

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR
MONGOLIA**

As approved by the Board of Directors at its meeting on 5 December 2006.

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I. EXECUTIVE SUMMARY

After the ratification by all member countries in June, Mongolia became a country of operation of the Bank on 15 October 2006. This is therefore the first country strategy for Mongolia. As such the Bank will endeavour to apply its experience and knowledge from elsewhere in the region in order to support the transition and development of Mongolia. To date the donor support and contribution, especially donors to the Mongolia Cooperation Fund, have been valuable in this process. The country is now a beneficiary of the Early Transition Countries Initiative (ECTI), which will allow the Bank to mobilise all appropriate facilities to accelerate Mongolia's transition and the development of private sector.

Mongolia has a multi-party system, a pluralistic society, and is making good progress towards the market-orientation of its economy as envisaged in Article 1 of the Agreement Establishing the Bank. The country has a vibrant network of NGOs, the media is relatively free, and there is increasing adherence to human rights standards. In January 2006 a new coalition Government was formed, and declared its strong commitment to continue with political and economic reforms.

Mongolia is a large, land-locked country bordered by China and Russia. The population is growing moderately but remains small at 2.6 million. The country is a low-income country with per capita GDP of USD710 in 2005, and approximately 36 per cent of the population officially live in poverty. Unemployment and disparities between rural and urban areas and generations are growing concerns for society. The authorities have created a national development plan in the form of the Economic Growth Support and Poverty Reduction Strategy (EGSPRS) to combat these concerns.

Economic performance has improved significantly in recent years. GDP growth has been strong, reaching 10.6 per cent in 2004 and 6.2 per cent in 2005, thanks to good weather conditions, high international mineral prices and consumer spending supported by higher incomes and growing remittances. Fiscal performance has also improved with increased tax revenues and improved expenditure management, and the budget recorded a surplus of 3 per cent of GDP in 2005, the first time a surplus was recorded in recent history. Externally the current account also turned into surplus, in part due to higher mineral prices and growing remittances.

Mongolia has managed to settle its pre-transition debt obligations to Russia without endangering macroeconomic sustainability. As a result the external debt situation has improved significantly. Although the public debt remains large at 62 per cent of GDP in nominal terms, most of the outstanding liabilities are on concessional terms and debt service does not currently constitute a large part of Government expenditure. Careful management of the sovereign debt capacity should remain a priority for the Government, and for these reasons the authorities will continue to refrain from incurring non-concessional borrowings.

Mongolia has made good progress in a number of liberalisation and structural reform areas, including price and trade liberalisation as well as privatisation. The country joined the WTO in 1997 and maintains a floating exchange rate regime with full currency convertibility. The privatisation process is at an advanced stage (private sector already accounts for 70 per cent of GDP). However, post-privatisation restructuring and corporate governance are considered weak and need to be improved in the future. While the Government has made progress in

financial sector reform, the cost of and access to finance remain obstacles to doing business for enterprises. Infrastructure is underdeveloped and the development of market-oriented institutions is at an early stage. Against this background, Mongolia's main transition challenges are to: (i) improving the business environment and corporate governance, (ii) develop the financial sector further, (iii) developing competitive and transparent framework in the natural resources sector, and (iv) promote commercialisation and private sector participation in public infrastructure.

Given, therefore, the macroeconomic environment and the stage of reforms mentioned above, the Bank will focus on the following operation priorities in the strategy period:

Financing Enterprise Development

The development of private businesses will be the main pillar of the Bank's strategy. The Bank will explore possibilities of direct financing in a number of key sectors, including agribusiness, hotel and tourism, infrastructure, property, services and, most importantly, natural resources. The Bank will also look for opportunities to support the remaining large privatisations, as well as increased commercialisation and corporatisation of large state-owned enterprises. The Bank will seek to attract strong and reputable international investors.

Inclusion of Mongolia within the ETC Initiative, providing access to the Medium-Sized Co-Financing Facility (MCFF), the Direct Investment Facility (DIF) and Direct Lending Facility (DLF) as well as due diligence TC, will enhance opportunities to develop local projects. In its efforts to support SME development, the Bank will build on its experience with the Turn Around Management Programme (TAM) and move to establish a BAS Programme.

In view of the structure of the emerging private sector, the Bank will put a special focus and priority on micro businesses through further development of micro and small business credit lines administered by local private banks, especially in the more remote regions.

Strengthening the Financial Sector

Support for the financial sector will be a key priority for the Bank, where there is currently limited access to term finance available for commercial banks and the cost of finance is high. The Bank will seek to strengthen financial intermediation and bank consolidation, and therefore to improve access to finance in the country, through the provision of various forms of credit lines and debt products to commercial banks meeting the Bank's financial and integrity criteria. The Bank will actively roll out the Trade Facilitation Programme (TFP) to several banks as trade finance is in high demand. The Bank will increase financing sources for micro and small enterprises through credit lines to commercial banks and to non-banks, particularly outside the capital. Since the ratification, EBRD has signed its first project in Mongolia with the leading micro lending institution to support rural financing needs.

The Bank will pursue opportunities for equity participation in banks, which will strengthen the local banks' capital base and improve corporate governance. The Bank will also endeavour to support the development of non-banking financial institutions such as non-bank micro financial institutions (NBFIs), leasing, residential mortgage loans, consumer finance, insurance and pensions.

To support institution building and ensure sustainability of the transferred skills in the relatively young Mongolian financial sector, the Bank will seek donor funding for technical assistance (TC) in such areas initially as credit lines for Micro Small and Medium Enterprises (MSME), TFPs and NBFIs followed by leasing, residential mortgages, insurance and pensions.

Active policy dialogue with the Bank of Mongolia will be pursued, with a focus on improving supervision, encouraging consolidation, and on specific issues such as the prevention of money laundering.

Developing in Sustainable Manner the Natural Resources Sector

Mongolia has a huge mineral endowment, which represents significant potential for its future and poverty alleviation. Although good progress was made with the launch of the WB-sponsored Minerals Law in 1997, delays in implementation of secondary regulations, and more recently the introduction of the Windfall Tax on gold and copper producers, have resulted in increased costs in doing business in the sector. There is a need to clarify the debates raised by the introduction of this tax. The rapid rise in mineral exploration in Mongolia after the 1997 law was not followed by actual investments in mine development. This law has been superseded by the 2006 Mineral Law. Although the provisions are not as clearly defined and friendly towards investors as the 1997 Law, this is the Government's attempt to increase the actual investment in the mine development. The Bank intends to support the sustainable development of this sector with a particular focus on transparency, governance, environment and regulation.

Furthermore, implementation of Extractive Industry Transparency Initiatives (EITI) remains a challenge. Following policy dialogue with the Bank and the WB, the Government announced its intention to adopt the EITI in late 2005, however progress was slow. The Bank is closely working with the WB, the Government, industry players and the NGO community towards the full implementation of EITI.

Support for Critical Infrastructure

The investment needs in infrastructure are significant, but constrained by limited public resources and the restriction on sovereign borrowing conditional upon the availability of at least 35 per cent grant element. This being the case, the Bank will explore opportunities for financing non-sovereign infrastructure which produces cash flows to meet debt repayments without recourse to sovereign guarantees. Such opportunities may exist in the areas of aviation, telecommunications and selected utilities and eventually in the construction of new power and transport infrastructure to support development of the mining industry. Moreover, the Bank will investigate the potential for bankable renewable energy projects including hydro and wind power.

The Bank would be ready to finance public infrastructure with a sovereign guarantee on a selective basis, on the assumption of being able to attract donors' grants to co-finance with its resources in order to increase affordability, and to achieve the necessary concessional terms. The ETC initiative and bilateral support will enhance the availability of such funds. By focusing on small-scale, well targeted projects (possibly not of a sufficient overall size to be covered by the other IFIs) the Bank might achieve a significant impact.

Cooperation with the ADB, the WB and key bilateral donors including Millennium Challenge Corporation (MCC) should also allow the Bank to participate in airport, road, railways and power transmission projects. Given the long experience of WB and ADB in Mongolia, the Bank will seek to establish a very close relationship with them to avoid any duplication and identify projects where its added value can be an obvious compliment to their respective programmes. In all cases the Bank will coordinate closely with other donors, IFIs and the Mongolian Government on the overall investment priorities in the country.

Policy Dialogue

Based on the unique experience and knowledge that it has accumulated in the region, the Bank will engage in comprehensive policy dialogue with the authorities in order to promote capital market development, improve the business environment and support reform efforts. Further liberalisation and commercialisation, good governance and better dialogue between foreign and local investors and the Government are some of the issues which should be addressed with the Bank's direct engagement. In this respect, the Bank proposes to work with the authorities to form a new consultative council on investment climate. The Bank has shared with the Government and Parliament its willingness to support them in finding a long term sustainable and fair solution in the development of the mining industry. The Bank will coordinate closely with other IFIs and the business community. The Bank's Environmental Policy and Public Information Policy will apply to all projects developed in Mongolia.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
ATTF	Agence de Transfert de Technologie Financière
AM	Annual Meeting
AML	Anti-money laundering
APS	Association for the Participation to the Development
BOM	Bank of Mongolia (Central Bank)
BAS	Business Advisory Service
CAS	Country Assistance Strategy
CCA	United Nations Common Country Assessment
CIS	Commonwealth of Independent States
CL	Credit Line
CRC	Communications Regulatory Commission
CSP	Country Strategy and Programme
DIF	Direct Investment Facility
DLF	Direct Lending Facility
EGSPRS	Economic Growth Support and Poverty Reduction Strategy
EITI	Extractive Industry Transparency Initiatives
ETCI	Early Transition Countries Initiative
ESAF	IMF Enhanced Structural Adjustment Facility
ESCCG	Economic Standing Committee on Corporate Governance
EU	European Union
EUR	Euro
EVD	Evaluation Department
FDI	Foreign Direct Investment
FI	Financial Institutions
FRC	Financial Regulatory Commission
GDP	Gross Domestic Product
GDR	German Democratic Republic
GSM	Global System for Mobile Communication
GTZ	German Technical Cooperation Fund
ICTA	Information & Communication Technologies Authority
ICTDC	Information & Communication Technologies Development Centre
ICDF	International Cooperation and Development Fund of Taiwan
IFC	International Financing Corporation
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau
KEGOC	Kazakhstan Electricity Grid Operating Company
KT	Korea Telecom
LTT	Legal Transition Team
MCC	Millennium Challenge Corporation
MCF	Mongolia Cooperation Fund
MCFF	Medium Size Co-Financing Facility
MOFE	Ministry of Fuel and Energy
MPRP	Mongolia People's Revolutionary Party
MF	Micro Finance
MIAT	Mongolian National Airline
MJHA	Ministry of Justice and Home Affairs
MNT	Mongolian Tugrug (local currency)
MOFE	Ministry of Fuel and Energy
MOID	Ministry of Infrastructure Development
MPRP	Mongolia People's Revolutionary Party

MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
MT	Mongolian Telecom
NEAP	National Environmental Action Plan
NGO	Non-Governmental Organisation
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PAM	Petroleum Authority of Mongolia
PIP	Public Investment Programme
PRGF	Poverty Reduction and Growth Facility
PSP	Private Sector Participation
RR	Resident Representative
RZD	Russian Railways
SARS	Severe Acute Respiratory Syndrome
SCO	Shanghai Cooperation Organization
SDR	Software Defined Radio
SME	Small and Medium Enterprise
SOE	State Owned Enterprise
SPC	State Property Committee
TACIS	Technical Assistance for Commonwealth of Independent States
TAM	Turn Around Management
TC	Technical Cooperation
TFP	Trade Facilitation Programme
UNEP	United Nations Environment Programme
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Fund
UNCITRAC	United Nations Commission on International Trade Law
USD	US Dollar
USAID	United States Agency for International Development
WB	World Bank
WHO	World Health Organisation
WTO	World Trade Organisation
WWF	World Wildlife Fund

Currencies

EUR	Euro, European Union Currency
USD	United States Dollar
Tugrug	Mongolian Currency

II. STRATEGY

1. The Bank's Portfolio

1.1. Overview of Activities to Date

Mongolia became the 61st member of the Bank in November 2000. After the ratification by all member countries in June 2006, Mongolia became a country of operation of the Bank on 15 October 2006. The President opened the Bank's Resident Office in Ulaanbaatar during his September visit to Mongolia. To mark the start of the banking operations the Bank has signed its first project in financial sector to support the micro lending activities in Mongolia.

To date, the Bank's activities in Mongolia have been mainly to TC activities. In March 2001, the Board approved the establishment of the Mongolian Cooperation Fund (MCF). The MCF consists of EUR10.3 million of grant contributions which have been provided by Japan (EUR5 million), the Netherlands (EUR3.3 million), Luxembourg (EUR1 million) and Taipei China (EUR1 million). The objective of the MCF was to facilitate Mongolia's transition into a market economy through providing TC assistance. It aims to support private sector activity, particularly small and medium-sized enterprises. It also helps to develop key sectors such as financial institutions, infrastructure and natural resources. A priority for the Fund is to assist Mongolia in implementing economic and legal reforms and to create an attractive investment climate.

Table 1 TC Activities under the MCF as of October 2006

	Number of TCs	Total TC Committed (€thousand)	Total TC Disbursed (€thousand)	Per cent Share of Commitment
FI	8	512	456	5.8
MSE financing	1	850	850	9.6
Telecom	2	550	466	6.2
Transport	4	1,904	1,002	21.4
Power	1	500	271	5.6
Natural Resources	2	168	49	1.9
General Industry	1	73	56	0.8
TAM	24	2,395	1,796	26.9
Legal Transition	4	1,207	264	13.6
Others	8	735	718	8.3
Total	55	8,894	5,928	100.0

To date the Bank has provided 55 TCs (including 8 administrative TCs such as office management, etc.) with a total commitment of EUR8.9 million from the MCF to Mongolia. The TCs cover a range of sectors, including financial institutions, aviation, power and telecommunications. The MCF also supports legal reform, training programmes and the TAM Programme. Some of the important TCs which have been provided to date under the MCF include: training to commercial bankers for basic banking skills, provision of experts for micro business lending, privatisation support for power and telecommunication sectors, a master plan for the aviation sector, management contract to the national airline (MIAT), legal transition support for corporate governance and secured transactions.

Following Mongolia's ratification as a Country of Operation, the MCF Donors Steering Committee in November 2006 decided that the MCF will concentrate only on two types TC projects: (i) project preparation TCs for individual loan and equity projects (feasibility study, due diligence, etc.) and (ii) TC for Ulaanbaatar urban transport project. The committee decided that both TC projects should be finalised by the end of June 2007 and disbursement should be completed by December 2008. Following the phasing out of the MCF, the ETC Multi-Donor Fund and bi-lateral donors will take a leading role for TC activities in Mongolia.

1.2 Transition Impact & Lessons Learned

The Bank's activities in Mongolia have been thus far has mainly been TC operations under the MCF. The Evaluation Department (EVD) undertook a mid-term review of MCF activities in October 2005 to assess the extent to which operations have been implementing the Bank's mandate, and to make recommendations from the evaluation findings.

Based on the review, the TC activities have led to successful results overall. The operations that essentially served identifiable private enterprises or institutions have succeeded, or are likely to succeed. This category includes MSE Advisory services for Khaan Bank, TAM and training projects. The success of these TC activities has been well received in Mongolia, and the Bank's presence was firmly recognised.

On the other hand, the results for the operations serving public sector enterprises or broader objectives have been mixed. The TC for national airline operation, and the downstream petroleum TC operation, were assessed as less than successful as the authorities did not go ahead with the pertaining privatisation plans. The privatisation TCs to support the telecommunication and power sectors are yet to be evaluated.

A key recommendation arising from this evaluation, apart from specific TCs, is closer communication with donors and ensuring adequate co-ordination with other donors through active and regular meetings with all parties.

2. Operational Environment

2.1 General Reform Environment

2.1.1 Political Developments

Mongolia has made significant progress towards a multi-party democracy and pluralism. The country has many political parties, including genuine opposition parties, and a vibrant network of NGOs. The media is relatively free and there is increasing recognition and adherence to the improvement of human rights conditions. Mongolia is a land-locked country with a small but dispersed population, sharing borders with China and Russia. Externally, the country is trying to maintain a balance in relations with its two large and powerful neighbours. The 1992 Constitution established a parliamentary system of Government, and former Prime Minister and Parliamentary Speaker Nambaryn Enkhbayar of Mongolian People's Revolutionary Party (MPRP) was elected President in May 2005 in an election where observers noted minor irregularities.

