms. EMSO 2 will help Mongolia to consolidate the adjustment already achieved, address some of the long-standing structural weaknesses and distortions in the economy and anchor macroeconomic policies going into an election year. In addition, it will help create fiscal space by substituting high-cost, short-term domestic borrowing with relatively more concessional and long-term external assistance.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1. RECENT ECONOMIC DEVELOPMENTS

**7. Mongolia's economic performance in the past two years has exceeded expectations.** GDP growth reached 6.9 percent in 2018, up from 5.3 percent in 2017 and 1.2 percent in 2016, supported by solid mineral exports, strong FDI, and sound fiscal policies. Higher global coal and copper prices and strong demand from China contributed to the robust recovery of the mineral sector. In addition, strong net FDI inflows (US\$1.9 billion in 2018 and US\$1.4 billion in 2017 from US\$121 million in 2016) boosted private investment, thereby contributing through backward and forward linkages to non-mining sector growth (particularly in the trade and transport service sectors). In fact, the rest of the economy has grown several times faster than the mining sector since 2016, indicating a gradual diversification of the growth drivers (Table 1). Improved market confidence following a \$5.5 billion support package agreed with donors in May 2017, skillful management of

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<sup>2</sup> The 2019 budget focuses on strengthening fiscal buffers by maintaining a primary fiscal surplus and accumulating additional savings in the Fiscal Stabilization Fund and Future Heritage Fund. The Fiscal Sustainability Fund and Future Heritage Fund are funds designed to save natural resource related revenues in good times and make them available to support spending when prices fall. The Parliament ratifies the annual budget for each of these funds and the MoF is responsible for overseeing the funds' operations. The 2019 budget also includes measures postponing actions that would have raised pension costs.



the macroeconomy, especially on the fiscal side, and steady progress on structural reforms have contributed to this strong overall economic performance.

**8. The dramatic turnaround in the fiscal situation is the result of a combination of cyclical and structural factors.** The fiscal stance has improved significantly, from a deficit of 15.1 percent of GDP in 2016 to a surplus of 2.8 percent of GDP in 2018 (Figure 1).<sup>3</sup> The improvement has continued, with the government reporting a surplus of 1.8 percent of GDP in the first four months of 2019. The outstanding fiscal improvement is explained by a massive revenue overperformance (strong performance in the mining sector and considerable revenue mobilization efforts by the government through improved tax administration), and a commitment to spending control (for example, a reduction in interest payments, streamlining the wage bill through a hiring freeze, and rationalization of underperforming capital spending).<sup>4</sup> Substantial improvements in the primary balance and use of the fiscal surplus to buyback expensive domestic debt have led to a sharp reduction in government debt between 2016 and 2018, which is expected to continue in the medium-term (Figure 2).<sup>5</sup>

Figure 1. Fiscal balance (percent of GDP), 2015–20

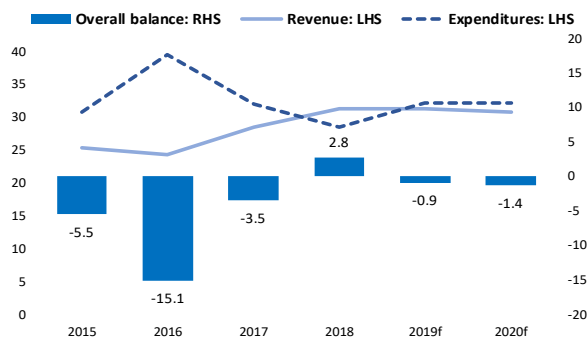
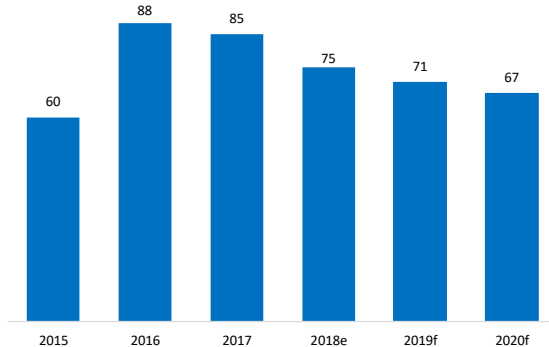


Figure 2. Government debt (percent of GDP), 2015–20



Sources: MoF data and World Bank staff estimates.

**9. Off-budget spending routed through the Development Bank of Mongolia (DBM) has been eliminated.** The external review of DBM’s operations during 2012–17, which was supported by this operation, revealed substantial weaknesses such as proliferation of non-performing loans and weak governance practices. DBM has since been restructured as a result of a new DBM law, becoming more independent and its activities have been restricted to commercial activities only. It has also taken several steps to improve its corporate governance including opening senior management positions to external hiring. All budget-related projects from DBM have been transferred to the government with the relevant funding resources. In addition, DBM’s

<sup>3</sup> Excludes DBM spending.

<sup>4</sup> Improved VAT administration through digital technologies, increased social security contribution, and increased excise taxes on alcohol and tobacco were key drivers of growth in non-mineral revenues. The Parliament approved revisions to the tax law in March 2019, broadening the tax base through simplification of filing and rationalizing the number of taxes paid by Small and Medium Enterprises (SMEs). Improvements in public spending have been equally impressive and the government has avoided budget amendments mainly through conservative revenue projections.

<sup>5</sup> Improved investor confidence, following successful implementation of the ERP supported by donors resulted in the refinancing on preferable terms of sovereign bonds that were due in 2017–18. Along these lines, Moody’s and Fitch upgraded their ratings in 2018 from Caa1 to B3 and from B- to B, respectively, citing improvements in external and fiscal parameters. S&P upgraded its rating from B- to B (stable outlook) in January 2019.



reliance on government funding and guarantees has gradually declined. In October 2018, taking advantage of a strong macroeconomic performance and a sound policy environment, DBM successfully issued an international bond of US\$500 million (without sovereign guarantee) with a maturity of 5 years and 7.25 percent interest rate.

**10. The central bank's engagement in quasi-fiscal lending has been significantly curbed.** The central bank law was amended in January 2018 to strengthen its independence and the legal status of its committees on monetary policy and supervision. The central bank law also led to the discontinuation of quasi-fiscal activities being undertaken by BoM. For example, BoM's exposure to the Housing Mortgage Program (HMP) is now limited to the total amount of principal and interest payments received on existing mortgage assets, thereby ensuring that no new liabilities are created. The restructured HMP program will be better targeted and operate under a hard budget constraint.<sup>6</sup> BoM's involvement in this financing scheme is expected to end by January 2020, as per the joint decree signed by the finance minister and the central bank governor.

**11. Monetary and exchange rate policies were, however, slower to adjust.** Inflation accelerated moderately to 8.1 percent in 2018 (close to the central bank target of 8 percent), driven by rising food and oil prices and strong domestic demand. A loose monetary stance in 2018, which led to high credit growth, contributed to the inflationary pressures.<sup>7</sup> Moreover, when loose monetary conditions and a risk-off sentiment with respect to emerging markets led the currency to depreciate in the second half of 2018, the central bank intervened in the market and lost a considerable amount of reserves.

**12. Mongolia's monetary policy stance has improved in recent months, lowering the risks to the balance of payments.** Monetary policy was tightened in late 2018 and the BoM seems committed to a more flexible exchange rate. Domestic credit grew at 26.5 percent in 2018, with credit to corporates and individuals growing at 17 percent and 35 percent, respectively. The sharp rise of credit reflected a series of factors including the lagged response to lower policy rates, improved market sentiments, and the reduction in uncertainty upon completion of the Asset Quality Review (AQR) under the IMF's EFF. Monetary authorities' response to the surge in imports and credit growth included a series of macroprudential measures aimed at limiting the debt-to-income ratio, reducing the maturity on non-mortgage household loans, and raising the risk rating on unhedged foreign currency borrowing. In addition, BoM adopted a tightening bias starting from September 2018 and raised the policy rate by 100 basis points to 11 percent in November 2018. As a result of these efforts, inflation has moderated to around 7 percent and credit growth to 23.5 percent (year-over-year) at the end of 2019 Q1.

**13. Despite loose monetary policies and heightened external sector pressures, gross international reserves increased in 2018.** The current account deficit sharply increased to 16 percent of GDP in 2018, from 10.2 percent in 2017. This was driven by a reduction in the trade surplus as strong exports growth (mainly coal and copper) was outpaced by a rapid growth in imports (for example, petroleum, vehicles, and investment-related goods for the mining sector) fueled by bank credit. The strong net FDI inflows were not enough to offset a widening current account deficit. Nonetheless, reserves increased from US\$3 billion to US\$3.5 billion (about five months of imports) in 2018 boosted by the US\$500 million DBM bond (without sovereign guarantee)

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<sup>6</sup> The restructured HMP scheme differs in two ways. First, the revised scheme improves targeting by focusing on the first-time homebuyers from the polluted *ger* district. Second, the size of the program is expected to decline with the exit of BoM in January 2020.



issued in October 2018. Moreover, the BoM purchased a historically high level of gold (about US\$800 million) from individuals and companies, which added to the level of reserves. Gross international reserves rose further to US\$3.6 billion in 2019 Q1 following the tightening of monetary policies and a US\$250 million bond issue by the Mongolia Mortgage Corporation in January 2019.

**14. The banking sector continues to represent an important source of potential macroeconomic risks, although some progress is being made to address the underlying issues.** According to the IMF's 5<sup>th</sup> EFF review in November 2018, the government has completed several actions:

- (i) Completion of AQR by the third-party auditors, which revealed a system wide shortfall of 1.9 percent of GDP;
- (ii) In May 2018, based on higher NPLs found by the AQR and banks' business plans, BoM increased the amount of new capital to be raised to 3.1 percent of GDP;
- (iii) In June 2018, Parliament passed the Recapitalization law to allow public capital to be used to recapitalize the systemic banks if they fail to raise enough private funds; and
- (iv) In September 2018, banks booked all additional provisions called for by the AQR and agreed to submit detailed updates regarding capital raised and how to deal with remaining capital shortfalls. As a result of the efforts to recognize capital shortfalls, NPLs, which were 7-8 percent in the first half of 2018 increased to 10.4 percent at end-2018 and 10.7 percent in March 2019.

**15. In addition, the following actions have also been undertaken by the government:**

- (i) In April 2019, BoM closed one of the six banks to be recapitalized, a non-systemic institution which was deeply insolvent and used the deposit insurance law to reimburse the small depositors; and
- (ii) In June 2019, following considerable delay, BoM agreed to engage a reputable external firm to audit the bank recapitalization process and to take the necessary steps to fully recapitalize the banks.

**16. Despite these positive steps, the banking sector reform program remains incomplete.** Several banks have failed to raise the necessary capital to fully close the gap identified in the AQR and the IMF has asked for a forensic audit to verify the sources of capital that was raised. The IMF EFF 6<sup>th</sup> review has been delayed pending progress on both fronts. The IMF remains concerned about the weak regulatory and supervisory capacity of the BoM, which has also been confirmed by Bank's own independent assessment. Given the associated risks to the financial stability, the EMSO program has therefore incorporated new policy actions to support implementation of the banking sector reform program, and the Bank team has strengthened its engagement on financial sector issues with the Mongolian authorities, as described below.

## 2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

**17. Mongolia's recent growth momentum is expected to continue in the medium term.** Supported by a stable macroeconomic environment, strong domestic demand, large inflows of foreign investment and relatively robust commodity exports, economic growth is projected to further increase to over 7 percent in 2019 from 6.9 percent in 2018, and then modestly decelerate to 6.6 percent during 2020–23. Maintaining the current macroeconomic stability is critical for Mongolia to signal its departure from the boom-bust cycle that has crippled its economy in the past. The mining sector will remain crucial for the medium-term growth outlook, especially with the large export potential of Oyu Tolgoi (OT) and imminent developments of the Tavan Tolgoi (TT) mining project. Manufacturing and transport services would continue to benefit from backward



and forward linkages with the mining sector. Export of livestock is projected to be strong in the medium term as measures to address animal health concerns are being deployed. The increase in public investment, coupled with improved management practices, should further support growth by addressing critical bottlenecks. GDP growth was 8.6 percent in the first quarter of 2019, signaling the strong momentum of 2018 continues.

**18. Despite the recent progress in lowering public sector debt, the pressures on the balance of payments are likely to continue.** With improved investor confidence, Mongolia successfully resolved immediate external debt repayments in 2017 and 2018 through issuing US\$1.4 billion in sovereign bonds (*Khuraldai* and *Gerege* Bonds) at more favorable terms than previous loans (8.75 percent interest rate and 7-year maturity and 5.63 percent interest rate and 5-year maturity respectively). Moreover, no large external debt repayments are due on the public sector side till 2021 except the renewal of People’s Bank of China (PBOC) swap line with BoM.<sup>8</sup> Nevertheless, a delayed implementation of ongoing reforms could affect Mongolia’s sovereign ratings and reduce the odds of refinancing under favorable conditions.

**19. Continued financial support from multilateral and bilateral partners will remain critical to maintain external balance, build buffers, and smooth the rollover of external debt.** Continued disbursement of funding from donors, including EMSO 2, would be instrumental in helping further reduce the public debt and improve reserves accumulation in a context of rising global uncertainty and expected large debt repayments. This in turn depends on the government’s continued implementation of measures to restore fiscal and external sustainability. The baseline financing program includes US\$2.2 billion in financial support from donors to fill the external financing gap during 2019–22 and help rebuild reserves toward adequate levels (Tables 1 and 2).

**20. Monetary policy tightening is expected to continue in the medium term.** While inflation currently remains contained below the central bank target, there is a risk of a substantial increase in inflation over the medium term, triggered by rising oil and food prices (mainly meat prices), a depreciating exchange rate, a loose monetary policy stance, and strong private consumption. The authorities have indicated their willingness to tighten policy further in the advent of negative price shocks or deteriorating external balances. Interventions in the foreign exchange market are expected to be limited to smoothing excessive volatility, allowing more flexibility in exchange rate movements, and rebuilding international reserves.

**21. The 2019 budget projects a primary surplus of about 1 percent of GDP, consistent with the objective of debt reduction.** Mainly driven by a surge in capital expenditures, primary spending (that is, excluding interest payments) is proposed to increase by about 3 percent of GDP, reflecting the desire of the authorities to return key expenditures to more sustainable levels after two years of sharp compression. Some of the key expenditures focus on reducing air pollution, building schools and hospitals, local infrastructure, and clearing unpaid concessions. The authorities have also increased the public wage bill by 16 percent to help raise the purchasing power of public employees, which has been on a significant decline over the last five years. Despite these increases, the budget is projected to yield a primary surplus.

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<sup>8</sup> Expected public debt repayments during 2020-24 include the following: PBoC swap line (US\$1.7 billion, June 2020), Mazaalai Bond (US\$500 million, due in 2021), Gerege Bond (US\$800 million, due in November 2022), Chinggis Bond (US\$1 billion, due in December 2022), Samurai Bond (US\$268 million, due in May 2023), Khuraldai Bond (US\$600 million, due in March 2024).



Table 1. Key Economic Indicators, 2016–23

	2016	2017	2018e	2019f	2020f	2021f	2022f	2023f
<b>Real Sector</b>								
Real GDP (% change y-y)	1.2	5.3	6.9	7.2	6.9	6.4	6.5	6.4
Mineral GDP (% change y-y)	0.2	-5.5	2.7	4.2	4.7	5.0	8.0	8.5
Non-Mineral GDP (% change y-y)	1.5	8.8	8.2	8.1	7.5	6.7	6.1	5.9
Consumer price index (% change y-y)	0.9	6.4	8.1	8.3	8.1	7.2	6.7	6.3
<b>Fiscal Account (in percent to GDP)</b>								
Revenue & grants	24.4	28.5	31.3	31.3	30.8	30.8	30.9	31.0
Expenditure	39.5	32.0	28.5	32.2	32.1	31.7	31.3	31.2
Overall budget balance	-15.1	-3.5	2.8	-0.9	-1.4	-0.9	-0.4	-0.3
Primary budget balance	-11.2	0.4	5.9	1.7	0.8	1.2	1.3	1.2
General government debt (in percent to GDP)	87.6	84.6	74.8	70.5	67.1	61.4	60.1	58.8
<b>External Accounts</b>								
Current account (million US\$)	-700	-1162	-1913	-1687	-1583	-1532	-1509	-1083
(% GDP)	-6.3	-10.2	-15.7	-12.4	-10.1	-8.7	-7.7	-4.8
Trade balance	1336	1489	685	945	1018	1041	1221	1824
Exports of goods	4809	5834	6557	7029	7288	7831	8356	9490
Imports of goods	-3473	-4345	-5871	-6084	-6269	-6790	-7135	-7666
Capital/Financial Account (million US\$)	873	2002	1888	1637	1561	1309	699	544
Capital Account	64	78	88	101	111	122	125	129
FDI 1/	121	1446	1924	1805	1734	1761	1353	1016
Portfolio	483	494	37	223	0	0	70	65
Trade Credits	-101	-43	78	-67	-12	-27	-47	-49
Currency and Deposits	-204	490	-112	-200	-218	-209	-220	-219
Loans 1/	844	1132	279	666	558	-105	-362	-410
International support 2/		789	418	904	774	246	233	
Errors and Omissions	-221	-62	-127	0	0	0	0	0
Overall BoP Balance (million US\$)	-48	1567	266	854	752	23	-577	-538
Gross international reserves	1296	3006	3573	4427	5180	5202	4625	4087
(months of imports)	2.4	4.3	4.8	5.8	6.3	6.0	5.0	4.7
<b>Monetary Sector (%)</b>								
Credit growth	5.8	13.6	26.5	17.0	17.0	17.0	17.0	17.0
Reserve money growth	24.6	30.5	19.5	16.6	12.6	17.3	14.0	14.0
<b>Memo items:</b>								
Nominal GDP (millions US\$)	11059	11363	12167	13640	15599	17551	19710	22414
Nominal GDP (billions MNT)	23943	27896	32166	36241	42069	48279	54754	62265

1/ FDI and loans for 2016 are adjusted for \$4.2 billion off-setting transactions for OT-2 project financing.

