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Mongolia: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director of Mongolia

In the context of Mongolia's request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended in June 2001, with the officials of Mongolia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 18, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of September 27, 2001, updating information on recent economic developments

- a Press Release summarizing the **views of the Executive Board as discussed during its September 28, 2001 discussion of the staff report that completed the review.**

- a statement by the Executive Director for Mongolia

The documents listed below have been or will be separately released.

Interim Poverty Reduction Strategy Paper
Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper
Letter of Intent*
Memorandum of Economic and Financial Policies*
Technical Memorandum of Understanding*

*May also be included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

MONGOLIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by Asia and Pacific Department

Approved by R. Anthony Elson and Shigeo Kashiwagi

September 18, 2001

- Discussions on a program that could be supported by a three-year arrangement under the Poverty Reduction and Growth Facility were held in Ulaanbaatar in September and December 2000 and March/April, May, and June 2001.

- The staff held discussions with Mr. Ulaan, Minister of Finance and Economy (MOFE), Bank of Mongolia (BOM) Governor Chulunbaat, and other senior officials. The staff teams participating in some or all of the discussions consisted of Mr. Molho (head), Messrs. Jang, Kalra, Fletcher, and Ms. Aturupane (all APD), Mr. Dodzin (PDR), Mr. Menchikov (MAE), and Ms. Purfield and Mr. Moissinac (FAD). The missions were assisted by Mr. Martin, the IMF resident representative, and worked closely with overlapping Bank missions.

- In concluding the last Article IV Consultation in January 2000, Directors stressed the need for continued fiscal consolidation and tight monetary policy to help achieve the government's inflation and external targets and protect fiscal sustainability. To promote growth and poverty reduction, Directors encouraged the authorities to pursue reforms to rationalize the size of the public sector, improve the efficiency of social expenditures, and enhance fiscal transparency.

- The quality and timeliness of macroeconomic data are broadly adequate for program monitoring, but some data suffer from serious deficiencies.

- The principal author of this report is Mr. Molho, with substantial inputs from Messrs. Jang, Dodzin, Moissinac and Ms. Aturupane.

Contents

Annexes

Attachments

Executive Summary

Mongolia has made great strides during the first decade of its transition to a market economy, but it continues to face important challenges. While good progress was made towards promoting macroeconomic stability and market-based reforms since the mid-1990s, weak fiscal governance and a deteriorating external environment led to a large buildup of fiscal arrears and an unsustainable rise in the public debt ratio in the late 1990s. With GDP growth remaining lackluster, progress towards poverty alleviation has lagged in recent years.

The reform agenda under the proposed PRGF arrangement and the I-PRSP aims to place Mongolia on a faster track for growth and poverty reduction. The strategy is centered on policies to maintain a stable macroeconomic environment, coupled with structural reforms to promote private sector-led growth and ensure that public resources are effectively used towards poverty reduction and social development.

A key objective under the program is fiscal sustainability. To begin to reverse the large buildup of the debt-to-GDP ratio, the fiscal deficit is to decline from 7¼ percent of GDP in 2001 to 6 percent of GDP over the medium term. Fiscal consolidation is being supported by bold structural reforms to improve fiscal transparency and accountability, arrest the buildup of arrears, strengthen tax administration, and rationalize public expenditure management.

Monetary policy will be geared to reducing inflation to the low single-digit range while also helping to bolster external reserves. Although an easing of monetary conditions led to a sharp pick-up in credit growth in late 2000 and early 2001, steps have since been taken to arrest the growth of reserve money. The program envisages a continuing shift toward an indirect system of monetary management and accelerated privatization of state-owned banks.

Prudent external debt management will be necessary to achieve the program's objectives. Nonconcessional external borrowing with implicit or explicit public guarantee will be avoided, and the government will reinforce its efforts to regularize relations with all creditors, including pre-1991 convertible ruble debts to Russia.

To ensure that the private sector becomes an engine for growth, the pace of market-oriented reforms will be stepped up. The privatization of large public enterprises, in particular, will be accelerated and a comprehensive energy sector reform will be implemented. The program envisages continuation of the process of trade liberalization, including a reduction of import duties to a uniform rate of 5 percent.

The risks to the program are considerable but manageable. To enhance the government's capacity to implement the planned reforms, the Fund and Bank will provide continuing technical assistance in the key areas of fiscal and financial sector reform. The program also envisages a number of prior actions and close monitoring through structural conditionality. Consistent with staff guidelines, PRGF conditionality will focus on macroeconomic policies and reforms to strengthen fiscal governance; financial sector, energy sector, and civil service reforms will be monitored in consultation with the Bank.

I. Introduction

1. Mongolia has made great strides since it embarked on its transition to a market economy in the early 1990s, but it continues to face important challenges. Market-oriented reforms were accelerated beginning in 1996–97 under a program supported under a three-year PRGF arrangement, but performance under the arrangement was mixed (Box 1). While good progress was made towards reducing inflation and restoring external stability, a lack of adequate financial controls over the budget in the face of a deteriorating external environment contributed to a sustained widening of the general government's deficit and a recurrent buildup of fiscal arrears. By 1999, the public debt exceeded 100 percent of GDP (72 percent of GDP in net present value (NPV) terms), posing a threat for fiscal sustainability.[1] As political support for much-needed adjustments in regulated prices and for privatization began to falter in late 1999, the financial imbalances of the state-run energy authority, coal mines, and the national petroleum company exacerbated the pressures on the budget.

2. Progress toward poverty alleviation has been lackluster in recent years. With economic growth averaging less than 3½ percent a year during the latter part of the 1990s, the number of people below the poverty line remained basically unchanged at about 36 percent of the population. Indeed, as is indicated in the government's Interim Poverty Reduction Strategy Paper (I- PRSP, EBD/01/78), the depth and severity of poverty appear to have increased in recent years, as the purchasing power of the poor in terms of basic necessities declined and the gap between their average consumption expenditures and the poverty line widened.

3. The first review under the second annual arrangement under the last three-year PRGF arrangement was completed in January 2000 (EBS/00/3, 1/10/00 and Supplement 1, 1/23/00). However, the program went off track as the reform effort flagged in the run-up to the general elections in mid-2000. The new government, which took office in August 2000, has since taken steps to redress the fiscal situation, safeguard macroeconomic stability, and revive the momentum of structural reforms, with a view to fostering more rapid growth and poverty reduction.

4. In the attached letter dated September 11, 2001, the Government of Mongolia requests a three-year arrangement under the PRGF for the period August 2001–July 2004 (Attachment I). The government's program is described in the Memorandum of Economic and Financial Policies for August 2001-July 2002 (MEFP, Attachment II) and in the I-PRSP. In a joint staff assessment (JSA, EBD/01/79), the staffs of the Fund and the World Bank

[1] The cited debt figures exclude Mongolia's unresolved pre-1991 transferable ruble debts to Russia, which amount to TR 10.5 billion or the equivalent of 10 times Mongolia's annual GDP.

Box 1. Performance under the PRGF Arrangement, 1997–2000[1]

The Executive Board approved a three-year PRGF arrangement for Mongolia on July 30, 1997. The arrangement envisaged a rapid reduction in inflation and a build-up of international reserves through monetary and fiscal tightening. The fiscal tightening was to be driven by rapid reductions in unproductive expenditures, with the expenditure-to-GDP ratio expected to be significantly reduced by the end of the program period. The current account deficit was expected to remain manageable, as foreign inflows of capital would help support accelerated private sector investment and economic growth. To support these goals, structural reforms were envisaged in a number of areas, including the implementation of a broad-based VAT, elimination of subsidies for public enterprises, liberalization of energy prices, and an aggressive privatization program.

Macroeconomic performance under the first annual arrangement initially exceeded expectations. Buoyed by favorable terms of trade and the government's aggressive reform program, exports grew by 34 percent in 1997, resulting in a small current account surplus and a 67 percent increase in reserves. These developments, along with a prudent monetary policy, helped to stabilize the exchange rate. The stable exchange rate, in turn, together with lower import prices, helped reduce inflation significantly.

However, performance deteriorated in the first half of 1998 as Mongolia experienced a large terms of trade shock and significant domestic political turmoil. As export commodity prices declined steeply, the current account shifted into a large deficit, growth slowed, and the exchange rate came under severe downward pressure. Just as budget revenue contributions of the large copper mine (Erdenet) slipped, the government was unable to restrain wage pressures. In addition, large expenditures were necessary to clear arrears on utility bills from the winter of 1997. These developments resulted in an overrun of the March 1998 fiscal targets. A package of corrective measures was agreed with Fund staff, but could not be implemented until September. In the meantime, the first annual arrangement lapsed at mid-year. For its part, the BOM tightened monetary policy and initially tried to maintain a stable exchange rate. While this policy stance resulted in significant reserve losses, it helped keep inflation in check. During the first year of the program, most structural targets were met: energy prices were liberalized, most small to medium-size businesses were privatized, and a VAT was introduced. However, a continued decline in export prices, together with poor management and lax regulatory oversight of the banking system, strained the weak financial position of a number of banks and slowed the reform of the banking system.

The second annual arrangement was approved in mid-1999, following the adoption of a strong package of corrective measures to lower the fiscal deficit, enhance exchange rate flexibility, and revive the process of bank reform. As a result, macroeconomic conditions stabilized, reserves rose to more comfortable levels, and the exchange rate was depreciated to facilitate an adjustment to the terms of trade shock. A fresh round of banking sector reforms was undertaken in the context of the program, and two insolvent banks were put under receivership in December and slated for closure, while a third was slated for restructuring along the lines of a plan agreed with Fund staff. In the fiscal area, while declining export prices weakened the budget's revenue performance, lower-than-programmed expenditures helped keep the overall budget deficit broadly on track. The Board completed the first review under the arrangement in early 2000.

Policy implementation faltered during the first half of 2000 in the run-up to the mid-year parliamentary elections. A roll-back of some revenue measures exacerbated revenue weakness during the earlier part of the year, and uncertainties about the fiscal position grew as there was a large accumulation of budgetary arrears. In the meantime, the fissures in the three-party government coalition deepened, and the government was unable to secure parliamentary approval for some structural reform measures envisaged under the program, especially in the area of privatization of large enterprises. The time period for the completion of the second review under the arrangement lapsed in mid-June and the commitment period expired on July 29, 2000.

[1]For further details on performance under the arrangement in 1999, see EBS/00/3 and Supplement 1.

consider that the I-PRSP provides a sound basis for the development of a fully participatory PRSP and for Fund and Bank concessional assistance, and recommend its endorsement by the respective Boards.

5. The request for financial assistance under the PRGF arrangement is in an amount equivalent to SDR 28.49 million (56 percent of quota), to be disbursed in seven equal semi-annual installments. Full disbursement, under the schedule set out in Table 1, would raise Mongolia's outstanding use of Fund resources to 87½ percent of quota by mid-2004, from 71 percent of quota at end-June 2001 (Table 2).

II. Developments in 2000 and Prospects for 2001

6. **Domestic economic performance was mixed in 2000 and early 2001.** The losses of the animal husbandry sector resulting from two consecutive harsh winters (Zud), and from a more recent outbreak of foot-and-mouth disease, have taken a heavy toll on output. While national accounts estimates point to a resilient performance of the nonagricultural sector, these estimates are subject to a large margin of error. Real GDP growth is estimated to have declined from 3¼ percent in 1999 to about 1 percent in 2000 and is projected to recover moderately in 2001. The year-on-year rate of inflation, after having peaked at 15½ percent in mid-2000, fell to 8 percent by end-2000, as a reversal of the earlier increase in meat prices more than offset the effects of increases in water use fees and energy prices. Inflation accelerated again in early 2001 under the impetus of higher electricity tariffs, and the Zud-related decline in domestic meat supplies, together with increases in public wages and pensions, exerted upward pressure on domestic prices through the first half of the year. However, the seasonal increase in meat supplies has since helped to reverse some of the earlier rise in food prices, thus easing inflationary pressures from mid-2001 onwards.

7. **The overall balance of payments recorded a large surplus in 2000 and prospects for external performance remain positive.** Export receipts rose by 18 percent in 2000 as international copper prices rebounded and cashmere prices picked up, while imports surged by 21 percent reflecting the strength of demand in the nonagricultural sector and the need for Zud-relief. Although the current account deficit widened, it was more than covered by increased official grants (largely for Zud relief) and private inflows. Gross official reserves rose by more than $30 million in 2000, reaching a level of $191 million or 14 weeks of imports of goods and services by year-end. Receipts from meat and textile exports were buoyant in the early part of 2001 and seasonal receipts from cashmere, copper, and gold exports are expected to keep the overall balance of payments strong through the rest of 2001 despite a partial reversal of the previous year's terms of trade gains.

8. **Fiscal discipline was eroded in the run-up to the elections in mid-2000.** Unrealistic budgeting, together with weak accounting, internal control, and auditing procedures, especially at the local government level, led to substantial expenditure overruns with respect to the initial budget approved in December 1999. Following the transfer of some Tog 8 billion from the central government for the payment of local government wages and social security contributions in December 2000, the increase in the outstanding stock of general government arrears was contained to the equivalent of about ½ percentage point of

GDP over the full year. The continuing accumulation of arrears, including by the major public enterprises that are excluded from the fiscal accounts, together with recourse to netting out operations to reduce overdue cross debts, has undermined the reliability and analytical content of official general government statistics.

9. **Revised fiscal data, using methodology developed with the help of FAD/STA technical assistance, suggest that an unanticipated surge in revenues led to a narrowing of the overall general government deficit from 12 percent of GDP in 1999 to less than 7 percent of GDP in 2000.** Receipts from Erdenet, a large joint-venture in the mining sector which is partly owned by the Mongolian government, rose sharply following the recovery of international copper prices, while the boom in imports, together with the full-year effect of the import duty introduced in mid-1999, bolstered customs duty and excise tax receipts. While current expenditures overshot the amended budget target by about 2 percentage points of GDP, delays in the implementation of foreign-financed capital projects, together with a buildup of arrears, kept total spending well below the amended budget target established in August 2000. Reflecting also the repayment by the Bank of Mongolia (BOM) to the treasury of some previously disputed claims, the government's net debt to the domestic banking system declined over the full year, while its net foreign borrowing was contained to 6½ percent of GDP. With the help of a weakening of the Japanese yen and the SDR relative to the US dollar (and the togrog), the public debt ratio fell to 96½ percent of GDP (66 percent in NPV terms) by end-2000.[2]

10. **The growth of bank credit to the private sector was restrained in early 2000, but credit growth picked up sharply beginning in late 2000.** Reserve money growth was spurred in late 1999 and early 2000 by BOM purchases of gold and foreign exchange and a large expansion in BOM credit to government. The year-on-year rate of growth of reserve money peaked at 100 percent in March 2000, before declining to 19½ percent as of end-December, as the earlier increase in BOM credit to government was largely reversed. Broad money growth was more restrained, reflecting a sustained rise in the currency-to-deposit ratio in the face of weak private sector confidence in the banking system. BOM bill rates rose broadly in line with the rate of inflation through the first nine months of 2000. However, beginning in October 2000, BOM bill rates fell sharply and remained largely negative in real terms through the first quarter of 2001. This development, together with a reported improvement in confidence stemming from the strengthening of provisions in bank legislation to facilitate loan recovery, led to rapid credit growth. The year-on-year rate of growth of credit to the private sector peaked at more than 100 percent by June 2001, but it is estimated to have slowed somewhat in the third quarter following the adoption of measures to tighten monetary conditions.

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[2] As of end-2000, 75 percent of Mongolia's public and publicly guaranteed external debt was denominated in Japanese yen or SDRs.

11. **The BOM has continued to pursue a flexible exchange rate policy, making recourse to intervention primarily to avoid excessive fluctuations in the exchange rate, especially during a period of unusually strong inflows in early 2000.** The value of the togrog, after having temporarily appreciated relative to the US dollar in the early months of 2000, moved in a relatively narrow range thereafter. The togrog depreciated by 2¼ percent vis-à-vis the U.S. dollar during 2000, before leveling off during the first eight months of 2001.

12. **While continued progress was made towards banking system restructuring during 2000, the reform and privatization of large public enterprises was stalled.** The liquidation of the Reconstruction Bank and the ITI Bank, whose licenses were revoked in December 1999, proceeded as scheduled, and the Agricultural Bank (AB) adopted a restructuring plan under a donor-financed external management contract, with a view to re-establishing its commercial viability and preparing it for privatization. The government issued Tog 4.2 billion (1/2 percent of GDP) of restructuring bonds in July 2000 to bolster the AB's capital and agreed to pay another Tog 600 million for services provided by the bank in the past to bring its negative net worth close to zero. In the area of privatization, while much of the technical work for the privatization of the Gobi Cashmere Company, the Neft Oil Import Concern (NIC), and the Trade and Development Bank (TDB) was completed, the parliamentary go-ahead to offer them for sale could not be secured prior to the elections. In the ailing energy sector, much-needed tariff adjustments and Parliamentary consideration of new draft legislation continued to be delayed. However, following the elections, the new government took important steps to revive the momentum of reform in these areas.

III. The Medium-Term Framework, 2001–04, and the I-PRSP

13. The government's overall poverty reduction strategy which is to be supported under the PRGF rests on three pillars outlined in the I-PRSP: (i) macroeconomic stability; (ii) private-sector led and outward-oriented growth; and (iii) broad-based and more equitable distribution of the benefits from growth. The authorities' medium-term program targets and the principal macroeconomic and structural policies underpinning the I-PRSP are summarized in Box 2 (see also paragraphs 35–39 of the I-PRSP). The promotion and maintenance of fiscal sustainability will be key to the achievement of the I-PRSP's objectives and a central element of the PRGF-supported program. Building on the recent fall in the fiscal deficit, the government will aim to contain the budget deficit to 7¼ percent of GDP in 2001 and reduce it to around 6 percent of GDP by 2004. This should lead to a reduction of the public debt ratio from 96½ percent of GDP (66 percent in NPV terms) in 2000 to 94 percent of GDP (58¼ percent in NPV terms) by 2004.

14. The government's structural reform program will aim to strengthen the institutions of macroeconomic management and create an enabling environment for private investment, which is to provide the main impetus for growth, while at the same time adopting policies to protect vulnerable groups from the adverse side-effects of reforms, direct the benefits from growth to social development, and deliver improved services to the public. Consistent with the objectives of the I-PRSP, structural conditionality under the PRGF-supported program

Box 2. Mongolia: Main Elements of the PRGF-Supported Program, 2001–04

Targets

- Raise real GDP growth to 6 percent by 2004 to lead to a meaningful reduction in poverty, while reducing inflation to 5 percent, containing the external current account deficit in the range of 6–7 percent of GDP, and raising gross official reserves to about four months of import cover.

Macroeconomic Policy

- **Fiscal**: Protect medium-term sustainability by reducing the overall general government deficit from an average of 11 percent of GDP during 1998–2000 to an average of 6¾ percent during 2001-04 and by relying mainly on external concessional financing, so as to lower the net present value of total public debt from 65 percent of GDP in 2000 to less than 60 percent by 2004. Fiscal adjustment to be centered primarily on revenue mobilization in 2001, but during 2002–04 policies to be reoriented to bring about an enduring reduction in the expenditure ratio, including through public wage and employment reforms.

- **Monetary and credit**: Keep the growth of money and credit within a prudent range to reduce inflation while continuing to bolster external reserves.

- **Exchange system**: Maintain a market-based exchange rate system, with BOM intervention to be limited to smooth excessive exchange rate fluctuations and meet the reserve targets of the program.

Structural Agenda

- **Fiscal reform**: Continue to strengthen tax administration, rationalize intergovernmental revenue sharing, and improve public expenditure management, including by strengthening fiscal transparency and accountability (see also Box 5).

- **Banking sector reform**: Continue to refrain from either administrative measures or moral suasion to subsidize and/or direct bank credit to favored industries and enhance the market orientation and soundness of the banking system, including by strengthening the legal and regulatory environment, bringing asset classification and provisioning standards and accounting and auditing standards into line with best international practices, and completing the restructuring, recapitalization, and privatization of the Agricultural Bank.

- **Public enterprise reform and privatization**: Implement a reform policy that includes privatizing state-owned assets, increasing private sector participation in the economy, and attracting foreign investment, including by privatizing large, most-valued companies and by reforming the energy sector (see also Box 6).

will be heavily centered on improving transparency, accountability, and enforcement mechanisms in budget implementation, ensuring a more efficient use of public resources and, thereby, facilitating fiscal consolidation while protecting poverty-reducing programs (the division of labor between the Bank and the Fund is discussed more extensively in Box 3, while the PRGF-supported program's medium-term fiscal framework is described in Box 4). The reforms that are aimed at improving public expenditure management and enhancing the effectiveness of poverty-reducing programs will be guided by the results of the World Bank's Public Expenditure Review (PER). In the context of the full PRSP, the authorities will also need to undertake Poverty and Social Impact Assessments (PSIA) in the key reform areas, with assistance from the World Bank. Banking sector reforms, which are to be supported primarily under the Bank's Financial Sector Adjustment Credit (FSAC), will aim to complete the shift to a market-oriented system of indirect monetary management, including through measures to strengthen bank supervision and accelerate the privatization of state-owned banks. Efforts will also be stepped up to reform and privatize the strategic energy sector, with support under the Bank's Energy Sector Adjustment Credit.

IV. Macroeconomic Objectives and Policies for 2001–02

A. Fiscal Policy and Reforms

15. **The pace of fiscal adjustment under the program is circumscribed by the need to promote fiscal sustainability while also taking decisive measures to improve fiscal transparency and meet the growth and poverty-reduction objectives of the I-PRSP.** Given that public expenditures were understated until 2000 by the continuing accumulation of arrears, the steps to ensure more realistic budgeting and begin to reduce the stock of arrears inevitably leave limited scope for expenditure reduction in the short run. Over the medium term, the fiscal adjustment targets must also take into account the costs of planned structural reform measures, including the privatization of large state-owned enterprises, the elimination of the 2 percent import duty surcharge, and the yet-to-be-quantified costs of civil service reform. Against this background, the staff believes that the programmed speed of deficit reduction, and of the associated public debt ratio, as described in paragraph 13 above, is appropriately ambitious (see also Table 5).

16. **In light of the above considerations, fiscal adjustment will be centered on revenue mobilization during 2001, but policies will be subsequently reoriented to bring about an enduring reduction in lower-priority expenditures so as to make room for more adequate provisions for poverty reducing programs.** The initial budget for 2001 introduced a substantial package of measures to offset the effects of an incipient decline in receipts from Erdenet and, thereby, consolidate the recent increase in the revenue-to-GDP ratio (see MEFP, paragraph 15). On the expenditure side, while the initial 2001 budget envisaged an overall reduction of current spending, it included significant new measures to improve the accessibility and quality of education and the supply of primary health care for the rural poor (see also paragraphs 64–83 of the I-PRSP). The deteriorating macroeconomic outlook following the onset of the Zud led to the submission to Parliament of an amended budget in mid-2001, including more adequate provisions to ease the impact of the Zud on

Box 3. Mongolia: Structural Conditionality

1. Coverage of Structural Conditionality in the Current Program

Structural conditionality in the program as set out in Table 3 of the MEFP (Attachment II) is in line with the guidelines for streamlining conditionality and the March 1, 2001 Executive Board discussion. Most structural performance criteria (SPCs) and benchmarks for the first year of the program focus on the achievement of the main fiscal policy objectives. The SPCs aim to strengthen fiscal transparency and accountability, including by introducing treasury reforms to prevent arrears accumulation and misuse of public funds; and to strengthen tax administration, including by enacting legislation to improve VAT collection and sharing. The main elements of the proposed fiscal reform program are based on the recommendations of recent FAD technical assistance missions.

2. Status of Structural Conditionality from Earlier Programs

The structural performance criteria and benchmarks from the latest PRGF-supported program can be found in EBS/99/98 (Table 2, pp. 59–60) and EBS 00/3 (Tables 3a and 3b, pp. 64–65). The unobserved measures include:

(i) Financial sector reform

The last PRGF-supported program envisaged replacement of bank restructuring bonds with marketable securities. While the proposed PRGF-supported program envisages the standardization of restructuring bonds as a prior action, the task of replacing them with marketable securities has been taken over by the World Bank's Financial Sector Adjustment Credit (FSAC).

In the banking system, the last PRGF-supported program envisaged recapitalization with private capital and/or privatization of the Agricultural Bank (AB). Although the AB was to be closed if privatization could not materialize, given the importance of the bank's rural branch network, the government decided, in consultation with Bank and Fund staff, to place the AB under a donor-funded external management contract for two years, with a view to eventual privatization. The AB's performance improved significantly during its first year of operation under the contract.

(ii) Privatization

The unobserved measures included bringing to the point of sale two non-financial companies (Gobi (cashmere garments producer), and NIC (petroleum importer and distributor) and the Trade and Development Bank (TDB)).

(iii) Civil service reform

The civil service reform envisaged under the previous PRGF-supported program has not materialized, but would be key to the effectiveness of the new PRGF-supported program. While detailed advice in this area is to be provided by the Bank's Public Expenditure Review, the proposed PRGF-supported program includes measures to contain the civil service payroll.

3. Structural Areas Covered by World Bank Lending and Conditionality

The World Bank approved its FSAC for Mongolia in April 2000. The key structural conditionality measures attached to this loan include implementation of the AB restructuring plan, development of an action plan to privatize the Savings Bank, continued steps to improve financial system regulation and supervision and enhance the operation of the government securities market; and privatization of TDB (floating tranche conditionality).

In the energy sector, the World Bank approved a US$30 million investment loan in March 2001. The structural conditionality attached to this loan includes the adoption of: time-bound action plans to: (i) restructure the sector with a view to attracting greater private sector participation; (ii) rationalize the tariff system, including by introducing life-line tariffs for low-income consumers; and (iii) revamp rural utility systems.

4. Other Relevant Structural Conditions Not Included in Current Program

The measures related to the privatization of Gobi and NIC are no longer part of structural conditionality. However, the government recently issued a tender for the sale of Gobi (which would have sufficed to meet the last program's SPC) and a tender for NIC is to be offered before end-2001. In addition, the government is now implementing Bank-supported reforms in the energy sector that were not included in previous Fund programs.

Box 4. Medium-Term Fiscal Framework

Public finances under the program are geared toward achieving medium-term fiscal sustainability while providing funding for fast-growing needs in social services, accommodating the costs of off-budget fiscal operations that are brought on budget, and making adequate provisions for Zud-relief and other contingencies. In order to stabilize the public debt burden, the overall fiscal deficit is to decline from about 7¼ percent of GDP during 2001–02 to 5 percent by 2006. Following the introduction of the 2001 tax package, which should keep up revenue at about 33½ percent of GDP in 2001, fiscal consolidation efforts are to be redirected toward expenditure reductions starting in 2002. Under the PRGF-supported program, noninterest current expenditures would be curtailed from 28¾ percent of GDP in 2001 to 25½ in 2005, while public savings would increase from 3 percent of GDP in 2001 to 5½ percent by 2006. Capital expenditures would be reduced only marginally in relation to GDP, with total public investment (including on-lending) remaining above 10½ percent of GDP throughout the program period.

A key challenge will be how to contain mounting expenditure pressures in education and health services. As indicated in the government's I-PRSP, the quality and accessibility of these services, especially for the poor, have deteriorated in recent years. As school enrollment has increased at an annual rate of 4 percent since 1995, schooling facilities have become overcrowded, there has been a growing lack of qualified teachers, and most schools in rural areas have had to close during the winter. The health system has also become under-equipped in rural areas and has used most of its financial resources for non-medical operating expenses, leading to a rapid accumulation of arrears on drugs. Reforms to enhance efficiency and better target the poor are indispensable, but they will require new public investments in facilities, equipment and staff training in both education and health. Accordingly, public expenditures in these two sectors, which were respectively estimated at about 7 percent and 4 percent of GDP in 1998-99, are projected to remain under strong upward pressure over the medium term.

Quasi-fiscal activities in the energy sector, previously financed by SOEs, have been explicitly incorporated in the budget starting in 2001, and a contingency allocation of 1 percent of GDP has been created. Explicit subsidies to aimag utilities paid by the Energy Authority have been quantified and shifted to the budget starting in 2001 (see Box 6). Rough estimates of other subsidies paid by SOEs in the energy sector are to be included in the budget starting in 2003, with their overall costs peaking at 1 percent of GDP in 2004 and declining afterwards, as the prices of electricity, heating and fuel are rationalized in aimags. In light of past budget disruptions caused by climatic disasters and the potential costs of yet-to-be identified quasi-fiscal activities, a contingency allocation of 1 percent has been included in the budget from 2001 onwards.

To meet the planned deficit targets, the program envisages far-reaching changes in the conduct of fiscal policy: (i) financial discipline is be restored by reforms to enhance treasury control over both the central and local government budgets so as to prevent expenditure overruns and arrest the accumulation of arrears (see also Box 5); (ii) ad hoc wage increases are to be discontinued and wage policy is to be articulated within a civil service reform framework from 2002 onwards; and (iii) expenditure savings are to be secured by portfolio ministries on a realistic and sustainable basis, within budget envelopes allocated by the MOFE.

To help achieve the sustainability objective, public sector debt is to be managed prudently. The government and the BOM will neither borrow on nonconcessional terms nor issue new guarantees on commercial loans, and a more rigorous screening and selection process will be adopted for new foreign-financed projects. While program loans on the order of $60 million would be required to meet the government's financing requirements during the program period, this would enable the government to rapidly retire its high-cost debt to the domestic banking sector (8½ percent of GDP), thus bringing about a gradual decline in the net present value (NPV) of total public debt. The total stock of public debt is projected to peak under the program at about 96¾ percent of GDP in 2002 and would be reduced to around 88¼ percent in 2006, while the NPV of public debt would fall steadily from 66 percent of GDP in 2000 to 55 percent in 2006.