In accordance with the Constitution, the single-chamber Parliament, the State Great Hural, is elected every four years. The last parliamentary elections took place in June 2004 and none

of the political parties secured a sufficient majority to form a Government. As a result, Mongolia's first coalition Government was established, which lasted less than two years. In January 2006 the MPRP formed a new coalition Government, together with smaller parliamentary parties headed by the MPRP candidate Miyegombo Enkhbold. The new Government is facing many challenges, including widespread poverty, unemployment and sustainable progress in implementation of the economic and social reforms. Externally, the Government is aiming to maintain a balance in relations with its large and powerful neighbours.

2.1.2 Legal Environment

In the last fifteen years, the legal system of Mongolia has undergone major reforms. The 1992 constitution, which is still in force, created the foundation for a democratic state based on republican principles. The Mongolian leadership has adopted as its strategy an open internal market by encouraging foreign investments and trade. Commercial legislation is being adopted based on international best practices, and this has created a relatively favourable business environment. However, maintaining a business presence remains a challenge, and the administrative infrastructure and the existing tax system constitute major obstacles to business activities.

As the transition from a planned system towards a market economy has been carried out, in the last decade more than 500 laws regulating commercial activities have been adopted regulating commercial entities, tax matters, banking activities, securities markets, arbitration and currency exchange. The adoption of the Civil Code in 2002 has been a major step in laying the foundations of a modern civil law system. The proper implementation of its provisions through secondary legislation and court practice remains a challenging goal for the local legislator and judiciary. In addition, judges tend to adopt rather simplistic and sometimes arbitrary decisions; there is widespread corruption and the existence of inefficient institutions.

In addition, commercial lending, in particular for SMEs, is troubled by high interest rates, lack of long term lending and an unsatisfactory institutional environment. It is hoped that new legislation on SMEs, tax incentives and loan facilities will be put in place in the near term to address such concerns. There are also expected to be improvements in tax administration, banking supervision and public enterprise restructuring. The government will focus on implementing a poverty reduction strategy and legislation covering concessions and secured transactions.

2.1.3 Environmental Issues

Key environmental issues in Mongolia include lack of sustainable management plans for natural resources, reduction of biodiversity and threat of extinction of a number of species. This is due to illegal poaching and loss of habitats, deforestation and rangeland degradation, damage to wetlands and waterways caused by mining activities and large-scale hydropower stations, desertification and overgrazing due to unsustainable herding practices, erosion of soil, degradation of landscapes and pollution of water by mining industry; rapid raise in water demand and insufficient supply, air pollution caused by coal-based power generation plants and domestic and industrial combustion, and inadequate management of hazardous and non-hazardous waste. Characterisation and management of these issues is limited by lack of precise baseline data.

The National Environmental Action Plan (NEAP) establishes the Government's priorities and identifies issues and actions for the protection of environmental quality, natural resources conservation and institutional capacity building and covers actions to the year 2010. The NEAP includes about 25 national environmental programmes in various areas such as desertification, forestry, biodiversity, water, protection and conservation of rare species.

Key environmental laws include the Law of Environmental Protection, Law on Minerals, and Law on Protected Areas, Natural Resources Use Fee Law, and Laws on Forestry, Wildlife and Hunting, the Law on protection of land resources, Law on Environmental Impact Assessment and Mining Law. Mongolia is also a party to a number of International Conventions on Environment. Characterisation and management of these issues is limited by lack of precise baseline data. The environmental NGO movement is largely supported by international donors and the majority of environmental NGOs are based in Ulaanbaatar. They focus primarily on environmental awareness, conservation and reforestation initiatives.

The Bank will conduct comprehensive due diligence on potential projects in Mongolia in order to identify any environmental, socio-economic, worker protection, community interaction and cultural heritage related issues that might be associated with its activities. The Bank will also work closely with its clients on developing environmental and social action plans aimed at mitigating identified negative impacts as well as achieving compliance with the Mongolian national and international environmental, health, safety and labour regulations and standards and best-industry practices, especially in the area of natural resources extraction activities. The Bank will foster public consultation and disclosure on its projects in line with the provisions of the Bank's Environmental Policy. The Bank will seek to identify opportunities for improvements in the areas such as energy efficiency, management of waste, environmental management and other areas and mobilise technical cooperation initiatives in respect of environmental, labour and community development issues, institutional strengthening and capacity building linked to its existing or potential investment projects.

2.1.4 Social Issues

Mongolia has a population of approximately 2.6 million, which is very small, considering the vast size of the country (1.6 million square km). The population is concentrated in the capital city - Ulaanbaatar. The population is mostly homogenous but there are a number of ethnic minorities, including a Kazakh minority comprising of approximately 100,000 people primarily concentrated in the western part of the country.

Currently 60 per cent of the population live in urban areas. Migration from rural to urban areas has increased recently after a series of natural disasters during 1999-2001. This led to the loss of incomes of many herder communities who subsequently decided to move to urban areas in search of employment, other sources of income and access to infrastructure and services. Professional personnel, including doctors and teachers, also migrated from rural to urban areas. This movement has caused deterioration in the access to social infrastructure in rural areas.

The UNDP Report on Economic and Ecological Vulnerabilities and Human Security in Mongolia (2005) indicates that economic vulnerability increased since 1990. Nevertheless, the incidence of poverty continues to decline from a level of 36 per cent in 2002 to 32 per

cent in 2006.¹ Rural areas have a poverty incidence of 43 per cent as compared to 30 per cent in urban areas.² Unemployment seems to be underestimated in the official statistics at 3.6 per cent in 2004, but the real unemployment rate is estimated at 17 per cent according to the 2000 population census. The majority of those unemployed are the young labour force, and the unemployment rate is also high in the urban areas where people come from rural areas to seek jobs.

There appears to be relative gender equality in Mongolia compared to many other countries in the region. Women represent approximately half of the workforce, and a significant number are the primary wage earners for their families. However, evidence from recent studies³ and a gender analysis of national statistics show that the impacts of the economic transition are different for women and men. This period of change is creating gender gaps which are new to Mongolia in many areas of economic and social development. In order to address gender issues, a National Committee on Gender Equality, chaired by the Prime Minister of Mongolia, was established by the Government Resolution N 26 of 2006 to assist with the implementation of these policies and to assess their results.

Mongolia has ratified all of the ILO core conventions. The law specifically prohibits forced or compulsory labour, and the Government generally enforces this provision. The Government has now signed and ratified the ILO Convention against forced labour. The law in general prohibits children under the age of 16 from working, although those who are 14 or 15 years of age may work up to 30 hours per week with parental consent. Those under 18 may not work at night, engage in arduous work or work in hazardous occupations such as mining and construction. Enforcement is limited, due to the small number of labour inspectors and the growing number of independent enterprises.

Children work informally in petty trade, scavenging in dumpsites, working in unauthorized small-scale mining, and herding animals. The majority of this work occurs in agriculture and seen as non-harmful. Increasing alcoholism and parental abandonment made it necessary for many children to have an income to support themselves, their siblings, and sometimes their parents. Estimates placed the number of children in the labour force as high as 58,000. The government prohibits forced and compulsory labour by children and effectively enforces this prohibition.

The amendment to the Law on Employment Promotion was adopted by the Parliament with a view to implementing employment promotion measures consistent with labour market demands and ensuring their compliance with unemployment and poverty reduction goals. These amendments include various important provisions concerning diversification of employment services, inclusion of informal sector workers and herders into employment services, development of new services and methods to deliver the services and refinement of revenue generating or disbursement procedures and the management structure of the Employment Promotion Fund. The Government has also adopted a Policy on informal sector employment.

Mongolia, as most of the transition countries, is a source country for women and men trafficked for the purposes of sexual exploitation and forced labour. Mongolia also faces a

¹ Poverty Assessment: Mongolia, 2006, World Bank. The poverty ratio is defined in the population with an income of MNT 25,000 (USD 20) or less a month.

² Poverty Assessment: Mongolia, 2006, World Bank.

³ Country Gender Assessment: Mongolia, Asian Development Bank and World Bank, 2005.

problem of children trafficked internally for commercial sexual exploitation. Although the Government of Mongolia does not fully comply with the minimum standards for the elimination of trafficking, it is making significant efforts to do so, and in March, 2006 implemented the “National Plan of Action on Trafficking and Protection of children and women from commercial sexual exploitation.” The Plan's main objectives are to create a stronger legal environment for trafficking prevention, to increase trafficking awareness, and to improve the protection and rehabilitation of victims. The Mongolian Government also cooperates with NGOs and regional and international organizations on anti-trafficking measures.

2.2 Economic Developments and Progress in Transition

2.2.1 Macroeconomic conditions for Bank operations

Mongolia's economy has traditionally been dominated by agriculture, particularly livestock production. Industry share in GDP is also high at 30 per cent, dominated by the mining sector (i.e. copper and gold). Wool and cashmere production have also become important over the past decade. The services sector remains relatively underdeveloped, but has been rapidly growing on the back of increasing remittances and household incomes. Annual economic growth is vulnerable to weather conditions and global commodity prices (i.e. prices of oil, metals and textiles). Whilst sharing many of the problems with other transition economies, Mongolia has recorded a relatively favourable overall output performance, and this is partly because the economic “shock” of the post communist regime at the initial stage of transition was relatively short and modest. Current GDP (2005) is 30 per cent higher in real terms than in 1990. Mongolia remains a low-income country with per capita GDP of USD710 in 2005. To support the sustainable economic development and alleviate poverty, the authorities developed a national development plan in the form of the Economic Growth Support and Poverty Reduction Strategy (EGSPRS) in 2003 and are currently in the process of developing a longer-term National Development Strategy.

During the past decade, the Mongolian economy has been affected by a series of external shocks, such as very cold winters and an outbreak of foot and mouth disease, and movements in commodity prices. The country also went through the initial economic shock of the post communist regime in the early 1990s and a number of financial crises during the transition period. For these reasons, the country was not stable until recently. During the past few years, Mongolia enjoyed reasonable economic stability with good economic performance. Real GDP grew by 10.6 per cent in 2004 and 6.2 per cent in 2005. This is attributable to good weather conditions, high international mineral prices and increased gold production, mining-related foreign direct investment, and consumer spending supported by higher incomes and growing remittances. Textile output has dropped significantly in the context of the phasing out of the quota regime under the Multi Fibre Arrangement (MFA).⁴

Mongolia's exchange rate regime is a managed float and the currency is fully convertible for current account transactions. The Central Bank targets stability in both the exchange rate and

⁴ The textiles and clothing industry had not been subject to the rules of the General Agreement on Tariffs and Trade (GATT) until recently and was subject to the extensive application of quotas by the major importing countries, which is known as the Multi-Fibre Arrangement (MFA). However, at the end of the Uruguay Round, it was agreed that countries wishing to retain quotas would undertake to phase them out gradually, with the last quotas being lifted on 1 January 2005. While China was restricted by these quotas in the past, Mongolia enjoyed the quota free status. By lifting quotas, the Mongolia's textile sector is now fully exposed to international competition.

in domestic prices. This approach appears to have been successful in recent years and exchange rates have been relatively stable. In recent years, broad money grew rapidly (by 37 per cent in 2005) mainly due to strong inflows of foreign exchange and banking sector credit growth. At the same time, prices of oil, agricultural products and utilities increased significantly. This fuelled inflationary pressures in the country and the 12 months inflation rate peaked at 18 per cent in June 2005. Due to the recent influx of cheap goods from China and the deceleration in food prices, the 12 months inflation rate has come down rapidly to 5 per cent in August 2006.

Fiscal performance has improved in the past several years. During 2005, fiscal revenues were boosted by robust economic growth and higher international commodity prices. On the expenditure side, expenditure management has improved thanks to the introduction of the Government Financial Management Information System (GFMIS), and expenditure dropped significantly from 40 per cent of GDP in 2004 to 34 per cent in 2005. Reflecting these improvements, the 2005 budget ended with a surplus of USD50 million (3.2 per cent of GDP), the first time a surplus was recorded since 1992. However, some fiscal loosening is anticipated in the next few years. For example, the 2006 budget envisages large increases in public wages and social spending.⁵ Moreover, as part of tax reforms, the new tax legislation was approved by Parliament in July 2006 (effective from January 2007) to reduce a number of key tax rates, including VAT and income tax.⁶ The impact on the 2006 budget may be insignificant, but there is likely to be a greater impact for 2007 and onwards.

External performance also improved as the current account turned into a surplus. This is in part due to higher mineral prices and growing remittances. Exports grew from USD872 million in 2004 to USD1,069 million in 2005 (23 per cent growth) while the amount of remittances increased from USD74 million in 2003 to USD134 million in 2005 (5 per cent and 7 per cent of GDP respectively). Mongolia also received a significant amount of foreign direct investments in 2005 (USD258 million or 13.7 per cent of GDP). Under these circumstances, the BOM was able to rebuild its foreign reserves from USD178 million in 2003 to USD333 million at the end of 2005 (covering 2.1 months of imports).

Mongolia has managed to settle its pre-transition debt obligations to Russia with a one-off payment of USD250 million in 2003-04. However, nominally the external debt (excluding the bilateral debt to Russia) has gradually risen from USD978 million in 2002 to USD1,308 million in 2005. Nevertheless, owing to rapid growth over this period, the debt to GDP ratio declined rapidly from 99 per cent in 2002 to 71 per cent by the end of 2005 (and expected to be 62 per cent in 2006). The majority of Mongolia's external debt is comprised of multilateral loans, payable at low interest rates over long periods of time, which reduces the debt to GDP ratio down to 43 per cent in NPV terms. Annual debt service remains insignificant (2.3 per cent of exports of goods and services) due to long grace periods. The IMF/World Bank Debt Sustainability Analysis concluded the risk of debt distress is moderate over the medium term, but also indicated that any slippage of debt management policies or significant external shocks (e.g. terms of trade shocks) will make external debt indicators unsustainable. The authorities recognise the necessity to manage the sovereign debt capacity carefully and will refrain from incurring any non-concessional borrowings.

⁵ A 30 per cent public wage increase was budgeted for 2006, and a further 20 per cent increase is currently under consideration for the 2007 budget.

⁶ The new tax legislation (effective from 1 January 2007) stipulates to lower the corporate tax rate (from the current rates of 15 or 30 per cent to 10 or 25 per cent depending on the annual income levels) and VAT from 15 per cent to 10 per cent. Income tax rates will be flat at 10 per cent, from the current rate of 10-30 per cent depending on income levels.

2.2.2 Progress in Transition and Remaining Challenges

2.2.2.1 Progress in Transition

According to the Bank's transition indicators, Mongolia made good progress in liberalisation and structural reforms during the past 15 years in transition.⁷ Mongolia compares relatively favourably to the transition countries in the CIS (See Table 2-1). Progress has been relatively strong in the areas of price and trade liberalisation and small and medium scale privatisation. In other dimensions the transition achievements in the financial institutions, enterprise restructuring and infrastructure sectors are similar to those of the CIS average.

Mongolia embarked on price liberalisation at the early stage of transition and ceased administration of wages and most prices between 1991 and 1993. The process was completed by the end of 1996. Trade liberalisation was also rapid. Mongolia introduced full current account convertibility and allowed the MNT to float in 1993. The BOM intervenes in the foreign exchange market only to reduce volatility. Mongolia reduced most tariffs to 10 per cent in 1993 and has since continued to reduce barriers to trade gradually and joined the WTO in 1997. Currently tariffs are flat at 5 per cent. Foreign investment has been encouraged since 1991, and laws governing property rights, company law, regulation and competition are broadly consistent with international best practice, although the implementation is considered weak.

Table 2-1 Transition Indicators of Mongolia and the CIS countries, 2006

Countries	Enterprises			Markets and Trade			Financial Institutions		Infrastructure
	Large-scale privatisation	Small-scale privatisation	Governance & enterprise restructuring	Price liberalisation	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Infrastructure reform
Armenia	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	2	4-	2+	4	4	2	2+	2-	2
Belarus	1	2+	1	3-	2+	2	2-	2	1+
Georgia	4-	4	2+	4+	4+	2	3-	2-	2+
Kazakhstan	3	4	2	4	3+	2	3	3	2+
Kyrgyz Republic	4-	4	2	4+	4+	2	2+	2	2-
Moldova	3	3+	2	4-	4+	2	3-	2	2+
Mongolia	3	4	2	4+	4+	2	2+	2	2
Russia	3	4	2+	4	3+	2+	2	3-	3-
Tajikistan	2+	4	2-	4-	3+	2-	2	1	1+
Turkmenistan	1	2	1	3-	1	1	1	1	1
Ukraine	3	4	2	4	3+	2+	3-	2+	2
Uzbekistan	3-	3	2-	3-	3-	2-	2-	2	2-
CIS Average	3-	3+	2	4-	3+	2	2+	2	2
EBRD Average	3	4-	2+	4	4-	2+	3	2+	2+

Note: The index ranges from 1, indicating little or no progress, to 4+ pointing to standards similar to advanced economies. See Transition Report 2006 for the detailed methodological notes.