2/ The projections for loans include multilateral and bilateral financial assistance in 2017-20.

Sources: IMF, MoF, BoM, WB staff estimates

**Table 2. External Financing Requirements and Sources, 2016–23 (millions of US\$)**

	2016	2017	2018e	2019f	2020f	2021f	2022f	2023f
<b>1. External Financing Requirements</b>	<b>2094</b>	<b>1983</b>	<b>3437</b>	<b>2843</b>	<b>2977</b>	<b>3226</b>	<b>4401</b>	<b>3045</b>
Current account deficit	700	1184	1978	1687	1583	1532	1509	1083
Amortizations	795	1227	2028	925	1176	1485	2672	1743
Portfolio investment	20	99	299	0	0	500	1206	1057
Loans	775	1128	1729	925	1176	985	1466	686
Other net capital outflows 1/	599	-428	-569	231	218	209	220	219
<b>2. Financing Sources</b>	<b>2052</b>	<b>1983</b>	<b>3437</b>	<b>2843</b>	<b>2977</b>	<b>3226</b>	<b>4401</b>	<b>3045</b>
<b>A. Capital and Financial Inflows</b>	<b>2034</b>	<b>2904</b>	<b>3586</b>	<b>2794</b>	<b>2956</b>	<b>3003</b>	<b>3591</b>	<b>3045</b>
Capital account inflow	64	78	88	101	111	122	125	129
FDI 2/	121	1446	1924	1805	1734	1761	1353	1016
Portfolio investment	465	575	562	236	13	513	1007	1070
Trade Credits	-101	-43	78	-67	-12	-27	-47	-49
Loans 2/	1485	848	935	719	1110	634	1153	880
<b>B. Multilateral and Bilateral Support 3/</b>		<b>789</b>	<b>418</b>	<b>904</b>	<b>774</b>	<b>246</b>	<b>233</b>	
IMF		114	104	142	36			
WB*	13	135	14	100	202			
Other multilaterals and bilaterals		540	300	662	537	246	233	
Memo: PBoC Swap Facility Extension		1785			1785			
<b>C. Changes in reserves: (-) means increa:</b>	<b>18</b>	<b>-1710</b>	<b>-566</b>	<b>-854</b>	<b>-752</b>	<b>-23</b>	<b>577</b>	<b>538</b>
<b>3. Gross International Rerves (end-year)</b>	<b>1296</b>	<b>3006</b>	<b>3573</b>	<b>4427</b>	<b>5180</b>	<b>5202</b>	<b>4625</b>	<b>4087</b>
(months of imports)	2.4	4.3	4.8	5.8	6.3	6.0	5.0	4.7

1/ Other net capital outflows include all other net financial flows and errors and omissions.

2/ FDI and loans for 2016 are adjusted for \$4.2 billion off-setting transactions for OT-2 project financing.

3/ The amount of annual financing from multilateral and bilateral partners is indicative.

\* It is defined as sum of Project Financing and Budget Support

Source: BoM, IMF, WB staff estimates

**22. The draft Medium-Term Fiscal Framework (MTFF) for 2020–22 emphasizes continued reduction in the fiscal deficit and in the debt to GDP ratio.** The 2020–22 MTFF projects an overall budget surplus of about 1 percent of GDP by 2022 from a 1.5 percent deficit in the approved 2019 budget.<sup>9</sup> We estimate the fiscal deficit (using the World Bank/IMF definition) to average around 0.9 percent of GDP during 2019–22, consistent with a debt level lower than what was planned in the ERP. Moreover, the expected strong revenue performance in 2019 will lead to government savings in a Future Heritage Fund.<sup>10</sup> Financial support from donors would significantly contribute to the fiscal consolidation process. Concessional budget support loans of multilateral and bilateral donors would allow expensive domestic debt to be replaced. Interest payments, reflecting projected concessional financing, are forecast to decline to about 2 percent of GDP during 2019–22 from 3.3 percent of GDP in 2018 and 3.9 percent in 2017 (Table 3).<sup>11</sup>

<sup>9</sup> According to the Fiscal Stability Law (FSL), the structural budget balance is defined as the difference between structural revenue (that is, total government revenue minus transfers to the Fiscal Stabilization Fund and the Future Heritage Fund) and total government spending (excluding DBM commercial projects). Meanwhile, the IMF and World Bank monitor the overall fiscal balance, including on the revenue-side, proceeds to the saving funds, and on the spending side, all DBM spending.

<sup>10</sup> Recently, the government indicated that a new sovereign wealth fund was under preparation.

<sup>11</sup> One key feature of the government's debt management strategy is to substitute expensive domestic debt with concessional borrowing and foreign debt obtained through refinancing on preferential terms, resulting in a considerable decline in interest payments in 2017-18.



**23. Government debt declined rapidly in 2018 and is projected to fall further in the presence of strong growth and a positive primary balance.** The improved fiscal outturn and strong recovery in growth have resulted in the reduction of the public debt to 74.8 percent of GDP in 2018 from 87.6 percent of GDP in 2016. It is projected to continue to fall in 2019 due to improvement in the primary balance, falling interest payments, and strong growth (Table 3).

**Table 3. Key Fiscal Indicators Outlook, 2016–23 (% of GDP)**

	2016	2017	2018e	2019f	2020f	2021f	2022f	2023f
Total revenues and grants	24.4	28.5	31.3	31.3	30.8	30.8	30.9	31.0
Accumulation into the FSF and FHF	0.0	2.4	2.6	3.6	3.0	2.7	2.6	2.6
Tax revenues	20.2	22.1	25.6	24.5	24.4	24.8	25.0	25.2
PIT	2.2	2.3	2.5	2.5	2.5	2.6	2.8	2.7
CIT	2.2	3.4	4.0	3.8	3.9	4.1	4.2	4.2
Social Security Contribution	4.6	4.7	5.0	4.9	4.9	4.9	4.9	4.9
VAT	4.8	5.8	6.8	6.6	6.4	6.5	6.4	6.2
Excise taxes & Special taxes	2.6	1.9	2.4	2.4	2.3	2.4	2.4	2.4
Taxes on foreign trade	1.4	1.8	2.1	2.0	2.0	1.9	1.8	1.8
Royalties	1.4	0.7	1.2	1.2	1.3	1.2	1.2	1.3
Other taxes	1.1	1.4	1.5	1.1	1.1	1.2	1.3	1.5
Non-tax revenues & Grants	3.7	3.6	3.2	3.2	3.3	3.3	3.3	3.2
Total expenditures	39.5	32.0	28.5	32.2	32.1	31.7	31.3	31.2
Current Primary expenditures	23.5	21.1	19.6	20.3	20.3	20.1	19.6	19.5
Wages and salaries	7.3	6.5	5.8	6.1	5.9	5.9	5.8	5.8
Goods and services	5.8	4.8	4.5	4.7	4.7	4.6	4.5	4.4
Subsidies	1.0	0.9	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	9.5	8.9	8.6	8.8	9.0	8.9	8.7	8.6
Social Welfare Spending	2.0	2.0	2.0	1.9				
Interest payment	3.9	3.9	3.3	2.6	2.2	2.0	1.7	1.5
Capital expenditures	9.9	5.9	5.0	9.0	9.0	9.0	9.5	9.8
Domestically-Financed	8.9	3.5	3.4	6.4	7.1	7.2	7.8	8.5
Foreign-Financed	0.0	2.4	1.6	2.6	1.8	1.8	1.7	1.3
Net Lending	3.2	-0.5	0.8	0.8	1.1	1.0	1.0	0.9
Net lending excl. mortgage loans	2.2	1.2	0.3	0.0	0.3	0.3	0.3	0.2
On-budget housing mortgage loans	0.0	0.0	0.4	0.3	0.3	0.3	0.3	0.3
DBM commercial loans	1.0	-1.7	0.1	0.5	0.5	0.4	0.4	0.4
Overall balance 1/	-15.1	-3.5	2.8	-0.9	-1.4	-0.9	-0.4	-0.3
Primary balance	-11.2	0.4	5.9	1.7	0.8	1.2	1.3	1.2
Memo: DBM net lending	1.0	-1.7	0.1	0.5	0.5	0.4	0.4	0.4
Government debt	87.6	84.6	74.8	70.5	67.1	61.4	60.1	58.8
External debt	67.6	71.0	69.5	66.3	65.3	61.0	58.1	56.2
Domestic debt	20.0	13.6	5.3	4.2	1.8	0.4	2.0	2.6

Sources: MoF; IMF and WB staff projections

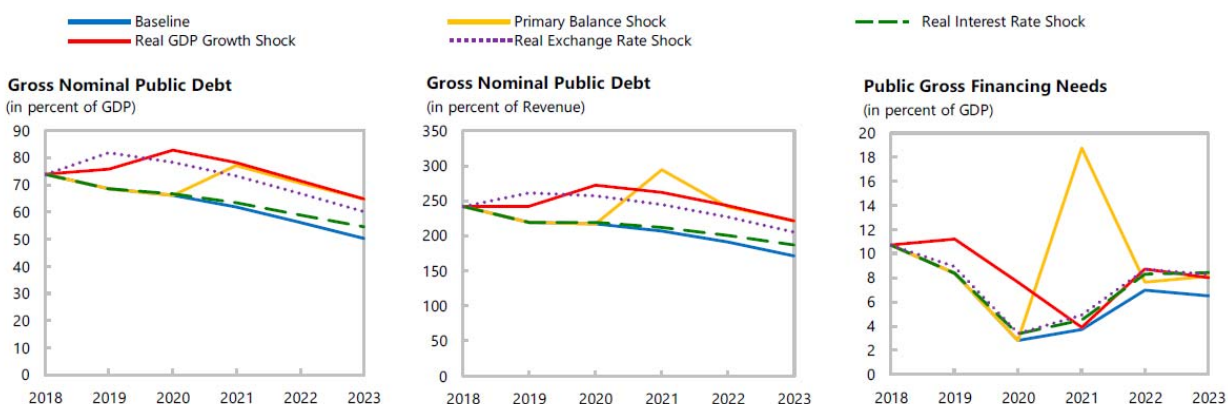
1/ DBM net lending is not included but monitored separately.

**24. The IMF Debt Sustainability Assessment (DSA November 2018 5<sup>th</sup> Review of EFF program) indicates that while the debt-to-GDP ratio is expected to fall further in the years ahead, important vulnerabilities remain (Figure 3).** The most important medium-term vulnerabilities pertain to the path for GDP growth, as well as fiscal and monetary policy management and the impact on the exchange rate. A decline in growth by one standard deviation below the long-term trend in 2019 and 2020 or a real exchange rate depreciation of 25



percent would push the debt-to-GDP-ratio back above 80 percent in 2020. Mongolia's net international investment position is weak, primarily reflecting limited foreign assets at the central bank (gross foreign exchange reserves are only 25 percent of GDP).<sup>12</sup> Moreover, Mongolia faces substantial external debt repayments amounting to US\$12.2 billion (close to 100 percent of the 2018 GDP) in the next five years, of which 45 percent is public sector debt including a US\$1.7 billion swap line with China. The conditions under which these debts can be rolled over are critical to the country's balance-of-payments outlook and long-term debt sustainability.

**Figure 3. Public and Publicly Guaranteed Debt Dynamics**



Source: IMF MAC Debt Sustainability Analysis, November 2018 (Fifth Review).

**25. The prospects of continued improvement in the fiscal and external positions and robust growth suggest that the current macroeconomic policy framework is adequate for this budget support operation to proceed.** The authorities have taken strong measures to restore fiscal sustainability and build external buffers through an economic policy adjustment program, in close coordination with development partners. The current program is expected to continue to reduce the budget deficit, stabilize the debt path, and rebuild external buffers by gradually reducing the current account deficit to adequate levels. The latest fiscal performance indicates that the fiscal consolidation remains on track, with a surplus of 1.6 percent of GDP in the first five months of 2019, against an end-year target of 5.9 percent deficit of GDP, initially planned in the EFF program document (May 2017).

**26. The economic outlook while positive is subject to considerable political and macroeconomic risks.** The major sources of external risks include (i) rising political pressures for loose policies in the run-up to the 2020 elections; (ii) a slower-than-expected increase in FDI in key mining projects due to an ongoing dispute on investment agreement with Oyu Tolgoi (OT); (iii) disruption in the transportation of mining products due to cross-border bottleneck; (iv) weaker-than-expected commodity prices, possibly due to increased global uncertainty including a planned slowdown of China's economy; (v) slower implementation of banking sector reforms and a possible delay in the IMF program; and (vi) slow implementation of measures to address deficiencies of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime. The proposed operation presents an opportunity to mitigate some of these risks: it provides an anchor for continued fiscal adjustment and supports the diversification of the economy. It also strengthens social policies, thereby reducing the risk of policy reversals triggered by an economic downturn. The IFC and MIGA

<sup>12</sup> Although dominated by intercompany and other private sector loans, external debt has risen to 240 percent of GDP from just 40 percent in the last 10 years.



are in close dialogue with the authorities to ensure the Oyu Tolgoi investment program is not interrupted. In addition, the authorities are in regular dialogue with the Chinese government. This dialogue and the upgrading of the customs facilities as planned in the 2019 budget are likely to mitigate cross-border bottlenecks and associated risks to export revenues. On AML issues, the authorities have taken steps to improve the AML/CFT framework with the 2019 budget allocating MNT 941.6 million to address these concerns.<sup>13</sup>

**27. An important risk to the medium-term outlook are the weaknesses in the banking sector, if left unaddressed.** An undercapitalized banking sector could exacerbate the vulnerability of the economy to a possible future economic downturn and increase its fiscal costs. As a result, the successful completion of the IMF EFF's 6<sup>th</sup> review is an important milestone to consolidate progress in financial sector reform. The authorities have committed to hire an external auditor to undertake a forensic audit of the recapitalization process and, based on the findings of the audit, to take the necessary actions to fully recapitalize the banks. These commitments have been incorporated in the EMSO program. The Bank's assessment is that while banking sector weaknesses represent a medium-term risk, there is no imminent danger to the macroeconomic framework. On the contrary, current economic conditions provide an excellent opportunity to address underlying concerns in the financial sector.

### 2.3. IMF RELATIONS

**28. In May 2017, the IMF's Executive Board approved a three-year US\$435 million Extended Fund Facility (EFF) for Mongolia.** The EFF program prioritizes (i) fiscal adjustment measures to reduce the deficit and restore debt sustainability, and structural fiscal reform measures to ensure fiscal discipline; (ii) measures to maintain appropriate monetary policy and a flexible exchange rate and to strengthen the governance and independence of the BoM; and (iii) measures to strengthen the resiliency of the banking system including the AQR of individual banks. As of end May 2019, five of the scheduled 12 quarterly reviews were completed. The World Bank and IMF have been closely coordinating on the reform program, including regular exchange of views, data, information, and cross-program triggers.

**29. The 6<sup>th</sup> review, originally planned for end-December 2018, was postponed due to delays in the implementation of reforms in the financial sector.** Under the IMF-supported program, the BoM is committed to take supervisory action (resolution or capital injection) against any bank that failed to address the capital shortfalls identified in the AQR. While the recent closure of one small and highly insolvent bank is a positive step, regulatory forbearance by the BoM remains a concern. Several banks remain undercapitalized and, in some cases, the integrity of the capitalization process is being questioned. More recently, the authorities have agreed to hire an external firm to undertake the forensic audit and to use the audit's findings to complete the recapitalization process (an effectiveness condition of EMSO 2), thereby beginning to address some of the factors that have delayed the completion of the sixth review.

