DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR MONGOLIA

As approved by the Board of Directors at its meeting on 7 June 2017

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EXECUTIVE SUMMARY

Mongolia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. In more than two decades since the beginning of transition, the country has made significant progress on the path to pluralistic democracy and an open market-oriented economy.

Parliamentary elections in June 2016 brought a landslide victory to the Mongolian People's Party (MPP). Following the elections, a single-party MPP government was formed, headed by the former Minister of Finance, Jargaltulga Erdenebat.

A major challenge for the new government will be to stabilise the economic situation. In recent years, Mongolia has suffered from falling commodity prices, the weakening of the Mongolian Tugrik, a slowdown in neighbouring countries, and the diminished interest of foreign investors partially as a result of inconsistent government policy. An Action Plan for 2016-2020 identifies key priorities of the new government aimed at resolving some of these issues.

Although Mongolia's long-term prospects remain promising, the economy faces a serious short-term deficit, with total external debt reaching 155 per cent of GDP as of December 2016. Economic growth has stagnated, slowing to 2.4 per cent in 2015, and then 1.0 per cent in 2016. The budget deficit for 2016 also increased to around 15 per cent, partly as a result of bringing on to the balance sheet unbudgeted spending programs previously undertaken by the Central Bank. Going forward, the Government plans to narrow the fiscal deficit to 10.4 per cent of GDP, reflecting a significant reduction in state-funded programme spending and a cut in the state's administrative expenses. Growth is also expected to improve, reaching 1.4 per cent in 2017 and then 2.8 per cent in 2018, supported by FDI, including the second phase of the Oyu Tolgoi mining project, and an expected improvement in commodity prices.

The ability to achieve projected growth in 2017 and ensure further acceleration will nonetheless critically depend on the ability of the country to implement much needed structural reforms, including a move towards a more balanced budget and a strategy for the use of revenues from the mining sector to support growth and improve the resilience of the economy. Significantly, in May 2017 International Monetary Fund (IMF) approved a US $440 million Extended Fund Facility. The programme contains conditions on fiscal consolidation, monetary policy and banking sector reforms.

Overall, the economy remains closely tied to China and heavily reliant on commodities cycles. Managing the country's substantial mineral wealth transparently, while at the same time charting a course to a more resilient, diversified and competitive economy, is thus crucial to its long term prospects. As the largest foreign investor in the country, the EBRD is uniquely placed to help Mongolia leverage its natural endowments in a way that will increase value added, enhance economic resilience and generate broad-based, inclusive growth.

In this context, the following strategic themes are proposed to guide the Bank's engagement with Mongolia in the forthcoming strategy period:

- **Enhancing Mongolia's resilience by strengthening the competitiveness of the non-extractive sector and easing access to finance:** While Mongolia's investment climate (among the best in the region) is conducive to innovation and entrepreneurship, much of the economy is still dominated by low-value added unprocessed minerals and agriculture, making it highly vulnerable to external shocks and commodity cycles. Standards of corporate governance and business conduct are low, value chains are under-developed, and the agriculture sector suffers from low quality and poor hygiene standards. In this context, the Bank will look to support the non-extractive sector to help broaden Mongolia's economic base and make the economy more competitive and resilient. In particular the Bank will enhance local corporate and SME competitiveness by financing projects that promote innovation, skills transfer and improved corporate governance, with a focus on agribusiness, construction materials, light manufacturing and services. The Bank will also facilitate improved access to finance, particularly in local currency, by continuing to provide partner banks with dedicated credit lines and risk sharing facilities, with a focus on SMEs, value chain finance and energy efficiency, and actively engage in the development of local currency and capital markets in order to further increase the resilience of the economy.

- **Leveraging a well-governed mining sector to enhance sustainability and maximise value creation:** Development of large expansion and exploration projects will be the key driver of economic growth in the coming years, but the sector requires further reform and investment to maximise value creation and ensure sustainable and inclusive growth. The effective implementation of mining sector projects can also provide opportunities to enhance competitiveness and value added content of domestic industries linked to mining through supply chains. The Bank will thus continue to support responsible mining, in particular through foreign investment, and will seek to deepen value-chain opportunities through upstream financing (both value chain and factoring) and deeper downstream processing.

- **Improving the quality and sustainability of infrastructure services through increased efficiency, commercialisation and "green" solutions:** Modernising and further developing Mongolia's infrastructure is crucial to meeting growing demand from mining and other industries, facilitate mineral exports and support non-extractive sector development. Transport, municipal and energy infrastructure all remain underdeveloped, with weak legal and regulatory frameworks, inefficient but dominant state-owned companies, low tariffs and constraints on private sector participation. The Bank will seek to develop bankable structures for financing creditworthy entities like the City of Ulaanbaatar on a sovereign/sub-sovereign basis. The financing of municipal infrastructure in secondary cities will continue to require a sovereign guarantee, and will be subject to sovereign borrowing space. The Bank will also look to enhance connectivity and regional integration through rail and road projects, and support PPPs in the energy sector with a view to introducing state-of-the-art technologies and renewable (wind and solar) energies.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector portfolio ratio: 100%[1], as of 30 April 2017

Sector	Portfolio				
Amount in EUR million	Number of projects	Portfolio	*% of Portfolio*	Operating Assets	*% of Operating Assets*
Energy	**11**	**629**	**70%**	**610**	**71%**
Natural Resources	8	571	63%	564	66%
Power and Energy	3	58	6%	46	5%
Financial Institutions	**14**	**105**	**12%**	**92**	**11%**
Depository Credit (banks)	11	102	11%	89	10%
Leasing Finance	1	1	0%	1	0%
Non-depository Credit (non-bank)	2	1	0%	1	0%
ICA	**21**	**167**	**19%**	**158**	**18%**
Agribusiness	6	38	4%	31	4%
Equity Funds	2	9	1%	6	1%
ICT	1	5	1%	5	1%
Manufacturing & Services	12	115	13%	115	13%
Infrastructure	**1**	**0**	**0%**	**0**	**0%**
MEI	1	0	0%	0	0%
TOTAL	**47**	**901**	**100%**	**860**	**100%**

Source: EBRD Business Performance Navigator

1.2 Implementation of the previous strategic directions

The present Country Strategy for Mongolia was approved by the Board on 25 June 2013 with the following priorities:

- Promoting diversification through support for non-resource sectors;
- Supporting sustainable growth through broadening access to finance;
- Promoting responsible mining and strengthening governance institutions; and
- Modernising infrastructure and bringing in the private sector.

Over the course of the current strategy period, Mongolia has had to confront both political and economic volatility that has undermined investment appetite. The government has gone through numerous high level changes at Prime Minister and Ministerial level, which have impeded the approval process with respect to high-impact mining and infrastructure projects. Combined with depressed commodity prices in the wake of a slowing Chinese economy, this has led to a significant deterioration of the macro-economic environment and negatively impacted some of the Bank's prominent clients in the mining sector.

Notwithstanding this challenging environment, the Bank has been able to expand its portfolio, investing a total of €648 million over 2013-2015 in line with the country strategy. In pursuing its objective of **promoting diversification**, for example, the Bank has supported the non-extractive private sector through a variety of financial, advisory and technical assistance engagements, investing €182 million across 22 projects since 2013. Although

[1] Cumulative Business Volume: 5 year rolling basis.

relatively moderate in volume, the Bank's investments in the non-extractive sector have sent an important signal to investors about the viability of such projects, and provided a base for further development and more balanced growth. Among the highlights:

- The Bank promoted best operational practices and energy efficiency in Mongolia's corporate sector through a series of investments in manufacturing, retail, telecoms, food processing, health, and hospitality. For example, the Bank financed construction of a state-of-the-art cement plant in the South Gobi, expansion of a chain of supermarkets outside Ulaanbaatar, and a local ice cream company.
- The Bank also maintained a high level of engagement through its Advice for Small Business facility, reaching out to over 200 MSMEs in Ulaanbaatar and the regions in the first three years of the strategy. As of November 2015, client SMEs on average had increased annual turnover by 75 per cent and labour productivity by 58 per cent.
- The Bank commenced direct long-term lending in local currency in order to decrease the vulnerability of local corporates to depreciation of the Mongolian Tugrik (MNT). In particular, the Bank issued the first MNT denominated bond (a 3-year offshore private placement with an equivalent of US $7 million), which helped to decrease the cost of MNT financing for a mobile phone operator.
- Through its Commercial Mediation Project, the Bank established a mediation capacity at the Chamber of Commerce in Ulaanbaatar and one regional centre, training 17 mediators and developing a launch plan to successfully market the service. To date, nine commercial disputes in the non-extractive sector have been successfully mediated, averaging two months as compared to three years under the conventional legal system.

The Bank also stepped up its efforts **to broaden access to finance** and develop a local currency market:

- The EBRD provided US $108 million equivalent to two partner banks and one Non-Banking Financial Institution (NBFI), as well as financing several corporate clients in MNT. Despite a limited universe of partner banks, the EBRD presently remains the only IFI to offer long-term MNT financing, with around US $50 million equivalent disbursed to date, which has decreased the FX mismatch of SMEs and stabilised businesses. Nonetheless, the increasing cost of funding in local currency (including for the Bank) has been an impediment to the Bank's ability to lend even more.
- Under the EBRD's first Mongolian Sustainable Energy Financing Facility (MonSEFF), US $10 million equivalent (in MNT and US$) was provided for on-lending to private enterprises together with a capacity building assistance for partner banks involved in energy efficiency investments. The MonSEFF, albeit slowly developing due to low energy costs, is enabling local companies to benefit from expert advice and reasonable long-term local currency financing. Overall, EBRD activities in 2013-2015 generated energy savings of more than 22,000 tonnes of oil equivalent (toe) per year.
- The Bank also provided its partner banks with targeted credit lines, such as the Value Chain Finance credit line, thereby facilitating access to more affordable interest rates for local SMEs contracting with reputable large mining companies. More than 60 small and diversified businesses in the regions have benefited from this product, with an average loan size of US $110,000.
- In the micro-finance sector, the Bank has worked with the most reputable micro-finance institution in the country, TransCapital, deepening its engagement through a

corporate governance programme and local currency financing. With EBRD support, this micro-finance institution was able to increase its customer base by 23 per cent, enabling it to reach additional underserved customers such as micro-enterprises in the poorer areas of Ulaanbatar or the regions.

- The Bank also supported the MongolBank (Central Bank of Mongolia) by providing TC on inflation targeting, starting in 2016. As a result of the Bank's assistance, the Central Bank was able to establish a formal Monetary Policy Committee to regularly discuss and implement key policy decisions, which not only improved analysis but also enhanced the efficiency and transparency of its decision-making.

The EBRD also continued to promote **responsible mining and improved corporate governance** in the mining sector notwithstanding challenges with the quality of mining portfolio as clients have been impacted by the drop in the commodities cycle.

- The Bank selectively invested in mining projects, focusing on well-managed companies with quality foreign ownership meeting the highest social, environmental and safety standards. In particular, the high-impact Oyu Tolgoi copper mine financing has been a landmark project for Mongolia, leading to renewed interest from foreign investors. The EBRD provided €368 million and syndicated an additional €700 million from 22 international commercial banks.
- The Bank has also worked to improve Mongolia's standards of environmental and social management, as well as transparency, among junior exploration companies, through the covenants of its gold mining project with Altan Rio Materials. As a result, for the first time a Mongolian-based listed exploration company has published an annual environmental report in accordance with best international practice. The company is also in the process of adopting and introducing modern environmental and safety management systems, and is now complying with the Extractive Industries Transparency Initiative (EITI).
- The Bank continued to provide technical assistance to the EITI secretariat responsible for coordinating national efforts in implementing the initiative. For example, the EBRD supported the finalisation and approval of a draft EITI Law for submission to the parliament and completion of an online 'e-Reporting' pilot. As a result, two commodity traders have started to disclose revenue payments electronically. Also, off-site meetings of the EITI sub-councils have also been organised in key mining provinces, involving regional and local governments and parliaments, mining companies and NGOs.
- The Bank also organised workshops with NGOs and mining companies to raise awareness on offsetting and biodiversity conservation while developing mining projects.

However, the Bank has been less impactful in helping Mongolia **modernise its infrastructure**, both municipal and regional.

- The abundance of cheap long-term financing from bilateral organisations and other IFIs, combined with the use of sovereign ('Genghis') bonds via the newly established Development Bank of Mongolia, has made EBRD financing economically less attractive to the authorities, particularly in the transport sector. In addition, the lack of a PPP framework and the politically sensitive issue of cost recovery tariffs for utilities have limited the Bank's ability to promote private sector participation and commercial solutions in the sector.

- In the municipal sector, the Bank has made several proposals to support municipal infrastructure in the capital city and the regions (for example, the South-Gobi waste water treatment plant). However, legal uncertainties regarding the possibility of sub-sovereign financing have slowed the Bank's efforts to finalise projects with the city of Ulaanbaatar. The Bank continues to work closely with the City of Ulaanbaatar and the Ministry of Finance to find a solution and facilitate sub-sovereign borrowing.

1.3 Key lessons

Overall, the Bank's experience in Mongolia over the existing strategy period demonstrates the benefits that can accrue from economic diversification via instruments such as direct financing, equity participations and risk-sharing with local commercial banks. Nonetheless, recognising that the mining sector can be expected to remain a dominant driver of the economy for the foreseeable future, the most effective and impactful way for the EBRD to enhance the resilience of Mongolia's economy may be to support the competitiveness of the non-extractive sector, rather than promoting diversification *per se*.

At the same time, given the importance of mining to the economy, the Bank should continue to support reputable projects in the sector, but concentrate on those with high export potential, possibly with deeper processing of mineral content, as a means to enhance the competitiveness of domestic industries linked to the sector through supply chains.

The Bank's ability to broaden its engagement with systemic banks will remain constrained by the small number of qualified partners. Engagement with the banking sector and, by extension, with MSMEs, will primarily be pursued through stronger relationships with existing partner financial institutions, which the Bank will focus on helping grow in order to become effective channels for financing non-extractive industries. The Bank will also continue to pursue bankable opportunities with its existing private corporate clients, including by offering long-term MNT financing.

The Bank's experience in the current strategy period also suggests that, despite limited privatisation, the state is likely to retain a strong presence in the short- to medium-term in key infrastructure areas, such as energy and transportation (e.g., railways, aviation),while cheap financing for the public sector will not likely abate, unless constrained by fiscal space. In this regard, as sovereign borrowing capacity becomes limited, financially self-sustainable solutions are likely to find more favour with the new government, and the first successful projects may send positive signals about the viability of such projects in the new strategy cycle. The Bank should thus continue to advocate relevant commercial solutions for municipal, energy and transport infrastructure, focusing in the short term on the most promising opportunities (particularly with the City of Ulaanbaatar) with a view to developing projects with high demonstration effects. It should also continue to support credible PPP projects, including in the energy sector, and engage with the Government to implement sustainable tariff mechanisms for utilities where possible.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

In more than two decades since the beginning of transition, Mongolia has made significant progress on the path to pluralistic democracy and an open, market-oriented economy.