Source: EBRD Transition Report 2006.

⁷ The EBRD transition indicators for Mongolia were constructed retrospectively, with assistance from USAID, using the same methodology as applied to all other countries in March 2006.

Private Sector Development

Progress in privatisation was relatively rapid for small-scale enterprises. Privatisation began during the early 1990s with a voucher privatisation programme and most small enterprises had been transferred to private ownership by 1993. The authorities passed two land laws which allow Mongolian nationals to own a parcel of land, while land ownership by foreign nationals/companies remains forbidden. Large scale privatisation accelerated in 1997 and a number of large-scale SOEs have been sold, mostly to foreign companies. Accordingly the private sector share in GDP rose to approximately 70 per cent by 2005. The Government formulated a new strategy on privatisation with a list of 28 companies, but most envisaged privatisations have been delayed. In the list, the most promising privatisations include Gobi Cashmere, coal mines, Mongolian State Airlines (MIAT) and power sector companies. The Gobi cashmere plant is due to be privatised by the end of 2006.

Enterprise restructuring has proceeded slowly. Mongolia has taken several steps to harden budget constraints and improve public financial management and enterprise governance. Subsidies and inter-state company arrears remain large, particularly for utility companies. Bankruptcy legislation, adopted in 1991 and amended in 1994, is weakly enforced. Corporate governance is generally considered weak, in part due to lack of disclosure and transparency of corporate information and protection of minority shareholders.

The business environment in Mongolia is relatively good by regional standards. According to the World Bank's Survey of Doing Business, most of the indicators are better than its regional neighbours (i.e. China and Russia) and Central Asian countries (see Table 2-2). The indicators were particularly encouraging in the areas of starting a business, dealing with licenses, hiring and firing, and registering property. Overall, Mongolia ranked 45th out of 175 countries surveyed in 2006.⁸ The recent amendments to the tax laws lowered corporate taxes from 30 per cent to 25 per cent and VAT from 15 per cent to 10 per cent. According to the latest Transparency International's Corruption Perceptions Index (CPI-2006), Mongolia is doing better than all the CIS countries, being ranked 99th out of 163 countries. The latest ranking, however, reflects backsliding compared to the last year's ranking of 85th out of 158 countries in 2005.

Table 2-2 Selected indicators from World Bank Doing Business, 2006

	Mongolia	China	Russia	Kazakhstan	Kyrgyz Republic
Time to start a business (Days)	20	35	28	20	21
Cost to start a business (per cent of income per capita)	5.1	9.3	2.7	7.0	9.8
Procedures to obtain a license (number)	18	29	22	32	20
Time to register property (Days)	11	32	52	52	8
Ease of getting credit (ranking among 175 countries)	65	101	159	48	65
Total tax payable (per cent of gross profit)	32.2	77.1	54.2	45.0	67.4
Documents needed for export (number)	11	6	8	14	NA
Time for export (days)	66	18	39	93	NA
Time to enforce a contract (Days)	314	292	178	183	140
Cost to enforce a contract (per cent of debt value)	17.6	26.8	13.5	11.5	12.0
Time to close a business (years)	4.0	2.4	3.8	3.3	4.0
Cost of closing a business (per cent of estate)	8.0	22.0	9.0	18.0	14.5

⁸ The 2006 ranking improved from that of 2005 (61st out of 155 economies). Source: Doing Business in 2006, World Bank

In the mining sector, there has been a rapid rise in mineral exploration in Mongolia. The good level of exploration investments is generally attributed to the 1997 Minerals Law, which aimed to attract foreign exploration companies. The Government announced its intention to adopt the Extractive Industry Transparency Initiatives (EITI) in late 2005. EITI supports improved governance in resource-rich countries through the full publication and verification of company payments and Government revenues from oil, gas and mining. This is seen as a good first step by the Government in improving transparency and accountability, but the implementation of the EITI is a clear medium-long term challenge. It should also be noted that a Development Fund was established in order that all mineral related revenues are generated for the time when commodity prices may be lower, and partly for funding capital investment programmes.⁹

Nevertheless, foreign investors and domestic enterprises continue to complain about the obstacles when doing business in Mongolia. According to a recently published World Bank report on the investment climate, the key impediments to the development of the private sector (according to investors' perceptions) are corruption and the lack of transparency and accountability in Government-business interactions.

The recent introduction of the Windfall Tax and the 2006 Minerals Law have resulted in increased costs in doing business in the mining sector. The Windfall tax imposed a 68 per cent tax on profits from the sale of copper and gold when prices of these commodities are above certain levels.¹⁰ The recent new Minerals Law stipulates mandatory listing of the shares of the mining companies on the Mongolian Stock Exchange (10 per cent of the shares), increased rates of royalties (from 2.5 per cent to 5 per cent), and the State right to acquire up to a 50 per cent stake (34 per cent if the exploitation is privately funded) of the strategic deposits discovered on Mongolian territory.¹¹ The tax holiday regime was also eliminated in the context of tax reform. These new measures have increased both the uncertainty and the actual costs of doing business for foreign investors in the mining sector. Following the adoption, gold sales to the BOM have significantly fallen and large processing investments have been postponed. Reportedly the Government and Parliament are considering some amendments to maintain attractiveness of Mongolia as an investment destination.

Financial Sector Development

Mongolia went through a number of financial crises during the 1990s (i.e. in 1994, 1996 and 1998-99). During these crises, significant banking sector restructuring was carried out. All of the former state banks were privatised, whilst others were closed. The capital base in the banking sector has increased significantly, partly as a result of the rise in minimum capital requirements to MNT 8 billion (equivalent to USD6.6 million) in March 2006. There are currently 17 banks and some of these have been sold to foreign investors during the privatisation process. Financial intermediation has advanced rapidly over the past several years, illustrated by the increase in the domestic credit to GDP ratio, which has doubled from 20 per cent in 2002 to 40 per cent in 2005.

⁹ While two thirds of the fund will be spent on social programmes and capital expenditure, one third will be saved for the time when mineral prices are lower.

¹⁰ For copper USD 2,600 per ton and for gold USD 500 per ounce, where as the market price of copper was USD 6,857 and that of gold was USD 625 in mid-November 2006..

¹¹ The Government needs to pay fair prices if it would like to buy shares of mining companies. The new Minerals Law also extended the maximum duration for investment contracts to 30 years.

However, the banking sector remains vulnerable. While credit to the private sector has grown rapidly, the stock of non-performing loans recently increased at the nominal yearly rate of 30 per cent in August 2006 (although the ratio of non-performing loans in total loans is on the down trend).¹² The cost of borrowing is high as the average lending rate remains at over 20 per cent. The spreads between the deposit and lending rates are high and have not narrowed significantly. This can be partly explained by the lack of property rights, lack of trust in accounting standards and weak lending practices. As yet, there is no deposit insurance scheme, although a law on such a scheme is currently being drafted.

The capital market remains underdeveloped. There are a reasonable number of enterprises listed in the stock exchange, but trading is thin and enterprises are not using the stock market to raise funds. The stock market served mainly to distribute share vouchers in the early 1990s. In 2006, 393 companies were traded with USD68 million in market capitalisation (about 3.5 per cent of GDP). In the absence of institutional investors and flagship companies in the market, it is hard to develop the equity market. In the insurance sector, there are currently 22 insurance companies, with their premium income accounting for only 0.7 per cent of GDP. The following insurance types are common: state social security, state health insurance, private insurances (property insurance, third party liability insurance and casualties insurance). The largest insurance company holds 47 per cent of the market share and there is little competition in the market. Yet there is no privately funded pension system and investment funds have not been developed in Mongolia. A 2002 law on non-bank financial institutions established the BOM as the sector regulator, but recently the regulatory responsibility of non-bank financial institutions was transferred to the FRC.

Infrastructure Reforms

The market oriented development of infrastructure is at an early stage in Mongolia. Most of the infrastructure assets are still owned by the state while privatisation of the infrastructure companies has been proceeding very slowly. Mongolian Railways are jointly owned by the Mongolian Government and the Russian Railways on a 50 per cent basis.. In the aviation sector, both airports and the national airlines company are owned and operated in public hands (a number of small-scale domestic private airlines operate in Mongolia). Nevertheless the management of the airline company and some water companies had been contracted out under foreign management in the past. In the energy sector, 18 joint stock companies have been created by Resolution No. 164 in 2001, but the subsequent privatisation plans have been suspended. In the telecommunications sector, the networks are owned by the state, while 40 per cent of the fixed line operator, Mongolian Telecom, is owned by Korean Telecom. Nevertheless, recently adopted privatisation guidelines and an implementing resolution envisage the introduction of free access to the fixed line networks and subsequent full privatisation of Mongolian Telecom. The mobile market is most advanced in terms of private sector participation. There are two existing private operators, i.e. Mobicom and Skytel, and a third license was recently granted to Unitel.

On the regulation side, regulatory functions are largely separated from policy making functions and operations (with a notable exception of airlines/air navigation services where a regulatory function is placed under the operating company). In recent years, a number of independent regulators have been established, including the Communications Regulatory Commission as a telecom regulator and Energy Regulatory Authority as an energy regulator.

¹² The ratio of non-performing loans in total loans has declined from 51 per cent in 1999 to about 6 per cent at the middle of 2006.

However, they are at an early stage of development and regulatory capacity and efficiency need to be improved further. In Mongolia important regulatory challenges relate to the establishment of the cost-recovery tariffs, the implementation of universal access in rural areas and the introduction of the transparent subsidy systems.

In Mongolia tariff adjustments are politically sensitive and have been difficult to implement. While railways (cargo) and telecommunications appear to be operating profitably, some other utility companies, including most power and water companies, continue to struggle to operate on a break even basis. While the donor community remains active in lending operations, many companies are heavily indebted and possibly in difficulty to service their debts. Establishing a sustainable financial framework is essential to maintain much needed infrastructure for Mongolia.

2.2.2.2 Transition Challenges

The following four areas are the key transition challenges for Mongolia over the strategy period:

Improving the business environment and corporate governance

The business environment in Mongolia has been considered relatively good compared to the other transition economies in the CIS. However, given the importance of foreign investments for the country (i.e. bringing capital and technologies) and current negative perceptions in the aftermath of the adoption of the mining related legislation, certain business obstacles should be removed to improve the business environment (particularly in the areas of corruption, and transparency and accountability in Government-business interactions). Moreover, transparency (including accounting standards and disclosure) and corporate governance need to be improved further.

Although the privatisation process was relatively rapid, the authorities should carry out privatisation and other forms of Private Sector Participation (PSP) for the remaining large-scale state enterprises without further delay. For the privatised enterprises facing operational and financial difficulties during post privatisation periods, significant restructuring needs to be undertaken. Increased commercialisation and corporatisation of large state-owned enterprises remains a challenge.

Developing the financial sector further

Although significant progress has been made in the banking sector, access to medium to long-term finance at affordable interest rates is considered difficult for enterprises and individuals. Lending rates remain high, in part due to lack of confidence in collateral and the judiciary system. Financial intermediation needs to be further deepened by providing access to finance for domestic enterprises, particularly long-term funding and funding for entrepreneurs and micro and small enterprises. Finances in the real sector and for new products such as mortgages are also encouraged. The capital market remains at an infant stage and needs to be developed in all aspects, particularly transparency, governance and regulation. On the demand side, the development of institutional investors, such as insurance companies, investment funds and pension funds, is a crucial element.

Developing competitive and transparent framework in the natural resources sector

Although good progress was made with the launch of the 1997 Minerals Law, the implementation of secondary regulations has been delayed. More recently, the

introduction of the Windfall Tax and the 2006 Mineral Law have resulted in increased costs in doing business in the sector. The authorities need to make sure that the business environment for mining is internationally competitive. The government also should ensure a level playing field for foreign investments (e.g. risk allocation between the government and foreign investors) and strengthen dialogue between the government and the business community. Moreover, the implementation of EITI remains a challenge.

Promoting commercialisation and private sector participation in public infrastructure

Given the lack of market-oriented reforms, continued efforts are needed to commercialise/restructure the remaining state enterprises. Tariffs should be increased to the affordable and cost recovery levels where necessary, and effectively monitored by independent regulatory agencies. Collection rates should be improved further while the fair and transparent subsidy system and the elimination of cross-subsidisation, if necessary, should be promoted. This is particularly challenging in the *ger* areas, where delivery costs are high and the population is low-income.

2.3 Access to Capital

Mongolia has a large territory with the population spreading around the country. Large capital investments are needed to establish good transport networks and other necessary infrastructure. Public finances remain essentially dependent on official financing from bilateral donors and IFIs. Mongolia has held a number of successful Consultative Group meetings in the past and the donor community has been committed to support the country's Economic Growth Support and Poverty Reduction Strategy. The country has received approximately USD250-300 million of Official Development Assistance (i.e. over 10 per cent of GDP) annually. Key donors are Japan, the Asian Development Bank, and the World Bank group.¹³ In the coming years, significant grant flows are expected to come from the US Millennium Challenge Corporation. Mongolia received foreign currency credit ratings of B+/Stable by Fitch ratings, B/Positive by Standard and Poor's and B+ by Moody's. However, the Government has not yet issued any international bonds.

There are also substantial investment needs in the private sector. This is particularly true for the natural resources sector where the majority of existing deposits are yet to be exploited and for the services sector which is growing fast in line with growing disposable incomes. However, access to medium- and long-term finance remains relatively limited. Domestically most financial arrangements are short-term and interest rates remain high. Access to bank lending is especially difficult for micro and small enterprises and enterprises located in the remote region. One sector which has attracted private financing is the mining sector. The sector attracted foreign direct investments for more than USD700 million in a decade. Other sectors which attracted foreign direct investments are trade and services, light industry, agro-processing and construction. There is a stock exchange in Mongolia, trading both equities and bonds, but the liquidity of the market is quite limited and the market is not functioning as a vehicle to raise additional funds for enterprises.

3. Strategic Orientations

3.1 The Bank's Priorities

¹³ Top donors by the amount (2003-04 average) of ODA allocated for Mongolia, according to OECD Development Co-operation Directorate (DAC).

3.1.1 Financing Enterprise Development

The support of the private sector is the most important objective of the Bank's strategy. The Bank will explore possibilities of direct financing in a number of key sectors, including agribusiness, hotel and tourism, infrastructure, property, services and most importantly, natural resources. The Bank will also look for opportunities to support the remaining large privatisations, as well as increased commercialisation and corporatisation of large state-owned enterprises. The Bank will seek to attract strong and reputable international investors.

The inclusion of Mongolia within the ETC Initiative will enhance opportunities to develop local projects by providing funding to the local enterprise through the MCFF, DIF and DLF as well as due diligence TCs. In its efforts to support SME development, the Bank will build on its experience with the Turn Around Management Programme (TAM) and move to establish a BAS Programme.

In view of the structure of the emerging private sector, the Bank will put a special focus and priority on micro businesses through further development of micro and small business credit lines administered by local private banks, especially in the more remote regions.

3.1.2 Strengthening the Financial Sector

Support for the financial sector will be a key priority for the Bank, where there is currently limited access to term finance available for commercial banks and the cost of finance is high. The Bank will seek to strengthen financial intermediation and bank consolidation, and therefore to improve access to finance in the country, through the provision of various forms of credit lines and debt products to commercial banks meeting the Bank's financial and integrity criteria. The Bank will actively roll out the Trade Facilitation Programme (TFP) to several banks as trade finance is in high demand. The Bank will increase financing sources for micro and small enterprises through credit lines to commercial banks and to non-banks, particularly outside the capital. Since the ratification, EBRD has signed its first project in Mongolia with the leading micro lending institution to support rural financing needs.

The Bank will pursue opportunities for equity participation in banks, which will strengthen the local banks' capital base and improve corporate governance. The Bank will also endeavour to support the development of non-banking financial institutions such as non-bank micro financial institutions (NBFIs), leasing, residential mortgage loans, consumer finance, insurance and pensions. Furthermore the Bank will contribute to the development of the country's capital markets (domestic bonds, equity, mortgage and local currency financing) mainly through its technical assistance.

With a view of building up the human resources and strengthening the base foundation of the relatively new non-bank financial sector and its regulator (FRC) in Mongolia, the Bank will actively request donor funding including ETC MDF. Funding will be sought to provide TCs within the following areas which the Government of Mongolia would like to develop over the medium term:

- activation of the Stock Exchange through development of the secondary securities market and restructuring of the Stock Exchange;

- development of the capital markets with the intention of building up sources of long term financing required for small and medium enterprises, particularly in remote *aimags* and *soums*;
- creation of the market for mortgage pledged securities and introduction of leasing services;
- development of the insurance and pension system, in particular, capacity building of the regulator;
- implementation of the systems for fund management;
- support for banking supervision and non-banking regulation.