The sensitivity of budget revenues to the terms-of-trade poses a major risk to the fiscal outlook. The surge in revenues observed in 2000 (6½ percent of GDP) mainly resulted from a boom in imports and the recovery of international prices of copper, gold and cashmere. The program's medium-term scenario takes into account the loss of dividends from privatized enterprises and the withdrawal of the temporary import-duty surcharge in 2002, but it does not allow for any further adverse effects from external shocks. Assuming that revenues are 1 percent of GDP lower than envisaged in the program's scenario from 2002 onwards, and that expenditures are maintained as programmed, the government's interest bill would rise by ½ percent of GDP over the medium-term in relation to the program's scenario and public debt would exceed the program target by some 5 percentage points of GDP in 2006.

rural incomes, increase outlays on health and education, mitigate the social impact of energy sector reforms, and enhance the pro-poor orientation of wage and pension increases (paragraphs 16–20 of MEFP). On the assumption that program loan disbursements rise to US$22½ million during 2001, the amended budget targets a small net repayment of government debt to the banking system (Table 4). If program loan disbursements are higher (lower), the reduction of net bank credit to government will be correspondingly higher (lower).[3]

17. **The amended budget has set aside the equivalent of 0.7 percent of GDP of expenditures as a reserve to be used for contingencies, while receipts from privatization have been estimated conservatively**. If there are no unanticipated pressures on expenditures, the reserved funds will be used exclusively to bring about a faster-than-targeted reduction of arrears. However, in the event that international copper prices and receipts from Erdenet are lower than projected, the reserve fund will be reduced commensurately. In addition, the Ministry of Finance and Economy (MOFE) has prepared a backup strategy for meeting exceptional shortfalls in the funding of the budget, including a detailed prioritization of expenditures to be approved by the Cabinet, with special preference to be granted to health and education consistent with the objectives of the I-PRSP. Budgetary allocations on the lowest priority domestically financed capital projects will be held in reserve until the third quarter of the year and released only if all the other key budget targets have been met during the first half of the year. The programmed repayment of domestic arrears will also be back-loaded and made contingent on satisfactory revenue performance and on the effectiveness of measures to prevent any accumulation of new arrears. Any larger-than-projected receipts from privatization will be earmarked for faster-than-programmed retirement of domestic debt.

18. **Beginning in 2002, a comprehensive public sector reform program will be implemented to rationalize the tax system, while streamlining government operations.** To pave the way for a strengthening of tax administration, the government's 2002 budget proposal will include measures aimed at improving intergovernmental fiscal relations and revenue sharing arrangements. On the expenditure side, the public wage bill will be targeted to decline progressively from 7½ percent of GDP in 2001 towards a level of 6½ percent of GDP over the medium-term, so as to reverse a part of the sharp increase recorded in the late-1990s. The wage bill during 2002 will be capped by allowing for no wage increases beyond the full-year effect of the increases being granted in 2001, except to the extent that these are compensated by clearly identified cuts in public employment and/or nonwage expenditures.

[3] Notwithstanding the symmetric application of the adjuster for external budgetary assistance, the projected amounts of such assistance have been estimated conservatively, with the result that the adjuster is most likely to result in a reduction in the ceiling for net credit to government. More specifically, the programmed external financing for 2001 is fully accounted for by program loans from the World Bank and the AsDB, which have already been approved and are to be disbursed upon Board approval of the PRGF arrangement.

The 2002 budget will include efficiency-enhancing civil service reforms, including targets for public employment reduction and wage decompression in 2002 and beyond, developed in the context of the Bank's PER. The government will also take steps to enhance the delivery and targeting of social services to the poor and protect the solvency of the social security funds, including by amending the indexation system under the 2002 budget to establish closer linkage between pensions and social security contributions.

19. **The program envisages bold steps to strengthen fiscal governance, including through comprehensive treasury reforms.** The reduction of public sector arrears is a key objective of these reforms. The government has been current on its interest payments since early 2001 and has allocated adequate funds for public debt service in the amended 2001 budget. To ensure that interest on government bonds is paid in an orderly and transparent fashion, the outstanding stock of restructuring bonds has been standardized and new contracts have been signed between the MOFE and the main bond holders stipulating the terms for the servicing of their restructuring bonds. Following the establishment of a good track record of orderly debt servicing, the government's ultimate objective will be to develop a well-functioning market for government bonds, thus paving the way for the conversion of restructuring bonds into marketable government securities. To address the problem of noninterest arrears, the MOFE, in coordination with the General Department of National Taxation (GDNT), the Customs Department, and the Social Security Funds, will also regularize its transactions with public enterprises (see also Box 5 and paragraphs 22–28 of the MEFP for more details on the reforms to improve fiscal transparency and accountability).

B. Monetary and Exchange Rate Policies and Banking System Reforms

20. **Monetary policy will be geared to reducing inflation to about 8 percent by end-2001, while continuing to bolster the stock of official reserves.** While the growth of broad money is projected to decline only modestly during the second half of 2001 in the face of the continuing recovery in intermediation, given the existing overhang of excess bank liquidity and the incipient increase in the money multiplier, reserve money growth has been targeted to decline to a range of no more than 11 percent over the full year. The BOM's net domestic assets (NDA) will accordingly be reduced somewhat under the program from their level as of end-June 2001 through increasing sales of BOM bills. The BOM's open market sales will also be guided by the need to rein in the expansion of credit. While the authorities believe that much of the increase in the demand for credit during the first half of 2001 was of a seasonal nature and should therefore abate in the latter part of the year, the BOM has supplemented the quantitative targets on its net domestic assets with indicative ceilings for the net domestic assets of the consolidated banking system. As a first step, sales of BOM bills were stepped up beginning in mid-2001 and their cutoff rates raised to the low double-digit range across most maturities (see also paragraph 33 of the MEFP).

21. **The authorities will refrain from measures to subsidize and/or direct domestic or foreign lending to favored industrial and other activities during the program period.** While the sharp pick-up in lending by some state-owned banks following initiatives by the

Box 5. Improving Fiscal Transparency and Accountability

Mongolia's fiscal management has in the past been plagued by weaknesses in the budgetary process, poor fiscal data quality, ineffective design and enforcement of intergovernmental fiscal arrangements, and a blurring of lines between the pursuit of the government's social objectives and commercial activities carried out by public enterprises. More specifically:

- **Fiscal controls and internal audit mechanisms have lacked effectiveness.** Commitments and payment responsibilities have been decentralized and have not been strictly separated, with budgetary entity managers making commitments irrespective of available resources. The transparency of operations conducted by entities whose activities are included in the budget has been hindered by their ability to open off-budget accounts under the present *Budget Law*. In addition, there has been a proliferation of extrabudgetary activities, whose management is opaque and not properly scrutinized.
- **Fiscal data reporting and reconciliation practices have been weak.** Substantial fiscal operations have gone unreported in the budget and have been financed from off-budget accounts or extrabudgetary funds, including those relying on donor financing. Deficient forecasting and costing methods and poor fiscal data quality, in turn, have resulted in unrealistic budgets, leading to frequent overspending and accumulation of arrears.
- **Financial controls over local government finances have been inadequate.** While being highly dependent on central transfers, local governments in Mongolia exercise broad economic responsibilities with great autonomy from central government policies. The local governments' financing gaps have generally been filled by ad hoc transfers determined through negotiation. The size of transfers has been unpredictable through the year and has tended to exceed the amounts allocated in the budget in the face of unsustainable arrears accumulation. Tax assignments have frequently changed as revenues have been allocated by tax payer rather than tax type, and the intergovernmental sharing arrangements used to allocate VAT revenues have had to be abandoned because of severe enforcement problems at the local government level.
- **Quasi-fiscal activities of state-owned enterprises (SOEs) have been extensive.** To finance their heavy losses, key SOEs have accumulated large amounts of tax and inter-enterprise arrears, which are not accounted for in the budget. Recourse to nontransparent cross-subsidy practices, including through the maintenance of uneconomic tariffs, has eroded the capital and hindered the privatization of some SOEs. Moreover, BOM guarantees on external borrowing by private enterprises have not been properly recorded in BOM's accounts.

The key elements of the reforms undertaken under the PRGF-supported program to redress the above weaknesses are as follows:

- **Treasury management and control are to be strengthened by transferring all government deposits in the banking system into a Treasury Single Account (TSA) in the BOM and by centralizing the responsibility for all payment and accounting responsibilities in an accounting cadre that is answerable to the MOFE.** The government has already ordered the closure of all off-budget bank accounts and is conducting a survey of extrabudgetary funds with the aim of including them in regular fiscal reporting. At the level of individual budgetary entities, expenditure commitments are to be validated against monthly warrants, thereby hardening budget constraints.
- **Measures are being taken to improve the timeliness and reliability of fiscal data, including by establishing a system of monthly reporting on fiscal arrears.** This, together with enhanced participation of line ministries in the budgetary process, should set the stage for more realistic budgeting, better monitoring of budget implementation, and reduced reliance on stopgap cost-cutting policies as a substitute for more enduring expenditure savings reforms.
- **Internal control institutions are to be strengthened and legislation passed to ensure that all public officials comply with the improved transparency standards.** The treasury and the State Financial Supervisory Agency are to coordinate their efforts to monitor budget entities' banking and accounting arrangements and the repayment of arrears. To provide a legal basis for treasury reforms in local governments, the accountability of local government officials is to be strengthened through appropriate amendments in the *Budget Law*.
- **Changes in revenue entitlements between central and local budgets are to create a sound and stable intergovernmental fiscal framework.** The centralization of the CIT and VAT, which should yield greater efficiency in revenue sharing, is to be complemented by adoption of a rules-based equalization model geared to determine budgetary transfers based on well-delineated expenditure responsibilities.
- **Reliance on implicit subsidies through the SOEs is being phased out, including by rationalizing energy tariffs and by funding remaining subsidies through the budget, and a time-bound plan is being established for the progressive elimination of cross-debts and netting out operations between the government and the major SOEs.**

Beyond these reforms, the weaknesses identified above demand sustained efforts to properly record all contingent liabilities of the government and the BOM, assess the quasi-fiscal activities undertaken by state-owned enterprises, and strengthen the role of line ministries in coordinating sectoral policies. It would be particularly important to maintain the existing legal framework pending its eventual replacement by a system of output-based budgeting. One key risk in this transition would be the premature removal of the existing systems of financial management and control before these can be effectively replaced by the mechanisms to be established under the new *Budget Law* that will formalize the shift to output-based budgeting.

Ministry of Industry and Trade to encourage the growth of low-cost loans to selected companies raised some concerns during the first half of 2001, both the Prime Minister and the Minister of Finance and Economy have pledged not to exercise moral suasion on the managements of state-owned banks to extend loans on noncommercial terms. In addition, important steps are being taken to increase the effective independence of BOM and insulate it from pressures to conduct quasi-fiscal operations. As a first step, the BOM will phase out under the program the practice of providing guarantees for nonconcessional external loans to gold mining companies or other domestic industries. In addition, the government intends to submit to Parliament legislation to liberalize the trading of gold, which should eliminate the BOM's legal monopsony on the domestic market, thus allowing it to pass on its functions of gold marketing agent to the private sector (see also paragraphs 34–35 of the MEFP).

22. **Mongolia will pursue a flexible exchange rate policy during the period of the PRGF arrangement**. The togrog is estimated to have appreciated somewhat in real effective terms in 2000 and the pace of appreciation picked up in the first half of 2001. While this appreciation does not appear to have had any significant adverse effects on export performance to date, the authorities will need to keep competitiveness indicators under close review, especially if there is a significant deterioration in the terms of trade. The BOM will continue to allow the value of the togrog to be determined primarily by market forces while limiting intervention to smooth excessive exchange rate fluctuations and meet the reserve targets of the program. Given the existing pipeline in official inflows and the additional inflows expected to be catalyzed by the PRGF-supported program, net international reserves are projected to increase by US$25 million during 2001, raising the import cover of gross reserves to about 15 weeks by the end of the year.

23. **BOM's prudential standards and their enforcement will continue to be strengthened under the program, with the lead role for the monitoring of reforms to be exercised by the World Bank under its FSAC**. To reinforce the government's efforts and the measures supported under the FSAC to improve the governance of the banking system, the PRGF-supported program envisages the application of strict selection criteria for the licensing of new foreign bank branches, in line with best international practices (paragraphs 37–39 of the MEFP).

C. Public Enterprise Reform and Privatization and Safety Nets

24. **The I-PRSP attaches high priority to promoting private sector-led economic growth, including by accelerating the privatization of state assets and attracting foreign investment**. The government's privatization program for 2001, which was approved in February, envisages the sale through competitive tender of several most-valued companies, including the Trade and Development Bank (TDB), Gobi Cashmere Company, and NIC (see also paragraphs 40–42 of the I-PRSP). Progress in this area has been rapid. The tender for Gobi has already been announced and expressions of interest by potential buyers were due by end-August 2001, while the tender documents for TDB are expected to be issued by end-September. The government has also embarked on a reform program for the energy sector, with support under a new World Bank project approved in April 2001 (Box 6 and

Box 6: The Energy Sector in Mongolia

Energy is a key sector in Mongolia. Because Mongolia is one of the coldest countries in the world, the efficient provision of heat and electricity is central to the effective functioning and competitiveness of the Mongolian economy, and problems that currently exist in the energy sector spill over to the rest of the economy. Inefficient operation and continued financial losses at the state-owned energy companies adversely affect the production and supply of energy and the government's fiscal position, divert scarce public resources, discourage private investment, and retard economic activity and poverty alleviation.

Most of the energy sector is controlled by the state-owned Energy Authority (EA). The EA consists of (i) the central energy system (CES), based on five coal-fired combined heat and power (CHP) plants connected to Russia's Siberian grid, which generates heat and electricity for the largest cities (Ulaanbaatar, Darhan, Erdenet and Baganuur) and six surrounding aimags (provinces), accounting for 90 percent of total electricity use and the majority of the demand for heating; (ii) Electricity Transmission Offices (ETOs) and Heat Distribution Offices (HDOs) that deliver energy to users and are also responsible for customer billing and collection; (iii) the aimag power system which provides electricity and heat to aimags outside the CES, and is based on small coal-fired CHP plants, heat-only boilers, and diesel generators; and (iv) a maintenance service company and other small entities. In addition, the EA imports electricity from Russia to meet peak load demand. The main suppliers of coal are the government majority-owned coal mines while diesel is imported primarily from Russia.

Since 1992, government and donor efforts have mainly focused on averting a crisis and ensuring a steady supply of energy. An emergency rehabilitation program of the basic energy supply infrastructure, financed primarily from external sources, has been in place since the early 1990s. The program includes the renovation of diesel generators, the improvement of aimag and soum (district) center diesel plants, the construction of a new thermal power station, and the rehabilitation of a number of power plants and the largest coal mines. The program has been largely successful in preventing a collapse of the system during the last decade and in ensuring a stable energy supply beginning in the late 1990s.

However, the energy sector continues to face further efficiency and structural problems, and the financial viability of the EA is under threat. The EA has incurred losses consistently during the 1990s, and accumulated losses in 2000 are estimated at $17 million (around 2 percent of GDP). These losses are a result of below-cost pricing geared to the implicit subsidization of some sectors, inefficient operation, poor management incentives and practices, nonpayment by both industrial customers and households exacerbated by an inadequate collection system, non-technical losses (primarily theft), and cross-subsidies of around $5 million per year to isolated aimag utilities for operating costs. Inter-company arrears, in particular, have been a persistent problem. Receivables, mainly from the Erdenet Copper Company (the largest consumer of energy) and government agencies, accounted for roughly 24 percent of annual sales of the EA in 2000. In addition, the EA is a net-debtor vis-à-vis the Baganuur Coal Company (the largest supplier of coal to the EA and the second largest consumer of electricity).

In April 2001, the Mongolian government reached agreement with the World Bank on a comprehensive program of energy sector reform. The program will support (i) investments and reforms necessary to improve the efficiency of the electricity distribution system, minimize technical losses and enhance revenue collection; (ii) reforms to improve transparency by incorporating quasi-fiscal activities previously financed by the EA in the budget; and (iii) the restructuring of the energy sector in order to attract greater private sector participation. The key elements of the reform strategy are as follows.

- ***Energy Law***: New electricity and heating legislation, proposed in consultation with the World Bank and donors, was approved by Parliament on February 2, 2001. The law provides the legal framework for the reforms and restructuring of the energy sector as well as establishes an independent regulatory entity, the National Energy Regulatory Authority.
- ***Energy tariff adjustments***: On December 15, 2000, the government increased coal, electricity and heating prices by 15 percent, 15 percent and 35 percent respectively. Future energy price increases will follow a cost recovery basis and be the responsibility of the National Energy Regulatory Authority.
- ***Clearance of inter-company arrears***: An action plan to reduce inter-company arrears between the EA and the Baganuur Joint Stock Company (BJSC) was agreed to in February 2001. The main components of the plan are the timely payment by the EA on current coal supplies from the BJSC and a schedule of payments on outstanding arrears during the next three and a half years.
- ***Discontinuation of cross-subsidies by the EA to aimag utilities***: Beginning in 2001, funds provided by the EA through a cross-subsidy from urban consumers with low service costs to isolated aimag utilities to cover the shortfall between revenue and operational (mainly fuel costs) and maintenance expenses, are to be transparently financed, on a temporary basis, by direct transfers from the central and aimag government budgets. These government transfers are to be phased out over the medium-term on the basis of a plan to be presented in Spring 2002.
- ***Future privatization of the energy sector***: In the near-term, the government proposes, as outlined in the *Privatization Program for 2001*, to offer the Ulaanbaatar power plant number 2, the Bayanhongor energy plant, and two aimag coal mines for competitive tender to strategic investors. The government also intends to restructure the EA into independent economic entities operating the generation, transmission and distribution of energy, with a view to their eventual privatization.

paragraphs 40–43 of the MEFP). Most recently, the government directed that Ulaanbaatar Electric Distribution Network (UBEDN) and Power Plant No. 2 be bundled into the first energy sector privatization tender offer, which should be ready for issuance in mid-2002.

25. **The I-PRSP underscores the government's intention to institute adequate social safety nets to protect vulnerable groups from the potential adverse side-effects of reforms.** As a first step, following the recent increases in energy tariffs, the budget has temporarily assumed responsibility for financing the cost of pro-poor energy subsidies that were previously borne by the Energy Authority. The government intends to phase out these subsidies over the medium term, on the basis of a plan to be presented in the Spring of 2002. The government will also explore the possible means to deliver and distribute petroleum supplies to the rural areas and will include adequate allocations in the 2002 budget to assume financial responsibility for the protection of the rural poor from future increases in petroleum prices resulting from the privatization of NIC. In the context of the full PRSP, the development of the government's policies on social safety nets will need to be guided by more systematic Poverty and Social Impact Assessments for the effects of recent and prospective reforms in the areas of trade policy, energy sector and civil service reforms, and privatization of state-owned enterprises. The World Bank is expected to assist in this endeavor.

D. External Sector Policies and Capacity to Repay the Fund

26. **The government will maintain regular relations with creditors, a prudent external debt policy, and an open trade and investment system under the program.** During the high-level intergovernmental committee meeting in November 2000, an agreement was reached for the clearance of overdue payments on Mongolia's post-1991 debt to Russia and for the payment of debt service due in 2000 and 2001. This schedule of repayments has been incorporated in the amended budget for 2001 and will be strictly adhered to. With respect to the pre-1991 transferable ruble debt, a new working group has been set up to examine options for dealing with the problem. The staff is encouraging the authorities to resolve this matter expeditiously, as a final settlement on the large stock of pre-1991 debt will be essential to consolidate the restoration of external sustainability. Contacts have also been established with other potential claimants to initiate the process of resolving disputed external claims arising from the granting of government guarantees on past external debt. The government and the BOM have pledged that they will not provide new public guarantees on private external debt during the program period nor contract any new external debts on nonconcessional terms without prior consultation with the Fund. To encourage export-oriented investment and growth, customs controls and licensing for imports and exports will be simplified under the program, all import tariffs will be reduced to a unified rate of 5 percent from 2002 onwards, and no new taxes, quantitative restrictions, voluntary restraints or other measures will be introduced on international trade. The staff has also recommended that the authorities eliminate the differential taxation of imported beer as soon as possible.

27. **With policies along the lines discussed above, and with continued donor support, Mongolia's external position is projected to improve gradually over the medium term.** Assuming that import growth reverts to a level that is more in line with GDP growth from 2001 onwards and that, consistent with WEO projections, the terms of trade recover in 2002–03 before leveling off thereafter, the current account deficit (including official grants) is projected to narrow from about 7¼ percent of GDP in 2001 to 6 percent in 2004. While the adjustment of the current account excluding official transfers is projected to be more marked, this would come about primarily as a result of the decline in grant-financed Zud-related imports, which were unusually large in 2000–01. Medium-and long-term official loan disbursements are projected to remain in a range of US$80–100 million a year, while official transfers would decline somewhat from the unusually high levels of close to $100 million reached in 2000–01. While foreign direct investment is projected to rise gradually towards $50–60 million a year, additional external assistance will be needed to fill the remaining financing gap in the balance of payments. External financing gaps on the order of US$15–30 million a year are projected to emerge during the program period. During 2001, an estimated financing gap of about $28 million is expected to be filled with the help of disbursements under the World Bank's FSAC loan, program loans from the AsDB, and drawings under the PRGF. In the staff's view, the programmed disbursements under the already-approved loans from the above sources and other donors, together with the existing pipeline of new loans, should be sufficient to close the financing gaps during the remainder of the program period.

28. **Based on the above scenario, public external debt, including Fund credit and short-term debt but excluding the large stock of pre-1991 transferable ruble debt to Russia, is projected to peak at about 94 percent of GDP (or less than 60 percent in NPV terms) in 2003 and decline steadily thereafter**. Mongolia's debt service payments, including on Fund credit and short-term debt, are projected to peak at about 7 percent of gross current receipts in 2001, reflecting the amortization of rescheduled post-1991 debts to Russia, and decline to 4½–5½ percent over the medium term. Repayments to the Fund would amount to 1 percent of gross current receipts during 2001–04, equivalent to 3 percent of projected gross official reserves. On the basis of this scenario and Mongolia's good record in making payments to the Fund, the authorities are expected to discharge their obligations to the Fund on a timely basis.

29. **The downside risks associated with this scenario suggest that the government should err on the side of caution in implementing its adjustment program**. A major risk stems from Mongolia's continued vulnerability to terms of trade and climatic shocks. An unanticipated weakening of copper prices, in particular, would put the fiscal accounts under serious strain, jeopardizing the achievement of the fiscal sustainability objective and threatening macroeconomic stability. This consideration reinforces the case for rigorous implementation of the government's fiscal adjustment program, including through a faster-than-programmed reduction of the budget deficit during periods in which the external situation is better than expected. Another risk relates to the size and composition of capital inflows. If the government's reform program is not sufficiently ambitious to encourage more foreign direct investment and/or if there is a shift in the composition of aid inflows in favor

of loans, the sustainability of Mongolia's external position may come under question. This, in turn, could further discourage capital inflows, undermining the achievement of the program's investment, growth, and poverty reduction objectives.

E. Statistical and Data Reporting Issues

30. **Mongolia has made impressive progress in developing its statistical base over the last decade, but further improvements will be necessary to establish the foundations for more effective policy analysis and program monitoring.** The priority areas for statistical development have been laid out in a Report on the Observance of Standards and Codes (ROSC), which has been published on the Fund's external website. The government is committed to taking appropriate follow-up actions to address remaining data weaknesses, with the help of continued technical assistance from STA and the World Bank. As data improvements take hold, however, ongoing revisions in key fiscal and monetary data could complicate program monitoring.

31. **Top priority will be given under the program to improving the reliability, timeliness, and comprehensiveness of fiscal data reporting.** Weak budgetary data and forecasting capacity within the MOFE undermined the development of a realistic budget for 2000 and made it difficult to assess the need for corrective measures in the course of the year. Improved statistical coverage and reporting of fiscal arrears will be essential for effective monitoring and implementation of the PRGF-supported program. Following the recommendations of a recent FAD/STA fiscal data quality mission, which also prepared a fiscal ROSC, the MOFE has already set up a system of accounts-based monthly reporting on government payments arrears, payables to Customs, the GDNT, and pension funds, and netting out operations. Moreover, beginning in September 2001, all government entities, including extrabudgetary funds (EBFs), will be required to report semi-annually to the MOFE and the MOFE will prepare semi-annual reports for consolidated central government accounts and available data on local governments, including comprehensive data on public employment. Legislation requiring all general government entities, including EBFs, to report quarterly to the MOFE will be submitted to parliament in conjunction with the 2002 budget.

32. **Important steps are also being taken to improve the reporting and monitoring of contingent foreign liabilities.** In the course of the program discussions, the staff encountered some difficulties in collecting comprehensive data on BOM-guaranteed external loans for the pre-financing of gold exports and on reserve liabilities associated with BOM's off-balance sheet derivatives transactions, owing in part to the fact that such operations had not in the past been recorded in the BOM's accounts. The BOM has since provided the staff with data on the schedules and amounts of previously granted guarantees and has agreed not to issue any new external debt guarantees under the program without prior consultation with the staff. In addition, the authorities have agreed to fully cooperate with the staff, with a view to providing a complete accounting in the NIR for all BOM liabilities, including derivatives and any other contingent liabilities by the time of the first review. To facilitate program monitoring, the authorities have also agreed to adhere henceforth to the reporting

requirements for nonconcessional external debt and guarantees in accordance with the Fund's definitions as stipulated in a Technical Memorandum of Understanding (TMU; Attachment III), including with regard to gold transactions and related BOM liabilities.

V. Program Monitoring

33. **Risks to program implementation derive primarily from possible difficulties in developing consensus for reforms within the government and from weaknesses in implementation capacity**. While the ruling Mongolia People's Revolutionary Party (MPRP) has consolidated its hold over power with the recent re-election of incumbent President Bagabandi for a second term, some of the reforms to increase fiscal transparency and accountability may enjoy less than universal support within the Cabinet. The difficulties in this area may be compounded by a shortage of adequately trained staff to implement treasury reforms within the MOFE. An additional risk stems from the fact that elements of the MPRP's well-publicized Action Program, which are strongly supported by some Cabinet members, may not be fully consistent with the proposed PRGF-supported program. More specifically, important constituencies within the MPRP may make it difficult to ensure that public wage policies remain prudent and that neither directed credit policies nor special tax privileges are used as a means to support domestic industry. To address these risks and send a clear signal regarding the government's resolve to implement the PRGF-supported program, the program provides for a number of prior actions (Table 2 of MEFP) and it envisages continued support of the treasury reforms through the assignment of an FAD advisor at the MOFE, with an initial term of six months which may be subsequently extended to one year. The program also provides for close monitoring of the implementation of macroeconomic and structural reforms through quantitative and structural performance criteria and benchmarks and through program reviews (Tables 1 and 3 and paragraphs 47–48 of the MEFP). As regards the division of labor in the structural conditionality under the program, the focus under the PRGF-supported program will be on monitoring macroeconomic policies and reforms to strengthen fiscal governance, while the World Bank will monitor financial sector and energy sector reforms under its structural adjustment programs and will provide advice on civil service reform under its PER.

VI. Staff Appraisal

34. Mongolia has made great strides during its first decade of transition to a market economy, but it continues to face important challenges. The progress towards disinflation and external stability was continued during the second half of the 1990s and bold reforms were launched to rehabilitate a virtually insolvent banking system, with support from the last PRGF-supported program. However, weak fiscal governance, in the context of a deteriorating external environment and the issuance of high-cost debt to shore up the banking system, led to an unsustainable buildup of public debt, and policy implementation slackened as the political consensus for reform dissipated. With growth performance remaining lackluster, the incidence of poverty has remained stubbornly high. The task for the

government that took office in August 2000 has been complicated by two consecutive years of severe winter weather, which aggravated rural poverty and placed new burdens on the budget.

35. The government's program, for which PRGF support is being requested, is a credible effort to redress this difficult situation. The reform agenda is appropriately centered on policies to foster fiscal sustainability and create an environment conducive to private sector-led growth. Sound fiscal and monetary management, together with reforms to strengthen fiscal transparency and accountability, rationalize tax and public expenditure policies, and establish a well-governed banking system, will be key elements of the strategy underpinning the program. To improve opportunities for private investment and reduce reliance on debt-creating capital inflows, the government is also reinvigorating its efforts to privatize large enterprises, restructure the energy sector, and maintain an open investment and trade system.

36. Fiscal consolidation will be essential to promote lasting disinflation, make room for adequate growth of credit to the private sector, and place the public debt-to-GDP ratio on a clearly declining path. Given the limited scope for expenditure reduction in the short run, the adjustment effort under the program will initially need to rely primarily on revenue mobilization. The government's budget for 2001 has accordingly introduced a substantive package of revenue measures, reinforced by long-overdue adjustments in domestic energy prices to arrest the drain on the budget resulting from the operations of loss-making public enterprises. On the expenditure side, the budget, as amended in mid-2001, appropriately focuses on making realistic allocations for budgetary entities to cover the full cost of their operations. This is an essential first step towards halting, and beginning to reverse, the accumulation of budgetary arrears. Top priority is to be given to ensuring the orderly servicing of government restructuring bonds based on a transparent and standardized mechanism for the determination of their interest rates. Based on conservative assumptions about program loan disbursements and privatization receipts, the budget envisages a respectable effort to begin to repay the government's net debt to the domestic banking system through a progressive retirement of high-yield bank restructuring bonds.

37. Beginning in 2002, fiscal consolidation will be secured primarily through a progressive reduction of Mongolia's relatively high current expenditure ratio. While efforts to strengthen tax administration and broaden the tax base will be intensified, the net effect on revenues is expected to be mitigated by the planned withdrawal of the 2 percent customs duty surcharge introduced in 2001. On the expenditure side, the government will need to adopt reforms to revamp civil service pay and employment, so as to reduce the cost of government without adversely affecting the provision of essential services for the poor. The budget for 2002 will allow for no general wage increases beyond the raises being granted in 2001, except to the extent that these are offset by savings generated through clearly specified cuts in employment and/or nonwage expenditures. The 2002 budget will also include measures to enhance the delivery of social services and the pro-poor orientation of safety nets, based on the recommendations developed under the World Bank's Public Expenditure Review (PER).