Mongolia has a liberal constitution, developed a competitive political party system and established a vibrant civil society. The media are free to report on a wide range of issues and there is an increasing adherence to the rule of law and respect for human rights, although many challenges remain.

The political process in Mongolia has been traditionally influenced by the country's two major political parties – the Mongolian People's Party (MPP) and the Democratic Party (DP). The MPP was the dominant political faction in parliament until the June 2012 elections, when the DP took a plurality of the seats in the legislature.

However, the parliamentary elections of 29 June 2016 brought a landslide victory to the MPP, which won 65 out of 76 parliamentary seats in a single-chamber legislature. The DP only managed to secure nine seats. No major problems were reported, with observers concluding that the elections were broadly in line with international standards for free and fair elections.

Following the elections, a single-party MPP government was formed quickly, headed by the former Minister of Finance, Jargaltulga Erdenebat. It is expected that the new government will be more stable than the fragmented DP. The latter has always been divided, but following the electoral result it will need to undergo a serious change to restore its place in domestic politics.

The next presidential election is due in June 2017. The incumbent President Tsakhiagiin Elbegdorj, a nominee of the current main opposition party DP in the presidential election of 2013, has already completed two terms in office and thus cannot run for re-election, according to the Constitution.

A major challenge for the new government is to stabilise the economic situation. In recent years, Mongolia has suffered from falling commodity prices, the weakening of the MNT, an economic slowdown in neighbouring Russia and China, and the diminished interest of foreign investors as a result of inconsistent government policy. An Action Plan for 2016-2020 identifies key priorities of the new government.

The longer-term challenge for any Mongolian government is how to manage transparently the wealth generated by vast natural resources in a country with significant levels of poverty. The reality of Mongolia's economic reliance on China has effectively been recognised by both political parties. The DP signed a Comprehensive Strategic Partnership with China in 2014. Since coming to power, the MPP has also continued to foster close relations with China.

2.2 Macroeconomic context

Mongolia's economic growth has been slowing markedly in recent years. From a peak of 17.3 per cent in 2011, economic growth slowed to 2.4 per cent in 2015 and then to 1.0 per cent in 2016, as domestic demand declined and investment struggled to recover from the downturn in previous years. Growth rebounded significantly in the last quarter of 2016, up by 9.9 per cent year-on-year in real terms and reached 4.2 per cent in the first quarter of 2017, primarily as a result of large fixed investments in mining sector. Currency pressures intensified in 2016 as the MNT depreciated by 20 per cent against the US dollar, resulting in weak domestic demand, with private consumption down by 11.7 per cent in real terms. The economic slow-down and weakening of the currency in turn has contributed to a rise in non-performing loans (NPLs), from 5.0 per cent in December 2014 to 8.5 per cent in December 2016. The Central Bank lowered the policy rate from 15 per cent to 14 per cent in December 2016, having previously raised it from 10.5 per cent in August in an attempt to stem a sharp depreciation of the currency against the dollar. Inflation moderated significantly, averaging 0.5 per cent in 2016 compared to 6.0 per cent in 2015, as a result of weak domestic demand.

Mongolia's external position remains weak. As investment activity slowed, the current account deficit declined, from around 26 per cent of GDP in 2011-2013 to around 4.0 per cent of GDP in 2016. However it is expected to widen again, once large import-intensive mining projects resume. Exports of goods and services dropped by 16 per cent and imports of goods and services were down by 26 per cent in 2016 compared to 2014. The high debt level remains the greatest risk to the country's external position, with total external debt reaching 155 per cent of GDP as of December 2016 (221.8 per cent when intercompany lending is included) and is expected to rise further as a result of new borrowing under the bailout package. Short-term liquidity pressures have abated, as the government refinanced an external bond due in March 2017 by issuing a new seven-year maturity note.

Public finances are deteriorating. The budget deficit for 2016 increased to around 15.4 per cent, from an initially budgeted 4 per cent, partly as a result of bringing on to the balance sheet unbudgeted spending programs previously undertaken by the Central Bank. This included Good Herder/Student/Fence policy loan programmes and a buyback programme for the purchase of public shares of Erdenes Tavan Tolgoi. The Government approved a supplementary budget in April 2017, which includes a series of new revenue and expenditure measures designed to narrow the fiscal deficit to fulfil the conditions required for approval of the IMF programme. The amendments include the reform of personal income tax, where a progressive schedule was introduced instead of a flat rate of 10 per cent. Other important amendments cover the raising of retirement ages, which will be increased by six months every year from 2018 to reach the target pension-drawing ages of 65 years for men and women by 2028 and 2038 respectively. Fuel taxes, tariffs on imported cigarettes, and excise taxes on alcoholic beverages and cigarettes were also increased. The 2017 Fiscal deficit was set at 10.4 per cent of GDP. The significant reduction in state-funded programme spending and fiscal consolidation path as required by the IMF can be expected to further limit the government's ability to stimulate the economy. However a financial package to be provided from IFIs and mechanisms for reform commitments spurred by the IMF programme are expected to put Mongolia back onto a more sustainable path. The resumption of Phase II of Oyu Tolgoi is another positive development to support budget performance via import related taxes, as the effects of the project begin to materialise.

The real estate market is slowing, contributing to macro and banking sector vulnerabilities. Over recent years, there has been significant growth in the housing market and real estate prices, largely driven by subsidised loans for housing, provided as part of the Government's Price Stabilisation Programme. Mortgages increased by 45 per cent in 2014 and 20 per cent in 2015, notwithstanding a slowdown in growth and declining house prices that started to materialise in 2015. In the light of further declines in 2016, the housing market has undergone a sharp correction, with house prices down by 6 per cent and mortgage loans dropping by 57 per cent in October 2016 year-on-year. This correction can be expected to lead to increased NPLs in the banking sector, increasing the vulnerability of the economy.

Outlook for the strategy period

Economic growth is expected to reach 1.4 per cent in 2017 and improve to 2.8 per cent in 2018, supported by increased investment in the second phase of Oyu Tolgoi (see box below) and improvements in the investment climate and consumer confidence, reflecting the improved economic environment. A gradual increase in mining production, combined with expected improvements in commodity prices, will support both exports and government revenues. However, a range of fiscal consolidation measures and tight monetary policy under the new IMF programme are expected to weigh on public and private consumption in the short term. The ability to achieve projected growth in 2017-2018 and ensure further acceleration going forward will nonetheless depend on the ability of the country to implement much needed macro structural reforms, including a more sustainable fiscal and borrowing policy by the Government. Externally, economic challenges in China, a key trading partner for Mongolia accounting for approximately 90 per cent of exports, could continue to depress export demand.

Mongolia: Main macroeconomic indicators

		2012	**2013**	**2014**	**2015**	**2016** (est.)
GDP growth	%, y-o-y	12.3	11.6	7.9	2.4	1.0
CPI inflation	%, avg.	15.0	8.6	12.9	6.0	0.5
Government balance	% of GDP	-4.8	-6.8	-1.2	-5.0	-15.4
Current account balance	% of GDP	-27.4	-25.4	-11.5	-4.8	-4.0
Net FDI	% of GDP	35.9	16.7	2.3	1.6	-36.7
Gross external debt	% of GDP	125.2	151.2	171.7	184.4	221.8
Gross reserves	% of GDP	33.6	17.8	13.5	11.3	11.7
Private sector credit	% of GDP	41.9	56.2	56.2	50.5	52.0
Nominal GDP	US$ bn	12.3	12.6	12.2	11.7	11.1
GDP per capita	current US$	4,329	4,365	4,169	3,946	3,660
Unemployment	per cent	8.2	7.9	7.9	7.5	7.9

The Oyu Tolgoi copper and gold mine

Mongolia is on track to become a globally significant copper and gold producer, with the Oyu Tolgoi (OT) mine one of the largest in the world. The project is jointly owned by the Government of Mongolia (34 percent stake) and Turquoise Hill Resources (THR). Rio Tinto has a 50 percent stake in THR and is the project manager. The first-phase open-pit mine began construction in 2010 with investment exceeding US $6 billion, and production commenced in 2013. The second phase (OT-2) assumes a five-year construction period, with first underground production in 2021 and five to seven years of ramping up to full production.

The commencement of the OT-2 project was delayed by ongoing negotiations between Rio Tinto and the authorities; however, in May 2015 the government and Rio Tinto signed an agreement to launch OT-2 worth US $6 billion. The agreement covers certain tax liabilities of OT following an earlier audit, the calculation of royalty payments and a number of other issues. In early May 2016 Rio Tinto announced the final and formal approval for the expansion of Phase II, and as of June 2016 had drawn down approximately US $4.3 billion of the project finance facility with the possibility of accessing an additional US $1.6 billion in supplemental financing in the future. The resumption of OT-2 is expected to support budget performance via import related taxes, increase FDI and lead to an improvement in the investment climate and consumer confidence as the effects of the project start to materialise.

Additional economic benefits will be expected to stem from the generation of additional local jobs (OT currently employs more than 3,000 people), spending on local supplies (from service companies, food and beverage suppliers, mining equipment contractors, transport and maintenance operations), investments in housing, utilities and services by the company employees, as well as in transport and energy infrastructure, and enhanced human capabilities achieved through the project sponsored university education and vocational training for mining and technical graduates across Mongolia.

2.3 Structural reform context

While the country has made progress in improving certain aspects of its macro-economic policy, including by developing a four-year Economic Stabilisation Plan and bringing unbudgeted spending programs previously undertaken by the Central Bank on to the balance sheet, such areas as fiscal position, government borrowing and monetary policy require significant structural reform. Among other reforms, it will be important for the country to adjust its budget spending policy to move towards a more balanced budget and develop a strategy for the use of revenues from the mining sector to support growth and improve the resilience of the economy.

In March 2016 the Central Bank transferred certain mortgage assets to the Government books, namely to the Future Pension Reserve Fund (FPRF), established in February 2016. The transferred assets included the outstanding residential mortgage-backed securities and Central Bank loans to banks that were extended under the subsidised mortgage programme over the last three years. Cash flows generated from the FPRF mortgage assets will finance new subsidised mortgages originated by the banks and support future pension payments, starting from 2030.

Mining policies have improved the investment attractiveness of the sector. As noted above, in May 2015 the government and Rio Tinto signed an agreement to launch the second phase of Oyu Tolgoi worth US $6 billion, restarting a project which had been effectively suspended since 2013. The agreement addresses a number of issues, including certain tax liabilities of Oyu Tolgoi following an earlier audit and the calculation of royalty payments. In early May 2016 Rio Tinto announced the final and formal approval for the expansion of Phase II of OT and project financing worth US $4.3 billion was disbursed in March 2016. This promises to be a positive signal to other foreign investors that are considering investments in the extractive sector. Implementation of another large coal mine, Tavan Tolgoi – worth US $4 billion – is also under negotiation.

Significantly, in May 2017 International Monetary Fund (IMF) approved a US $440 million Extended Fund Facility. The programme contains conditions on fiscal consolidation, monetary policy and banking sector reforms. Other IFIs such as World Bank and ADB are also expected to provide budget support loans on a concessional basis with a total financing package of around US $5.5 billion. Regardless of the final contours, the Government appears committed to implementing wide-ranging reforms. The key priorities in the programme are to reduce the fiscal deficit and establish an independent Fiscal Council to improve fiscal discipline. Other reforms will focus on the banking system, where a comprehensive diagnosis will be undertaken and necessary restructuring/recapitalization undertaken. These actions will be complemented by strengthening the regulatory and supervisory framework, as well as improving the deposit insurance system and strengthening the regime for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). A major priority will also be the adoption of a new Bank of Mongolia law to clarify its mandate, strengthen governance, and improve independence. Monetary policy will remain appropriately tight, given the objective of price stability, and the exchange rate will continue to move flexibly with limited interventions.

2.4 Access to finance

Private sources of capital

The banking sector remains the dominant player in the Mongolian financial system with more than 95 per cent of total assets. Concentration is extremely high with the three largest banks holding nearly 70 per cent of banking assets. Non-banking financial institutions, such as insurance companies, micro-finance institutions and savings and credit cooperatives, remain very small in terms of asset size. There is no corporate bond market in Mongolia and it is not expected to develop in the near future, as the handful of high credit corporate borrowers have been heavily serviced by the banks and there is presently limited economic incentive for borrowers or investors to develop the corporate bond market. The equity market is more of a trading venue for few shares and does not play a significant role in providing financing to the broader economy. The Mongolian market also lacks long-term financing sources, as there are no substantial institutional investors, such as life insurance providers and pension funds, to invest in long-term financial products.

Multilateral and bilateral development bank finance and the EU

The **Asian Development Bank (ADB)** has been Mongolia's largest multilateral development partner since 1991, approving assistance totalling US $1.92 billion over 24 years. Cumulative disbursements for lending and grants financed by ordinary capital resources, the Asian Development Fund, and other special funds have amounted to US $1.1 billion. In 2015, the

ADB increased its commitment in Mongolia with new approvals totalling US $297.5 million, focusing on job creation, social protection, and climate change. To prevent cuts to welfare programs, the ADB has also backed a US $150 million Social Welfare Support Program. Additional financing of US $50 million was approved for an Agriculture and Rural Development Project and $60 million for a Credit Guarantee Support Project.

Mongolia became a member of the **World Bank Group (WB)** in February 1991. The World Bank has since provided US $808.17 million to Mongolia. As of April 2016, its portfolio in Mongolia had total commitments of US $188.14 million, composed of 8 operations financed by IDA credits totaling US $163.45 million and 12 trust funds totaling US $24.69 million. The majority of World Bank projects support infrastructure development, economic governance and institutional strengthening of the mining sector. In addition to the lending and grant operations, the World Bank also provides analytical and advisory work to Mongolia to support its medium and long term development objectives and capacity building to implement the Government's reform strategy in key areas.

The **International Finance Corporation (IFC)** opened its office in Ulaanbaatar in 1997. Since then IFC has invested and mobilised more than US $818 million. IFC's strategy in Mongolia is close to the EBRD's; it invests in Mongolian financial institutions, particularly banks, to expand their services and access to finance for SMEs. IFC promotes international corporate-governance and environmental and social standards, and invests in essential infrastructure, such as renewable power, telecom, and middle-income housing. It also supports world-class sustainable mining projects to bring global financing, international technology, and best environmental practices to Mongolia. IFC is working with partners across the mining sector to raise awareness and standards on water management in the South Gobi desert. IFC also invests in agribusiness and supports long-term reform to promote food-safety standards and competitiveness.

The **Japan International Cooperation Agency (JICA)**'s Mongolia Office was established in 1997. JICA has dispatched over 620 volunteers to Mongolia since 1992 and more than 4000 technical trainees to Japan. JICA is Mongolia's most important bilateral donor, providing long-term sovereign loans in excess of US$ 500 million. JICA's policy is for the Government of Mongolia to achieve a National Development Plan through 3 target categories, with 5 development sectors. This policy was based on the new Directions of the Assistance of Mongolia, launched in April 2012 by the Government of Japan. Priority areas of assistance include: 1) sustainable development in the mineral resource sector and stronger governance, 2) support for inclusive growth, and 3) enhancement of the capacity and function of Ulaanbaatar as an urban center.