## 3. GOVERNMENT PROGRAM

**30. The Government of Mongolia's economic reform program is anchored in the "Economic Recovery Program" (ERP), approved by the Parliament on November 24, 2016 (Figure 4).** The ERP aims to mitigate the

<sup>13</sup> In recent months, the authorities adopted amendments to the AML Law and Law on Infringements to address some of these concerns, but not in time to be considered for an upgrade at the annual Asian Pacific Group plenary in July 2018.



economic and social impact of the slowdown of 2014–16 and to restore fiscal sustainability, while pursuing structural reforms and promoting economic diversification. Modalities of the reform are further defined in a new development strategy called the “Three Pillars Development Policy” approved in February 2018. It has three pillars: (i) a diversified economic development policy; (ii) disciplined, accountable, and stable governance; and (iii) a social policy centered on the people of Mongolia.<sup>14</sup>

Figure 4. Key Reform Areas of the Government’s Economic Recovery Program (ERP)

Economic Recovery Program	
Strategic Objective I	Strategic Objective II
Economic policy adjustment to overcome short-term economic difficulties	Structural reforms for long-term stable growth path
<ul style="list-style-type: none"> <li>• Restore fiscal sustainability by: (i) reducing inefficient and unnecessary expenditures; and (ii) expanding the budget revenue base.</li> <li>• Discontinue the quasi-fiscal expenditures of the BoM and the DBM.</li> <li>• Assess the performance of, and the contingent liabilities from quasi-fiscal expenditures.</li> <li>• Prepare a plan to resolve the repayments of bonds issued by the government and the DBM.</li> <li>• Enhance monetary policy to: (i) increase international reserves; (ii) stabilize inflation; and (ii) maintain flexible exchange rate.</li> <li>• Maintain financial stability by appropriate liquidity management and proper prudential supervision of the banking system.</li> </ul>	<ul style="list-style-type: none"> <li>• Promote economic diversification by supporting non-mining sectors with large potential, e.g., livestock products such as meat, dairy, and skin/leather goods.</li> <li>• Expand bilateral trade and transit transport.</li> <li>• Attract foreign investments for sustainable and stable growth.</li> <li>• Strengthen the FDI environment, including the establishment of the Investor Protection Council.</li> <li>• Strengthen the fiscal legislation to restrict the parliament's power during the budget preparation.</li> <li>• Improve the governance, independence, and operational transparency of the BoM.</li> <li>• Improve the DBM law to ensure its transparent and efficient management.</li> </ul>

#### 4. PROPOSED OPERATION

##### 4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

**31. The proposed Second Economic Management Support Operation DPF (EMSO 2) supports the government’s efforts to** (i) restore debt sustainability through fiscal adjustments, (ii) strengthen social protection systems, and (iii) promote economic competitiveness by advancing structural reforms. These three components are fully consistent with the objectives of the ERP. EMSO’s Pillar 1 is linked to restoring fiscal sustainability objectives under the ERP. The second pillar aims to mitigate adverse impacts on poor households during fiscal adjustment by strengthening poverty-targeted social welfare programs and improving the long-term sustainability of the pension system. Pillar 3 of the proposed operation is squarely aligned with the structural reforms for the diversification objective of the ERP. More recently, the three-pillar development policy highlighted the importance of investing in the people of Mongolia, which is also the focus of EMSO’s Pillar 2.

<sup>14</sup> The government sees the Three Pillar Policy Development Policy as consistent with existing planning documents (for example, the Global SDGs [2015–2030]), Sustainable Development Concept for Mongolia 2030, Government Action Plan for 2016–20, and Economic Recovery Program), and it is an umbrella of public investment programs for 2018–20.



**32. The government's commitment to reforms is evidenced by recent measures introduced in the 2019 budget.** One of the key provisions includes saving any revenue overperformance in the Future Heritage Fund. It also postponed implementing measures to expand pension benefits and reduce eligibility conditions, which would have worsened the financial sustainability and fairness of the pension system. This is further supported by the ongoing preparation of amendments to the social insurance legislation to roll back some of the February 2017 measures.<sup>15</sup> The effort to stabilize the pension system continues despite the reversal of the measure to extend the retirement age, as agreed under EMSO 1.

**33. The proposed operation is designed using the lessons learned from the World Bank's experience with previous DPF operations in Mongolia.** The results of DPFs in Mongolia, in terms of the government's performance and outcomes, have been mixed. As indicated, the government reversed, at least partially, two prior actions agreed in EMSO 1. Moreover, the design of the EMSO program was built on important lessons from past DPFs: highest level political commitment to reforms; selectivity of the reform areas based on the government's implementation capacity; consensus building and good understanding of the political economy environment; and donor coordination, technical assistance, and linking the selected reforms with the World Bank's investment financing projects in the country.

#### 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

**34. This section describes the policy reforms implemented under EMSO 2 and envisaged for EMSO 3 under each pillar of the program.** The first operation laid the groundwork for continued reforms in targeted priority areas to be supported through the programmatic series. During the preparation of EMSO 1, the World Bank and the authorities identified a list of indicative triggers for EMSO 2 and EMSO 3. To be converted into the prior actions of EMSO 2, these individual triggers were reevaluated and the formulation of some of them was adjusted based on government's evolving priorities and progress on the ground (Annex 5). The triggers for EMSO 3, also presented in this section, may be amended over time.

##### Pillar 1. Restoring Debt Sustainability

**35. The government is determined to implement fiscal reforms to increase fiscal space and address Mongolia's daunting development challenges.** The most urgent actions to restore fiscal stability include phasing out quasi-fiscal spending of the DBM and the BoM, which was the major driver of unsustainable fiscal expansion and monetary easing during 2013–16; and improving the efficiency of the tax system and public investment management.

##### *Phasing Out DBM's Off-budget Spending*

**36. Rationale.** The DBM's off-budget operations were a major driver of Mongolia's unsustainable fiscal expansion of 2013–16, accounting for almost three-quarters of the consolidated budget deficit over the same period. Without stricter control and oversight over the DBM's operations, political pressures could end up pushing DBM again to engage in quasi-fiscal activities. Consequently, the government has adopted a set of reform actions on the DBM. These measures included ending DBM's non-commercial lending to the

<sup>15</sup> Reforms to repeal earlier pension buybacks and special provisions for herders are expected to be submitted to Cabinet and would then be considered by Parliament in the fall session.



government in 2017 (a prior action of EMSO 1) and the amendment of the development bank law to transform DBM into an independent and self-sustainable development bank, targeting only commercially viable projects. The successful bond issuance of US\$500 million by DBM (without government guarantee) in October 2018 is a validation from the market that it has turned around.

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**Prior Action 2.1:** *To improve Development Bank of Mongolia (DBM) corporate governance through transparency, the Recipient has publicly disclosed the comprehensive external special review on DBM's operations from 2012 to 2017.*

*As evidenced by:*

*(i) The Financial Diagnostic of the Development Bank of Mongolia dated December 4, 2018, published at <http://www.dbm.mn/>.*

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**37. Prior action.** A proposed reform measure for EMSO 2 was to comprehensively review the operations of DBM during 2012–17 through an external agency and publicly disclose the report (**Prior action 2.1**). This review will be the basis for the development of a comprehensive reform program to strengthen DBM financial soundness. The consulting firm PricewaterhouseCoopers (PwC) was hired by DBM to undertake the special review, and the final report is now published on DBM's website. A key highlight of the special review was that 30 out of a total of 40 corporate loans and about 88.5 percent of a total MNT 2 trillion exposure in 2017 were reclassified as non-performing. A government working group has already started to prepare a comprehensive reform program based on the findings of the special review. The government, which already requested technical assistance support from the World Bank and ADB, has signaled its intention to recruit key management of the DBM through an international competitive process.

**38. An indicative trigger for EMSO 3** will support the implementation of the recommendations of the special review for 2012–17 to further improve the DBM's management and operational structure toward an independent, profitable, and financially sound development bank in line with the amended DBM law (**Trigger 3.1**).

**39. Expected Outcome.** The proposed measures are expected to contribute to fiscal adjustment, by eliminating DBM-financed, off-budget capital expenditure. These will also help reduce fiscal risks by stopping the buildup of contingent liabilities in the future. The outcome will be measured by the elimination of the DBM-financed capital expenditure recorded in the budget, and the absence of new government guarantees in DBM resources mobilization efforts.

#### ***Phasing Out BoM's Quasi-Expenditure and Improving capital adequacy of banks***

**40. Rationale.** In the run-up to the 2016 macroeconomic crisis, the BoM engaged in large quasi-fiscal operations which were a key source of underlying fiscal vulnerability. In addition, lack of transparency in decision-making and implementation processes of key quasi-fiscal programs—particularly the Price Stabilization Program (PSP) and financial support to companies—had created significant concerns about the credit allocation mechanism and governance of the central bank. EMSO 1 supported the discontinuation of the BoM's net financing of the Housing Mortgage Program (HMP). The HMP has been run as a revolving fund since early 2017, using only principal repayments and interest inflows for additional loans. In 2019, the HMP was further amended as per the MOU between the BoM and the MoF along the following lines: (i) MoF to provide matching co-financing to commercial banks, and (ii) BoM to stop financing the Program entirely from



2020. A key prerequisite to improve the legal and regulatory reform of the mortgage securitization is the establishment of a Working Group consisting of MoF, Financial Regulatory Commission (FRC) and BoM as permanent members. To advance the recapitalization process, the authorities have agreed to engage an external auditor to conduct a forensic audit (an effectiveness condition for EMSO 2) and then to take the necessary steps to recapitalize the banks to meet prudential norms (a trigger for EMSO 3, jointly with the IMF EFF program).

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**Prior Action 2.2:** *To phase out the Bank of Mongolia (BoM)'s quasi-fiscal activities, the Recipient has restructured the Housing Mortgage Program to support affordable housing in a more cost-effective way, and with a time-bound plan for BoM to fully exit the Housing Mortgage Program.*

*As evidenced by:*

*(i) The Joint Decree between the BoM and the Minister of Finance (№ 285/A-334) dated December 20, 2018.*

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**Prior Action 2.3:** *To improve the Bank of Mongolia (BoM) corporate governance through transparency, the Recipient has publicly disclosed the independent special external review on BoM's quasi-fiscal operations, including the Housing Mortgage Program, Price Stabilization Program, and financial support to companies*

*As evidenced by:*

*(i) Special review on quasi-fiscal policy activities dated November 15, 2018, accessible at <https://www.mongolbank.mn/eng/news.aspx?id=2141&tid=1>.*

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**41. Prior Actions.** A proposed reform measure for EMSO 2 aims to restructure the Housing Mortgage Program (HMP) to better serve the purpose of affordable housing and establish a time-bound plan for the BoM to fully exit the program (**Prior action 2.2**). Another critical measure focuses on the public disclosure of the findings of an external review of all quasi-fiscal activities (including the HMP, PSP, and financial support to companies) (**Prior action 2.3**). The Minister of Finance and the BoM Governor signed a joint decree that stipulates the final exit (stoppage of funding) of the BoM from the HMP by 2020. The KPMG consulting firm conducted the special review on BoM's quasi-fiscal activities, and two versions of the report (English and Mongolian translation) have been posted on the BoM's website since December 31, 2018. Selected key highlights of the review include increased BoM exposure to counterparty credit risk and lax bank supervision resulting in a rise in the NPLs for commercial banks. Moreover, accounting losses incurred by BoM represented 16.6 percent of the state budget in 2013 and 12.8 percent in 2014. Many of these weaknesses are already being addressed including the amended central bank law.

**42. An indicative trigger for EMSO 3** will support implementation of the BoM's time-bound exit plan from the HMP starting from 2020. (**Trigger 3.2**). A second trigger for EMSO 3 will focus on strengthening the legal and regulatory framework of mortgage securitization. Following the start of this work in 2018, a formal decision [e.g., a joint decree with MoF, FRC, and BoM as co-signatories] to establish a Working Group with MoF, FRC, and BoM as permanent members and finalization of the detailed reform roadmap are expected in 2020 (**Trigger 3.3**). A third trigger will support measures to recapitalize the banks based on the findings of the forensic audit (**Trigger 3.4**).

**43. Expected outcome.** The proposed actions are expected to strengthen fiscal discipline, transparency and credibility of monetary policy, and banks to meet prudential capital norms. The outcomes will be measured by: (i) reduction of the BoM's net financing of the HMP, (ii) BoM's outstanding loans to the Price Stabilization



Program (PSP) and corporate bond holdings, and (iii) recapitalization of banks to meet prudential norms. The PSP loans were fully withdrawn in 2018. The outstanding corporate bonds held by the BoM will be contained at their current level, following the discontinuation of corporate bond purchases. The repayment of outstanding corporate bonds is expected to start in 2020.

### ***Efficient and Sustainable Domestic Revenue Mobilization Management***

**44. Rationale.** Tax reforms supported by the EMSO program aim to contribute to fiscal consolidation by mobilizing additional revenues and expanding the tax base. Tax expenditures, mainly driven by exemptions and incentives, have been a significant source of tax base erosion (Public Expenditure Review [PER] 2018), with an estimated revenue forgone of 14.5 percent of total tax revenue in 2016. The country lacked a transparent and comprehensive evaluation framework to assess the cost-effectiveness of tax expenditures and to take informed decisions. On March 22, 2019, the Parliament approved a revised package of tax amendments aimed at simplifying tax policy and broadening the tax base. The package includes measures to rationalize tax exemptions and incentives, although the latter are not based on a cost-benefit analysis. EMSO 3 will assess whether the revised tax legislation recently approved draws on international taxation principles such as transfer pricing, General Anti-Abuse Rule (GAAR), and other Base Erosion and Profit Shifting (BEPS) issues.<sup>16</sup>

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***Prior Action 2.4:*** *To improve efficiency of revenue mobilization, the Recipient has established a framework to evaluate the tax expenditure system in terms of the costs and benefits aimed to reduce ineffective tax incentives and exemptions, starting with the 2020 budget.*

*As evidenced by:*

*(i) Ministerial Order (№ 99) of May 1, 2019.*

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**45. Prior Action.** A proposed reform measure for EMSO 2 is the adoption of an evaluation framework of tax expenditures to reduce ineffective tax incentives and exemptions, starting with the 2020 budget (***Prior action 2.4***). A World Bank technical assistance to rationalize tax exemptions and incentives using a costs and benefits framework was provided to the MoF. The evaluation framework was adopted through a ministerial order on May 1, 2019 (*Ministerial Order № 99*).

**46. An indicative trigger for the third-year operation (EMSO 3)** will support the submission of a draft 2020 budget law in which new requests for tax exemptions and incentives are assessed based on a cost-benefit analysis of individual tax incentive and exemption programs (***Trigger 3.5***). Another trigger to support revising tax laws and regulations to align Mongolia's tax regime with agreed international tax standards (transfer pricing regulations, interest deductibility, and Base Erosion and Profit Shifting [BEPS]-related actions), and to introduce a General Anti-Avoidance Rule (GAAR) (***Trigger 3.6***).

**47. Expected Outcome.** The measures to enhance efficiency of tax revenue and administration, including through the reduction of ineffective tax exemptions and incentives and the adoption of GAAR principles, are aimed at broadening Mongolia's tax base.

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<sup>16</sup> The PER 2018 also advised a thorough review of international aspects of tax laws including effectiveness of related party definitions, updating of transfer pricing legislation, transfer pricing instruments, thin capitalization, and double tax treaty application, and to include a General Anti-Avoidance Rule (GAAR) in the Mongolian legislation to better fight against tax avoidance arrangements.



### ***Efficient Public Investment Management***

**48. Rationale.** Following the halting and indefinite suspension of the Promissory Notes Program in 2017 (under EMSO 1), which contributed to the sharp increase in capital expenditure at the end of 2016 (from 6.0 percent in 2015 to 9.9 percent of GDP in 2016), the focus shifted to strengthening the Public Investment Management (PIM) system. This was done by gradually developing an appropriate legal and regulatory structure for the state-budget-funded PIM including guidelines and procedures, methodological manuals, and the legal framework.<sup>17</sup> Actual project planning, appraisal, and budgeting processes were managed by internal discussions and agreements among key stakeholders, including the MoF and line ministries, without clear technical guidance for setting rules and decision making. In fact, there was no detailed technical guidance for (pre-) feasibility studies, no operational guidance for project implementation, and no technical guidance for DBM or PPP project management in the budget process.

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***Prior Action 2.5:*** *To improve efficiency of ongoing and new investment projects in the budget, the Recipient has adopted a regulation to enhance appraisal, prioritization and selection of projects.*

*As evidenced by:*

*(i) Ministerial Order (№ 295) of December 25, 2018.*

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**49. Prior Action.** A proposed reform measure of EMSO 2 focuses on the adoption, by a ministerial order, of a new public investment regulation for project selection, appraisal, and rationalization aimed at improving planning and management of public capital expenditure (***Prior action 2.5***). In December 2018, the government, through Ministerial Order No. 295, adopted a new regulation for appraisal, prioritization, and selection of projects. The Ministerial Order includes both elements for the appraisal and selection of new investments, as well as a rationalization methodology for ongoing projects.<sup>18</sup> The regulation was developed with technical assistance from the Bank, and covers two major aspects of the Mongolia PIM: it introduces assessment and evaluation elements to increase the quality at entry of new investments, and it establishes specific provisions for rationalization of the current portfolio of projects that has been subject to poor project preparation and implementation in recent years. The new regulation is expected to be applied for the preparation of the 2020 public investment budget in at least the three ministries. The full rollout is expected to take place in 2021.

**50. An indicative trigger for EMSO 3** aims to improve the selection of new projects by better aligning the public investment budget with strategic priorities and a hard budget constraint. This measure builds on the Public Investment Management Assessment Report jointly prepared by the IMF and the Bank, and the 2018 Public Expenditure Review (PER) of the Bank. The Integrated Budget Law is expected to (a) publish the medium-term public investment spending in the Medium-Term Fiscal Framework; (b) require all projects, regardless of funding source, to be properly appraised prior to the budget, and approved through the budget

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<sup>17</sup> To facilitate implementation of the various provisions in the Integrated Budget Law (IBL) and the related resolutions, specific practical guidance should have been developed, yet only limited or weak guidance was provided and disseminated in practice.