38. The PRGF-supported program aims to strengthen enforcement mechanisms in budget implementation, arrest the buildup of budgetary arrears, and ensure that pro-poor transfers and social expenditures are effectively channeled to the intended beneficiaries. The staff strongly endorses the efforts under way to strengthen fiscal reporting and monitoring systems and revamp treasury operations, including through the establishment of a treasury single account at the Bank of Mongolia. These efforts warrant continued FAD technical assistance.

39. Monetary and exchange rate policies under the program will aim to ensure that inflation declines towards the low-single digit range and that external reserves continue to be bolstered. Given the intensification of inflationary pressures in the first half of 2001, an excessive easing of monetary and credit conditions would carry the risk of allowing higher inflation to become embedded in market expectations. To keep the growth of monetary and credit aggregates within prudent limits, the BOM has recently stepped up its sales of BOM bills. BOM bill rates will need to remain consistently positive in real terms throughout the program period given their influence on interest rates on restructuring bonds and commercial bank deposits and on the liquidity and solvency of major state-owned banks. The BOM will continue to allow the exchange rate of the togrog to be determined primarily by market forces and will limit intervention to smooth excessive exchange rate fluctuations and meet the reserve targets of the program.

40. A key objective under the program will be to consolidate the shift to a market-oriented system of indirect monetary management based on open market operations in government securities. Once a good track record has been established in the servicing of public debt, the government will begin to convert the remaining stock of restructuring bonds into marketable securities and use them to gradually replace BOM bills in the conduct of open market operations. The use of administrative measures or moral suasion to unduly influence commercial banks' lending decisions and the granting of public guarantees on external borrowing by domestic enterprises have in the past undermined the efficiency and soundness of Mongolia's banking system and placed heavy burdens on the budget. The staff welcome the authorities' pledges not to interfere in commercial bank management and lending operations and not to extend new public guarantees on private loans. These policies, together with the government's commitment to place the privatization of key state-owned banks on a fast track, should serve to reassure market participants that the recent improvement in the soundness of the banking system will be sustained and that credit will continue to be allocated based on strictly commercial criteria. It will be important, in this connection, that BOM's prudential standards and their enforcement continue to be strengthened, including by applying strict selection criteria for the licensing of new banks.

41. The staff welcomes the plans to accelerate the privatization of most-valued public enterprises. Determined pursuit of the privatization program, together with the energy sector reforms supported by the World Bank, should enlarge the scope for foreign direct investment and reduce reliance on debt-creating capital inflows. To limit any adverse social impact of these reforms, the government will develop a transparent framework to incorporate some of the pro-poor implicit subsidies previously provided by public enterprises into the budget.

42. Mongolia's external position is expected to strengthen gradually over the medium term with program implementation and should remain viable as long as the external environment is moderately favorable. With continued pursuit of prudent fiscal and debt management policies, external debt indicators are projected to be placed on a declining path over the medium term. However, given the country's high vulnerability to terms of trade and climatic shocks, domestic policies will need to err on the side of caution and the concessionality of aid inflows will need to be maintained.

43. The risks to the program are considerable but manageable. To prevent slippages in implementation, the government will need to build solid support for the politically sensitive elements of reform in the areas of treasury operations, public wages, and credit policy. It will also be important that the Bank, the Fund, and bilateral donors provide adequate technical assistance to help establish the social safety nets necessary to prevent an erosion of public support for reforms and to build an adequate level of technical capacity within the MOFE and key spending ministries. Close monitoring of the program will also be essential, including in coordination with the Bank's FSAC and PER. While Mongolia has made good use of Fund technical assistance in developing its statistical base over the last decade, strong political commitment will be required to continue to address data weaknesses that may hamper policy analysis and to establish accurate, timely and forthright data reporting to the Fund.

44. The staff consider the proposed reform program to be appropriately ambitious and realistic. The proposed PRGF access is consistent with Mongolia's balance of payments need and outstanding use of Fund credit. The government's reform program merits the support of the international community, and the staff therefore recommends Board approval of the authorities' request for a three-year arrangement under the PRGF.

Table 1. Mongolia: Proposed Schedule of Disbursements Under the PRGF Arrangement, 2001-04

Amount (In millions of SDRs)	Available Date	Conditions for Disbursement
4.07	September 28, 2001	Board approval of the three-year arrangement
4.07	March 2002	Observance of end-December 2001 quantitative and structural performance criteria and completion of first review
4.07	September 2002	Observance of end-June 2002 quantitative performance criteria and end-April 2002 structural performance criteria and completion of second review
4.07	March 2003	Observance of end-December 2002 performance criteria and completion of third review
4.07	September 2003	Observance of end-June 2003 performance criteria and completion of fourth review
4.07	March 2004	Observance of end-December 2003 performance criteria and completion of fifth review
4.07	September 2004	Observance of end-June 2004 performance criteria and completion of sixth review

Table 2. Mongolia: Fund Position and Indicators of Fund Credit, 2000-2006 1/

	2000	2001					2002	2003	2004	2005	2006
		Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Cumulative					
						(In millions of SDR)					
Transactions during the period (net)	1.1	-0.9	-1.5	-1.5	2.6	-1.3	2.2	2.0	3.3	-4.0	-4.0
Enhanced Structural Adjustment Facility											
repayments (net)	4.8	0.9	1.5	1.5	1.5	5.4	5.9	6.1	4.9	4.0	4.0
disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
repayments	4.8	0.9	1.5	1.5	1.5	5.4	5.9	6.1	4.9	4.0	4.0
Poverty Reduction and Growth Facility											
disbursements (net)	5.9	0.0	0.0	0.0	4.1	4.1	8.1	8.1	8.1	0.0	0.0
disbursements	5.9	0.0	0.0	0.0	4.1	4.1	8.1	8.1	8.1	0.0	0.0
repayments	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Fund Credit Outstanding (end of period)	38.6	37.7	36.2	34.7	37.3	37.3	39.5	41.5	44.8	40.8	36.7
Enhanced Structural Adjustment Facility	38.6	37.7	36.2	34.7	33.2	33.2	27.3	21.1	16.3	12.3	8.2
Poverty Reduction and Growth Facility	0.0	0.0	0.0	0.0	4.1	4.1	12.2	20.4	28.5	28.5	28.5
						(In percent of quota)					
Total Fund Credit Outstanding (end of period)	75.5	73.7	70.8	67.9	72.9	72.9	77.3	81.2	87.6	79.8	71.9
Enhanced Structural Adjustment Facility	75.5	73.7	70.8	67.9	65.0	65.0	53.4	41.4	31.9	24.0	16.1
Poverty Reduction and Growth Facility	0.0	0.0	0.0	0.0	8.0	8.0	23.9	39.8	55.8	55.8	55.8

Sources: International Monetary Fund, Treasurer's Department; and staff projections.
1/ Assumes disbursements and debt service under the prospective PRGF arrangement.

Table 3. Mongolia: Selected Economic and Financial Indicators, 1998-2004

Nominal GDP (1999): $906 million
Population (1999): 2.36 million
Quota: SDR 51.1 million

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
						Est.		Prog.		
						(Percent change)				
Real GDP	6.3	2.4	4.0	3.5	3.2	1.1	1.4	4.0	5.0	6.0
Consumer prices (period average)	56.8	46.8	36.6	9.4	7.6	11.6	8.8	6.0	5.0	5.0
Consumer prices (end period)	53.1	44.6	20.5	6.0	10.0	8.1	8.0	6.0	5.0	5.0
						(In percent of GDP)				
General government revenue	25.6	24.8	25.5	27.6	27.2	33.6	33.6	32.7	32.6	32.6
General government expenditure	31.5	32.7	34.5	41.9	39.4	40.5	41.0	39.8	39.2	38.6
Current balance	6.2	4.0	1.6	-0.7	-0.2	3.1	2.7	3.1	3.4	4.0
Overall balance	-5.9	-7.9	-9.1	-14.3	-12.2	-6.8	-7.3	-7.1	-6.6	-6.0
Net domestic credit to government	-2.1	2.1	-3.3	4.1	0.0	-0.7	-1.5	-2.3	-1.3	-0.9
Total public debt 1/ 5/	42.3	54.0	64.5	85.3	102.5	96.5	94.9	96.7	96.2	93.9
NPV of total public debt	...	...	...	...	71.7	66.0	63.4	62.4	60.8	58.3
						(Percent change)				
Net foreign assets	87.0	69.0	68.3	-31.6	96.9	33.6	13.0	16.8	...	...
Net domestic assets	12.4	-1.4	-6.3	56.5	-23.6	-17.9	23.4	-7.6	...	...
Domestic credit	-21.6	133.4	-5.1	60.1	-11.1	-8.0	0.8	-4.4	...	...
Credit to enterprises	18.1	-20.1	13.2	18.5	-39.7	29.5	38.3	33.9	...	...
Broad money	32.9	25.8	19.8	8.8	31.7	17.5	15.3	11.1	...	...
Reserve money	...	36.2	26.2	13.5	51.8	19.4	11.1	10.8	...	...
Broad money velocity (GDP/BM) 2/	5.4	5.0	5.5	5.0	4.3	4.1	4.0	3.9	...	...
Annual interest rate on central bank bills (percent) 3/	62.4	42.0	35.0	23.3	11.4	8.5	10.0	...	...	...
						(In millions of US dollars, unless otherwise indicated)				
Current account balance, excluding official transfers	-52	-101	14	-129	-124	-167	-170	-159	-155	-159
(In percent of GDP)	-4.3	-8.5	1.3	-13.2	-13.7	-17.2	-16.7	-14.7	-13.4	-12.7
Current account balance, including official transfers	26.9	-36.9	75.2	-75.5	-57.1	-68.3	-74.6	-76.5	-70.1	-74.2
(In percent of GDP)	2.2	-3.1	7.1	-7.8	-6.3	-7.0	-7.3	-7.1	-6.1	-5.9
Trade balance	-3	-87	31	-120	-113	-150	-150	-132	-124	-126
(In percent of GDP)	-0.3	-7.4	3.0	-12.4	-12.5	-15.5	-14.7	-12.3	-10.7	-10.0
Exports, fob	486	423	569	462	454	537	549	601	647	693
(Percent change)	84.1	-12.8	34.5	-18.8	-1.7	18.2	2.3	9.4	7.7	7.0
Imports, cif	489	511	538	582	567	687	699	733	771	819
(Percent change)	12.8	4.5	5.4	8.2	-2.6	21.2	1.7	4.9	5.2	6.2
Financial and capital account balance	19	41	53	116	59	68	72	81	81	89
(In percent of GDP)	1.5	3.5	5.0	12.0	6.5	7.1	7.1	7.5	7.0	7.0
Gross official international reserves (end-period) 4/	115	98	137.5	124.7	156.8	190.9	209.2	237.1	259.8	284.2
(In weeks of next year/projected imports c.i.f.)	11.7	9.4	12.3	11.4	11.9	14.2	14.8	16.0	16.5	17.0
Public and publicly guaranteed external debt 5/	504	542	605	753	850	854	912	1009	1089	1171
(In percent of GDP)	41.1	46.0	57.4	77.4	93.9	88.0	89.4	93.6	94.2	93.1
NPV of public and publicly guaranteed external debt	...	...	...	...	571	558	591	639	679	724
(In percent of GDP)	...	...	...	...	63.0	57.5	57.9	59.2	58.7	57.6
Debt service 5/	64.2	56.6	41.0	39.3	41.3	31.5	45.8	37.4	40.9	36.5
(In percent of exports of goods & services)	12.1	11.8	6.3	7.3	9.3	6.0	7.0	5.3	5.4	4.5
Exchange rates										
Togrogs per US dollar (end of period)	474	694	813	902	1,072	1,097	...	...	...	...
Togrogs per US dollar (period average)	449	548	790	841	1,022	1,077	...	...	...	...
NEER, end-period (1995=100) 6/	95.9	69.0	63.0	69.0	60.8	59.3	60.7	...	...	...
REER, end-period (1995=100) 6/	108.2	105.9	113.2	117.6	107.5	108.1	119.9	...	...	...
Export prices (US dollar, percent change)	26.0	-21.8	-3.4	-18.3	-6.9	10.5	-4.3	4.7	3.1	2.0
Copper price (US dollar, percent change)	40.2	-36.9	19.3	-38.1	-5.8	18.4	-11.0	13.3	6.0	3.4
Import prices (US dollar, percent change)	9.6	1.7	-6.5	-6.8	-2.9	2.9	-5.2	0.3	0.5	1.6
Terms of trade (percent change)	15.0	-23.1	3.3	-12.3	-4.2	7.4	0.9	4.4	2.6	0.4
Private savings-investment balance (in percent of GDP)	8.1	4.7	16.2	6.5	5.9	-0.2	0.0	0.1	0.5	0.1
Nominal GDP (billion togrogs)	550	647	833	817	925	1,045	1,152	1,270	1,401	1,559
Nominal GDP (million US dollars)	1,227	1,179	1,054	972	906	970	1,020	1,078	1,156	1,257

Sources: Mongolian authorities; and Fund staff estimates and projections.
1/ Includes IMF loans, guarantees and arrears.
2/ Seasonally adjusted figures for broad money velocity from 1997 onwards.
3/ Annualized yield on end-period auction of 14-day bills. For 2001, as of end-August.
4/ Beginning December 2000, includes commercial banks' foreign exchange deposits with the Bank of Mongolia.
5/ Excludes unresolved claims estimated at TR 10.5 billion to Russia.
6/ For 2001, end-June.

Table 4. Mongolia: Summary Operations of the General Government, 1997-2002

	1997	1998	1999	2000	2001			2002
	Actual 1/				Original budget	Program	Amended 6/	Program
					(In billions of togrogs)			
Total revenue and grants	212.1	225.5	251.7	351.4	368.4	387.3	389.0	414.8
Total expenditure and net lending	287.6	342.1	364.6	422.6	454.2	472.0	474.1	505.6
Overall balance (incl. grants)	-75.5	-116.6	-112.9	-71.3	-85.8	-84.7	-85.1	-90.8
Discrepancy between deficit above and below the line	0.0	0.0	4.5	-0.4	0.0	0.0	0.0	0.0
Financing	75.5	116.6	117.3	70.8	85.8	84.7	85.1	90.8
Foreign Financing (net)	92.8	68.6	105.8	66.6	86.2	56.1	56.6	86.5
Privatization receipts	10.4	14.5	11.7	7.2	10.5	10.2	10.5	9.7
Domestic Bank Financing (net)	-25.4	33.6	-0.2	-7.1	-10.9	-16.8	-7.4	-29.6
Other (settlement of claims with the BOM and non-bank financing)	-2.3	0.0	0.0	4.2	0.0	9.8	0.0	0.0
Financing gap	...	...	...	...	...	25.4	25.4	24.2
					(In percent of GDP)			
Total revenue and grants	25.5	27.6	27.2	33.6	32.0	33.6	33.8	32.7
Current revenue	24.7	26.5	26.5	33.2	31.3	33.1	33.1	32.0
Tax revenue and social security contributions	19.7	18.8	19.7	25.0	25.0	25.7	25.9	24.9
Income taxes	7.5	5.1	4.2	6.0	5.8	5.7	5.9	5.8
Enterprise income tax	6.6	3.8	2.9	4.6	4.2	4.3	4.4	4.3
Personal income tax	0.9	1.2	1.4	1.4	1.5	1.4	1.5	1.5
Social security contributions	2.6	3.2	3.3	3.8	3.3	3.3	3.4	3.3
Sales tax and VAT	4.6	5.6	6.5	7.3	8.2	8.0	8.2	7.9
Excise taxes	2.4	3.0	2.9	3.9	3.3	4.0	4.0	4.0
Customs duties and export taxes	1.1	0.2	1.0	2.1	2.6	2.7	2.6	2.0
Other taxes	1.5	1.8	1.8	1.8	1.8	2.0	1.8	2.0
Nontax revenue	5.0	7.7	6.8	8.2	6.3	7.4	7.1	7.2
Capital revenue and grants	0.7	1.1	0.7	0.5	0.7	0.5	0.7	0.6
Total expenditure and net lending	34.5	41.9	39.4	40.5	39.4	41.0	41.1	39.8
Current expenditure	23.1	27.2	26.7	30.1	28.0	30.5	30.5	29.0
Wages and salaries	5.4	6.8	6.9	8.2	7.5	7.5	7.5	7.1
Purchase of goods and services	10.0	12.2	10.9	11.9	11.0	12.6	12.6	11.6
Of which: clearance of budget entities' arrears	...	...	...	...	0.0	0.4	0.3	0.3
Subsidies to public enterprises	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Transfers	5.2	6.8	7.0	8.1	7.7	7.9	7.9	7.6
Interest payments	2.5	1.4	1.9	1.7	1.7	1.7	1.7	1.7
Contingency allocation	...	...	...	...	...	0.7	0.7	1.0
Capital expenditure and net lending	11.4	14.6	12.7	10.4	11.4	10.5	10.7	10.8
Capital expenditure	3.5	4.2	4.0	5.0	4.3	4.5	4.6	4.0
Net lending	7.9	10.5	8.7	5.4	7.1	6.0	6.0	6.8
On-lent foreign project loans (net)	8.1	9.0	8.3	5.2	6.9	5.8	5.8	6.5
Domestic lending minus repayments	-0.2	1.5	0.4	0.2	0.2	0.2	0.2	0.3
Current balance (exclud. privatization receipts)	1.6	-0.7	-0.2	3.1	3.3	2.7	2.6	3.1
Overall balance (incl. grants)	-9.1	-14.3	-12.2	-6.8	-7.4	-7.3	-7.4	-7.1
Overall balance (incl. grants, excl. Erdenet)	...	...	-12.3	-9.4	...	-9.3	...	-9.0
Discrepancy between deficit from above and below the line	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0
Financing	9.1	14.3	12.7	6.8	7.4	7.3	7.4	7.1
Foreign Financing (net)	11.1	8.4	11.4	6.4	7.5	4.9	4.9	6.8
Project loans	8.1	9.0	9.4	6.0	7.9	7.1	7.1	7.8
Program loans	5.3	0.9	1.8	1.3	1.3	0.0	0.0	0.0
Buligaar 2/	0.0	0.0	1.5	0.0	0.0	0.0	0.0	0.0
Amortization	2.2	1.6	1.1	0.9	1.7	2.2	2.2	1.0
Privatization receipts	1.2	1.8	1.3	0.7	0.9	0.9	0.9	0.8
Settlement of claims with the BOM	0.0	0.0	0.0	0.4	0.0	0.9	0.0	0.0
Domestic Bank Financing (net)	-3.1	4.1	0.0	-0.7	-0.9	-1.5	-0.6	-2.3
Domestic Non-Bank Financing (net)	-0.3	0.0	0.0	0.0	...	0.0	0.0	0.0
Financing gap (identified)	...	...	...	...	...	2.2	2.2	1.9
Memorandum items:								
Social expenditure 3/	15.7	19.4	19.1	21.6	20.2	...	20.8	...
Education	5.6	7.1	7.0	7.9	7.3	...	7.6	...
Health	3.4	4.0	3.9	4.4	4.0	...	4.2	...
Housing and community	0.4	0.5	0.5	0.7	0.7	...	0.6	...
Social welfare	5.1	6.3	6.5	7.3	7.1	...	7.2	...
Culture	1.1	1.4	1.2	1.4	1.1	...	1.2	...
Defense expenditure	1.9	2.2	2.0	2.5	2.2	...	2.2	...
Outstanding stock of public sector arrears 4/	...	...	1.8	2.3	...	1.1	1.2	0.7
Of which: budget entities' arrears	...	...	1.8	1.6	...	1.1	1.2	0.7
Stock of domestic debt 5/	7.1	7.9	8.7	8.5	...	5.5	5.5	3.1
Current revenue and repayment of on-lent loans from netting	...	...	2.8	2.8	...	...	...	...
Nominal GDP	833	817	925	1,045	1,152	1,152	1,152	1,270

Sources: Ministry of Finance, and Fund staff estimates and projections.

1/ Beginning in 1999, fiscal data is consolidated in strict conformity with GFS methodology.

2/ Equals transfer from BOM for acceptance of contingent liability.

3/ Excludes foreign-financed capital expenditures.

4/ Public sector arrears are defined as budget payments overdue by more than 30 days. They comprise arrears accumulated by budget entities and the MOFE treasury (for exports servicing the government's external debt); they do not include arrears accrued by extrabudgetary funds.

5/ Beginning in 1999, includes public sector arrears; excludes liabilities to the BOM for IMF loans.

6/ Consolidates the approved central government budget with preliminary estimates for local government budgets. An exceptional transfer of BOM profits, which permitted to retire Tog 9.8 billion of domestic debt in June 2001 was not accounted for in the official amended budget.

Table 5. Mongolia: Medium-term fiscal outlook, 1998-2006

	1998	1999	2000	2001	2002	2003	2004	2005	2006
				Program				Proj.	
	(In percent of GDP, unless otherwise indicated)								
Total revenue	27.6	27.2	33.6	33.6	32.7	32.6	32.6	32.6	32.6
Of which: revenue excluding receipts from Erdenet and dividends from enterprises to be privatized	...	26.6	30.5	31.2	30.7	30.6	30.6	30.6	30.7
Total expenditure and net lending	41.9	39.4	40.5	41.0	39.8	39.2	38.6	38.1	37.7
Of which: expenditure adjusted for expenditure arrears and the shift of quasi-fiscal activities to the budget 1/	...	...	40.3	40.1	38.9	38.1	37.4	37.3	37.0
Current expenditure	27.2	26.7	30.1	30.5	29.0	28.6	28.1	27.5	26.9
Non-interest expenditure	25.9	24.8	28.3	28.8	27.3	27.1	26.6	26.3	25.8
Interest payments 2/	1.4	1.9	1.7	1.7	1.7	1.5	1.5	1.2	1.1
Capital expenditure	14.6	12.7	10.4	10.5	10.8	10.6	10.6	10.6	10.8
Current balance	-0.7	-0.2	3.1	2.7	3.1	3.4	4.0	4.6	5.2
Primary balance	1.7	2.4	5.3	4.8	5.4	5.5	6.0	6.3	6.8
Overall balance	-14.3	-12.2	-6.8	-7.3	-7.1	-6.6	-6.0	-5.5	-5.1
Discrepancy between deficit from above and below the line	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	14.3	12.7	6.8	7.3	7.1	6.6	6.0	5.5	5.1
Foreign financing	8.4	11.4	6.4	4.9	6.8	6.1	5.7	5.2	5.3
Project loans	9.0	9.4	6.0	7.1	7.8	7.2	6.7	6.4	6.4
Cash loans	0.9	1.8	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Buligaar	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	1.6	1.1	0.9	2.2	1.0	1.0	1.1	1.2	1.1
Privatization	1.8	1.3	0.7	0.9	0.8	0.9	0.8	0.6	0.5
Settlement of claims with the BOM	0.0	0.0	0.4	0.9	0.0	0.0	0.0	0.0	0.0
Domestic financing	4.1	0.0	-0.7	-1.5	-2.3	-1.3	-0.9	-0.3	-0.7
Financing gap	0.0	0.0	0.0	2.2	1.9	0.9	0.5	0.0	0.0
Adjusted deficit 3/	...	...	-9.8	-8.9	-8.3	-7.4	-6.8	-6.7	-6.3
Government debt/GDP ratio (excl. IMF) 4/ 5/	70.4	94.5	89.6	89.6	92.7	93.6	92.0	89.7	87.4
Gross domestic debt (excl. IMF) 6/	7.9	8.7	8.5	5.5	3.1	2.0	0.8	0.6	0.1
Government debt/GDP ratio, including IMF 4/	75.4	100.2	94.8	93.8	96.1	96.1	93.7	90.9	88.2
Government debt/GDP ratio, including IMF and guarantees 4/ 7/	85.3	102.5	96.5	94.9	96.7	96.2	93.9	91.1	88.3
NPV of foreign debt, including IMF and guarantees / GDP	...	63.0	57.5	57.9	59.2	58.7	57.6	56.0	54.7
NPV of total public debt / GDP	...	71.7	66.0	63.4	62.4	60.8	58.3	56.7	54.9
Memorandum items:									
Revenue forgone because of removal of import duty surcharge	...	...	...	0.0	0.6	0.6	0.6	0.6	0.6
Change in the stock of public sector expenditure arrears	...	...	0.1	-0.4	-0.3	-0.3	-0.3	0.0	0.0
Cost of quasi-fiscal activities brought on budget	...	0.0	0.2	0.4	0.6	0.8	0.9	0.8	0.7
Average interest rate on domestic debt (in percent)	12.1	17.9	14.4	13.9	13.5	12.5	10.5	10.0	9.0
Average interest rate on foreign debt (in percent)	0.8	0.8	1.0	1.2	1.4	1.5	1.5	1.3	1.3
Togrogs per US dollar (p.a.)	841	1022	1077	...	...	...	...	...	...
Togrogs per US dollar (eop)	902	1072	1097	...	...	...	...	...	...
Nominal GDP (in billions of togrogs)	817	925	1045	1152	1270	1401	1559	1735	1931
Inflation	9.4	7.6	11.6	8.8	6.0	5.0	5.0	5.0	5.0
Real GDP growth	3.5	3.2	1.1	1.4	4.0	5.0	6.0	6.0	6.0

Sources: Ministry of Finance; Fund staff estimates and projections.

1/ Includes expenditures financed through the buildup of arrears and excludes outlays for the repayment of arrears and the cost of quasi-fiscal activities brought on budget.
2/ For 1999, excludes interest arrears accrued in 1998.
3/ Excludes revenues from Erdenet and dividends from enterprises to be privatized, and adjusts expenditures for arrears and the shift of quasi-fiscal activities to the budget.
4/ Excludes unresolved claims estimated at TR 10.5 billion to Russia.
5/ Includes debt serviced by the budget or through the budget by recipients of on-lent loans.
6/ Beginning in 1999, public sector arrears are included in the domestic debt stock.
7/ Includes BOM guarantees, guarantees on two commercial loans, and guarantee for Airbus purchase.

Table 6. Mongolia: Monetary Aggregates, 1997-2002 8/

	1997	1998	1999				2000				2001				2002
			March	June	Sep	Dec	March	June	Sep	Dec	March	June	Sep	Dec	Dec
												Actual	Prog.	Prog.	Prog.
	(In billions of togrogs, end-period)														
Monetary survey															
Broad Money 1/	170.1	167.3	153.7	184.6	199.2	220.4	228.1	255.8	266.1	258.8	270.5	313.9	308.4	298.4	331.5
Currency	49.8	56.4	48.1	73.8	76.5	87.3	95.0	118.9	114.5	100.9	93.7	125.5	116.7	112.6	125.1
Deposits	120.3	110.8	105.6	110.8	122.7	133.1	133.1	137.0	151.6	157.9	176.8	188.5	191.7	185.8	206.4
Net foreign assets	112.3	76.8	63.7	76.1	110.4	151.2	160.5	173.8	196.1	202.1	200.6	222.9	224.1	228.4	266.8
Net international reserves	131.1	93.6	83.4	94.4	122.9	153.6	162.3	169.7	195.7	206.5	178.4	195.4	215.3	232.8	271.2
Bank of Mongolia	73.1	67.5	54.1	62.3	89.7	113.0	115.5	123.8	136.9	154.3	121.3	144.8	162.6	176.2	203.6
Commercial banks	57.9	26.1	29.3	32.1	33.1	40.7	46.8	46.0	58.8	52.2	57.1	50.6	52.7	56.6	67.6
Other foreign assets, net 1/	-18.8	-16.8	-19.7	-18.3	-12.5	-2.4	-1.8	4.1	0.4	-4.4	22.2	27.5	8.8	-4.4	-4.4
Net domestic assets	57.8	90.4	90.0	108.5	88.8	69.1	67.6	82.1	70.0	56.8	70.0	91.1	84.3	70.0	64.7
Domestic credit	91.7	146.8	163.5	173.9	150.5	130.6	136.7	117.3	118.4	120.1	138.8	141.4	134.3	121.1	115.8
Net credit to government 2/	21.3	47.9	58.1	68.7	44.0	47.7	51.0	58.6	57.3	51.3	56.1	42.0	42.8	33.1	3.5
Claims on nonbanks 3/	70.4	98.9	105.4	105.2	106.4	82.8	85.7	58.6	61.1	68.8	82.7	99.4	91.5	88.0	112.3
Of which:															
Claims on public enterprises	11.7	18.3	18.0	14.6	15.9	8.6	9.3	6.9	6.8	6.3	5.2	8.8	8.8	7.9	9.4
Claims on the private sector	44.2	48.0	51.9	51.3	44.9	31.4	33.7	34.7	36.5	45.5	60.6	76.7	66.3	63.7	86.4
Nonperforming loans	14.5	32.6	35.5	39.3	45.6	42.1	41.9	16.4	17.4	15.9	15.7	12.1	15.3	15.3	15.3
Other items, net	-33.9	-56.4	-73.5	-65.4	-61.6	-61.4	-69.2	-35.2	-48.4	-63.4	-68.8	-50.3	-50.0	-51.1	-51.1
Monetary authorities															
Reserve money	64.6	73.3	60.0	90.4	97.7	111.3	120.1	144.7	145.2	132.9	127.1	154.5	151.3	147.6	163.6
Net foreign assets	71.4	70.6	55.8	65.3	93.9	119.3	119.8	131.9	141.6	154.6	148.2	178.1	176.1	176.6	204.0
Net international reserves	73.1	67.5	54.1	62.3	89.7	113.0	115.5	123.8	136.9	154.3	121.3	144.8	162.6	176.2	203.6
Other assets, net	-1.7	3.1	1.8	3.0	4.2	6.3	4.3	8.2	4.6	0.4	26.8	33.3	13.5	0.4	0.4
Net domestic assets	-6.9	2.7	4.1	25.2	3.7	-8.0	0.4	12.8	3.6	-21.7	-21.0	-23.7	-24.8	-28.9	-40.4
Net credit to government	17.6	29.7	33.8	41.7	29.5	32.6	43.7	53.3	48.8	34.1	38.2	26.6	27.8	22.9	2.9
Claims on deposit money banks	3.1	5.6	8.0	10.3	7.0	6.7	7.7	6.0	4.6	4.8	3.0	3.9	4.0	4.8	4.8
Claims on nonbanks	3.9	9.0	10.3	10.1	10.4	4.6	4.6	0.9	0.9	0.9	1.0	1.0	0.9	0.9	0.9
Minus: Central bank bills (net)	19.1	11.7	5.2	8.1	16.3	21.2	19.6	27.0	30.0	21.1	18.1	28.8	31.3	28.3	19.8
Other items, net	-12.4	-29.8	-42.8	-28.9	-26.9	-30.6	-36.0	-20.4	-20.8	-40.4	-45.2	-26.3	-26.2	-29.2	-29.2
Of which: precious metals	12.3	4.5	3.7	13.3	18.4	5.5	4.2	16.0	20.1	7.8	4.2	14.5		7.8	7.8
Memorandum items:	(In percent, unless otherwise indicated)														
Annual broad money growth 1/	19.8	8.8	0.0	15.2	20.0	31.7	48.4	38.6	33.6	17.5	18.6	22.7	15.9	15.3	11.1
Annual growth of credit to nonbanks 4/	13.2	18.5	4.0	-8.8	-16.3	-39.7	-38.4	-36.8	-28.7	29.5	52.8	105.3	73.2	38.3	33.9
Annual growth of credit to nonbanks 5/	-7.6	40.5	23.7	10.7	9.3	-16.3	-18.6	-18.6 6/	-17.2 6/	15.6 6/	27.9 6/	69.5	49.7	27.9	27.6
Annual reserve money growth	26.2	13.5	3.0	25.6	31.0	51.8	100.4	60.1	48.6	19.4	5.8	6.7	4.2	11.1	10.8
Velocity, seasonally adjusted	5.5	5.0	5.0	4.5	4.4	4.3	4.1	4.1	4.0	4.1	4.1	3.7	3.8	4.0	3.9
Broad money/reserve money	2.6	2.3	2.6	2.0	2.0	2.0	1.9	1.8	1.8	1.9	2.1	2.0	2.0	2.0	2.0
Nonperforming loans/total loans	20.5	33.0	33.7	37.4	42.9	50.8	48.8	27.9	28.4	23.1	19.0	12.2			
Total loans/deposits	58.5	89.3	99.8	94.9	86.7	62.2	64.4	42.8	40.3	43.6	46.8	52.7	47.7	47.4	54.4
Excess reserves (billions of togrogs)	1.3	0.2	-3.0	-2.2	-1.9	0.9	3.7	1.5	7.3	6.5	14.0	6.5	4.0	4.8	6.0
NIR of the BOM (million US$) 7/	89.6	74.9	51.9	61.4	84.8	105.4	106.0	116.2	126.1	140.6	110.6	132.0	148.2	160.6	185.6
Of which:															
Monetary gold (million US$)	24.6	9.1	7.1	3.9	4.6	0.4	3.5	7.8	43.4	22.5	5.6	17.5			

Sources: Mongolian authorities; and Fund staff estimates and projections.