In 1997 **European Investment Bank** (EIB), the European Union's long-term financing institution, and Mongolia concluded the Framework Agreement under which the Bank conducts its financing and capital investment in the country. Since 2014, the EIB has invested around €50 million to date. The bank has primarily focused on financing transport, water sewage and energy infrastructure projects under an investment programme in the Ger areas of Ulaanbaatar. The EIB is also preparing to sponsor an onshore wind farm near Sainshand.

Since 2006, Mongolia has been eligible to receive **European Commission** development assistance. The Partnership and Cooperation Agreement signed in 2013 between the EU and Mongolia outlines and deepens their cooperation in trade, development, agriculture, and energy, which materialized in €85 million in grants for the period 2014-2020. Part of that includes a €9.3 million SME development program, a comprehensive program implemented by the EBRD to support SMEs, ranging from small consultancy to first loss guarantees to mitigate risk when co-financing with local commercial banks. Among the most recent engagements are Trade Related Assistance (TRAM) aimed at enhancing economic diversification and the Economic Growth for Equitable Growth project.

2.5 Business environment and legal context

Business Environment

Mongolia is relatively advanced in terms of promoting private ownership, and market distortions are fairly limited. The country ranked 64th out of 190 in terms of ease of doing business according to the World Bank *Doing Business 2017* report, scoring particularly well in the areas of starting a business, dealing with construction permits, protecting minority investors and paying taxes, although the overall rating is constrained by low scores for access to electricity and trading across borders. In *Doing Business 2017* Mongolia significantly improved its score in paying taxes by introducing an electronic system for filing and payment of taxes, moving from 73rd place to 35th.

According to the World Bank / EBRD Business Environment and Enterprise Performance Survey (BEEPS V) the top three business environment obstacles identified by Mongolian firms were access to finance, competitors' practices in the informal sector and electricity issues. Access to finance remained the top obstacle, despite the relatively high share of firms with bank loans (48.1 per cent), well above the Central Asia (CA) and BEEPS V averages. However, out of the firms that needed a loan, 46.8 per cent of SMEs and 65.0 per cent of young firms were credit-constrained – i.e., they were either discouraged from applying or rejected when they did. Virtually all recent loans (99.5 per cent) required collateral, the highest share across BEEPS countries. Access to land was also among the top obstacles for SMEs, young and manufacturing firms, while large firms were concerned about workforce skills and corruption. According to Transparency International's 2016 Corruption Perceptions Index, Mongolia ranks 87th out of 168 countries.

Institutional strength is low; the country ranks in the bottom quartile for government effectiveness, control of corruption and the rule of law in the World Bank's *Worldwide Governance Indicators.* Shortcomings remain in terms of standards of corporate governance and business conduct, and levels of carbon intensity are still high. In the mining sector, issues surrounding the share of state ownership, the rules governing the allocation of risks and rewards between the state and private investors, and the tax regime have all been subject to change and uncertainty.

Legal Context

Mongolia has enacted a number of new laws in recent years with a view to strengthening its legal framework for business. Nevertheless, significant reforms are still required in a number of key areas. The EBRD Corporate Governance Assessment (2015) highlighted a framework in need of reform in most areas under consideration. Similarly, Mongolia's bankruptcy legislation seems to be very short on detail and procedure and is in need of comprehensive reform in order to promote bankruptcy as a tool for reorganisation. The access to finance legislation, on the other hand, has significantly improved with the adoption of a new law on pledges of movable property and is expected to facilitate lending, especially for SMEs. However, a study looking at factoring law in the EBRD countries of operation (2016) identified significant areas of Mongolia's factoring institutional and legislative framework which need upgrading.

In 2015, the Mongolian parliament approved the revised Energy Law and Renewable Energy Law directed towards adopting a more commercially-oriented approach to the energy sector. The reforms include the introduction of a special "support tariff" to be levied on end-users to fund the difference between the feed-in tariffs and average production costs. The amended legislation also provides that the validity period of a power purchase agreement should be set in accordance with investment payback period. A long-awaited Energy Efficiency Law was adopted in November 2015. Among other important provisions, the new law provides a foundation for the activities of energy auditors, energy service companies and energy efficiency managers, as well as envisages penalties for non-compliance with the energy efficiency legislation. The Energy Efficiency Law also provides for the obligations of designated consumers to undergo energy audits, develop and introduce energy saving measures and report on their implementation to the Energy Conservation Council.

The 2010 Concessions Law was adopted at the time when Mongolia had almost no prior experience in the Public Private Partnership (PPP)/concessions projects. Given the growing number of projects in the pipeline and frequent institutional changes, there is a need to support further development of the regulatory framework for PPPs and strengthen the government's capacity to implement PPP/concession projects.

The Mongolian government has also identified judicial sector priorities for 2016 – 2020. Specifically, these include the intention to improve the legal framework for settlement of disputes, including the review of the Laws on Settlement of Civil Cases in the Court and on Arbitration, to improve the process of selecting judges and the quality of courts decisions, as well as the review of the Law on Judicial Administration.

Public procurement legislation needs modernising, in particular with a view to aligning it with current best practice and international regulatory standards, for example, the 2012 World Trade Organisation Government Procurement Agreement (WTO GPA). There is a need for a comprehensive sector reform, in particular implementing principles of competition and transparency in public spending. Increase of accountability of procurement decisions is recommended. Reform of the public procurement review system is also required to simplify procedures and achieve a fair procedure for review and remedies in public procurement.

Although commonly expected provisions necessary to underwrite fully effective competition in the electronic communications sector may not yet be present in law or regulation (e.g. absence of a general authorisations regime, lack of clarity on facility sharing, infrastructure access and rights of way), the electronic communications market still appears to function on a largely competitive basis, with some competition present in all main subsectors.

2.6 Social context

Mongolia ranks 90th out of 188 countries on the UNDP 2015 Human Development Index (HDI), placing it in the category of countries with 'high human development'. It is only second to Kazakhstan (56th) and above other countries in Central Asia (Turkmenistan, 109th; Uzbekistan, 114th; Kyrgyzistan, 120th and Tajikistan, 129th). Since the 1980s Mongolia has experienced a substantial improvement of human development, at a rate comparable to China.

This is attested by increased life expectancy at birth (from 60 in 1990 to 69.5 years in 2014) and expected years of schooling (14.6 years).

While Mongolia ranks 104th out of 140 in the World Economic Forum's Global Competitiveness Index, this stands in notable contrast to higher rankings for indices related to human capital (such as higher education and training, 62nd; health and primary education, 69th; and labour market efficiency, 41st), implying that structural issues constitute the most pressing challenges to competitiveness. Public spending on education was 12.15% of the government's total spending in 2011, and spending on education as a share of GDP was 5.5%. Despite the resulting improvement in the quantity of education, transition from school-to-work for young people is of increasing concern. According to the ILO, the youth unemployment rate in Mongolia was 14.7 per cent in 2015 (compared to the adult unemployment rate of 5.9 per cent). In 2013, more than one-fifth of all young people in Mongolia aged 15 to 29 were not in employment, education, or training (NEET), although Mongolia's NEET rate is low compared to other Central Asian countries. The inactivity of young people is particularly high among youth living in 'aimag' (province) centres, with a NEET rate of 27.1 per cent as compared to the 21.1 per cent national average.

Significant regional disparities remain. Mongolia is the most sparsely populated country in the world with over 40 per cent of its 3 million population living in the capital city of Ulaanbaatar. The incidence of poverty is 8 times higher in rural areas (22.2 per cent) compared to urban areas (2.8 per cent). Regional inclusion gaps also remain large in relation to access to services, including water, heating, ICT infrastructure and education. Access to electricity and the lack of cross-border trade infrastructure are identified as the main impediments to doing business.

Although the rate of labour force participation by Mongolian women is relatively high at ~60 per cent, women remain more vulnerable than men to under- and-unemployment because of the high degree of gender segregation and specialization in the labour force. Women continue to be concentrated in less productive economic sectors and in professions with lower levels of responsibility, income and status, and are under-represented in high-paid sectors such as mining, transportation and energy, where prospects for advancement are greater, as well as in managerial and technical roles. There is also a growing gender wage gap with women earning 14.3 per cent less than men. Pervasive social norms about 'non-traditional' areas of work and women's already subordinate positions in families, where home or childcare duties often inhibit their equal access to the formal labour market, persist. Gender disparities also tend to be greater in rural than in urban environments. Although no apparent gender gaps are reported in terms of accessing formal financial services, lack of collateral remains an issue to accessing credit. High mortality rates and health concerns are also growing, especially among men, notably due to substance abuse.

2.7 Green Economy Transition

Mongolia remains a highly energy intensive economy, with rapidly growing demand. The average energy intensity per capita is more than double that of EBRD countries of operations and three times higher in carbon intensity per capita – which is four and five times that of EU-28 averages respectively. Over 90 per cent of the total primary energy supply comes from coal and oil, with most of the electricity and heating generated from aging coal-fired plants in substantial need of rehabilitation and investment.

To date, the EBRD has financed projects for a total of €114 million under its Green Economy Transition (GET) approach. Renewable energy projects account for over half of the total, followed by corporate energy efficiency (25 per cent). The first sustainable energy financing credit line was introduced by the Bank in 2014 – the Mongolia Sustainable Energy Financing Facility (MonSEFF) – which aimed to support investment in energy efficiency measures through local intermediary banks, targeting large energy intensive industries, including mining.

Mongolia's renewable energy share remains close to 3-4 per cent of total electricity output (2-3 per cent wind and 1 per cent hydro) and 8 per cent of installed capacity, mainly wind (5 per cent) and hydropower (3 per cent). Mongolia has substantial potential for further renewable energy generation, including solar resources. Since the adoption of a Renewable Energy Law in 2007, the Government has passed amendments of both Energy and Renewable Energy Laws to introduce "support tariffs" to cover the costs of electricity production from renewable energy sources, which Mongolia has targeted to constitute 20 per cent of installed power capacity by 2023 under its National Renewable Energy Program. There are currently two 50MW wind farms in Mongolia, both financed by the EBRD – Salkhit (operational since 2013) and Tsetsii (under construction). Some concerns exist over the capacity of the existing electricity grid to accommodate the rapidly increasing renewable energy share, particularly wind.

Mongolian municipal infrastructure remains basic as a result of underinvestment. In some areas, such as ger districts, there is no connection to main utilities services, including district heating, which requires urgent solutions to address these basic needs.

Mongolia faces serious climate adaptation challenges and is a highly water stressed region. Over the course of half a century, the average temperature has gone up by over 2 degrees Celsius with changing rainfall patterns and growing desertification. Projections show intensification of dry climate conditions, imposing serious negative environmental and socioeconomic impacts, in particular in the agricultural sector (animal husbandry and farming) that consumes 44 per cent of total water use (followed by industry, consuming 43 per cent). Better land-use practices, irrigation and water management systems, particularly in industrial uses, as well as wider penetration of climate technologies, are needed to strengthen the country's climate resilience. Municipal water supply and wastewater treatment infrastructure remains underdeveloped, which poses health risks to the population relating to water-borne diseases.

Mongolia's material productivity (economic output generated per material input) ranked the lowest in the world in 2010, according to the Global Material Flows Database[2]. There is no national target for resource efficiency or waste reduction, but a waste management programme for Ulaanbaatar was approved in 2013, which sets quantitative targets for collection and recycling, mainly for household wastes. Generally, there is no reliable information system for waste generation and treatment by sector, although the mining sector is assumed to produce the most amount of waste. In 2012, the Parliament adopted a Law on Waste that combined the Law on Household and Industrial Waste and Law on Hazardous and Toxic Chemicals, which was updated in 2016 with current concepts of international waste management policies. However, local governments, responsible for industrial and municipal solid waste management, are considerably lacking in human and financial resources, as well

[2] Vienna University of Economics and Business (WU), www.materialflows.net

as in technology and expertise to manage waste. There is negligible private sector involvement beyond waste transport. Hazardous waste is discharged with household waste in open dumps and landfills, and in many cases it is stored in inappropriate conditions, causing severe environmental and health damages. Upon the request of the Ministry of Environment and Tourism, the EBRD is currently conducting a study to provide technical assistance on hazardous waste management in Mongolia.

Mongolia has one of the worst urban air qualities in the world, particularly in Ulaanbaatar which recorded more than 16 times the PM10 level and 3 times the PM2.5 level stipulated in the World Health Organisation guidelines for particulate matters (including fine particles) respectively. A 2011 World Bank study “Air Quality Analysis of Ulaanbaatar, Improving Air Quality to Reduce Health Impacts” has estimated this to cost around a fifth of Ulaanbaatar’s GDP as result of thousands of deaths and hospital admissions due to lung and heart diseases. High PM concentrations are largely caused by the widespread use of Ger stoves, followed by windblown dust, combustion residues, road dust and exhaust particles from vehicles and heat only boilers. The environmental challenges and opportunities facing the Bank in Mongolia are described in more detail in Section 3.4.

Mongolia submitted its intended nationally determined contribution (INDC) to the UNFCCC in September 2015, and ratified the Paris Agreement on 21 September 2016. The INDC adopted by the Parliament provides for a 14 per cent emissions reduction compared to business as usual by 2030, and estimates an implementation cost of US $3.5 billion. The conceptual foundation of Mongolia’s INDC is provided by the Government’s Green Development Policy, adopted in 2014, and is complemented by the National Action Programme on Climate Change (NAPCC), endorsed by the Parliament in 2011.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

Mongolia is an early transition country with vast natural resources but a still nascent private sector outside of the extractive industries. The economy remains closely tied to China and heavily reliant on the boom-and-bust commodities cycle. Managing the country’s substantial mineral wealth transparently, while at the same time charting a course to a more resilient, diversified and competitive economy, is thus crucial to its long term prospects. Upgrading supply chains, developing sustainable transport and municipal infrastructure and promoting good governance inside and outside the extractive sector are all necessary to attract greater investment and catalyse private sector development. As the largest foreign investor in the country, the EBRD is well placed to help Mongolia leverage its natural endowments in a way that will increase value added, enhance economic resilience and generate broad-based, inclusive growth. To that end, the Bank will support resilience by focusing on strengthening the competitiveness and the efficiency of non-extractive sectors at every level (management, operations, environment, logistics), leveraging its multi-instrument proposal, ranging from stand-alone technical cooperation to direct financing. It will also seek opportunities to leverage investment to ensure equitable development across Mongolia’s regions.