<sup>18</sup> Detailed methodological manuals and tools to complement the provisions set forth in the new regulation (for both existing and new projects) are currently available. Training on the methodologies is being conducted for the relevant line ministries and local government officials and the use of the draft manual is being piloted as part of the preparation of the 2020 budget. To reflect the adoption of the regulation on appraisal, prioritization and selection of projects and other ongoing efforts to improve transparency of public investment financing with support of an IT platform, the MOF is working on amending the Ministerial Order No. 415 (of December 2016) on Public Investment Planning, Financing, Monitoring, and Reporting.



process; (c) publish project appraisal and selection criteria for all new investment projects consistent with planning guidelines issued by the authorities; and (d) require an adequate maintenance budget of all investment projects (*Trigger 3.7*).

**51. Expected Outcome.** The outcome of the proposed actions will be measured by the removal of the capital expenditure for promissory notes in 2017–19; improved efficiency of the investment budget by restructuring non-performing projects based on the Rationalization Guideline; and selection of all new public investment projects, including PPPs and concessions, based on the new appraisal and selection methodology that fully incorporates operation and maintenance costs.

#### *Governance of government's special funds*

**52. Rationale.** Despite the government's efforts to bring about more transparency and accountability in public matters, the governance and management of public resources was seriously questioned when potential improper use of the Small and Medium Enterprises (SMEs) Development Fund was brought to light. Incidentally, the MoF initially raised concerns on the operationalization of government special funds and requested support from the international partners to address the governance concerns.

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*Prior Action 2.6: To improve transparency of Government Special Funds, the Recipient has improved the legal, governance, and monitoring frameworks of the state budget-financed Government Special Funds that extend loans and grants.*

*As evidenced by:*

*(i) The Cabinet Resolution (No 87) dated February 27, 2019.*

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**53. Prior Action.** A proposed reform measure of EMSO 2 focuses on the adoption of a resolution by the government to improve the legal, operational, and monitoring frameworks of government special funds and other special programs financed from the state budget. Following the government's review of the active special funds (a total of 29), a government resolution issued (No. 87 on February 27, 2019) provides a framework to improve their structure and operation. Key decisions taken after the review was conducted include (i) closing the operations of seven funds, (ii) merging the operations of three funds, (iii) improving the operations of three funds, and (iv) maintaining the existing operations of the remaining 20 funds. Fourteen specific actions were included in this resolution aimed to improve the operationalization of the state budget-financed special funds and other programs that extend loans and grants. This is a new prior action included in EMSO 2 in response to the need to improve the governance of SME development fund and other government special funds.

**54. An indicative trigger for EMSO 3** will support the government's implementation of an action plan to improve the management and monitoring of government special funds and other programs financed from the state budget (*Trigger 3.8*).

**55. Expected Outcome.** The outcome of the proposed steps will be measured by the public disclosure of beneficiaries' (legal entities and individuals) information (including names, amounts, terms, and repayment status) of the government special funds in accordance with the relevant laws by 2020, and the government special funds that extend loans and grants to be channeled through banks in good standing as assessed by the Assets Quality Review of BoM by 2020.



## Pillar 2. Strengthening the Social Protection System

### *Safeguarding the poor and vulnerable*

**56. Rationale.** Ensuring adequate protection of the poor is vital in maintaining economic and social stability during periods of fiscal adjustment, particularly considering the deterioration of poverty indicators between 2014 and 2016.<sup>19</sup> The EMSO series focuses on expanding social welfare support targeted toward the poor and vulnerable households. It ensures (i) expansion of funding for the Food Stamp Program (FSP) and other poverty targeted programs, and (ii) improvement of the legal framework for making the social welfare system more pro-poor. The EMSO 2 prior action represents a first important step toward a deeper reform that intends to channel more resources to the poor, consolidate benefits, and increase efficiency. EMSO 2 focuses on an increased aggregated budget allocation to both FSP and other poverty-targeted programs in the 2019 budget. The Ministry of Labor and Social Protection (MoLSP) plans to improve the targeting of existing beneficiaries in line with ongoing revisions of the poverty targeting methodology.<sup>20</sup>

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**Prior Action 2.7:** *To increase protection of the poor, the Recipient has increased the total budget allocation for the Food Stamp Program (FSP) and other poverty-targeted programs in 2019 compared to the 2016 level, in line with MTFE allocations.*

*As evidenced by:*

*(i) The Minister of Finance Ordinance (No 309) on the 2019 budget monthly plan, dated December 28, 2018.*

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**57. Prior Action.** A proposed prior action of EMSO 2 will support the increased budget allocation toward the poverty-targeted Food Stamp Program and other poverty-targeted programs in 2019 (**Prior action 2.6**). The 2018 budget allocated MNT 42.2 billion to the FSP compared to MNT 18.1 billion in the 2017 budget. The 2019 budget execution schedule approved by the MoF (as of December 2018) indicated MNT 31.1 billion for other poverty-targeted programs in addition to maintaining the amount for the FSP. The combined allocation for both programs (MNT 73.3 billion) in 2019 represents a substantial increase over the 2016 level.

**58. An indicative trigger for the third-year operation (EMSO 3)** will support maintaining the level of social spending on poverty-targeted benefits and the rationalization of existing social welfare programs to improve their governance and efficiency (**Trigger 3.9**). Following a review of the social welfare programs, the government has issued a resolution to rationalize these programs while maintaining the funding for poverty-targeted programs in the 2020 budget.<sup>21</sup> Based on the resolution, the Social Welfare Law is expected to be revised to strengthen the principles of targeting, increase efficiency in service and program delivery, and introduce links between social assistance and employment support.

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<sup>19</sup> The release of the 2018 poverty incidence is scheduled for July 2019.

<sup>20</sup> The MLSP plans to channel a greater proportion of available budgetary resources to support the poor through a gradual application of poverty targeting to the existing benefits. It envisaged channeling the resources for (i) increasing the monthly allowance for caretakers of disabled children in need of permanent care to the level of Social Welfare Pension, and (ii) partial reimbursement of school uniform costs for children from poor families, starting from 2020. Together these two programs will require up to MNT 13 billion per year. If the government sticks to this plan, the total budget required for the FSP and above-mentioned benefits would entail a total budget commitment of MNT 55.2 billion, which is more than three times the 2016 level of MNT 18.1 billion.

<sup>21</sup> Review of social welfare benefits is currently ongoing and is expected to be completed by October 2019.



**59. Expected Outcome.** The proposed actions are expected to lead to better protection of the poor during fiscal adjustment and improve the efficiency of the social welfare system. While the Food Stamp Program coverage and benefit size per beneficiary are expected to be maintained at the 2018 level (significantly higher than the 2016 level), the additional support to the poor will be provided through other poverty-targeted programs. This reform is viewed as a transitional step toward a more ambitious and sustainable reform in EMSO 3, which will increase efficiency of spending and rationalize existing social welfare programs.

***Enhancing the financial sustainability of the pension system***

**60. Rationale.** The overall fiscal cost of the social insurance system and the direct budgetary subsidy to pensions have been increasing in recent years, reaching 2.2 percent of GDP in 2018, and both are forecasted to materially increase in the coming years. The legal amendments to pension legislation enacted in February 2017, unless corrected, will further increase the fiscal burden and create considerable inequity in the pension insurance system. These include (i) reducing the age for eligibility for pension insurance benefits by five years for herders; (ii) calculating each year of herders' contributory service as 1.5 years instead of one year; (iii) introducing a second round of service "buyback" options for herders and the self-employed; (iv) awarding 1.5 service years for retiring mothers per child; and (v) guaranteeing social insurance premiums for mothers looking after a child under three years of age, financed by employers and the Social Insurance Fund. With the Parliamentary approval of the 2019 budget, implementation of most of these measures was postponed until January 2020 while the reduction in the herder's benefit eligibility age became effective in 2018. While the postponement was welcome in terms of controlling more rapid escalation of the pension system deficit, the continued presence of such provisions in the social insurance law has remained a future risk. Against this backdrop, the EMSO series aimed to support a three-phased program of changes in pension parameters and qualifying conditions, as indicated below.

**61. The first phase supported under the EMSO** involved a gradual increase in both the retirement age and the pension insurance contribution rate from 14 percent to 19 percent (taking together the contribution of employer and employee) over three years. However, shortly after board approval of EMSO 1, the authorities partially reversed the prior action on increasing the retirement age in February 2018 by allowing voluntary early retirement at age 55 for women and 60 for men. At the same time, the authorities introduced some additional parametric changes (such as gradual increase of the pension vesting period from 20 to 25 years and the wage reference period from 60 months to 74 months) that are projected to have some positive effects on pension system finances. The second phase aims to reverse most of the legal changes made in February 2017 that further jeopardize pension finance and have had their effectiveness delayed to date. The third phase aims for more comprehensive reform of pension system parameters in subsequent years with the aim of containing the escalation in the pension system deficit.

**62. Prior Action. No prior action** has been proposed on pensions under EMSO 2. However, recognizing the risks of the 2017 legal changes remaining in the pensions policy framework, the government plans to introduce corrective measures to the 2017 amendments to the social insurance legislation, which could have been considered as a potential prior action for the proposed EMSO 2. But, the approval of these measures is expected to be done during the fall session of the Parliament and hence could not be included in this operation.<sup>22</sup>

<sup>22</sup> The key features of the amendment package included: (i) introduction of a set of limits to the service buyback for herders and self-



**63. Indicative triggers for the third-year operation (EMSO 3)** will support the adoption of a comprehensive reform package to the Pension Insurance Scheme aimed at maintaining the financial sustainability of the pension system and improving its fairness. The first trigger of the operation in this area will focus on the submission to Parliament of a set of corrective measures to the above-mentioned legal changes made in 2017 (**Trigger 3.10**). The second trigger will emphasize the Cabinet’s endorsement of a reform package to the Pension Insurance Scheme which aims to improve the financial sustainability of the pension system (**Trigger 3.11**). This trigger was initially envisioned for EMSO 2 but is being postponed to EMSO 3 to allow more time to prepare a coherent reform package with a strong emphasis on parametric reform of the defined benefit pension provisions, recognizing the complexity of the various laws governing the social insurance system. The precise combination of reform measures will be developed over the coming months, but in combination would aim to contain the escalation of the pension system deficit and improve the fairness of the pension system.<sup>23</sup> The government’s sustainability target set out in the state policy on pension reform was passed by Parliament in 2015 to limit the state subsidy to pensions to 2.0 percent of GDP by 2030.

**64. Expected Outcome.** If legislated, the proposed corrective actions that are currently in progress will effectively remove the bulk of fiscal costs of the 2017 legal changes and thus act as a key stabilization measure for the pension system. Beyond that, the EMSO 3 reform package aims to put pension system finances on a path to achieve a fiscally sustainable position, and further enhance the fairness of the system across different social groups and cohorts.

### **Pillar 3. Supporting Economic Competitiveness through Structural Reforms**

#### ***Enhancing the investment and business climate***

**65. Rationale.** Improving the investment and business environment is paramount to revitalizing foreign and domestic investments and creating jobs and sustained economic growth. However, investor confidence in Mongolia continues to be eroded by a weak regulatory environment due to (i) uneven access to regulatory information, licenses, or finance; (ii) frequent changes in laws and regulations; and (iii) sectoral issues such as access to land for agricultural investments.<sup>24</sup> Uneven treatment of companies also affects competition and generates barriers to entry to newcomers.

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***Prior Action 2.8:*** *To improve ease of doing business, the Recipient has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public administrations and reducing their number.*

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employed, (ii) cancellation of the legal provision on the herders’ service supplement of counting one year of herding as one year and six months of service for pension calculation, and (iii) introduction of cost sharing for the guaranteed Social Insurance premium for mothers looking after a child under three years of age (50/50 cost share between mothers and the Social Insurance Fund). As of the end of May 2019, the first two steps toward the submission of legal amendments have been completed, that are the Ministry of Justice and Internal Affairs (MoJIA) has approved the concept note submitted by the MoLSP outlining the above amendments; and the draft legal changes have been reviewed and cleared by other line ministries.

<sup>23</sup> The Bank team has worked with the MoLSP to model pension system finances under different parametric reform scenarios using the Bank’s pension reform options simulation toolkit (PROST). The modeling results would provide a robust base for estimating the trajectory of pension system finances to 2030 and beyond. Some additional accrual projections are currently ongoing.

<sup>24</sup> Although Mongolia is ranked favorably (#23) on construction permits of in the Doing Business Report 2019, the issue has always been the high number of permits and licenses required for doing business which is believed to fuel red tape. According to the Bank’s Worldwide Governance Indicators, regulatory quality remains low (below the midpoint) and has not improved since the early 2000s, while the indicators for the rule of law and for corruption have significantly decreased.



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*As evidenced by:*

*(i) The summary accompanying the draft Permit Law to the Parliament jointly signed by the cabinet secretariat minister and justice minister, dated April 30, 2019. Accessible at <http://forum.parliament.mn/projects/593>.*

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**66. Prior Action.** The operation will focus on the reform of permits and licenses to reduce the administrative burden on businesses. The government will submit a draft Permit Law to Parliament—an umbrella law to clarify in a comprehensive manner all the licenses granted by public administrations (for example, business and trade) (**Prior action 2.9**). The government has completed an internal review of the draft Permit Law by ministries and agencies and organized several public consultations on the law in accordance with law drafting requirements set by Law on Legislation from end-March. The minister of finance recently submitted the draft Permit Law to Parliament, which is listed among the draft bills to be discussed by the Parliament during the spring session.

**67. An indicative trigger for EMSO 3** will support the government’s efforts to enhance the effectiveness of Competition Policy in Mongolia by developing the tools to embed competition principles across sectors and regulatory authorities to level the playing field between private and public operators (**Trigger 3.12**). The Authority for Fair Competition and Consumer Protection (AFCCP) is expected to identify and remove key anticompetitive interventions of governmental bodies to level the playing field and prevent grievances.<sup>25</sup>

**68. Expected Outcome.** The proposed measures are expected to contribute to improving investor sentiment through stronger investor protection mechanisms, reducing the administrative burden on businesses through streamlined permit requirements, and providing a level playing field for private businesses through improved competition policy. Moreover, the number of permits is expected to be reduced based on the criteria of legality, necessity, and business friendliness, and could also have significant environmental and social benefits.

### ***Improving the Competitiveness of Livestock Products***

**69. Rationale.** This set of proposed actions aims to support the competitiveness of meat exports, one of the non-mineral products with significant potential, by addressing its key constraint—animal health. An important priority for the government—as described in their Government Action Plan 2016–2020—is to diversify their export capacity to non-mining products and goods. Meat is already one of the main non-mineral export products and has a significant potential to contribute to diversifying the country’s export basket. A recent World Bank report highlights the emergence and rapid growth of new markets for the red meat sector from China, Vietnam, Egypt, and other Middle East countries. These new markets show strong interest for Mongolian livestock products as they are perceived as being produced in an “organic” and environmentally sustainable way. However, regular occurrence of outbreaks of major contagious animal diseases have prevented Mongolia from securing access to those opportunities.<sup>26</sup>

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<sup>25</sup> Building on the prohibition of anticompetitive actions by public bodies established by Article 13 of the Competition Law, this effort could identify and suppress the rules that (i) reinforce dominance or limit entry—for example, absolute entry restrictions, incumbent involvement in entry decisions; (ii) facilitate collusive outcomes—for example, regulations facilitating price fixing through self-/co-regulation or information exchange; and/or (iii) discriminate and protect vested interests—for example, explicit discriminatory rules without justification, selective subsidies and incentives that distort the level playing field, explicit lack of competitive neutrality.

<sup>26</sup> Uruguay absorbs about 20 percent of the Chinese demand for red meat, mainly by controlling transboundary animal diseases and



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**Prior Action 2.9:** *To improve competitiveness of livestock product exports, the Recipient has approved a package of regulations, ordinances, or guidelines to operationalize the Livestock and Animal Health Law, including the modalities of (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal disease control strategic plans, and (iv) herders' obligations.*

*As evidenced through:*

*(i) the Regulation on determination and declaration of disease-free status adopted as an Appendix to the Resolution A-40 issued by Minister of Food, Agriculture and Light Industry dated February 20, 2019;*

*(ii) the Regulation on the activities to be implemented during the quarantine and restriction regime adopted as an Attachment 2 to the Government Resolution Number 266 issued by the Government dated August 22, 2018; and*

*(iii) the Guidelines on veterinary and quarantine for transboundary animal disease free compartment adopted as an Appendix 1 to the Order A/17 issued by Director of General Authority for Veterinary Services dated April 24, 2018.*

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**70. Prior Action.** The proposed prior action of EMSO 2 focuses on preparing and adopting regulations, ordinances, and guidelines that are necessary to enforce the new animal health management framework, using a consultative and participatory approach. The regulations will define the modalities, terms, and conditions for (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal diseases control strategic plans, and (iv) herders' obligations under the new Livestock and Animal Health Law (**Prior action 2.10**). The new Livestock and Animal Health Law became effective in June 2018. The General Authority for Veterinary Services (GAVS) has been established and an agency head and directors of all departments appointed. GAVS has identified about 120 regulations at all levels that need to be in place covering the broad remit of the veterinary services including the disease-free zone, quarantine, and herder engagement issues.<sup>27</sup> Of these, 90 regulations have been approved.