Active policy dialogue with the Bank of Mongolia and Financial Regulatory Commission (FRC) will be pursued, with a focus on improving supervision, encouraging further consolidation, and on specific issues such as the prevention of money laundering.

3.1.3 Sustainable Development of the Natural Resources Sector

Mongolia has a huge mineral endowment, which represents significant potential for its future and poverty alleviation. Although good progress was made with the launch of the WB-sponsored Minerals Law in 1997, delays in implementation of secondary regulations, and more recently the introduction of the Windfall Tax on gold and copper producers, have resulted in increased costs in doing business in the sector. There is a need to clarify the debate raised by the introduction of this tax. The rapid rise in mineral exploration in Mongolia after the 1997 law was not followed by actual investments in mine development. This law has been superseded by the 2006 Mineral Law. Although the provisions are not as clearly defined and friendly towards investors as the 1997 Law, this is the Government's attempt to increase the actual investment in the mine development. The Bank intends to support the sustainable development of this sector with a particular focus on transparency, governance and regulation.

Furthermore, implementation of Extractive Industry Transparency Initiatives (EITI) remains a challenge. Following policy dialogue with the Bank and the WB, the Government announced its intention to adopt the EITI in late 2005, however progress was slow. The Bank is closely working with the WB, the Government, industry players and the NGO community towards the full implementation of EITI.

3.1.4 Support for Critical Infrastructure

The investment needs in infrastructure are significant, but constrained by limited public resources and the restriction on sovereign borrowing conditional upon the availability of at least 35 per cent grant element. This being the case, the Bank will explore opportunities for financing non-sovereign infrastructure which produces cash flows to meet debt repayments without recourse to sovereign guarantees. Such opportunities may exist in the areas of aviation, telecommunications and selected utilities and eventually in the construction of new power and transport infrastructure to support development of the mining industry. Moreover, the Bank will investigate the potential for bankable renewable energy projects including hydro and wind power.

The Bank would be ready to finance public infrastructure with a sovereign guarantee on a selective basis, provided there are available donors' grants to achieve the necessary concessional terms and increase affordability. The ETC initiative and bilateral support will enhance the availability of such funds. By focusing on small-scale, well targeted projects (possibly not of a sufficient overall size to be covered by the other IFIs) the Bank might achieve a significant impact.

Cooperation with the ADB, the WB and key bilateral donors including Millennium Challenge Corporation (MCC) should also allow the Bank to participate in airport, road, railways and power transmission projects. Given the long experience of WB and ADB in Mongolia, the Bank will seek to establish a very close relationship with them to avoid any duplication and identify projects where its added value can be an obvious compliment to their respective programmes. In all cases the Bank will coordinate closely with other donors, IFIs and the Mongolian Government on the overall investment priorities in the country.

3.1.5 Policy Dialogue

Based on the unique experience and knowledge that it has accumulated in the region, the Bank will engage in comprehensive policy dialogue with the authorities in order to promote capital market development, improve the business environment and support reform efforts. Further liberalisation and commercialisation, good governance and better dialogue between foreign and local investors and the Government are some of the issues which should be addressed with the Bank's direct engagement. In this respect, the Bank proposes to work with the authorities to form a new consultative council on investment climate. The Bank has shared with the Government and Parliament its willingness to support them in finding a long term sustainable and fair solution in the development of the mining industry. The Bank will coordinate closely with other IFIs and the business community. The Bank's Environmental Policy and Public Information Policy will apply to all projects developed in Mongolia.

3.2 Sectoral Challenges and Bank Operational Objectives

3.2.1 Enterprises

The Bank's main transition goal in this sector is to strengthen the private sector base of the economy. Investments which can make improvements in market functioning, competition, corporate governance and transparency standards of the sector and provide benchmarks for global best practice in operations and customer orientation will be supported.

Most investments, however, are small (limiting the Bank's ability to make meaningful impact through traditional operations) making the ETC Initiative all the more important. In the strategy period, the Bank will:

- Speak out for adoption of strong governance standards by the Government and by investors. Implement the ETC Initiative for local companies. The Bank will aim to restart a TAM programme with closer linkages to the Bank's direct operations and will introduce the BAS programme.
- Projects, such as the MCFF, DLF under the ETC initiative could help to reach partner banks' relatively larger clients. Implementation will require significant cooperation within the Bank and also TC to make the Bank financing more efficient for smaller projects.
- Equity: there is a lack of equity and fast growing enterprises facing capital constraint. Therefore the Bank will seek opportunities through ETCI to enhance its equity funds DIF.

3.2.1.1 ETCI Multi-Donor Fund

In early 2004 the Bank launched a new initiative to increase its activities in the seven 'Early Transition Countries' (ETCs). These are the poorest EBRD countries of operations: Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. Launched in November 2004, the ETC MDF is aimed at improving the predictability of the Bank's assistance delivery in the ETC countries and at improving overall coordination of donor support. The ETC Fund operates alongside the support that is provided through bilateral funding channels. To date, amounts pledged to the Fund were approximately EUR37 million funded by 12 donor countries. ETC Fund resources are directed towards projects and initiatives that support strong, sustainable growth assisting a country with its transition to a market-based economy, and thereby leading to poverty reduction.

Mongolia was approved by the Bank's Board of Directors as the 8th ETC country and on 17 November became formally eligible as a recipient of the ETC Multi-Donor Fund. The Mongolia Cooperation Fund which has been a main source of TCs in Mongolia is now focusing on only two areas including project preparation TCs (feasibility study, due diligence etc.) and TC for Ulaanbaatar Urban Transport project. The MCF is working towards an operational deadline of end of June 2007 and final disbursement of end 2008, with the ETC Fund and direct bilateral funding progressively taking over.

As an ETC beneficiary under the ETC Multi Donor Fund, Mongolia has become eligible for TC funding in the priority areas of activity of the Fund. The activities of the Fund in Mongolia will towards the promotion of:

- sound conducive environment for development of the private sector;
- private enterprise development, in particular the SME/MSE sector;
- the financial sector, improving access to and delivery of affordable basic services;
- environmental improvement and innovation
- extended reach initiatives.

The first TC project was approved in November 2006, EUR1 million TC for MSME and Leasing Credit Advisory Services which will benefit four commercial banks and one non-bank micro lending financial institution. Mongolia has also become eligible for the TC frameworks for the DIF, DLF, and the MCFF with local banks. Consideration is being given

by the ETC Multi-Donor Fund Assembly in November 2006 to channeling part of a Dutch funded contribution for grant co-financing, provided via the ETC Fund, to the Ulaanbaatar Municipal Transport project, currently under preparation.

3.2.1.2 Enterprises Institutional Support: TAM/BAS

The development and growth of local enterprises will be central to Bank operations. Investment alone cannot answer all of the economic development needs. Individual enterprises require urgent assistance in order, for example, to develop strategic business and marketing plans, to improve management skills, to develop new products and to raise quality standards to those now demanded for export. These goals can only be reached quickly through provision of customised and focused assistance to individual companies with the explicit objective of achieving such results. TAM/BAS expertise and experience can assist developing these features of private companies, and promote entrepreneurial initiatives.

TAM has been active in Mongolia since 2001. A total of 24 TAM Projects, covering a wide range of business sectors, have now been undertaken in Mongolia, utilising EUR2.3 million from the Mongolian Cooperation Fund. Projects have been carried out in 12 industry sectors, the major sector for TAM being food/beverages (30 per cent), followed by textiles, with a success rate of 90 per cent of completed and evaluated Projects.

Given the important impact the Programme can make, TAM plans to implement a minimum of 20 projects in Mongolia in the next 3 years. Japan has confirmed to fund such a proposal for EUR1.55 million to undertake 20 TAM projects. It is also planned to carry out a Feasibility Study for a BAS Programme in Mongolia. About EUR2.8 million will be needed from the donors to continue TAM and launch BAS, if the feasibility study is positive.

The Bank's wide policy of integrating TAM/BAS as a core activity of the Bank, implemented from January, 2005, has resulted in stronger intra-Bank linkages and is increasing the transition impact of the Bank. The synergies between the unique strengths of TAM/BAS (including the skills of the industry-specific, widely experienced TAM Senior Advisors and the BAS databases of competent local consultants in many of the Bank's countries of operation) are now being fully exploited within the Bank's Banking Teams. This development is expected to immediately take place in Mongolia. In that context, TAM and BAS will provide a pipeline of potential candidate companies for external funding. This is achieved because working with enterprises on advisory projects pre-investment is a very effective screening procedure. Moreover, that same TAM/BAS expertise can also be applied to strengthening a company's performance in the post-investment phase.

3.2.2 Financial Institutions

Support for the financial sector will be a key priority for the Bank in Mongolia, where there is currently limited access to term finance available for commercial banks other than from IFIs. Corporate and retail customers of commercial banks find it difficult to borrow on reasonable terms, limiting the ability to start new businesses, expand existing operations, purchase or renovate real estate, etc. The Bank will seek to strengthen financial intermediation, and therefore to improve access to finance in the country, through provisions of various forms of credit lines and debt products to commercial banks meeting the Bank's financial and integrity criteria. Term financing for medium, small and micro size enterprises (MSMEs) will be a priority, but other forms of debt will be offered including but not limited to senior loans for

general corporate purposes, co-financing/risk sharing under MCFF and residential mortgage loans.

The Bank will seek to actively roll out the Regional Trade Facilitation Programme (TFP) to several banks. The TFP is in high demand due to the lack of credit lines available from commercial banks for trade finance purposes.

The Bank will pursue opportunities for equity participation in banks, which will strengthen the target banks' capital base and improve corporate governance. This could take the form of straight equity, but other forms of equity and quasi-equity participation will be considered. Subordinated and convertible debt will also be considered including participation in private equity funds.

Although these sectors are undeveloped, the Bank will also endeavour to support non-banking financial institutions such as leasing, consumer finance, insurance, pension, and non-bank micro financial institutions (NBFIs). The preferred method of financing for NBFIs will be equity, although term debt will be considered for leasing, consumer finance and non-bank micro financial institutions.

The Bank will seek donor funding for technical assistance (TC) to support institution building and ensure sustainability of the transferred skills. TC will be required to support the Banks in their MSME activities – MSE financing today is provided primarily by only two banks, often on a collateralised basis and SME financing has little history in the country. A Trade Finance Advisory Services consultancy programme will be required to support the TFP. It is expected that any equity participation will require TC, likely in the form of a “twinning” programme with an international bank.

Given the slow development of the NBFIs, TC will also be required to support the Bank's initiatives with these companies. Furthermore the Bank will focus on the capacity building in the NBFIs and security markets, in particular the equity, bond, mortgage and insurance market development and local currency financing.

Policy dialogue with the Bank of Mongolia and FRC will be pursued, with a focus on improving supervision, encouraging further consolidation and specific issues such as prevention of money laundering and terrorist financing. Lastly, the Bank will also look into the possibility of accessing local currency funding over the medium term from local sources when suitable projects are identified.

3.2.3 Natural Resources

Mongolia has considerable mineral resources that have yet to see significant commercial operations. Support for the natural resources sector will be a key priority for the Bank in Mongolia, where there is currently very limited access to term finance available other than from IFIs.

Term financing for foreign and domestic enterprises involved in the mining sector will be a priority. The Bank will also support financing for the oil and gas sector, the services sector, and the state-owned enterprises when appropriate conditionality is developed, including clear steps towards increased commercialisation, corporatisation, transparency and improved EHS management. The Bank is ready to provide large scale syndicated long term finance for the

next stage of the development of the mining sector and to pursue equity participation. In addition, the Bank is for the Government TC to support if necessary the further improvements in the fiscal and legislative environment in mining sector.

The Bank will aim at setting high standards for business conduct and environmental protection. To support institution building and ensure sustainability of the transferred skills in the relatively young Mongolian natural resources sector, the Bank will seek donor funding for technical assistance (TC) in such areas as capacity building for the regulatory authority MRPAM and the “School of Mines”, aim at the further commercialisation and corporatisation of large state-owned mining companies, and aim at providing the skills and competences needed to support the growth of a vibrant SME industry able to compete domestically and regionally.

Policy dialogue with the Ministry and MRPAM will continue, in particular in relation to the improvement of natural resources sector legislation (including taxation), and correct implementation of the Extractive Industries Transparency Initiative, where the Bank will continue to work closely with the WB, the Government, industry players and the NGO community.

3.2.4 Agribusiness

While Agriculture is a dominant sector of the country's economic activity, for the time being the Bank has not identified project pipeline. At any rate, the level of agribusiness activity would appear to be at the primary production level and the livestock production is a main sub-sector. Risks associated with supporting primary production is always extremely high and the Bank will try, with the help of an FAO consultant, to identify successful processors of basic food items for general consumption and aim to raise quality and efficiency improvements in the processing sector with good management. Export activities of processed meat can also become a sector of interest. At this stage of the involvement in the new market, the following sub-sectors will be critical areas for the Bank financing: retail, confectionery and beer/beverages. A country potential assessment trip will be organised as soon as possible to identify potential targets for investments.

3.2.5 Infrastructure

Concessionality Requirement for the Bank’s Lending

In conformity as other low-income and highly indebted countries, as part of an IMF requirement, Mongolia is not allowed to borrow money on a commercial basis. This requirement was translated into a local legislation – “Law of Mongolia on the Co-ordination of Foreign Loans and Grant Aid” of 12 June 2003, and still valid even though there is no longer an IMF programme. The public sector can only borrow if at least 35 per cent of the loan (in NPV terms) is provided on a grant basis. Local and regional authorities can only borrow from the central Government (Article 57 of the Public Sector Management and Finance Act). The law is silent on the ability of local Governments to guarantee, but the Ministry of Finance is adamant that local authorities are not allowed to guarantee loans and so-far, any IFI or bilateral soft loan has been guaranteed by local and regional authorities and on-lent to utility companies that belong to local authorities.

Under these circumstances, the Bank will primarily focus on private sector operations, but will seek concessional and grant financing for the projects in the public sector. The ETC MDF and bi-lateral support will enhance the availability of such funds. In November 2006 the Netherlands expressed its intention to provide a grant co-financing source of EUR5 million to ETC MDF which enables the Bank to finance sovereign projects

3.2.5.1 Transport

The main challenge in this sector is to improve the quality of transport infrastructure in a way that is commensurate with the limited public resources available and which creates the basis for sustainable future operation of infrastructure enterprises, where possible through the attraction of private investment. The Bank will aim to support new investment selectively in the light of the limited borrowing capacity of the country.

Aviation Sector

Following the successful implementation of two technical cooperation projects in the sector (i.e. management assistance to Mongolian Airlines and the preparation of the Master Plan for the Civil Aviation Sector), the Bank has been requested by the Civil Aviation Authority (MCAA) to consider supporting runway rehabilitation of four domestic airports as well as selected air navigation equipment. Both components have been identified as priority investments in the Master Plan for the sector in view of their impact on flight safety, the necessity to ensure minimum level of connection from remote regions to the capital and the expected positive impact on the development of tourism. The Bank has obtained the technical cooperation funding from the Mongolian TC Fund and intends to finalise the project preparation in 2007.

The Bank will also seek and support potential private sector opportunities in Mongolia subject to satisfactory feasibility assessment, in particular in the area of private airline passenger operations and cargo services.

Road Sector

Out of the network of 49,250km roads, only 12 per cent of the network constitutes paved roads, with 13 per cent being gravel and 75 per cent being earth roads. Road density is extremely low at 0.03 km per square km. Hence the investment needs in the sector are enormous. However, the investment opportunities are severely mitigated by the restrictions on sovereign budget support. The Bank will seek potential opportunities for co-financing with both ADB and WB in the sector with the IFI coordinated approach to sector reform.

Railway Sector

Mongolian Railways Company is owned 50/50 between the Mongolian State and the Russian Railways (RZD). The Company was founded in the late 1940s by the Treaty and as such has a unique legal status (e.g. it does not pay any profit tax). Its unique ownership and legal status precludes any direct cooperation at present. However, the Bank will seek opportunities to support the railways efforts with rolling stock renewal, track equipment fleet expansion and infrastructure upgrade, if and when there is sufficient progress in the corporatisation of the railway entity.

3.2.5.2 Municipal & Environmental Infrastructure

This sector has borrowed significant amounts from IFIs as well as from several bilateral sources. All loans have been raised at the Government level and been on-lent to the end-borrowers. While the principle of on-lending is in line with the best practice, the debt levels imposed on the utilities are now at unsustainable levels for most of the utility enterprises involved in these programmes. As a result, a number of municipal utility companies are facing difficulties in servicing their debt obligations. This is in part due to the inability of local or the Government to implement tariff adjustments in the face of real or perceived affordability constraints. On the whole, tariff adjustment requirements by IFIs have never been fulfilled.