In this context, the following strategic themes are proposed to guide the Bank’s engagement with Mongolia in the forthcoming strategy period:

- **Theme 1: Enhancing Mongolia's resilience by strengthening the competitiveness of the non-extractive sector and easing access to finance:** While Mongolia's investment climate (among the best in the region) is conducive to innovation and entrepreneurship, much of the economy is still dominated by low-value added unprocessed minerals and agriculture, making it highly vulnerable to external shocks and commodity cycles. Standards of corporate governance and business conduct are low, value chains are under-developed, and the agriculture sector suffers from low quality and poor hygiene standards. In this context, the Bank will look to support the non-extractive sector to help broaden Mongolia's economic base and make the economy more competitive and resilient. In particular the Bank will enhance local corporate and SME competitiveness by financing projects that promote innovation, skills transfer and improved corporate governance, with a focus on agribusiness, construction materials, light manufacturing and services. The Bank will also facilitate improved access to finance, particularly in local currency, by continuing to provide partner banks with dedicated credit lines and risk sharing facilities, with a focus on SMEs, value chain finance and energy efficiency, and actively engage in the development of local currency and capital markets in order to further increase the resilience of the economy.

- **Theme 2: Leveraging a well-governed mining sector to enhance sustainability and maximise value creation:** Development of large expansion and exploration projects will be the key driver of economic growth in the coming years, but the sector requires further reform and investment to maximise value creation and ensure sustainable and inclusive growth. The effective implementation of mining sector projects can also provide opportunities to enhance competitiveness and value added content of domestic industries linked to mining through supply chains. The Bank will thus continue to support responsible mining, in particular through foreign investment, and will seek to deepen value-chain opportunities through upstream financing (both value chain and factoring) and deeper downstream processing.

- **Theme 3: Improving the quality and sustainability of infrastructure services through increased efficiency, commercialisation and "green" solutions:** Modernising and further developing Mongolia's infrastructure is crucial to meeting growing demand from mining and other industries, facilitate mineral exports and support non-extractive sector development. Transport, municipal and energy infrastructure all remain underdeveloped, with weak legal and regulatory frameworks, inefficient but dominant state-owned companies, low tariffs and constraints on private sector participation. The Bank will seek to develop bankable structures for financing creditworthy entities like the City of Ulaanbaatar on a sovereign/sub-sovereign basis. The financing of municipal infrastructure in secondary cities will continue to require a sovereign guarantee, and will be subject to sovereign borrowing space. The Bank will also look to enhance connectivity and regional integration through rail and road projects, and support PPPs in the energy sector with a view to introducing state-of-the-art technologies and renewable (wind and solar) energies.

3.2 Key challenges and Bank activities

Theme 1: Enhancing Mongolia's resilience by strengthening the competitiveness of the non-extractive sector and easing access to finance

Transition Challenges

- The economy remains vulnerable to boom-and-bust cycles due to the high extractives share, while most jobs are being created in other sectors, including services. Minerals account for around 80 per cent of total exports, mainly bound to China. Overall, greater diversification of export destination markets is needed.
- The business environment for private enterprise needs to be improved further, especially in the areas of corporate governance and business conduct in the non-extractive sectors. Public administration capacity and the judiciary need to be strengthened to further promote new entry and exit of MSMEs in manufacturing and services sector.
- There is a scope for improving the productivity and efficiency of companies along the value added chain. At the same time, a lack of market-oriented skills has hindered the competitive development of value added activities – with vocational training often not providing skills that match the needs of the private sector.
- Standards in hygiene, quality and traceability through all stages of production, processing and distribution are low, which, when combined with substandard infrastructure in rural areas, are holding back the development of a more competitive and marketable agriculture sector in general.
- Access to land remains a major impediment to private sector development, according to BEEPS V. Eliminating corruption, streamlining property-related bureaucracy and ensuring transparency in land sales and property registration are all needed. There is also an insufficient supply of modern and well-designed residential and commercial property.
- An underdeveloped banking sector and non-existent capital markets put particular pressure on MSMEs. Access to finance remains the top obstacle for Mongolian firms, despite the relatively high share of firms with bank loans. However interest rates are at times very high and almost all recent loans have required collateral, which constrains the ability of firms to obtain credit, particularly those newly established.
- Internal practices in the banking sector, including corporate governance, risk management and consumer disclosure all require improvement. The supervisory role of the Central Bank needs to be strengthened, along with the regulatory framework and market institutions, including by facilitating the operations of a Deposit Insurance Agency and privately-owned Credit Information Bureau. The Central Bank is working to improve its governance and further clarify its goals. The Law on Banking is expected to be revised by end 2017.
- Capital markets are characterised by low liquidity and limited trading, clearing and settlement infrastructure, an insufficiently developed legal and regulatory framework and a small pool of investors.

Operational Response

- The Bank will continue to support competitiveness in the non-extractive private sector by providing direct, as well as intermediated, debt and equity finance to both corporates and SMEs, with a particular focus on agribusiness, construction materials, and light manufacturing sectors, as well as services. The Bank will prioritise sectors where Mongolia can best take advantage of enhanced export opportunities to large markets, particularly China (including by certification of agriproducts and improvement of health and safety standards, which would provide a competitive advantage to niche exports like cashmere).

- Investments will be complemented by the Bank's Advice to Small Businesses services in order to build export capacity, promote entrepreneurship and support SMEs in meeting market demand. These services will provide specialised training with an emphasis on developing agribusiness (dairy, meat and cashmere in particular) and energy efficiency for industry. The Bank will also seek to promote enhanced vocational training and work-based learning in order to address the skills mismatch in the private sector areas with the most job-creation potential, with a particular focus on the agribusiness sector. The Bank will also promote best practices in equal opportunities policies with corporate clients.
- The Bank will seek to strengthen value chains by working alongside established aggregators (e.g. export-oriented buyers, local processing companies, off-takers) and their suppliers, developing value chain financial products (pre- and post-invoicing), supporting Mongolian exporters by providing trade finance credit lines through partner banks, and backing foreign investments in non-mining companies. Through its projects, the Bank will seek to support the introduction of processes and technologies that are new and innovative for Mongolia (including by further developing IT infrastructure), enhance quality standards and improve governance and business practices. Agribusiness and primary agriculture will require new farming techniques and new distribution / export channels that the Bank will explore with reputable companies.
- At the same time, to help private businesses sell their goods and services domestically in a country where the state still plays an important role in the economy, the Bank will continue to support the development of transparent and competitive public e-procurement.
- To improve access to finance for the private sector, the Bank will continue to deploy risk sharing facilities and credit lines via local partner banks and microfinance institutions, with a focus on facilities supporting improved competitiveness, SMEs, and energy and resource efficiency, and will explore targeted financing for women-led businesses in the country through PFIs. The Bank will also support frameworks to broaden access to finance by SMEs such as leasing, factoring and the Credit Bureau.
- In order to enhance the resilience of the financial sector, the Bank will continue to support de-dollarisation and further development of local currency capital markets, including by providing advisory on strengthening money market and derivative instruments, with a view to easing FX liability management for banks. Further to this end, the Bank will aim to provide firms and partner financial institutions with long-term local currency finance. To diversify its sources of local currency funding, the Bank will continue issuing MNT bonds.
- The Bank will also deploy technical cooperation to help the Mongolian Stock Exchange improve its operational capacity.
- The Bank may build on the IMF programme and provide broad-based policy support to promote diversification and economic resilience. The Bank stands ready to assist the Central Bank in enhancing banking supervision and promoting early intervention practices. In particular, the Bank will continue working on various aspects of financial policy and the regulatory framework, as a follow up to previous policy dialogue, including improvements of mortgage, pledge, non-bank financial institutions and

factoring laws, and credit bureaus. New topics of NPL recovery and deposit insurance and protection of depositors will also be explored to help the banking sector navigate the current downturn.

Results Framework for Theme 1: Enhancing Mongolia's resilience by strengthening the competitiveness of the non-extractive sector and easing access to finance

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	There is a substantial scope for improving the productivity and competitiveness of the private sector	**Increase governance and business conduct standards in non-mining sectors, support high value added activities**	• Provide direct and intermediated debt and equity finance, with a focus on agribusiness, construction materials, light manufacturing and services • Support non-mining FDI, work alongside established aggregators and develop value chain financing • Introduce new and innovative processes and technologies, enhance quality standards and improve governance and business practices, including by promoting equal opportunities in the workplace for men and women • Help improve human capacity through ASB (incl. specialized training to build export capacities), vocational training and work-based learning	• Volume of FDI inflows facilitated by the entry of foreign investors *(Baseline- 0)* • Number of clients (and qualitative account) that introduced innovative processes and technologies, enhanced quality standards and improved governance and business practices, including equal opportunities, with the Bank's support *(Baseline – 0)* • Number of ASB clients reporting increased productivity *(Baseline – established at projects' approval)*
1.2	The banking sector is underdeveloped and capital markets are nearly non-existent	**Support improvement of practices in the banking sector and development of capital markets**	• Deploy risk sharing facilities and credit lines via PFIs, including in LCY, with focus on competitiveness, SMEs (incl. women-led), exporters and resource efficiency • Continue issuing MNT bonds and provide firms and PFIs with LCY, whenever possible • Support de-dollarisation and further development of LCY markets through advisory on strengthening money market and derivative instruments	• Volume/Number of sub-loans disbursed by partner financial institutions directly with EBRD's finance, as targeted (e.g. MSMEs,women-led SMEs, LCY, RE, factoring - as specified at project level) *(Baseline – established at projects' approval)* • Volume/Number of new instruments (e.g. MTN bonds, money market, derivative instruments - as specified at project level) introduced *(Baseline – 0)*
	Context indicators: WEF GCI's Goods market efficiency *(Baseline 2016-2017 score - 4.0; rank - 104 out of 138)* % of firms identifying access to finance as a major constraint (*Baseline 2013 – 31.7%, World Bank / EBRD Enterprise Surveys)*			

Theme 2: Leveraging a well-governed mining sector to enhance sustainability and maximise value creation

Transition Challenges

- For the mining sector to become an engine of inclusive, sustainable growth, regulatory practices in the sector will need to be improved, including by promoting greater transparency in the licencing process. Integrity, safety and environmental sustainability standards need to be upgraded. Developing well-functioning institutions and further improving and effectively implementing existing legislation to ensure a stable, well-governed and investor-friendly business environment are also essential.
- Domestic industries related to natural resources remain low on the value chain, and linkages between the mining sector and local suppliers underdeveloped. Although mining projects can take time to develop, increasing competitiveness and value-added along mining supply chains would help private companies not directly involved in the extractive sector to leverage off the mining sector's development, and create favourable conditions for economic diversification. Promoting good practices to ensure that the benefits of mining trickle down to men and women in local populations is also important to ensure the inclusiveness of the sector.
- The effective regulation of the mining sector also needs to be improved, primarily by strengthening the independence and technical capacity of the regulatory bodies to ensure transparent and sustainable revenue management, accompanied by prudent fiscal policies. A well-developed Future Heritage Fund could provide a useful vehicle in this regard.

Operational Response

- The Bank will continue to finance projects in the extractive sector (including independent downstream oil companies), provided they are consistent with the Bank's high operational and environmental standards based on the use of efficient technologies and pollution prevention and control methods in line with best available techniques (BAT) as per its Environmental and Social Policy. Selected reputable foreign investors committed to sustainable mining practices will be supported with debt and equity finance, including at an early stage. However, no major increase in mining investments is envisaged in the medium term, as project preparation usually extends over a long timeframe.
- To further improve the conditions in the natural resources sector, the Bank will continue to support the global Extractive Industries Transparency Initiative (EITI) to promote transparency in the industry, and will also support improvements to existing mining legislation to ensure a stable and investor-friendly environment. The EBRD has been providing TC grant funding to help implement the initiative in Mongolia since 2010. Mongolia is performing well, becoming one of the first countries to become EITI compliant. Building on its existing work, the Bank will start a third phase of its TC aiming at extending EITI outreach and increasing awareness at the local level, including publication and public dissemination of revenue data from the extractives industry.
- Bearing in mind the lengthy time required to fully develop most mining projects, the Bank will work to develop the upstream mining value chain (e.g., light equipment and clothing services, catering, equipment leasing and transportation companies), in particular for SMEs contracting with mining companies. The Bank will provide

necessary financing to those SMEs, preferably with/through local commercial banks, as well as technical cooperation to improve their competitiveness and efficiency in order to be able to bid successfully for contracts.

- The Bank will also seek opportunities to support deeper processing of minerals with significant export potential, thereby adding value to the industry.
- In response to a request by the mining authority, the Bank will explore TC options for establishing a database of the Geological Information System (GIS), thereby creating an open and transparent map of the country's mineral deposits.
- The Bank will also support improvements in the capacity of Mongolia's Future Heritage Fund, focusing on areas such as procurement practices.
- The Bank will explore opportunities to promote women's participation in the mining sector through equal opportunities projects with selected clients and to promote women-led MSMEs' participation in the mining supply chain.

Results Framework for Theme 2: Leveraging a well-governed mining sector to enhance sustainability and maximise value creation

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	Domestic industries related to natural resources remain low on the value chain and linkages between the mining sector and local suppliers are underdeveloped	**Increase value-added along mining supply chains to leverage the mining boom and create favourable conditions for economic diversification**	• Contribute to development of a sustainable mining sector by financing companies in the extractive sector that meet the highest standards of integrity, safety and environmental sustainability; promote best practices in the promotion of equal opportunities in the mining sector; provide equity and debt financing to selected foreign investors • Provide financing and technical assistance to SMEs (including women-led) contracting with mining companies to develop the upstream mining value chain	• Number of clients where standards or practices (e.g., on EITI transparency standards or environmental management or equal opportunities practices - as specified at project level) improved to the agreed level *(Baseline – 0)* • Volume/Number of sub-loans disbursed by partner financial institutions directly with EBRD's finance, as targeted in mining (e.g., MSME, women led SMEs-as specified at project level) *(Baseline – 0)*
2.2	Regulatory practices in the mining sector need to be improved, including by increasing transparency	**Assist with establishing a well-governed and investor friendly environment in the mining sector**	• Implement the third phase of the technical cooperation assistance aimed at extending Extractive Industries Transparency Initiative (EITI) outreach and awareness to the local level • Explore options to provide TC on establishing database of the Geological Information System (GIS) • Support improvements in existing mining legislation to ensure a stable and investor-friendly environment	• Regulatory progress to advance EITI outreach to the local level, as well as in increasing the transparency of extractives revenue data (Baseline – N/A) • Legal improvements in mining legislation and regulations promoting a level-playing field in the sector *(Baseline – N/A)*
	Context indicator: *Number of companies reporting their revenues captured by the EITI (Baseline 2014 – 992)*			

Theme 3: Improving the quality and sustainability of infrastructure services through increased efficiency, commercialisation and "green" solutions

Transition Challenges

- Utilities in the water and wastewater sector are underdeveloped due to lack of investment, operated inefficiently and require commercialisation and corporate restructuring. Advancements in regulation, development and application of a modern tariff methodology and an increase in collection rates, together with improvements in water quality, resource efficiency and water and wastewater infrastructure and services are all needed.
- In urban transport, publicly owned companies would benefit from greater autonomy, including in developing contractual arrangements with municipalities. Greater private sector participation is also needed to improve the quality of services and operational performance and raise environmental standards.
- Road construction and maintenance suffer from insufficient funding, and a lack of transparency and competition in contracting. Regulatory practices, particularly in public procurement, should also be made more transparent.
- The lack of railway capacity is a significant constraint and a bottleneck to more balanced, sustainable growth. Modernisation of the existing railways and development of new networks, to be partly privately funded under PPP structures, and employing "green" aspects where feasible, are becoming increasingly urgent challenges.
- Modernisation of the power generation system is also critical to meet the growing power demands from mining and other industries, as well as serve the population in an efficient and environmentally sustainable manner. Corporatisation of state-owned companies and replacement of outdated and inefficient infrastructure are necessary. The independence of the regulator in the power sector also should be strengthened and methodologies reviewed to make tariffs cost-reflective.
- There is an ample scope to deploying and mainstreaming "green" solutions in industries, agriculture, infrastructure and energy. The legal and institutional framework supporting renewable energy is insufficiently developed and tariffs for end-consumers are not cost-reflective. Capacity needs to be strengthened for effective implementation of carbon finance projects.