1/ The end-1997 broad money stock is artificially inflated by a one-off increase due to a US$20 million (16.3 billion togrogs) deposit, which was reversed in early 1998. The annual broad money growth rate reflects an adjustment for this increase.

2/ Includes restructuring bonds and the government liabilities to the Fund regarding PRGF disbursements, which amounted to SDR 23.7 million at end-2000.

3/ During the second half of 1999, 11.8 billion togrogs of on-lent credits to enterprises through the TDB by the government were transferred to TDB's off-balance-sheet items to properly present TDB's credit exposure.

4/ Excludes nonperforming loans.

5/ Includes nonperforming loans.

6/ Including the seven liquidated banks' claims on nonbanks, which amounted to 27 billion togrogs at end-June 2000.

7/ Beginning December 2000, includes foreign exchange assets arising from commercial banks' foreign exchange deposits with the BOM. Beginning January 2001, excludes BOM's monetary gold pledged as collateral for external loans to domestic private companies.

8/ Beginning April 2000, excludes the seven liquidated banks.

Table 7. Mongolia: Balance of Payments, 1998-2005

	1998 1/ Est.	1999 Est.	2000 Est.	2001	2002 Prog 2/	2003	2004	2005 Proj.
	(In millions of U. S. dollars)							
Trade balance	-120.1	-113.0	-150.2	-149.7	-132.2	-123.6	-126.3	-130.5
Exports, f.o.b.	462.3	454.3	537.1	549.2	601.0	647.5	692.9	740.6
Copper	124.8	119.2	160.3	151.2	176.5	193.6	207.7	224.2
Imports, c.i.f. 3/	-582.4	-567.3	-687.3	-698.9	-733.2	-771.1	-819.2	-871.0
Services, net	-11.5	-8.4	-10.6	-13.2	-15.7	-17.5	-18.5	-19.7
Receipts	77.9	99.6	102.2	102.9	106.0	110.3	116.9	123.9
Payments	-89.4	-108.0	-112.7	-116.0	-121.7	-127.8	-135.4	-143.6
Income, net	0.4	-10.1	-14.1	-16.2	-19.6	-23.0	-23.8	-22.3
Official interest payments 4/	-9.2	-7.9	-9.5	-10.7	-13.2	-15.0	-16.5	-14.6
Private unrequited transfers	2.5	7.4	8.0	9.0	9.0	9.0	9.5	10.5
Current account balance, excluding official transfers	-128.8	-124.1	-166.9	-170.1	-158.5	-155.1	-159.2	-161.9
Public unrequited transfers, net	53.2	67.1	98.6	95.5	82.0	85.0	85.0	85.0
Official grants	45.8	60.2	86.2	85.3	75.0	80.0	80.0	80.0
Other official transfers, net	7.4	6.9	12.4	10.2	7.0	5.0	5.0	5.0
Financial and capital account	116.4	58.6	68.5	72.0	81.2	80.6	88.5	97.0
Direct investment	18.9	30.4	40.0	45.3	44.4	47.6	57.0	64.5
Loans	93.7	109.1	90.6	79.1	97.3	95.2	92.1	91.3
Medium- and long-term, net	93.7	97.2	80.6	70.1	90.3	88.2	86.1	86.3
Disbursements	122.5	173.7	151.0	153.6	165.8	165.8	168.8	172.5
Public sector	122.5	101.8	71.0	72.6	83.8	82.8	84.8	87.4
Private sector	...	71.9	80.0	81.0	82.0	83.0	84.0	85.0
Amortization	-28.8	-76.6	-70.4	-83.5	-75.6	-77.6	-82.7	-86.2
Public sector	-28.8	-31.7	-15.4	-27.9	-16.1	-17.6	-20.2	-20.4
Private sector	...	-44.9	-55.0	-55.6	-59.5	-60.0	-62.5	-65.8
Short-term, net	0.0	11.9	10.0	9.0	7.0	7.0	6.0	5.0
Currency and deposits, net	40.0	-22.7	-12.5	-3.5	-10.0	-12.5	-12.0	-12.0
Commercial banks, net	40.0	-22.9	-13.5	-4.0	-10.0	-12.5	-12.0	-12.0
Other	...	0.2	1.0	0.5	0.0	0.0	0.0	0.0
Trade credits, net	6.6	-12.9	-9.7	-9.0	-10.0	-9.6	-9.5	-9.6
Other, net	-42.9	-45.3	-40.0	-39.9	-40.5	-40.0	-39.0	-37.2
Errors and omissions	-69.6	15.4	33.9	0.0	0.0	0.0	0.0	0.0
Overall balance	-28.8	17.0	34.1	-2.6	4.7	10.6	14.4	20.0
Financing	28.8	-17.0	-34.1	2.6	-4.7	-10.6	-14.4	-20.0
Increase in net official reserves (-)	15.0	-30.5	-35.2	-25.3	-35.8	-30.9	-30.9	-20.0
Use of IMF credit	-1.3	4.2	1.6	-6.9	-7.9	-8.2	-6.5	-5.4
Increase in gross official reserves (-)	16.3	-34.7	-36.8	-18.3	-27.9	-22.7	-24.4	-14.6
Arrears accumulation (+) / payments (-) (net)	13.8	2.0	-15.8	0.0	0.0	0.0	0.0	0.0
Accumulation of new arrears (+)	13.8	15.8	0.0	0.0	0.0	0.0	0.0	0.0
Repayment of outstanding arrears(-)	0.0	-13.8	-15.8	0.0	0.0	0.0	0.0	0.0
Exceptional financing / rescheduling	0.0	13.8	16.8	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	27.8	31.1	20.3	16.6	0.0
Memorandum items:								
Current account balance, excluding official transfers (in percent of GDP) 3/	-13.2	-13.7	-17.2	-16.7	-14.7	-13.4	-12.7	-11.9
Current account balance, including official transfers (in percent of GDP) 3/	-7.8	-6.3	-7.0	-7.3	-7.1	-6.1	-5.9	-5.6
Exports, f.o.b. (annual growth)	-18.8	-1.7	18.2	2.3	9.4	7.7	7.0	6.9
Imports, c.i.f. (annual growth) 3/	8.2	-2.6	21.2	1.7	4.9	5.2	6.2	6.3
Export volume growth	-0.7	5.6	7.0	6.9	4.5	4.5	4.9	5.3
Import volume growth 3/	16.1	0.3	17.7	7.2	4.5	4.6	4.6	4.6
Export price index change	-18.3	-6.9	10.5	-4.3	4.7	3.1	2.0	1.5
Import price index change	-6.8	-2.9	2.9	-5.2	0.3	0.5	1.6	1.7
Trade balance (in percent GDP)	-12.4	-12.5	-15.5	-14.7	-12.3	-10.7	-10.0	-9.6
Net official reserves (end-period) 5/ 6/	74.9	105.4	140.6	165.9	201.7	232.6	263.5	283.5
Gross official reserves (end-period)	124.7	156.8	190.9	209.2	237.1	259.8	284.2	298.8
(In weeks of next year/ projected imports, c.i.f.) 3/	11.4	11.9	14.2	14.8	16.0	16.5	17.0	16.8
Outstanding arrears (end-period)	13.8	15.8	0.0	0.0	0.0	0.0	0.0	0.0
Debt service (in percent of exports of goods and services) 4/	7.3	9.3	6.0	7.0	5.3	5.4	4.5	4.2
Public and publicly guaranteed external debt stock 4/	753	850	854	912	1009	1089	1171	1236
NPV of public and publicly guaranteed external debt 4/	...	571	558	591	639	679	724	765
Public and publicly guaranteed external debt stock (in percent of GDP) 4/	77.4	93.9	88.0	89.4	93.6	94.2	93.1	90.5
NPV of public and publicly guaranteed external debt (in percent of GDP) 4/	...	63.0	57.5	57.9	59.2	58.7	57.6	56.0
GDP (in millions of U.S. dollars)	972	906	970	1020	1078	1156	1257	1366

Sources: Mongolian authorities; and Fund staff estimates and projections.

1/ In 1999, BOP coverage was expanded due to a new private sector survey. Thus, 1998 data is not directly comparable with subsequent years.

2/ Assumes implementation of staff proposals.

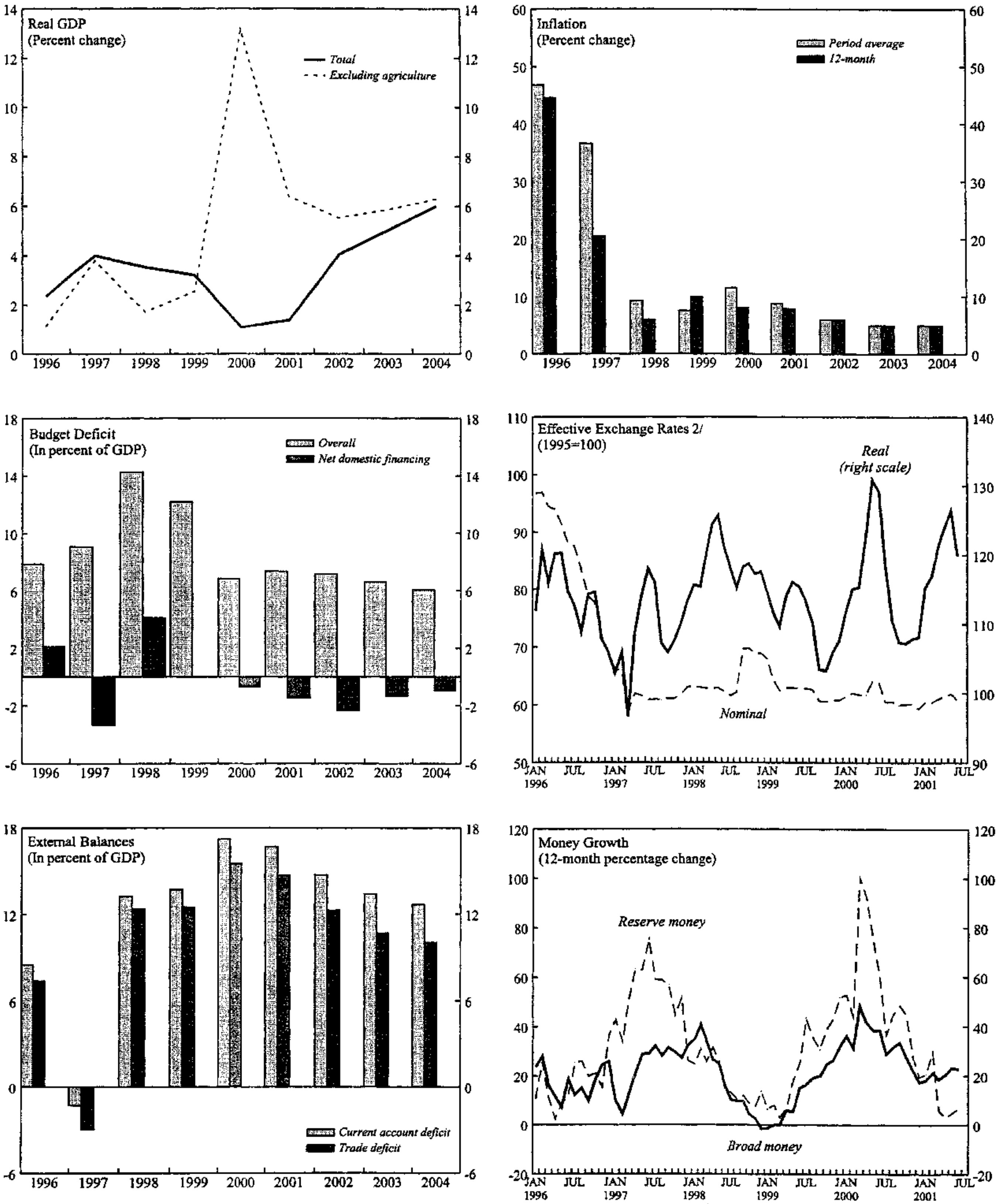
3/ Includes the lease of an aircraft valued at US$28.8 million in 1998.

4/ Includes payments on CMEA debts that have been converted via formal intergovernmental agreements.
Excludes unresolved claims estimated at TR 10.5 billion to Russia.

5/ Beginning December 2000, includes commercial banks' foreign exchange deposits with BOM.

6/From 2001 onwards does not include projected IMF disbursements under new PRGF program. With projected IMF disbursements NIR would be equal to US$ 160.6 million.

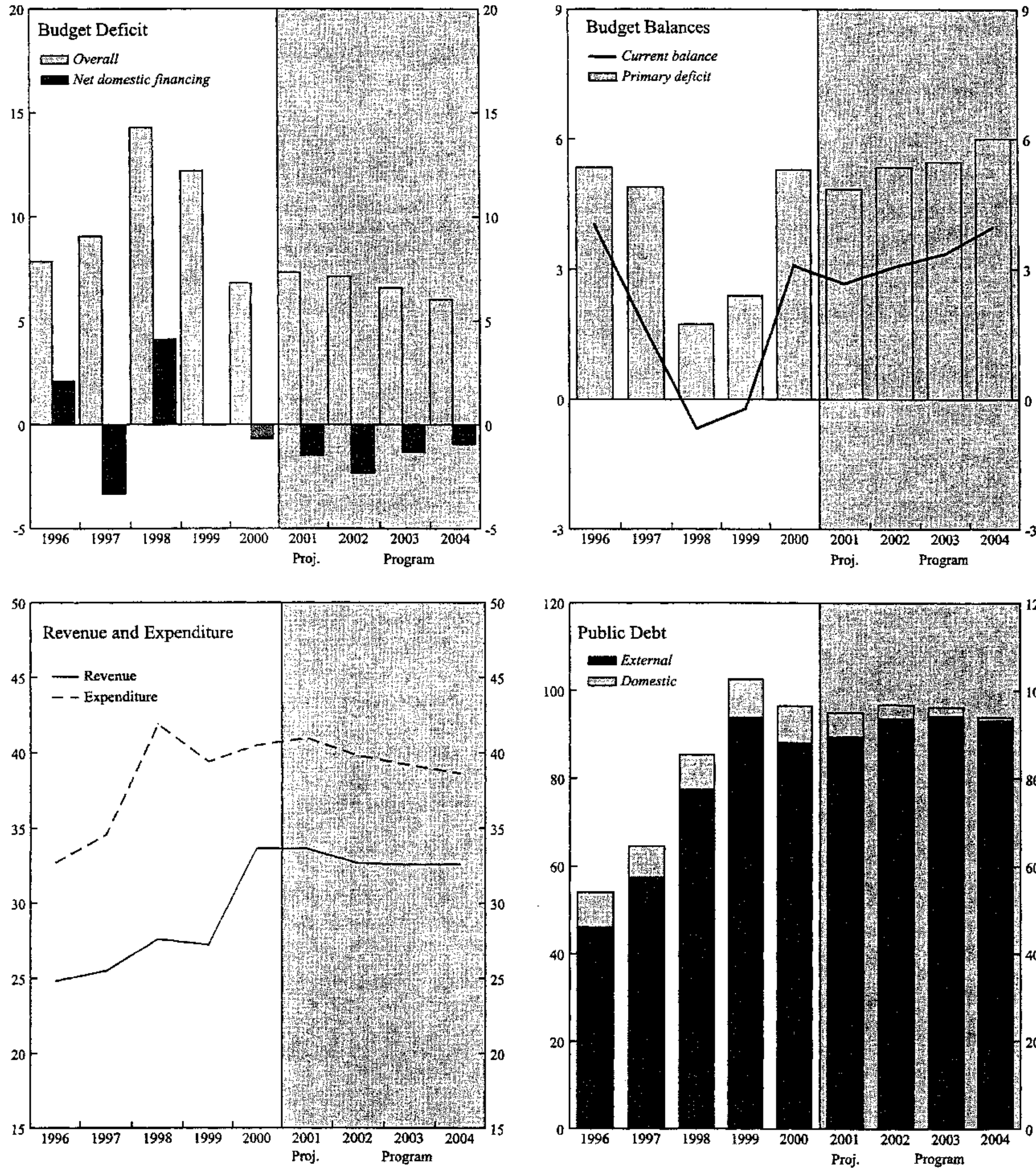
Figure 1. Mongolia: Economic Developments, 1996-2004 1/



Sources: Mongolian authorities; and Fund staff estimates.

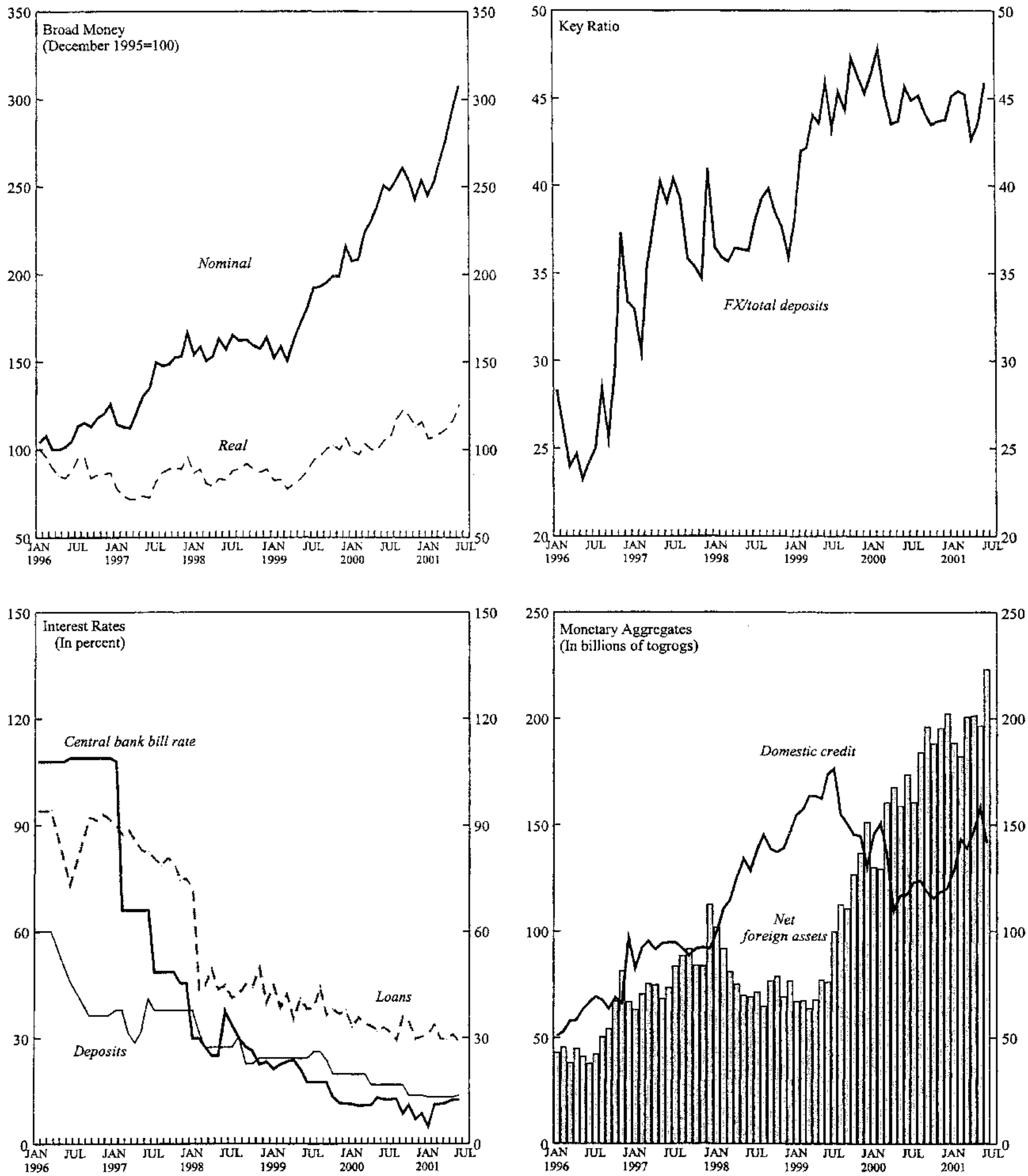
1/ 2000 values are estimates; 2001-2003 values are program numbers.
2/ An increase indicates appreciation.

Figure 2. Mongolia: Fiscal Indicators, 1996-2004
(In percent of GDP)



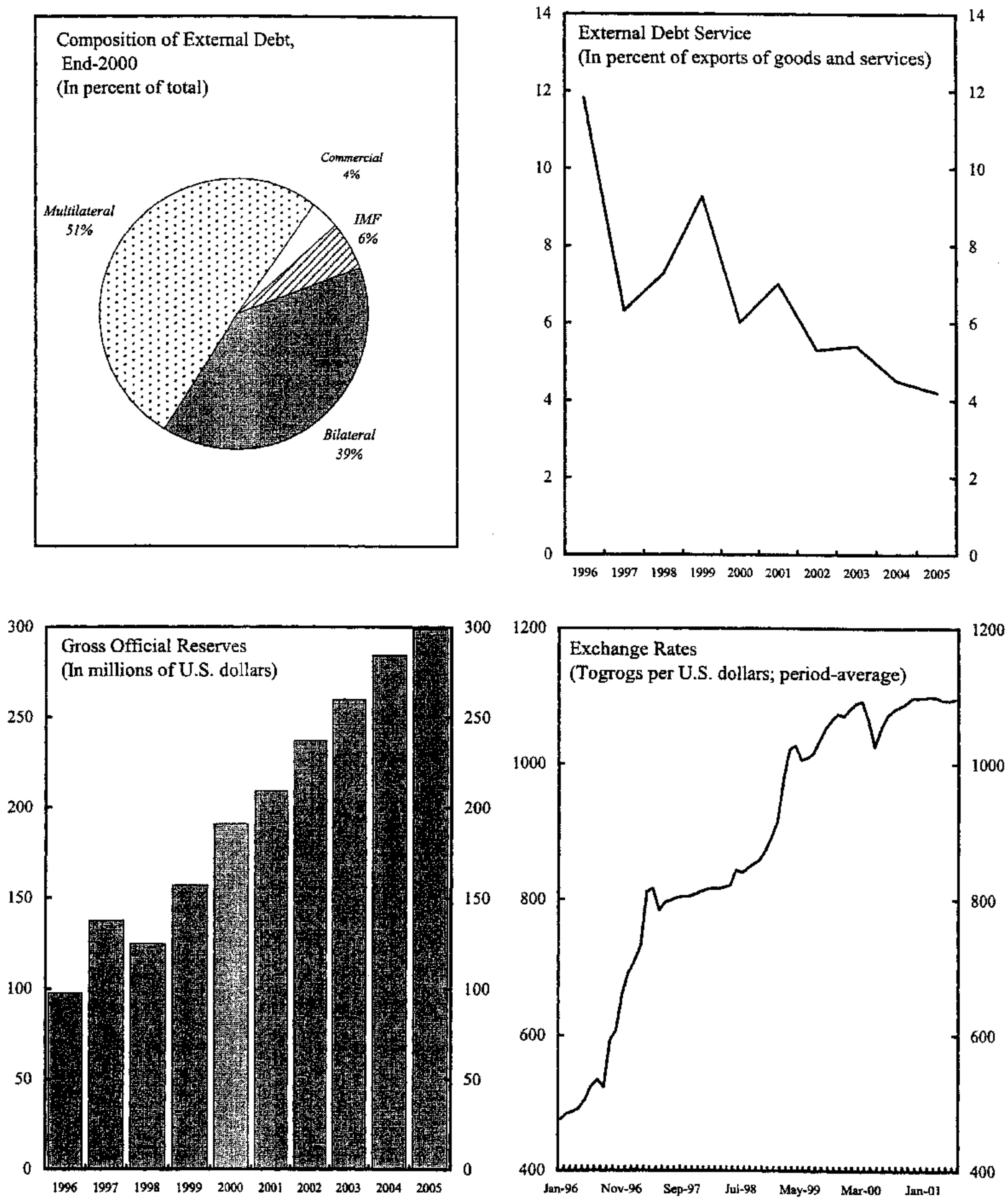
Sources: Mongolian authorities; and Fund staff estimates and projections.

Figure 3. Mongolia: Monetary Developments, 1996-2001



Sources: Mongolian authorities; and Fund staff estimates.

Figure 4. Mongolia: External Developments, 1996-2005



Sources: Mongolian authorities, Fund staff estimates; and *International Financial Statistics* : IMF.

Mongolia—Fund Relations
(As of June 30, 2001)

I. Membership Status: Joined: 02/14/1991; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	51.10	100.0
Fund Holdings of Currency	51.05	99.9
Reserve Position in Fund	0.06	0.1

III. SDR Department:	SDR Million	Percent Allocation
Holdings	0.01	N/A

IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
ESAF/PRGF Arrangements	36.17	70.8

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	07/30/1997	07/29/2000	33.39	17.44
ESAF	06/25/1993	06/24/1996	40.81	29.68
Stand-by	10/04/1991	12/31/1992	22.50	13.75

VI. Projected Obligations to Fund: (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	6/30/2001	2001	2002	2003	2004	2005
Principal		3.0	5.9	6.1	4.9	4.0
Changes/interest		0.1	0.2	0.1	0.1	0.1
Total		3.1	6.1	6.2	5.0	4.1

VII. Safeguards Assessments

Under the Fund's safeguards assessment policy, the Bank of Mongolia is subject to a full Stage One safeguards assessment with respect to a PRGF arrangement that is scheduled for Executive Board discussion on September 21, 2001.

A Stage One safeguards assessment of the Bank of Mongolia is underway.

VIII. Exchange Arrangement:

On May 27, 1993, Mongolia moved from a fixed exchange rate against the U.S. dollar to a floating exchange rate system. The official exchange rate is now set weekly on the basis of transactions in the interbank market. At end-June 2001, the official midpoint rate was Tog 1,097 per U.S. dollar.

IX. Article IV Consultation:

The 1999 Article IV consultation (EBS/00/3) was concluded by the Executive Board on January 24, 2000 (SUR/00/14). Mongolia is on the standard 12–month consultation cycle.

X. ROSC Assessments

- ROSC, Data Module, May 2, 2001 (SM/01/144)
- ROSC, Fiscal Transparency Module.

XI. Recent Financial Arrangements:

A three-year arrangement under the Enhanced Structural Adjustment Facility in an amount equivalent to SDR 40.81 million (80 percent of quota) with a first annual arrangement in an amount of SDR 18.55 million (36.3 percent of quota), was approved on June 25, 1993 (EBS/93/79). The second annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota) was approved on November 23, 1994 (EBS/94/213). The ESAF arrangement lapsed on June 24, 1996.

A new three-year arrangement under the PRGF in an amount equivalent to SDR 33.4 million (65.4 percent of quota), with a first annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota), was approved by the Executive Board on July 30, 1997. The first year arrangement lapsed on July 30, 1998. The second annual arrangement of SDR 14.8 million (29 percent of quota) was approved on June 16, 1999. The first review under that arrangement was completed in January 2000 and the arrangement lapsed on June 15, 2000.