In view of the limited availability of sovereign guarantees and the paucity of creditworthy municipalities in Mongolia, the Bank need to focus on identifying bankable opportunities with private operators, such as creditworthy privately-owned urban transport companies on a small scale and/or selective public sector projects mobilising grant financing.

The Bank will support, within the existing tight affordability constraints, a commercial approach by municipal entities to improve service delivery and cost control, while introducing gradually cost recovery tariffs and improved collection practices to enable these utilities and service companies to provide a financially sustainable service in the medium term. This will require significant organisational restructuring, while municipalities need to ensure that adequate project implementation and supervision capacity at enterprise and municipal level is in place to undertake new investments.

3.2.5.3 Power

The power and energy utilities sector in Mongolia faces significant challenges such as old-dated assets resulting in high level of technical and commercial losses, huge investment needs for improved capacity and efficiency, and already relatively high tariff levels thus limiting room to manoeuvre for further tariff adjustments. In addition, some key sector entities are already implementing large sovereign-guaranteed projects, therefore limiting additional borrowing and implementation capacity.

The Bank will investigate the opportunities to develop small-scale power transmission projects, possibly without sovereign guarantee as secured transaction. Furthermore, the Bank will pursue rehabilitation project of existing power transmissions and construction of new power lines including to Western and Eastern grids and to the South where power demand could increase very significantly due to exploration and operations of new mineral deposits. The Bank will investigate the possibility of renewable projects, such as medium size hydro- or wind- generation projects.

On the basis of its experience gained during the implementation of the power sector TCs, the Bank will continue to work with the relevant authorities and other IFIs to seek to improve further the sector regulatory and legislative framework, in particular: the improvement of tariff methodologies, revised Energy Law (strengthen regulator independence, development of bilateral contracts power market) and Renewable Energy Law.

3.2.5.4 Telecoms

In March 2004 a TC entitled Privatisation Options approved for Mongolian Telecom. The specific objectives of the TC are: (i) to assist the Government to reach a consensus on the

further privatisation of telecommunications assets; (ii) to assist the Government to reach agreement with other stakeholders, notably Korea Telecom (KT) and donors, on the form of privatisation to be undertaken; and (iii) to assist the Government to carry out, where necessary, the transfer of assets and the privatisation. Initial investigations, together with recommendation of the Japan Telecommunications Engineering Consulting Service (JTECS), led the consultants to propose an open-access configuration with a network operating company (Netco) and a service only company (Servco). This recommendation was included in the Privatisation Guideline and passed by the Parliament of Mongolia in July 2005. Implementation has been delayed due to a certain extent to the change of the Government in early 2006. The Government is now proceeding with the setting up of Netco as a precursor to privatisation, and the TC was extended in September 2006 in order to see through the implementation and further negotiate with KT.

The Bank will continue its dialogue with the Government during the process of separating Servco and Netco and the subsequent privatisation of MT and seek to finance both Servco and Netco in the form of pre-privatisation loans or other appropriate instruments. In addition, the Bank will investigate the opportunity to acquire shares in both companies upon privatisation. The mobile telephone sector is currently taking off with a third licence being awarded to a private operator in 2006. The Bank will try to identify opportunities to finance private sector companies using the whole array of the Bank's instruments from corporate loans to equity or mezzanine financing.

4. IFIs and Multilateral Donors

The Bank will co-operate with other IFIs and bilateral donors which have been involved in the process of Mongolia's transition and development for more than a decade. Cooperation should include co-financing, complementary projects and the close co-ordination of policy dialogue. Close cooperation will be maintained both through the monthly donor co-ordination meetings attended by the Bank's Resident Office in Ulaanbaatar, as well as regular contacts at working level on a bilateral or multilateral basis. The Bank will seek to mobilise increased donor grant co-financing of selected investment projects.

4.1 International Monetary Fund (IMF)

Mongolia joined the IMF in February 1991. The Government has been supported by the IMF in its efforts for economic reforms and poverty reduction. A three-year IMF Enhanced Structural Adjustment Facility (ESAF) programme was approved in June 1993 with a total of SDR 40.8 million, but went off-track in June 1996. Subsequently the IMF Executive Board approved a three year ESAF/Poverty Reduction and Growth Facility (SDR 33.4 million) in July 1997. The IMF Board approved a Poverty Reduction and Growth Facility (PRGF, three-year programme for SDR 28.4 million) in 2001. The objectives of the facility were to tighten and monitor public expenditure, promote privatisation, financial sector restructuring and monetary policy. However, this arrangement lapsed in July 2005 without the completion of the third and subsequent reviews and there is currently no IMF programme in place. The Fund concluded the Article IV consultation and discussion of the Ex-Post Assessment of Longer-Term Program Engagement in September 2005, and a new programme is under consideration.

4.2 World Bank Group

Mongolia became a member of IBRD, IDA and IFC in February 1991. The World Bank Group has assisted the country in the areas of poverty reduction, private sector development, financial sector reforms and infrastructure development in line with the Economic Growth Support and Poverty Reduction Strategy (EGSPRS). The World Bank committed over USD325 million along with technical assistance projects, of which IDA has completed 12 lending projects with a total of USD207.7 million. The portfolio is dominated by infrastructure, and followed by financial and private sector development projects and poverty alleviation and public sector reforms. According to the IDA-14 grant eligibility criterion calculations, Mongolia is still qualified to receive grant only assistance in the Bank's fiscal year 2006.

The International Finance Corporation (IFC) has had a limited number of private sector projects in Mongolia. The first investment by the IFC was made in 1996 to a leather processing facility (USD1.75 million, including USD 0.3 million equity investment). In 2002, the IFC made an investment in the financial sector to XacBank (USD0.4 million) to provide finance for micro entrepreneurs and small and medium enterprises. In 2004, another project was signed to provide a USD5 million investment, including an equity investment (USD1.5 million) and subordinated loan (USD3.5 million) to the Trade and Development Bank. In 2004, the IFC signed an agreement with the Khaan Bank, under which the IFC will provide USD1.2 million equity along with a USD1.8 million loan in support of micro and small businesses across Mongolia. In 2005, the TA project on Mongolia Leasing Development to promote leasing as a tool to support business was started.

The current WB Country Assistance Strategy (CAS) for 2004-07, broadly aligned with the EGSPRS, was approved in April 2004. The CAS focuses assistance in three main areas: (i) consolidating the transition to a market economy, (ii) reducing rural and urban vulnerabilities and (iii) aligning policies and resources around results. It envisaged an IDA envelope of about SDR 60 million for four years. The World Bank now has a wide-ranging policy dialogue covering structural reforms to promote economic growth and poverty reduction, including public administration/civil service reform, financial sector reform, private sector development, education, health, social reforms, urban and rural development, infrastructure, and judicial reforms. The World Bank Group is exploring ways to strengthen its support for poverty assistance and social sector work in response to declining indicators for the country's social well-being.

4.3 Asian Development Bank (ADB)

Mongolia joined ADB in 1991 and has since received 36 loans totalling USD616 million and 121 technical assistance grants totalling USD59 million as at 31 December 2005, in support of agriculture, industry, finance, governance, health, education, telecommunication, transport, urban development and social security sectors. One private sector equity investment amounting to USD6 million was provided to support the largest private commercial bank. ADB loans for policy reforms, technical improvements, and commercialisation supported economic re-orientation. Infrastructure investments contributed to better technical performance, laid the foundation for unbundling industries, and encouraged private sector participation. Agriculture sector support helped to increase agricultural producers' income and reduce vulnerability by delivering an integrated package of support services in the target regions. Sector Wide Approach introduced in the education sector improves management and donor coordination in the sector, and enhances its service delivery quality.

The latest Country Strategy and Programme (CSP) for 2006-2008 approved in August 2005, supports the implementation of the two major pillars of the Government strategy: (i) stable broad-based growth, and (ii) inclusive social development. The programme adopts a results-based approach, and includes assistance in agriculture, transport, education, health, and urban development and support for administrative consolidation in support of interventions in these sectors. An indicative level of USD85 million for lending and USD5.6 million for non-lending activities is programmed for 2006-2008, which will be supplemented with an additional USD40 million from the Regional Fund and co-financing sources.

4.4 United Nations Development Programme (UNDP)

The United Nations Development Programme (UNDP) has been in Mongolia since 1973. The second country cooperation framework for 2002-2006 was approved in July 2001, focusing on five areas: (i) democratic governance, (ii) human development and poverty reduction, (iii) economic development, (iv) environment and sustainable natural resource management (e.g. energy efficiency and pollution control) and (v) disaster management. The UNDP programme is based on the United Nations Common Country Assessment (CCA) and the United Nations Development Assistance Framework (UNDAF). The financial resources are estimated at USD9.1 million under the current programme.

III. ANNEXES

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Annex 1 – Political Assessment

Compliance with Article 1

Mongolia is committed to and is making progress in the application of the principles of multi-party democracy, pluralism and market economics embedded in Article 1 of the Agreement Establishing the Bank. Consistent application of these principles will help to consolidate the democratic achievements of the country.

Mongolia's progress in democratic transition is evident. Since the beginning of transition, Mongolia has adopted a liberal democratic Constitution, developed a competitive political party system, produced a vibrant civil society and implemented market-oriented reforms. The media are relatively free and there is an increasing recognition and adherence to the rule of law and respect for human rights.

Those impressive achievements notwithstanding, Mongolia continues to face many challenges. These emanate from frequent political crises resulting in frequently changing Governments, widespread poverty, low earnings and limited access to health and educational opportunities.

Strong commitment to reform, building on the positive track record of political and economic achievements to date and a participatory political process, involving all major stakeholders, could be a recipe for continued success.

Political Environment

Until 1990 Mongolia was modelled on the Soviet system with only the Communist Party officially permitted to function. The democratic ferment in Eastern Europe and the former Soviet Union in the early 1990s was mirrored in Mongolia. The country held its first multi-party parliamentary elections in 1990 and adopted its first democratic Constitution in 1992.

Mongolia is a land locked country, which shares borders with Russia and China, and has a small and dispersed population. The country has a harsh climate and access to basic social services is a problem. Poverty, unemployment and significant disparities between rural and urban areas are major challenges of Mongolia's advancement.

Against this background, Mongolia has made significant progress towards multi-party democracy and pluralism. The country has many political parties, including genuine opposition parties, and a vibrant network of NGOs. There are some 5,000 NGOs which are playing an active role in the country's development. The media are relatively free and there is an increasing recognition and adherence to human rights standards.

The Constitution of 1992 established a parliamentary system of Government. Although the President has the power to veto legislation, he can be overruled by a two-thirds parliamentary majority of the country's 76 seat one-chamber parliament. Since 1990 Mongolia has consolidated its democratic achievements through five parliamentary and four presidential elections, which were recognised as, on the whole, being in conformity with international standards.

Former Prime Minister and Parliamentary Speaker Nambaryn Enkhbayar of the Mongolian People's Revolutionary Party (MPRP) was elected President in May 2005 in an election where observers noted minor irregularities. Voter turnout was 75 per cent and Nambaryn Enkhbayar won 53 per cent of the vote. The Constitution limits the President to two four-year terms in office. The President chairs the national Security Council and the armed forces. Frequent changes of Government have enhanced the role of the presidency.

Members of State Great Hural, the national parliament, are elected directly for a four-year term. Last parliamentary elections took place in June 2004 and no single political party secured sufficient seats to form a majority Government. As a result, Mongolia's first coalition Government (Grand Coalition) was formed by the MPRP and the MDC (Motherland-Democratic Coalition), which comprised Mongolia's main opposition parties. The MDC collapsed in December 2004 and a Government crisis was averted when the Democratic Party (DP), the largest party in the MDC, formed a joint caucus with the MPRP parliamentary group.

The Grand Coalition lasted less than two years. In January 2006 the MPRP formed a new coalition Government together with three smaller parliamentary parties, headed by the MPRP candidate Miyegombo Enkhbold, a former Mayor of Ulaanbaatar. Noticeably, the transfer of power between the two major political forces of the country, the MPRP and the Democratic Party (DP), succeeding each other in forming various Governments, was peaceful and carried out in an orderly fashion.

The new Government is faced with many challenges such as poverty, unemployment, low wages and the handling of natural resources. Street demonstrations in the capital in April 2006 were primarily about the large role played by foreign companies in the commercial development of the country's natural resources. Although the protests subsided after the Government promised to look into the demonstrators' grievances, the issue of mineral wealth exploitation by foreign companies remains a very sensitive issue in such a poor country. The Government is trying to strike a balance between national and industry interests by seeking to minimise damage to investor confidence in the mining sector.

The rule of law and protection of human rights

A prominent feature of Mongolia's democratic transition is the country's commitment and increased adherence to the rule of law and human rights standards. Although Mongolia has made commendable progress in the advancement of democracy, there are areas requiring attention of the authorities. These are related to improving democratic governance, consolidation of democratic representation, decentralisation of public administration and increased accountability and transparency.

Mongolia has ratified all major human rights treaties and protocols, including all eight ILO core conventions. Mongolia submits regular reports required as part of its international obligations. The country has also established an independent National Human Rights Commission to deal with the entire spectrum of human rights issues.

The Government generally respects the human rights of its citizens. However, the following problems were noted in the US State Department's Human Rights Practices Report of 2005: police abuse of prisoners and detainees; poor conditions in prisons; arbitrary arrests, lengthy detention and corruption within the judicial system; possible Government intimidation of the

media resulting in self-censorship by the press; domestic violence against women; child abuse and cases of international trafficking in people.

Last year Mongolia ratified the UN Convention on Anti-Corruption in an important step towards creating a legal framework for combating corruption. This is linked to earlier commitments under the Anti-Corruption Plan of the ADB/OECD. The political will to tackle corruption was also evident in adoption of a special MDG (Millennium Development Goal) envisaging zero tolerance to corruption. The Government has a National Programme for Combating Corruption and has formed a National Council for coordinating the Programme and a Parliamentary Anti-Corruption Working Group. Notwithstanding those efforts, corruption remains a major problem and more tangible practical results in fighting corruption are needed.

In general the media are free and critical of Government policies. According to media monitors, violations of press freedom are rare although the Government is using the state-owned national broadcaster to promote its own activities. There are many newspapers but their circulations are mostly small.

There are no major problems in the area of labour rights. The laws recognise the right of the workers to form and join trade unions, to organise and bargain collectively and to strike. Forced labour is prohibited and in 2005 the country ratified the ILO Convention against forced labour. The law also prohibits child labour and, although there are reports of incidents of child labour being informally used in some cases, the prohibition is generally enforced.

External orientations

Mongolia is trying to maintain a balance in relations with its two large and powerful neighbours. The country has extensive bi-lateral cooperation with Russia and China. After the disintegration of the former Soviet Union, Mongolia developed relations with the new independent states.

Links with Russia and other republics contributed to the stabilisation of the Mongolian economy. In July 2006 the Russian Prime Minister Mikhail Fradkov visited Mongolia, accompanied by a large business delegation, reflecting increased interest by Russian companies in expanding the already existing and traditionally strong economic ties between the two countries.

The rapprochement in Mongolian relations with China observed since mid-1980s has culminated in a 1994 Treaty of Friendship and Cooperation, which codifies mutual respect for independence and territorial integrity of both sides. China's strong economic growth opens up opportunities for expanded bi-lateral contacts with Mongolia.

In a multi-lateral setting Mongolia has acquired an observer status in the increasingly important regional grouping of six countries of the Shanghai Cooperation Organisation (SCO). It comprises, in addition to Russia and China, four Central Asian countries: Kazakhstan, Uzbekistan, Tajikistan and the Kyrgyz Republic. The country hopes to benefit from expanded economic cooperation opportunities offered by the SCO.

Beyond its immediate neighbourhoods, Mongolia is seeking to advance its regional and global relations. In this context, ties with Japan and South Korea are particularly strong.

Mongolia has also made a considerable effort to boost relations with the European countries and the United States. George W. Bush was the first US President to visit Mongolia. President Bush welcomed Mongolia's democratic progress and congratulated the country on eligibility for the United States' Millennium Challenge Account.

Annex 2 – Key Environmental and Social Issues

Key Environmental Issues

The range of geographical zones in Mongolia, including highlands, steppes and a desert, accounts for the diversity of Mongolia's flora and fauna. The Government of Mongolia has established 28 nature reserves. Currently protected areas of land cover 13.1 per cent of the total land area. In order to sustain the existing range of wildlife species and ecosystems, the Ministry of Nature and Environment has set a target of 30 per cent of the total land area to be under protected areas, including national parks, by 2030.