**71. An indicative trigger for the third-year operation (EMSO 3)** will support the government's efforts to further develop remaining regulations and guidelines needed for the adequate implementation for the Livestock and Animal Health Law. Moreover, it will support the implementation of animal disease free zone regulation by controlling through vaccination the spread of foot and mouth disease (FMD) and *Peste des Petits Ruminants* (PPR) in risk-prone areas (**Trigger 3.13**). The government has started implementing the public awareness and knowledge/capacity building campaign of the new legal and regulatory framework for animal health targeting the capital city, all *aimags* (21) and *soums* (330). Livestock and Animal health law orientations have taken place in several provinces through regional veterinary conferences (500 vets were directly involved) and veterinary license trainings (450 veterinarians). The utilization of herder's log book of animal health activities by veterinarian and veterinary paraprofessionals has already started nationwide. Herder's log book serves as an important reference for assessing the veterinary activities and therefore readiness of animal

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ensuring full identification and traceability of its livestock

<sup>27</sup> These include quarantine procedures adopted by the Cabinet (August 22, 2018); veterinary services during livestock supply, transportation, and receipt by slaughtering facilities adopted by Mongolian Ministry of Food, Agriculture and Light Industry (MOFALI) (Order No. 181); and the list of quarantine animal diseases adopted by the Cabinet (Decree 225, July 9, 2018); the list of animal diseases to announce a special quarantine regime; and 24 approved guidelines on animal diseases. In addition, contingency plans for 71 diseases (out of 72) and 1 emergency preparedness plan (out of 4) have been approved.



products for market. GAVS is also developing a comprehensive capacity building strategy and relevant materials to scale-up training and extension activities.

**72. Expected Outcome.** The adoption and dissemination of the legal framework for animal health will contribute to strengthening veterinary services, better controlling and reducing the number of disease outbreaks, and eventually facilitating livestock exports.

#### ***Facilitating Trade and Improving the Border Clearance Process***

**73. Rationale.** The potential benefits of trade facilitation reforms for Mongolia and the trading community are significant. Mongolia's trade facilitation performance remains hampered by high trade costs, long delays, and a generally complex and opaque trade environment. Addressing these issues will be critical to improve the business environment and attract new investments. Trade facilitation reforms will also contribute to strengthening competition in the economy, which currently remains limited in key sectors.<sup>28</sup> Against this backdrop, EMSO 2 and EMSO 3 support the government in successfully implementing the complex reform program of the border clearance process and management, requiring a high degree of interagency cooperation and coordination. The National Trade Facilitation Committee was set up in December 2017 in the context of the Trade Facilitation Agreement (TFA), but its operationalization remains limited due to understaffing. The development of a national Trade Information Portal is ongoing.

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***Prior Action 2.10:*** *To improve the trade environment, the Recipient has adopted the institutional framework for the TFA implementation, including (i) a time-bound action plan for its full implementation, (ii) establishment of an interagency coordination mechanism for the TFA, and (iii) establishment of a Trade Information Portal (TIP).*

*As evidenced by:*

*(i) The National Committee on Trade Facilitation Strategic Action Plan 2018–2022, October 4, 2018.*

*(ii) The decision made during the fourth meeting session of National Committee on Trade Facilitation, January 10, 2019.*

*(iii) Joint Order (No. A/27/78) by the Minister of Foreign Affairs and Minister of Finance signed on March 29, 2019.*

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**74. Prior Action.** The proposed EMSO 2 supports the government's efforts to adopt an institutional framework for TFA implementation to prompt effective coordination across government's agencies and start implementing priority commitments (***Prior action 2.10***).<sup>29</sup> The National Trade Facilitation Committee meeting held in October 2018 approved the National Trade Facilitation Roadmap for 2018-2022 and the National Committee on Trade Facilitation Strategic Action Plan for 2018-2022. It also established a special working group to monitor progress on the development of the Trade Information Portal as a repository of all import and export regulations. Customs was mandated by the MoF as the responsible agency for the Trade

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<sup>28</sup> To make improvements, Mongolia needs to reduce physical inspections of cargos at the borders, by implementing risk-based approaches and increasing the use of ICT for information sharing, developing more competitive infrastructure at the borders, and improving its services and tracking systems.

<sup>29</sup> The establishment of the National Trade Facilitation Committee as a coordination mechanism will respond to commitments under Article 13.2. Approving a time-bound action plan for TFA implementation will enable the committee to closely monitor implementation progress.



Information Portal. A joint resolution (No. A/27/78) between the MoFA and MoF was signed on March 29, 2019.

**75. An indicative trigger for the third-year operation (EMSO 3)** will support the implementation of more complex trade facilitation reforms to border management. These reforms will include (i) improving coordination and eliminating duplication of activities among customs and other border agencies, (ii) improving border inspection processes by implementing a fully integrated risk management approach to better target high-risk consignments for physical inspection of cargos, and (iii) reducing the time needed for physical inspections and testing of low-risk cargo (*Trigger 3.14*).

**76. Expected Outcome.** Implementation of the TFA is expected to contribute to export facilitation and private sector expansion by reducing trade transaction costs, improving transparency and predictability, and lowering processing and clearance time for imports, exports, and transit goods.

#### 4.3 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

**77. The national consultation processes took place with a wide range of stakeholders, led by the government.** The World Bank has conducted a series of consultation meetings and public presentations with relevant standing committees of parliament, local government as well as academics and the business community on the proposed structural reforms. In particular, an extensive dialogue has been held on the pension and social welfare prior actions given their complexity. In addition, the three pillars of this operation featured high during the SCD and CPF consultations in August-September 2017 and January 2019 with a broad range of stakeholders in Mongolia.

**78. This operation has been developed in close consultation with key Development Partners.** Close collaboration has been maintained particularly with the IMF, ADB, JICA and Korea from the scoping stage of the EMSO programmatic series. Assessments on the macro-economic framework and policy recommendations have been exchanged between the World Bank and the IMF, through the World Bank's regular Mongolia Economic Updates and the IMF's Article IV missions and sequential reviews of its EFF program. The World Bank and ADB joined a staff-level mission of the IMF and closely coordinated on key reform areas supported by each institution. The proposed policy matrix of the DPF has been regularly shared with the IMF, ADB, and JICA and extensive collaboration has been made between the task teams of each institution. The World Bank economists frequently provide updates on Mongolia's economic performance and the status of the economic reforms at the monthly meetings of Development Partners. The IMF has provided an assessment letter reflecting their views of the macroeconomic framework and the risks associated in particular with delays in the implementation of banking sector reform. The Bank is strengthening its engagement on financial sector stability issues under the EMSO series in reflection of these concerns and will continue to coordinate closely with the IMF team through the implementation of this programmatic series.

#### 4.4 LINK TO CPF AND OTHER BANK OPERATIONS

**79. The key areas of support by this DPF are consistent with the last Country Partnership Strategy (CPS) and the most recent Progress and Learning Review (PLR).** The CPS, which was launched in 2012 and will soon need to be renewed, stressed, among others, the importance of improving resource revenue management, promoting economic diversification and competitiveness, and better targeting of social welfare programs. The PLR, which was discussed by the Board in December 2016, confirms these areas as important priorities and



highlights the government's request for a DPF to support Mongolia's economic recovery in close coalition with the IMF and other development partners. The PLR further confirms the Bank's readiness to engage in policy-based lending. In addition, the three pillars of the proposed operation are squarely aligned with the development priorities highlighted in the recent Systematic Country Diagnostic (SCD), which was published in November 2018. The DPF has been closely supported by the analytic work and technical assistance of the Bank, including: (i) the Public Expenditure Review - 2018; (ii) the Strengthening Fiscal and Financial Stability Project (SFFS); and (iii) other sectoral TA activities including audits of the BoM and the DBM, restructuring of the Housing Mortgage Program, tax expenditure review and the preparation of the PIP Guideline, and pension reforms and TFA.

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1. POVERTY AND SOCIAL IMPACT

**80. The Poverty and Social Impact Analysis (PSIA) focuses on a subset of the proposed policy actions of this DPF that are likely to have short-term poverty and distributional consequences.** Such measures include the restructuring of the Housing Mortgage Program, and the expansion of the Food Stamp Program and other poverty-targeted programs. Finally, the PSIA focuses on the distributional impacts of changes to the Livestock and Animal Health Law, because the herders represent an important share of the population, the labor force, and the poor. Over the medium term, the measures supporting improvements in the business climate and non-mining sector job creation under pillar 3 are expected to improve the trickle down from growth to poverty reduction, which has remained limited in recent years.

**81. The expansion of the Food Stamp Program and other poverty-targeted programs will have a pro-poor impact.** By the end of the program, the combined budget allocation for both programs will have expanded by at least 300 percent compared to the baseline (2016). The implementation of these reforms is projected to have a strong progressive impact on disposable incomes. We assume an additional 20 percent increase in food stamp benefits<sup>30</sup> and randomly assign the transfers with a probability of 0.5 among those below the official poverty line. Increase in per capita consumption of those under the official poverty line is around 5 percent compared to no change seen in per capita consumption among the non-poor households who are not eligible for these programs, and the official poverty headcount rate is estimated to drop by around 2.5 percentage points after the reform. This simulation exercise only looks at the short-term cash-transfer side of the policy reforms.<sup>31</sup>

**82. The impact of pension system reform on the poor could be positive in the medium to long run but is uncertain in the short term.** While the 2017 measures may have benefited some poor in the short run, they would—if not reversed—undermine the overall fairness, coherence, and sustainability of the pension system,

<sup>30</sup> The simulation uses 2016 Household Socio-Economic Survey data.

<sup>31</sup> The simulations of tax and cash transfers are done following the principles outlined in recent World Bank studies. These studies follow methods developed by N. Lustig in the "Commitment to Equity Handbook. A guide to estimating the impact of fiscal policy on Inequality and Poverty," Tulane University, 2016; and from L. Abramovski and D. Phillips, "A tax micro-simulator for Mexico (MEXTAX) and its application to the 2010 tax reforms," Institute for Fiscal Studies Working Paper, W15/23, London, 2012. In general, the following procedures were adopted: (i) gross-up disposable income as reported in household survey by deducting the current personal income tax and removing public transfers; (ii) apply new personal income tax, (iii) add new public transfers, and (iv) derive changes in prices of consumption goods due to changes in excise taxes and equal them to changes in disposable income.



thus threatening the future adequacy of pensions for all participants across the distribution. Working toward achieving the sustainability of the pension system—one of the main objectives of the pension reform supported by the EMSO program—will contain the escalation of the budgetary subsidy to the pension system and free up fiscal resources that could be directed toward a variety of pro-poor programs, such as non-contributory social pensions or social assistance for poor households.

**83. The restructured Housing Mortgage Program could be favorable to households at the lower end of the distribution.** The restructured program resulted in limited new mortgage financing in the market, but the extension of the mortgage will target some of the low-income household groups including first-time buyers and households moving from ger district to apartments in the urban areas. Although the medium- and long-term aspects of the reform in terms of targeting the mortgage program are not fully gauged, policy changes that restructure the program to bring it within the government's budget and better target the mortgage program to those in need are expected to create positive pro-poor impacts.

**84. The proposed operation is expected to be gender neutral or positive.** Most of the actions envisioned in this program are cross-cutting in nature and would not be expected to have differentiated impacts on different genders, nor would gender equality be significantly advanced or hampered by the proposed actions. On social protection, however, some of the actions could conceivably have gender dimensions. Expanding the poverty-targeted programs, notably the Food Stamps Program, will have a neutral or possibly a positive effect on female-headed households, considering that poverty rates are slightly higher among female-headed households (30.3 percent for female-headed households compared to 29.5 percent for male-headed households for 2016).<sup>32</sup>

## 5.2. ENVIRONMENTAL ASPECTS

**85. The specific country policies supported by the proposed operation are expected to have limited adverse environmental consequences.** A review of specific policy reforms supported by EMSO 2 revealed that these actions are unlikely to cause significant environmental impacts, including on forests and other natural resources. Implementation of measures under EMSO 2 are largely neutral from this perspective. Improved efficiency of public spending could contribute to enhanced environmental protection through more reliable and predictable financing for the ministries and line agencies in charge of managing natural resources and the environment. More importantly, the new guideline for appraisal and selection of projects (prior action 2.5) includes the requirement of a social and environmental impact assessment among its key criteria (Section 4.2.5 Operational Regulation for Rationalizing and Selecting Projects to be implemented in the State budget). Moreover, in the draft Permit Law (Prior action 2.8), protecting the environment is listed among the key principles of the draft law. In fact, the duration of licensing/permits on a project which carries a heavy burden on environment would be shortened. On the trade facilitation prior action, the Trade Information Portal (TIP), supported by the World Bank Group, is expected to include all the regulations required for trade, including environmental related regulations. Finally, strengthening the social protection system would increase the resilience of the vulnerable populations most at risk from extreme climate events, and implementation of the Livestock and Animal Health Law would contribute to increasing the resilience of herder families as well as slowing down land degradation.

<sup>32</sup> National Statistics Office of Mongolia, "Poverty Profile 2016," National Statistics Office of Mongolia, Ulaanbaatar, 2017.



**86. There are some recent positive signs regarding the government's commitment to environmental sustainability.** Overall, environmental policies and institutions in Mongolia are characterized by a strong legislative framework for environmental protection, but with weak implementation. A National Green Development Policy was adopted by Parliament in 2014, followed by an Action Plan adopted by the Government of Mongolia in 2016, setting an ambitious goal to become among the top 30 countries in green development indicators. Other notable progress includes the 2018 revision to the Law on Air, which contains several important air pollution reduction measures; and revision in 2018 of the Law and Air Pollution Fee, which reestablishes the Clean Air Fund as the Anti-Air-Pollution Fund. This is reflected in the budget allocated to the Ministry of Environment, the funding for which has greatly increased for the third year in a row; the 2019 budget is more than double the 2018 budget and is the highest since at least 2012 in absolute and relative terms, reaching 2.3 percent of the state budget.

### 5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

**87. The most recent assessments of Mongolia's PFM system include the 2015 PEFA and the 2018 Public Expenditure Review.** Recent PFM and macroeconomic analytical work and the Bank's continued technical assistance to the government in implementing the PFM reform underlie this operation. The 2015 PEFA Report, the Bank staff's analysis toward preparation of EMSO 1, and the 2018 Public Expenditure Review contribute to the formulation of policy recommendations for the proposed EMSO 2 operation, while implementation of the Bank-financed Strengthening Fiscal and Financial Stability Project and the EU-funded Strengthening Governance in Mongolia project, among others, support the government with implementation of the policy triggers of the DPF series.

**88. These assessments point to opportunities for improvement despite the achievements driven by a modern and comprehensive PFM legal framework as a key enabler for further reforms.** The PEFA PFM Performance Report (2015) and other recent analytics note strong tax administration and transparency in taxpayer obligations, a timely and orderly annual budget process supported by a new budget preparation system, a functional Treasury Single Account, a partially integrated Government Financial Management Information System (GFMIS), uniform charts of accounts supporting most reporting, an accounting and auditing standards board, a debt management office, financial statements prepared on a modified accrual basis with the government's audit completed within four months after year-end, and statutory internal audit units in all government's ministries. Yet, priority areas of improvement include more realistic revenue projections; better predictability in budget execution and visibility in cash flows to line ministries; integration of budget entities' financial reporting and government-wide consolidation in GFMIS; completion of the IPSAS implementation; stronger PIM processes and controls, particularly in relation to PPPs; strengthening of civil service management and payroll controls; and ensuring competitive procurement processes; among others. Most of these needs are planned to be addressed through the Strengthening Fiscal and Financial Stability Project and the EU-funded Strengthening Governance in Mongolia project and are a part of the overall PFM Strategy and Action Plan recently approved by the Minister of Finance in December 2018.

**89. The annual general government budget is available online.** Public disclosure of fiscal information also includes the annual budget documentation at the time of submission to Parliament, in-year budget execution reports, year-end financial statements, external audit reports, contract awards, and information on resources available to primary service units. The annual budgeting exercise is undertaken in a generally well-regulated and orderly manner. The budget circular is clear and comprehensive. Ministries, however, do not use this



guidance effectively and in general do not abide by the ceilings in preparing their budget estimates. The coverage of the MTFE is limited and the links between the MTFE and the annual budget are weak. Budgeting for investment and recurrent expenditure are often separate processes, with the former being a responsibility of the National Development Agency (NDA) (for investment projects with a value of MNT 30 billion or more) and the latter the responsibility of the MoF, with little or no coordination between them.

**90. Good progress has been made in treasury and procurement management.** Mongolia has a well-functioning treasury with a Treasury Single Account (TSA) and the GFMIS. Cash management is, however, weak, and the MoF changes monthly budget allotments regularly with little notice to line ministries. The regulatory framework for procurement is comprehensive, and open competitive procurement is the default method of procurement. Expenditure commitment controls are lacking, and payroll controls weak.

**91. Accounting, recording, and reporting practices are generally strong.** In-year and annual budget execution reports are prepared in a timely manner from the GFMIS on a cash basis, and the latter gets audited by the Supreme Audit Institution together with the annual Consolidated Financial Statements of the government, that are required by law to be prepared on the accrual basis. Financial reporting is, however, not in full compliance with the International Public Sector Accounting Standards (IPSAS). Under the Bank-financed Strengthening Fiscal and Financial Stability Project, the government is currently working on enhancing implementation of the IPSAS and exploring opportunities to integrate accrual-based financial reporting into the GFMIS.