XII. Technical Assistance:

Missions:

- Review of treasury and intergovernmental fiscal reforms (FAD), August 2001
- Banking supervision and accounting (MAE), May-June 2001
- Money and banking statistics (STA), May 2001
- Government finance statistics (STA), March 2001
- Fiscal transparency and ROSC (FAD), March 2001
- Intergovernmental fiscal relations and budget reform (FAD), January 2001

- Visits by MAE peripatetic experts on banking supervision, payment system, monetary policy, and accounting and audit, November 2000 (ongoing).
- Consumer price statistics (STA), September-October 2000
- ROSC: data module (STA), May 2000
- Restructuring bonds and other securities (MAE), March 2000
- National accounts statistics (STA), February 2000

Resident Advisors:

- National accounts statistics (STA), August 2001-July 2002
- Treasury reform (FAD), June 1999-December 2001
- Balance of payments (STA), March 1999-May 2001

Technical assistance for the period May 1995–October 1999 is reported in Annex II of EBS/00/3.

XIII. Resident Representative:

Mr. Martin replaced Mr. Oestreicher in mid-November 1999.

Mongolia—Relations with the World Bank Group[1]

Mongolia became a member of the World Bank, IDA and IFC in February 1991. A Country Assistance Strategy (CAS) for 1998–2000 was approved by the Board on June 2, 1998. The primary goal of the CAS is to support the government through lending and nonlending services in completing the transition to a market-led economy, improve living standards, and reduce poverty.

Completed lending operations: The following credits have been fully disbursed and closed: An *Economic Rehabilitation Credit* (US$30 million) and a *Technical Assistance Credit* (US$5 million), both approved in December 1991; an *Economic Transition Support Credit* (US$20 million), approved in October 1993, to finance critical imports and technical assistance for the mining and transport sectors; a *Banking and Enterprise Adjustment Credit* (US$10 million) approved in July 1997, associated with the *Banking, Enterprise and Legal Technical Assistance Credit* described below; and the *Poverty Alleviation for Vulnerable Groups Credit* (US$10 million), approved in July 1995, aimed to promote income-generating activities for the poor, raise basic education enrollment rates, reduce maternal mortality, and assist the disabled, particularly children.

Ongoing lending operations: The current portfolio comprises nine active projects. The *Transport Rehabilitation Credit* (US$30 million), approved in May 1994, addresses key constraints in the transport sector, particularly by arresting the deterioration of the quality and quantity of transport services in railways, urban transport, trucking, and roads. The *Coal Project* (US$35 million), approved in May 1996, is helping to upgrade operations and management of the Baganuur coal mine and finance training in mine operation, mine management, and feasibility studies. The *Banking, Enterprise and Legal Technical Assistance Credit* (US$2 million) became effective in November 1997 and supports the government in implementing its structural reform programs in the financial and enterprise sectors and in developing the legal framework for commercial and financial transactions. The *Ulaanbaatar Services Improvement Project* is helping to upgrade water supply and sanitation facilities in the capital's low-income *ger* districts; it became effective in July 1998. A *Fiscal Technical Assistance Project* was approved by the Board in June 1998 and became effective in February 1999. This project supports the development of an efficient and transparent government financial management system and the introduction of a value-added tax to strengthen the government's revenue base. A *Private Sector Development Credit* was approved in May 1999 and became effective in December 1999. It supports the development of Mongolia's private enterprise and financial sectors. A *Financial Sector Adjustment Credit* (US$32million) was approved in May 2000 to support policy reforms required to implement a medium-term strategy for financial sector reform. The *Transport Development Project* (US$34 million), approved in March 2001, will reconstruct and upgrade roads in Mongolia's central and western regions to provide rural communities with better access to health, education and social services; facilitate domestic marketing and distribution; mitigate further damage to fragile pasture lands from erosion by vehicles; and reduce the number of fatalities

[1] Prepared by World Bank staff.

resulting from road accidents. The *Energy Project* (US$30 million), approved in May 2001, will reduce system losses and improve revenue collection in electricity distribution companies, and improve the reliability and financial sustainability of electricity distribution companies.

Future lending operations: Future IDA lending will continue to concentrate on supporting macroeconomic stabilization and structural adjustment programs, investment projects, and technical assistance. Credits are being proposed in support of technical assistance for the financial sector, facilitating private sector development, developing infrastructure, and supporting the government's poverty reduction program.

Table 1. World Bank: Credit Approvals and Disbursements to Mongolia, FY 1992-01
(In millions of U.S. dollars)

	Credit approvals	Credit disbursements	Undisbursed balance at the end of the fiscal year
FY92	35.0	15.6	19.4
FY93	0.0	12.7	6.7
FY94	50.0	15.2	41.5
FY95	0.0	8.4	33.1
FY96	45.0	11.9	66.2
FY97	12.0	11.8	66.4
FY98	21.7	34.6	53.5
FY99	12.0	16.0	47.0
FY00	32.0	13.3	65.5
FY01	64.0*	10.9*	113.5

Source: World Bank estimates.
* As of June 30, 2001.

Nonlending services: Three Country Economic Memoranda (CEMs - 1991, 1994 and 1997) have been distributed to the Board. An Energy Sector Review, a report on Prospects for Wheat Production, and a National Environmental Action Plan were completed in FY95. A Poverty Assessment and a Public Enterprise Review were completed in FY96. A report on the consequences of large-scale privatization, prepared in collaboration with the University of Maryland, was completed in early 1998. A Transport Strategy Study was completed in FY99. World Bank staff participate regularly in PRGF missions. The World Bank opened an office in Ulaanbaatar in June 1998. The first Country Portfolio Performance Review was held in June 1999. Current non-lending services include, a poverty update report and a participatory living standards assessment, and a new public expenditure review.

Aid coordination: The World Bank continues to play a strong role in aid coordination. Six Assistance Group Meetings of donors took place in Tokyo since 1991, co-chaired by the World Bank and the Government of Japan. The seventh meeting was held in Ulaanbaatar in June 1999. The Mongolia Consultative Group Meeting, chaired by the World Bank, was held for the first time in Paris in May, 2001. In addition, the World Bank (IDA, FIAS, IFC and

MIGA) is assisting the government with the promotion of Foreign Direct Investment (FDI). The first Investors' Conference on oil, gas and mining was held in Ulaanbaatar in June 1997, and the second on agro-industry and tourism took place in Ulaanbaatar in June 1998.

IFC: Mongolia is part of IFC's *Extending Reach Program*, an initiative to promote private sector development and investment in selected countries where difficult country conditions have constrained IFC activity. As part of this program, IFC invested in a small leather garmenting operation and is currently considering projects in the tourism, cashmere, and banking sectors. IFC has also mobilized trust funds to conduct technical assistance in developing a tourism development program and in helping draft Mongolia's leasing law. IFC has assisted in conducting two foreign investment seminars to promote FDI. IFC's investment strategy in Mongolia is to provide long-term financing to private companies, improve the investment framework in the country, and assist in attracting technical know-how and foreign investment.

MIGA: Mongolia signed the MIGA convention in 1991 and ratified it the following year. MIGA will be able to assist the country in attracting foreign investment through its marketing and guarantee activities. MIGA has provided TA to the Board of Foreign Investment in investment promotion.

WBI: The World Bank Institute (formerly the Economic Development Institute), the World Bank's external training division, has organized a number of seminars and courses in Mongolia as part of its Central Asia program. Courses included economic management, business valuation, financial sector development, and social sector reform.

Mongolia—Relations with the Asian Development Bank[1]

Mongolia became a member of the Asian Development Bank (ADB) in February 1991. ADB operations in Mongolia have been guided by its Country Operational Strategy (COS). The first COS covering 1994–99 was prepared in 1994. It was aimed at facilitating Mongolia's transition to a market economy by (i) creating an environment in which a competitive efficient market economy can flourish; (ii) developing the human resources and skills necessary for a market economy; and (iii) developing the infrastructure needed for a market economy. In line with the Poverty Reduction Strategy approved by the ADB Board in 1999, ADB entered into a Poverty Partnership Agreement (PPA) with the Government of Mongolia in 2000. Within the framework of the PPA and built on the lessons learned during the period 1994–99, ADB formulated in May 2000 its new COS for 2000–05. The new COS places poverty reduction at the highest level of importance to be achieved through pro-poor interventions that foster private sector-led economic growth and good governance. The new COS is aimed at fostering economic growth and combat poverty by switching the main mechanism for growth generation from public sector investments in infrastructure to employment-generating investments aimed at engaging the private sector. Accordingly, ADB currently focuses its operations on the five core sectors, namely, finance, public sector, social sector, agriculture, and urban development.

In April 2001, ADB and the Government conducted the first joint annual review of the implementation of PPA. The PPA annual review confirmed the relevance of the COS. Based on the findings and recommendations of the annual review, ADB will give greater emphasis on addressing the poverty concerns in the rural areas, enhancing human resources development, and promoting more balanced regional development. Furthermore, as noted during the PPA annual review, ADB would also consider continuing its assistance to the road sector given the important role that this sector plays in reducing poverty and promoting the integration of the regional economy. ADB also has a window—the Private Sector Group (PSG) for private sector operation without government guarantee. The PSG is currently working with the International Finance Corporation in providing assistance to the Government in the privatization of the Trade and Development Bank to supplement ADB's public sector interventions in the financial sector.

By end-December 2000, the ADB had approved 25 loans from the Asian Development Fund (ADF) totaling $469.4 million. In addition, by that date, the ADB had approved 100 technical assistance (TA) grants amounting to $46.6 million. ADB has taken a lead role in several key sectors (e.g., policy and institutional reforms in the agriculture sector, public administration reforms, education, health, finance, roads, telecommunications, power, air navigation, and housing). Two program loans that were confirmed by the Government to have high priority for the financial and agriculture sectors were processed in 2000. These are the Second

[1]Prepared by Asian Development Bank staff.

Financial Sector Program Loan ($15 million) and the Agriculture Sector Development Program Loans (with a policy-based loan of $7 million and an investment project loan of $10 million. TA grants totaling $3.6 million were also approved in 2000.

To ensure more effective use of development resources to achieve the development goals, ADB has recently adopted a new policy on performance-based allocation of its concessional ADF resources. According to this new policy, from 2002 onward, ADB will allocate the ADF resources to its eligible member countries including Mongolia, based on a country performance assessment. The country assessment focuses on major indicators concerning sustainable economic growth, socially inclusive development, governance and public sector management, and portfolio performance.

For 2001, it is currently envisaged that ADB lending to Mongolia will range from $35 to $40 million, subject to project requirements finalized during processing. For 2002, in line with the aforementioned new policy, ADB's lending level to Mongolia will be determined through country performance assessment. As a parallel support to its lending operation, ADB will endeavor to provide annually about $3.5 million technical assistance grant to Mongolia, mainly for project preparation, and activities directly related to reduction of poverty and promotion of good governance.

The ADB has regularly participated in Mongolia Consultative Group meetings and coordinated its operations with the Fund, the World Bank and other donors. At the Eighth Assistance Group Meeting held in Paris in May 2000, the ADB was the lead discussant on governance and poverty issues. Through this and other forums, the ADB will continue to be actively involved in policy dialogue with the government, particularly with regard to continuing of reforms in the (i) promotion of good governance in formulating effective policies and establishing efficient institutions; (ii) public sector management and finance which will lay a foundation for effective macroeconomic management; and iii) financial sector, particularly the banking system to provide affordable financing services badly needed for increased private sector investment and production efficiency. The ADB will also continue to assist Government in strengthening its capacity in aid coordination, and planning and management of public investments.

Mongolia: Statistical Issues

1. Progress to Date

The Mongolian authorities have established a framework for monitoring macroeconomic developments and have made substantial improvements in all statistical areas with extensive technical assistance, including from the Fund. Core data are provided on a timely basis. Mongolia is participating in the General Data Dissemination System (*GDDS*), and its metadata are posted on the Dissemination Standards Bulletin Board (*DSBB*). A ROSC mission that visited Mongolia in May 2000 assessed data dissemination practices in Mongolia in relation to the IMF's *GDDS*. The data module of the ROSC for Mongolia has been posted on the IMF website.

An STA mission to assist in the continuing process of improving national accounts visited Mongolia in February 2000. In conjunction with this mission, the authorities revised the annual GDP estimates for 1995–99 to incorporate the new source data and rebase to 1995 prices.. Per the request of the National Statistical Office (NSO), STA has posted a long-term resident advisor on real sector statistics at the NSO for one year, beginning August 2001.

An STA mission on consumer price statistics was fielded in September-October, 2000. Based on the recommendations of this mission, the methodology utilized to compile the CPI was substantially revised in January 2001. The main revisions were as follows: (i) the CPI expenditure weights were updated using the results of the 1999 Household Income and Expenditure Survey (HIES); (ii) the CPI market basket was updated based on the results of the 1999 HIES. The previous CPI contained 205 items while the market basket of the revised CPI comprises 239 items; a deletion of four items and an addition of 38 new items. Furthermore, a number of old items were redefined, such as the replacement of certain domestic goods with the corresponding import substitutes, in order to better reflect current consumption patterns; and (iii) the CPI was rebased from a price base period of December 1995 to December 2000.

The authorities have just adopted systematic procedures for compiling fiscal reports for general government and each of the subsectors of general government, on the basis of the methodology proposed by an FAD/STA mission which visited Mongolia in March 2001. They have also completed an inventory of all government bank accounts and instituted stricter standards for registering bank accounts for government agencies and state-owned enterprises in order to allow the full reconciliation between government accounts data and banking data.

The May 2001 monetary and financial statistics mission found that the Bank of Mongolia (BOM) implemented most of the recommendations of the 1997 STA mission, including the valuation of monetary gold and the recording of Fund accounts in the BOM balance sheet.

In May 2001, the long-term resident advisor in balance of payments statistics completed a 26–month assignment to help develop the balance of payments statistics compilation system, which included the implementation of an enterprise survey. The results from the survey were reflected in the 1999 balance of payments figures and also used to generate some partial international investment position estimates for the nonbank sector. A new report form on international transactions that pass through domestic banks was developed, but the existing legislation does not mandate reporting of the data by the banks. Measures were also undertaken to conduct a survey of foreign embassies and international organizations.

2. **Outstanding Issues**

- While significant progress has been made in developing a national accounts framework, the quality of GDP estimates, particularly with respect to the current deflation methods for constant price estimates, could be improved further. Further efforts are also needed to improve coverage of the informal sector and small-scale activity, especially in the services sector, for the period prior to 1998–99. Raw data could be refined with a view to producing reliable quarterly estimates of GDP. Furthermore, the construction of expenditure-based national accounts in constant price terms would serve as a useful check for the production side estimates.

- There has been limited progress in implementing the recommendation of the STA mission on consumer price statistics to compile a national CPI and to develop a producer price index, mainly due to resource and capacity constraints.

- There are a number of deficiencies in the data on wages and earnings. The development of labor market statistics through the establishment of quarterly sample surveys would help mitigate these shortcomings.

- The May 2001 STA mission identified a number of issues, including the coverage of monetary statistics, classification of a number of foreign on-lent loans, and recording of repurchase agreements on the treasury bills. The BOM is actively following up on the recommendations of the mission.

- The quality of fiscal data—provided either for budgetary purposes or for publication in the *GFS Yearbook*—could be improved substantially, and improvements are underway in light of the FAD/STA mission of March 2001. Key weaknesses have been noncomprehensive coverage of the fiscal accounts, weaknesses in source accounting data, nondocumented compilation and consolidation procedures, lack of reconciliation between government accounts data and banking data at an aggregate level. These weaknesses are also present in monthly and quarterly reports, but compounded by the incomplete coverage of government accounts. Indeed, the poor quality of the quarterly data reported for publication in *IFS* has meant that the latest data published in *IFS* are for 1996 Q3.

Quarterly data are expected to be substantially improved in 2002. The planned application of an integrated government-wide chart of accounts will help resolve the underlying technical problems while ongoing treasury reforms should significantly improve accounting and reporting practices.

- The coverage and quality of balance of payments statistics have improved. However, the compilation of data from the exchange record is limited due to the insufficient legal basis to mandate reporting by banks.

3. **Publications**

The National Statistical Office publishes timely monthly and annual *Statistical Bulletins* in English and Mongolian. These bulletins include data on population, employment, national accounts and prices, household income and expenditure, central and local government revenue and expenditure, and external trade. The BOM publishes a monthly *Statistical Bulletin* (within 15 days of the end of the month which includes summary statistics for the central bank, consolidated balance sheet of commercial banks, and interest and exchange rate data) and *Annual Reports* since 1993. All publications are available to the public.

Mongolia: Core Statistical Indicators
(As of August 31, 2001)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt
Date of Latest Observation	August 24, 2001	August 24, 2001	August 24, 2001	August 24, 2001	July 31, 2001	August 27, 2001	July, 2001	July 2001	Q2 2001	July 2001	2000	2000
Date Received	August 31, 2001	August 31, 2001	August 31, 2001	August 31, 2001	August 10, 2001	August 31, 2001	August 10, 2001	August 27, 2001	August 27, 2001	August 27, 2001	March 21, 2001	May 8, 2001
Frequency of Data	Daily	Daily	Daily	Daily	Monthly	Weekly	Monthly	Monthly	Quarterly	Monthly	Annual	Annual
Frequency of Reporting	Weekly	Weekly	Weekly	Weekly	Monthly	Weekly	Monthly	Monthly	Quarterly	Monthly	Annual	Annual
Source of Data	BOM	BOM	BOM	BOM	BOM	BOM	NSO	BOM	BOM	MOFE	NSO	MOFE
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Fax	Fax	Fax
Confidentiality	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly	Annual	Annual

1/ BOM is Bank of Mongolia, NSO is National Statistical Office, and MOFE is Ministry of Finance and Economy.

Mongolia: Social and Demographic Indicators

Indicator	Unit of Measure	Latest single available year			Same region/income group	
		1980-89	1990-95	1996-2000	East Asia & Pacific	Low-income
POVERTY						
National headcount index	% of population	..	36.3	35.6	..	..
Urban headcount index	% of population	..	38.5	39.4	..	..
Rural headcount index	% of population	..	33.1	32.6	..	..
INCOME						
GDP per capita	US$	..	549	384	1,030	426
Gini coefficient		..	0.31	0.35	..	..
HEALTH						
Mortality						
Infant mortality	Per 1,000 live births	..	44.4	32.8	34.8	77.3
Maternal mortality	Per 100,000 live births	..	101	81	..	..
Immunization rate						
Measles	% under 12-months	86	85	98	83.4	64.0
DPT	% under 12-months	84	88	92	81.9	70.4
Child malnutrition	weight for age, % under 5 yrs	..	12.3	8.6	11.8	..
Life expectancy at birth						
Total	Years	61	64	65	69	59
Male	Years	60	62	63	67	58
Female	Years	63	65	68	71	60
Access to water supply	% of population	..	67.5	51.9	75	76
Population per physician	Persons	..	393	368	909	1,667
Population per nurse	Persons	..	279	324	..	..
Population per hospital bed	Persons	..	100	133	333	667
EDUCATION						
Gross enrollment rates						
Primary						
Total	% of age group	..	93.4	102.1	119.4	96.6
Male	% of age group	..	93.6	101.5	120.9	102.5
Female	% of age group	..	93.1	102.6	120.9	85.5
Secondary	% of age group	..	65.6	68.2	68.9	45.7
Pupil-teacher ratio: primary	Pupils per teacher	30.9	24.8	30.9	24.4	49.7
Adult illiteracy						
Total	% of population aged 15+	48.2	41.7	38.6	14.9	38.5
Male	% of males aged 15+	35.6	30.5	28.1	8.4	29.1
Female	% of females aged 15+	60.5	52.7	49.0	21.5	48.0
HUMAN RESOURCES						
Population						
Total	Millions, mid-year	2.1	2.2	2.4	1,840.0	2,420.0
Urban	% of population	56.2	52.3	57.6	34.5	31.4
Population growth rate						
Total	Annual %	2.4	1.5	1.3	1.1	1.9
Urban	Annual %	6.0	-1.7	-1.0	..	3.4
Labor force (aged 15-64)						
Total	Millions		0.81	0.85	1,000	1,100
Female	% of labor force		47.3	48.7	44.4	37.8
Age dependency ratio	Dep. to working-age pop.	0.84	0.74	0.67	0.5	0.7
Fertility rate	Births per woman	4.8	3.6	2.5	2.1	3.7
NATURAL RESOURCES						
Land area	Thousand, sq. km	1,564.2	1,564.2	1,564.2	16,400	33,000
Population Density	Persons per sq. km	..	1.4	1.5	115.0	73.2
Arable land	% of land area	0.88	0.84	0.84	12.0	13.0
Irrigated land	% of crop land	5.6	6.4	6.4	..	26.6

Sources: World Bank: *World Development Indicators Database*, National Statistical Office of Mongolia (NSO), UNDP and NSO: *Living Standard Measurement Survey (1998)* and staff estimates.

Mongolia: Poverty Profile

Mongolia ranks among the low-income nations in the world, and is one of the poorest countries in East Asia with a per capita GDP of $384 in 1999. Based on the *2001 World Development Indicators*, per capita GNP in Mongolia in 1999 was around one-third the level recorded in the low-and middle income countries of the East Asia and Pacific region.

Statistical data on poverty in Mongolia need to be improved significantly in order to obtain comparable and current estimates of poverty measures. The Living Standards Measurement Surveys (LSMS) conducted in 1995 and 1998, with the assistance of the World Bank and the United Nations Development Programme (UNDP) respectively, are the most reliable sources of quantitative data on poverty available. Based on these sources, the salient trends in Mongolia's poverty profile can be summarized as follows.[1]

- **The number of people living below the poverty line remained relatively unchanged from 1995–98, after having risen significantly during the early 1990s**. Following a sharp increase from a virtual absence of officially recorded poverty prior to the early 1990s, the poverty rate stabilized at around 35–36 percent during the second half of the decade.

- **However, the depth and severity of poverty increased over the period 1995–98, as did income inequality**. The depth and severity of poverty rose during the second half of the 1990s, indicating a widening of the gap between average consumption expenditures of the poor and the poverty line, and a decline in the purchasing power of the poor to acquire basic needs. Income inequality worsened, as evidenced by an increase of the Gini coefficient from 0.31 in 1995 to 0.35 in 1998, but still remains modest by international standards.

- **The incidence of poverty is higher in urban centers relative to rural areas**. The overall poverty headcount was higher in the aimag (province) centers as was the depth and severity of poverty. This is likely partly a symptom of the lack of economic opportunities in rural areas, and the resultant migration from rural to urban.

- **The incidence of poverty is high among female-headed households and large households regardless of location**. In 1998, 47 percent of urban and 36 percent of rural female-headed households (defined as households with no surviving male partner) were classified as poor compared to 29 percent of urban and 26 percent of rural male-headed households. The same year, 45 percent of poor and

[1] However, there exist problems of direct comparability between some indicators in the two LSMS, as the methodology utilized in each were not entirely consistent.

55 percent of extremely poor[2] urban households were large households (defined as households with six or more members), while the corresponding figures for the rural areas were 51 and 49 percent.

- **Labor market status and educational achievement are important determinants of poverty**. In 1998, 57 percent of the unemployed lived below the poverty line, while 60 percent of the working age population without a secondary education were classified as poor compared to 18 percent with tertiary or vocational training.

The Participatory Living Standards Assessment (PLSA) 2000, indicates that the gap between the wealthy and the impoverished is perceived to have widened significantly over the period 1995–2000. The PLSA was conducted in 2000 by the National Statistical Office of Mongolia (NSO), with assistance from the World Bank and other international agencies, and is a qualitative assessment of poverty in Mongolia. The PLSA indicates that people's perceptions are that new categories of "wealthy" and "impoverished" emerged during the period 1992–95 compared to the relatively low income inequality prevalent prior to 1992, and that the gap between the rich and the poor intensified over the period 1995–2000.

The PLSA indicates that multiple sources of insecurity and vulnerability emerged in the 1990s. The privatization of state-owned enterprises and pastoral collectives, and the subsequent loss of an assured income from formal employment in the public sector, led people to engage in informal sector production and employment, livelihoods particularly vulnerable to seasonal variation. The decline in public action to reduce risks associated with the animal husbandry sector shifted the burden of pastoral risk management from the state to individuals and heightened vulnerability to inclement weather. As a result, two common triggers of impoverishment identified in the PLSA were unemployment in the urban centers, and in rural areas, the loss of livestock due to adverse weather. The cost of education and the unexpected illness of a household member and the associated cost of medical treatment, were also identified as significant impoverishment triggers common across both urban and rural areas.

Other social indicators point to a deterioration in social conditions during the 1990s. In particular, secondary school enrollment rates declined in the 1990s and infant mortality worsened during the latter half of the decade. The Human Development Index for Mongolia decreased from 0.669 in 1995 to 0.628 in 1998, relegating the country from a rank of 101 in 1995 to 117 in 1998 from among 174 countries. However, most social indicators, primarily school enrollment and maternal and infant mortality rates, have demonstrated a marked improvement since 1999.

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[2] Persons with income lower than 40 percent of the minimum living standard are classified as 'extremely poor'.

September 11, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, DC 20431
USA

Dear Mr. Köhler:

1. The Government of Mongolia has adopted an economic reform program for 2001–04, which aims to maintain macroeconomic stability and increase private sector–led growth as key elements of its poverty reduction strategy. To achieve these objectives, the government is committed to pursuing sound fiscal, monetary, and external sector policies and accelerated structural reforms, with a view to consolidating Mongolia's transition from a centrally–planned to a market–oriented economy. The details of the Government's reform program are set out in the attached Memorandum of Economic and Financial Policies (MEFP) and Interim Poverty Reduction Strategy Paper (I-PRSP). In support of the program, we are requesting a three–year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 28.49 million (56 percent of quota).

2. The Government believes that the policies and measures set forth in the MEFP and I-PRSP are adequate to achieve the objectives of the program, but will take any further measures, in consultation with the IMF staff, which might be necessary for this purpose. The Government will conduct with the Fund the first review of the first–year PRGF–supported program to be completed no later than end–March 2002.

3. The Government will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations and will provide the Fund with any information it requests to monitor economic developments and implementation of policies under the program.

4. To enhance transparency and facilitate wider distribution of the MEFP and I-PRSP, the government of Mongolia has authoritized their publication by the Fund.

Sincerely yours,

/s/	/s/
Ch. Ulaan Minister of Finance and Economy	O. Chuluunbat Governor Bank of Mongolia

MONGOLIA

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR AUGUST 2001-JULY 2002

I. Introduction

1. This memorandum outlines the Government's economic and financial policies for August 2001–July 2002, the first year program under a three-year PRGF arrangement, and the medium-term framework covering the period August 2001-July 2004. This framework is consistent with the Interim Poverty Reduction Strategy Paper (I-PRSP), dated June 28, 2001.

2. Mongolia has made great strides during a decade of transition to a market economy, but it continues to face important challenges. Significant progress has been made in the establishment of a vibrant private sector and the key institutions of macroeconomic management. Market-oriented reforms were accelerated beginning in 1996–97 under a program supported under a PRGF arrangement, and macroeconomic conditions were stabilized despite a large terms of trade shock in 1998. However, economic growth averaged less than 3½ percent a year during the latter part of the 1990s, which was insufficient to make decisive inroads against the country's poverty and left the number of people below the poverty line basically unchanged. Indeed, there are indications that the depth and severity of poverty have increased in recent years, especially in the urban areas, while access to health and education services declined from the levels achieved prior to 1990.

3. On the policy front, the principal challenge is how to make continued progress in the process of transition while also taking prompt steps to redress an unsustainable fiscal situation. With the general government's annual budget deficit averaging about 10 percent of GDP during the second half of the 1990s, the public debt rose to more than 100 percent of GDP by end-1999. While the debt buildup was due in part to extenuating factors, including the need to cover the costs of restructuring a poorly governed and severely undercapitalized banking system, it cannot continue indefinitely. In fact, a lack of adequate financial controls over key areas of the government budget has contributed to a recurrent buildup of arrears on public debt service, pensions, wages, and payments for goods and services. These developments have weakened confidence in government policies and threatened the stability of the banking system. As political support for much-needed adjustments in regulated prices and for privatization began to falter in late 1999, the financial imbalances of the state-run energy authority, coal mines, and the national petroleum company exacerbated the pressures on the budget.

4. With the reform effort flagging, the last PRGF-supported program went off track in the run-up to the general elections in mid-2000. The current government, which took office in August 2000, is strongly committed to reviving the momentum of reform.

II. Recent Developments and Short-Term Prospects

5. Domestic economic performance was mixed in 2000 and prospects for 2001 remain uncertain. The losses of the animal husbandry sector resulting from two consecutive harsh winters (Zud), and from the more recent outbreak of foot-and-mouth disease, have taken a heavy toll on output. An estimated 10 percent of the country's total herd stock was lost during 2000, and the latest projections point to a loss of the same order of magnitude during 2001. While preliminary national accounts estimates point to a resilient performance of the nonagricultural sector, these estimates are subject to a large margin of error. Real GDP growth is estimated to have declined from 3¼ percent in 1999 to about 1 percent in 2000 and is projected to edge up to no more than 1½ percent in 2001. The year-on-year rate of inflation, after having risen to a peak of 15½ percent in mid-2000, fell to 8 percent by December 2000, as a reversal of the earlier increase in meat prices more than offset the effects of increases in water use fees and energy prices. However, inflation accelerated again in early 2001 under the impetus of higher electricity tariffs, and the Zud-related decline in domestic meat supplies, together with recent increases in public wages and pensions, can be expected to exert upward pressure on domestic prices through the first half of the year.

6. The external balance of payments recorded a large surplus during 2000 and short-term prospects remain positive. Export receipts rose briskly in 2000 as international copper prices rebounded and cashmere prices picked up, while imports boomed reflecting the strength of demand in the nonagricultural sector and the need for Zud-relief. Although the current account deficit widened significantly, it was more than covered by increased official grants (largely for Zud relief) and private inflows. Gross official reserves increased by more than $30 million in 2000, rising to a level of $191 million or 14 weeks of imports of goods and services by year-end. Receipts from meat and textile exports were buoyant in the early part of 2001 and import growth moderated, helping to keep the overall balance of payments strong despite a partial reversal of last year's terms of trade gains. Although the outbreak of foot-and-mouth disease has curtailed foreign demand for Mongolian exports of meat and unprocessed animal products, seasonal receipts from cashmere, copper, and gold exports are expected to pick up in the second half of the year, and the pressures on the current account should remain manageable.