There are a number of environmental issues and concerns in Mongolia, which include a shortage of precise data and estimates on water, forest and other reserves as well as on the numbers of protected and endangered species, and lack of sustainable management plans for natural resources; reduction of biodiversity and threat of extinction of a number of endangered species due to illegal poaching and loss of habitats due to deforestation and rangeland degradation; damage to wetlands and waterways as a result of industrial activities (mining, large-scale hydropower stations); desertification and overgrazing due to unsustainable herding practices; soil erosion, degradation of landscapes and pollution of water caused by mining industry; forest destruction due to illegal logging and man-made fires; rapid raise in water demand and insufficient supply as well as increased level of economic activities in key watershed areas; air pollution caused mainly by coal-based power generation plants and other industry as well as by coal fired heating stoves used by individual dwellings; inadequate management of hazardous and non-hazardous waste.

The country is also subject to winter specific natural hazards (known as *dzuds*) which cause a big loss of livestock by herding communities. These are triggered by severe droughts in summer and cold temperatures and heavy snowfalls in winter, and are further exacerbated by the overgrazing of pastures in some areas and disappearance of grasslands and general environmental degradation.

National Environmental Action Plan (NEAP)

Mongolia developed a National Environmental Action Plan (NEAP) in 1993, which covers actions to the year 2010. The NEAP establishes the Government's priorities and identifies issues and actions for the protection of environmental quality, natural resources conservation and institutional capacity building. The NEAP is composed of three parts: (1) Principal Environmental Issues is sub-divided into four sub-sections: environmental protection, management of natural resources, conservation, and natural disaster mitigation; (2) Social and Economic Dimensions; and (3) Other Mechanisms and Responses.

The NEAP includes about 25 national environmental programmes in the areas of desertification, forestry, biodiversity, water, protection and conservation of rare species. National programmes are sub-divided into policy oriented and action oriented programmes. Enforcement and implementation of NEAP is poor due to the financial problems. Although NEAP has detailed work plans, it has no budget estimates and there is shortage of resources, which hurdles the implementation of NEAP.

Environmental legislation

According to the Ministry of Nature and Environment the first environmental law was approved in 1994 and thereafter the majority of Mongolian environmental laws were enhanced in 1995-1996. Key environmental laws include the Law of Environmental Protection (1995), Law on Protected Areas (1997); Natural Resources Use Fee Law (1995-97), Laws on Forestry, Wildlife and Hunting (1995), the Land Law on protection of land resources (1995) and the Law on Environmental Impact Assessment (1997). A new Law on Mining was approved by the Parliament in mid-July 2006.

There is a view at the Ministry of Nature and Environment that, although the environmental laws are very clear, some streamlining of the environmental legislation is required as currently there are about 28 separate environmental laws and about 160 regulations and standards. Currently the work on streamlining individual pieces of environmental legislation is in progress, but the Ministry of Nature and Environment wishes to involve international expertise and experience to do this job efficiently.

Mongolia is party to the Vienna Convention for the Protection of the Ozone Layer, Montreal Protocol on Substances that deplete the Ozone Layer, Convention on Climate Change, Convention on Biological Diversity, Convention to Combat Desertification, Convention on International Trade on Endangered Species of Wild Fauna and Flora, Basel Convention on Control of Trans-boundary Movements of Hazardous Waste and their Disposal, Ramsar Convention on Wetlands, Convention on the Conservation of Migratory Species of Wild Animals, and the Kyoto Protocol.

Activities of other international institutions and NGOs

A number of international environmental and development institutions and programmes are active in Mongolia.

UNDP is implementing a number of projects aimed at achieving the Millennium Development Goals (MDG) on global issues of desertification, water and air pollution. It is also active in developing small community-based initiatives in the areas of herding, forestry and wildlife management throughout Mongolia and is currently implementing four landscape conservation projects in four *aimags* of Western Mongolia, and a grassland management project aimed at remedying the degradation of pasture land in northern and central provinces of Mongolia. UNDP has also implemented a project on strengthening of Disaster Management Capacity in Mongolia (in response to a series of natural disasters in 1990-2001 which found the country and, particular, herders' communities, completely unprepared to respond to natural hazards situations). The first phase of such a project covered the reorganisation of the institutional framework and the establishment of an Agency on Emergency Management. The second phase included assisting on developing the Law on Disaster Management, which has been recently adopted by the Government. It is expected that a National Disaster Management Plan for 2006-2015 will be approved shortly.

WWF: Mongolia's current programme for 2003-2010 is in line with conservation priorities identified under the WWF Global Programmes and Altai Sayan Eco-regional Action Plan. It targets conservation of priority species and maintenance and protection of freshwater ecosystems and analyses threats to the species and biodiversity from illegal wildlife trade,

unsustainable mining practices, overgrazing and over-ambitious plans on exploitation and natural resources.

The German Technical Cooperation Fund (GTZ), jointly with the Dutch Embassy in Beijing, are implementing a programme on the Conservation and Sustainable Management of Natural Resources, which covers the protection and sustainable management of protected areas in Central Mongolia and in the Gobi region, and contains elements of the economic development of local communities and eco-tourism.

The environmental NGO movement is largely supported by international donors. The majority of environmental NGOs are engaged primarily in environmental education and training activities; and in environmental conservation activities and reforestation activities to a lesser degree.

Key Social Issues

Labour Issues

Unemployment seems to be underestimated in the official statistics at 3.6 per cent in 2004, but the real unemployment rate is estimated at 17 per cent according to the 2000 population census. The majority of those unemployed are the young labour force and the unemployment rate is also high in the urban area where people come from rural areas to seek jobs.

Mongolia has ratified all of the ILO core conventions. The law specifically prohibits forced or compulsory labour, and the Government generally enforces this provision. The Government has now signed and ratified the ILO Convention against forced labour. The law in general prohibits children under the age of 16 from working, although those who are 14 or 15 years of age may work up to 30 hours per week with parental consent. Those under 18 may not work at night, engage in arduous work or work in hazardous occupations such as mining and construction. Enforcement is limited, due to the small number of labour inspectors and the growing number of independent enterprises.

Children work informally in petty trade, scavenging in dumpsites, working in unauthorized small-scale mining, and herding animals. The majority of this work occurs in agriculture and seen as non-harmful. Increasing alcoholism and parental abandonment made it necessary for many children to have an income to support themselves, their siblings, and sometimes their parents. Estimates placed the number of children in the labour force as high as 58,000. The government prohibits forced and compulsory labour by children and effectively enforces this prohibition.

The amendment to the Law on Employment Promotion was adopted by the Parliament with a view to implementing employment promotion measures consistent with labour market demands and ensuring their compliance with unemployment and poverty reduction goals. These amendments include various important provisions concerning diversification of employment services, inclusion of informal sector workers and herders into employment services, development of new services and methods to deliver the services and refinement of revenue generating or disbursement procedures and the management structure of the Employment Promotion Fund. The Government has also adopted a Policy on informal sector employment.

Mongolia, as most of the transition countries, is a source country for women and men trafficked for the purposes of sexual exploitation and forced labour. Mongolia also faces a problem of children trafficked internally for commercial sexual exploitation. Although the Government of Mongolia does not fully comply with the minimum standards for the elimination of trafficking, it is making significant efforts to do so, and in March, 2006 implemented the "National Plan of Action on Trafficking and Protection of children and women from commercial sexual exploitation." The Plan's main objectives are to create a stronger legal environment for trafficking prevention, to increase trafficking awareness, and to improve the protection and rehabilitation of victims. The Mongolian Government also cooperates with NGOs and regional and international organizations on anti-trafficking measures.

Demographics and Regional Differences

Mongolia has a population of approximately 2.6 million which is very small taking into consideration the vast size of the country (1.6 million square km). The population is mostly homogenous but there are a number of ethnic minorities, including a Kazakh minority comprising of approximately 100,000 people primarily concentrated in the western part of the country.

Currently 60 per cent of the population lives in urban areas, migration from rural to urban areas having increased recently after a series of natural disasters in 1999-2001. This led to the loss of incomes of many herder communities, who subsequently decided to move to urban areas in search of employment, other sources of income and access to infrastructure and services. Professional personnel, including doctors and teachers, also migrated from rural to urban areas. This in turn has caused deterioration in the access to social infrastructure in rural areas. Most of the urban population is concentrated in Ulaanbaatar and, according to UNDP, the population in the Mongolian capital increased by 20 per cent between 1990 and 1998, while the population of other seven urban areas decreased by 17.6 per cent. The Ministry of Social Welfare and Labour estimates that currently 800,000 people inhabit Ulaanbaatar while the existing infrastructure can only efficiently absorb 500,000 people.

In order to reduce the adverse impacts of migration, a National Summit on population migration was conducted, which produced recommendations for addressing migration-related issues. The recommendations included raising the level of participation and responsibilities of Government organisations, civil society, private sector and families in reducing the adverse impacts of migration. A working group to oversee implementation of these recommendations has been established at the Parliament Standing Committee on Social Policy.

Human Development and Poverty

The UNDP Report on Economic and Ecological Vulnerabilities and Human Security in Mongolia (2005) indicates that economic vulnerability increased since 1990. Nevertheless, the incidence of poverty continues to decline from a level of 36 per cent in 2002 to 32 per cent in 2006.¹⁴ Rural areas have a poverty incidence of 43 per cent as compared to 30 per cent in urban areas.¹⁵ More than half of the population in the west of the country was classified as poor, which is about double the rate of that of the capital Ulaanbaatar. The

¹⁴ Poverty Assessment: Mongolia, 2006, World Bank.

¹⁵ Poverty Assessment: Mongolia, 2006, World Bank.

single largest group amongst the poor is that of herder households, which also show the highest incidence of poverty.

Nearly a third of Mongolia's population lives in households which rely on herding as the primary source of livelihood. Vulnerability to livestock mortality is a widespread risk, and sudden incidences of mortality negatively affect consumption and the well-being of herder households.

Basic levels of literacy level are high in Mongolia both in urban and rural areas. Compulsory schooling is limited to 8 years. However, access to health services in rural areas is sometimes problematic due to remoteness. Rural communities have low capacity in the provision of preventative health care, the current approach being more focused on curative health.¹⁶

Using non-monetary indicators such as infant mortality, access to medical services, water supply and provision of bath houses, living standards have improved. Access to water and electricity has also increased, proportionately more for the poor.

A reasonable basket of minimal needs in Mongolia comprises only 44 per cent of food items and 56 per cent non-food items, of which heating is a significant component. Despite its intention, the existing system of subsidies in the energy sector does not specifically target the poor or vulnerable consumers. Given the harsh winters¹⁷, the poor in Ulaanbaatar easily spend at least one-fifth of their total consumption during the winter months on fuels (primarily dirty) for heating. Heat expenditure (using traditional stoves) places the heaviest burden on the budget of *ger* households, the poorest sections of the Ulaanbaatar population. Mongolia's population, however, has relatively good access to electricity, although there is insufficient generating capacity in many rural areas.

The Mongolian Government, with the help of international institutions and development programmes, is working at tackling socio-economic issues. The specially created National Committee will coordinate inter-sectoral coordination of Policy and there will be sub-committees working on (a) development of families; (b) development of children, teenagers and youth; (c) elderly and ageing and (d) persons with disabilities. Currently a database on household and population is being established. This will improve registration of the socio-economic status of the population and enable the processing of information and subsequent evaluations.

Equal Opportunities and Gender

There appears to be relative gender equality in Mongolia compared to many other countries in the region. Women represent approximately half of the workforce, and a significant number are the primary wage earners for their families. However, evidence from recent studies¹⁸ and a gender analysis of national statistics show that the impacts of the economic transition are different for women and men. This period of change is creating gender gaps which are new to Mongolia in many areas of economic and social development.

¹⁶ The Asian Development Bank is providing assistance to the Government in the health sector; such as assistance in establishing Family Group Practices and developing a primary care system and renovation of hospitals.

¹⁷ With temperatures of below freezing for six consecutive months and average temperatures for Ulaanbaatar of -25°C in January and February and temperatures can reach -40°C in rural areas.

¹⁸ Country Gender Assessment: Mongolia, Asian Development Bank and World Bank, 2005.

Migration has been a common response to poverty, and has disrupted social networks and left women under additional pressure to manage their multiple responsibilities within and outside the household, with little help from traditional support networks (*khureelel*). Initially as livestock herds were privatised, thousands of families lost their jobs in state-owned enterprises. These same families were then forced to return to urban areas for employment as three successive harsh winters from 1999–2001 wiped out their herds. Women and girls often led this retreat in the hope that jobs in the service sectors would still be available. Employment opportunities, however, remain limited, and the small, peri-urban *soum* and *aimags* now have a high proportion of increasingly poor *de facto* female-headed households.

Organisations offering financial or other support to micro or small and medium-sized enterprises note that women seem to have acclimatised to the new business environment more readily than men.

The reverse gender gap in enrolment and attendance rates at all levels of education is creating imbalances in achievements with significant economic and social impacts. Poverty is keeping more boys than girls out of school, as there are more opportunities for boys to contribute to family income, and because herding is traditionally a male occupation. Parents also feel that the education system is failing to prepare students for employment opportunities. In order to address gender issues, a National Committee on Gender Equality, chaired by the Prime Minister of Mongolia, was established by the Government Resolution N 26 of 2006 to assist with the implementation of these policies and to assess their results.

The Extractive Industry and its Socio-economic Impacts

The economic growth and development of Mongolia is supported by the extraction of natural resources such as gold and copper and livestock production. The formal mining sector employs 12,000 people and the informal (artisan or ‘ninja’) mining sector involves many times this number. Although artisan and small scale mining is not a traditional activity in Mongolia, it increased its significance as being a principal source of livelihood for tens of thousands of people (estimates range from between 30,000 and 100,000) during the difficult economic times, and it became a social safety net for herders who lost their herds during the periods of natural disasters (*dzuds*). Commercial miners and local Government have been critical of these operations, citing environmental health hazards and the fact that they operate outside the legal framework. A new Artesian Mining Law is currently being drafted. There are cases when artisan, often unskilled miners, infringe on the officially licensed mining areas, which result in confrontation between mining companies, operators of the licence areas and illegal miners. Such artisan mining also causes impacts both on the environment and health as illegal miners often use substances such as mercury to wash the tailings left by the mining companies.

A particular issue of concern is the relationship between mining companies and local communities. While extraction of resources is one of the pillars of the Mongolian economy, it generates limited employment for local communities. Currently the ownership of land and natural resources belongs to the state, and pasture land and other resources are provided free of charge to rural, sometime semi-nomadic communities, traditionally involved in livestock breeding activities. Licenses to develop natural resources deposits are handled centrally by the Ministry of Industry and Trade with no prior consultation with the local administration and communities. Erosion of soil, contamination of rivers by heavy pollutants and general degradation of landscape cause discontent of local communities, and tensions between mining

companies and local communities are on the rise. Development programmes are undertaken by mining companies as 'add-on' measures, but the expenditure remains limited.

Annex 3 – Project Pipeline¹⁹

Sectors	No of projects	USD million	Public/Private
Textile/General Industry	5	16.5	Private
Financial	8	46.0	Private
Mining	1	20.0	Private
Power	1	20.0	Private
MEI/Transport	3	35.0	Private/public
Property/Tourism	2	10.0	Private
Total	20	147.5	

¹⁹ The list of pipeline projects does not represent any commitment by the Bank. It does not include potential projects that might emerge later during the Strategy period.

Annex 4 – Committed TC Operations (Mongolia Cooperation Fund)

	Commitments in €000	Disbursements in €000
Enterprise	73	56
SME management training	73	56
Financial Institutions	1362	1306
Khan Bank Microcredit Advisors	850	850
Mongolian Bankers' Training Programme	322	322
Credit Analysis Training for Mongolian Bankers	25	25
Training on international banking operations (5)	115	109
Development of Mongolian capital markets	50	-
TAM	2,395	1,796
TAM (24)	2,395	1,796
Infrastructure and Natural Resources	3,122	1,788
MIAT management contract	675	643
Master plan for civil aviation	359	359
Emergency Domestic Airport Upgrade	350	-
Ulaanbaatar Urban Transport	520	-
Power Sector Privatisation	500	271
Telecommunications Privatisation (2)	550	466
Downstream petroleum	49	49
Capacity building for the Mongol Mining Authority	119	-
Legal Transition	1,207	264
Corporate Governance	226	226
Legal transition in Telecom sector	801	38
Secured transaction	180	-
Others	735	718
Administrative TCs and others (9)	735	718
Total (55)	8,894	5,928

Note: number of TCs under the same objectives/project is noted in parentheses.