**92. All central government entities are audited annually, either by the Mongolia National Audit Office (MNAO) or by auditing firms hired by the MNAO.** A range of financial audits and some aspects of performance audit are performed, and audit reports are submitted to the legislature in a timely manner. Parliament, however, only does a cursory review of these audit reports and approves the reports with no recommendations.

**93. The government's ownership and commitment to further improvements in the existing PFM system is strong as laid out in its Economic Recovery Program.** Both the substantial PFM analytical work and the Bank's technical assistance experience provide a sound basis for the government's PFM reforms to be implemented successfully, provided risks are properly mitigated. Efforts of better coordination and sequencing of reforms is evidenced in the above-mentioned PFM Strategy and Action Plan of the government the progress of which is to be monitored and reported to the government and relevant stakeholders, with support from the EU-funded Strengthening Governance in Mongolia Project.

**94. The proposed credit will follow the Bank's regular disbursement procedures for DPFs.** The credit proceeds will be disbursed against satisfactory implementation of the DPF prior actions and will not be tied to specific expenditures. As for the EMSO 1, the EMSO 2 credit proceeds will be deposited in a U.S. dollar account at the BoM designated by the Borrower and acceptable to the Bank. The Borrower shall ensure that an equivalent amount of local currency is credited to a Treasury account that finances budget expenditures. Within 30 days, the Borrower will confirm in writing to the Bank that the proceeds have been received in the foreign currency deposit account, which forms part of the country's foreign exchange reserve, and the equivalent amount (including the amount of local currency transferred, the exchange rate used for converting U.S. dollars into local currency) has been credited and accounted for in the Treasury account.



**95. The central bank (BoM) publishes a full set of audited financial statements as part of its annual report.**

The BoM's annual financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS). The central bank's audit is performed by one of the internationally recognized *Big Four* accounting firms. PricewaterhouseCoopers (PwC) Audit LLC expressed an unqualified audit opinion on the BoM's 2017 annual financial statements but issued a qualified audit opinion on the 2018 financial statements of the central bank. The qualification, however, was not related to the BoM's control environment but rather about the revaluation and recognition of old coins in the central bank's balance sheet. The overall foreign exchange risk is considered to be at an acceptable level.

#### 5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

**96. The Ministry of Finance will be responsible for overall monitoring and evaluation of the proposed operation and for coordinating actions among relevant ministries and agencies.**

Policy dialogue and monitoring and evaluation (M&E) of the reform program supported by this DPF will be shared with the BoM and the government line ministries. A working group chaired by the State Secretary of the MoF coordinates M&E activities under the EMSO. Regular discussions with the government and the donor community, including regular roundtables on implementation progress, will continue. The Bank will continue to monitor the actions and review progress on the implementation of the proposed operation, as well as the subsequent actions of the government program, by using the baseline and expected overall program outcomes outlined in the Policy Matrix. The Bank will also continue to participate in regular reviews of the IMF to jointly assess macroeconomic performance and progress toward observance of the program's structural benchmarks. The IMF reached a Staff-Level Agreement on the fifth review of its program on November 21, 2018.

**97. Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local or national grievance redress mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel, which determines whether harm occurred, or could occur, because of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

## 6. SUMMARY OF RISKS AND MITIGATION

**98. This operation carries substantial risks.**

**99. Political risks are high** considering the upcoming parliamentary elections in 2020, which might lead to expansionary economic policies. The government has shown unusual fiscal rectitude so far, but loose fiscal policy prior to elections has been a norm rather than an exception in Mongolia's democratic history. Mitigation measures include (i) elimination of quasi-fiscal activities by DBM and BoM and public disclosure of special external reviews of their operations; and (ii) adoption of fiduciary measures to improve the governance of Government Special Funds, which assumes greater importance following the revelation of improper use of



the SME Fund. The Bank's mitigation measures also include policy outreach activities to improve the understanding on the importance of a prudent economic policy framework, through participation of Bank staff in the electronic media and knowledge exchange events. Moreover, there has been no sign of loose fiscal policy prior to the approaching general elections. In fact, the fiscal surplus in the first five months of 2019 was significantly higher than expected.

**100. Macroeconomic risks are high.** The major sources of external downside risks include (i) weaker-than-expected global commodity prices, as mineral revenue accounts for about 20 percent of total revenue; (ii) lower-than-planned minerals production due to weaker import demand from China; and (iii) lack of sustainable resolution of southern border bottlenecks, the main commodity export gateway for Mongolia. These external factors could undermine growth recovery, fiscal sustainability, and external balance, thereby slowing the projected improvement in fiscal and external sustainability. To mitigate against these risks, EMSO 2 includes substantial macroeconomic policy adjustment that would strengthen the policy capacity to cope with external shocks by restoring fiscal and external buffers. To address the structural vulnerability of the economy to external shocks, EMSO 2 also aims to support structural reforms to improve the competitiveness and diversification of the non-mining sector and promote a more business-friendly environment. The resolution of southern border transit exit is dependent on the agreement and mutual understanding with China.

**101. The slow progress in recapitalizing the banks, while not an immediate threat to macro stability, poses a significant risk to Mongolia's medium-term growth outlook.** The undercapitalization problem is currently confined to few smaller banks, but if left unaddressed, will gradually spread the rest of the sector. It is therefore encouraging that the authorities have agreed to engage an independent external auditor to examine the integrity of the recapitalization process through a forensic audit (an effectiveness condition of EMSO 2). The authorities have also agreed to pursue the recapitalization of banks to meet required prudential norms (an EMSO 3 trigger). Moreover, with the budget in surplus, the government currently has the financial means to cover the shortfalls in systemic banks when necessary.

**102. Risks in sector strategies and policies are substantial.** The ability of the government to build consensus and coordinate across key implementing agencies is growing but still limited. While the MoF coordinates preparation of the overall government budget, sectoral strategies are decided by line ministries, limiting the coordination role of the MoF to allocate aggregate budget envelopes to line ministries. While the coordination authority of the MoF has improved over the past two years, it is however, supplemented by the active support of the Prime Minister and the Cabinet Secretariat.

**103. Risks in the technical design of the program are moderate.** The design of the proposed operation reflects the key reform priorities of the government. Considering the medium-term horizon of the proposed reform measures, a programmatic approach was proposed. The proposed triggers for EMSO 3 will remain flexible and subject to further discussions with the government.

**104. Risks in institutional capacity for implementation and sustainability are substantial.** Institutional frameworks that are foundations of most of the prior actions were established in 2009–11 with the adoption of the Fiscal Stability Law, the Integrated Budget Law, and the amendment of the Social Welfare Law. The Debt Management Law was adopted in 2015 to monitor and control public debt, with the support of the Bank. On animal health, the General Authority for Veterinary Services was created in 2018. Capacity of the authorities has also been significantly improved in recent years with technical assistance of various Bank



activities and other development partner support. Key challenges, however, have been the weak implementation of the institutional framework under growing political pressures. Against this backdrop, the Fiscal Council, under the Parliament, aimed at assessing government's fiscal discipline, was recently established. But its capacity needs strengthening to make it an effective institution. Moreover, the amendment of the civil service law adopted in December 2017 is expected to help strengthen the role of the Civil Service Commission. This development also aims to institute a meritocratic culture in the public administration to limit high turnover linked to politicization in the civil administration. Technical and analytic support of the World Bank in key reform programs—such as tax reform, public investment adjustment, social protection and pension reform, and business and investment environment—would help mitigate implementation risk and sustain reform momentum throughout the remaining years of the program.<sup>33</sup> In contrast, because the line ministries have limited capacity for policy making and effective disbursement of public resources, the MoF assumes the responsibility to oversee implementation of the foreign-funded investment projects.

**105. Fiduciary risks are substantial.** The overall fiduciary risks to this operation arising from Mongolia's public financial management (PFM) system, including the use of budget resources, and its foreign exchange environment controlled by the Bank of Mongolia, are substantial. This risk principally arises from opportunities to incur quasi-fiscal expenditures and contingent liabilities and insufficient controls to limit, within a reasonable range, political influence on the budget. The recent improper use of the SME Fund was evidence of growing existing fiduciary weaknesses in the PFM system. These risks would be substantially mitigated after the implementation of actions identified in the government's Economic Recovery Program through consolidating and phasing out the off-budget and quasi-fiscal expenditures of the DBM and the BoM. In addition, the new prior action (#2.6) to improve the governance of special funds will also mitigate this risk.

**106. Environment and social risks are moderate.** The operation is not expected to have a significant environmental impact. Tighter fiscal and monetary policies are expected to have contractionary effects on the economy, which could affect the poor and vulnerable in the short term. The operation, therefore, supports the policy actions to expand the coverage and benefits of poverty-targeted social welfare programs to mitigate possible adverse short-term impacts on the poor. However, building on a strong growth momentum over the past two years, a positive medium-term outlook combined with fiscal adjustment reforms is expected to help support poverty reduction in 2019–20.

**107. Stakeholders' risks are moderate.** The operation is well aligned with the reform priorities of the government strategy, and the commitment of the current Cabinet remains strong. This operation will actively encourage strong participation and a consultative process with all political parties, and support policy outreach activities to the general public on the importance of policy reforms. The operation will ensure continued close coordination with various donors.

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<sup>33</sup> Resources are available under the Strengthening Fiscal and Financial Stability Project.



**Table 4. Risk Categories**

Risk Categories	Rating
1. Political and Governance	● High
2. Macroeconomic	● High
3. Sector Strategies and Policies	● Substantial
4. Technical Design of Project or Program	● Moderate
5. Institutional Capacity for Implementation and Sustainability	● Substantial
6. Fiduciary	● Substantial
7. Environment and Social	● Moderate
8. Stakeholders	● Moderate
9. Other	
<b>Overall</b>	● High



ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions DPL 1	Prior Actions DPL 2	Triggers DPL 3	Results Indicators
<b>PILLAR I: RESTORING DEBT SUSTAINABILITY THROUGH FISCAL ADJUSTMENTS</b>			
<p><b>Prior Action 1.1.</b> The Government has terminated DBM’s financing to capital expenditure through noncommercial loans.</p>	<p><b>Prior action 2.1.</b> To improve Development Bank of Mongolia (DBM) corporate governance through transparency, the Recipient has publicly disclosed the comprehensive external special review on DBM’s operations from 2012–2017.</p>	<p><b>Trigger 3.1.</b> The government further improves the management and operational framework of the DBM to ensure its independence, profitability, and the financial soundness, based on external special review.</p>	<p><b>Capital expenditure financed by the DBM through non-commercial loans</b> Baseline: MNT 252 billion in 2016. Target: MNT 0 billion in 2019–20.</p>
<p><b>Prior Action 1.2.</b> The BoM has discontinued net financing to the Housing Mortgage Program.</p>	<p><b>Prior action 2.2.</b> To phase out the Bank of Mongolia (BoM)’s quasi-fiscal activities, the Recipient has restructured the Housing Mortgage Program to support affordable housing in a more cost-effective way, and with a time-bound plan for BoM to fully exit the Housing Mortgage Program.</p> <p><b>Prior action 2.3.</b> To improve the Bank of Mongolia (BoM) corporate governance through transparency, the Recipient has publicly disclosed the independent special external review on BoM’s quasi-fiscal</p>	<p><b>Trigger 3.2.</b> The BoM stopped financing the Housing Mortgage Program.</p> <p><b>Trigger 3.3.</b> Formal establishment of the “Mortgage Securitization Legal and Regulatory Reform Working Group” [<i>Joint decree of MoF, FRC and BoM</i>] and finalization of a detailed reform roadmap.</p> <p><b>Trigger 3.4.</b> Based on the findings of the forensic audit, the recipient has taken necessary measures to recapitalize the banks.</p>	<p><b>Net financing from the BoM to the Housing Mortgage Program</b> Baseline: MNT 404 billion in 2016. Target: MNT 0 billion in 2019–20.</p> <p><b>Legal and regulatory framework of the mortgage securitization</b> Baseline: Legal and regulatory is flawed in 2016. Target: formal decision and action plan to strengthen specific elements of the legal and regulatory framework in 2020.</p>



	<p>operations, including the Housing Mortgage Program, Price Stabilization Program, and financial support to companies.</p>		<p><b>BoM's outstanding assets for the Price Stabilization Program (PSP) and companies in the balance sheet</b> Baseline (end-2016): Outstanding loans to the PSP (MNT 32.9 billion) and outstanding corporate bond holdings (MNT 815 billion). Target (end-2019): Outstanding loans to the PSP is fully withdrawn and outstanding corporate bond holdings are no more than MNT 815 billion.</p> <p><b>The recapitalization of banks is advanced to meet prudential norm</b></p> <p>Baseline (2017): The banks are undercapitalized based on the AQR results. Target (2020): The banks are recapitalized to meet the Capital Adequacy Ratio (CAR).</p>
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<p><b>Prior Action 1.3.</b> The Government has raised the personal income tax rates on high income groups and the excise taxes on alcohol a tobacco, with a gradual increase of the minimum income tax threshold to reduce tax burden on lower income groups.</p>	<p><b>Prior action 2.4.</b> To improve efficiency of revenue mobilization, the Recipient has established a framework to evaluate the tax expenditure system in terms of the costs and benefits aimed to reduce ineffective tax incentives and exemptions, starting with the 2020 budget.</p>	<p><b>Trigger 3.5.</b> The government has submitted to Parliament a draft 2020 budget law in which new requests for tax exemptions and incentives are assessed based on a framework of evaluation of the tax expenditure in terms of costs and benefits.</p> <p><b>Trigger 3.6.</b> The government has submitted amendments to tax laws and regulations to align the tax regime with agreed international tax standards such as transfer pricing regulations, interest deductibility and BEPS-related actions, and to introduce a General Anti-Avoidance Rule (GAAR).</p>	<p><b>Tax exemptions and incentives are reduced</b></p> <p>Baseline: 14.5 percent of total tax revenue in 2016. Target: At least by a 1.5 percentage points reduction by 2020, compared with the baseline.</p> <p><b>Legal inclusion of General Anti-Avoidance Rule</b></p> <p>Baseline (2016): Not included. Target (2020): GAAR established in tax laws.</p>
<p><b>Prior Action 1.4.</b> The Government has terminated the Promissory Note Program, to prevent using deferred payments to finance capital expenditure.</p>	<p><b>Prior action 2.5.</b> To improve the efficiency of ongoing and new investment projects in the budget, the Recipient has adopted a regulation to enhance appraisal, prioritization and selection of projects.</p>	<p><b>Trigger 3.7.</b> The Integrated Budget Law is amended to better align public investment budget with strategic priorities and a hard budget constraint, through (a) publishing in the Medium-Term Fiscal Framework estimates of sustainable investment spending; (b) publishing project appraisal and selection criteria; (c) requiring an adequate funding for maintenance.</p>	<p><b>Capital expenditure for the clearance of promissory notes is removed</b></p> <p>Baseline: MNT 672 billion in 2016. Target: MNT 0 billion in 2017–20.</p> <p><b>Efficiency of public investment portfolio is improved</b></p> <p>Baseline (2016): Public investment portfolio is costly. Target (2020): Restructuring of all non-performing projects</p>



			<p>based on the Rationalization Guideline, evidenced by the project performance evaluation document included in the 2019-2020 Guideline.</p> <p><b>Improved selection of new public investment projects</b></p> <p>Baseline (2016): Inefficient selection of public investment projects. Target (2020): Selection of new public investment projects based on appraisal criteria stipulated in the guideline.</p>
	<p><b>Prior action 2.6.</b> To improve transparency of Government Special Funds, the Recipient has improved the legal, governance, and monitoring framework of the Government Special Funds that extend loans and grants.</p>	<p><b>Trigger 3.8.</b> The government implements the action plan to improve the management and monitoring of government special funds and other programs financed from the state budget.</p>	<p><b>Disclosure of beneficiaries (legal entities and individuals) information (including names, amount, terms, and repayment status) from Government Special Funds</b></p> <p>Baseline (2018): Limited disclosure. Target (2020): Public disclosure of the government special funds in accordance with the relevant laws.</p> <p><b>Government Special Funds are extended through banks with good standing (Asset Quality</b></p>



			<p><b>Review)</b></p> <p>Baseline (2018): Limited use of the banks.  Target (2020): Government special funds that extend loans and grants channeled exclusively through banks in good standing as assessed by the Asset Quality Review of BoM (2020).</p>
<b>PILLAR II: STRENGTHENING THE SOCIAL PROTECTION SYSTEM</b>			
<p><b>Prior Action 1.5.</b> The Government has maintained budget allocation for the poverty-targeted Food Stamp Program, in the 2017 Supplementary budget, excluding administrative costs, at least at the level of the 2017 original budget.</p>	<p><b>Prior action 2.7.</b> To increase protection of the poor, the Recipient has increased the total budget allocation for the Food Stamp Program (FSP) and other poverty-targeted programs in 2019 compared to the 2016 level, in line with MTFE allocations.</p>	<p><b>Trigger 3.9.</b> Following a review of the social welfare programs, the government has issued a resolution to rationalize the programs while maintaining the allocation for poverty-targeted programs in the 2020 budget.</p>	<p><b>The coverage and benefit size of the Food Stamp Program and other poverty-targeted programs</b></p> <p>Baseline (2016): The budget allocation for the Food Stamp Program is MNT 18.1 billion and no budget is allocated for other poverty-targeted programs.  Target (2020): The total budget for the Food Stamp Program and poverty-targeted programs is tripled in relation to the 2016 level.</p>