7. Fiscal discipline was eroded during the first half of 2000 in the run-up to the parliamentary elections, but the government adopted a supplementary budget in August 2000 to contain the fiscal imbalance. Unrealistic budgeting, together with weak accounting, internal control, and auditing procedures, especially at the local government level, led to substantial expenditure overruns with respect to the initial budget approved in December 1999. These problems were compounded by poor fiscal data quality and weaknesses in fiscal transparency and accountability, which hampered the government's assessment of fiscal policy trends. Following the transfer of some Tog 8 billion from the central government for the payment of local government wages and social security contributions in December 2000, the stock of outstanding local government arrears was contained to Tog 11 billion or 1.1 percent of GDP as of end-2000, while central government

The government's I-PRSP articulates a private-sector led growth strategy within the framework of a medium-term macroeconomic stabilization program as the main impetus behind the alleviation of poverty in Mongolia. The government's target is at least a halving of the number of households living below the poverty line and at least a 25 percent reduction in the number of extremely poor households by 2005, with further inroads by 2015.

arrears more than doubled to Tog 13 billion or 1.2 percent of GDP. The pervasive accumulation of arrears, including by the major public enterprises that are excluded from the fiscal accounts, together with recourse to netting out operations as the principal means to reduce overdue cross debts within the enlarged public sector, have undermined the reliability and analytical content of official data on the general government finances.

8. Revised estimates of fiscal data for 1999 and 2000, using methodology developed with the help of IMF technical assistance, appear to suggest that an unanticipated improvement in revenue performance led to a narrowing of the overall general government deficit from 12 percent of GDP in 1999 to less than 7 percent of GDP in 2000. Receipts from Erdenet rose sharply following the recovery of international copper prices, while the surge in imports, together with the full-year effect of the import duty introduced in mid-1999, bolstered customs duty and excise tax receipts. Although current expenditures exceeded the amended budget target by about 2 percentage points of GDP as fiscal discipline weakened in the wake of the elections, delays in the implementation of foreign-financed capital projects, together with a buildup of arrears, helped keep total spending well below the amended budget target. Reflecting also the repayment by the Bank of Mongolia (BOM) to the treasury of some Tog 4 billion of previously disputed claims, the government's net debt to the domestic banking system declined by Tog 7 billion or 0.7 percent of GDP over the full year, while net foreign financing of the budget was contained to US$59 million or 6½ percent of GDP.

9. Reserve money growth was spurred in late 1999 and early 2000 by the pickup in net international reserves (NIR) as well as a large expansion of net BOM credit to government, but the growth of broader monetary and credit aggregates was temporarily restrained by an apparent shift in the composition of money demand in favor of currency. The year-on-year rate of growth of reserve money peaked at 100 percent in March 2000, before declining to 19½ percent as of end-December, as the earlier increase in BOM credit to government was largely reversed. Broad money growth declined from a peak of 48 percent in March 2000 to 17½ percent by year-end. The yield on BOM bills rose broadly in line with the rate of inflation through the first nine months of 2000, as the placement of bills was gradually stepped up to moderate the increase in excess bank liquidity.

10. Monetary and credit conditions were considerably eased beginning in the fourth quarter of 2000. While the amount of bills sold at auction became insufficient to absorb the liquidity generated by the balance of payments surplus, an apparent rebalancing of money holdings in favor of bank deposits led to increasing intermediation and a rise in the money multiplier. Real BOM bill rates fell sharply beginning in October 2000, and remained mostly negative through the first quarter of 2001. The consequent buildup in excess bank reserves, together with improved confidence stemming from the strengthening of provisions in bank legislation to facilitate loan recovery, led to a sharp pickup in credit growth, with the year-on-year rate of growth of credit to the private sector peaking at more than 100 percent in

June 2001. Since then, however, the BOM has taken decisive steps to increase the placement of BOM bills, including by allowing the cut-off rates to rise towards positive levels in real terms.

11. The BOM has continued to pursue a flexible exchange rate policy, making recourse to intervention primarily to avoid excessive fluctuations in the exchange rate, especially during a period of unusually strong seasonal inflows in early 2000. The value of the togrog, after having temporarily appreciated relative to the U.S. dollar in the early months of 2000, moved in a relatively narrow range thereafter. The togrog depreciated by a cumulative 2¼ percent vis-à-vis the U.S. dollar during 2000, before leveling off at a rate of Tog 1,090–1,100 per U.S. dollar during the first seven months of 2001.

III. Objectives and Policies for 2001-04

A. Overall Strategy and Macroeconomic Framework

12. The government's macroeconomic policies have been developed in the context of a medium-term framework aimed at supporting more rapid, private-sector led growth and poverty reduction. The three-year PRGF-supported program will aim to create a stable macroeconomic environment conducive to higher private investment, with a view to gradually raising the annual rate of GDP growth to 4–6 percent over the program period, while reducing the rate of inflation to the low single-digit range. The external current account deficit will be targeted to be restrained to about 6 percent of GDP by 2004. This should serve to ensure that the external debt service burden remains manageable, while helping to raise the import cover of gross reserves to 16–17 weeks of imports.

13. The government's structural reform program will be guided by the need to strengthen the institutions of macroeconomic management, while also creating an enabling environment for private sector development. In the fiscal area, the highest priority will be given to reforms to improve transparency, accountability, and enforcement mechanisms in budget implementation and to ensure a more efficient allocation of public expenditure. Banking sector reforms will aim to consolidate the shift to a market-oriented system of indirect monetary management, including through measures to strengthen bank supervision and accelerate the privatization of state-owned banks. Efforts will also be stepped up to reform and privatize nonfinancial public enterprises, establish a sound legal and regulatory framework, and maintain an open trade and investment system, including in the strategic energy sector, so as to enhance opportunities and incentives for private participation in infrastructure projects and limit reliance on debt-creating capital inflows.

B. Budgetary Policy and Reforms to Strengthen Fiscal Governance

14. A stable macroeconomic environment, underpinned by a sustainable fiscal position and greater fiscal transparency and accountability, will be key to the achievement of the government's macroeconomic and poverty reduction objectives as articulated in the I-PRSP. The approved general government budget for 2001 aimed to build on the recent improvement

in the fiscal position by containing the general government deficit to 7¼ percent of GDP in 2001 and reducing it to around 6 percent by 2004. This should lead to a reduction of the public debt-to-GDP ratio from about 96½ percent in 2000 to 94 percent by 2004.

15. Fiscal adjustment is to be centered primarily on enhanced revenue mobilization during 2001, but policies will be subsequently reoriented to bring about an enduring reduction in the expenditure ratio, including through reforms to strengthen the budgetary process, curtail unproductive public expenditures, and enhance the pro-poor orientation of social programs. As a first step, the initial budget for 2001 introduced a substantial package of measures to bolster the revenue-to-GDP ratio. With effect from January 1, 2001, the VAT rate was raised from 13 percent to 15 percent; a temporary, one-year customs duty surcharge was applied at a flat rate of 2 percent; an excise tax on imported beer was introduced at a rate of 20 cents per liter; the excises on cigarettes, wine, and tobacco were increased by 50 percent; and new taxes were introduced on real estate and on the livestock sector. The government remains committed to avoiding recourse to tax measures that would distort investment, trade, or production incentives. Accordingly, customs duty rates or taxes on exports of unprocessed agricultural products will not be increased to protect national industries nor will tax exemptions or other tax incentives be extended.

16. On the expenditure side, the initial 2001 budget envisaged a containment of current spending to 28 percent of GDP. Despite the large increases in domestic energy prices introduced in late 2000, expenditures on goods and services were budgeted to decrease by almost 1 percent of GDP in 2001. In addition, the public wage bill was to be reduced in relation to GDP through a prudent wage policy. The cumulative increase in public wages was envisaged to be limited to 7 percent during 2001, except in the health sector where the budgeted increase was 14 percent. These increases were to be implemented in a phased manner, with the first installment (8 percent in the health sector and 4 percent in all other sectors) to take effect in April and the second (6 percent and 3 percent, respectively) in October. The budget envisaged an increase of 7 percent in pensions during 2001, to be phased in the same manner as public wages in the nonhealth sector.

17. The key macroeconomic assumptions underlying the initial 2001 budget framework changed significantly following the onset of harsh winter conditions for a second year in a row, which threatened the attainment of the poverty reduction objectives established in the government's I-PRSP. This led to the preparation and submission to Parliament of an amended budget in mid-2001. The amended budget includes more updated projections on revenues and foreign financing, together with increased provisions for selected social programs, without significantly altering the overall deficit. On the assumption that program loan disbursements rise to US$22½ million during 2001, the amended budget targets a net repayment of government debt to the banking system on the order of Tog 7 billion or 0.6 percent of GDP. If program loan disbursements are higher (lower), the reduction of net bank credit to government will be correspondingly higher (lower).

18. Consistent with the I-PRSP's objectives, the amended budget allocates Tog 3½ billion for Zud relief and for the government's livestock vaccination program, while

also providing for new expenditures to mitigate the social impact of the measures introduced in the context of the government's energy sector reform program. In line with the agreement reached with the World Bank, the budget assumes responsibility for the payment of Tog 5 billion of subsidies previously provided by the Energy Authority to provincial (aimag) diesel stations. Another Tog 4 billion is to be provided during 2001 to make up for underestimates for fuel and drug expenses in the initial budget, as well as to cover the higher-than-expected public utility bills of budgetary entities resulting from the fact that the structure of tariff adjustments enacted in December 2000 had a somewhat higher inflationary impact than envisaged in the initial budget. An additional Tog 4½ billion is earmarked for the repayment of budget entities' arrears during 2001.

19. To enhance the pro-poor orientation of wage and pension policies, the amended budget provides somewhat higher than initially budgeted increases for selected categories of civil servants and pensioners, while restraining the government's overall wage bill to Tog 86½ billion (7½ percent of GDP) and the pension bill to Tog 60½ billion (5¼ percent of GDP). The wage increases are being introduced in two stages. In the first stage, which took effect on April 15, 2001, about 53,500 civil servants belonging to the lowest-paid administrative category received raises ranging from 3½ to 10 percent, depending on their grade. In addition, some 34,000 employees of hospitals, schools and cultural centers run by aimag governments and municipalities (soums) were granted supplementary salary allowances ranging from 8–20 percent of their salary, with a view to strengthening their incentives to serve in the poorest, remote regions. Altogether, about 77,500 civil servants accounting for 57 percent of public employment were covered by the April wage increases, with an estimated 10,000 benefiting from both schemes. In the second stage, which is to begin in October, the remaining civil servants will receive raises of Tog 3,000 a month (7½ percent to 9.7 percent) if their monthly salary is lower than or equal to Tog 40,000, or Tog 2,500 (3.2–6.3 percent) if their salary exceeds Tog 40,000, as stipulated in a government decree issued following the approval of the amended budget. Pensions were raised by 4½ percent to 10½ percent in April, with the largest increase applying to low-income pensioners receiving up to Tog 17,700 a month. The minimum monthly pension is to increase by another 7.2 percent in October—to a level of Tog 18,850—thus keeping it in line with the anticipated increase in the minimum wage as stipulated in the existing indexation mechanism.

20. The full-year effect of the increases in salaries and pensions is projected to raise the government's wage bill to Tog 89½ billion (7.1 percent of GDP) and the pension bill to Tog 65 billion (5.1 percent of GDP) in 2002. Consistent with the objective of fiscal sustainability, the wage bill has been targeted to decline towards a level of 6½ percent of GDP over the medium-term, so as to reverse a part of the sharp increase recorded in the late-1990s. As a first step, the wage bill during 2002 will be capped at the level of Tog 90 billion by allowing for no wage increases beyond the full-year effect of the increases being granted in 2001, except to the extent that these are compensated by adequate cuts in other current outlays. The scope for additional wage increases will be revisited in the context of the 2002 budget exercise, if the government has in the meantime agreed to generate offsetting savings

through clearly identified cuts in public employment and/or nonwage expenditures, including through social safety net reform, in line with the recommendations of the World Bank's Public Expenditure Review (PER) (see below).

21. To prevent slippages in budget implementation, the amended budget has set aside Tog 8 billion (0.7 percent of GDP) of expenditures as a reserve to be used for contingencies, while receipts from privatization have been estimated conservatively. If there are no unanticipated pressures on expenditures, the reserved funds will be used exclusively to bring about a faster-than-targeted reduction of arrears. However, in the event that international copper prices and receipts from Erdenet are lower than projected, the reserve fund will be reduced commensurately. In addition, the Ministry of Finance and Economy (MOFE) has prepared a backup strategy for meeting exceptional shortfalls in the funding of the budget, including a detailed prioritization of expenditures to be approved by the Cabinet. As a part of this strategy, domestically financed capital expenditures budgeted for 2001 have already been classified into four categories, depending on the priority attached to each project. Budgetary allocations on some Tog 5 billion worth of projects classified as lowest-priority will be held in reserve until the third quarter and will be released only if all the other key revenue, expenditure, and financing targets have been met during the first half of the year. The repayment of domestic arrears will also be back-loaded and made contingent on satisfactory revenue performance during the first three quarters of 2001, and on the effectiveness of measures to prevent any further accumulation of arrears. If the government's privatization program generates larger-than-projected receipts during 2001, these will be earmarked for faster-than-programmed retirement of restructuring bonds held by domestic banks.

22. The recent steps toward more realistic budgeting will be complemented by decisive action to strengthen transparency, accountability, and enforcement mechanisms in budget implementation. While a new treasury department has been set up within the MOFE, the treasury function remains highly decentralized; budgetary units still make commitments and payments without communicating them to the treasury; and a disciplined accounting cadre under the technical direction of the Head of Treasury has yet to be fully established. Budgetary units also maintain their own bank accounts, often at commercial banks, and manage these at their discretion. The government has begun to address these problems based on the recommendations of recent technical assistance missions from the IMF's Fiscal Affairs Department (FAD).

23. Important steps are under way to improve treasury monitoring and control over the government's finances. An inventory of all government accounts was completed on May 10, 2001 and a Cabinet resolution has been adopted centralizing the registration of the bank accounts of the whole nonfinancial public sector and requiring all central budget entities and extra-budgetary funds (EBFs) to provide a detailed monthly report on the balances of all their bank accounts, with supporting bank statements. The Cabinet has also issued new regulations on the responsibilities of Chief Accountants clearly specifying the

authority of the Head of Treasury with regard to accounting and payments functions. The requirement to provide certified reports on bank balances will be extended to local budget entities and EBFs and aimag governments by April 2002.

24. Additional measures will be required to ensure that public officials at all levels of government are—and continue to be—held accountable for the faithful implementation of approved budgets while longer-term reforms of public sector financial management are being introduced. To that end, the government will introduce amendments to the Budget Law of Mongolia in the context of the 2002 budget, to clarify the responsibilities of officials at all levels of government, including by specifying the penalties for arrears accumulation, and to ensure that they will continue to be held accountable for the execution of the budget following the enactment of the Public Sector Management and Finance Law. Moreover, any delegation of controls over budget execution to line ministries will be postponed until there is adequate assurance that these responsibilities can be effectively carried out. The devolution of greater fiscal autonomy to other budgetary entities, especially with regard to employment and wage policies, will also be deferred until an adequate framework for safeguarding financial discipline is in place.

25. A Cabinet resolution to establish a Treasury Single Account (TSA) at the BOM was adopted on June 20, 2001 and the transfer to the TSA of all foreign-currency deposits of the central government at commercial banks is well under way. A Cabinet resolution to initiate the pilot phase of the TSA, including a cash warrant system and BOM subaccounts for each budget entity, was adopted on June 20, 2001. During this phase, three large budget entities, including the Ministry of Education, Culture and Sciences, the Ministry of Health, and the Social Insurance Authority will route all their payments through zero-balance commercial bank accounts. In addition, eight smaller budget entities, including the Cabinet Secretariat, the State Financial Inspection Authority, the General Department of National Taxation (GDNT), the Mongolian National University, Hospital Number 1, the Ministry of Defense, the Ministry of Natural Environment, and the State Property Committee (SPC) will have all their payments centrally authorized and processed by the treasury. During the pilot phase, all budgetary entities participating in the TSA will be barred from opening new commercial bank accounts, will close all of their budget and off-budget accounts held at commercial banks, and will transfer all of their own receipts directly to their subaccounts at the BOM. The government will complete the implementation of the TSA for all budgetary units covered in the pilot phase and will extend the TSA to all line ministries and Ulaanbaatar City, including the requirement to close all off-budget accounts, in consultation with IMF staff, by end-December 2001, with a view to having all central government and Ulaanbaatar City deposits and EBFs transferred to the TSA by end-June 2002. Completion of the transfer of all central government and Ulaanbaatar City deposits to the TSA, encompassing the closure of all their off-budget accounts and the routing of at least 75 percent of their total expenditures through the TSA system, will be a structural benchmark for end-June 2002 under the PRGF arrangement.

26. The government is also taking steps to improve the reliability, timeliness, and comprehensiveness of fiscal data reporting. The MOFE is paying particular attention to the need to improve the statistical coverage and reporting of arrears. To that end, a system of accounts-based monthly reporting has been set up on government payments arrears, payables to Customs, the GDNT, and pension funds, and netting out operations. Beginning in September 2001, all government entities, including EBFs, will be required to report semi-annually to the MOFE and the MOFE will prepare semi-annual reports for consolidated central government accounts and available data on local governments, including comprehensive data on public employment. Legislation requiring all general government entities, including EBFs, to report quarterly to the MOFE, including on the number of staff employed disaggregated by agency, will be submitted to parliament in late 2001 in conjunction with the 2002 budget. The government will make available to the IMF staff, as a matter of course and in a timely manner, all official budget documents submitted to Parliament, including accompanying legislation, background tables, local government budgets, and the key underlying macroeconomic assumptions. Semi-annual and quarterly fiscal reports, as well as reports on unanticipated changes in legislation, local government budgets, data reclassifications, or any other factors expected to affect the budgetary outturn, together with needed explanations, will also be provided to the IMF staff in a timely manner.

27. The progressive elimination of public sector arrears is a key objective of the program to improve fiscal governance. The government attaches the highest priority to eliminating debt service arrears. Interest arrears on restructuring bonds and treasury bills were largely cleared in September 2000. While domestic interest arrears have periodically resurfaced, the government has remained current on its interest payments since early 2001. For the period ahead, to restore the government's credit-worthiness and protect the viability of the bank restructuring program, adequate funds for public debt service were allocated in the amended 2001 budget. In addition, to ensure that interest on government bonds is paid in an orderly and transparent fashion, the outstanding stock of restructuring bonds has been standardized and new contracts have been signed between the MOFE and the main bond holders stipulating the terms for the servicing of their restructuring bonds.

28. To also address the problem of noninterest arrears, the treasury will adopt a joint action program with the State Financial Supervisory Agency (SFSA) by end-2001 specifically to monitor budget entities' bank accounts, ensure that payments arrears problems are properly addressed, and establish a time-bound plan for the progressive reduction and elimination of arrears. The amended 2001 budget includes specific provisions for the reduction of arrears in the budget allocations of debtor budgetary entities. Chief Accountants will be instructed by the Head of Treasury to ensure that priority is given to achieving the planned reduction in arrears and that avoidance of new arrears is strictly observed. This will require allocating any higher-than-budgeted own receipts of debtor budgetary entities for the further clearance of their arrears. The MOFE, in coordination with the GDNT, the Customs Department, and the Social Security Funds, is also taking steps to regularize its transactions with public enterprises. To that end, the government has signed memoranda of understanding (MOUs) with the Baganuur Coal Company, the Energy Authority, Erdenet, and the Neft

Import Concern (NIC) verifying each entity's outstanding payables and receivables related to the budget and establishing a time-bound plan for the elimination of noncash transactions and the settlement of cross debts.

29. Beginning in 2002, a comprehensive public sector reform program will be implemented to rationalize the tax system, while reducing the cost of government and streamlining its operations. On the revenue side, the 2 percent customs duty surcharge introduced in 2001 will be withdrawn and collection efforts will be focused increasingly on strengthening tax administration. To pave the way for this, the government will submit its 2002 budget proposal to Parliament in conjunction with measures aimed at improving intergovernmental fiscal relations and rationalizing revenue sharing arrangements. In particular, proceeds from VAT collected at all levels of government will be centralized and a fixed percentage of VAT receipts will be assigned to the local government sector as a whole to be distributed among the aimags in a more equitable manner (e.g., on the basis of per capita entitlements). The government will also submit a proposal to Parliament to reassign the corporate income tax and the excise tax on alcohol to the central budget starting in 2002. On that basis, a new transfer equalization model will be developed to be used as a guide for the 2002 budget. This new model will move away from the system of ad hoc subsidies, and will be based on fully specified estimates of the revenue capacity and expenditure responsibilities of local governments.

30. Improved public expenditure management will be key to achieving the social objectives of the I-PRSP without undermining fiscal sustainability. The 2002 budget will include efficiency-enhancing reforms associated with civil service pay and employment, including targets for public employment reduction and wage decompression in 2002 and beyond, in line with the recommendations of the World Bank's PER. The government, in consultation with the World Bank, will design and implement a plan to rationalize the delivery and targeting of social services, with a view to redistributing them in favor of poverty-reducing programs. Policies on public pensions will be guided by the need to protect the solvency of the social security funds. To that end, the existing indexation mechanism will be modified with legislation submitted under the 2002 budget, with a view to establishing a closer linkage between pensions and social security contributions in line with the medium-term pension reform concept plan to be approved by Parliament by end-December 2001. In line with the macroeconomic framework envisaged in the I-PRSP, the 2002 budget will include adequate allocations for a continuing reduction of arrears and a wage and employment policy consistent with the maintenance of current expenditures within the agreed envelope.

C. Monetary and Exchange Rate Policies

31. Monetary policy will be geared to reducing inflation to about 8 percent by end-2001, while continuing to bolster the stock of official reserves. Upward pressures on domestic prices were intensified in the early months of 2001 as the Zud disrupted domestic meat supplies, the energy tariff increases were passed through to consumer prices, and domestic demand was spurred by the increases in public wages and pensions. In these circumstances,

an excessive easing of monetary and credit conditions would carry the risk of allowing higher inflation to become embedded in market expectations. To prevent this, the annual rate of growth of broad money has been targeted to be reduced from 22¾ percent in June 2001 to no more than 15½ percent by year-end. This reduction would facilitate the achievement of the external reserve objective, while also providing adequate room for a healthy expansion of credit to the private sector.

32. Consistent with the above objectives, the BOM considers it appropriate to aim to maintain the rate of growth of reserve money to a range of no more than 11 percent in 2001, while keeping the required reserve ratio unchanged at a level of 14 percent. Given that reserve money already rose by more than 16 percent during the first half of 2001, this will require a significant tightening of monetary conditions to bring policies back on track in the second half of the year. The BOM's net domestic assets (NDA) have accordingly been targeted to decrease somewhat during the second half of 2001 from their level as of end-June 2001. Achievement of this target is likely to require a sustained increase in sales of BOM bills. Given the sharp expansion of credit to the private sector since late 2000, the BOM's open market sales will also be guided by the need to guard against an excessive expansion of credit. While much of the increase in the demand for credit during the first half of 2001 was probably of a seasonal nature and should abate in the latter part of the year, the BOM has supplemented the quantitative targets on its net domestic assets with quarterly indicative ceilings for the net domestic assets of the consolidated banking system. This is expected to ensure that credit growth remains within prudent limits throughout the program period.

33. As a first step, sales of BOM bills were stepped up from mid-2001 onwards, and their cutoff rates were raised across the whole spectrum of maturities. The aim has been to keep the BOM's NDA on a downward path, arrest, and begin to reverse, the increase in reserve money that took place in the first half of the year and, thereby, ensure that, by end-August, both of these aggregates get back on track to meet the program's indicative targets and quantitative performance criteria as set out in Table 1. The BOM will keep cut-off rates for its bills at levels which are positive in real terms throughout the program period. It is important that the yields on BOM paper are sufficiently remunerative given their influence on interest rates on restructuring bonds and commercial bank deposits. Maintaining an appropriate structure of rates on these instruments will contribute to the restoration of confidence in the domestic banking system and to the protection of the liquidity and solvency of major state-owned banks. Over time, as more tangible progress is made towards fiscal consolidation, disinflation, and banking system reform, there may be some room for a decline in nominal interest rates, while still keeping rates at positive levels in real terms.

34. The government and the BOM will refrain from either administrative measures or moral suasion to subsidize and/or direct bank credit to favored industrial and other activities during the program period, and they will not provide any implicit or explicit guarantees on external borrowing by private companies, as such measures would undermine the efficiency and soundness of the banking system and could eventually place new burdens on the budget.

While concerns may have been raised by the sharp pick-up in lending by some state-owned banks following recent initiatives by the Ministry of Industry and Trade to encourage the growth of low-cost loans to selected companies, the Minister of Finance and Economy has since issued a public statement to reiterate the government's commitment to a market-based system of credit allocation; both the government and the BOM have pledged not to exercise moral suasion on the managements of state-owned banks to extend loans on noncommercial terms. This policy, together with the tangible progress towards keeping aggregate credit growth within prudent limits and the government's commitment to place the privatization of key state-owned banks on a fast track (see below), should serve to reassure market participants that the recent improvement in the soundness of the banking system will be sustained.

35. The government is committed to enhancing the effective independence of the BOM and is taking important steps to better insulate it from pressures to engage in quasi-fiscal activities. During the first half of 2000, extraordinary recourse to government borrowing from the BOM appears to have breached the legal limit for such borrowing, at least by some measures. Since then, a substantial portion of the government's short-term debt to the BOM has been repaid and a new agreement was reached to resolve pending disputed claims between the MOFE and the BOM. Once a track record of orderly public debt servicing has been established, the BOM will begin to convert its holdings of restructuring bonds into marketable government securities and substitute these or other debt instruments (e.g., treasury bills) for BOM bills in its open market operations. To pave the way for this conversion, as already noted, the MOFE has standardized the existing restructuring bonds, irrespective of holder, including by adopting a unified mechanism for the determination of the rate of return on restructuring bonds. The government also intends to submit legislation to Parliament before the end of 2001 to liberalize the domestic gold market, thereby eliminating any pressures on the BOM to act as the sole gold marketing agent and/or guarantor of external nonconcessional loans to domestic gold mining companies. Beginning in March 2001, to facilitate the financing of the domestic gold industry, the BOM entered into a Deposit and Trading Agreement with a foreign metals trading company, whereby US$25 million of short-term credits were provided for the pre-financing of exports by domestic gold mining companies under a BOM administrative guarantee backed by the BOM's monetary gold deposits as collateral. The outstanding credits under this agreement are programmed to decline steadily from US$25 million as of end-June to zero by end-November 2001. In the meantime, the BOM has revoked previously granted guarantees on US$3 million of external nonconcessional loans that are not strictly linked to the pre-financing of gold exports and will not extend any new guarantees under its existing Deposit and Trading Agreement. The administrative guarantee and gold collateralization elements of this agreement will be terminated in November 2001 as soon as all outstanding export-prefinancing loans have been repaid. The BOM will not extend any new loan guarantees thereafter without prior consultation with the Fund.

36. Mongolia will pursue a flexible exchange rate policy during the period of the PRGF arrangement. The togrog is estimated to have appreciated somewhat in real effective terms in 2000. However, in the government's view, the recent appreciation has not had any significant adverse effects on external competitiveness or export performance. The BOM will continue to allow the value of the togrog to be determined primarily by market forces while limiting intervention to smooth excessive exchange rate fluctuations and meet the reserve targets of the program. Given the existing pipeline in official inflows and the additional inflows expected to be catalyzed by the PRGF-supported program, net international reserves (NIR) of the BOM (excluding the portion of BOM's monetary gold pledged as collateral for external loans to domestic private companies and other off-balance sheet reserve liabilities) are projected to increase by US$20 million during 2001, raising the import cover of gross reserves to about 15 weeks by the end of the year. While the current definition of reserve liabilities of the BOM suffers from limitations owing to the existence of yet-to-be-quantified off-balance sheet derivatives transactions, including those entered into according to the aforementioned Deposit and Trading Agreement, the BOM is committed to cooperating with the staff, with a view to fully accounting for all liabilities in the measurement of NIR by the time of the first review under the PRGF arrangement.

D. Banking System Reforms

37. The government will continue to strengthen the legal and regulatory environment in the banking system. In the cases of the ITI Bank and Reconstruction Bank, which are still under liquidation, court action has been taken against past managers who were responsible for the banks' fraudulent activities. The receivers' efforts to improve recovery on the two banks' remaining loan portfolio are being stepped up, while overdue debts on which a court decision has already been issued are being transferred to the bailiff for immediate collection. More difficult-to-recover loans, together with an equivalent amount of government bonds, are to be transferred to the Mongolian Asset Recovery Agency (MARA), whose legal powers will be enhanced through new legislation. Legislation has also been adopted to enable commercial banks to sell collateral on nonperforming loans without undue delays and to make it a criminal offense to provide false information to a financial institution for the purpose of obtaining credit. To reduce commercial bank incentives to under-provision for their nonperforming loans and other assets, the amendments to the corporate income tax law, which were to eliminate the tax-deductible status of asset loss provisions, have been revoked.

38. BOM's prudential standards and their enforcement will continue to be strengthened. Asset classification and provisioning standards will be brought into full compliance with best international practices by the end of 2001 and the quality of banks' financial reports will continue to be upgraded by improving accounting and auditing standards. The BOM will introduce a new, expanded bank rating system, based on the CAMELS components, and will adopt a formal framework for prompt remedial supervisory actions to be automatically triggered whenever a bank's CAMELS ratings fall below specified thresholds. The minimum capital requirement for banks was raised to Tog 2 billion with effect from end-June 2001, thereby contributing to a further consolidation of the banking system. BOM will encourage

under-capitalized banks to be merged into, or acquired by, stronger institutions, but it will bar mergers among weak institutions that are unlikely to reconstitute themselves as viable entities, including in the case of state-owned banks. While the Agricultural Bank has made good progress towards rehabilitating itself as a profitable institution during its first year of operation under a donor-financed external management contract, it remains undercapitalized. The government will take early action to settle its remaining debts to the bank and bring its capital position up to prudential norms, with a view to preparing it for privatization within the time frame stipulated in the external management contract. The BOM will apply strict selection criteria for the licensing of new banks, in line with the recommendations of IMF and World Bank staff. In the particular case of foreign bank branches, prospective applicants will be limited only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision. Consistent with these criteria, in July 2001, the BOM suspended the bank license previously granted to an institution based in an offshore center and will reconsider licensing it as a finance company following the approval of new legislation on the regulation of nonbank financial institutions, which is expected to be considered by the autumn session of Parliament.