Annex 5 – TC Project Pipeline

Project	Sector	Amount in EUR
Biodiversity Project	Environment	50,000
Trade Finance Advisory Services for Mongolian Banks	Depository Credit (Banks)	250,000
Mongolia Multibank facility for on-lending to SMEs	Depository Credit (Banks)	1,000,000
Development of Mongolian Mortgage Market	Non-depository Credit (Non-Bank)	1,000,000
Twinning Programme for Mongolian Bank	Depository Credit (Banks)	1,500,000
Institution Building Programme (2 years)	Microfinance	2,000,000
Project Due Diligence/Feasibility Studies/Post Investment Advisories	General	425,000
TAM Programme, support to 10 enterprises	Miscellaneous Manufacturing	744,000
BAS Programme	Consultancy	500,000
Total		7,469,000*

Note: EUR1.2 million of the TC requirements will be committed from the remaining MCF fund and the remaining balance of EUR6.3 million will be raised from the ETC fund and other bilateral donors.

Annex 6 – Legal Assessment

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). This annex presents a summary of the results for Mongolia, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments. Given the fact that Mongolia is a new country of operations of the Bank, some assessments are more succinct than usual and will need to be expanded during the oncoming strategy period.

Capital Markets

The Securities Law is the principal legislation dealing with securities markets in Mongolia. It was approved by the Great Khural (Parliament) of Mongolia in September 1994 and entered into force on 1 January 1995

The Securities Law was substantially amended in December 2002 and a new law entered into force on 1 January 2003. The Securities Law sets out the main provisions concerning investors’ protection and securities issuing, trading, clearing and settlement.

The Mongolian Stock Exchange was set up in 1991 and started trading privatisation vouchers in February 1992. A secondary market of securities started only in August 1995, following the enactment of the Securities Law and the creation of the Securities Commission.

Since February 2006 the newly formed FRC started regulating all non-bank financial institutions including securities companies. It is also responsible for monitoring and regulating the market and for creating a proper regulatory and supervisory environment for all non-bank financial transactions.

Company Law and Corporate Governance

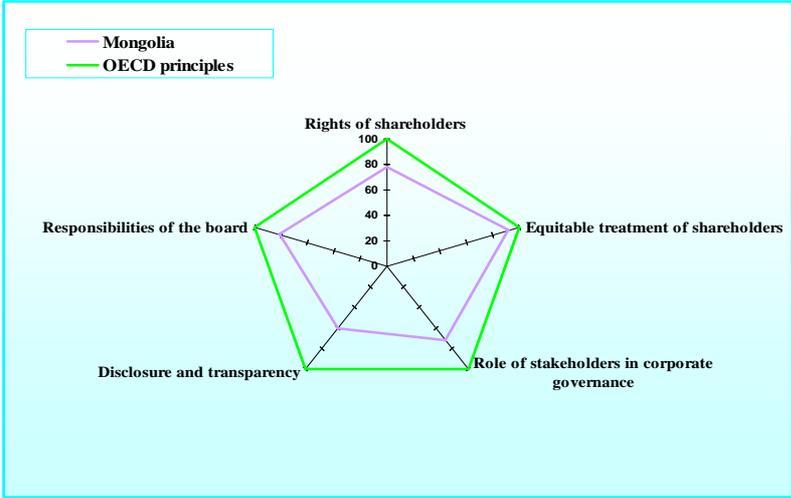
The corporate governance framework is regulated by the Civil Code and the Company Law that became effective in 1999. The Company Law has replaced and superseded the provisions of the former Partnership and Company Law that were applicable to companies before 1999.

The EBRD Corporate Governance Sector Assessment, which measured the effectiveness of the law or the quality of the “law on the books”, found that overall corporate governance legislation in Mongolia was in “high compliance” with the international standards as set out in the OECD Principles of Corporate Governance. Measured against such principles as a benchmark, it is especially strong in ensuring the equitable treatment of shareholders.

The major problems were however found in the “Disclosure and Transparency” category. Here the assessment revealed that the law does not require companies to prepare group accounts on a consolidated basis or to disclose key positions held by members of the board of directors in other companies. Moreover there is no legal requirement to make relevant

company documentation (e.g. minutes of shareholders meeting, amendments to company charters and name of resigned and newly appointed directors) publicly available.

Quality of corporate governance legislation – Mongolia (2004)



Note: The extremity of each axis represents an ideal score in line with international standards, such as the OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely corporate governance laws of the country approximates these standards.

Source: EBRD Corporate Governance Sector Assessment, 2003-04.

In 2005, the EBRD launched a survey for testing the effectiveness of corporate governance (how the law works in practice). Two case studies dealing with related-party transactions in a listed and an unlisted company were designed. The case studies investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: institutional environment, enforceability, complexity and speed.

The survey revealed several shortcomings in Mongolia. Procedures for obtaining disclosure and redress can be quite complex, especially if the company and/or the controlling shareholder refuse(s) to spontaneously collaborate with the minority shareholder. As to the institutional environment, the survey evidenced that company information is generally not reliable, while statutory auditors are usually unable to act independently. Both conditions reduce the possibility of obtaining a successful disclosure.

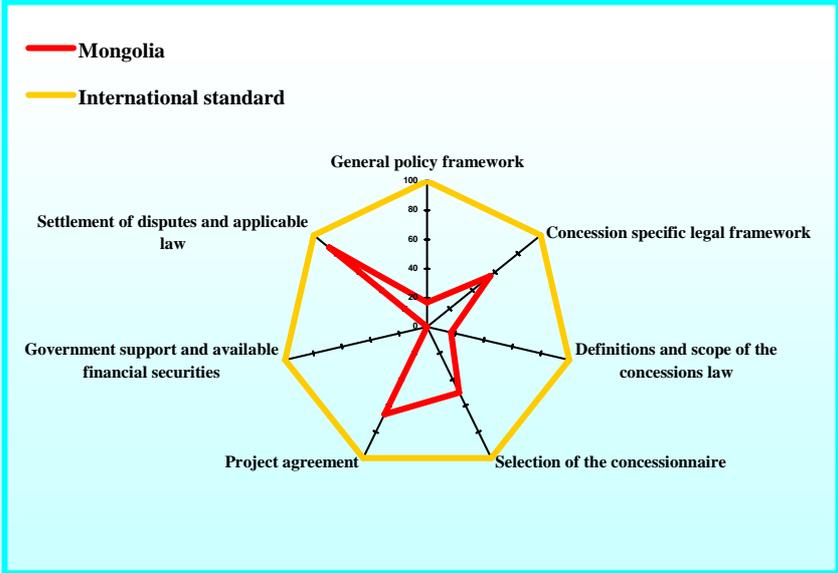
The absence of case law offering guidance on the interpretation of the law also adversely affects the clarity of proceedings. The time needed to obtain an executable judgement was assessed to be around one year, but it is quite easy for the defendant to delay the process. Enforceability of judgements is reported as problematic. Usually, enforcement procedures are difficult and very time-consuming. When considering redress, the survey reported a lack of experience and competence of the lower courts in corporate law cases and their potential partiality. This is especially true when the case is against a powerful defendant. As a result, the effectiveness of corporate governance legislation in the country can be said to be generally low.

Concessions

Mongolia does not have a general policy framework for promoting public-private partnerships. Nor does it have a law on concessions. However, the Government has recently undertaken to draft a set of rules governing concessions aimed at forming a part of the amendments to the Law on Public State and Local Property.

Mongolia currently has a limited legal framework for the development of public private partnerships in infrastructure and services. The chart below, based on methodology developed by the EBRD Concessions Sector Assessment, indicates a need for improvement in virtually all dimensions of the concessions legal regime when compared with international standards.

Quality of concession legislation –Mongolia (2005)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the ‘web’, the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2005

The current version of the Law on State and Local Property provides for the transfer of state property to third parties by way of concession or leasing agreements with the approval of the authorised body. When it comes to land or subsoil, the matter must be specifically regulated by law. In the absence of a specific concession law, this type of arrangement may be granted under sector-specific laws such as the Petroleum Law, the Minerals Law, the Water Law, the Railway Transportation Safety Law, the Auto Transportation Law, the Health Law, and the Law on Education and the Energy Law.

Generally, the Mongolian legal system does not contain extensive provisions on the scope and definition of concession related agreements. In particular, the Law on State and Local Property does not define the term “concession”. Due to this insufficient regulatory framework, the level of flexibility in terms of concession agreements remains low. The Public Procurement Law requires a competitive selection procedure for granting concession-like agreements. In addition, it should be noted that the various sector-specific laws do not provide for compensation of concessionaires in case the licence is revoked (with the exception of the Minerals Law). Mongolian law provides for a relatively developed regime of dispute resolution, including where foreign parties are involved. The Civil Code generally permits parties to a contract to choose the applicable law and to refer their disputes to arbitration. This flexibility will be of great use to concessionaires, as the relevant sector-specific laws do not preclude such arrangements. However, in some sectors the legislation provides for mandatory application of Mongolian law (for example, the Petroleum Law).

Insolvency

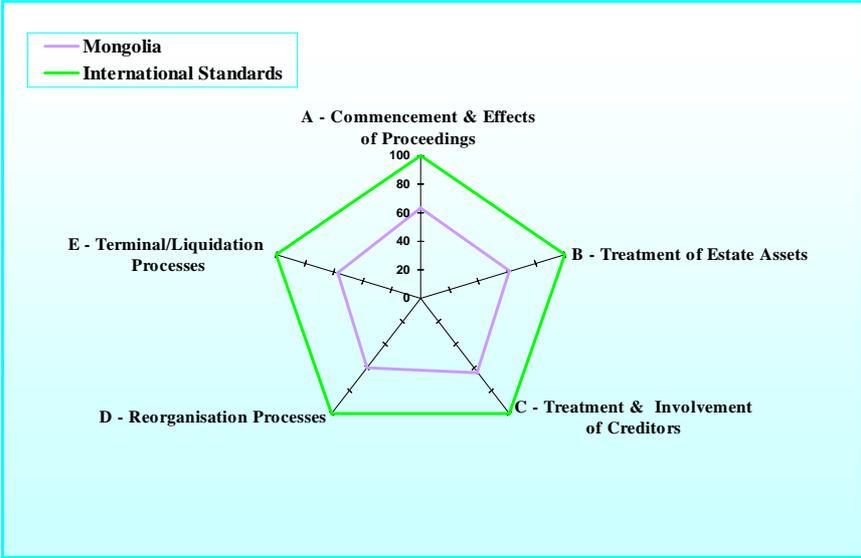
Insolvency is governed by the Bankruptcy Law adopted in 1997. The Bankruptcy Law provides users with basic tools for initiating insolvency and resolving resulting conflicts. However, there remain numerous concerns about the function of insolvency proceedings and the lack of experience by trustees and courts. When assessed against international standards applicable to insolvency, as per the methodology of the EBRD Insolvency Sector Assessment, the Bankruptcy Law scored as being in “low compliance” with such standards (see Chart 3).

The low score reflects the law’s serious shortcomings. The definition of insolvency is a financial test, but it is unclear, stating that insolvency shall be deemed to exist when the debtor is in default for an amount representing at least 10per cent of its capital. Greater clarity is required, particularly with regard to the maturity of overdue debt.

The law does not provide for mechanisms allowing the trustee to obtain information on the bankrupt company’s financial condition nor does it specifically require the debtor or third parties in possession of debtor property to cooperate with the trustee. The provisions dealing with void transactions and transfers at undervalue are unclear, relying on undefined terms and the need to prove intent. As well, the period for reviewing transactions that grant improper preferences to certain creditors reaches back only 120 days prior to the commencement of the bankruptcy case, a period that is too short and subject to abuse. Reorganisation financing is another subject upon which the law gives no guidance. Finally, cross-border insolvency proceedings are not covered at all.

These are fundamental problems. Significant reform aimed at correcting these problems and enhancing predictability and clarity could dramatically improve the investment climate in the country.

Quality of insolvency legislation – Mongolia (2005)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank’s Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on “Legislative Guidelines for Insolvency Law”, and others. The fuller the ‘web’, the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment, 2003/4

Secured Transactions

Taking security in Mongolia is mostly governed by the 2002 Civil Code, which offers a relatively detailed framework.²⁰ In addition, the Law on Registration of Rights over Immovable Property contains important provisions for the perfection of security rights over immovable property. Court-led enforcement is governed by the Law on Enforcement of Court Orders but recently Mongolia has sought to equip itself with a Law on Non-Judicial Foreclosure of Mortgaged Assets. However, this law which entered into force in December 2005 has been subject to constitutional challenges and the extent of which, if at all, this law is applicable is unclear. Sector specific laws also include regulations that would apply: for example, the Minerals Law has provisions that apply to the charge of mining licences.

Although the Civil Code is relatively recent, the legal provisions applicable to security over movable property (equipment, inventory, receivables, etc) are not adapted to market economic practices and it is difficult to see the market expanding without comprehensive reform taking place. The type of collateral that can be offered is limited and does not allow for generally described assets (e.g. inventory, future equipment) to be charged. The system allows for registration of the pledge over movable property in the Land Registry (that is, against the asset's title), which is in most cases impractical and unnecessarily limiting. Users complain that the enforcement process is inefficient; yet, as mentioned above, the attempt to provide for an out-of-court means of enforcement, which would probably facilitate such enforcement, has been constitutionally challenged. The Bankruptcy Law appears to be wholly inadequate in terms of priority ranking it gives to secured creditors, but a complete reform is currently underway (led by the German technical assistance agency GtZ).

The EBRD is currently working with the Ministry of Justice and Home Affairs, providing technical assistance for the reform of the legal framework for secured transactions, which would include complete revision of the legal provisions and the development of a specific pledge register.

Telecommunications

The communication sector is currently governed by the Communications Law of 2001 (the "Communications Law") and regulated by the Communications Regulatory Commission (the "CRC"). Since 2004 the policy making function within the communications sector has been assigned to the Information and Communication Technologies Authority (the "ICTA"), established following the abolition of the Ministry of Infrastructure. ICTA reports to the Prime Minister's office and is responsible for the development and coordination of national information and communication technologies policy, including management of the government's communications assets and implementation of sector investment programmes.

CRC was established in 2001 as an independent communications regulator. It has a number of specific tasks outlined in the Communications Law. These tasks include development of a competitive environment, licensing, approval of tariffing methodologies and approval of the general terms of interconnection agreements. Whilst CRC is, under the Communications Law, the sector regulatory authority, a number of recent regulatory decisions in the sector continue to be taken and issued by ICTA.

²⁰ Articles 153-185.

The Mongolian communications market is currently segmented vertically by service. Incumbent former monopolist fixed line provider Mongolian Telecom (MT) offers basic telephone, fax and some data services, while Mobicom, Skytel and others operate mobile and wireless data and ISP services. MT leases the government owned network assets from ICTDC (a unit of ICTA responsible for managing and developing the state-owned telecom assets) to provide ongoing licensed public telecom services. MT was partially privatised in 1995 with approximately 5per cent sold to individual shareholders and 40per cent to Korean Telecom (KT). The privatisation agreement between the Government of Mongolia (the “Government”) and KT confers upon MT a monopoly over the leasing of bandwidth on the state-owned backbone, such that third parties operators and Internet service providers must sublease bandwidth from MT.

In July 2005 the Mongolian Parliament passed “Privatisation Guidelines” directing the restructuring of the sector, requiring full separation of network assets from service provision, which will result in infrastructure and services being provided by different (physically separate) organisations. The separation will include the formation of an open-access network operating company, NETCO, and be accompanied by the full privatisation of MT as a service only company. The principal reason for restructuring in this manner is to create incentives for operators to make more efficient infrastructure investments and compete more vigorously to reduce prices for services. To facilitate this separation, the restructuring will see the future issue to operators of either a network or service licence, but not both, requiring operators to choose whether they will be service or network providers. Whilst the proposed restructuring is a further development of the pre-existing sector structure, it is believed that Mongolia will be the one of the first market to implement full formal physical separation of network and services.

The EBRD is currently funding advisory services to the Government with respect to the restructuring and the related privatisation of remaining state communications assets. Additionally, the EBRD is providing regulatory development technical cooperation assistance to the Government and sector regulator aimed at updating sector policy and laws, reforming the institutional structure and revising the regulatory framework, enabling it to support the restructured sector.