Operational Response

- The Bank will help develop commercially and environmentally sustainable solutions for Mongolia's municipal infrastructure, by financing municipal companies on a sovereign (subject to sufficient borrowing space) and sub-sovereign basis, the latter in Ulaanbaatar. The Bank will couple this with technical cooperation to support effective financial management of municipal companies' and cities' budget structures, with a view to assisting them in designing efficient tariff and collection mechanisms for utilities and other services. Early success may pave the way for future opportunities by demonstrating the viability of these projects, and the Bank will concentrate initially on visible smaller projects, recognising that tariff reform may take longer to implement. Municipal projects will need capital grant contribution at early stage to enable more gradual increase of tariff towards cost-recovery.
- The Bank will seek opportunities to support development of transport infrastructure, in particular railway infrastructure and rolling stock, which is seen as a high priority

by the Government notwithstanding high levels of public debt. Such investments will not only increase the country's competitiveness as an exporter of mineral resources, but will also enhance regional integration and inclusion. They will also decrease the reliance of mines in the South Gobi on truck transportation, which has a significant environmental impact (dust, usage of fuel, etc.). In the road sector, the EBRD will seek to contribute to further development of the "Steppe Road" transport corridors, in cooperation with other MDBs (including, possibly, the AIIB) and encourage PPP structures where possible. To this end, the Bank will also continue to support the development of an appropriate regulatory framework for PPPs, as well as increased government capacity in implementing such structures.

- The Bank will continue to support development of logistics and warehousing centres that can address Mongolia's increasing transportation and logistics costs, which at present are reliant on foreign (mostly Chinese) intermediaries.
- Following the successful implementation of the Salkhit wind farm and signing of the Tsetsii wind farm (both 50MW) with SoftBank as anchor investor, it will continue to look for opportunities to finance renewable energy, in particular wind and solar, with reputable investors. The Bank will also explore development of routes for renewable energy transmission within the country and abroad as another potential business area.
- The Bank will also support the Government's goal of achieving a 20 per cent share of renewable sources in the country's electricity mix by 2023 by helping develop a transparent and efficient tendering process for renewable energy investments. This work will require a substantial grant component.
- The Bank will support less energy intensive solutions by providing pre-financing advisory on energy efficient equipment (energy audit) and facilitating access to energy efficiency project financing.
- The Bank will also seek to contribute to the development of state-of-the-art, green and least carbon-intensive energy solutions, utilising PPP structures where possible. Where new energy generation solutions are based on the use of coal as fuel, such as the Ulaanbaatar Thermal Power Plant No.5 project (CHP-5), a proposed 450-MW coal-fired combined heat and power station, any Bank financing would need to meet the requirements of the Bank's 2013 Energy Sector Strategy.

Results Framework for Theme 3: Improving the quality and sustainability of infrastructure services through increased efficiency, commercialisation and "green" solutions

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
3.1	Utilities are operated inefficiently and require commercialisation and corporate restructuring	**Promote and support commercial and environmentally sustainable solutions in developing Mongolia's municipal infrastructure**	• Provide financing to municipal companies on a sovereign or sub-sovereign basis • Support development of efficient tariff and collection mechanisms for municipal utilities and services	• Number of municipal companies with improved efficiency (e.g., reduced costs/employees) through new technology, skills, standards, restructuring - as specified at activity level) *(Baseline – 0)* • Number of municipal companies with improved performance ratio as per identified key metric (e.g., collection rate; cost savings; waste reduction - as specified at activity level) *(Baseline – 0)*
3.2	Greater private sector participation is needed to improve the quality of transportation services and address the lack of railway capacity	**Support development of transport infrastructure and supporting services by promoting PPPs and private sector participation**	• Invest in railway infrastructure and rolling stock, and seek to contribute to development of "Steppe Road" transport corridors, in cooperation with other MDBs • Support development of the regulatory framework for PPPs by strengthening the authorities' capacity in undertaking and implementing concessions and PPPs • Finance development of logistics and warehousing centres to address Mongolia's increasing transport costs	• Transport services transferred to private sector though performance-based arrangement with a targeted mechanism (e.g., management contract, lease, outsourcing - as specified at activity level) *(Baseline – N/A)* • Number of logistic companies and warehousing centres with performance ratio improved as per identified key metric (e.g., collection rate, cost savings - as specified at activity level) *(Baseline – 0)* • Legal and regulatory frameworks in concessions and PPPs improved – as specified at activity level (qualitative account) *(Baseline – N/A)*
3.3	Modernisation of the energy sector is critical to meet the growing power demands in an environmentally sustainable manner	**Develop state-of-the-art, green economy energy solutions, utilising PPP structures**	• Finance renewable energy projects, in particular wind and solar, with reputable investors • Support the Government's goal of achieving a 20% share of renewable sources in the electricity mix by 2023 by helping develop a transparent and efficient tendering process for renewable energy investments	• Renewable energy generated with the Bank's support in MWh/y *(Baseline – 0)* • Regulatory frameworks in tendering process for renewable energy investments improved– as specified at activity level (qualitative account) *(Baseline – N/A)*

	Context indicator: Doing Business Trading across Borders Indicator (Baseline 2017 rank – 103 out of 190; DTF – 66.89%) Δ in carbon emission intensity *(Baseline 2014 – 1.59 kgCO2/ 2010 USD GDP; IEA)*

3.3 Potential Risks to Country Strategy implementation

The proposed Country Strategy builds upon the strengths of the country, yet is realistic in focusing on improving SME competitiveness and financing infrastructure. The EBRD's ability to deliver on its strategy nonetheless will be influenced by a number of factors outside of its control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with its clients, IFI partners and the Government.

Specific risks to the Strategy implementation include:

- **Implementation of the IMF programme.** The overall macroeconomic situation and the ability of the Government and state agencies (like the Development Bank of Mongolia) to refinance its bonds at a reasonable rate will largely depend on the credibility of the IMF programme and its pace. Should the programme not be implemented in full and on time, the markets would certainly not be willing to participate in sovereign or quasi-sovereign bonds refinancing, thus affecting FX stability, the country's rating and budget balancing.

- **Further depression of commodities prices.** Mongolia is highly dependent on commodities prices, mostly coal, iron, gold and copper. A further decrease of coal prices would impact many companies exporting coal, as well as the balance of payments. A decrease in iron prices would have less impact, but would affect greatly some of the EBRD clients, including partner banks having some exposure to iron exporters. A deterioration of gold and copper could lead to a delay in the implementation of Oyu Tolgoi, thus affecting local suppliers to the mine's second phase.

- **Instability of investment climate.** The 2012 changes to Monoglia's foreign investment laws greatly impacted the country's attractiveness as an investment destination. The current foreign investment law, as well as the current mining law, have since improved the overall investment climate, but any change would add uncertainty that could damage foreign investment, which remains critical for the EBRD to implement successfully the new strategy, in particular in the mining sector. Despite improvements in the legal framework, inconsistent and discretionary application of laws and regulations impose additional risks on investors, including the EBRD.

- **Macro-economic risks.** The economy is gradually adjusting to external pressures that led to the slowdown. However low commodity prices, subdued growth in China and economic challenges in the US and the EU continue to depress growth, which is exacerbated by the negative impact of political instability on consumer, business and investor confidence. In the short run, the country will continue to largely rely on commodities exports to drive growth. Internally, the banking sector remains a concern, as the sector faces lack of long-term MNT liquidity, a high level of dollar exposure and legacy (and increasing) NPLs.

- **Continued availability of local currency finance**. Interest rates in MNT and USD remain very high and have put pressure on banks' funding costs. The Central Bank is no longer in a position to offer long-term, affordable SWAP arrangements with local banks. Any further tightening could have pronounced effects on the Bank's lending to local corporates and SMEs and/or its ability to issue additional MNT-denominated bonds.

- **Increased credit risk in the banking sector.** Given the Bank's limited ability to engage with more systemic banks, it will need to channel its lending programmes through existing partner financial institutions or second-tier banks. However additional credit risks may arise as the Bank begins to engage with these lower tiers of the banking sector, including, for example, high concentrations, potential balance sheet distortions related to recent mergers, acquisition and restructurings, and lack of an established track record.

3.4 Environmental and Social Implications of Bank Proposed Activities

Mongolia faces a number of environmental and social challenges related to its location, climate and potential impacts of climate change going forward, as well as socio-economic factors and fast-paced transformation. The rapid population growth in key cities, Ulaanbaatar in particular, caused by influx from rural areas, poses challenges in the development of robust municipal environmental infrastructure. In addition to infrastructure issues, urbanisation has also resulted in significant negative impacts to air quality in key cities related to the use of coal to generate heat and power, both centrally, but also within the 'ger districts' on the periphery of most cities where recent arrivals to the city build settlements with individual coal burning stoves. There are significant human health impacts in relation to these challenges and the Bank will continue to work with industry, the Government and other IFIs in seeking solutions through project and TC related initiatives.

The three main themes in the current strategy each carry environmental and social implications for the Bank's work in the country, both in terms of the requirements associated with project implementation, but also the TC support and policy dialogue required to promote the transition objectives of the Bank in Mongolia.

- Enhancing the resilience and efficiency of the non-extractives sector will, due to the nature of industries and commerce within Mongolia, focus on the SME sector. Building environmental and social risk management capacity within clients' organisations within this sector will be a primary focus and may require TC support at the project level.
- Leveraging the mining sector will often involve the development and implementation of complex projects with significant potential impacts, both positive and negative, to environmental media, including biodiversity, the local population, and its cultural heritage. The Bank now has considerable experience in such projects and has a series of mitigation measures and strategies available to deal with such risks and opportunities. This is described in more detail below.
- Development of sustainable infrastructure will entail the implementation of projects in the Municipal Environmental Infrastructure and Transport sectors involving, *inter alia*, water supply; wastewater treatment; solid waste collection, treatment and disposal; and road and rail construction and operation. There are obvious environmental and social risks and opportunities associated with such projects that will require application of the Bank's Environmental and Social Policy, but there are also challenges in relation to the development of policy dialogue with the Government and capacity building within the regulatory bodies. TC support, already being

developed in the solid waste sector, will be required to address these challenges in all the sub-sectors.

In the energy sector, the Bank may be requested to consider investments in new power generation capacities, including coal-fired generation. Any Bank assessment would be undertaken in close coordination with other participating IFIs and donors, and include an analysis of alternatives and carbon capture and storage feasibility as well as be subject to a comprehensive Environmental and Social Impact Assessment ("ESIA") inclusive of a participatory public disclosure and consultation process. In addition, any Bank financing for coal-fired generation would need to comply with the specific requirements set out in the 2013 Energy Sector Strategy.

There are a number of initiatives in Mongolia in relation to legally protected or internationally recognized areas of biodiversity value. These include Specially Protected Areas and Important Bird Areas which are present throughout the country, and in particular in the Gobi regions where a number of natural resources projects are, and will be, located. Projects considered by EBRD in the vicinity of areas with a specific protection status should be developed in consultation with the appropriate authorities, both at the Aimag and central government level, in order to minimize the risk of adverse impacts and seek synergies and cooperation opportunities. TC funds could be used at various levels to support initiatives aimed at boosting such synergies or restoring biodiversity. The Bank has been involved in such capacity building initiatives at the regional level for a number of years and this should continue both on the regional as well as the local levels where possible.

Occupational safety and health (OSH) is a key area that EBRD will be carefully reviewing in individual project appraisals. Mongolia has only ratified two of the ILO OSH conventions, those pertaining to the general OSH and to Mining, while other key conventions, such as Construction, remain unratified. Road safety standards need to be improved and vehicle accidents are common, with the WHO estimating 21 road deaths per 100,000 population annually (the global average is 17), and ranking the country at level 3 (out of 10) in regard to enforcement of road safety legislation. This lack of institutional capacity in regard to the development of enforcement and technical knowledge is noted across many industrial sectors. Where deemed necessary, EBRD will consider providing support through TC funds to communities and clients to improve road safety, especially around public service vehicles and occupational road risks.

In regard to employment Law, Mongolia has ratified all eight ILO core conventions and taken steps to ensure alignment of the domestic legislation with the conventions. To that end, legislative acts have been adopted or amended, such as the Law on Combating Human Trafficking, Law on the Promotion of Gender Equality and the Law on State Employment. However, overarching issues remain around access to justice for workers, particularly relating to termination of employment, and further amendments will be needed, in particular to the labour code. While the labour inspectorate is lacking in capacity and data with which to carry out and guide interventions, the revisions to the criminal code adopted in December 2015 and the proposed revisions to the labour law affirm Mongolia's commitment to aligning its labour governance to international standards and norms. Gender discrimination regarding the types of jobs that women can do also still remains in Mongolian legislation. Under the GSP+, the EU will continue to monitor the binding undertaking given by Mongolia to observe the reporting obligations under the relevant conventions. An EU-funded project called 'Support to Employment Creation in Mongolia (SECiM)' was signed in May 2015 and a related technical assistance (TA) to the Ministry of Labour should be in place by the first semester of 2016. This technical assistance will assist the government in improving the functioning of the labour market and enhancing quality employment.

About one third of Mongolia's population is dependent on herding for survival and projects involving the acquisition of land can be expected to have livelihood impacts even in the more remote and/or overgrazed areas of the country. Currently, pressures on land tend to be concentrated in certain areas in and around the capital, as well as some fast developing regions, e.g. in parts of the South Gobi. Cumulative pressures on pastures and groundwater need to be well understood, and collective approaches to sustainable land, water, and herd management need to be identified and adapted for project-specific implementation.