39. To enhance confidence in the banking system, the government plans to introduce a formal deposit insurance system over the medium term. Given the still precarious financial position of some institutions, and in light of the need to protect the integrity of the insurance fund from moral hazard, deposit insurance will be phased in as and when the above-mentioned legal and regulatory reforms have taken full effect, in consultation with IMF and World Bank staff.

E. Public Enterprise Reform and Privatization

40. The government is committed to an overall reform policy which includes privatizing state-owned assets, increasing private sector participation in the economy, and attracting foreign investment. The government's Privatization Guidelines for 2001-2004 were approved by Parliament in January 2001 and its privatization program for 2001 was approved in February. According to this program, the government will privatize 27 fully or partially state-owned enterprises as well as 66 state-owned unfinished buildings and facilities in 2001. In addition, the government intends to restructure 25 enterprises and organizations and ensure their preparation for privatization.

41. The government intends to privatize several most-valued companies through competitive tender in 2001. More specifically, it will sell controlling stakes in the Trade and Development Bank (at least 70 percent of shares), Gobi Cashmere Company (70 percent of shares), and NIC (80 percent of shares). The government is also embarking on a reform program for the energy sector, whose serious financial difficulties have recently posed a threat for the health of both the real economy and the public finances. Coal, electricity, and heating prices were increased with effect from December 15, 2000, by 15 percent, 15 percent, and 35 percent, respectively. The government, in consultation with the World Bank and donors, secured Parliamentary approval of the necessary legislation on electricity,

heating, and the establishment of an independent regulatory authority on February 2, 2001 and reached agreement with the World Bank in April 2001 on a comprehensive medium-term program of energy sector reform and privatization.

42. The government will develop a transparent policy framework within which to address the impact of recent adjustments in energy prices on the poor. The possible means to deliver and distribute petroleum supplies to the rural areas will be explored in the context of the planned privatization of NIC. To pave the way for privatization, the government will develop, by October 2001, a system for the full accounting and monitoring of arrears among the state-owned enterprises in the energy sector and a credible plan for their elimination. Beginning in 2002, pro-poor outlays in these areas will be fully incorporated in, and explicitly accounted for, in the government budget.

F. External Sector Policies

43. The government is committed to maintaining regular relations with creditors. During the high-level intergovernmental committee meeting in November 2000, an agreement was reached for the clearance of $15.8 million of overdue payments on Mongolia's post-1991 debt to Russia and for the payment of debt service due in 2000 and 2001 ($6.4 million and $5.7 million, respectively). Out of a total amount due of $27.9 million, Mongolia has already paid $2 million in cash and some $5.5 million in kind. Of the remaining obligations due in 2001, it was agreed that about $5 million will be paid in cash and the rest in kind. The government has duly incorporated this schedule of repayments in the amended budget for 2001 and will strictly adhere to it. With respect to the pre-1991 convertible ruble debt, it has been agreed to form a new working group to examine all options for dealing with the problem. The government has also established contact with other potential claimants to initiate the process of resolving disputed external claims arising from the granting of government guarantees on past external debt. The government and the BOM will not incur new external arrears during the program period nor will they provide new public guarantees on private external debt (see also paragraph 35 above).

44. Mongolia's liberal trade regime has served the country well in recent years and will remain key to promoting efficient investment and growth during the next stage of transition. To encourage export-led growth and enhance rural incomes, customs controls and licensing for imports and exports will be simplified and the setting of minimum export prices for meat exports discontinued. The government will introduce no new taxes, quantitative restrictions, voluntary restraints or other measures to discourage exports or imports during the program period and will reduce all import tariffs to a unified rate of 5 percent from January 1, 2002.

IV. External Financing Requirements

45. The above policies are expected to help Mongolia reduce the vulnerability of its external position over the medium term. The current account deficit (including official grants) is projected to narrow from about 7¼ percent of GDP in 2001 to 6 percent in 2004,

with total external debt peaking at about 94 percent of GDP in 2003 and declining steadily thereafter. While medium-and long-term loan disbursements are projected to average about US$80–100 million a year, additional external assistance will be needed to fill external financing gaps on the order of US$15-30 million a year. During the PRGF-supported program period, these gaps are expected to be closed through program loans from the World Bank, the AsDB and other donors, and drawings from the Fund.

V. Program Monitoring

46. The first year of the PRGF-supported program will cover the period August 1, 2001-July 31, 2002. To jump-start reforms and provide a strong signal to the domestic and international community of the government's resolve to implement the PRGF program, a number of prior actions have been taken to: (i) Prepare a sound and realistic mid-term amendment for the 2001 budget; (ii) institute a prudent monetary policy; (iii) strengthen treasury management and control over the government's accounting and payments functions; and (iv) begin to regularize the government's outstanding stock of restructuring bonds. The prior actions are presented in greater detail in Table 2.

47. The attached Table 1 and Technical Memorandum of Understanding provide details on a set of quantitative targets agreed with the IMF staff, for the purpose of monitoring progress under the PRGF arrangement. The program's quarterly benchmarks and semi-annual quantitative performance criteria included in Table 1 are related to: (i) net banking system credit to government; (ii) net domestic assets of the BOM; (iii) net international reserves (NIR) of the BOM; (iv) government and government-guaranteed external debt; (v) external arrears; and (vi) domestic interest arrears. In addition, indicative ceilings have been specified for the net domestic assets of the consolidated banking system. The structural benchmarks and performance criteria for the first year of the PRGF arrangement are described in Table 3.

48. The first review under the PRGF arrangement will be completed by end-March 2002 and will assess economic performance based on the observance of the quantitative targets for end-December and the structural benchmarks and performance criteria as of end-September and end-December 2001. At that time, the quantitative performance criteria for end-June 2002 will also be established. The second review will be completed by end-September 2002 and will assess performance based on the observance of the quantitative targets as of end-June 2002 and the structural benchmarks and performance criteria as of end-April and end-June 2002.

49. To increase the transparency of the government's policy intentions, the government has decided to publish this Memorandum in the Mongolian media and on the IMF Website.

Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, 2001-02 1/

	2001			2002		
	End-June Actual	End-Sep. Indicative Targets	End-Dec. Performance Criteria	End-March Indicative Targets 15/	End-June Performance Criteria 15/	End-Dec. Indicative Targets 15/
Quantitative Performance Criteria						
	(In billions of togrogs)					
1. Net bank credit to government (ceiling) 2/ 3/ 4/ 5/	-8.0	-7.1	-16.8	1.5	1.8	-29.6
2. Net domestic assets of the Bank of Mongolia (stock, ceiling) 4/ 6/ 7/ 8/	-23.7	-24.8	-28.9	-28.9	-29.4	-40.4
3. Domestic interest arrears (stock, ceiling) 9/	0.0	0.0	0.0	0.0	0.0	0.0
	(In millions of U.S. dollars, unless otherwise indicated)					
4. Net international reserves of the Bank of Mongolia (stock, floor) 7/ 10/	132.0	148.2	160.6	161.0	170.0	185.6
5. New nonconcessional external debt contracted or guaranteed by the government or the BOM (ceiling)						
Maturities of less than 1 year 3/ 11/ 12/	25.0	10.0	0.0	0.0	0.0	0.0
Maturities of 1-12 years 3/ 11/	0.0	0.0	0.0	0.0	0.0	0.0
6. External payments arrears (stock, ceiling) 9/ 13/	0.0	0.0	0.0	0.0	0.0	0.0
Indicative Target						
Net domestic assets of the banking system (stock, ceiling) 4/ 7/ 14/ (In billions of togrogs)	91.1	84.3	70.0	82.7	89.2	64.7
Memorandum items:						
BOM's monetary gold pledged as collateral for external loans to domestic private companies	30.0	12.0	0.0	0.0	0.0	0.0
Balance of payments support 3/ Excluding disbursements from the IMF	5.2	22.5	22.5	0.0	5.2	20.5
External budgetary assistance (program loans) 3/ (In billions of togrogs)	5.7	25.4	25.4	0.0	6.1	24.2
Privatization receipts 3/ (In billions of togrogs)	1.1	3.4	10.2	0.0	0.0	9.7
Transfer from the BOM to government 3/ (In billions of togrogs)	9.8	9.8	11.3	0.0	0.0	1.7
Reserve money (in billions of togrogs)	154.5	151.3	147.6	148.1	157.4	163.6

1/ The attached technical memorandum of understanding (TMU) sets out the definitions for the above targets under which Mongolia's performance under the program will be assessed.
2/ Defined as net claims on government in the monetary survey.
3/ Cumulative from the beginning of the year.
4/ The targets will be adjusted downward (upward) by the amount of external budgetary assistance in excess of (lower than) that programmed as set out in the above table.
5/ The targets will be adjusted downward by the amount of privatization receipts in excess of that programmed as set out in the above table.
The targets will be adjusted downward by the amount of transfer from the BOM to government in excess of that programmed as set out in the above table.
6/ Defined as the difference between net foreign assets of the monetary authorities and reserve money. Foreign currency-denominated items will be valued at program exchange rates.
7/ The ceilings and floors specified are adjusted to exclude monetary gold pledged as collateral for external loans to domestic private companies.
8/ The targets will be adjusted downward by 80 percent of the amount of net international reserves of the BOM in excess of that programmed as set out in the above table.
9/ Applicable on a continuous basis.
10/ The targets will be adjusted upward (downward) by the amount of balance of payments support, excluding disbursements from the IMF, in excess of (lower than) that programmed as set out in the above table.
11/ For the definition of external debt, see Annex II of the TMU.
Excludes changes in indebtedness resulting from rescheduling operations (including deferral of interest on commercial debt), disbursements from the Fund, loans from the Export-Import Bank of China for the zinc mine project, normal import-related trade credits, and those with grants element equivalent to 35 percent or more, calculated using a discount rate based on OECD commercial interest reference rates (CIRRs).
12/ Short-term loans include domestic private company borrowings from an international metals trading company under an administrative guarantee by the BOM which is backed by BOM's monetary gold.
13/ Excludes external debt in arrears that is in dispute.
14/ Defined as broad money less net foreign assets of the banking system.
15/ The indicative targets for end-March 2002 and the performance criteria for end-June 2002 will be revised during the upcoming staff visit in October 2001.

Table 2. Mongolia: Prior Actions for Board Consideration of New PRGF Arrangement

(To be completed by September 14, 2001)

- Issue government decree specifying the structure of civil service wage increases to take effect during the remainder of 2001 and submit to Parliament an amendment to the 2001 budget, in line with the understandings reached with IMF staff. **(Status: largely completed; government decree has been issued and the central government budget has been amended broadly in line with understandings reached with the staff. Aimag budgets have all been amended but the MOFE has not yet consolidated the resulting data for the general government.)**

- Raise cut-off rates on BOM bills and increase quantity of bills sold as needed to bring the monetary program on track to meet the indicative targets for end-September 2001 as set out in Table 1, including by ensuring that the BOM's NDA and reserve money as of end-August are both smaller than or equal to their levels as of end-June 2001. **(Status: pending; BOM bill placements and cut-off rates have been increased substantially since the beginning of the year, but end-August monetary data are not yet available.)**

- Complete an inventory of all government bank accounts and adopt a Cabinet resolution requiring all central budget entities and extra-budgetary funds (EBFs) to provide a detailed monthly report on the balances of all their bank accounts, with supporting bank statements. **(Status: largely completed; the inventory is to be extended to all government agencies once bank accounts of project implementation units (PIUs) have been registered.)**

- Adopt a Cabinet resolution to establish a treasury single account (TSA) at the Bank of Mongolia (BOM), transfer to the TSA all foreign-currency government deposits owned by central budget entities and EBFs, and send letters to all donors seeking their concurrence to transfer to the TSA all Project Implementation Units (PIUs) and other related government accounts held jointly with donors. **(Status: largely completed; Cabinet resolution was adopted and the transfer of foreign currency deposits owned by the central government was initiated in June.)**

- Adopt a Cabinet resolution to initiate the pilot phase of the TSA, institute a cash warrant system and subaccounts in the BOM for all pilot entities, close all their off-budget accounts, and begin to have their payments routed through zero-balance commercial bank accounts or centrally authorized and processed by the treasury. **(Status: completed.)**

- Sign memorandum of understanding between the MOFE (in coordination with the GDNT, Customs, and the Social Security Funds) and the Baganuur Coal Company, the Energy Authority, Erdenet, and NIC verifying each entity's payables and receivables related to the budget, and establish monthly reporting and a time-bound plan for the elimination of noncash transactions and the settlement of cross debts. **(Status: pending; a working group was set up in June to address the state-owned enterprises' cross-debts with the government, but no information is yet available on signed MOUs.)**

- Standardize stock of restructuring bonds and sign contracts between the MOFE and the main holders stipulating the terms for the servicing of their restructuring bonds. **(Status: pending; agreement on an interest rate formula was reached in June, but the ministerial resolution establishing the formula and the contracts between the MOFE and bond holders have not yet been received by the staff.)**

- Finalize the BOM's decision regarding the disposition of recent or prospective bank license applications by foreign institutions consistent with the MEFP's stipulation that applicants be limited only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision, and ensure that the commencement of operations by any new banks is phased in so as not to jeopardize the achievement of the BOM's monetary program targets, in consultation with IMF and World Bank staff. **(Status: completed.)**

Table 3. Mongolia: Structural Benchmarks and Performance Criteria

Structural Benchmarks

- Enforce legal requirement to report semi-annually to the MOFE on all government entities, including EBFs, and prepare semi-annual report for consolidated central government and available data on local governments, including comprehensive data on public employment (end-September 2001), with the first semi-annual report to cover data for January–June 2001.

- Submit bill to the Parliament to reassign the Corporate Income Tax and the excise tax on alcohol to the central budget starting in 2002 and develop a new equalization transfer model to be used as a guide for the 2002 budget (end-December 2001).

- Adopt joint action program agreed by Treasury and SFSA to monitor budget entities' bank accounts, ensure that payments arrears problems are properly addressed, and establish a time-bound plan for the progressive reduction and elimination of arrears (end-December 2001).

- Adopt legislation requiring all general government entities, including EBFs, to report quarterly to the MOFE, including on the number of staff employed disaggregated by agency (end-December 2001).

- Implement arrears reduction plan and meet arrears reduction targets set for each debtor agency under the Treasury/SFSA joint action program (end-June 2002).

- Complete transfer of all central government and Ulaanbaatar City deposits and EBFs to the TSA, close all off-budget accounts held by central government and Ulaanbaatar City, and ensure that at least 75 percent of total central government and Ulaanbaatar City expenditures are routed through the TSA system (end-June 2002).

- Adhere to best international standards for the licensing of new banks, including by limiting prospective applicants only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision, and consult with IMF staff about the appropriate interpretation of these standards when considering applications for new bank licenses (Continuous).

Structural Performance Criteria

- Secure Parliamentary approval of amendment to Budget Law to clarify and strengthen the accountability of local government officials with respect to the control and reporting of bank accounts and the enforcement of Cabinet regulations and directives from the head of treasury, including by specifying the penalties for arrears accumulation and the misuse of public funds (end-December 2001).

- Secure Parliamentary approval of legislation to centralize the proceeds from VAT collected at all levels of government and assign a fixed percentage of VAT receipts to the local government sector as a whole (end-December 2001).

- Complete transfer of all pilot entities' deposits to the TSA, adopt a Cabinet resolution to extend the TSA to all line ministries and Ulaanbaatar City and close all their off-budget accounts, and initiate transfer of remaining central government deposits to the TSA (end-December 2001).

- Require local governments to adopt the same reporting standards on bank accounts as the central government and to provide monthly reports on their account balances (end-April 2002).

- Obtain parliamentary approval of 2002 Budget in line with the macroeconomic framework agreed with the IMF, including adequate allocations for a continuing reduction of arrears and expenditure saving reforms and a wage and employment policy consistent with the maintenance of current spending within the agreed envelope (end-December 2001).

Mongolia: Technical Memorandum of Understanding

1. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which Mongolia's performance under the program supported under a Poverty Reduction and Growth Facility (PRGF) arrangement will be assessed. Monitoring procedures and reporting requirements are also specified.

I. Quantitative Performance Criteria and Indicative Targets

2. Performance criteria for December 31, 2001 and June 30, 2002, and indicative targets for September 30, 2001 and March 31, 2002 have been established with respect to

- ceilings on the level of net domestic assets of the Bank of Mongolia (BOM);
- floors on the level of net international reserves of the BOM;
- ceilings on the level of net domestic bank credit to the general government;
- ceilings on the contracting and guaranteeing by the central government or the BOM of new nonconcessional medium- and long-term external debt; and
- ceilings on the contracting or guaranteeing by the central government or the BOM of new short-term external debt.

3. Performance criteria that are applicable on a continuous basis have been established with respect to

- ceilings on the stock of domestic interest arrears of the general government; and
- ceilings on the stock of external arrears of the central government and the BOM.

4. Indicative targets for September 30, 2001, December 31, 2001, March 31, 2002, and June 30, 2002 have been established with respect to

- ceilings on the level of net domestic assets of the consolidated banking system.

II. Institutional Definitions

5. The general government includes all units of budgetary central government, social security funds, extrabudgetary funds, and local governments. See Annex I for the description of units in each of these subsectors.

6. The domestic banking system is defined as the BOM, the existing and newly licensed commercial banks and their branches. The seven liquidated banks are not included in the consolidated accounts of commercial banks.

III. Monetary Aggregates

7. **Valuation**. Foreign currency-denominated accounts will be valued in togrogs at the program exchange rate between the togrog and the U.S. dollar (Tog 1,097 per U.S. dollar). Foreign currency accounts denominated in currencies other than the U.S. dollar, excluding SDRs, will first be valued in U.S. dollars at actual end-of-period exchange rates used by the BOM to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of SDR 1=US$1.25. Monetary gold will be valued at US$270.6 per ounce.

A. Reserve Money

8. Reserve money consists of currency issued by the BOM (excluding BOM holdings of currency), commercial banks' deposits held with the BOM, and deposits of nonbanks with the BOM (excluding the general government as defined above).

B. Net International Reserves of the BOM

9. A floor applies to the level of net international reserves (NIR) of the BOM.

10. NIR will be calculated as gross international reserves less international reserve liabilities.

11. **Gross international reserves** of the BOM are defined as the sum of

- monetary gold holdings of the BOM;
- holdings of SDRs;
- Mongolia's reserve position in the IMF; and
- foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the BOM and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.

Excluded from the definition of gross reserves are any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

12. **International reserve liabilities** of the BOM are defined as the sum of

- all outstanding liabilities of Mongolia to the IMF; and
- any foreign convertible currency liabilities of the BOM with an original maturity of up to and including one year.

Excluded from the definition are liabilities arising from balance of payments support of original maturities of more than one year from the World Bank and the Asian Development Bank.

13. **Adjusters.** The floor on NIR will be adjusted upward by the amount of balance of payments support from official multilateral creditors (excluding the IMF) in excess of the programmed level as set out in the table on quantitative performance criteria. The floor on NIR will be adjusted downward by the amount of balance of payments support from official multilateral creditors (excluding the IMF) falling short of the programmed level as set out in the table on quantitative performance criteria.

C. Net Domestic Assets of the BOM

14. A ceiling applies to the level of net domestic assets (NDA) of the BOM.

15. NDA will be calculated as the difference between reserve money and the sum of NIR and other net foreign assets (ONFA) of the BOM.

16. ONFA is defined as the sum of (i) BOM's monetary gold pledged as collateral for external loans to domestic private companies and (ii) other net foreign assets of the BOM, including the difference between accrued interest receivables on gross international reserves of the BOM and accrued interest payables on international reserve liabilities of the BOM.

17. **Adjusters.** The ceiling on NDA will be adjusted downward by the amount of external budgetary assistance in excess of the programmed level as set out in the table on quantitative performance criteria. The ceiling on NDA will be adjusted upward by the amount of external budgetary assistance falling short of the programmed level as set out in the table on quantitative performance criteria.

18. The ceiling on NDA will be adjusted downward by 80 percent of the amount of NIR of the BOM in excess of the programmed level as set out in the table on quantitative performance criteria.

D. Net Bank Credit to the General Government

19. A ceiling applies to the net bank credit flows to the general government (NBCGG) measured cumulatively from the beginning of the year.

20. **NBCGG** is defined as the sum of (i) net borrowing from the BOM (ways and means advances, loans, holdings of restructuring bonds, holdings of treasury bills and other government bonds, and the government liabilities to the IMF regarding PRGF/ESAF disbursements minus deposits) and (ii) net borrowing from commercial banks (loans, advances, holdings of restructuring bonds, and holdings of treasury bills and other government bonds minus deposits).

21. **Adjusters**. The ceiling on NBCGG will be adjusted downward by the amount of external budgetary assistance in excess of the programmed level as set out in the table on quantitative performance criteria. The ceiling on NBCGG will be adjusted upward by the amount of external budgetary assistance falling short of the programmed level as set out in the table on quantitative performance criteria.

22. The ceiling on NBCGG will be adjusted downward by the amount of any transfer, including of profits and provisions, over the program baseline from the BOM to the central government and upward for any shortfall.

23. The ceiling on NBCGG will be adjusted downward by the full amount of privatization receipts in excess of the programmed level as set out in the table on quantitative performance criteria.

E. Net Domestic Assets of the Banking System

24. A ceiling applies to the level of net domestic assets (NDABS) of the banking system.

25. NDABS will be calculated as the difference between broad money and net foreign assets of the banking system.

26. Broad money is defined as the sum of currency outside banks and all current, savings and time deposits of nonbanks (excluding the general government as defined above) with the banking system, including foreign currency deposits.

27. Net foreign assets of the banking system are defined as the sum of NIR and other net foreign assets of the BOM (as defined above) and net foreign assets of the deposit money banks (DMBs). Net foreign assets of the DMBs are defined as foreign assets minus foreign liabilities. Foreign assets comprise gold and foreign currency holdings and claims on nonresidents. Foreign liabilities comprise all liabilities to nonresidents.

28. **Adjusters**. The ceiling on NDABS will be adjusted downward by the amount of external budgetary assistance in excess of the programmed level as set out in the table on quantitative performance criteria. The ceiling on NDABS will be adjusted upward by the amount of external budgetary assistance falling short of the programmed level as set out in the table on quantitative performance criteria.

IV. DOMESTIC INTEREST ARREARS

29. A continuous performance criterion applies to the nonaccumulation of domestic interest arrears on domestic debt contracted by the central government. Domestic interest payments are in arrears when the payment is not made on the due date, as specified in the contractual agreements.

V. EXTERNAL DEBT

A. Medium- and Long-Term External Debt

30. A ceiling applies to the contracting and guaranteeing by the central government, the BOM, or other agencies on behalf of the central government of new debt with nonresidents with original maturities of over one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received.

31. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex II).

32. Excluded from the ceiling are (i) the use of Fund resources; (ii) adjustment lending from the World Bank, the Asian Development Bank and the International Fund for Agricultural Development (IFAD); (iii) debts to restructure, refinance, or prepay existing debts; (iv) concessional debts; (v) loans from the Export-Import Bank of China for the Mongolian zinc mine project; and (vi) any togrog-denominated treasury bill and government bond holdings by nonresidents.

33. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the BOM, or other agencies on behalf of the central government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the central government, the BOM, or other agencies on behalf of the central government to finance a shortfall incurred by the loan recipient.

34. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element **is equal to** (nominal value **minus** NPV) **divided by** nominal value). The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculated the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through December 2001, the CIRRs published by the OECD in January 2001

will be used. For example, based on January 2001 CIRR rates, a U.S. dollar-denominated debt with a 10–year maturity would be considered concessional if the interest rate did not exceed 3 percent.

B. Short-Term External Debt

35. A ceiling applies to the contracting and guaranteeing by the central government, the BOM, or other agencies on behalf the central government of new debt with nonresidents with original maturities of one year or less. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received.

36. For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex II). The guarantee of a debt is defined in paragraph 33 above.

37. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the BOM; (ii) debts to restructure, refinance, or prepay existing debts; (iii) togrog-denominated treasury bills, government bonds, and BOM bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VI. External Payment Arrears

38. A continuous performance criterion applies to the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government or the BOM. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements. However, overdue debt and debt service obligations that are in dispute will not be considered as external payment arrears for the purposes of program monitoring.

VII. Reporting

39. The authorities have committed themselves to using the best available data, so that any subsequent data revisions will not lead to a breach of a performance criterion. All revisions to data will be promptly reported to the Fund's Resident Representative, particularly when the changes are significant. The likelihood of significant data changes, including definitional changes, will be communicated to Fund staff as soon as the risk becomes apparent to the authorities.

40. Data required to monitor performance under the program, including those related to performance criteria and indicative targets, will be provided electronically to the Fund's Resident Representative by the 15th day of each month, unless otherwise indicated. The data to be reported are listed below, and the reporting responsibilities are indicated in parentheses.

A. Monetary Data (BOM)

- The monetary survey, the balance sheet of the BOM, and the consolidated balance sheet of the commercial banks. Data will be provided on a monthly basis, with the exception of the balance sheet of the BOM, which will be provided on a weekly basis within five working days of the end of the respective week.

- Net international reserves and interventions of the BOM in the foreign exchange market on a weekly basis within five working days of the end of the respective week.

- Interest rates and volume on standing facilities and market operations on a weekly basis within five working days of the end of the respective week.

- A detailed breakdown of net credit to government from the BOM and the commercial banks.

- Stock of monetary gold in both thousands of fine troy ounces and U.S. dollars. If the BOM engages in monetary gold transactions or employs any other accounting rate, directly or implicitly, for valuing gold assets or liabilities guaranteed by gold, this information will be reported to the Fund. Any increase in monetary gold through purchases from domestic sources and refining of nonmonetary gold held or purchased by the BOM will also be reported (both prices and volumes).

- A detailed breakdown of "other items net" for both the BOM and the commercial banks, including, inter alia, all valuation changes in net international reserves and net other foreign assets arising from exchange rate changes and/or revaluation of gold.

- Outstanding balances of any new deposit accounts of the general government opened in addition to the existing ones for grants and loans received from multilateral or bilateral donors, including associated counterpart funds.

- A bank-by-bank list of required reserves and actual reserves.

- A bank-by-bank list of ceilings on commercial bank lending to nonbanks imposed by the BOM along with the actual stock of outstanding amounts.

- Results of each central bank bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank, announced rates, and cut-off rates.

B. Fiscal Data (Ministry of Finance and Economy (MOFE))

- Consolidated accounts of the central, local, and general government, including detailed data on tax, nontax, and capital revenues, current and capital expenditures, net lending, and financing. Financing components should be separated into foreign sources (cash and project loans) and domestic sources (bank and nonbank).

- Classified transactions of all five social insurance funds, the culture and art development fund, the privatization fund, and the road fund.

- Interest arrears on domestic debt of the government.

- Noninterest outstanding payables by each subsector of the general government, including the social security funds, with a detailed breakdown by major categories and remaining maturity.

- Results of each treasury bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank and nonbanks, and the average yield in percent per month.

- A detailed breakdown, within one month following the quarterly test date, of the financial accounts of 9 large public enterprises, including budgetary subsidies, grants, and lending, government guarantees, and bank credit (in consultation with the BOM).[1]

- Data on civil service employment (semi-annually in 2001 and quarterly in 2002).

C. External Sector Data (BOM and MOFE)

- Outstanding stock, disbursements, amortization, and interest payments of short-term external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

- Outstanding, disbursements, amortization, and interest payments of medium- and long-term external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

- Daily midpoint exchange rates of the togrog against the U.S. dollar, including the official, interbank, and parallel market exchange rates (BOM).

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[1] Net Import Concern, Gobi Cashmere Company, MIAT, Energy Authority, Baganuur Coal Company, Erdenet, Mongolian Railways, Darkhan Minimetal, and Ulaanbaatar Bus Company.

- Arrears on the external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

D. Other Data (National Statistical Office)

- The overall monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

- The NSO's monthly statistical bulletin, including monthly export and import data.

Mongolia: Units of General Government

Central Government Units Covered by Central Budget

1. Cabinet office, constitutional council, general prosecutor's office, ministries, parliament, president's office, and supreme court
2. Government agencies
3. Poverty Alleviation Fund
4. Privatization Fund

Central Government Units with Individual Budgets

5. Disability Allowance Insurance Fund
6. Health Insurance Fund
7. Industrial and Other Accidents Insurance Fund
8. Social Security Fund
9. Unemployment Fund
10. Culture and Art Development Fund
11. Employment Promotion Fund
12. Environment Foundation
13. Food Fund
14. Fund for Development of Small and Medium-sized Enterprises
15. Road Fund

Local Government

16. City and 12 districts of Ulaanbaatar
17. 21 provinces
18. 340 districts

Data Coverage

Data on budgetary central government tables cover operations of units 1–4. Units 5–9 are social security funds; units 10–15 comprise extrabudgetary funds. The Cultural and Historical Fund was dissolved in 2000.

Data in local government tables cover operations of units 16–18.

Guidelines on Performance Criteria with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 12274, as revised on August 24, 2000

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

MONGOLIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility Supplementary Information

Prepared by Asia and Pacific Department

(In consultation with other departments)

Approved by R. Anthony Elson and Shigeo Kashiwagi

September 27, 2001

1. This supplement summarizes information on recent developments that has become available since the circulation of the staff report (EBS/01/166). Special reference is made to the status of prior actions and recent economic performance relative to the key program targets. The new information does not change the thrust of the staff appraisal contained in EBS/01/166.