<p><b>Prior Action 1.6.</b> The Government has amended the Social Insurance Law and the Pensions and Benefits Paid from Social Insurance Funds Law to gradually increase the pension insurance contribution rate and the retirement age.</p>		<p><b>Trigger 3.10.</b> The recipient has submitted to the parliament a set of corrective measures to the legal changes made in 2017 to the Social Insurance legislations. The key measures are: (i) introduce a set of limits to the service buyback for herders and self-employed; (ii) cancel the legal provision on the herders’ service supplement of counting one year of herding as one year and six months of service for pension calculation; and (iii) introduce cost sharing for the guaranteed Social Insurance premium for mothers looking after a child under three years of age (50/50 cost share between mothers and the Social Insurance Fund).</p> <p><b>Trigger 3.11.</b> The Cabinet has approved a reform package to the Pension Insurance Scheme which would result in financial sustainability of the pension system.</p>	<p><b>Pension reform options simulation toolkit (PROST) model projections of the state subsidy to the pension fund used as basis for estimating baseline and projection with reforms</b></p> <p>Baseline (2017 projection): State subsidy is projected to reach 6 percent of GDP in 2030 under the current growth assumptions.</p> <p>Target (2020 projection with reform): State subsidy to the pension fund is projected to reach a fiscally sustainable level by 2030 under current growth assumptions.</p>
<b>PILLAR III: SUPPORTING THE COMPETITIVENESS OF THE ECONOMY THROUGH STRUCTURAL REFORMS</b>			
<p><b>Prior Action 1.7.</b> The Government has established the Investor Protection Council (IPC), aimed at fostering the timely and systematic resolution of investor grievances.</p>	<p><b>Prior action 2.8.</b> To improve ease of doing business, the Recipient has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public</p>	<p><b>Trigger 3.12.</b> The government has approved a National Competition Policy, embedding competition principles across sectors and improving regulations to level the playing field between public and</p>	<p><b>Number of permits and licenses</b></p> <p>Baseline (2016): 890 (2013). Target (2020): the number of permit and licenses are reduced</p>



	administrations and reducing their number.	private operators.	by more than 10 percent from the baseline.  <b>Share of investor grievances successfully treated by the IPC to the total number of investor grievances received by the IPC</b>  Baseline (2016): 0 percent Target (2020): at least 70 percent
<b>Prior Action 1.8.</b> The Government has submitted a draft legislation on animal health to the Parliament, proposing the adoption of an animal health legal framework which is consistent with international standards as these are set forth by the World Organization for Animal Health.	<b>Prior action 2.9.</b> To improve competitiveness of livestock product exports, the Recipient has approved a package of regulations, ordinances or guidelines are approved to operationalize the Livestock and Animal Health Law, including the modalities of: (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal diseases control strategic plans, and (iv) herders' obligations.	<b>Trigger 3.13.</b> To improve competitiveness of livestock exports, the government has (i) adopted regulations and guidelines needed for the adequate implementation for the Livestock and animal health law, and (ii) started the implementation of animal disease free zone regulation by controlling through vaccination the spread of foot and mouth disease (FMD) and Peste des Petits Ruminants (PPR) in risk-prone areas.	<b>Number of outbreaks of, and small ruminants vaccinated against PPR (Peste des Petits Ruminants—small ruminants Plague) in western region</b>  Baseline (2016): <ul style="list-style-type: none"> <li>• 126 outbreaks of PPR were reported in western region (Khovd aimag).</li> <li>• 10.4 million small ruminants vaccinated against PPR in the western region.</li> </ul> Target (2020): <ul style="list-style-type: none"> <li>• The western region (aimags of Khovd, Bayanulgee, Gobi-Altai, Uvs and Zavkhan) is maintained free of PPR.</li> <li>• A cumulative number of at least 20 million small</li> </ul>



			ruminants are vaccinated against PPR in the western region by 2019–20.
<b>Prior Action 1.9.</b> The Parliament has ratified the WTO Trade Facilitation Agreement (TFA).	<b>Prior action 2.10.</b> To improve trade environment, the Recipient has adopted the institutional framework for the TFA implementation, including (i) a time-bound action plan for its full implementation; (ii) the establishment of an interagency coordination mechanism for the TFA; and the establishment of a trade information portal (TIP).	<b>Trigger 3.14.</b> Customs and other border agencies have improved coordination and streamlined clearance procedures, including data sharing, joint inspections and improved risk management, to be in line with the WTO TFA commitments and best practices.	<b>Proportion of shipments selected for physical inspection</b>  Baseline (2016): 90 percent Target (2020): 70 percent  <b>Average customs clearance time</b>  Baseline (2016): 12 hours and 35 minutes. Target (2020): 20 percent reduction in average customs clearance time.



ANNEX 2: LETTER OF DEVELOPMENT POLICY

Date: June 17, 2019

Ulaanbaatar

Ref. No.: 10/4065; 1/166

Mr. David Malpass  
President  
the World Bank  
Washington DC, 20433  
USA

Dear President Malpass,

First of all, we would like to take this opportunity to express, on behalf of the Government of Mongolia, our sincere congratulations on your appointment as the President of the World Bank Group.

Given the economic difficulties of 2014-16, the Government of Mongolia, in close collaboration with and financial support from our development partners, has implemented the "Economic Recovery Program", which aims to stabilize the economy, restore confidence and pave the way for robust economic recovery. With favorable commodity prices, strong mineral exports and effective program implementation, the economic growth has accelerated since then, leading to improvements in the fiscal position and debt dynamics. Specifically, the Mongolian economy grew by 5.7 percent in 2017 and 6.9 percent in 2018. We achieved an overall fiscal surplus of 2.6 percent of GDP in 2018; the first over the last 8 years. Public debt GDP ratio dropped substantially by 20 percentage points between 2016 and 2018. We have also strengthened our external buffers by building substantially our gross international reserves to about US\$ 3.6 billion (4.8 months of imports) from US\$ 1.3 million (2.4 months of imports). Moving forward, we wish to build on these positive developments to further strengthen our economy and improve the lives of the Mongolian people.

The Government has achieved notable progress in the implementation of a set of policy reforms agreed with development partners. More particularly in the context of policy actions supported by the World Bank, the Government of Mongolia has successfully fulfilled the 10 prior actions agreed under the second Economic Management Support Operation (EMSO 2).

The policy reforms supported by EMSO 2 are structured around three main pillars: (i) restoring debt sustainability, (ii) strengthening the social protection system, and (iii) enhancing competitiveness. These three pillars are aligned with the two strategic objectives of the Economic Recovery Program. We have elaborated in further details below, the completion of all the 10 prior actions agreed under EMSO 2. Moreover, the preparation of the third operation in the series (EMSO 3) has already started earnestly with the World Bank.

The Pillar I on Restoring Debt Sustainability through Fiscal Adjustments comprises of six prior actions. First, following the termination of the Development Bank of Mongolia's off-budget financing of public capital expenditure through its non-commercial loans, a financial diagnostic of the Development Bank of Mongolia, covering the period between 2012-2017, has been carried out by an external auditor. The findings of this diagnostic study have been publicly disclosed on the website of Development Bank of Mongolia. This measure will ensure that the Development Bank of Mongolia stays accountable and disengaged from fiscal activities under the newly revised Development Bank of Mongolia Law. In addition, an indicative trigger for EMSO 3 will support the implementation of the recommendations of the special



review to further improve the DBM's management and operational structure toward an independent, profitable, and financially sound development bank. Second, a joint decree signed by the Minister of Finance and the Governor of the Bank of Mongolia in December 2018, outlines a restructured Housing Mortgage Program with planned discontinuation of the Bank of Mongolia's financing of the Housing Mortgage Program. The restructuring involves improving the eligibility criteria to better meet the needs of targeted borrowers and market segments. A time bound action plan, annexed to the joint decree, stipulates Bank of Mongolia's final exit from the Housing Mortgage Program by January 2020. An indicative trigger of EMSO 3 will support the implementation of the BoM's time-bound exit plan from HMP, including to an end to its funding by BoM from 2020. Another trigger for EMSO 3 will focus on strengthening the legal and regulatory framework of mortgage securitization.

Third, an independent special review of quasi-fiscal policy activities of the Bank of Mongolia from 2012-2016 to improve the transparency and accountability of its operations has been carried out by a reputable international audit company. The review covers government programs such as the Housing Mortgage Program, Price Stabilization Program and financial support to companies which were not properly assessed in the past, despite their significant fiscal and monetary policy implications. The final report of the special review has been submitted to the Parliament of Mongolia and publicly disclosed on the Bank of Mongolia website since December 31, 2018. Fourth, The Government of Mongolia is committed to reducing in the coming years the tax expenditures relative to the total tax revenues. With a technical assistance of the World Bank, we have developed a new Regulation on Assessment and Reporting of Tax Expenditures, which was signed on May 1, 2019. To further confirm our commitment, we have introduced a specific provision on tax incentives in the revised General Tax Law, which was approved by the Parliament in March 2019. The provision states that tax expenditure proposals shall be introduced with annual Budget Law which will prevent granting of tax incentives after the approval of a given year budget. Reform measures under EMSO 3 will support the submission of a draft 2020 budget law in which new requests for tax exemptions and incentives are assessed based on an evaluation framework recently adopted under EMSO 2. The recently approved tax law also emphasizes the introduction of the principles of international tax standards and General Anti-Avoidance Rule (GAAR).

Fifth, given the Government of Mongolia's investment portfolio that has been subject to poor project preparation and implementation in recent years, efforts to reduce the cost of existing investment projects for the budget are being undertaken. With technical assistance from the World Bank, the Ministry of Finance has adopted a Public Investment Rationalization Guideline in December 2018. This Guideline includes basic methodologies and criteria to identify underperforming projects and procedures for rationalizing/prioritizing the underperforming investment projects. It also discusses the appraisal and evaluation, priority and selection of investment projects. The Public Investment Management Information System has been developed recently. Series of training activities on introducing the Public Investment Management Information System and guidelines, targeting government and local municipality officials involved in the preparation of the public investment projects, have been successfully carried out. This will help build the capacity for efficient implementation of the Guidelines for the preparation of investment projects starting from 2020 budget. All budget governors are expected to submit their initial draft investment project proposals through this Public Investment Management Information System as of June 1, 2019. Subsequent reforms under EMSO 3 will focus on improving the selection of new projects by better aligning the public investment budget with strategic priorities and a hard budget constraint.

Sixth, to improve fiscal transparency, accountability and operations of the state budget financed Government special funds, the Government of Mongolia has initiated a special review of designated special funds. Based on the findings of the review, the Government has adopted a resolution, dated



February 27, 2019, which sets out an action plan that calls for certain measures to improve the legal and regulatory framework to ensure the transparency and accountability of Government special funds. Under this action plan, an inter-ministerial working group was established to formulate necessary amendments and revisions to the required legislation. The working group has prepared an initial draft amendment to the Law on Government special funds, which is the fundamental legislation governing such funds. Paramount actions, that the Government of Mongolia is undertaking, include consolidating the management of applicable funds, special funds and projects that extend financial support and subsidized loans. For EMSO 3, the Government has committed to accelerate the implementation of an action plan to improve the management and monitoring of government special funds and other programs financed from the state budget.

Under the Pillar II on Strengthening the Social Protection System, the seventh prior action concerns the increased budget allocations for the Food Stamp Program (FSP) as well as other poverty-targeted programs. As a commitment to further strengthen protection of the households below the poverty line by improving the coverage and benefits of pro-poor programs, in 2019 budget, the Government of Mongolia increased the budgetary allocation of the Food Stamp Program and of the poverty-targeted programs in line with MTF allocations relative to their levels in 2016. These allocations are intended to strengthen the protection of the poor population during the times of economic adjustment. Moreover, the Government in collaboration with other development partners is working on the rationalization of the social welfare spending to help free up resources for poverty-targeted programs. Furthermore, reform measures for EMSO 3 will support maintaining the level of social spending on poverty-targeted programs and the rationalization of existing social welfare programs to improve their governance and efficiency.

The Pillar III on the Supporting the Competitiveness of the Economy through Structural Reforms consists of three prior actions. The eighth prior action focuses on a reform aimed to improve the business environment. In this regard, the Government has submitted a revised Permit Law to Parliament on April 30, 2019, along with a list of licenses and permits granted by public administrations. The draft law intends to reduce and streamline permits and licenses granted by various public administration bodies, hence easing the administrative burden on businesses. The reform measures envisaged under EMSO 3 will support the adoption of a comprehensive reform package to the Pension Insurance Scheme aimed at maintaining the financial sustainability of the pension system and improving its fairness.

Ninth, the Livestock and Animal Health Law was adopted by the Parliament of Mongolia in December 2017. The new law is an important step towards compliance with international standard requirements of the World Organization for Animal Health. Improved governance of veterinary services enables more systematic control of animal diseases, thus eventually improving the competitiveness of livestock exports. Following the adoption of the law, a designated government institution with dedicated staff at local level was established. Subsequently, a package of regulations, ordinances and guidelines, necessary for the enforcement and operationalization of the new animal health management framework has been adopted. Key regulations and guidelines covering (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major trans-boundary animal diseases control strategic plans, and (iv) herders' obligations under the new Animal Health Law have been approved. Furthermore, in order to enhance public awareness and knowledge about the new animal health related legal and regulatory framework and to ensure its full dissemination, a series of training and capacity activities are being carried out by the Government. Under EMSO 3, policy reforms are expected to support the government's efforts to further develop remaining regulations and guidelines needed for the adequate implementation for the livestock and animal health law and the implementation of animal disease free zone regulation in risk areas.



Tenth, following an approval of the the World Trade Organization Trade Facilitation Agreement by the Parliament of Mongolia in November 2016, a National Trade Facilitation Committee has been established. The National Trade Facilitation Committee is mandated to ensure the coordination mechanism for Mongolia’s compliance with the World Trade Organization’s Trade Facilitation Agreement and to create favorable external and internal business conditions for the entities and business people. The operations of the National Trade Facilitation Committee are guided by Roadmap for Trade Facilitation Agreement implementation and a time-bound strategic medium-term action plan, which was adopted by National Trade Facilitation Committee in October, 2018. Furthermore, a joint decree by Minister of Foreign Affairs and Minister for Finance, dated March 29, 2019, mandated the Customs General Administration of Mongolia to be the responsible agency for the Trade Information Portal, to be established with a technical assistance from the International Finance Corporation. EMSO 3 will support the implementation of more complex trade facilitation reforms to border management.

Mr. President, we strongly believe that this Development Policy Financing series has been critical to further accelerate our policy reform agenda and to improve our fiscal and financial stance, hence vital to consolidate our economic performance. Moreover, we remain firmly committed to structural reforms in the banking sector. In line with the findings of the Assets Quality Review (AQR) agreed under the IMF program, we have taken several steps to address the banking sector problems. These steps include among others, the passage of a recapitalization law, increased provisioning of banks, as well as the reclassification of non-performing loans in line with the AQR findings. In April 2019, the Bank of Mongolia closed one insolvent non-systemic bank. Building on the recent measures, Bank of Mongolia remains steadfast in ensuring that the banks are adequately capitalized, and the banking sector is healthy, stable and follows good governance practices. The Bank of Mongolia is committed to support the completion of a forensic audit of the recapitalization process by a reputable external audit firm and to recapitalize all banks to meet prudential norms under EMSO 3.

With Government’s strong commitment to undertake agreed policy reforms and Bank’s support in the form of technical assistance and expertise, the Government of Mongolia has fully completed all prior actions as set out in the agreed policy matrix under the EMSO 2. Moreover, we remain committed to implement the indicative policy measures planned beyond EMSO 2. Therefore, hereby we officially request the World Bank for the Development Policy Financing under the Second Economic Management Support Operation.

We look forward to a close collaboration and partnership with the World Bank under your strong leadership.