The on-going involvement of the EBRD in the extractive sector in Mongolia will require particular attention from an environmental and social point of view: meeting good international practices and ensuring transparent stakeholder engagement will be essential. The country presents a unique environment for the Bank in terms of the interactions of risks associated with impacts to water resources, waste management, biodiversity, and local communities. In particular, the EBRD has been involved in water conservation and water management issues (along with other IFIs) with the national government, regional authorities, industry bodies (Mongolian Mining Association) and the private sector. Given the unique water situation in Mongolia (where there is a relative abundance in some areas and a strict shortage in others) this will be a crucial area for continued involvement leveraging TC funds on priority items, especially given that the national government is currently involved in long term water planning on a national scale.

Mongolia also has a rich cultural heritage that needs to be protected. Greenfield infrastructure projects and construction works should therefore be developed in consultation with the appropriate authorities and the affected communities in order to devise approaches needed to avoid or mitigate potential adverse effects.

The Bank will continue to monitor and consider technical support and capacity building as appropriate to its clients in order to maintain a high level of stakeholder engagement to ensure that stakeholder concerns and priorities are understood and taken into account in decision making processes.

3.5 EBRD co-operations with MDBs

Cooperation with other IFIs in Mongolia is close, both on investment and policy dialogue, despite the fact that 100 per cent of the portfolio is currently in the private sector. The Bank is recognised by the authorities and other donors as being the most active IFI in supporting the private sector in Mongolia.

The Bank will continue its engagement with existing IFIs and will be open to co-financing opportunities with the newly established Asian Infrastructure Investment Bank (AIIB).

In the **financial sector**, the International Finance Cooperation (IFC), the Asian Development Bank (ADB), and Financierings-Maatschappij voor Ontwikkelingslanden (Netherlands Development Finance Company, or FMO) are providing equity and/or credit lines to local banks, NBFIs and to an equity fund for MSME financing alongside the EBRD. The European Union (EU), under its Asian Investment Facility, is also active in Mongolia on **SME**

development, providing €9.3 million co-financing, technical cooperation and small business support (financing the ASB until 2019).

In the **corporate sector**, the Bank has co-financed numerous projects with the IFC, including a large mining, hospital and a few agribusiness projects. The EBRD will seek risk sharing opportunities for large corporate sector projects with the IFC. Alongside the EBRD, the ADB, World Bank and IFC are the most active IFIs on **investment climate** issues. The IFC finalised in 2016 the law on movable assets pledge, while the ADB mostly supports corporate governance of SOEs. The Bank will closely coordinate its policy dialogue with the ADB and IFC, in particular on capital market and credit bureau development.

In the **renewable energy sector**, the EBRD has partnered with the Japanese International Cooperation Agency (JICA) as well as the FMO. The EBRD will seek to cooperate with the ADB on large municipal and transport **infrastructure projects** under sovereign guarantees that aim to improve regional and internal connectivity. With the AIIB, the EBRD may utilise opportunities to co-invest in infrastructure projects. Should the Millennium Challenge Corporation (MCC) develop a new Compact in 2018 focusing on municipal infrastructure, the Bank will aim at blending the MCC funds with sovereign or sub-sovereign lending.

ANNEX 1 – POLITICAL ASSESSMENT

Mongolia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank.

In more than two decades since the beginning of transition, the country has made significant progress on the path to pluralistic democracy and open market-oriented economy. Mongolia has a liberal Constitution, developed a competitive political party system and established a vibrant civil society. The media are free to report on a wide range of issues and there is an increasing adherence to the rule of law and respect for human rights, although many challenges remain.

A major challenge for the new government is to stabilise the economic situation as the country was affected by falling commodities prices, weakening of the national currency, and economic slowdown in neighbouring countries. The longer-term challenge for any Mongolian government is how to manage transparently the wealth generated by vast natural resources in a country with significant poverty levels.

Free Elections and Representative Government

Free, fair and competitive elections

The Constitution provides for a democratic government with universal suffrage.

Mongolia's electoral legal framework comprises the Constitution, the 2015 Law on Elections, the 2006 Law on the Central Election Body, the 2011 Law on the Automated Election System, and General Election Commission regulations. The new election law adopted in December 2015 consolidated various election laws, which was a positive development according to the International Election Observation Mission (IEOM) comprised of the Organization for Security and Co-operation in Europe Office for Democratic Institutions and Human Rights (OSCE/ODIHR) and the European Parliament (EP).[3] However, the May 2016 change of the mixed (party list plus majoritarian) electoral system to a solely majoritarian one resulted in profound population discrepancies among constituencies, and in practical elimination of smaller political parties not capable of forwarding strong candidates in all of the 76 single-mandate constituencies.

According to IEOM, the latest parliamentary elections of June 2016 "were highly contested and the freedoms of assembly and association were respected", while "election day proceeded in an orderly manner throughout most of the country".[4] The main opposition party until the 2016 elections, the MPP, made a landslide victory by winning 65 seats, while the DP won nine seats with the rest two seats being equally shared by the Mongolian People's Revolutionary Party (MPRP) and one independent candidate.

The latest presidential election was held in June 2013 with the DP nominee incumbent President Tsakhiagiin Elbegdorj being re-elected for his second term in office. The OSCE/ODIHR Election Observation Mission (EOM) noted that "the election was

[3] OSCE/ODIHR, International Observation Mission, Mongolia - Parliamentary Elections, Statement of Preliminary Findings and Conclusions, 29 June 2016, p.1
[4] OSCE/ODIHR, International Observation Mission, Mongolia - Parliamentary Elections, Statement of Preliminary Findings and Conclusions, 29 June 2016, p.2

characterized by a competitive campaign conducted in an environment that respected fundamental freedoms, although restrictive legal provisions prevented media from providing sufficient information to the voters."[5]

Separation of powers and effective checks and balances

Mongolia is a democratic and unitary republic. The head of state is the president, directly elected for four years. The Constitution limits the president to two four-year terms in office. The president has the power to veto legislation, but the laws or decisions shall remain in force if two thirds of the members present in the session of the parliament do not accept the president's veto. The prime minister is the head of government. All legislative power is vested in the State Great Khural, Mongolia's unicameral parliament, which has 76 members who are elected by popular vote for a term of four years. The judiciary is largely independent, but corruption is still an issue.

A separation of powers and responsibilities between the legislature, the executive, and the judiciary is enshrined in the Constitution. A formal separation of powers is laid out in the 1992 Constitution; however members of parliament simultaneously hold posts in the cabinet, a practice that has been allowed after the constitutional amendments in 2000. In 2014, the parliament argued that this practice undermines parliamentary rights by giving the cabinet too much power. However, the State Great Khural has been successfully exercising its oversight function in recent years, frequently summoning the ministers to parliamentary hearings.

Effective power to govern of elected officials

Mongolia's elected officials have considerable power to govern without constraints on their power.

The military is under firm civilian control and does not play a significant role in the political decision-making process.

Civil Society, Media and Participation

Scale and independence of civil society

Mongolia has a vibrant and, to a large extent, well organised civil society, which has played an important role in facilitating transition from communism to a pluralistic democracy since the early 1990s. Most civil society organisations (CSOs) are based in Ulaanbaatar. Herders and rural population are under-represented in various civil society groups due to the lack of financial support and limited access to information. However, grassroot activism on environmental issues has started to emerge in rural areas. The number of interest groups involved in environmental protection is growing steadily due to the expansion of mining sector.

CSOs focusing on human and women's rights issues have developed good partnerships, and have influence on policy-making and the legislature. The effectiveness of CSO engagement with public authorities depends on the personal attitude of a given government official, and

[5] OSCE/ODIHR, Presidential Election 26 June 2013, Mongolia, Election Observation Mission Final Report, 18 September 2013, p. 1

the type of the CSO. The legal framework for CSOs is rather liberal, though there are inconsistences in the implementation of the NGO law by state institutions.

Independence and pluralism of media operating without censorship

The media sector is vivid and free to report on a wide range of issues, however some outlets are affiliated with political actors and a few imposed restrictions on digital contents remain unclear. The law provides for freedom of speech and press; however political interference and restrictions on users to comment on internet sites has been noted. The sector is overseen by the Communications Regulatory Commission whose members are appointed by the government.

The Media Freedom Law, enacted in 1998, prohibits state ownership of media. Most outlets are owned directly or indirectly by political actors who exert some influence on their publications. According to IEOM, during the last parliamentary elections “the media offered extensive coverage, but abandoned its intermediary role, primarily granting access to the politicians”.[6]

Around 300 media outlets operate in Mongolia with television remaining the main source of information. Despite the growth of several privately-owned print and broadcast outlets alongside international media operating in the country, the main source of news for the vast countryside remains the state-owned Mongolian National Broadcaster. The internet penetration rate is growing rapidly, with 21.4 per cent of Mongolians having web access in 2015 compared to 10 per cent in 2009.[7] Politicians also campaigned extensively on social media platforms during the 2016 parliamentary elections.

Multiple channels of civic and political participation

The law requires that government expenditures be audited in a transparent process. Officials with authority to issue government funds are required to report the expenditures and the audit results on their respective ministry website.

In July 2014, the State Great Khural adopted the Budget Transparency Law (commonly called Glass Account Law) in order to ensure the efficient and proper use of state and local government funds, the transparency of decisions and actions concerning budget management and public overview of the same. The Law entered into force on 1 January 2015 and obliges all government agencies and legal entities with state involvement to make information on budgets and financial matters available to the public.

Freedom to form political parties and existence of organised opposition

Mongolia has a developed multiparty system including opposition parties. The legislation on forming independent political parties is observed in practice. The political process in the country is traditionally strongly influenced by the two major political parties – the MPP and the DP, successively replacing each other in government by gaining majority in parliament. Political parties are free to recruit members and campaign for office. The right to oppose government initiatives is legally protected and is observed in practice.

[6] OSCE/ODIHR, International Observation Mission, Mongolia - Parliamentary Elections, Statement of Preliminary Findings and Conclusions, 29 June 2016, p.10
[7] International Telecommunication Union (ITU) Statistics, “Percentage of Individuals Using the Internet,” 2000-2015

A citizen who is at least 25 years old and has full legal capacity is eligible to be a candidate. Twelve political parties and three coalitions were registered by the General Election Committee in the latest parliamentary elections. There were 498 candidates, including 69 independents, while only the MPP and DP contested all constituencies.[8]

In the current parliament the MPP has 65 seats, the DP nine, the MPRP one, and there is also one independent MP.

Rule of Law and Access to Justice

Supremacy of the law

Article 14 of the Constitution guarantees equality before the law of all citizens regardless of their ethnic origin, language, race, age, sex, social origin or status, property, occupation or post, religion, opinion or education.

All citizens have right to a fair trial and freedom from arbitrary arrest or detention.

The EU and international NGOs have raised concerns about a delay in implementation of the new criminal code (until the summer of 2017), which would, among other things, abolish the death penalty.

Independence of the judiciary

The Constitution provides for an independent judiciary and key safeguards are in place to ensure its impartiality. Nevertheless CSOs and citizens have reported cases of corruption in the judicial system.

Legislation on the judiciary includes the Law on Courts, Law on Legal Status of Judges, Law on Court Administration, Law on Legal Status of Citizens' Representatives. According to the Organisation for Economic Co-operation and Development (OECD), the judiciary remains susceptible to political influence and nepotism and the Judicial General Council should be brought in line with international standards. All judges are appointed for permanent tenure by the President of Mongolia upon proposal of the Judicial General Council. Nominations of the Supreme Court judges are first submitted to the parliament. The president is not bound by the Council's recommendation and may reject the successful candidates. In addition, according to the OECD, the composition of the Judicial General Council should be brought in line with international standards, as all its members are currently appointed by the president.[9]

Government and citizens equally subject to the law

The right to a fair trial is enshrined in the legislation and public officeholders are subject to prosecution when they violate the law. However, in practice officials who break the law and engage in corruption are not always or sufficiently punished.

[8] OSCE/ODIHR, International Observation Mission, Mongolia - Parliamentary Elections, Statement of Preliminary Findings and Conclusions, 29 June 2016, p.7-8

[9] OECD, Anti-Corruption Reforms in Mongolia, Joint First and Second Rounds of Monitoring of Istanbul Anti-Corruption Action Plan, report adopted on 9 October 2015, p.96-99

Effective policies and institutions to prevent corruption

Corruption remains an important issue at all levels of government. According to OECD, "criminal law of Mongolia remains incompliant with international standards on criminalisation of corruption."[10] In the progress update published in October 2016, the OECD assesses that there is lack of progress in aligning offences of active and passive bribery with international standards, due to the fact that the reform of the criminal code is on hold.[11]

The Independent Authority against Corruption (IAAC) is the body responsible for fighting corruption and deals with corruption prevention, public awareness-raising, investigation of cases, reviewing assets and income declarations of public officials. The Anti-Corruption Law of Mongolia requires from persons specified in the law to report to IAAC any corruption-related information, while the IAAC has wide powers in conducting undercover operations. One of the remaining issues that have been reported is the lack of effective supervision over political party finances, which promotes political corruption and vested interests controlling government institutions. Existing basic provisions on party finances are not enforced and are easily circumvented in practice.

Civil service is politicised, nevertheless despite efforts towards a merit-based appointment of civil servants, merit-based approach is not always implemented in the promotion of civil servants.[12]

According to the 2016 Transparency International Corruption Perceptions Index (CPI), Mongolia's ranking fell from 72nd to 87th place (out of 168 countries); however this decline was exaggerated by improvements in similarly ranked countries, with its score falling only one point, from 39 to 38. However there is no room for complacency on this issue, and reports of officials engaging in corrupt practices while being treated with impunity are worrying.

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

Mongolia is party to key international human rights conventions, including all core International Labour Organisation conventions. The country has a National Human Rights Commission. Its mandate includes the review of complaints on human rights and freedoms.

The law provides for the freedoms of assembly and association, entitles workers to form or join independent unions without any authorisation, and protects the right to strike and collective bargaining. Trade unions remain independent and active. The constitution recognises "freedom of conscience and religion" as a fundamental freedom of citizens.

The latest assessment of track record of Mongolia in the area of human rights in the framework of the United Nations Universal Periodic Review (UPR) was adopted in 2015. In

[10] OECD, Anti-Corruption Reforms in Mongolia, Joint First and Second Rounds of Monitoring of Istanbul Anti-Corruption Action Plan, report adopted on 9 October 2015, p.5
[11] OECD, Istanbul Anti-Corruption Action Plan, Fourth Round of Monitoring, Mongolia, Progress Update, October 2016, p. 12-13
[12] OECD, Anti-Corruption Reforms in Mongolia, Joint First and Second Rounds of Monitoring of Istanbul Anti-Corruption Action Plan, report adopted on 9 October 2015, p.6

the course of this cycle, the top three recommendations included Rights of the Child (27.11 per cent); Women's Rights (23.49 per cent); International Instruments (18.67 per cent). Mongolia accepted 91.57 per cent of a total of 166 recommendations.[13]

Political inclusiveness for women, ethnic and other minorities

Equal rights, including equal pay for equal work and access to education, for women and men are enshrined in the Constitution but the elimination of discrimination against the former in practice in a variety of contexts, including employment and family, remains a challenge.