Prior Actions

2. **All the prior actions for Board consideration of Mongolia's request for a three-year arrangement under the PRGF have been implemented as of September 27, except one relating to monetary policy and the net domestic assets (NDA) of the Bank of Mongolia (BOM).**[1] Although BOM bill placements have been increased substantially, the NDA of the BOM exceeded the target for end-August by Tog 5 billion or the equivalent of 0.4 percent of GDP (Table 1). Nevertheless, reserve money growth has decelerated broadly in line with the program target and the authorities have indicated their intention to place more BOM bills during this month's auctions to bring the BOM's NDA broadly on track with the

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[1] Eight prior actions for Board consideration were specified in Table 2 of the MEFP (EBS/01/166, 9/18/01, Attachment II, pp. 72–73).The verification of two prior actions relating to the settlement of cross-debts between the government and key public enterprises and the standardization of restructuring bonds was completed in less than five days prior to the scheduled Board meeting. The delay in verifying these actions was caused by the need to translate the documents provided by the authorities as evidence of compliance and by subsequent staff requests for clarification. Following a review of the translated documents, and based on the clarifications provided by the authorities, the staff is now confident that both prior actions have been met.

adjusted indicative target for end-September 2001.[2] While the NDA of the consolidated banking system have continued to expand, this has been due primarily to market-driven lending by private banks spurred by the continuing trends towards re-intermediation, the strong pent-up demand for bank credit, and the ongoing rehabilitation of the banking system (including the Agricultural Bank).

Recent Developments and Policies

3. **Overall economic performance remains broadly on track to achieve the program's main macroeconomic targets**. Though harsh winter (Zud) and the outbreak of foot and mouth disease now appear to have taken a heavier toll on the animal husbandry sector than projected in the staff report, preliminary data suggest that the nonagricultural sector has exhibited relatively robust growth as envisaged. The rate of inflation has remained on a declining trend, with the year-on-year rate at 9 percent as of end-August, broadly in line with program projections, as the seasonal increase in meat supplies continued to exert downward pressure on meat prices. While copper prices have remained weak, export growth has been underpinned by a sustained growth of gold exports as new gold mines have come on stream. As a result, net international reserves are projected to significantly exceed the indicative program target for end-September. The togrog has remained relatively stable vis-à-vis the U.S. dollar.

4. **The final data on the amended general government budget for 2001, including the consolidated accounts of local budgets as approved by the local parliaments, imply a budget deficit that is fully in line with the agreed program targets**. Although budgeted revenues exceed the previously envisaged target by about ½ percent of GDP, the revised estimates are realistic, as the initial revenue projections appeared to err on the conservative side. Half the additional revenue is to be used for a faster repayment of arrears, while the remainder is mainly to finance new public investment. The composition of public expenditure is fully in line with the PRGF-supported program's priorities as outlined in the staff report. In particular, the budget incorporates separate arrears reduction targets for the central and local governments (0.3 percent and 0.4 percent of GDP, respectively).[3]

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[2] In the attached table, the staff has provided preliminary estimates of adjusted program targets for end-September 2001 on the basis of available information for external financing (which points to a large shortfall with respect to the end-September target) and net international reserves (which are projected to significantly exceed the end-September adjusted target).

[3] These targets cover expenditure arrears of budgetary entities only. At the end of July, the treasury had also paid an additional Tog 7 billion (0.6 percent of GDP) of arrears on payments due to domestic suppliers of meat exports in connection with the earlier clearance of the government's external debt service arrears to Russia.

5. **Preliminary data for January–July 2001 indicate that fiscal performance is on track to achieve the program targets**. Total revenue has been significantly stronger than expected due to higher-than-projected receipts from the corporate income tax, the VAT, excises, and social security contributions. With expenditures remaining largely under control, the overall government deficit for the first seven months of 2001 was lower than projected and net credit to government has remained well within the program targets (adjusted for the expected shortfall in external financing). Consistent with program objectives, the stock of expenditure arrears was reduced from Tog 17 billion (1.6 percent of GDP) at end-2000 to Tog 14 billion (1.2 percent of GDP) by end-August 2001.

6. **The government is making good progress towards implementing the structural reforms envisaged under the program**. All the key elements of the program to improve fiscal transparency and accountability, which were included in the program's prior actions, have been put in place. In the area of privatization, the tender for the Trade and Development Bank was issued in the second week of September, and bidding for the GOBI cashmere company is due by November 5. In both cases, the government intends to sell its entire equity position (76 percent and 70 percent, respectively). Preliminary information suggests that good quality bidders are likely to express interest in bidding for the two enterprises.

Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, 2001-02 1/

	2001					2002		
	End-June	End-Aug	End-Sep.		End-Dec.	End-March	End-June	End-Dec.
			Indicative	Adjusted	Performance	Indicative	Performance	Indicative
	Actual	Est.	Targets	Targets 16/	Criteria	Targets 15/	Criteria 15/	Targets 15/
Quantitative Performance Criteria								
					(In billions of togrogs)			
1. Net bank credit to government (ceiling) 2/ 3/ 4/ 5/	-8.0	-3.7	-7.1	12.5	-16.8	1.5	1.8	-29.6
2. Net domestic assets of the Bank of Mongolia (stock, ceiling) 4/ 6/ 7/ 8/	-23.7	-18.7	-24.8	-20.1	-28.9	-28.9	-29.4	-40.4
3. Domestic interest arrears (stock, ceiling) 9/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
					(In millions of U.S. dollars, unless otherwise indicated)			
4. Net international reserves of the Bank of Mongolia (stock, floor) 7/ 10/	132.0	130.9	148.2	130.9	160.6	161.0	170.0	185.6
5. New nonconcessional external debt contracted or guaranteed by the government or the BOM (ceiling)								
Maturities of less than 1 year 3/ 11/ 12/	25.0	19.0	10.0	10.0	0.0	0.0	0.0	0.0
Maturities of 1-12 years 3/ 11/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. External payments arrears (stock, ceiling) 9/ 13/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indicative Target								
Net domestic assets of the banking system (stock, ceiling) 4/ 7/ 14/ (In billions of togrogs)	91.1	99.3	84.3	104.0	70.0	82.7	89.2	64.7
Memorandum items:								
BOM's monetary gold pledged as collateral for external loans to domestic private companies	30.0	22.8	12.0	12.0	0.0	0.0	0.0	0.0
Balance of payments support 3/ Excluding disbursements from the IMF	5.2	5.2	22.5	5.2	22.5	0.0	5.2	20.5
External budgetary assistance (program loans) 3/ (In billions of togrogs)	5.7	5.7	25.4	5.7	25.4	0.0	6.1	24.2
Privatization receipts 3/ (In billions of togrogs)	1.1	...	3.4	3.4	10.2	0.0	0.0	9.7
Transfer from the BOM to government 3/ (In billions of togrogs)	9.8	9.8	9.8	9.8	11.3	0.0	0.0	1.7
Reserve money (in billions of togrogs)	154.5	150.4	151.3	155.1	147.6	148.1	157.4	163.6

1/ The attached technical memorandum of understanding (TMU) sets out the definitions for the above targets under which Mongolia's performance under the program will be assessed.
2/ Defined as net claims on government in the monetary survey.
3/ Cumulative from the beginning of the year.
4/ The targets will be adjusted downward (upward) by the amount of external budgetary assistance in excess of (lower than) that programmed as set out in the above table.
5/ The targets will be adjusted downward by the amount of privatization receipts in excess of that programmed as set out in the above table.
The targets will be adjusted downward by the amount of transfer from the BOM to government in excess of that programmed as set out in the above table.
6/ Defined as the difference between net foreign assets of the monetary authorities and reserve money. Foreign currency-denominated items will be valued at program exchange rates.
7/ The ceilings and floors specified are adjusted to exclude monetary gold pledged as collateral for external loans to domestic private companies.
8/ The targets will be adjusted downward by 80 percent of the amount of net international reserves of the BOM in excess of that programmed as set out in the above table.
9/ Applicable on a continuous basis.
10/ The targets will be adjusted upward (downward) by the amount of balance of payments support, excluding disbursements from the IMF, in excess of (lower than) that programmed as set out in the above table.
11/ For the definition of external debt, see Annex II of the TMU.
Excludes changes in indebtedness resulting from rescheduling operations (including deferral of interest on commercial debt), disbursements from the Fund, loans from the Export-Import Bank of China for the zinc mine project, normal import-related trade credits, and those with grants element equivalent to 35 percent or more, calculated using a discount rate based on OECD commercial interest reference rates (CIRRs).
12/ Short-term loans include domestic private company borrowings from an international metals trading company under an administrative guarantee by the BOM which is backed by BOM's monetary gold.
13/ Excludes external debt in arrears that is in dispute.
14/ Defined as broad money less net foreign assets of the banking system.
15/ The indicative targets for end-March 2002 and the performance criteria for end-June 2002 will be revised during the upcoming staff visit in October 2001.
16/ Based on available information for external financing and the BOM's net international reserves (projected at US$148 million at end-September).

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FOR IMMEDIATE RELEASE
October 1, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$37 Million PRGF Arrangement for Mongolia

The Executive Board of the International Monetary Fund (IMF) today approved a three-year arrangement for Mongolia under the Poverty Reduction and Growth Facility (PRGF)[1] for SDR 28.49 million (about US$37 million). As a result of today's decision, Mongolia will be able to draw SDR 4.07 million (about US$5 million) from the arrangement.

Following the Board discussion on Mongolia, Anne Krueger, First Deputy Managing Director, and Acting Chair said:

"Mongolia has made great strides during the last decade in fostering a market economy and promoting macroeconomic stability. However, it continues to face important challenges. Weak economic governance in the past has contributed to an increase in the quasi-fiscal losses by state-owned banks and nonfinancial enterprises, a buildup of fiscal arrears, and an unsustainable increase in the public debt ratio. As the pace of privatization and other market-oriented reforms slowed in the late 1990s, the prospects for private investment and sustained economic growth weakened. Also, with domestic incomes depressed by adverse terms of trade and severe weather conditions, progress toward poverty alleviation has been slow in recent years.

"Consistent with the government's interim Poverty Reduction Strategy Paper (I-PRSP), policies under the PRGF-supported program will seek to protect macroeconomic stability and strengthen the momentum of structural reform, with a view to promoting faster, private sector-led growth and poverty reduction. The government's strategy will need to be centered on an ambitious, but realistic effort to gradually reduce the public debt burden, while also providing for the country's

[1] On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was replaced by the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Mongolia, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½ year grace period on principal payments.

social needs. With the help of a substantial package of revenue measures, which has largely already been implemented, the fiscal deficit is to be contained at a level that can be comfortably financed by concessional external loans. There are ongoing efforts to strengthen fiscal transparency and accountability through improved fiscal data quality and reporting, more realistic budgeting, better treasury management, and the elimination of quasi-fiscal activities and arrears, but further progress is necessary. From 2002 onwards, fiscal consolidation will focus primarily on expenditure-saving reforms that will not jeopardize the government's poverty reduction objectives.

"Monetary policy will be directed towards reducing inflation to the low single digit range, while continuing to bolster external reserves. To keep the growth of monetary and credit aggregates within prudent limits, the Bank of Mongolia (BOM) has recently stepped up its sales of BOM bills, while ensuring that BOM bill rates remain positive in real terms. The government will take steps to enhance the BOM's independence and discourage its involvement in quasi-fiscal operations. The government and the BOM are committed to a market-based system of credit allocation and will not exercise moral suasion over the management of state-owned banks to extend loans on non-commercial terms.

"Steadfast program implementation will be required to protect Mongolia's external viability over the medium term. Given the country's high external debt burden and its vulnerability to terms of trade and climatic shocks, nonconcessional external public borrowing should continue to be avoided and the concessionality of aid inflows maintained. Reforms will need to be pursued with determination to strengthen competition and efficiency, maintain an open trade and investment regime, and reduce reliance on debt-creating capital inflows. The accelerated progress towards privatization and energy sector reform is particularly welcome in this context.

"The government has prepared an I-PRSP through a broad consultative process which provides a sound basis for preparing a full-fledged PRSP and for concessional assistance from the Fund and the World Bank. The full PRSP will need to reflect careful consideration of the tradeoffs between the government's poverty reduction agenda and the overall budget constraint, including through the costing, prioritization, and sequencing of programs likely to entail increased public spending. It will also need to be based on a realistic assessment of the economy's growth prospects. Solid domestic political support and continued donor assistance will be essential in implementing the authorities' program. Accurate and timely data reporting will also be necessary to facilitate program monitoring," Ms. Krueger said.

Recent Economic Developments

The losses of the animal husbandry sector, resulting from two consecutive harsh winters (Zud) and from a recent outbreak of foot-and-mouth disease, have taken a heavy toll on Mongolia's output in 2000 and early 2001. Real GDP growth is estimated to have declined from 3¼ percent in 1999 to about 1 percent in 2000 and is projected to recover moderately in 2001. The year-on-year inflation rate fell to 8 percent by end-2000, but accelerated again in the first half of 2001 partly due to higher electricity tariffs and the Zud-related decline in domestic meat supplies. The seasonal increase in meat supplies has since, however, helped to reverse some of the earlier rise in food prices, easing inflationary pressures from mid-2001.

The overall balance of payments recorded a large surplus during 2000. Export receipts rose by 18 percent in 2000 as international copper prices rebounded and cashmere prices picked up, while imports surged by 21 percent reflecting the strength of demand in the nonagricultural sector and the need for Zud-relief. Although the current account deficit widened, it was more than covered by increased official grants and private inflows. Gross official reserves reached a level of $191 million or 14 weeks of imports of goods and services by end-2000.

Fiscal discipline was eroded in the run-up to the parliamentary elections in mid-2000. Unrealistic budgeting, together with weak accounting, internal control, and auditing procedures, especially at the local government level, led to substantial expenditure overruns. The accumulation of arrears, including by the major public enterprises that are excluded from the fiscal accounts, tended to undermine the reliability and analytical content of official general government statistics. An unanticipated surge in revenues towards the end of 2000 (coming mainly from the revenue increase at a mining sector company partly owned by the government), together with delays in the implementation of foreign-financed projects, led to a narrowing of the overall general government deficit from 12 percent of GDP in 1999 to less than 7 percent of GDP in 2000. Reflecting also favorable movements in exchange rates, the public debt ratio declined from 102½ percent of GDP (72 percent in NPV terms) in 1999 to 96½ percent of GDP (66 percent in NPV terms) in 2000.

The growth of bank credit to the private sector was restrained in early 2000, but credit growth picked up sharply beginning in late 2000. While BOM bill rates rose broadly in line with the rate of inflation during the first nine months of 2000, they fell sharply beginning in late 2000. This development, together with an apparent trend towards reintermediation as confidence in the banking system improved in response to continuing bank reforms, led to rapid credit growth through the first half of 2001. Since then, however, the BOM has taken important steps to increase BOM bill rates and open market sales, with a view to slowing the growth of monetary and credit aggregates.

Program Summary

In the medium-term, the government's poverty reduction strategy under the PRGF rests on three pillars: (i) macroeconomic stability; (ii) private-sector led and outward-oriented growth; and (iii) broad-based and more equitable distribution of benefits from growth. To lead to a meaningful reduction in poverty, the government seeks to raise real GDP growth to 6 percent by 2004 while reducing inflation to 5 percent, containing the external current account deficit in the range of 6-7 percent of GDP, and raising gross official reserves to about four months of import cover.

To reverse the buildup of the debt-to-GDP ratio, the government aims to contain the budget deficit to 7¼ percent of GDP in 2001 and reduce it to around 6 percent of GDP by 2004. This should lead to a reduction of the public debt ratio to 94 percent of GDP (58 percent of NPV terms) by 2004. The pace of fiscal adjustment under the program is circumscribed by the need to promote fiscal sustainability while also taking decisive measures to institute more realistic and transparent budgeting and meet the government's growth and poverty reduction objectives. During 2001, fiscal adjustment will be centered on revenue mobilization, but during 2002-2004 policies will be reoriented so as to contain unproductive expenditures and make room for more adequate provisions for poverty reducing programs.

Monetary policy will be geared to reducing inflation to about 8 percent by end-2001, and to the low single-digit range over the medium term while continuing to bolster the stock of official reserves. The authorities will refrain from measures to subsidize and/or direct domestic or foreign lending to favored industrial activities during the program period. The authorities will also pursue a flexible exchange rate policy and maintain a market-based exchange rate system.

The government projects Mongolia's external position to improve gradually over the medium term, with policy measures under the program and continued donor support. The current account deficit is projected to narrow from about 7¼ percent of GDP in 2001 to 6 percent in 2004, assuming that import growth reverts to a level that is more in line with GDP growth from 2001 onwards and that the terms of trade recover in 2002-2003 before leveling off thereafter. A major risk stems from Mongolia's continued vulnerability to terms of trade and climatic shocks. An unanticipated weakening of copper prices, in particular, would put the fiscal accounts under serious strain. Another risk relates to the size and composition of capital inflows. A shift in the composition of aid inflows in favor of loans could threaten the sustainability of Mongolia's external position.

On the structural agenda, aside from a far-reaching reform program to enhance fiscal transparency and accountability and to strengthen tax administration, the government seeks to implement public enterprise reform and privatization. The program for 2001 envisages the sale through competitive tender of several companies, including the Trade and Development Bank, and Gobi Cashmere Company. The government has also embarked on a reform program for the energy sector. At the same time, the government aims to institute adequate social safety nets to protect vulnerable groups from the potential adverse side effects of reforms. It will also continue to implement measures to strengthen bank regulation and supervision and banking-sector reforms.

Mongolia joined the IMF on February 14, 1991. Its quota[2] is SDR 51.10 million (about US$66 million). Its outstanding use of IMF credits totals SDR 35.62 million (about US$46 million) as of end-August.

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[2] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table. Mongolia: Selected Economic and Financial Indicators, 1998–2004

Nominal GDP (1999): $906 million
Population (1999): 2.36 million
Quota: SDR 51.1 million

	1998	1999	2000 Est.	2001 Prog.	2002	2003	2004
			(Percent change)				
Real GDP	3.5	3.2	1.1	1.4	4.0	5.0	6.0
Consumer prices (period average)	9.4	7.6	11.6	8.8	6.0	5.0	5.0
Consumer prices (end period)	6.0	10.0	8.1	8.0	6.0	5.0	5.0
			(In percent of GDP)				
General government revenue	27.6	27.2	33.6	33.6	32.7	32.6	32.6
General government expenditure	41.9	39.4	40.5	41.0	39.8	39.2	38.6
Current balance	-0.7	-0.2	3.1	2.7	3.1	3.4	4.0
Overall balance	-14.3	-12.2	-6.8	-7.3	-7.1	-6.6	-6.0
Net domestic credit to government	4.1	0.0	-0.7	-1.5	-2.3	-1.3	-0.9
Total public debt 1/ 5/	85.3	102.5	96.5	94.9	96.7	96.2	93.9
NPV of total public debt	...	71.7	66.0	63.4	62.4	60.8	58.3
			(Percent change)				
Net foreign assets	-31.6	96.9	33.6	13.0	16.8	...	...
Net domestic assets	56.5	-23.6	-17.9	23.4	-7.6	...	...
Domestic credit	60.1	-11.1	-8.0	0.8	-4.4	...	...
Credit to enterprises	18.5	-39.7	29.5	38.3	33.9	...	...
Broad money	8.8	31.7	17.5	15.3	11.1	...	...
Reserve money	13.5	51.8	19.4	11.1	10.8	...	...
Broad money velocity (GDP/BM) 2/	5.0	4.3	4.1	4.0	3.9	...	...
Annual interest rate on central bank bills (percent) 3/	23.3	11.4	8.5	10.0	...	...	...
			(In millions of US dollars, unless otherwise indicated)				
Current account balance, excluding official transfers	-129	-124	-167	-170	-159	-155	-159
(In percent of GDP)	-13.2	-13.7	-17.2	-16.7	-14.7	-13.4	-12.7
Current account balance, including official transfers	-75.5	-57.1	-68.3	-74.6	-76.5	-70.1	-74.2
(In percent of GDP)	-7.8	-6.3	-7.0	-7.3	-7.1	-6.1	-5.9
Trade balance	-120	-113	-150	-150	-132	-124	-126
(In percent of GDP)	-12.4	-12.5	-15.5	-14.7	-12.3	-10.7	-10.0
Exports, fob	462	454	537	549	601	647	693
(Percent change)	-18.8	-1.7	18.2	2.3	9.4	7.7	7.0
Imports, cif	582	567	687	699	733	771	819
(Percent change)	8.2	-2.6	21.2	1.7	4.9	5.2	6.2
Financial and capital account balance	116	59	68	72	81	81	89
(In percent of GDP)	12.0	6.5	7.1	7.1	7.5	7.0	7.0
Gross official international reserves (end-period) 4/	124.7	156.8	190.9	209.2	237.1	259.8	284.2
(In weeks of next year/projected imports c.i.f.)	11.4	11.9	14.2	14.8	16.0	16.5	17.0
Public and publicly guaranteed external debt 5/	753	850	854	912	1009	1089	1171
(In percent of GDP)	77.4	93.9	88.0	89.4	93.6	94.2	93.1
NPV of public and publicly guaranteed external debt	...	571	558	591	639	679	724
(In percent of GDP)	...	63.0	57.5	57.9	59.2	58.7	57.6
Debt service 5/	39.3	41.3	31.5	45.8	37.4	40.9	36.5
(In percent of exports of goods & services)	7.3	9.3	6.0	7.0	5.3	5.4	4.5
Exchange rates							
Togrogs per US dollar (end of period)	902	1,072	1,097	...	...	...	...
Togrogs per US dollar (period average)	841	1,022	1,077	...	...	...	...
NEER, end-period (1995=100) 6/	69.0	60.8	59.3	60.7	...	...	...
REER, end-period (1995=100) 6/	117.6	107.5	108.1	119.9	...	...	...
Export prices (US dollar, percent change)	-18.3	-6.9	10.5	-4.3	4.7	3.1	2.0
Copper price (US dollar, percent change)	-38.1	-5.8	18.4	-11.0	13.3	6.0	3.4
Import prices (US dollar, percent change)	-6.8	-2.9	2.9	-5.2	0.3	0.5	1.6

Terms of trade (percent change)	-12.3	-4.2	7.4	0.9	4.4	2.6	0.4
Private savings-investment balance (in percent of GDP)	6.5	5.9	-0.2	0.0	0.1	0.5	0.1
Nominal GDP (billion togrogs)	817	925	1,045	1,152	1,270	1,401	1,559
Nominal GDP (million US dollars)	972	906	970	1,020	1,078	1,156	1,257

Sources: Mongolian authorities; and IMF staff estimates and projections.
1/ Includes IMF loans, guarantees and arrears.
2/ Seasonally adjusted figures for broad money velocity from 1997 onwards.
3/ Annualized yield on end-period auction of 14-day bills. For 2001, as of end-August.
4/ Beginning December 2000, includes commercial banks' foreign exchange deposits with the Bank of Mongolia.
5/ Excludes unresolved claims estimated at TR 10.5 billion to Russia.
6/ For 2001, end-June.

Statement by Michael J. Callaghan, Executive Director for Mongolia
September 28, 2001

The preparation of this request for an arrangement under the PRGF has had a long gestation period and my authorities are very pleased that it is now before the Board. For over twelve months they have worked very closely with Fund staff to develop a program and, along with the assistance of Bank staff, prepare a participative I-PRSP.

Soon after coming into office in July 2000, the Government entered into negotiations with the Fund for a PRGF arrangement because the Government clearly recognized the necessity of enhancing and deepening the economic reform process in order to accelerate the country's transition to a market economy, encourage sustained private sector-led growth and through this achieve a substantial reduction in poverty and a more equitable distribution of the benefits from stronger growth.

The Mongolian Government is fully committed to the reform effort and there is no question of a lack of ownership with this program. As highlighted in the JSA, one of the notable strengths of the I-PRSP process is the full country ownership of the document.

It is sometimes overlooked how far Mongolia has come in a relatively short space of time in its transition to a market economy. The withdrawal of Soviet Union assistance and the collapse of COMECON resulted in a severe economic crisis in Mongolia in the early 1990s. Between 1990-1992 GDP fell by 20 percent. However, through a series of economic reforms and a process of liberalization, growth returned to the Mongolian economy in 1994 and has remained positive since.

Mongolia also had to contend with major terms of trade shocks, with a sharp fall in world prices of its main export commodities following the Asian crisis and severe weather conditions. Mongolia has had particularly severe winters over the past two years, combined with a drought. These adverse climatic conditions, along with the outbreak of foot-mouth disease, resulted in a 10 percent decline in the herd stock in 2000. This followed a fall in the herd stock the previous year. Due to major losses in animal husbandry, GDP growth in 2000 was 1 percent compared with 3.2 percent in 1999.

Despite these difficult economic and climatic conditions, the Government continued to pursue its comprehensive reform agenda and what it has achieved since coming into office in mid-2000 is a testament to its commitment to implementing the needed economic reforms. The fiscal deficit was reduced from 12 percent of GDP to 6.8 percent of GDP in 2000 and the Government has introduced far-reaching reforms to strengthen financial management reporting, accounting, auditing and monitoring, as well as reactivating the privatization program.

As highlighted in the staff report, part of the task facing the authorities is to correct past policy shortcomings, particularly with respect to fiscal policy. These shortcomings resulted in previous Fund programs going off-track, but this was in part a consequence of political volatility. One of the positives is that not only is the current Government committed to the reform task, but it has a strong mandate and has consolidated its position with the recent re-election of the President. This has brought much needed political stability and an improved environment to implement what are often difficult reform measures.

Fiscal Policy

The authorities clearly recognize the need to promote fiscal sustainability as well as to improve the quality and reporting of fiscal data, along with enhancing transparency throughout the economy. The first priority of the Government was to eliminate the domestic and external payment arrears. The debt service arrears were cleared in 2000 and the Government has been current on its interest and debt payments since 2001. To restore the Government's credibility and protect the viability of the bank restructuring program, adequate funds for public debt services were allocated in the 2001 amended budget. The Government has also been current on wage, pension and other payments since September 2000.

The medium-term fiscal policy framework for 2002-2004 has been developed with the objective of improving budgetary and fiscal management. The Government has taken steps to introduce more robust budgetary arrangements and has taken decisive action to strengthen transparency, accountability and enforcement mechanisms in budget execution. An inventory of all budget accounts was completed and regulations on the establishment of budget accounts have been issued. Importantly, the establishment of single treasury account at the Bank of Mongolia is well underway.

Improving fiscal data quality and reporting has been a high priority for the Government, for it recognizes the lasting policy benefits that can come from effectively "institutionalizing" good fiscal processes. With the assistance of the FAD, a new methodology for the consolidation of the budget was adopted. In order to improve the coverage and reporting of arrears, a system of account-based monthly reporting has been set up on payment arrears covering customs, the tax authority, social security funds and netting out operations. Semi-annual fiscal reporting has also been re-introduced.

In addition, the Government has taken steps to improve inter-governmental fiscal relations. A working group has been set up to develop a new transfer equalization model.

Importantly, the authorities have set a realistic objective of attaining medium-term fiscal sustainability, while also allowing for the significant developmental and social needs of the country, including the necessity to allow for relief efforts to address the impact of adverse climatic conditions. As noted in the staff report, with the introduction of the 2001 tax package, public sector revenue will be around 33-½ percent of GDP – a very high level compared with many other developing countries. Consequently, it is appropriate that the fiscal consolidation efforts be redirected towards expenditure control. Towards this end, and with the assistance of the World Bank, the first public expenditure review has been initiated.

One of the objectives of this review is, in consultation with the World Bank, to design and implement a plan to rationalize the delivery and targeting of social services.

Public sector wages have been controlled and the public wage bill as a proportion of GDP has been reduced. In April 2000, instead of the initial proposed general increase in public wage and pensions, the Government only increased wages of the lowest paid civil servants and minimum pension recipients.

Monetary and Exchange Rate Policies

Monetary policy is directed towards ensuring that inflation declines into the single digit range. The upward pressure on prices in the beginning of the year was significantly influenced by higher meat prices as a result of stock losses following the severe winter and the pass through of administered price increases. The Bank of Mongolia (BOM) is aware of the need for the careful handling of monetary and credit conditions in these circumstances to ensure that these price pressures do not become embedded in inflationary expectations. The latest developments on the inflation front are encouraging, with the CPI falling by 1.5 percent in August and a further decline expected in September. This trend is consistent with inflation reaching the single digit range by the end of the year.

The Government is committed to enhancing the effective independence of the BOM and to ensure that it does not become involved in quasi-fiscal operations. In addition, the Government and BOM are committed to a market-based system of credit allocation and have issued public statements not to exercise moral suasion over the management of state-owned banks to extend loans on non-commercial terms.

Public Enterprise Reform and Privatization

The Government has accelerated progress with the privatization of state assets. The Parliament approved the Privatization Guidelines for 2001-2004 and the privatization program for 2001 involves the sale of several of the state's most valuable enterprises. The tender for Gobi Cashmere Company has been announced and expressions of interest by potential buyers have been received. In addition, the tender for the Trade and Development Bank has also recently been announced.

Given the nature of Mongolia's climate, an efficient energy sector is vital for the overall performance of the economy. With that in mind, the Government has embarked on an ambitious energy sector reform program in consultation with the World Bank. Legislation has been enacted to provide a framework for the restructuring of the energy sector and an independent regulatory authority has been established. In addition, in December 2000 electricity and heating tariffs were increased by 15 percent and 35 percent, respectively.

I-PRSP

It is worth highlighting the observation in the JSA that the consultations within the Government on the preparation of the I-PRSP have been "remarkable". The authorities have developed a "country" owned I-PRSP through a fully participatory process which included a wide cross-section of the public, NGOs, academic institutions and civil society. A working group consisting of officials from government agencies and NGOs was established to formulate and develop the I-PRSP. The I-PRSP development went through a series of iterations based on consultations among the working group, government agencies, NGOs and donors.

Conclusion

The Government of Mongolia has expressed its commitment to macroeconomic stabilization and structural reform policies, not only through words but through actions. There are many challenges ahead, and the Government recognizes the importance of a close association with the Fund and the other IFIs in meeting these challenges. In particular, they would like to extend their profound appreciation to the Fund staff and management for all the assistance and support that has been provided to Mongolia.

The authorities have agreed to the publication of the staff report and accompanying documentation.