/s/ 

Ch. Khurelbaatar  
Minister of Finance

/s/ 

N. Bayartsaikhan  
Governor, Bank of Mongolia



**ANNEX 3: PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS**

Proposed Prior Actions	Indicative triggers of EMSO 3	Analytical Underpinnings
<b>Pillar I: Supporting Restoring Debt Sustainability through Fiscal Adjustments</b>		
<p><b>#2.1.</b> To improve Development Bank of Mongolia (DBM) corporate governance through transparency, the Recipient has publicly disclosed the comprehensive external special review on DBM’s operations from 2012–2017.</p>	<p><b>#3.1.</b> The government further improves the management and operational framework of the DBM to ensure its independence, profitability, and the financial soundness, based on external special review.</p>	<p>WBG staff analysis (2016) Just in Time PER (2016)</p>
<p><b>#2.2.</b> To phase out the Bank of Mongolia (BoM)’s quasi-fiscal activities, the Recipient has restructured the Housing Mortgage Program to support affordable housing in a more cost-effective way, and with a time-bound plan for BoM to fully exit the Housing Mortgage Program.</p>	<p><b>#3.2.</b> The BoM stopped financing the Housing Mortgage Program.</p> <p><b>#3.3.</b> Formal establishment of the “Mortgage Securitization Legal and Regulatory Reform Working Group” [Joint decree of MoF, FRC and BoM] and finalization of a detailed reform roadmap.</p>	<p>WBG, Mongolia Economic Update (November 2015)</p> <p>IMF, Article IV Report (April 2015)</p> <p>WBG staff analysis (2016)</p> <p>Ongoing WBG technical assistance to the financial sector (SFFS project, 2017)</p> <p>Systematic Country Diagnostic (2018)</p>
<p><b>#2.3.</b> To improve the Bank of Mongolia (BoM) corporate governance through transparency, the Recipient has publicly disclosed the independent special external review on BoM’s quasi-fiscal operations, including the Housing Mortgage Program, Price Stabilization Program, and financial support to companies.</p>	<p><b>#3.4.</b> Based on the findings of forensic audit, the recipient has taken necessary measures to recapitalize the banks.</p>	<p>WBG, Mongolia Economic Update (November 2015)</p> <p>IMF, Article IV Report (April 2015)</p> <p>WBG staff analysis (2016)</p> <p>Systematic Country Diagnostic (2018)</p> <p>WBG, Financial Sector Note (2019)</p>
<p><b>#2.4.</b> To improve efficiency of revenue mobilization,</p>	<p><b>#3.5.</b> The government has submitted to</p>	<p>WBG staff analysis (2016)</p>



<p>the Recipient has established a framework to evaluate the tax expenditure system in terms of the costs and benefits aimed to reduce ineffective tax incentives and exemptions, starting with the 2020 budget.</p>	<p>Parliament a draft 2020 budget law in which new requests for tax exemptions and incentives are assessed based on a framework of evaluation of the tax expenditure in terms of costs and benefits.</p> <p><b>#3.6.</b> The government has submitted amendments to tax laws and regulations to align the tax regime with agreed international tax standards such as transfer pricing regulations, interest deductibility and BEPS-related actions, and to introduce a General Anti-Avoidance Rule (GAAR).</p>	<p>Just in Time PER (2016)</p> <p>WBG Mongolia Public Expenditure Review (June 2018)</p> <p>Systematic Country Diagnostic (2018)</p>
<p><b>#2.5.</b> To improve the efficiency of ongoing and new investment projects in the budget, the Recipient has adopted a regulation to enhance appraisal, prioritization and selection of projects.</p>	<p><b>#3.7.</b> The Integrated Budget Law is amended to better align public investment budget with strategic priorities and a hard budget constraint, through (a) publishing in the Medium-Term Fiscal Framework estimates of sustainable investment spending; (b) publishing project appraisal and selection criteria; (c) requiring an adequate funding for maintenance.</p>	<p>Just in Time PER (2016)</p> <p>WBG Mongolia Public Expenditure Review (June 2018)</p> <p>IMF PIMA report (February 2018)</p> <p>Systematic Country Diagnostic (2018)</p>
<p><b>#2.6.</b> To improve transparency of Government Special Funds, the Recipient has improved the legal, governance, and monitoring frameworks of the state budget-financed Government Special Funds that extend loans and grants.</p>	<p><b>#3.8.</b> The government implements an action plan to improve the management and monitoring of government special funds and other programs financed from the state budget.</p>	<p>WBG staff analysis (2019)</p>
<b>Pillar II: Strengthening the Social Protection System</b>		
<p><b>#2.7.</b> To increase protection of the poor, the Recipient has increased the total budget allocation for the Food Stamp Program (FSP) and other poverty-targeted programs in 2019 compared to the 2016 level, in line</p>	<p><b>#3.9.</b> Following a review of the social welfare programs, the government has issued a resolution to rationalize the programs while maintaining the allocation for poverty-</p>	<p>WBG, Review of program Design and beneficiary profiles of social welfare programs in Mongolia (2015)</p>



<p>with MTFF allocations.</p>	<p>targeted programs in the 2020 budget.</p> <p><b>#3.10.</b> The recipient has submitted to the parliament a set of corrective measures to the legal changes made in 2017 to the Social Insurance legislations. The key measures in the amendment package are (i) introduce a set of limits to the service buyback for herders and self-employed, (ii) cancel the legal provision on the herders’ service supplement of counting one year of herding as one year and six months of service for pension calculation, and (iii) introduce cost sharing for the guaranteed Social Insurance premium for mothers looking after a child under three years of age (50/50 cost share between mothers and the Social Insurance Fund).</p> <p><b>#3.11.</b> The Cabinet has approved a reform package to the Pension Insurance Scheme which would result in financial sustainability of the pension system.</p>	<p>WBG staff analysis (2016)</p> <p>Systematic Country Diagnostic (2018)</p>
<b>Pillar Iii: Supporting the Competitiveness of the Economy through Structural Reforms</b>		
<p><b>#2.8.</b> To improve ease of doing business, the Recipient has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public administrations and reducing their number.</p>	<p><b>#3.13.</b> The government has approved a National Competition Policy, embedding competition principles across sectors and improving regulations to level the playing field between public and private operators.</p>	<p>WBG, “Investor Protection in Mongolia” (2016)</p> <p>WBG staff analysis (2016)</p> <p>WBG, “Mongolia: toward a more effective competition policy framework” (2013)</p>



		<p>WBG, “Investment Reform Map” (2018)</p> <p>Systematic Country Diagnostic (2018)</p>
<p><b>#2.9.</b> To improve competitiveness of livestock exports, the Recipient has approved a package of regulations, ordinances or guidelines are approved to operationalize the Livestock and Animal Health Law, including the modalities of: (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal diseases control strategic plans, and (iv) herders’ obligations.</p>	<p><b>#3.12.</b> To improve competitiveness of livestock exports, the government has (i) adopted remaining regulations and guidelines needed for the adequate implementation for the Livestock and Animal health law, and (ii) started the implementation of animal disease free zone regulation by controlling through vaccination the spread of foot and mouth disease (FMD) and Peste des Petits Ruminants (PPR) in risk-prone areas.</p>	<p>WBG, “Mongolia’s Red Meat Value Chain” (2017)</p> <p>WBG, Mongolia Agriculture Productivity and Marketing Study (2015)</p> <p>WBG, Agricultural Public Expenditure Review (2015)</p> <p>Systematic Country Diagnostic (2018)</p>
<p><b>#2.10.</b> To improve trade environment, the Recipient has adopted the institutional framework for the TFA implementation, including (i) a time-bound action plan for its full implementation; (ii) the establishment of an interagency coordination mechanism for the TFA; and the establishment of a trade information portal (TIP).</p>	<p><b>#3.14.</b> Customs and other border agencies have improved coordination and streamlined clearance procedures, including data sharing, joint inspections and improved risk management, to be in line with the WTO TFA commitments and best practices.</p>	<p>WBG staff analysis (2016)</p> <p>WBG, Doing Business 2016 Report</p> <p>OECD, Trade Facilitation Indicators – Mongolia</p> <p>UN, Trade Facilitation in Selected Landlocked Countries in Asia</p>



**ANNEX 4: COMPARISON OF TRIGGERS AND PRIOR ACTIONS**

Triggers EMSO 1	Prior Actions EMSO 2	Changes
#2.1. A comprehensive external special review on the DBM’s operation from 2012-2016 and an annual audit on the DBM’s operation during 2017 have been publicly disclosed on the DBM’s website.	#2.1. To improve Development Bank of Mongolia (DBM) corporate governance through transparency, the Recipient has publicly disclosed the comprehensive external special review on DBM’s operations from 2012-2017.	Minor change in formulation to expand coverage of external audit.
#2.2. The Housing Mortgage Program is restructured through a joint decree by the BoM and the Government to better serve the purpose of supporting affordable housing in a more cost-effective way, with a time bound plan for the BoM to fully exit the program.	#2.2. To phase out the Bank of Mongolia (BoM)’s quasi-fiscal activities, the Recipient has restructured the Housing Mortgage Program to support affordable housing in a more cost-effective way, and with a time-bound plan for BOM to fully exit the Housing Mortgage Program.	No change.
#2.3. An independent special external review on the BoM’s quasi-fiscal operations—including Housing Mortgage Program, Price Stabilization Program, and financial support to companies—has been publicly disclosed on the BoM’s website.	#2.3. To improve the Bank of Mongolia (BoM) corporate governance through transparency, the Recipient has publicly disclosed the independent special external review on BOM’s quasi-fiscal operations, including the Housing Mortgage Program, Price Stabilization Program, and financial support to companies.	No change.
#2.4: The Government has submitted amendments to tax laws and regulations to reduce tax exemptions and incentives, based on a cost-benefit analysis of individual tax incentive and exemption programs.	#2.4: To improve efficiency of revenue mobilization, the Recipient has established a framework to evaluate the tax expenditure system in terms of the costs and benefits aimed to reduce ineffective tax incentives and exemptions, starting with the 2020 budget.	Change is justified by pending methodology provided by the Bank through a technical assistance which was delayed.
#2.5. The Public Investment Rationalization Guideline has been approved by the Cabinet to reduce the cost for on-going investment projects, starting with the 2018 budget.	#2.5. To improve the efficiency of ongoing and new investment projects in the budget, the Recipient has adopted a regulation to enhance appraisal, prioritization and selection of projects.	Minor change in formulation to reflect the instrument used.



	<b>#2.6.</b> To improve transparency of Government Special Funds, the Recipient has improved the legal, governance, and monitoring frameworks of the state budget-financed Government Special Funds that extend loans and grants.	New prior action.
<b>#2.6.</b> The Government has increased the coverage and benefit size of the Food Stamp Program and/or other social welfare programs that are poverty-targeted based on the PMT-based Integrated Household Database.	<b>#2.7.</b> To increase protection of the poor, the Recipient has increased the total budget allocation for the Food Stamp Program (FSP) and other poverty-targeted programs in 2019 compared to the 2016 level, in line with MTFE allocations.	No change.
<b>#2.7.</b> A comprehensive reform package to the Pension Insurance Scheme is submitted to the Parliament, to maintain the financial sustainability of the pension system.	Postponed to EMSO3.	Client needed more time for preparation.
<b>#2.8:</b> The Government has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public administrations and reducing their number.	<b>#2.8:</b> To improve ease of doing business, the Recipient has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public administrations and reducing their number.	No change.
<b>#2.9.</b> A package of 13 regulations, ordinances or guidelines are approved to operationalize the Livestock and Animal Health Law, including the modalities of: (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major trans-boundary animal diseases control strategic plans, and (iv) herders' obligations.	<b>#2.9.</b> To improve competitiveness of livestock exports, the Recipient has approved a package of regulations, ordinances or guidelines are approved to operationalize the Livestock and Animal Health Law, including the modalities of: (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal diseases control strategic plans, and (iv) herders' obligations.	No change except the reference to the exact number of regulations to be included in the package has been removed.
<b>#2.10.</b> The Government has adopted the institutional framework for the TFA implementation, including: (i) a time-bound action plan for its full implementation; (ii) the establishment of an inter-agency coordination	<b>#2.10.</b> To improve trade environment, the Recipient has adopted the institutional framework for the TFA implementation, including (i) a time-bound action plan for its full implementation; (ii)	No change.



mechanism for the TFA; and (iii) a complete repository of all import and export regulations and procedures to increase transparency and reduce arbitrary application.	the establishment of an interagency coordination mechanism for the TFA; and the establishment of a trade information portal (TIP).	
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**ANNEX 5: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE**

Prior actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects
<b>Pillar I: Supporting Restoring Debt Sustainability through Fiscal Adjustments</b>		
<b>Prior action 2.1.</b> To improve Development Bank of Mongolia (DBM) corporate governance through transparency, the Recipient has publicly disclosed the comprehensive external special review on DBM’s operations from 2012–2017.	<b>Neutral.</b> Neutral environment effects.	<b>No.</b> No distributional effects are envisaged.
<b>Prior action 2.2.</b> To phase out the Bank of Mongolia (BoM)’s quasi-fiscal activities, the Recipient has restructured the Housing Mortgage Program to support affordable housing in a more cost-effective way, and with a time-bound plan for BoM to fully exit the Housing Mortgage Program.	<b>Positive.</b> Positive environmental impact as target of the new program on new home buyer from the ger district is aimed to reduce air pollution.	<b>No.</b> Currently the HMP has little impact among the poor. The proportion of the poor using loans for acquiring a dwelling is below 10 percent. Consequently, policy changes that restructure the program to bring it within the government budget but keep the previous mechanisms for allocation of loans would mostly have no impacts among the poor.
<b>Prior action 2.3.</b> To improve the Bank of Mongolia (BoM) corporate governance through transparency, the Recipient has publicly disclosed the independent special external review on BoM’s quasi-fiscal operations, including the Housing	<b>No.</b> No environment effects.	<b>No.</b> No distributional effects are envisaged.



Mortgage Program, Price Stabilization Program, and financial support to companies.		
<b>Prior action 2.4:</b> To improve efficiency of revenue mobilization, the Recipient has established a framework to evaluate the tax expenditure system in terms of the costs and benefits aimed to reduce ineffective tax incentives and exemptions, starting with the 2020 budget.	<b>Positive.</b> Promoting better tax collection may have positive environmental impacts through more reliable and predictable financing for the ministries and line agencies in charge of managing natural resources and the environment in the long run.	<b>Positive.</b> Improving the efficiency of tax expenditure is expected to increase government fiscal space for critical social spending.
<b>Prior action 2.5.</b> To improve public investment efficiency, the Recipient has initiated the reduction of costs for ongoing and new investment projects in the budget through adoption of a regulation for appraisal, prioritization and selection of projects.	<b>Positive.</b> improve the public budget, financial management and more efficient allocation of public expenditures may have positive environmental impacts through more reliable and predictable financing for the ministries and line agencies in charge of managing natural resources and the environment in the long run.	<b>Positive.</b> Improving the efficiency of public investment management is expected to increase government fiscal space for critical social spending.
<b>Prior action 2.6.</b> To improve transparency of Government Special Funds, the Recipient has improved the legal, governance, and monitoring frameworks of state budget-financed Government Special Funds that extend loans and grants.	<b>Positive.</b> Improving management of Government Special Funds such as crop production support fund, livestock protection fund and SME fund will ultimately relieve the pressures on livestock activities on pasture lands.	<b>Positive.</b> Improving management of Government Special Funds will allow to use resources to be used for proper purpose. Therefore, beneficial to low income households.
<b>Pillar II: Strengthening the Social Protection System</b>		
<b>Prior action 2.7.</b> To increase protection of the poor, the Recipient has increased the total budget allocation for the Food Stamp Program (FSP) and other poverty-targeted programs in 2019 in	<b>Neutral.</b> Neutral environment effects.	<b>Positive.</b> The simulation of the impact of increased coverage of the food stamp program <sup>34</sup> suggests a very

<sup>34</sup> Simulation based on a doubling of the number of beneficiaries (from around 147,000 in 2016 to 294,000 in 2019) and benefits growing 20 percent (that is, from 13,000 and



relation to the 2016 level.		pro-poor result: changes in disposable income hover ranges 9 to 11 percent of disposable income for the two bottom deciles, and zero percent for those above the 4th decile.
<b>Pillar III: Supporting the Competitiveness of the Economy through Structural Reforms</b>		
<b>Prior action 2.8:</b> To improve ease of doing business, the Recipient has submitted a revised Permit Law to Parliament, listing all licenses and permits granted by public administrations and reducing their number.	<b>Neutral.</b> Neutral environment effects.	<b>No.</b> No distributional effects are envisaged.
<b>Prior action 2.9.</b> To improve competitiveness of livestock exports, the Recipient has approved a package of regulations, ordinances or guidelines are approved to operationalize the Livestock and Animal Health Law, including the modalities of: (i) animal disease free zone establishment, (ii) international quarantine procedures, (iii) major transboundary animal diseases control strategic plans, and (iv) herders’ obligations.	<b>Positive.</b> It will frame and guide the implementation of the new Livestock and Animal Health Law, organize training and public awareness activities country-wide to help disseminating the new Law and increase its understanding by veterinary professional and herders, the planned policy adjustments are aimed at a gradual approximation of Mongolian regulatory systems with international good practice in animal health management, it will lead to an increased coverage of vaccination, notably against the disease called PPR (Small Ruminants Plague) as an outcome of the better legislative and policy framework by making public investments in the livestock and animal health sector more efficient, which is	<b>Neutral to Positive.</b> Assuming fully subsidized veterinary services to all producers for key public-good animal health services (say, for instance, meat inspection or key strategic vaccination campaigns), and if this public-good service represents a fixed proportion of total cost, no matter the level of production, then the policy should have a neutral impact. If assuming economies of scale in the provision of the services by size of the producer, then the subsidized provision would be progressive (i.e., vaccination services represent a larger share of total

6,500 MNT monthly per adult and child, to 16,500 and 7,800 MNT, respectively).



	beneficial to the environment and the health of the people.	costs for smaller producers and hence full subsidization benefits them proportionately more). A combination of public/private funding of these would have a pro-poor effect in as much as public funding of these services is targeted to small/poor producers. <sup>35</sup>
<b>Prior action 2.10.</b> To improve trade environment, the Recipient has adopted the institutional framework for the TFA implementation, including: (i) a time-bound action plan for its full implementation; (ii) the establishment of an interagency coordination mechanism for the TFA; and the establishment of a trade information portal (TIP).	<b>Neutral.</b> Neutral environment effects.	<b>No.</b> No distributional effects are envisaged.

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<sup>35</sup> This is a purely deductive argument about the distributional impact of fully subsidized private provision of veterinaries for key public-good animal health services. A more empirically based analysis would require granular farm-level data that were not available during the production of this PSIA.