According to the Election Law, 20 per cent of the candidates proposed by a political party of coalition shall be women. In the last parliamentary elections all parties and coalitions complied with this gender quota, resulting in 26 per cent of contestants being women. Despite this measure, only 13 of the 76 members of the current parliament are women; women thus remain underrepresented and below the current OSCE average of 24.4 per cent.[14] However, as noted by IEOM there were no women in more than one-third of the constituencies.[15] It should be noted that the two major parties, the MPP and DP, had the lowest percentage of women candidates, 21 per cent both, while smaller parties nominated a larger percentage of female candidates. Overall women remain underrepresented at the political level.

Ethnic minority groups in Mongolia make up around 18 per cent of the population. There are no legal impediments to the participation of ethnic minorities in politics. The UN Special Rapporteur has recognised the steps that have been taken to protect the rights of ethnic minorities and has welcomed the measures taken to improve access to information in minority languages. However, she has noted that ethnic minorities are still not able to fully participate in Mongolian society.[16] Isolated acts of violence mainly against Chinese residents in Mongolia continue to be an issue.

There is no law prohibiting discrimination on the basis of gender identity or sexual orientation, but there were reported cases of discrimination and violence against LGBT (lesbian, gay, bi-sexual and transgender) persons. A high proportion of LGBT community is living in poverty due to difficulties in finding employment or receiving sufficient education because of stigmatisation.[17]

Freedom from harassment, intimidation and torture

The law prohibits torture and other cruel, inhuman, or degrading treatment or punishment. However, there were reports that police abused some prisoners and detainees, while human rights CSOs have reported obstacles to gathering evidence of torture or abuse. Conditions in some detention centres remain poor, with CSOs reporting overcrowding, insufficient medical care, clothing, bedding and food, and problems with the accommodation for persons with disabilities.

[13] United Nations, Universal Periodic Review (UPR), Mongolia and UPR Info Statistics available at http://www.upr-info.org/database/statistics/index_sur.php?fk_sur=115&cycle=2
[14] Parline. 2014. *Mongolia*. http://www.ipu.org/parline-e/reports/2219_A.htm
[15] OSCE/ODIHR, International Observation Mission, Mongolia - Parliamentary Elections, Statement of Preliminary Findings and Conclusions, 29 June 2016, p.2
[16] UN Report of the Special Rapporteur on extreme poverty and human rights, Mission to Mongolia, 30 May 2013, p. 11
[17] UN Report of the Special Rapporteur on extreme poverty and human rights, Mission to Mongolia, 30 May 2013, p. 13

The UN Committee Against Torture stated in its Concluding Observations on the Second Periodic Report of Mongolia in September 2016, its concern at the postponement of the entry into force of the new Code of Criminal Procedure. It noted that while the new Code contained a definition of torture, there were still deficiencies, including on punishments.[18]

[18] United Nations Office of the High Commissioner for Human Rights, Committee Against Torture, Concluding Observations on the Second Periodic Review of Mongolia, September 2016.

ANNEX 2 – SELECTED ECONOMIC INDICATORS

Mongolia

	2011	2012	2013	2014	2015	2016
Output and Expenditure			*(Percentage change in real terms, sa.)*			
GDP	17.3	12.3	11.6	7.9	2.4	1.0
Private consumption	15.8	13.0	15.4	6.3	7.2	na
Public consumption	15.3	19.9	15.8	12.2	-4.7	na
Gross fixed capital formation	66.2	14.7	-7.2	-21.7	-34.4	na
Exports of goods and services	18.2	8.3	12.8	53.2	1.2	na
Imports of goods and services	49.5	15.4	7.6	6.8	-11.5	na
Industrial gross output	na	na	na	10.2	-5.1	na
Labour market			*(Percentage change)*			
Gross average monthly earnings (annual average)	24.2	31.5	33.6	6.9	7.0	na
Real LCU wage growth	10.2	15.6	10.5	1.9	2.4	na
			(In per cent of labour force)			
Unemployment rate	7.7	8.2	7.9	7.9	7.5	7.9
Prices			*(Percentage change)*			
Consumer prices (annual average)	7.7	15.0	8.6	12.9	6.0	0.5
Consumer prices (end-year)	7.4	14.2	11.2	10.7	1.1	0.5
Fiscal Indicators			*(In per cent of GDP)*			
General government balance	-4.8	-6.8	-1.2	-3.9	-5.0	-15.4
General government revenues	33.9	29.8	31.2	27.8	25.1	23.7
General government expenditure	37.9	38.9	40.1	39.1	33.6	40.7
General government debt	na	na	na	na	na	na
Monetary and Financial Sectors			*(Percentage change)*			
Broad money (M2, end-year)	37.0	18.8	24.1	12.5	-5.5	20.2
Credit to the private sector (end-year)	72.8	23.9	54.1	16.1	-6.5	6.2
			(In per cent of total loans)			
Non-performing loans ratio	5.8	4.2	5.3	5.0	7.4	8.5
Interest and exchange rates			*(In per cent per annum, end-year)*			
Local currency deposit rate	2.8	2.7	2.6	2.8	2.9	2.8
Foreign currency deposit rate	1.1	1.3	1.5	1.5	1.6	1.7
Local currency lending rate	15.5	18.2	17.4	19.5	19.1	19.7
Foreign currency lending rate	12.1	13.5	12.7	12.9	12.0	13.0
Policy rate	12.3	13.3	10.5	12.0	13.0	14.0
			(MNT per US dollar)			
Exchange rate (end-year)	1,396	1,392	1,659	1,888	1,996	2,148
Exchange rate (annual average)	1,265	1,360	1,526	1,818	1,971	2,490
External sector			*(In per cent of GDP)*			
Current account	-26.5	-27.4	-25.4	-11.5	-4.8	-4.0
Trade balance	-20.7	-21.6	-20.9	-4.6	2.9	1.7
Merchandise exports	46.3	357	33.9	47.4	39.8	43.1
Merchandise imports	55.8	48.3	44.4	39.2	29.3	31.2
Foreign direct investment (net)	44.4	35.9	16.7	2.3	1.6	-37.6
Gross reserves (end-year)	25.3	33.6	17.8	13.5	11.3	11.7
External debt stock	92.5	125.2	151.2	171.7	184.4	221.8
Public external debt	21.3	33.3	37.7	42.4	46.8	60.0
Private external debt	71.2	91.8	113.4	129.3	137.5	161.8
			(In months of imports of goods and services)			
Gross reserves (end-year)	5.8	9.3	5.4	3.1	3.0	2.9
Memorandum items			*(Denominations as indicated)*			
Population (end-year, millions)	2.8	2.8	2.9	2.9	3.0	3.1
GDP (in billions of MNT, nominal)	13,173	16,688	19,174	22,227	23,134	23,886
GDP per capita (in USD, nominal)	3,736	4,328	4,365	4,169	3,946	3,660
Share of industry in GDP (in per cent)	38.3	35.5	40.0	42.0	37.6	41.6
Share of agriculture in GDP (in per cent)	10.3	11.3	13.4	13.3	13.7	13.3
Net FDI (in billions of USD)	4.6	4.4	2.1	0.2	0.1	-4.1
External debt - reserves (In US$ billion)	8.5	13.1	17.6	20.2	21.4	23.3
External debt/exports of goods and services (per cent)	177.0	287.8	382.0	329.8	407.0	439.3
Broad money (end-year in per cent of GDP)	48.7	45.6	49.3	47.9	43.4	42.1

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market Structure	Market Institutions	Key challenges
CORPORATES		
Agribusiness		
Medium	Medium	▪ Further advancing reforms in road and rail sectors to facilitate private investments in the sector in the rural areas; ▪ Enhancing hygiene, quality and traceability standards to improve competitiveness and marketability; ▪ Optimising agricultural production in the context of nomadic structures.
Manufacturing and Services (M&S)		
Large	Medium	▪ Strengthening public administration and judiciary to further promote new entry and exit of enterprises and create an environment to support the growth of small and medium-sized enterprises; ▪ Enhancing corporate governance and business practices of large group companies; ▪ Establishing centralised collateral registration and related by-laws to ease access to financing.
Real Estate		
Large	Large	▪ Increasing the supply of affordable housing and of well-designed commercial property, especially outside the office segment in Ulaanbaatar; ▪ Further streamlining the property-related bureaucracy and ensuring transparency in land sales and property registration; ▪ Improving building standards across segments, with particular focus on energy efficiency and sustainability.
Information & Communication Technologies (ICT)		
Large	Medium	▪ Privatising the fixed line incumbent Mongolia Telecom; ▪ Further developing the regulatory framework; ▪ Further developing the telecommunications infrastructure (broadband internet, mainly outside larger urban areas).

Market Structure	Market Institutions	Key challenges
ENERGY		
Natural Resources		
Medium	Large	▪ Improving transparency of the licencing process; ▪ Allowing state-owned companies to be operated on an independent economic basis; ▪ Implementing existing legislation, that enables a stable and investor-friendly environment, and developing well-functioning institutions to contain macroeconomic volatility triggered by natural resources revenues; ▪ Leveraging the mining boom to develop the mining supply chain and create a favourable climate for economic diversification; ▪ Supporting the expansion of the oil downstream sector, ending regulation of retail fuel prices, and enhancing competition in the fuels distribution sector; ▪ Strengthening the independence and the technical capacity of the regulatory bodies, namely, the Energy Regulatory Administration (ERA), the Mineral Resources Authority of Mongolia (MRAM) and the licensing body for the oil and gas industry, the Petroleum Authority of Mongolia (PAM)[19].
Sustainable Energy		
Large	Medium	▪ Introducing cost reflective tariffs for end consumers; ▪ Developing and implementing legal and institutional framework for supporting sustainable energy; ▪ Strengthening capacity for implementation of carbon finance projects.
Power		
Large	Large	▪ Increasing the corporatisation of the state-owned entity; ▪ Strengthening the independence of the regulator; ▪ Introducing cost reflective tariffs for end consumers along with adequate measures to protect vulnerable consumers.
INFRASTRUCTURE		
Water and wastewater		
Large	Large	▪ Improving regulation (e.g. development and application of the modern tariff methodology); ▪ Developing contractual arrangements between the owner/policy maker and the company; ▪ Further increasing tariffs and collection rates; ▪ Corporate restructuring and further commercialisation (including reduced water losses and increased water quality); ▪ Introducing meters and meter-based billing.

[19] Until 2010, MRAM and PAM were part of the Mineral Resources and Petroleum Authority of Mongolia (MPRAM).

Market Structure	Market Institutions	Key challenges
Urban Transport		
Large	Large	▪ Developing city-wide urban transport policy (i.e. integrated urban transport strategy); ▪ Increasing autonomy of publicly owned companies and development of contractual arrangements with the municipalities; ▪ Improving quality of services and operational performances; ▪ Initiating steps towards private sector participation; ▪ Introducing e-ticketing system and improvements in collection rates; ▪ Developing integrated urban road and street management system.
Roads		
Large	Large	▪ Reforming the road user charges to allow for sustainable maintenance of key roads conditions; ▪ Increasing competition in construction and maintenance contracts; ▪ Enhancing and increasing transparency of regulatory activities (including public procurement).
Railways		
Medium	Medium	▪ Further commercialising and improving governance and transparency of the incumbent railways; ▪ Developing the regulatory functions and operational successes of the forthcoming PPP projects.
FINANCIAL INSTITUTIONS		
Banking		
Large	Medium	▪ Facilitating improvements in internal practices of banks, including their corporate governance, risk management and disclosure of risks to borrowers; ▪ Strengthening role of foreign strategic investors; ▪ Strengthening role of the supervisor, improving regulatory framework and market institutions, including through facilitating the operations of a Deposit Insurance Agency and a privately-owned Credit Information Bureau.
Insurance and other financial services		
Large	Large	▪ Broadening access to insurance, including widening of a range of insurance products available; ▪ Facilitating improvement of corporate governance, business conduct and skills base in the insurance sector; ▪ Facilitating establishment of necessary legal and regulatory framework in private pension sector; ▪ Broadening access to leasing, including widening of a range of leasing products available on the leasing market.

Market Structure	Market Institutions	Key challenges
Micro, small and medium-sized enterprises		
Medium	Large	▪ Increasing local currency bank lending to MSMEs; ▪ Developing other sources of finance for SMEs including leasing and equity capital; ▪ Improving legal and institutional framework that supports SME access to finance including enforcement of creditor rights and development of efficient private credit bureau.
Private equity		
Large	Medium	▪ Improving understanding of and broadening companies' access to PE and VC financing, including demonstrating to local entrepreneurs how they benefit from bringing in private equity; ▪ Facilitating the launch and development of (SME-focused) PE and VC funds; ▪ Facilitating improvements in governance standards and institutionalisation of potential investee companies; ▪ Increasing interest in Mongolia (outside large mining-related companies) among reputable international Sponsors and LPs.
Capital markets		
Large	Medium	▪ Facilitating increase in liquidity in local capital markets; ▪ Improving trading, clearing, and settlement infrastructure and operations; ▪ Improving the legal and regulatory framework governing capital markets.

ECONOMIC INCLUSION		
Inclusion gap dimension	**Inclusion gap**	**Key challenges**
Regions		
Access to Services	Large	▪ Improving regional access to water, heating, electricity, and ICT infrastructure
Labour markets	Medium	▪ Enhancing access to jobs and training in regional centres ('aimags') and rural areas
Youth		
Youth Employment	Large	▪ Strengthening work-based learning opportunities (i.e. internships, apprenticeships, trainee programmes) through collaboration between the private sector and education providers to improve vocational education and technical training outcomes in line with employer requirements ▪ Supporting the government's continued effort to introduce competency-based curriculum, skills standards, and verification mechanisms that reflect employer requirements and the international standards
Quality of Education	Medium	▪ Improving the quality and relevance of TVET and higher education to respond better to labour market needs ▪ Providing greater career guidance throughout education
Gender		
Labour Practices and Policies	Medium - Large	▪ Incentivising private sector clients to improve equal opportunities practices, including: equal pay practices; access to employment; access to quality child care; and adoption of female leadership programmes ▪ Encouraging young women to seek training in non-traditional, future-oriented occupations through better career guidance to address systemic segregation of roles
Health Services	Medium	▪ Supporting better access to quality health services for men and women

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Mongolia during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme. For ease of reference, the analysis is presented along the main strategic orientations defined in this country strategy, in particular the actions proposed under 'Policy dialogue and TC'.

Theme 1: Enhancing Mongolia's resilience by strengthening the competitiveness of the non-extractive sector and easing access to finance

Access to Finance

Mongolia significantly upgraded its legal framework on pledges of movable and intangible property, with the new Law on Pledge of Movables expected to be in force in March 2017. The new law seems to have addressed some of the main deficiencies identified in the current framework. Among others, the law provides a much wider scope of movable assets that can be taken as security and is expected to facilitate lending in Mongolia, especially to SMEs which typically have a wide range of movable assets and limited immovable assets.