Annex 7 – Selected Economic Indicators

Mongolia	2000	2001	2002	2003	2004	2005 <i>Estimate</i>	2006 <i>Projection</i>
Output and expenditure							
	<i>(Percentage change in real terms)</i>						
GDP	1.1	1.0	4.0	5.5	10.6	6.2	6.0
Industrial gross output	1.1	0.6	1.5	3.0	15.0	-0.9	na
Agricultural gross output	1.6	1.0	5.0	3.7	17.7	7.7	na
Employment							
	<i>(Percentage change)</i>						
Labour force (end-year) ¹	-0.7	2.9	3.3	6.4	2.7	1.4	na
Employment (end-year)	-0.6	2.9	4.6	6.4	2.6	1.7	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year) ²	4.6	4.6	3.4	3.5	3.6	3.5	na
Prices and wages							
	<i>(Percentage change)</i>						
Consumer prices (annual average)	11.6	8.0	0.3	5.1	8.3	12.5	4.1
Consumer prices (end-year)	8.1	8.0	1.7	4.7	11.0	9.2	6.6
Producer prices (annual average)	na	na	na	na	na	na	na
Producer prices (end-year)	na	na	na	na	na	na	na
Gross average monthly earnings in economy (annual average)	33.5	4.7	9.4	22.0	16.0	23.5	na
Government sector							
	<i>(In per cent of GDP)</i>						
General government balance ³	-7.0	-5.4	-5.9	-4.2	-2.1	3.2	-3.1
General government expenditure ³	41.5	43.9	44.4	42.1	39.4	33.7	na
General government debt ⁴	97.3	90.1	100.3	121.2	100.7	83.5	na
Monetary sector							
	<i>(Percentage change)</i>						
Broad money (M2, end-year)	17.6	27.9	42.0	49.6	20.5	37.1	na
Domestic credit (end-year)	6.5	6.1	42.9	147.3	23.1	22.2	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	25.4	29.7	37.9	48.1	44.3	51.2	na
Interest and exchange rates							
	<i>(In per cent per annum, end-year)</i>						
Central bank bills rate	8.7	8.6	9.9	11.5	15.8	4.4	na
Deposit rate ⁵	16.8	14.3	13.2	14.0	14.2	13.0	na
Lending rate ⁵	32.8	30.2	28.4	26.3	25.4	23.6	na
	<i>(Togrog per US dollar)</i>						
Exchange rate (end-year)	1,097.0	1,101.3	1,122.2	1,168.3	1,211.8	1,221.0	na
Exchange rate (annual average)	1,076.7	1,097.6	1,108.5	1,142.7	1,185.2	1,205.2	na
External sector							
	<i>(In millions of US dollars)</i>						
Current account	-54	-77	-108	-99	27	28	70
Trade balance	-140	-170	-229	-199	-149	-155	-72
Merchandise exports	536	523	524	627	872	1,069	1,295
Merchandise imports	676	693	753	827	1,021	1,224	1,367
Foreign direct investment, net	40	43	78	132	129	258	215
Gross reserves, excluding gold (end-year)	191	207	271	178	208	333	na
External debt stock	837	854	978	1,287	1,360	1,307	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	2.9	3.0	3.4	2.0	1.8	2.5	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	3.8	5.3	4.5	34.0	7.4	2.5	2.6
Memorandum items							
	<i>(Denominations as indicated)</i>						
Population (end-year, million)	2.5	2.5	2.6	2.6	2.6	2.7	na
GDP (in millions of togrog)	1,018,885	1,115,641	1,241,000	1,461,000	1,911,000	2,267,000	2,737,000
GDP per capita (in US dollar)	379	402	437	494	617	710	na
Share of industry in GDP (in per cent)	na	22.0	22.5	25.3	29.9	30.2	na
Share of agriculture in GDP (in per cent)	na	24.9	20.7	20.1	20.9	21.7	na
Current account/GDP (in per cent)	-5.8	-7.6	-9.6	-7.7	1.6	1.5	3.1
External debt - reserves (in US\$ million)	646	647	707	1,109	1,152	974	na
External debt/GDP (in per cent)	88.4	84.0	87.4	100.7	84.3	69.5	na
External debt/exports of goods and services (in per cent)	130.8	134.1	138.0	154.1	112.5	88.1	na

¹ Economically active population registered at the employment registration office.

² Officially registered. According to the 2003 Population Census, the real unemployment rate was 17 per cent.

³ General government revenue and expenditure include grants and net lending.

⁴ Direct and assumed debt of the central government and loans guaranteed by the government.

⁵ Weighted average over all maturities.

Annex 8 – Bilateral Assistance

European Union

EC-Mongolia cooperation started when the entry came into force of the Trade and Cooperation Agreement in 1993. Since then Mongolia has received about EUR70 million of EC development aid, mainly under the TACIS programme and since 2004 under the ALA programme (for Asian and Latin American developing countries). Aid initially focussed on the transition towards market economy, including human resources, support to SMEs, institutional and infrastructural development and alleviating the social consequences of transition. Since 2000 EC cooperation has concentrated on rural development which represented over 80 per cent of financial assistance.

A number of complementary actions have been undertaken under regional programmes, such as TEMPUS (university cooperation) or support to NGO activities and emergency aid through ECHO to alleviate the consequences of harsh winters and drought. The latest ECHO aids (EUR1 million grant in 2004 and EUR900,000 in 2005) focus on disaster-preparedness by supporting small-scale projects, for example kitchen gardens, cash-for work, water system restoration and hay preparation. Since 2004, Mongolia is also eligible for calls for proposals under the Asia-wide programmes.

The upcoming Country Strategy/National Indicative Programme for the period 2007-2013 will probably continue to focus on rural development with the specific objective to build sustainable income generation possibilities for poor and vulnerable people in rural areas and to improve their access to social services. The EC envisages support to areas such as development and introduction of pastoral risk management; development of micro finance services and development of local infrastructure and social services provision.

In addition, Mongolia will continue to be eligible for a number of regional and thematic EC programmes and may receive support in areas related to democracy and human rights, non state actors in development, immigration and asylum, human and social development, environment and sustainable management of resources and food security.

The EU intends to work together with other donors, notably the World Bank, and considers co-financing the Sustainable Livelihoods Programme.

Germany

Germany and Mongolia has enjoyed extremely friendly relations, which have grown out of the longstanding links between Mongolia and the former German Democratic Republic (GDR). Many people in Mongolia can speak German.

The development co-operation that currently exists with Mongolia began in 1991, following the country's political and economic transformation. Before that, Mongolia had received development support from the GDR. The GDR was the main donor of aid through COMECON after the Soviet Union.

With commitments and commitment authorisations of around EUR235 million²¹ since 1991, Mongolia is one of the countries that receive most support from Germany per capita. This is in part a reflection of the special long-standing friendly relations between the two countries and in part in recognition of the democratisation of Mongolia and the country's efforts in terms of structural reform and poverty reduction.

German-Mongolian development co-operation initially focused on the central problems of the country:

- establishment of a market economy and support for economic reforms (including the associated legal framework and a functioning financial system),
- infrastructure for energy and telecommunications, areas of particular importance for the country,
- environmental protection (protection of natural resources, renewable energies).

In October 2001, it was agreed that, in view of changing circumstances (developments in the country, involvement of other donors) and in order to improve efficiency, co-operation would in future concentrate on the following priority areas:

- economic reform and development of the market system
- environmental policy (including energy efficiency and renewable energies)

Measures should also concentrate more on rural areas.

Overview of commitments (since 1992):

	1992 (DM mln)	1993 (DM mln)	1994 (DM mln)	1995 (DM mln)	1996 (DM mln)	1997 (DM mln)	1998/99 (DM mln) (Two- year commitm ent) ¹⁾	2000/01 (Two-year commitme nt) for the last time in DM mln	2002/03(Two- year commitm ent) (€mln)	2004/05 (Two- year commitm ent) (€mln)	Sum total of commitments to date (from 1991) (€mln)
FC	10	14	17	12	15	15	25 +17 ²⁾	20 + 8 ⁵⁾	10	9 +9.3 ⁸⁾	114.20
TC in the strict sense	5	11	11	13	14	15	25 + 3 ³⁾	20 + 6 ⁴⁾	10 + 1 ⁷⁾	11 + 1 ⁹⁾	90.49
Subtotal	15	25	28	25	29	30	70	54	21	24	204.69
TC in the broad sense											30.3
Total ⁶⁾											234.99

1) In 1998, two-year commitments were introduced.

2) Commitment during President Herzog's visit to Mongolia: DM 17 million for "Telecommunications II and III".

3) Commitment during President Herzog's visit to Mongolia: DM 3 million for "Advisory Services to the Reform of Economic Law".

4) Commitment of DM 2 million outside of Government negotiations for "Special Support Programme Dzud 2000/2001" and DM 4 million for programmes in the field of renewable energies in 2000.

5) Commitment of DM 8 million outside of Government negotiations for "Renewable Energies" programme in 2001.

6) Excluding funding from the German states and other German ministries (1991-2000: EUR 21.88 million approx. (DM 42.80 million)).

7) Commitment during Parliamentary State Secretary Eid's visit to Mongolia: EUR1 million for "Training and re-training of lawyers".

8) a) EUR3.0 million Special funding for measures of global significance (energy efficiency), b) EUR3.0 million (2005 commitment authorisation) secondary loan with equity features to the XAC Bank micro finance institution with conversion option, c) EUR3.3 million (2005 commitment authorisation) loan programme to promote housing construction

9) Special funding for measures of global significance (HIV prevention measures)

Italy

²¹ Made up of around EUR 204.69 million for financial co-operation and technical co-operation in the strict sense (1991-2004) and around EUR 30.3 million for technical co-operation in the broad sense (1991-2004).

In 2003, the Veneto region approved a financing of EUR118,000 for the project “Potable Water and Renewable Energy in Bogd”. The National Research Council of Padova is responsible for the implementation of the project.

In the industrial sector, an initiative was promoted by the Italian NGO APS (Association for the Participation to the Development) in favour of micro and small enterprises managed by women in four Mongolian regions. The Italian Development Cooperation contributed to the initiative with a financing of around EUR250,000. In the period 1995-2002 the Italian Development Cooperation provided food aid to Mongolia for a total amount of EUR3.1 million.

The Italian Development Cooperation in Mongolia is about to finance the two-year project "Improvement of the Research Centre of Mother-Child Medicine for the Republic of Mongolia" in Ulaanbaatar, the only hospital of this kind in the whole country. The Italian total financing commitment will be around EUR5556,000 out of which EUR5.16 million would be aid financing and the balance of EUR396,000 would be grants. The aid credit will finance the supply of diagnostic, hospital and surgical facilities by Italian companies, for the training of medical and paramedical staff and for the restructuring of some hospital departments. The grant will cover the costs of Italian experts providing technical and supervisory support, and the costs of local consultancies, part of the project costs and some study trips to Italy for managers, doctors and technicians working for the Centre.

Japan

Since Mongolia started its transition in politics and economics in 1990, Japan has been actively engaged in supporting the process through its official development assistance programme. In the early stage of transition, Japan’s support mainly focused on stabilizing the turbulent economy and the mitigation of social constraints by B/P supports (approximately USD140 million in 1990-93) while investing in the rehabilitation of key infrastructures such as main railway lines and a power station (approx. USD160 million during 1991-95) with grants and concessional loans.

To support Mongolia’s efforts for poverty reduction through sustainable economic growth, Japan is currently prioritising its support with the following agenda, in coordination with other development partners;

- Institutional and human resource development to support accelerating transition to market economy,
- Rural development including livestock in selected regions,
- Protection of environment and traditional habitat, and
- Infrastructure development for industries and utilities directly relating to livelihood.

In this respect, Japan has recently extended its assistance of, for example in 2005, concessional loans to promote SMEs with consideration of environmental protection (approximately USD25 million) and grants for investing in facilities for primary education and rehabilitation of water supply systems (in total approx. USD25 million). Technical assistance has also enhanced in social sectors and in administration and governance such as fiscal/tax revenue management and audit functions.

Luxembourg

As a donor to EBRD MCF with a financial contribution of EUR1 million, it has an ongoing fruitful cooperation with Mongolia on a bilateral basis.

Since 2000, the Luxembourg Government has made available approximately EUR800,000 to cover technical assistance needs in the form of financial training and consultancy services to Mongolia, most of which have been provided by Luxembourg's ATTF ("Agence de Transfert de Technologie Financière"), an agency created in 1999 at the initiative of the Luxembourg Government with the objective to transfer general and specific know-how in the banking and financial fields especially to emerging countries. (For further information on the ATTF, please consult www.attf.lu.)

Through the ATTF, Mongolia has benefited from study visits, consultancies and seminars, both on-site and in Luxembourg, covering such wide-ranging topics as the functioning of a financial centre; banking and financial industries in a market economy; credit assessment; banking risks; banking performance; banking marketing and strategic planning; branch management; external and internal audit; international financial markets; globalisation; risk management; asset and liability management; private banking; new financial products; communication skills; leadership; human resources management; anti-money laundering. Target groups were mainly bank staff (top management, senior executives, other employees), government officials, central bank representatives.

In addition, Luxembourg funding has also been devoted since 2005 to cover the tuition fees of a number of students from Mongolia to attend full-time courses at the Luxembourg School of Finance. It is envisaged for 2007 and beyond to extend funding for training and consultancy services in the insurance field.

It is worth mentioning that the ATTF has also received funding from the EBRD in the total amount of approximately EUR200,000 in 2003 and 2004 to provide further bank training.

Luxembourg has been providing assistance in the following areas:

- In 2001, a health care project was started in Mongolia which aims to improve the prevention and treatment of cardiovascular diseases. Initial funding for the period 2001-2006 was in the amount of EUR950,000 and additional funding in the amount of EUR2.5 million has been approved recently by the Luxembourg Government for the period 2007-2010.
- Contributing EUR640,000 to UNDP for the purposes of the disaster management project in Mongolia.
- Financing through the Asian Development Bank to reform the Mongolian Pension System which will be implemented in 2007. Initial funding amounts are USD500,000.

In light of the above, total financial aid extended by Luxembourg to Mongolia (disbursed and committed; bilateral and multilateral channels) currently stands at approximately EUR6.3 million.

The Netherlands

One of the biggest challenges for the Mongolian Authorities lies in the field of good governance and also in maintaining the unique unspoilt ecosystem. The Dutch Government

will support Mongolia with projects focussed on environment, biodiversity, land and water management. For this purpose an annual amount of EUR7.5 million has been allocated to Mongolia.

In addition to that Mongolia can benefit from co-financing within the Programme ORET (Development Relevant Export Transactions).

United States of America

The United States provides significant economic and military assistance to Mongolia. Most of this assistance is provided through partners from the private sector and civil society.

- a) The U.S. Agency for International Development (USAID) plays the lead role in providing bilateral U.S. assistance to Mongolia. Total USAID assistance provided from 1991 through 2006 totals amounts to nearly USD165 million, all of it in grant form. The program is managed by a nine-person USAID Mission based at the American Embassy in Ulaanbaatar. Specific projects are implemented through a network of contractors and guarantees in cooperation with Mongolian partners from the public and private sectors.

USAID assistance for Mongolia is results-focused and emphasizes two main goals: sustainable, private sector-led economic growth, and more effective and accountable governance. Every USAID-funded project in Mongolia is organized around at least one of these two mutually reinforcing goals. The current USAID strategy in Mongolia covers the period 2004-2008 and includes the following project components:

The Economic Policy Reform and Competitiveness Project (EPRC): Working in conjunction with the Prime Minister's office, technical experts provide analysis on key issues related to trade, investment, and private sector development. Specially-targeted issues include energy sector reform and the strengthening of industries where Mongolia has a competitive advantage.

The Gobi and Ger Initiatives: The Gobi Initiative promotes economic growth by helping to develop and strengthen rural businesses. Activities include the facilitation of financial transactions with local banks, technical support for herder groups and small and medium-sized enterprises, and providing expanded business information services through various media, including radio programs and a monthly magazine. The *Ger* Initiative is a similar project that targets the poor residents of Mongolia's major urban centres.

Judicial Reform Project: This project focuses on improving the professional and institutional capacity of the judiciary, aiming towards greater accountability, improved ethical standards, increased professionalism, and greater judicial system independence.

Electoral and Parliamentary Support Project: This project works with Mongolia's Parliament to make it more open and effective, and with electoral institutions and the public to ensure free and fair elections.

Anti-Corruption Support Project: This project works to promote the passage and implementation of effective anti-corruption legislation.

- b) Peace Corps Mongolia is a team of volunteers and staff dedicated to providing grassroots, demand-driven development assistance, and to promoting cross-cultural understanding between Americans and Mongolians. Over 90 volunteers are posted in 18 of the 21 provinces of Mongolia. Peace Corps Mongolia employs a staff of 29 people (24 Mongolians and 5 Americans) to manage its operations and support its volunteers.
- c) Since 2000, the U.S. has provided more than USD30 million to support Mongolia's goal of reforming and modernizing its peacekeeping forces. This assistance has included the provision of both equipment and training.
- d) The U.S. Department of Agriculture (USDA) has been providing food aid to Mongolia since 1993. To date, the total amount of assistance provided exceeds USD60 million.
- e) Following a broad consultative process, Mongolia submitted a final proposal to MCC in October 2005. MCC is currently conducting due diligence on the projects contained in Mongolia's proposal; it is anticipated that this phase will be completed in early 2007. Once the due diligence phase is completed, MCC and the Government of Mongolia will begin negotiations on a final Compact agreement.

The proposed five-year Compact addresses the country's underlying needs in health, education, communication, transportation, finance, and property rights in a way that reduces poverty and enables economic growth for Mongolians.