In 2016, EBRD carried out a Factoring Survey in EBRD's countries of operation, including Mongolia ("Survey"). According to the Survey, there is no specific law on factoring in Mongolia and no definitions for various types of factoring; with non-recourse factoring being the only type of factoring defined in the legislation. Introducing a definition of factoring services or types of factoring transactions would help increase legal certainty of the factoring transactions, hence reducing involved costs and risks of re-characterisation of transactions. While the Law on Financial Leasing generally regulates financial leasing activities, it does not regulate operational leasing at all and there are no legal or regulatory rules in this respect apart from the general lease provisions in the Civil Code. Operational leasing is particularly important in Mongolia given the recent rise in demand for operational leasing services in the mining industry. EBRD supported the Bank of Mongolia in preparing amendments to the leasing legislation, aimed at improving financial leasing regulation and providing an adequate framework for operating leasing operations. The proposed amendments are still to pass the legislative process and have not been approved yet.

Judicial Capacity and Contract Enforcement

Since *EBRD Judicial Decisions Assessment 2011*, which found that the quality of court judgments in commercial law matters in Mongolia was among the poorest in the assessed region (Commonwealth of Independent States, Georgia and Mongolia), the ability of Mongolian judges to effectively handle commercial law cases has improved with the contribution of a dedicated judicial training programme implemented by EBRD. Although the judges' competence in commercial law matters improved, Mongolia needs to take further steps to enhance the professional training of judges, in particular in certain areas of commercial law, to improve the quality of court decisions as well as public access to such decisions. The *EBRD Enforcement Agents Assessment 2013*, a study on regulation and functioning of enforcement agents in the Commonwealth of Independent States, Georgia and Mongolia, found that at the time of the assessment Mongolia's performance was below the average in the region, including based on such important criteria as enforcement costs and speed of enforcement. To address the identified shortcomings, the EBRD launched an ongoing technical cooperation project aimed at enhancing the capacity of Mongolian bailiffs to enforce court judgments in commercial matters.

In 2013, Mongolia introduced the Law on Mediation and Conciliation which provided a legal framework for a system of court-annexed mediation and creation of private mediation centres in Mongolia. At that time private mediation centres did not exist in the country and the first private mediation centre at the Mongolian Chamber of Commerce was established with the EBRD's support. There remains a need to further promote the use of alternative dispute resolution methods in the business community of Mongolia.

Theme 2: Leveraging a well-governed mining sector to enhance sustainability and maximise value creation

Corporate Governance

The EBRD assessment on the corporate governance legislation and practices of companies in the EBRD region, published in 2016, revealed that the corporate governance framework and practices in Mongolia are in need of reform. Joint stock companies in Mongolia are organised under a one-tier board system where the roles of the CEO and the chair of the board cannot be combined. While the law requires that at least one third of the board is composed of independent directors, the definition of independence does not include any "positive criteria" (i.e., what it is expected in practice from independent directors). The legal framework on internal control of the companies does not seem to be well developed either. While listed companies and banks are required by law to appoint an independent external auditor, it is the board, rather than shareholders, who appoint the external auditor and this represents a major shortcoming. Gender diversity at the boards of the largest listed companies is among the lowest in the EBRD region. The legal framework in place in Mongolia does not ensure high levels of transparency of financial and non-financial information either as only two of the ten largest listed companies post their annual reports online. The Corporate Governance Code ("Code"), initially adopted in 2007, was recently reviewed in 2014. The new Code proposes less detailed recommendations than the previous one, and omits many important regulatory aspects. There seem to be no authorities monitoring the Code's implementation and none of the ten largest listed companies in Mongolia seemed to report their compliance with the Code as required.

On the positive side, it appears that a number of basic shareholder rights are provided by law, such as the right to call a general shareholders' meeting, to add items to the agenda, to nominate candidates to the board as well as general inspection, cumulative and pre-emptive rights. Derivative suits are prescribed in the law and supermajority is required to approve major corporate changes.

Theme 3: Improving the quality and sustainability of infrastructure services through increased efficiency, commercialisation and "green" solutions

Energy/Renewable Energy

Mongolia has an enormous unexploited renewable energy potential in wind, hydro and solar energy resources; however, the energy sector remains largely focused on Combined Heat and Power (CHP) plants, and there is need to attract more foreign investment to develop the renewables. In its Green Development Policy adopted in 2014, the Mongolian parliament set targets to increase the share of renewable energy in the total installed power generation capacity with a view to reaching 20% by 2023 and 30% by 2030. In 2015, the parliament adopted the State Energy Policy which changed the date of reaching the 20% target from 2020 to 2023. The revised targets remain ambitious in relative terms, yet insignificant when measured in absolute terms.

Further to 2015 reforms directed towards adopting a more commercially-oriented approach to the energy sector, the Ministry of Energy is expected to prepare and approve standards for renewable energy equipment and operations, grid code and regulatory requirements for connection and transmission of electricity from renewable sources, which would help integrate renewables into the distribution system. The legal framework for ensuring dispatch priority of renewables is still missing. Mongolia should focus on increasing the role of the private sector in the energy system of the country and removing legal and regulatory barriers to competitive energy market. The country should maintain its support for the development of renewables.

Energy Efficiency

Although there has been some improvement in recent years, the infrastructure, in particular generation assets and heat and electricity distribution networks, is mostly old and highly inefficient. Implementing energy efficiency measures in the residential sector and increasing energy efficiency in the power sector are among the top national priorities. The Green Development Policy adopted in 2014 mentions the promotion of resource efficient, low carbon production and consumption with emphasis on waste reduction, promotion of investment in clean technology and incentive mechanisms to finance the green economy among its strategic objectives. More specifically, the policy calls for the reduction of building heat losses by 20% and 40% by 2023 and 2030 respectively through the introduction of green solutions, energy efficient and advanced technologies and standards, including green building rating system, energy audits and the introduction of incentives to promote these initiatives.

In 2015, Mongolia adopted the long-awaited Energy Efficiency Law, which was followed by the implementing regulations – Resolution No. 294, setting thresholds for large energy consumers based on their annual energy consumption or energy losses, and Resolution No. 295, approving important regulations such as governing the performance of energy audits, determining the requirements for energy audit agencies and energy service companies and procedures for their accreditation, establishing rules for training and certification of energy auditors and others. It is important that the energy efficiency measures introduced by recently enacted legislation be effectively implemented into practice.

Public Private Partnerships (PPPs)/Concessions

The 2010 Concession Law, prepared on the basis of international standards and best practices in the sector, covered all key aspects of the legislative and institutional framework and presents an example of good rules on the books. Amendments to the investment law in 2013 along with a rather strong enabling framework in the concession legislation together created a fairly level playing field for foreign and domestic investors. Despite the above positive developments, the regulatory framework for PPP/concession projects in Mongolia needs to be further strengthened. Mongolia's capabilities to prepare and procure PPP projects remain weak and require further reform.

ANNEX 5 – GENDER PROFILE

Highlight

Mongolia is a signatory to all major international instruments pertaining to women's rights and gender equality.[20] In 2011, the Parliament passed a Law on the Promotion of Gender Equality and, in 2013, the country adopted *A Mid-term Strategy and Action Plan.*[21] Though women's labour force participation is relatively high at ~60 per cent, women remain vulnerable to under– and-unemployment because of the high degree of gender specialization by training, which contributes to industrial segregation and women missing out on opportunities in high-value, high-paying sectors such as Natural Resources, Power and Energy and Transportation. This is because (a) these fields commonly reflect societal and cultural beliefs as to what constitutes an appropriate area of work for a woman and (b) there are no well-developed career guidance systems in place to encourage young women to seek training in non-traditional, future-oriented occupations. Such barriers are compounded by women's home or childcare duties.

Gender inequality and human development

According to the UNDP 2015 Human Development Index (HDI), Mongolia is among the countries with a high human development index.[22] The country ranks 90th out of 155 countries in terms of the UNDP Gender Inequality Index (GII).[23] The SIGI Index[24] categorised Mongolia as very low in terms of gender discriminatory laws and practices.

Labour force participation and gender pay gap

Common to other Central Asia countries, Mongolia has a relatively high rate of female participation in the labour force at 60%[25] (compared to Kyrgyz Republic [56.3%], Tajikistan [59.1%] and Kazakhstan [67.9%].[26] Young women's (15-24) labour force participation rate at 31 per cent is substantially less than young men's labour force participation rate at 41 per cent,[27] but some of this can be attributed to higher numbers of young women enrolled in tertiary education, reflecting a trend in Mongolia for families to invest more in the education of girls than boys. Occupational segregation in the labour market is, however, persistent. Women remain concentrated in less productive economic sectors and professions with lower levels of responsibility, income and status, and under-represented in managerial, technical and high-paid sectors such as mining, transportation and energy, where prospects for

[20] The CEDAW was ratified in 1981.
[21] Swiss Agency for Development and Coordination. *Gender Overview. Mongolia Desk Study*. 2014. Retrieved from https://www.eda.admin.ch/content/dam/countries/countries-content/mongolia/en/SDC-Gender-%20Overview-Mongolia-%202014-EN.pdf
[22] The HDI is comprised of three dimensions: health, education and decent standard of living. http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/MNG.pdf
[23] The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.
[24] The SIGI value is based on qualitative and quantitative data on discriminatory social institutions.
[25] The World Bank. 2014. *Mongolia*. http://data.worldbank.org/indicator/SL.TLF.ACTI.FE.ZS/countries
[26] The World Bank. 2014. *Mongolia*. http://databank.worldbank.org/data/reports.aspx?Code=SL.TLF.CACT.FE.ZS&id=2ddc971b&report_name=Gender_Indicators_Report&populartype=series
[27] The World Bank. 2014. *Mongolia*. http://data.worldbank.org/indicator/SL.TLF.ACTI.1524.FE.ZS?view=chart

advancement are greater.[28] There is also a growing gender wage gap with women earning 14.3% less than men.[29]

While the Labour Law in Mongolia provides women and men equal rights in the area of employment, it contains a discriminatory provision which prohibits women from freely choosing their employment based on an outdated list of hazardous occupations from which women are excluded. Women are not encouraged to enter jobs that are deemed "unsuitable and unsafe" and it is considered that women should be protected from "hard jobs". [30]

Entrepreneurship and access to finance

Based on the 2015 Business Environment and Enterprise Performance Survey (BEEPS), 37.8 per cent of the firms surveyed in Mongolia had women among their owners. Of all firms surveyed, 25 per cent were at least 1/3 owned by women; women comprised 42.3 per cent of full-time workers and 35.6 per cent of top management. No quota has been introduced for women on corporate boards and a study from the Office of the General Counsel at the EBRD (2016) shows that only 3.2 per cent of women are represented on the boards of the ten largest listed companies of Mongolia, the lowest in EBRD countries of operation.

No apparent major gender gaps are reported in terms of accessing formal financial services with 93.2 per cent of women and 90.3 per cent of men having an account at a formal financial institution, both representing high number of accounts ownership in absolute terms.[31] However, for women and men alike, lack of collateral remains an important issue to accessing credit. A 2011 EBRD-commissioned field study on women's use of microcredit in rural areas in Mongolia found that group lending had a positive impact on women's entrepreneurship, particularly for less educated women.[32]

Leadership and decision-making

In 2011, Mongolia established binding quotas of twenty per cent for women candidates by party or coalition for the Parliament elections.[33] Despite this measure, only 13 of the 76 members of the current parliament are women; women thus remain underrepresented and below the current OSCE average of 24.4 per cent.[34] Women are better-represented in the judiciary (13 out of 24 justices are women[35]) but remain generally under-represented in management and decision-making positions, especially in the private sector.

[28] The Asia Foundation. 2015. *Women's Labor Rights: The Road Ahead*. http://asiafoundation.org/in-asia/2015/04/29/womens-labor-rights-the-road-ahead/
[29] Swiss Agency for Development and Coordination. 2014. *Gender Overview. Mongolia Desk Study*. Retrieved from https://www.eda.admin.ch/content/dam/countries/countries-content/mongolia/en/SDC-Gender-%20Overview-Mongolia-%202014-EN.pdf
[30] OECD. *SIGI Index. Mongolia*. http://www.genderindex.org/country/mongolia#_ftn5
[31] The World Bank. Findex. *Mongolia*. http://databank.worldbank.org/data/reports.aspx?source=1228
[32] EBRD. 2011. *Group lending or individual lending? Evidence from a randomised field experiment in Mongolia.* http://www.ebrd.com/downloads/research/economics/workingpapers/wp0136.pdf
[33] Parliament of Mongolia Election Law. Art. 27.2 Retrieved from http://anfrel.org/wp-content/uploads/2012/04/20120130_New-Parliamentary-Election-Law_Eng-changed-20120201.pdf
[34] Parline. 2014. *Mongolia*. http://www.ipu.org/parline-e/reports/2219_A.htm
[35] Supreme Court of Mongolia. http://www.supremecourt.mn/english/content/7

Others

Gender disparities are greater in rural than in urban environments. Domestic violence is a serious problem for women in Mongolia.

There are also a number of concerns associated with the deteriorating health condition of men given their increasingly high morbidity and mortality rates. This is due partly to substance abuse (smoking and alcohol consumption), high suicidal rates, murder and traffic accidents as well as hard labour activities.[36] The future implications of men's under-representation in tertiary education remain unclear.

[36] Swiss Agency for Development and Coordination. 2014. *Gender Overview. Mongolia Desk Study*. Retrieved from https://www.eda.admin.ch/content/dam/countries/countries-content/mongolia/en/SDC-Gender-%20Overview-Mongolia-%202014-EN.pdf

ANNEX 6 – EBRD AND THE DONOR COMMUNITY

Grant funded technical cooperation (TC) in Mongolia has allowed the Bank to undertake programme preparation support, including the preparation of infrastructure investment opportunities, building capacities of prospective clients, and regulatory and judicial capacity building. TC funds have also been provided to support the transfer of skills and the growth of local private MSMEs, including through local and international consultants under the Advice for Small Businesses, which is part of the Small Business Initiative.

Mongolia has also benefited from co-investment grants in the form of financial incentives and first loss cover in the sustainable energy and financial sectors. These grants have been financed by multilateral funds for climate change and multi-donor special funds.

The focus of donor grants is expected to remain in line with previous support. A 2017 grant needs analysis in Mongolia shows the highest demand for the support of municipal and environment infrastructure projects, capacity building related to green economy transition and technical assistance to improve judicial and regulatory systems.

To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank or managed externally, in addition to resources made available by its shareholders:

- **Bilateral** grants – the EBRD will continue to explore opportunities with bilateral donors, both through the EBRD multi-donor funds such as the Early Transition Countries Fund, as well as bilateral funds.

- **The European Union** – the EBRD will also continue to partner with the EU and seek funding from instruments that can be applied in Mongolia, including working closely with the local EU delegation.

- **The EBRD Shareholder Special Fund (SSF) -** endowed by the Bank's net income. The SSF is a complementary facility to donor resources and will provide TC and non-TC support in areas where there is shortage or lack of support, however the area remains a priority for the Bank to advance transition.